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FOIL UPDATE 7th July 2022

Defendants and Damages Based Agreements

Candey Limited v Tonstate Group Limited and others (2022) EWCA Civ 936

Section 45 of the Legal Aid, Sentencing and Punishment of Offenders Act 2012 ("LASPO") made amendments to section 58AA of the Courts and Legal Services Act 1990 ("the 1990 Act"). These amendments, among other matters, legalised damages-based agreements ("DBAs") as a means of remuneration of a party's legal representatives in civil litigation. In consequence, it is now permissible for a claimant (which expression, for the purposes of this judgment, includes a counterclaiming defendant) to enter into an agreement with his solicitors to pay them a percentage of whatever he recovers from his opponent if he wins. However, in order to be enforceable, the DBA must strictly comply with the requirements of the relevant Regulations made by the Lord Chancellor pursuant to his powers under S58AA(5) of the 1990 Act.

This appeal raised the apparently novel question of whether it is lawful for a party *against* whom a claim is made (i.e., the defendant to a claim or counterclaim) to enter into an agreement that, if he succeeds in defending that claim in whole or in part, he will pay his legal representatives a percentage of the money or the value of the assets that he has *resisted* having to pay or transfer to his opponent. There is no dispute that such an agreement would be unlawful at common law.

IN BRIEF

The Court of Appeal has held that it is not possible for a defendant to litigation to enter into an enforceable agreement with his legal representatives that he will pay them a percentage of such part of the sums or assets claimed from him as he has resisted paying or transferring to his opponents.

Consequently, that issue turned on the interpretation of S58AA of the 1990 Act and the Damages-Based Agreements Regulations 2013, SI 2013 No. 609 ("the 2013 Regulations").

The Appellant, Candey Ltd. ("the Solicitors") acted for Mr Edward Wojakovski in a complex legal dispute, pursuant to a DBA. There were three separate and related actions. One was a claim brought against Mr Wojakovski for the rescission of transfers to him by the other shareholders, a Mr and Mrs Matyas, of shares in a property investment company named Tonstate Group Limited ("TGL") ("the Shares Claim"). At the time the dispute arose, Mr Wojakovski owned 50% of the shares in TGL, and Mr and Mrs Matyas, his parents-in-law, the remaining 50%.

In consequence of a settlement of the Shares Claim, Mr Wojakovski transferred 75% of the shares he held in TGL to Mr and Mrs Matyas and to his estranged wife Nadine. He retained 25% of his previous 50% shareholding (22,500 shares). Thus, he was partially successful in resisting the claim against him in that action, which was for the return of *all* the shares. Mr and Mrs Matyas and Nadine also agreed not to dispute his title to the retained shares, nor to use their voting rights under TGL's articles of association to issue any further shares so as to dilute that minority (12½%) shareholding.

Mr Wojakovski was subsequently declared bankrupt. The Solicitors claimed that by virtue of the DBA they were entitled to be paid a percentage of the value of the 22,500 shares that he had retained in TGL. They sought a charge over the shares under S73 of the Solicitors Act 1974, and claimed that their charge took priority over a final charging order which had been made by consent in favour of the Respondents on 21 July 2020.

In a judgment handed down on 30 April 2021 ("the April judgment'') a High Court Judge held that the DBA only entitled the Solicitors to payment from Mr Wojakovski if he recovered something from an opposing party in or as a consequence of the proceedings. It did not entitle them to payment if Mr Wojakovski retained some or all of the shares that were claimed from him. Moreover, even if (contrary to that conclusion) the DBA did entitle the Solicitors to payment of a percentage of the value of the retained shares, it was not an agreement permitted by the 2013 Regulations, and therefore would be unenforceable to that extent.

In a subsequent judgment delivered on 2 July 2021 ("the July judgment") the judge held (on the hypothesis that his conclusions in the April judgment were wrong) that although the Solicitors had an equitable interest in the shares from the making of the consent order on 21 May 2020 which settled the Shares Claim, it was defeated by the final charging order in favour of the Respondents, which was acquired for value without notice of their lien.

The Solicitors appealed against both judgments. They raised four grounds of appeal, namely:

(1) The judge was wrong to find that no entitlement to payment arose under the DBA;

(2) The judge was wrong to find that, even if the DBA was to be construed so as to entitle the Solicitors to payment it was unenforceable because a necessary prerequisite under the Regulations is recovery from the other side;

(3) Alternatively to (2), the judge was wrong to find that the Regulations were not *ultra vires* in prohibiting a DBA unless it provided for payment as a proportion of amounts recovered from another party to the legal proceedings;

(4) The judge was wrong to find that the final charging order took precedence over the Solicitors' lien.

By way of Respondents' Notice, in answer to Grounds 1-3 the Respondents raised a legal argument that they had not raised before the Judge, namely, that if the DBA were construed in the manner contended for by the Solicitors, it would be contrary to the primary legislation as well as contrary to the 2013 Regulations. They contend that the definition of "damages-based agreements" in section 58AA(3) of the 1990 Act cannot extend to the defence of what counsel for the Respondents termed an "incoming" claim (i.e. a claim made against the client).

[The fourth ground of appeal raised complex legal arguments which would not arise for determination unless the Solicitors succeeded in demonstrating that the judge was wrong on both the construction and enforceability issues, and that they were entitled to payment under the DBA and thus to a charge over the shares. After hearing the arguments on the DBA issues, the appellate court formed the clear view that the appeal should be dismissed on each of the first three grounds. In those circumstances, there was no longer any basis for an appeal against the July judgment, as the premise on which that aspect of the case had proceeded did not arise].

The Court of Appeal held that it is not possible for a defendant to litigation to enter into an enforceable agreement with his legal representatives that he will pay them a percentage of such part of the sums or assets claimed from him as he has resisted paying or transferring to his opponents. Such an agreement is not a "Damages-based Agreement" as defined by S58AA(3) of the 1990 Act and cannot comply with the requirements of the 2013 Regulations. In any event, that was not what Mr Wojakovski agreed with the Solicitors. Therefore, the judge was right to find that they had no entitlement to be paid a percentage of the value of the shares retained under the settlement agreement. That being so, there was no right to a charge over the shares and the issue of which charge takes priority did not arise.

The full judgment may be found at: Candey Ltd v Tonstate Group Ltd & Ors [2022] EWCA Civ 936 (06 July 2022) (bailii.org)