THE LAW SOCIETY OF HONG KONG
香港律師會

WORKING PARTY ON CONDITIONAL FEES

RESPONSE TO THE CONSULTATION PAPER OF THE LAW REFORM COMMISSION ON CONDITIONAL FEES

February 2006

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- Mr. Augustine L.S. Cheng, Judiciary Administrator's Office, The High Court, Hong Kong
- Mr. Benjamin K.M. Cheung, JP, Director of Legal Aid, the Legal Aid Department
- Professor Elsa Kelly, The Chinese University of Hong Kong, School of Law
- Mr. Thomas E. Kwong, Assistant Director of Legal Aid, the Legal Aid Department
- Mr. Robert Musgrove, Chief Executive, The Civil Justice Council, England
- Mr. Stuart M.I. Stoker, Secretary, The Law Reform Commission
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- Mr. Raymond Ho, Member, Insurance Law Committee of the Law Society
- Mr. Nicholas D. Hunsworth, Chairman, Civil Litigation Committee of the Law Society
- Mr. Amirali B. Nasir, Council Member, Member, Civil Litigation Committee of the Law Society
- Ms. Angela S.Y. Yim, Member, Insurance Law Committee of the Law Society
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ABBREVIATIONS

ADR	Alternative dispute resolution
APIL	Association of Personal Injury Lawyers, England
ATE insurance	After the event Insurance
BTE insurance	Before the event legal expenses insurance
CFA	Conditional Fee Agreement
CFAs	Conditional Fee Agreements
CJC	The Civil Justice Council, England
CJR	Civil Justice Reform
CLAF	Contingency legal aid fund
DCA	Department for Constitutional Affairs of The British Government
DLA	The Director of Legal Aid
DOJ	Department of Justice
Guide to Professional Conduct	The Hong Kong Solicitors' Guide to Professional Conduct
LAD	Legal Aid Department
LPO	Legal Practitioners Ordinance Cap. 159
LRC	The Law Reform Commission of Hong Kong
LSEW	The Law Society of England and Wales
OFT	Office of Fair Trading, England
RTA	Road Traffic Accidents
SLAS	Supplementary Legal Aid Scheme

1. Introduction

1.1 The Working Party on Conditional Fees ("the Working Party") was convened by the Council of the Law Society on 4 October 2005 to study the Consultation Paper on Conditional Fees ("the Consultation Paper") published by the Conditional Fees Subcommittee of the LRC on 14 September 2005. The terms of reference of the Working Party are:

- To assist the Council to formulate a response to the Consultation Paper;
- To consider the expansion of SLAS as an alternative means of increasing access to justice;
- To consider the problem of unrepresented litigants in Hong Kong;
- To consider the availability of ATE insurance in Hong Kong;
- To consider the progress of the CJR;
- To consider the ethical issues in relation to conditional fees.

1.2 The Law Society invited applications from the general membership for co-option to the Working Party. A total of 13 applications was received. All applicants were appointed except where there were 2 applicants from the same firm, only one could be represented; and an in-house lawyer of an insurance company.

1.3 The Working Party comprises:

Members: Mr. Michael J. Lintern-Smith (Chairman)
Mr. Patrick M. Burke
Mr. Joseph W.K. Chan
Mr. Paul E. Firmin (resigned on 9/12/2005)
Ms. Barbara A. Hung
Mr. Mark Lin
Mr. Ludwig S.W. Ng
Ms. Szwina S.K. Pang
Mr. Richard K.C. Tsun
Mr. Michael K. Turnbull
Mr. Tommy K.M. Wong
Mr. Felix K. Yau

Secretary: Ms. Vivien Lee

1.4 The Working Party considered the Consultation Paper over the course of 7 meetings including a meeting with Professor Elsa Kelly of the Chinese University of Hong Kong who is conducting research into the problem of unrepresented litigants.

1.5 The Working Party also took into account the views of the Civil Litigation Committee, the Family Law Committee, the Insurance Law Committee and other Members who had expressed their views to the Law Society.

1.6 The Working Party's comments on the Consultation Paper and their specific responses to the 13 Recommendations of the LRC are set out in Sections 2 to 16 of this Report.

1.7 The LRC has granted an extension to 28 February 2006 for the Law Society to respond to the Consultation Paper.

1.8 In the meeting of the Council of the Law Society on 7 February 2006, the Council resolved to adopt the responses of the Working Party as set out in this Report.

2. General Comments on the Consultation Paper

2.1 The LRC studied the costs system in many jurisdictions including an in-depth study into the problems in England, the conditional fee system in Australia, and contingency fees in U.S.A. and Canada. However, some of the fundamental issues have not been thoroughly considered and the Working Party submits that it will be imprudent and premature to adopt conditional fees in Hong Kong without having explored these issues and the problems arising from them.

2.2 One of the issues which should be investigated is the problem of unrepresented litigants. The principal argument in favour of allowing conditional fees is that it would enhance access to justice to the growing number of unrepresented litigants. Whilst the Consultation Paper provides statistics to show the number of unrepresented litigants had increased between 2001 to 2004 in the High Court, no empirical research was conducted into why litigants represented themselves and the impact of self-representation on the civil justice system.

2.3 According to a letter dated 13 December 2005 from DLA to the Working Party, **Appendix 1**, out of the 22,206 applications for legal aid in 2004, 6,810 applications (30.7%) for civil legal aid were refused. Of these

applications, 6,036 (27.2%) were refused on ground of merits; 774 (3.5%) were refused on ground of means. The majority of those rejected on merits involved matrimonial disputes.

2.4 In another survey, one conducted by the Steering Committee on Resource Centre for Unrepresented Litigants in 2002[1], 632 responses were received, and of those responding, 54% were unrepresented litigants. 63% of the unrepresented litigants cited 'cannot afford to engage lawyers' as the reason for self-representation; 30% said they did not consider it would be necessary to engage lawyers, 7% cited other reasons such as 'lack of trust on lawyers' or legal representation was disallowed by legislation. More importantly, 33.8% of the unrepresented litigants were involved in bankruptcy claims. More than 75% of the unrepresented litigants were unaware of the Duty Lawyer Service Free Legal Advice Scheme or the Bar Association's Free Legal Service Scheme.

2.5 These statistics show diverse reasons for self-representation. Litigants are eligible for legal aid but their applications have been refused on ground of merits; they are eligible for legal aid but have not applied for it because they are unaware of its availability. There are those who are not eligible for legal aid or supplementary legal aid but do not have sufficient funds to pay for legal representation. There are litigants who consider their claims are so straightforward that hiring a solicitor appears unwarranted. Others feel they do not trust solicitors or they would not be good value for money. There is also the extreme end of the spectrum, the vexatious litigant or serial appellant bringing multiple appeal applications.

2.6 Further, the status of a litigant may change from being unrepresented to being represented and vice-versa in the course of a case. If one looks at cases at too early a stage, a huge percentage of all actions may be thought to involve unrepresented litigants simply because they have not yet instructed solicitors or because their solicitors have not yet come onto the court's record. Moreover, a very substantial percentage of High Court cases end with a default judgment. In these cases, the fact that a defendant is unrepresented does not pose any problem to the civil justice system. Others may alternate between self and legal representation as a tactical move to evade service of proceedings.

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[1] Report of the Steering Committee on Resource Centre for Unrepresented Litigants, December 2003

2.7 For litigants whose applications for legal aid have been rejected on ground of merits; for the vexatious litigants or serial appellants who have an unmeritorious claim, and for the defendants who choose to alternate between self and legal representation as a tactical move in litigation, it is arguable that conditional fees may not alter their position.

2.8 The Working Party submits that without a systematic study on the reasons for self-representation, the types of proceedings involved and the stages of proceedings at which litigants choose to represent themselves, it cannot be stated with certainty conditional fees will help to alleviate the problem of unrepresented litigants.

2.9 The Working Party is aware that a research project, entitled 'Investigation and Analysis of Issues Raised by Self-Representation in the High Court of Hong Kong' is being conducted by Professor Elsa Kelly of the Chinese University of Hong Kong. It is expected the project will be completed in 2006. The research aims to:

- identify the factors contributing to the rise of unrepresented litigants in the civil courts in Hong Kong.
- establish whether these factors are peculiar to Hong Kong and its legal system.
- evaluate the impact of unrepresented litigants on the legal process.
- document the experience of legal process on unrepresented litigants.
- assess the play of specific factors e.g. the level of legal fees, the availability of legal aid, simplification of legal proceedings, the nature of dispute etc. in accounting for such phenomenon.
- assess the implications for policy and judicial administration e.g. the impact upon judicial resources, time and costs.

2.10 The Working Party reserves the right to file a supplementary report upon the findings of the research project.

2.11 The Working Party further submits that the question of conditional fees must not be considered in isolation, and any suggestion to implement the system must be considered in conjunction with the progress of the CJR in

Hong Kong, the availability of legal aid; and any measures to curb the activities of claims intermediaries.

2.12 It is interesting to note that in a recent review of funding options[2] by the British Government, the CJC suggested that the delivery of access to justice is dependent upon many factors including:

- the claimant having a meritorious case.
- the participants having at the outset access to means of funding the case.
- the lawyers on each side having at the outcome *(sic)* access to reasonable remuneration.
- the cost of the last two factors being proportionate to what is at stake.
- the availability of an efficient and properly resourced court system.

2.13 Having reviewed the costs systems in 18 jurisdictions other than conditional fees in England, the CJC concluded there was no simple single solution to the global or even local problems of funding civil cases.

2.14 The recommendations of the LRC on the areas which CFAs should be allowed seem to go beyond the ambit of the English system, especially in family law proceedings.

2.15 The position in England is that under S27 of the Access to Justice Act 1999, family proceedings cannot be the subject of an enforceable CFA. Family proceedings means proceedings under any one of the following:-

- The Matrimonial Causes Act 1973;
- The Adoption Act 1976;
- The Domestic Proceedings and Magistrates' Courts Act 1978;
- Part III of the Matrimonial and Family Proceedings Act 1984;
- Parts I, II and IV of the Children Act 1989;

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[2] 'Improved Access to Justice – Funding Options and Proportionate Costs', Report and Recommendations, CJC, August 2005.

- Part IV of the Family Law Act 1996; and

- The inherent jurisdiction of the High Court in relation to children.

2.16 CFAs are therefore excluded from family proceedings in England, not just those relating to the welfare of children. In fact in most Australian States where CFAs are permitted, they are excluded from family and criminal proceedings.

2.17 The Working Party objects to CFAs being applied to family law. (Please refer to the response to recommendation 2).

2.18 The LRC took the view CFAs would enable lawyers to compete on a level playing field with claims intermediaries. Given the experience of CFAs in England, the Working Party does not believe this is the case. Unlike England the activities of claims intermediaries in funding civil litigation are illegal in Hong Kong. In May 2005, the Law Society issued a Circular[3] advising members not to accept referrals from these companies. The Working Party believes the effective means to curtail the activities of claims intermediaries is to educate the public, conduct vigilant prosecution and regulate their activities.

2.19 The Consultation Paper makes no proposal on the treatment of the indemnity principle if CFAs were to be implemented. In the consultation conducted by the DCA of the British Government in 2003[4], the majority of the respondents proposed the abolition of the principle because of its impediment to the development and use of CFAs and other fee arrangements. They believe the principle hinders the proper and transparent use of CFAs and alternative methods of funding litigation. The DCA is considering the abolition of the principle with the CJC and what should replace it.

2.20 The Working Party proposes to deal with the specific recommendations in the Consultation Paper i.e. recommendations 2 to 13, before proceeding to deal with the general recommendation to introduce CFAs i.e. recommendation 1.

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[3] Law Society Circular 05-261(SG) dated 17 May 2005.

[4] 'Making simple CFAs a reality', DCA, 29 June 2004, Paper no. CP22/04

3. Response to Recommendation 2

3.1 *It is recommended that conditional fees be allowed in personal injury, family cases except where the welfare of children is involved; commercial cases in which an award of damages is the primary remedy sought; product liability cases; probate; insolvency; employees' compensation claims and professional negligence claims.*

3.2 The Working Party does not agree that CFAs should be introduced in Hong Kong. (Please refer to the response to recommendation 1.)

3.3 However, if the Government were to implement CFAs, the Working Party does not see any logic in excluding them from any civil proceedings. Family and criminal proceedings should not be included under any circumstances.

3.4 The Working Party notes that family proceedings are specifically excluded from CFAs in England and the LRC's assertion that CFAs were extended by the Access to Justice Act 1999 to family work relating to financial matters and property is therefore incorrect. The Working Party objects to CFAs being applied to matrimonial proceedings for 2 reasons. In most matrimonial proceedings, there is no win /lose situation e.g. where the petitioner applies for maintenance and transfer of property and/or division of proceeds of the sale of the property, and only maintenance is awarded. Secondly, it is compulsory for parties to resort to mediation through the financial dispute resolution process prior to resolving any dispute in the Family Court. CFAs, with the success fee and ATE insurance (together "the additional liabilities"), encourage the retention of the adversarial system which is out of step with the development of matrimonial jurisprudence in Hong Kong and in comparable jurisdictions.

3.5 The LRC pointed out in the Consultation Paper family proceedings relating to the welfare of children and criminal proceedings were excluded in England because to apply CFAs to them would be highly contentious and there was a risk that lawyers acting on CFAs might be subject to greater improper pressure, and hence, a greater risk of improper conduct. The Working Party considers these disadvantages of CFAs apply to all family proceedings and indeed to all proceedings thus fortifying its belief that CFAs should not be implemented at all.

3.6 CFAs as recommended by LRC would not be tenable in employees' compensation proceedings. S46 of the Employees' Compensation Ordinance Cap. 282 ("the EC Ordinance") prohibits the compensation to be passed to any person other than the employee and no claim shall be set off against such compensation, except in the case of an aided person, the compensation payable shall be subject to the first charge of the DLA. Accordingly, any recoverability of success fee or ATE insurance premium from the employee would fall foul of S46.

3.7 Recoverability of the additional liabilities is also inconsistent with the treatment of persons under disability. The present costs system provides for common fund costs to be awarded against the defendant where a claimant under disability is successful in his claim. This is to ensure his damages will not be depleted by the unascertained amount of costs.

3.8 It is unclear whether the LRC is recommending CFAs to be applied to claimants only; whether defendants may also utilize CFAs in defending their claims. In England, CFAs are applicable to both parties to the litigation although defendant CFAs are not as prevalent.

3.9 In England, CFAs have generally been used in personal injury claims where legal aid has been withdrawn. It is used in recovery actions instituted by liquidators and defamation actions where legal aid has never been available. The extensive use of CFAs in personal injury work is due to 2 factors; the high success rate in those claims and the volume of work. These 2 factors make personal injury claims attractive to insurance providers, so that insurance is readily available. CFAs are seldom used in complex commercial claims where the upfront costs e.g. Counsel's fees and expert fees are high, and the merits may often not be clear until trial e.g. in applications for injunction, and the outcome of litigation and amount of damages are not predictable. The Working Party has reservations whether CFAs would be equally successful in areas of civil litigation other than personal injury claims in Hong Kong, the majority of which are currently covered by legal aid. If not, there may not be a sufficiently large market in Hong Kong to attract insurance providers.

3.10 **Summary of response: CFAs should not be implemented in Hong Kong but if they were, they should be excluded from all matters relating to family and criminal law. The position of the claimants under disability and the applicants under the EC Ordinance has to be reconsidered given the prohibition under S46 against any erosion of compensation.**

4. Response to Recommendation 3

4.1 *It is recommended the additional liabilities should not be recoverable from the losing party.*

4.2 The Working Party notes that recoverability of the additional liabilities was introduced in England in 2000 as a result of the virtual withdrawal of legal aid from personal injury claims. The purpose was to ensure claimants on CFAs would not be worse off than those on legal aid by having their damages reduced by the additional liabilities. But the result of recoverability was to increase substantially the costs payable by the defendants and their insurers, making costs recovery generally a more complex and time-consuming process in England. Recoverability combined with ATE insurance also make litigation very attractive to the claimants because they enter a costs-free, risks-free zone to pursue their claims. This has provided an opportunity for unregulated claims intermediaries to exploit the personal injury market. Evidence some of which is anecdotal shows that these claims intermediaries employ unethical sales tactics to pressurize claimants into agreements which may not be the best funding options for them and there is no full and frank disclosure of their liability for costs if their claims fail. Recoverability gave rise and continues to give rise to a spate of satellite litigation. This issue was one of the main concerns which prompted the British Government to conduct a full scale review of CFAs in 2003, as a result of which reforms were introduced to simplify the conditional fees regime. These are summarized in paragraph 8.5 of this Report. In addition, the DCA commissioned a comprehensive study to assess the impact of recoverability on the outcome of personal injury claims. The DCA advised the Working Party the study had been completed and the findings would be published in February 2006.

4.3 Meanwhile, the DCA suggested in a Consultation Paper published in August 2005[5] that recoverability should be maintained as the additional liabilities were designed as compensation for the risk undertaken by lawyers and insurers in supporting access to justice for the claimant. To require individual claimants to meet those costs would create a substantial

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[5] 'New Regulation for Conditional Fee Agreements (CFAs)', A summary of responses to the consultation paper Making Simple CFAs a Reality, August 2005, DCA, Paper no. CP(R) 22/04

barrier to their right to obtain redress. Others, notably, defendant insurers disagreed. They suggested recoverability was at the root of the difficulties faced by defendants in all classes of litigation. They believe the system should not operate so as to force defendants with meritorious defences into early settlement as a result of the costs consequences of the additional liabilities.

4.4 Pending the findings from the study on recoverability and any further reforms proposed by DCA, the English solution so far is to move towards a fixed costs/fixed success fees regime to curb satellite litigation.

4.5 The Working Party notes that 2 such schemes have already been implemented in England in respect of RTA and employers' liability (disease) claims.[6] Through the mediation of the CJC, industry agreements were drawn up between the defendants and claimants to fix the amounts of success fees awarded to solicitors and barristers. Terms of these agreements have been incorporated into the Civil Procedure Rules, Part 45, Section II. Nevertheless, it is noted the fixed rates are only applicable to claims involving damages of less than £500,000 in RTA claims and in employers' liability (disease) claims, damages of less than £250,000. In addition, costs recoverable from the losing party are also fixed as a percentage of the damages recovered for any RTA claims settled without the issue of proceedings and where the value of the claim is £10,000 or less.

4.6 The Working Party believes that the recoverability of additional liabilities has contributed to the spate of satellite litigation in England. However, shifting the burden to the clients may not reduce satellite litigation. It merely transfers such litigation to the solicitor and his client. In addition to challenging the technicalities in the CFA, the client may assert other grounds, e.g. undue influence, in an effort to avoid the contract. Further, the dispute between the client and the solicitor is likely to be exacerbated if the client accepts a global settlement of damages inclusive of costs.

4.7 Costs negotiators who have proliferated since the introduction of CFAs in England, may still be employed by the claimants to attack bills. Typically, they are paid by results in that they receive a percentage of the reduction in costs. Practitioners in England have raised concerns that the question of costs is pursued over-vigorously by these companies.

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[6] 'Improved Access to Justice – Funding Options & Proportionate Costs', Report and Recommendations, CJC, August 2005

4.8 Recovering the success fee from the client, in claims where the primary remedy is damages anyway, would have the same effect as introducing the American style of contingency fees in Hong Kong. Although the success fee is not calculated as a percentage of the damages recovered, it nevertheless goes to reduce damages. It should be noted that other than SLAS, this is yet another departure from the common law principle that the object of the damages is to give the claimant compensation for the loss or injury he has suffered and that as far as possible, the damages should put the claimant in the same position as he would have been in if he had not sustained the wrong causing his loss or injury.

4.9 **Summary of response: The additional liabilities encourage satellite litigation and shifting their recoverability to the claimant does not curb but may in fact encourage such litigation.**

5. Response to Recommendation 4

5.1 *It is recommended the method/criteria for fixing success fees should as far as practicable be fixed by legislation, and should be determined by the various stakeholders including insurers, legal practitioners, consumers, to reach an agreement on a reasonable method and criteria. Further the level of success fee should be adjusted according to the different stages of litigation.*

5.2 The Working Party queries whether agreement can be achieved on the method and criteria for fixing success fees, given the conflicting interests of the relevant stakeholders.

5.3 There are essentially 2 components to a success fee: the risks of litigation and the level of financial subsidy that a solicitor will have to bear to run the case i.e. the cost of postponement of payment of his fees. The LSEW provides a probability table as a reference to help law firms to calculate the success fee. The probability table is set out in **Appendix 2**. The success fees set out in the probability table are based on the following actuarial formula:

F/S X 100 = SF

Where F = prospects of failure
S = prospects of success
SF = success fee

5.4 However, the LSEW acknowledges that the formula is subject to the following limitations[7]:

- For the formula to work in practice, the prospects of success and the risk of failure must be accurately assessed at the outset of a claim, and this is not easy, even for the most experienced solicitor. There may also be divergent views between the solicitor and his client on the prospects of success.

- The formula is further complicated in practice by the fact that the costs incurred in each case, and therefore the amount of financial risk being run each time by a law firm, will not be identical.

- The LSEW suggests a list of 36 key issues which should be considered by law firms before deciding whether to take on a claim on CFA. The list is attached as **Appendix 3**. The list is not exhaustive but it does show how diverse and unpredictable the risk factors are. Accordingly, the LSEW also advises that the formula may not be appropriate for complex cases where the value of claim involved is over £10,000.

- The formula has not taken into account extraneous factors and unforeseen circumstances which may affect the outcome of a claim. Litigation is notoriously uncertain and every litigator will have experience of cases which on law and facts, should have succeeded but did not e.g. the judge may take against a client, an experienced expert witness may suddenly unravel in the witness box, the client may have withheld important evidence which affects the merits of his claim. There is no way of predicting when such unexpected events might strike. The LSEW suggests that because of the potential impact these unpredictable factors may have on the risk of failure of a claim and hence on the finances of a law firm in running a claim on CFA, it is appropriate to routinely add extra percentages to the success fee to provide for a margin of error. The LSEW however does not provide any guidelines on how the margin of error can be calculated.

- The law requires the solicitor to explain the success fee to a client. Utilizing the probability table entails the explanation of actuarial principles and probability theory. This may not be suitable for most lay

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[7] Conditional Fees, A Survival Guide, 2nd edition, edited by Fiona Bawdon, Michael Napier and Gordon Wignall, published by the LSEW.

clients and would create an unjust burden on the solicitor, even if the requirement is moved to the professional conduct rules.

5.5 In addition to the formula recommended by the LSEW, the Working Party also considered the rates fixed for RTA claims and employers' liability (disease) claims mentioned in paragraph 4.5 of this Report. The process of agreeing on the fixed rates for RTA claims illustrates how difficult it is to calculate success fee.

5.6 A study[8] was commissioned by the CJC to assist in determining what constituted a 'reasonable' success fee. The study suggested one measure of reasonableness was to calculate the success fee such that a CFA case would on average yield the same revenue to a solicitor as a claim run on an hourly rate basis, that is, a success fee which would make the choice between CFA cases and hourly fee cases "revenue – neutral" over a sufficiently large number of RTA claims.

5.7 In order to calculate the reasonable success fee on the basis of the criterion suggested above, those commissioned to conduct the study collected data on a large number of RTA cases run on CFAs and on an hourly rate basis. A comparison was made at each stage of litigation on the expected revenues on the 2 funding options e.g. at first contact with client; at the time the claim is made; when proceedings are issued. The difference in the expected revenues on the 2 funding options was interpreted as the success fee that would be necessary at that stage of proceedings to make the expected revenue from the claim run on CFA stream equal with that run on hourly rate. These estimated success fees formed the basis of negotiations between the defendants and claimants which resulted in the fixed rates for success fees in RTA and employers' liability (disease) claims in England.

5.8 It is noteworthy that the study qualified the data used for calculating the success fees in the following respects:

- Data were provided by BTE and ATE insurers, claimant and defendant solicitors, the Motor Insurance Bureau and the Compensation Recovery Unit of the British Government. The data included the value and number of claims handled on a CFA and hourly rate bases; the revenue collected by legal practitioners and insurers

[8] Calculating 'Reasonable' Success Fees for RTA Claims, A Report to CJC, October 2003, Paul Fenn, University of Nottingham Business School, Neil Rickman, Department of Economics, University of Surrey.

from such claims; the costs and volume of cases rejected by insurers; and information on whether these claims were litigated; the stage at which they were settled and the means of funding in each claim. The study advised none of those who participated were able to produce a complete set of data e.g. it was impossible for defendant solicitors to advise what costs were incurred prior to the claims becoming known to them; claims dropped or repudiated prior to any payment made by insurers were not always recorded in the insurers' databases to enable an estimate of success rates be calculated by type of claim. There was no data on the proportion of RTA cases which went to trial. Not all insurers kept a record of the means of funding or whether a case was litigated.

- ATE insurers and legal practitioners had pointed out that tactical moves such as payment into court, Part 36 offers had a significant impact on the balance of risks between the claimant and the defendant but the actuarial calculations adopted in the study had no means of estimating the impact.

- The financial risk faced by a law firm in undertaking work on a CFA basis is to a certain extent affected by the size of a firm and the volume of work. A firm with a small number of cases would likely be subject to a greater variation in the revenue when using CFAs than a large firm with many cases. How the size of a firm or the volume of work may affect the financial risk had not been factored into the actuarial calculations.

- Some defendant solicitors had argued that the hourly rates charged by claimant solicitors already contained a margin which covered the losses they suffered from non-profitable work. It is therefore not strictly accurate to regard the difference between the revenues from CFA and hourly rate cases as the success fee. Those commissioned to conduct the study in any event admitted this was only one method to determine the level of success fee.

- An important assumption underlying the estimated success fees was that a case run on CFA would be run in the same way, with the same costs and litigation stages, as one run on an hourly fee basis. In reality this is hardly the case. In fact, the LSEW advises[9] that the use of CFAs requires structural and strategic changes to the way in which

[9] Conditional Fees, A Survival Guide, 2nd Edition, edited by Fiona Bawdon, Michael Napier and Gordon Wignall.

law firms run their practices. Law firms will need to make changes to the way in which each individual case is managed. These changes would at least include the implementation of clear internal protocols on screening cases for CFAs; a computerized case management system to track the progress and costs exposure of CFA cases; the compilation of a manual on the firm's policy on financial and risk management issues, model forms and checklists to ensure compliance with rules of professional conduct, client care letters, insurance details etc. These factors have not been reflected in the fixed rates.

5.9 For these reasons, the study concluded there was a significant degree of uncertainty surrounding the estimated success fees which formed the basis of negotiations between the defendants and the claimants. It is probable that the unreliability of these estimates was one of the reasons for which the fixed success fees were only applicable to claims whose value was under £500,000 in RTA claims, and £250,000 in employers' liability (disease) claims.

5.10 The English experience demonstrates the difficulties and limitations of devising an accurate method or criteria for calculating success fee. It is doubtful whether one formula can be applied to all types of proceedings. The study commissioned by the CJC also shows that it might be impracticable to work out the calculations unless a system of conditional fees has been implemented in a jurisdiction for a period of time so that data pertinent to the calculations are available.

5.11 It must also be borne in mind that fixed rates for success fees or the 2-stage success fees proposed in Callery-v-Gray (2002) 1 WLR 2000 are readily acceptable in England because the Access to Justice reforms which streamlined the procedures in civil litigation have been implemented for over 5 years and RTA cases are now run on fast track and multi track systems. In Hong Kong, the Working Party is advised that the draft instructions for the first 100 or so CJR reforms are with the DOJ and the Government estimates the first batch may be implemented by November 2006.

5.12 The majority of the Members of the Working Party consider that no method or criteria could practically be devised for a success fee and the best that can be achieved would be to cap the fee. Even if a formula or criteria could be formulated, specific details or qualifications must be spelt out in the CFA or the relevant Practice Direction, with the definition of 'success' clearly defined, failing which any uncertainty is bound to give rise to disputes.

5.13 The minority of the Working Party considers the formula suggested by the LSEW can be adopted.

5.14 There is no mention in the Consultation Paper whether the success fee is subject to taxation. In England, any agreement the lawyer makes with the client for a success fee, including the amount thereof, may be reviewed by the courts.

5.15 Summary of response: The majority of the Members of the Working Party believe it would not be feasible to prescribe a method/standard formula which can accurately reflect the prospects of success and failure of a claim, hence, the risks undertaken by the solicitors and the success fee, given the uncertainties in litigation. The best that can be achieved is to prescribe a cap in different stages and for different types of proceedings.

6. Response to Recommendation 5

6.1 *It is recommended a cap of the success fee lower than the cap of 100% of normal costs in England be adopted. 2 methods of calculating the cap are suggested: (i) a cap based on a prescribed percentage of the normal costs; (ii) a cap based a prescribed percentage of the amount recovered.*

6.2 The necessity to double cap the success fee arises from the problem of the solicitor having to recover his success fee from the claimant, to ensure that whilst the success fee is calculated as a percentage of the normal costs, it should not erode a substantial proportion of the damages of the claimant, given that it is not uncommon for costs to be disproportionate to the damages recovered. The Working Party reiterates that the consequence of implementing recommendation 3 would be tantamount to introducing the American style of contingency fees through the back door, namely, the consequence is to reduce the damages recovered by the claimant. This is likely to lead to satellite litigation. According to the LSEW[10], before 2000, where there was no recoverability of the additional liabilities, a successful client could lose a substantial proportion of his damages, probably up to 25%, in his solicitor's success fee.

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[10] Conditional Fees, A Survival Guide, 2nd Edition, edited by Fiona Bawdon, Michael Napier and Gordon Wignall.

6.3 The method of accurately fixing the cap is subject to all the uncertainties that beset the method and criteria for calculating the different rates of success fee, as set out in paragraph 5 of this Report. The Working Party refers in particular to the English experience in fixing the rates for RTA and employers' liability (disease) claims. The experience shows that it may be impracticable to prescribe any cap unless a system of conditional fees has been implemented for some time and data pertinent to the calculations are available. In any event, given the divergent factors which affect the risks of litigation, different caps may be applicable even within the same type of litigation, and the clients, not only the solicitors may favour maximum flexibility in terms of the agreements they can enter to.

6.4 Summary of response: The majority of the Members of the Working Party believe that the cap cannot be accurately calculated given the divergent factors which affect the risks of litigation in each claim. Even if the cap serves to protect the claimant, it does not reduce satellite litigation.

7. Response to Recommendation 6

7.1 *It is recommended the claimants utilizing conditional fees should be required by law to notify the defendant and the court should have the discretionary power to request the claimants to pay security for costs.*

7.2 The purpose of this recommendation is to ensure a successful defendant will be able to recover his costs against an unmeritorious claim brought by an impecunious claimant. It is however noted that under the present law[11], the insolvency or poverty of a plaintiff is no ground for requiring him to give security for costs nor will it be required from a defendant who is compelled to litigate or to take proceedings which are merely defensive. To empower the courts to order security for costs against a claimant who is impecunious and who is on CFA is a departure from the present law. In any event, if the claim is unmeritorious, the present civil justice system already provides the courts with the power under Order 18 rule 9 of the Rules of the High Court to strike out such claims. Any additional power is unnecessary and may be utilized by the defendant to delay the proceedings to his tactical advantage.

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[11] Hong Kong Civil Procedure 2006, Volume 1, para 23/3/13, para 23/3/16.

7.3 The Working Party queries whether a requirement to disclose the existence of the CFA would deter frivolous and nuisance claims. The position in England is that both the court and the other parties must be notified of the existence of CFA where the additional liabilities of the success fee and ATE insurance premium are claimed from the opponent. Notification must be provided in respect of the original funding arrangement and any changes. There is no obligation however to disclose the amount or the basis of calculation of the additional liabilities. The rationale for disclosure in England is therefore recoverability. There is however no evidence from England that the requirement has deterred unmeritorious claims. In Hong Kong, the recommendation is that these amounts should not be recoverable from the defendant.

7.4 The LRC has not indicated who should be paying for the security for costs. If the solicitors have to pay for such security, it would be an unjust burden on the solicitors and may offend the principles of champerty and maintenance. (Please refer to the response to recommendation 1).

7.5 Summary of response: The requirement to disclose CFAs to the opponent is unlikely to deter frivolous claims. The present civil justice system already provides the means to monitor such claims under Order 18 rule 9 of the Rules of the High Court and any additional power to order security for costs is unnecessary.

8. Response to Recommendation 7

8.1 *It is recommended the simplified version of CFAs introduced in England in 2003 should be adopted. Client-care provisions should be set out in professional codes of conduct so that trivial breaches can be dealt with expeditiously by professional bodies instead of the courts.*

8.2 The DCA proffered the following reasons[12] for removing the client-care provisions from the CFA legislation in England to the Law Society's Costs Information Code:

- Despite the Court of Appeal's decision in Hollins-v-Russell(2003) EWCA Civ 718, it is still difficult to predict whether a court would consider a breach of the legislation as having a materially adverse impact on the client or the administration of justice, thus rendering the

[12] 'Making simple CFAs a reality', DCA, CP22/04.

CFA unenforceable, or whether non-compliance would be regarded as a mere technical breach that would not invalidate the CFA. In any event, costs judges could apply the test of materiality differently as a matter of discretion. As a result, technical challenges are still being made by costs negotiators and insurers on CFAs.

- The CFA legislation was too complex and extensive.
- They are difficult for individuals to understand.
- They duplicate the requirements of the Law Society's professional conduct rules.

8.3 However, some practitioners in England[13] have expressed doubts as to whether shifting the legislation to client-care provisions would make any difference. It is said that a prudent solicitor, who wants to charge his client, will ensure ample explanation is given to his client on the structure of the fee payment, how the success fee is assessed, the circumstances in which the success fee may be claimed; the circumstances in which the client may be liable for his own costs and the other party's costs; when he is entitled to tax his costs etc. Otherwise, he may render himself uninsurable. Further, the Solicitors' Practice (Client Care) Amendment Rules 2005 requires the solicitor to disclose any interest he may have in recommending a particular insurance policy or other funding. It is said that a 'CFA lite', recommended by the LRC to be adopted in Hong Kong, would be a problem to solicitors where no insurance is available. It is also noteworthy that when 'CFA lite', the simplified version of CFA was introduced in 2003 to avoid many of the prescriptive requirements of the British legislation, it was not endorsed by the LSEW.

8.4 Others believe that challenges to technicalities in CFAs will shift to the professional conduct rules. They suggest further changes to legislation create new uncertainty, raise the prospect of new technical challenges and shift to the LSEW a responsibility which it could not sustain.

8.5 The Working Party notes that the Conditional Fee Agreements Regulations 2000 and Collective Conditional Fee Agreements Regulations 2000 were revoked in England with effect from 1 November 2005. The LSEW is due to introduce a new Law Society Code of Conduct in 2006. Paragraph 2.03 of the draft code (information about the costs) is set out in **Appendix 4** to

[13] 'A simple shift in emphasis' Law Gazette, Thursday, 15 July 2004.

this Report. Whether these reforms are going to achieve the purposes for which they were introduced are yet to be seen. The British Government will review the new regime 3 years after their implementation. The Working Party reiterates its concern it would be premature to adopt conditional fees in Hong Kong when measures to cure the anomalies arising from the English system are at an embryonic stage.

8.6 The Working Party agrees that legislation concerning CFAs should be simplified but raises concern that shifting the client-care provisions to professional conduct rules will create an onerous burden both financially and administratively on the legal profession. Solicitors may suffer double jeopardy if a CFA is not materially compliant with the professional conduct rules. He may be disciplined and fined by the disciplinary tribunal. In addition, the paying party may allege non-compliance renders the CFA unenforceable and the solicitor will lose his costs if the court so adjudged. Solicitors have also been warned[14] the CFA is not a substitute for an engagement letter which is the first document a court will examine should a client challenge the solicitor for breach of duty of care.

8.7 Disciplinary proceedings are funded primarily by the Law Society although where a conviction is decided, the respondent is responsible for the costs of the litigation. S25 of the LPO provides the DOJ may pay for reasonable expenses of such proceedings. In reality, not all costs are recovered. The burden and the costs of enforcement may eventually impact the profession.

8.8 LRC suggested another reason for transferring the client-care provisions to professional conduct rules is to ensure breaches can be dealt with expeditiously and such breaches will not disrupt the claimant's claim. In fact, disciplinary proceedings generally take 4 to 5 years to conclude. A conviction may involve an appeal as a solicitor's reputation, and even his livelihood may be at stake. Disciplinary proceedings can be costly. As far as the conduct of proceedings is concerned, where a solicitor is found to be in breach of a professional conduct rule, there may be a conflict of interest for him to continue to act for his client. It may be necessary for the client to seek separate legal representation and this will disrupt the conduct of the client's claim.

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[14] 'CFA reforms effective 1 November 2005 – how ready are you?' Andrew Nickels, Zurich Professional @risk October 2005.

8.9 Summary of response: Transferring the client-care provisions may not reduce satellite litigation. It merely shifts the burden to the legal profession.

9. Response to Recommendation 8

9.1 *It is recommended professional bodies should adopt appropriate rules to safeguard the interests of the solicitors' clients and have effective disciplinary measures to deal with and deter breaches of code of conduct.*

9.2 The Guide to Professional Conduct already prescribes guidelines for solicitors dealing with clients. The Working Party agrees that appropriate adjustments may be made to cater for the protection of clients on CFAs.

9.3 Summary of response: The Working Party agrees if there have to be rules to regulate CFAs, these should be provided for in the professional conduct rules of the professional bodies.

10. Response to Recommendation 9

10.1 *It is recommended one set of regulations be prescribed to cover both individual and collective CFAs.*

10.2 The Working Party has no objection for one set of regulations to cover CFAs and collective CFAs. The Working Party notes that unlike the trade unions and commercial organizations in England, workers' unions in Hong Kong are not active in providing assistance to their members for claims arising out of accidents at the workplace. Collective CFAs may therefore be of limited use and may only be utilized by a limited number of consumers e.g. banks or builders' associations.

10.3 Summary of response: The Working Party has no objection for one set of regulations to cover CFAs and collective CFAs.

11. Response to Recommendation 10

11.1 *It is recommended the following forms of CFAs be allowed:*

- *No win, no fee; if win, success fees;*

- *No win, no fee; if win, normal fees;*
- *No win, reduced fee, if win, normal fees;*
- *No win, reduced fee; if win, success fees.*

11.2 *It is recommended contingency fees arrangements should remain unlawful for contentious business.*

11.3 There is no distinction between profit costs and disbursements in the 4 categories of conditional fees recommended by the LRC. The Working Party notes that in Australia, lawyers under CFAs can require the client to pay for disbursements even if the client does not succeed in his claim. The Working Party suggests that solicitors should be allowed to adopt the same measure in Hong Kong, especially given that barristers may not agree to work on CFAs, and expert witnesses are not allowed to be paid on such a basis.

11.4 The Working Party notes other variations of CFAs have been utilized in England: CFAs with break clauses; CFAs which allow for deduction of disbursements from interim damages; the solicitor requesting the client to pay privately for initial investigation, including expert reports and that the provisions of CFAs only come into play after the institution of proceedings. The Working Party suggests these variations may be adopted in Hong Kong.

11.5 The Working Party notes that the last 3 types of CFAs have serious financial implications for the legal profession. (Please refer to the response to recommendation 1).

11.6 The term 'no win, no fee' is in any event misleading. Hong Kong applies the English rule that costs follow the event i.e. loser pays. A claimant who loses his claim is still liable to pay the opponent's costs, unless insurance is available to cover such costs.

11.7 Summary of response: The Working Party notes that the different types of CFAs recommended by the LRC have serious financial implications for the legal profession and suggests variations in England and Australia be adopted to ensure solicitors should not be unjustly burdened with the responsibility of disbursements.

12. Response to Recommendation 11

12.1 *It is recommended the Government conducts an in-depth study on the commercial viability of ATE insurance in Hong Kong.*

12.2 The Working Party notes that the study conducted by the CJC[15] reveals there is no BTE insurance in Hong Kong since insurers do not think there is a market for the product. ATE insurance does not exist.

12.3 Without insurance, small solicitors' firms would lack the financial resources to fund their client's litigation. Enquiry with APIL in England reveals that law firms in England experience cash flow problems working under CFAs. With preparing the documentation, getting an opinion from the barrister on the prospect of success, the front-loading of costs is high. Even where ATE insurance is available in England, an ATE insurance provider may turn down the claim unless there is a favourable opinion that the claim has a 80%/90% success rate, otherwise, all preparation costs are irrecoverable. Anecdotal evidence in England shows that small firms may have been driven out of business or forced to merge practices. Reduction in competition in the legal profession may limit the choice of consumers.

12.4 Without insurance, not only will the solicitors be funding the litigation, but with the 'loser pays' principle, it is unlikely an impecunious claimant will pursue a claim unless the merits are manifestly clear at the outset of proceedings because of the exposure to adverse costs order.

12.5 In England, there has been a general hardening of the markets since 2001. As a result, the costs of ATE insurance have continued to rise to an extent their reasonableness is the subject of much satellite litigation. It was about £85.00 in the 1990s. Recently, premium ranges from £700.00 to £1,000 on average.[16] The OFT has raised concerns over the level of insurance premiums, and whether there is sufficient competition in the ATE insurance market. There is also the question of the existence of the so-called 'ghost policies' where there is in fact no insurance in existence in respect of the individual claim, but a general safety net for the law firm in the event the firm cannot meet the cost liabilities of a losing claimant. These policies offer no protection to a defendant even if he succeeds in his defence.

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[15] 'Improved Access to Justice – Funding Options & Proportionate Costs', Report and Recommendations of the Civil Justice Council, August 2005.

[16] 'Contingency and Conditional Fees, The Structure, The Position in Hong Kong, and the Comparison with England', Andrew Jeffries, 11 March 2004.

12.6 The Working Party suggests enquiry should be directed at the insurers instead, as to whether they consider CFAs are commercially viable, having taken into account the size of the premium pool in Hong Kong, which is much smaller and fragmented than the pool in England. Considerations should also be given by the Government as to whether an exceptionally restrictive market in Hong Kong should be subject to any regulations, in view of the concerns raised by the OFT in England.

12.7 Some have argued that without the recoverability of the additional liabilities, it would be unnecessary for litigants to have insurance protection. Therefore, even if ATE insurance is not available in Hong Kong, CFAs may be sustainable. This is essentially the system which operates in the Australian States of New South Wales and Victoria.

12.8 In both States, the maximum success fee for any claims other than RTA and employer's liability cases is 25% of the time costs. There is no ATE insurance and insurers do not fund adverse costs. The success fee is not recoverable from the losing party.

12.9 However, there are also significant distinctions between the costs systems in the two States and Hong Kong.

12.10 In New South Wales, tort law reform restricts proceedings for personal injuries to only those cases where the claimant has sustained a permanent disability of more than 15% and it is said by the CJC[17] this has had a chilling effect on litigation. District courts are now running at 40% of their previous levels. There are statutory limitations on the recovery of costs and the amount of damages awarded, depending on the value of the claim. In particular, for RTA claims, CFAs are only enforceable if no success fee is charged. In the case of workers injury damages claims, the maximum success fee allowed is 10% of professional costs. Legal aid is not available in personal injury claims.

12.11 In Victoria, in employer's liability cases, unless the claimant has sustained more than a 30% disability, he cannot sue in negligence but must use the Workman's Compensation Scheme. RTA claims are dealt with under an entirely separate arrangement which does not normally involve the courts. The use of ADR is compulsory and the courts are keen to ensure that it is used. Legal aid has long been withdrawn from personal injury claims.

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[17] 'Improved Access to Justice – Funding Options & Proportionate Costs', Report & Recommendations, CJC, August 2005.

12.12 The Working Party submits that the non-adversarial approach in Australia, the restrictions on costs and damages awarded and the types of cases which may be the subject of litigation, and the fact that lawyers are entitled to exclude disbursements from CFAs, render ATE insurance unnecessary. In the absence of these safeguards in Hong Kong, it will be inequitable for the solicitors to shoulder the costs of litigation on behalf of the client, especially in the light of the recent Court of Appeal's decision in Arkin-v-Borchard Lines Ltd. (Please refer to the response to recommendation 1).

12.13 Summary of response: The Working Party agrees the availability of ATE insurance is essential to the feasibility of CFAs. It suggests enquiry should be made with insurers for them to investigate whether there is a commercially viable market in Hong Kong, and whether they are able to provide indicative quotes for such insurance, to enable the Government to consider whether the prices are affordable by the public. If insurers are willing to provide insurance, the Government should consider measures to prevent some of the malpractices which have occurred in England.

13. Response to Recommendation 12

13.1 *It is recommended that the scope of SLAS be widened by raising the financial eligibility limits and by enlarging the range of cases covered.*

13.2 The Working Party supports the LRC's recommendation. Subject to the findings of the research project on unrepresented litigants, the Working Party acknowledges the success of claims intermediaries in Hong Kong indicates there may be a gap in the provision of legal services to those with meritorious claims but are not eligible for legal aid. The Working Party considers SLAS to be the most practical means of increasing access to justice. The Working Party recommends that the categories of actions eligible for SLAS be extended to include all types of litigation. The Government should increase the limit of personal disposable income above which litigants are excluded from SLAS. Despite a Government deficit, which, in any event, appears to be diminishing rapidly in the current economic upturn, the seed money required for the extension of SLAS is well within the Government's budget. Otherwise, the seed money can be provided by charities.

13.3 It is to be noted in the Interim Report and Consultation Paper on CJR[18], the Working Party on CJR also recommended expanding legal aid as a means of resolving the problem of unrepresented litigants.

13.4 Legal aid should also be considered as a funding source for 'unbundled litigation assistance' i.e. providing legal advice or assistance at key points of the litigation. One example of such a scheme is the 'Green Form Scheme' in England which is funded by legal aid. It enables a litigant of limited means to consult a solicitor for two hours to resolve key issues, e.g. initial general advice on the merits of a case; advice whether to settle a claim; or writing letters.

13.5 There is considerable support in some jurisdictions[19] for the conclusion that changes to legal aid have been the most significant contributory factor in the increase of unrepresented litigants. The Working Party suggests further research to consider the percentage of litigants in person who applied for legal aid; the reasons why they did not apply for legal aid; whether they had legal aid for certain stages of the litigation only; and if so how they compare their experience with legal aid representation to their experience representing themselves.

13.6 Summary of response: The Working Party supports the recommendation to expand SLAS to cover all categories of claims irrespective of the means of the applicants although those who are not financially eligible under the currently prescribed limits may be called upon to pay a higher contribution and be subject to a larger amount of first charge on the damages recovered.

14. Response to Recommendation 13

14.1 *It is recommended a CLAF be established pursuant to which private lawyers may act on a conditional fee basis. The fund would pay the defendants' legal costs in unsuccessful cases and would, in effect, take over the role of ATE insurance. The LRC envisages the fund (not means-tested) would co-exist with SLAS (means-tested).*

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[18] 'CJR, Interim Report and Consultation Paper', Chief Justice's Working Party on CJR.

[19] 'Litigants in Person in Civil Proceedings: Part I' 32 HKLJ 313, Camille Cameron, Elsa Kelly.

14.2 The Working Party endorses in principle the recommendation of the establishment of a CLAF. It is however queried whether initial and ongoing funding may be available.

14.3 The Scottish Law Commission conducted research into funding for multi-party actions in July 1996[20] and concluded the only working example of a CLAF was in Hong Kong, namely, SLAS. A CLAF would only be financially viable and effective in cases where substantial sums of money are recoverable. The Scottish Law Commission predicted that a CLAF for class actions anyway, would be dependent on public funding for years, possibly indefinitely. The Scottish Law Commission considered CLAF would be of limited use if legal aid continued to be available and in any event, CLAF would be of no use to claims where damages or a monetary award are not sought.

14.4 CLAF has been in existence in South Australia, Queensland and Western Australia since the 1990s. The Working Party notes the seeding fund was provided by professional legal and state bodies. For example, the South Australian Litigation Assistance Fund, which was set up in 1992, is still in existence and is maintained by the Law Society of South Australia. The fund claims 15% of the damages or value of property received by the successful litigant. There is also a Disbursements Only Fund. A successful claimant must repay the whole of the disbursements incurred by the fund on his behalf with an uplift of 25% to 100%.

14.5 The Law Commission of New Zealand[21] concluded however the South Australian Litigation Assistance Fund is of limited aid to litigants as it is only available in civil litigation and usually only for claims of money and property. The Law Commission of New Zealand arrived at the same conclusion as its Scottish counterpart, namely, that the sustainability of such a CLAF is dependent on maintaining a level of funding, either through money recovered from successful litigation or from loan repayment.

14.6 The Working Party notes lawyers will be paid on a conditional fee basis under the LRC's recommendation. This is subject to all the problems associated with CFAs. The Working Party submits any fund should only mirror SLAS. As personal injury claims are already covered by SLAS, any

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[20] Report of the Scottish Law Commission on Multi-Party Actions, July 1996, Scot Law Com No. 154

[21] 'Delivering Justice for all – A Vision for New Zealand Courts and Tribunals', The Law Commission of New Zealand, March 2004

such fund should only be utilized in proceedings presently not covered by SLAS.

14.7 Summary of response: The Working Party considers the establishment of a CLAF deserves further consideration. The Working Party raises the concerns where the seed money for establishing the fund may be provided, and whether such a fund would generate enough income to be self-financing.

15. Response to Recommendation 1

15.1 *It is recommended that conditional fees be allowed in certain types of civil litigation so as to enhance access to justice.*

15.2 Whilst the Working Party appreciates conditional fees may increase access to justice, offer more flexible and competitive price options to consumers, and may enable an impecunious defendant who is not eligible for legal aid to oppose a weak and frivolous claim by an oppressive plaintiff, the Working Party nevertheless considers there are many disadvantages to the system.

15.3 CFAs may escalate the costs in litigation despite the LRC recommends against recoverability of the additional liabilities. Costs can escalate for the following reasons:

- As success fee is a percentage of base costs, this forms the incentive to increase base costs.

- As the LRC's recommendation is for the additional liabilities to be recouped from the claimant's damages, litigation on costs between the solicitor and client may proliferate.

- Anecdotal evidence in England suggests CFAs have encouraged claims and increased costs. According to the DCA[22], consumer advice agencies have seen an increase in the number of clients asking for advice on making claims and CFAs. Liability insurance industry said that in personal injury cases CFAs had contributed to the general increase in legal costs. The Bar Council also confirmed many local

[22] 'New Regulation for Conditional Fee Agreements (CFAs)', August 2005, DCA, Paper no. CP(R) 22/04

authorities had received a plethora of small claims professionally prepared by firms operating on a 'production line basis' or from people who had allegedly injured themselves at work. Some of these were settled because it was not cost-effective to investigate or defend them. It was said the practical consequence was that premiums for employer's public liability insurance cover had risen substantially over the last 5 years. Still in another survey[23] published in the Law Gazette, 87% of the local authorities believed CFAs increased the number of claims, with 68% reporting an increase in tenuous or fraudulent claims. The research carried out on behalf of the local Government Association and Zurich Municipal cited extreme examples, such as a claim for an accident in a play area that did not exist at the time of the alleged claim. Defendant media organizations also testified that CFAs inhibited media organizations from running a legitimate defence and provided defamation claimants with an unfair advantage. CFAs encourage and enable claimants with weak defamation claim to litigate. Solicitors take on hopeless cases on a speculative basis in the hope the high costs of litigation may coerce a settlement. This is referred by the media as the 'ransom effect'.

- The introduction of CFAs in England has produced a new industry, the costs negotiators. As they charge a percentage of the amount by which costs or the level of success fees is reduced, legal practitioners in England believe they have contributed to satellite litigation.

15.4 Satellite litigation not only increase costs, but causes delays in assessments of damages and clogs up court proceedings. It also introduces uncertainty in the civil justice system. All these disadvantages impede access to justice.

15.5 CFAs encourage the activities of unregulated and unqualified claims intermediaries. Invasive advertising and ambulance chasing are prevalent in England. These claims intermediaries charge as their fees a percentage of recovered damages. There is evidence clients are misled on their eligibility for legal aid and claims are settled by these agents below their proper value.

15.6 In England, CFAs have been used as a substitute for legal aid. It is the Working Party's view that CFAs and legal aid cannot co-exist. The present legal aid categories will still be needed.

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[23] 'Councils blame CFAs', Law Gazette, Thursday, 28 October 2004

15.7 Conditional fees alter the relationship between a solicitor and his client. Where the solicitor aligns his interest with the client's on the outcome of litigation; they effectively become partners in the litigation and the conflict of interest is exacerbated by any disagreement in the conduct of litigation e.g. if a client refuses to settle or accept a payment into court despite the solicitor's advice or a client refuses to disclose certain documents which would affect the merits of his claim. Under the present costs system, a solicitor may terminate his agreement and chooses to recover his costs and disbursements. Under CFA, there may be various arguments on what constitutes 'success' or the client may be forced to continue with the solicitor as he is yet to recover his costs from his opponent.

15.8 The LRC argued[24] that the risk of conflicts of interest between the client and the solicitor already existed under the present costs system. An unscrupulous solicitor may attempt to maximize his fees by delay and obfuscation or where the solicitor is anxious to retain his business in the future and the client's interests are significant, there are pressures to win at all costs. The fact however remains that under the existing system, a solicitor will be paid regardless of the outcome of litigation. Where, however, direct financial incentives are involved in the outcome of litigation, his professional judgment may be influenced by the fee economics rather than the legal issues. Solicitors may lose their objectivity and may compromise their duty as officers of the court.

15.9 There is a possibility CFAs will encourage litigants and solicitors to bring nuisance or unmeritorious claims with the aim of coercing the defendants into a settlement and to earn a success fee, albeit from his own client, as opposed to the defendant, under the LRC's recommendation. This is already evident from England, see paragraph 15.3 in this Report and there is anecdotal evidence of this abuse in other areas of law in Hong Kong where costs are not recoverable even if one successfully defends an action.

15.10 The Consultation Paper refers to the lack of ethical problems brought about by the introduction of CFAs in England. It is suggested the lack of evidence of professional misconduct by lawyers is probably due to the fact that the additional liabilities are paid by the losers of litigation.

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[24] Conditional Fees: Proposals from the Law Reform Commission, Stuart M.I. Stoker, Secretary, LRC of Hong Kong, Hong Kong Lawyer, October 2005.

15.11 To the extent CFAs will result in increase in litigation, solicitors behaving less ethically and nuisance claims being pursued (and perhaps encouraged) by solicitors, they may undermine the image of the profession.

15.12 The system increases the financial burden of solicitors, especially the small firms which may not have a sufficiently large caseload to spread the risks of litigation. Whilst the LRC recommends the client-care provisions be dealt with by codes of professional conduct, the legal profession is still lumbered with the task of complying with those provisions. The preparation of CFAs, the need to explain the details to the clients and potential clients, the need to negotiate corresponding agreements with barristers all add significantly to the administrative costs.

15.13 In addition, for a law firm to run their business successfully on CFAs, comprehensive risk management measures is a must. Acting on a success fee involves a financial risk and, in order to be profitable, the firm has to ensure the success fees on 'wins' outweigh the potential fees and costs sacrificed on the 'losses'. The consequence of getting the risk assessment wrong or simply not undertaking the exercise can have far-reaching consequences. The failure of a number of prominent claims intermediaries in England is a testimony to the necessity for risks and case management. As set out in paragraph 5.8 of this Report, the use of CFAs entails law firms to implement protocols on screening cases, to monitor the progress of claims run on conditional fees and their costs exposure, etc.

15.14 Unless ATE insurance is available, solicitors are extending credit to the clients by paying court fees, expert fees and other expenses. If a barrister does not agree to work on CFA, the solicitor will be personally liable to pay the barrister's fee.

15.15 A lawyer as a funder of litigation may also be exposed to potential liability to an adverse costs order against him if his client loses his claim, given the recent decision of the English Court of Appeal in Arkin-v-Borchard Lines Ltd. (2005) EWCA Civ 655[25]. In Arkin, the Court of Appeal held that if a non-party to the litigation was not merely funding the proceedings, but substantially also controlled or at any rate was to benefit from them, justice would require that, if the proceedings failed, he would pay the successful party's costs.

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[25] Gazette in Practice, 18 August 2005, 'Costs Update'

15.16 The problem of solicitors funding the litigation in the absence of ATE insurance also raises legal issues of champerty and maintenance, which, unlike England, remains a crime in Hong Kong. These issues must be thoroughly explored and resolved before CFAs can be implemented.

15.17 By shifting the client-care provisions to the professional conduct rules, the British Government emphasized[26] that the focus of the new regime would be on the professionalism of solicitors and the responsibility of clients to agree whatever they want within a very clear and simple statutory framework; and on 'letting market forces bring an element of competition to the various terms solicitors are prepared to offer'. The Working Party is concerned that the introduction of CFAs will have the same effect on the profession as the abolition of scale fees in conveyancing, namely, it will create an environment for cut-throat prices to be offered for legal services.

15.18 The Working Party notes the following other means of meeting the needs of unrepresented litigants were recommended by the Working Party on CJR in the Interim Report and Consultation Paper:

- Getting litigants professional legal advice or assistance at key points of the litigation i.e. unbundled legal assistance;
- Streaming disputes involving unrepresented litigants to small claims courts or to special court lists.
- Encouraging pro bono work like the establishment of similar organizations as the Citizens' Advice Bureau in the U.K.
- Getting the court to provide information about court proceedings, such as regarding the filing of forms etc.
- Simplifying the rules, procedures and court forms to give litigants a better chance of being able to conduct cases for themselves.
- Diverting unrepresented litigants away from the civil justice system by encouraging or requiring them to use ADR schemes.
- Training judges and court staff to deal with unrepresented litigants.

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[26] New Regulation for Conditional Fee Agreements (CFAs)' August 2005, DCA, Paper no. CP(R) 22/04

15.19 The Working Party notes that the drafting instructions on the first 100 or so CJR have been sent to the DOJ and it is expected they might be implemented in November 2006.

15.20 The Working Party is also aware of the use of a 'McKenzie' friend i.e. the facility provided by the Royal Courts of Justice in England for litigants in person to be accompanied in Court.

15.21 The Working Party notes the establishment of the Resource Centre for Unrepresented Litigants in December 2003 in the High Court. The Working Party suggests its availability should be publicized and similar facilities be made available in the lower courts.

15.22 The Working Party reiterates that short of expanding SLAS, these measures may serve to alleviate the problem of unrepresented litigants without being entangled with the problems associated with CFAs.

15.23 Summary of response: The disadvantages of CFAs outweigh their advantages and the system should not be implemented in Hong Kong.

16. Conclusions

16.1 The crux of the matter is who should bear the risks of litigation and pay for the costs of legal services. There are 4 possible sources of funding:

- One is the litigant. This is the system currently in place in Hong Kong.
- The second source of funding is insurance companies.
- The third source of funding is through the contingency fee or conditional fee system under which the risks may be borne by the practitioners, the clients or the opponents through the success fee or higher awards of damages under the US system.
- The fourth is the Government.

16.2 The Working Party notes the English experience of funding through insurers and CFAs has not proved to be beneficial to the public nor the practitioners. In fact, the British system is moving towards a fixed costs/fixed success fees regime and deregulation to cure some of the anomalies created by CFAs.

16.3 The LRC recommends CFAs and attempts to avoid the problems experienced in England by revoking the recoverability of the additional liabilities. The Working Party has reservations whether this would eliminate satellite litigation and submits it would be premature to adopt the CFA regime given the reforms in England are at an embryonic stage.

16.4 The Working Party had the benefit of considering the Consultation Paper and comes to the conclusion that CFAs would not be in the interests of the public, nor the profession in Hong Kong. It is in any event only feasible if ATE insurance is available which is not the case. Without insurance, it would be unfair for the solicitors to take on the costs of litigation, especially when legal aid is available.

16.5 The Working Party notes there are other means of increasing access to justice, notably the expansion of SLAS. If it is professionally managed with the input of risks assessors, lawyers and law costs draftsman, the burden of litigation can be shouldered by the Government through legal aid with no extra costs to taxpayers.

APPENDIX 1

法律援助署
Legal Aid Department

本署檔號 Our ref: LA/ADM/55/4 (Pt.16)
來函檔號 Your ref: VL/mc/CF
電話 Tel: 2867 3398
圖文傳真 Fax: 2234 9336

By Post

13 December 2005

Ms. Vivien Lee,
The Law Society of Hong Kong,
3/F Wing On House,
71 Des Voeux Road
Central, Hong Kong

Dear Ms. Lee,

Conditional Fees

The Director has asked me to reply to your letters dated 4 November 2005 and 7 December 2005.

In respect of your letter dated 4 November 2005, we have the following observations:

1. As regards paragraph 4 of your letter, please note that the grant and refusal of legal aid in a year do not necessarily relate to legal aid applications made in that year since applications processed in a year may have been made in the previous year.

2. While there were 10,161 refusals in 2004, they represent the total number of refusals for both criminal and civil applications. For the purpose of the conditional fees discussion, we hope you will agree that only the number of civil applications and refusals is relevant. In this connection, there were 6,810 refusals in 2004 for civil cases.

3. In respect of the three particular questions raised at page 2 of your letter, we would advise as follows:-

   (i) the total number of civil legal aid applications refused on merits during 2004 was 6,036;

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(ii) the total number of civil legal aid applications refused on means during 2004 was 774; and

(iii) breakdown of civil legal aid applications refused during 2004:

Case Type	Refusal on Means	Refusal on Merits
Matrimonial	254	3,257
Personal Injury	279	953
Wages Claim	14	110
Others	227	1,716
Total	774	6,036

The Administration is also considering the issues arising from the LRC Report on Conditional Fees including those raised in your letter dated 7 December 2005 and will respond to the LRC direct. We therefore do not consider it appropriate to address the issues here at this stage.

Yours sincerely,

(Thomas E. Kwong)
for Director of Legal Aid

APPENDIX 2

Ready reckoner for mathematical calculation of the success fee

Prospect of success %	Success fee %	Prospect of success %	Success fee %	Prospect of success %	Success fee %
100	0	70	43	40	150
99	1	69	45	39	156
98	2	68	47	38	163
97	3	67	49	37	170
96	4	66	52	36	178
95	5	65	54	35	186
94	6	64	56	34	194
93	8	63	59	33	203
92	9	62	61	32	213
91	10	61	64	31	223
90	11	60	67	30	233
89	12	59	69	29	245
88	14	58	72	28	257
87	15	57	75	27	270
86	16	56	79	26	285
85	18	55	82	25	300
84	19	54	85	24	317
83	20	53	89	23	335
82	22	52	92	22	355
81	23	51	96	21	376
80	25	50	100	20	400
79	27	49	104	19	426
78	28	48	108	18	456
77	30	47	113	17	488
76	32	46	177	16	525
75	33	45	144	15	567
74	35	44	127	14	614
73	37	43	133	13	669
72	39	42	138	12	733
71	41	41	144	11	809

Locate success rate and read off the required uplift from the adjacent column.

APPENDIX 3

RISK ASSESSMENT

Firms should make an accurate assessment of all elements of the risk involved in a case before entering into a CFA. This means that more investigative work needs to be done at an early stage. Once a CFA is signed, both parties are likely to be stuck with it and its terms. A solicitor cannot unilaterally pull out, save for a good reason which is clearly provided for in the CFA. Neither will it be possible to be able to change the terms of the CFA, for instance by increasing the success fee to reflect what are subsequently seen as the risks involved.

Depending on the size and structure of the firm, it may be appropriate to devise a questionnaire which guides the fee earners into addressing key issues before entering into a CFA. The questionnaire should cover the two key areas: details of the case itself (including any anticipated difficulties with liability, causation or quantum) and the costs/likely return if the case is successful.

The questionnaire should help identify whether a case has very good, good, fair, or poor prospects for success. Each firm will have to develop its own definition of these terms. For instance, over 90 per cent may represent cases with very good prospects, 75-90 per cent good prospects, and so on. Firms will also have to decide which categories of case they are prepared to take on under CFA terms. It is likely that some types of case, such as clinical negligence, will generally be more difficult to assess accurately at the outset, and may result in a lower percentage prospect for success and a higher success fee.

Key issues: factual

As to the factual issues, the following issues should be considered:

(1) Are the facts of the case clear-cut, or complicated?

(2) How strong is the client's evidence?

(3) How strong is the evidence of other witnesses, and how available are they?

(4) Will the input of expert witnesses be required in order to establish liability (which will add to the cost), or can the facts be established without recourse to an expert? (If not, it is likely to be a complex case.)

(5) Is the client, and are the other witnesses plausible? Will they go down well with a judge or jury if the case comes to court?

(6) What supporting material is there? How accessible is it? What volume of it is there?

(7) Who are the defendants? Are they insured (or do they have other means) Where are they?

(8) Is there potentially more than one defendant? Is it the kind of case where there is likely to be a third party notice? If so, tread carefully; in this situation, there is a danger of winning against one but losing against another.

Key issues: legal

As to the legal issues, relevant issues will include the following:

(1) Does the case turn on an established legal issue?

(2) Are the issues clear cut? Are they novel? If the latter, the solicitor may still want to take on the case if other circumstances prevail, such as the potential for a particularly high return, or the chance to break new legal ground and to help a particular client.

(3) Are the issues complex? (It will be necessary to analyse and research the relevant case law speedily.)

(4) Is the case within the limitation period? Is there enough time to do the work required before issuing proceedings? If the solicitor is not confident that there is, then it may be necessary to turn away the case. If it is a personal injury case and the limitation period has been exceeded, is the case one where it is worth applying to the court for an extension of the time allowed?

(5) Is there likely to be a counterclaim which would reduce the pot of potential damages?

(6) Are there issues as to causation?

Key issues: damages

As to damage, the following issues may well be relevant:

(1) Are there issues as to foreseeability?

(2) What are the minimum and maximum damages which are likely?

(3) Is the client's loss easy to quantify or are there likely to be problems proving damage? Will the input of an expert be required?

(4) What levels of damages have been awarded in similar cases? What are the guidelines for these awards? (Urgent research may need to be carried out in this area.)

(5) Who sets the level of damages, judge or jury? If the latter, the amount may be less predictable.

(6) Is there scope for aggravated or exemplary damages?

(7) Is there scope for interim payments, which could be used to fund disbursements (if the client has no other means of meeting these costs)?

Key issues: costs

Questions also need to be asked about the likely costs, in particular:

(1) Is insurance available (and on what terms) to protect the client from having to pay the other side's costs if he loses? Is the level of cover on offer adequate?

(2) What is the likely overall level of disbursements? Who will be funding these, the client or the firm?

(3) If an expert witness is needed, will he have to be paid while the case progresses, or at the end?

(4) How long is the case likely to take to be resolved before getting paid?

(5) What is the likely overall level of financial subsidy for the firm? (This would involve taking into account time lag before payment, payment of disbursements and insurance, and the amount of fee earner time likely to be needed.)

(6) What are the total likely costs on which the success fee will be based (that is, what is the likely overall recovery)?

Key issues: various

Other factors too need to be considered, for instance:

(1) Will the case qualify for the fast or multi-track if it reaches court? (A fast-track case should mean that the firm gets paid within a reasonable period. If costs are fixed, it should be easier for the firm to assess the likely recovery in advance, although the attractiveness of fast-track cases will obviously depend on costs being set at a realistic level.)

(2) What level of judge will decide the case? (A more junior judge may be reluctant to make a decision which breaks new legal ground.)

(3) Is the client a private individual or company? (A company may be more able to pay disbursements. But, conversely, if company personnel change, it may hinder the handling of the case.)

(4) Are there any other likely claimants with similar cases? (If so, it might be that the work invested in this case could be useful for them, too.) However, multi-party litigation will require special consideration so far as CFA insurance is concerned.

(5) Is the case in an area where the firm already has proven experience and expertise? (A conditional fee case is not a good time to start experimenting in untested areas.)

(6) Is arbitration or mediation an option? (If so, it could mean the case being settled more quickly.)

(7) Is there sufficient expertise available to do the advocacy in-house? (This may be particularly important in a fast-track case with fixed costs.)

(8) Does the firm have the spare capacity in terms of fee earners and support personnel to take on the case?

(9) Can the firm stand the financial strain of carrying the case until its conclusion (always bearing in mind that if the case is lost, payment will not just be delayed, but simply will not happen)?

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APPENDIX 4

A new Law Society Code of Conduct is due to be introduced in 2006. Paragraph 2.03 of the draft code (Information about the costs), which bears a similarity to regulation 4 of the Conditional Fee Agreements Regulations 2000, states:

"1) You must give your client the best information possible about the likely overall cost of a matter both at the outset and, when appropriate, as the matter progresses. In particular you must:

a) advise the client of the basis and terms of your charges;

b) advise the client if charging rates are to be increased;

c) advise the client of likely payments which you or your client may need to make to others;

d) discuss with the client how the client will pay, in particular;

i) whether the client may be eligible and should apply for public funding; and

ii) whether the client's own costs are covered by insurance or may be paid by someone else such as an employer or trade union;

e) advise the client that there are circumstances where you may be entitled to exercise a lien for unpaid costs;

f) advise the client of their potential liability for any other party's costs; and

g) discuss with the client whether their liability for another party's costs may be covered by existing insurance or whether specially purchased insurance may be obtained.

2) Where you are acting for the client under a conditional fee agreement, (including a collective conditional fee agreement) in addition to complying with (1) above and (4) and (5) below, you must explain the following, both at the outset and, when appropriate, as the matter progresses:

a) the circumstances in which your client may be liable for your costs and whether you will seek payment of these from the client, if entitled to do so; and

b) if you intend to seek payment of any or all of your costs from your client, you must advise your client of their right to an assessment of those costs.

3) Where you are acting for a publicly funded client, in addition to complying with 1) above and 4) and 5) below, you must explain the following at the outset:

a) the circumstances in which they may be liable for your costs;

b) the effect of the statutory charge;

c) the client's duty to pay any fixed or periodic contribution assessed and the consequence of failing to do so; and

d) that even if your client is successful, the other party may not be ordered to pay costs or may not be in a position to pay them.

4) Any information about the cost must be clear and confirmed in writing.

5) You must discuss with your client whether the potential outcomes of any legal case will justify the expense or risk involved including, if relevant, the risk of having to pay an opponent's costs.

6) If you can demonstrate that it was inappropriate in the circumstances to meet some or all of the requirements in 2.03 (1) and (4), you will not breach 2.03."