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THE NEWS

Nick Parsons and Shirley Denyer explain the possible implications of the DBA Report, which was recently published by the CJC Working Group.

Let's be honest, Damage Based Agreements (DBAs) are a technical and dry subject. It was therefore something of a surprise, and a relief, when a speaker at the CJC Jackson Conference in April 2014 raised a hearty laugh around the room by likening DBAs to a Yeti – everyone has heard of them but no one has ever seen one! In the eighteen months since then little has changed.

Although the MOJ initially seemed sanguine that there was virtually no take-up of DBAs after new regulations allowed them to be used in litigation outside employment cases in 2013, in October last year, Lord Faulks sought the assistance of the CJC in improving the regulatory framework and a new set of 2015 draft regulations were produced by the Government for the purposes of review. A CJC working group was set up to undertake the review, chaired by Professor Rachael Mulheron. It has now published its report, making recommendations to the Government on reform of the regime.

So how might the proposals affect personal injury claims?

Use of DBAs by Defendants
Under the 2013 DBA regulations it was contemplated that only claimants would use DBAs. Under the draft 2015 regulations prepared by the Government, defendant DBAs are expressly permitted: the references to payment of costs from "*the sum recovered*" have been replaced by reference to payment from "*any financial benefit obtained*".

The Working Group take the view that "*financial benefit*" means the damages that the defendant would have to pay to the claimant if the claim had been successful – or the difference between the sums paid to the claimant and the value of the whole claim - raising the question of how that should be quantified. Should the "*financial benefit*" be quantified by reference to the reserve, the amount in the claim form, or perhaps the Schedule of Loss prepared by the claimant pre-settlement?

The working group makes no recommendation on which methodology should be adopted to identify "*financial benefit*", and instead recommends, generally, that it should be open to the client and legal representative to define "*financial benefit*" as they see fit, on a case-by-case basis. The report recognises that quantifying it could be very difficult, particularly as the different valuations of the claim referred to above are likely to vary considerably as the case progresses.

The Government had included in the draft regulations a cap on the costs a defendant representative could retain, of 25% of the financial benefit obtained by the client. The working party sees no need to adopt the same 25% cap applicable to claimant DBAs believing that, if introduced, defendant DBAs would have more in common with commercial matters, and that the 50% cap applicable in those cases should apply. The working party assumes that the defendant solicitor's DBA fee would be calculated on the entirety of the damages 'saved' from being paid, including damages for future loss, although it will not include any sums 'saved' from the claimant's costs.

> 'The Government's aim is to ensure that damages for future care and loss should not be included in the definition of "financial benefit" '

Hybrid DBAs
Will law firms be able to make use of concurrent 'hybrid' DBAs, working under a DBA in conjunction with a second funding arrangement, for example, by putting in place a reduced hourly rate payable in any event, (no win, low fee). This has been a contentious issue since the 2013 regulations were introduced, and uncertainty on the point has been one of the issues that has deterred the use of DBAs.

The Government is opposed to concurrent hybrid DBAs, partly on the basis that it fears they would allow lawyers to increase their costs significantly, without any increase in risk. The Government is also concerned at the potential for unforeseen consequences around hybrid DBAs (and the risk of a new costs war) and intends to examine the issue as part of the post-implementation review of LASPO in 2016-18.

The working group was divided on whether there was any reason to prohibit the use of concurrent hybrid DBAs and concluded that the decision was one for the Government.

The Government is not opposed to sequential hybrid DBAs, under which a DBA is used to fund one or more of the stages of litigation. For example, an hourly rate could be charged for the investigatory and preparatory stages of the litigation, with a DBA for the later stages or for the trial. This type of DBA is allowed under the Government's draft 2015 regulations.

Use of DBAs pre-issue
The MOJ has always taken the view that DBAs cannot be used to fund cases pre-issue, and that primary legislation would be required to allow that. If the DBA Regulations do not apply pre-issue, the working group is concerned that DBAs outside the regulations, with uncapped fees, might be used for pre-litigation work. It recommends that the Government considers making the changes to primary

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legislation the MOJ believes necessary to ensure that the regulations apply to pre-issue DBAs.

The Ontario model v the success fee model
Under the existing 2013 regulations, DBAs work on what is referred to as the 'Ontario Model', rather than the 'Success Fee Model'. Under the Ontario Model, costs recovered from an opponent are deducted from the fee to be paid by the client under the DBA; under the Success Fee Model the sums payable under the DBA are retained by the lawyer in addition to costs recovered from an opponent.

Most members of the working group favoured the implementation of a Success Fee Model, "*given the several advantages which the Success Fee Model entails*". It suggested that Government policy on the issue be reviewed, although recognised that, if the Success Fee Model were to be adopted, the percentage caps may need to be reduced.

The Heads of Damage from which costs can be paid
The Government's aim is to ensure that damages for future care and loss should not be included in the definition of *"financial benefit"*. The working group notes that the current DBA regulations also exclude various other heads of damage from the costs calculation, including the conventional sum for wrongful conception and awards of aggravated or exemplary damages (for example, in assault claims). It decided, however, not to recommend a change to the current wording, to ensure that the DBA regime remains the same as the CFA regime on this point.

Where personal injuries awards are assessed as a lump sum
Potential issues arise when a claim is settled by a lump sum with no breakdown of the heads of damage, leaving unclear the sum from which costs can be paid. The working group reports that the MOJ takes the view that the claimant's solicitor is responsible for ensuring that the settlement specifies the sum paid by way of general damages and the working group makes no recommendation on the point.

The indemnity principle
The Government's clear policy is that the indemnity principle applies to DBAs, which has the potential to create difficulties for claimant representatives in cases where 25% of the damages is less than the sums recovered in costs from the defendant. In these circumstances, the defendant will pay less than the assessed costs and enjoy a windfall. Although views were mixed, on balance the working group recommended that the "*strength of arguments*" were in favour of abolishing the indemnity principle with regard to DBAs. The 'windfall' argument was the most compelling but it was also felt that removing the indemnity principle would reduce the incentive for defendants to challenge the validity of DBAs.

Further recommendations
The working group also made the following recommendations:

- Counsels' fees, where counsel is not working under a DBA, should always be treated as a disbursement and therefore outside the cap.
- VAT should remain within the cap (as at present) where it is not recoverable by the client, but where it is recoverable it should be excluded.
- Where the litigant enters into two DBAs, with solicitor and counsel, the regulations should make it clear that the fees of both representatives together must not exceed the cap.
- In circumstances where an error results in the DBA being unenforceable, the working party rejected the idea that the regulations might then permit costs to be recovered on a quantum meruit. The group considered it possible that a *Hollins v Russell*-type remedy might be judicially developed with regard to DBAs, to enable immaterial breaches of the regulations to be disregarded.
- The working party considered it unnecessary for an opponent to be given notice that a DBA is being used as a funding mechanism, and made no recommendation for a change in the regulations to require that.

It remains to be seen how the MOJ will respond to the recommendations of the working party. If the recommendations made by the CJC are accepted then the amendments to the regulations will make the whole regime clearer, and ought to give solicitors more confidence in using DBAs. Whether they will be regarded as sufficiently financially attractive to the claimant market remains to be seen. With regard to the changes to the regulations allowing defendant DBAs, potentially, this could introduce a fresh dynamic into the relationship between insurers and their panel solicitors. It will be interesting to observe the market's appetite for such an arrangement.

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