

**EXPLANATORY MEMORANDUM TO
THE DAMAGES-BASED AGREEMENTS REGULATIONS 2013**

2013 No. 609

1. This explanatory memorandum has been prepared by the Ministry of Justice and is laid before Parliament by Command of Her Majesty.

2. **Purpose of the instrument**

2.1 A damages-based agreement (“DBA”) is a private funding arrangement between a representative and a client whereby the representative’s agreed fee (“the payment”) is contingent upon the success of the case, and is determined as a percentage of the compensation received by the client.

2.2 These Regulations prescribe the requirements (additional to those provided in section 58AA(4) of the Courts and Legal Services Act 1990 – “the 1990 Act”) with which an agreement between a client and a representative must comply in order to be an enforceable damages-based agreement, both in civil proceedings and employment matters.

2.3 These requirements are—

- (i) in all cases, the matters which the terms and conditions of an agreement must specify, including the reason for setting the payment at the agreed level (regulation 3);
- (ii) in civil litigation, stating the maximum payment (as a percentage of damages recovered and including VAT) that the representative may take from the claimant’s damages (namely, in personal injury cases, 25% of the damages specified in these Regulations, and, in all other civil litigation, 50% of the damages ultimately recovered by the claimant), as well as what the payment is intended to cover (regulation 4); and
- (iii) in employment matters—
 - (a) the information that must be given to the client before the agreement is made (Regulation 5);
 - (b) the form any amendments to the agreement must take (Regulation 6);
 - (c) stating the maximum payment (as a percentage of damages recovered and including VAT) that the representative may take from the client’s damages, namely 35% of the damages ultimately recovered by the client (regulation 7); and

(d) certain requirements in respect of termination of the agreement (regulation 8).

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Legislative Context

4.1 Part 2 of the Legal Aid, Sentencing and Punishment of Offenders Act 2012 (“LASPO Act”) contains reforms to the funding and costs of civil litigation following the Government’s acceptance of recommendations made by Lord Justice Jackson – see *Reforming Civil Litigation Funding and Costs in England and Wales – Implementation of Lord Justice Jackson’s Recommendations: The Government Response*, March 2011 (CM8041). The cap on a lawyer’s fees under a DBA forms part of these reforms, and allows a prescribed amount of claimants’ damages to be protected.

4.2 Section 58AA of the 1990 Act makes provision for the regulation of DBAs in employment matters. The Damages-Based Agreements Regulations 2010 (2010/1206 - “the 2010 regulations”), made under section 58AA, further regulate the use of DBAs in employment matters. These Regulations revoke the 2010 regulations, but replicate their provisions.

4.3 Section 45 of the LASPO Act amends section 58AA to permit the use of DBAs in all areas of civil litigation, and to enable the Lord Chancellor to regulate their use and, in particular, to specify the maximum payment that may be made from damages under a DBA in particular proceedings.

4.4 It is intended that these Regulations will come into force on the same day as section 45 of the LASPO Act, i.e. 1st April 2013.

4.5 The DBA principles are based on the lawyer not being able to recover any more than the DBA fee.

5. Territorial Extent and Application

5.1 This Order applies to England and Wales.

6. European Convention on Human Rights

6.1 The Parliamentary Under-Secretary of State for Justice, Helen Grant, has made the following statement regarding Human Rights:

In my view the provisions of the Damages-Based Agreements Regulation 2013 are compatible with the Convention rights.

7. Policy background

- *What is being done and why*

Civil litigation

7.1 Until now, damages-based agreements have not been permitted in litigation before the courts, but their use has developed in ‘non-contentious’ business (i.e. work which falls outside the courts), including employment matters. Section 58AA(10) of the 1990 Act defines an employment matter as “a matter that is, or could become, the subject of proceedings before an employment tribunal”.

7.2 Lord Justice Jackson recommended that DBAs should be extended to all areas of civil litigation. He argued that this would provide litigants with the choice of funding methods and the freedom to choose the one that they consider is most appropriate for their case. The Government accepted this recommendation, which is reflected in section 45 of the LASPO Act.

7.3 Lord Justice Jackson also suggested that the current regulations for DBAs in Employment Tribunal cases, which address the issue of unfair settlement and penalty clauses on termination of the agreement, could be adapted for DBAs in all areas of civil litigation. Under the regulations governing DBAs in Employment Tribunals, the maximum percentage of damages that a representative may take as a fee is 35% (including VAT). In respect of DBAs, Lord Justice Jackson recommended that the lawyer’s fee in personal injury proceedings should not exceed 25% of the claimant’s damages, excluding damages for future care and loss. The Government accepted the latter recommendation and agreed that claimants should have their damages protected from excessive legal fees. A similar, although not identical, approach has been taken in respect of conditional fee agreements (“CFAs”) in proposed regulations made under sections 58 and 58A of the 1990 Act for the same reasons. At present in DBAs in respect of employment matters, the 35% cap is inclusive of VAT.

7.4 It was not considered necessary to adapt the provisions in the 2010 regulations which deal with termination (now regulation 8), those which prescribe the information which must be provided to a client before entering a DBA (now regulation 5) or the form in which any amendments to the agreement must take (now regulation 6). This is because section 58AA of the 1990 Act and the 2010 regulations were introduced following concerns that some representatives in employment cases were providing inadequate advice to their clients. This included failure to inform clients about alternative options for funding their claim (for example, through trade union representation and legal expenses insurance cover) and the use of unfair terms and conditions (for example, imposing unfair charges where a client wished to instruct another representative or refused to accept the representative’s advice to settle their claim). The 2010 regulations were designed to ensure that all representatives, whether solicitors or claims management companies, adhered to the stringent requirements specified in the regulations when providing a service under a DBA.

7.5 Only qualified legal representatives, who are subject to regulation by their professional bodies and whose conduct may be subject to challenge through those bodies, will undertake civil litigation (i.e. contentious business). It is therefore considered that, at this stage, further regulation is not required. Moreover, the consequence of failing to comply with these Regulations is that the DBA will not be enforceable and, in those circumstances, the representative will receive no payment.

There is a concern that this could lead to attempts to avoid payment, by suggesting that the legal representative had failed to comply with one or more of the additional regulations (as happened when CFAs were subject to greater regulation), leading to satellite litigation.

7.6 Although the 2010 regulations applied to employment matters as non-contentious business, they did not apply to other non-contentious business. The LASPO Act maintains this position by providing that DBAs in non-contentious business (save for employment matters) will not be unenforceable if they do not comply with the provisions of section 58AA of the 1990 Act or regulations made under that section. Consequently, these Regulations do not apply to other types of non-contentious business.

7.7 The Civil Justice Council (CJC), during their consideration of how DBAs should be implemented, suggested that in consumer and micro enterprise cases, the lawyer's fee should be capped at 50%, but there should be no cap in commercial cases. The Government agreed that there should be a cap of 50% of the damages that the lawyer may take in DBAs, but considered, in the interests of the claimant, that this should be extended to all cases which were not otherwise capped (i.e. personal injury claims and employment matters). The figure of 50% is based on the CJC's recommendation, and would allow claimants to keep 50% of damages.

7.8 In order to be enforceable, a DBA in civil proceedings must meet the requirements specified in this instrument. Regulation 3 requires, amongst other matters, the DBA to specify the circumstances in which the payment from the claimant's damages will be payable. In civil proceedings the "payment" is defined as that part of the sum recovered in respect of the claim or damages awarded that is agreed to be paid to the representative in respect of the representative's costs (effectively the representative's hourly rate). The definition excludes expenses (for example medical reports), but specifically includes counsel's fees, which would be paid for as a disbursement by the representative.

7.9 In particular, in claims for personal injury, regulation 4 requires that a DBA must further provide that the payment will only be payable from damages ultimately recovered for pain, suffering and loss of amenity ("PSLA") and pecuniary loss (other than damages for future care and loss) and, inclusive of VAT, must not exceed 25% of those damages (although a lower percentage may well be agreed between the parties), net of both any sums recovered from the losing party and any deductions made by the Compensation Recovery Unit ("the CRU" - the Department for Work and Pensions' agency with responsibility for recovering benefits paid out to a claimant who subsequently recovers damages which include loss of income).

7.10 By way of example, a claimant ("C") agrees to pay 25% of their damages to their representative in the event of winning their claim. The claimant is awarded £10,000, £6,000 of which is for PSLA and past pecuniary loss. £1,000 is recovered by the CRU. In this case, then, the payment to the representative is notionally 25% of £5,000 (i.e. £1,250). However, as is typically the case, the defendant is ordered to pay costs in respect of both the representative's fee and counsel's fees, which amount to £1,000. On that basis, the sum that C must pay the representative from their damages is £250. The fact that the representative might have incurred costs exceeding £1,250 is irrelevant; no more will be payable by the claimant in respect of the agreed fee and it

will be for the representative in these cases to consider his likely costs before reaching agreement as regards the payment to be made from the claimant's damages.

7.11 So as not to breach the indemnity principle (i.e. that a losing party cannot be ordered to pay more in costs than the successful party has already agreed to pay his representative), rules of court, made by amendment to the Civil Procedure Rules 1998, will provide that the court may not order the losing defendant to pay a claimant any costs which exceed the agreed payment. Taking the above example, if the defendant was ordered to pay £1,250 in costs, then the claimant would not have to pay anything from damages in satisfaction of the sum agreed to be paid - the £1,250 from the defendant being paid over to the representative. Moreover, even if the representative's costs incurred in representing C exceed £1,250, the representative would not be able to recover any further payment from the losing party in respect of them.

7.12 In civil proceedings other than claims for personal injury, the payment under the DBA, inclusive of VAT, must not exceed 50% of all sums ultimately recovered by the claimant. Again, depending upon the amount ordered to be paid by the losing defendant by way of costs, the claimant may not be required to pay their representative anything, but, in these instances, the calculation of the payment will not be limited to particular heads of damages.

7.13 In all civil proceedings, expenses, such as the costs of reports or court fees, which might be paid for by the claimant's solicitor during the proceedings, are not included in the agreed fee payable under the DBA. They are nonetheless to be paid by the claimant to the extent that they are not ordered to be paid by the losing defendant. This means that, as well as possibly paying a sum directly from their damages, claimants might also be required to pay an additional sum to their representative to meet these expenses.

7.14 The 25%/50% cap does not apply to appeal proceedings, where the parties will be free to negotiate the payment. This reflects the additional risks that can be incurred by a representative in representing a client in appeal proceedings.

Employment matters

7.15 In an employment matter, the definition of "payment" again excludes all expenses, but, in this instance, expenses include counsel's fees as well as, for example, the costs of reports, and, as such, are required to be paid separately. As well as the additional provisions mentioned above, the payment, inclusive of VAT is capped at 35% of the sum ultimately recovered by the client (regulation 7). The representative's payment must not, therefore, exceed this prescribed maximum, although a lower percentage may well be more appropriate especially where the claim is one of several similar claims or proceedings the representative is dealing with. For this reason regulation 3 not only requires the representative to specify in the agreement the reason for setting the payment at the agreed level, but to have regard to whether the claim or proceedings is one of several similar claims or proceedings. The "sum recovered" is the final amount which the client ultimately receives, not the damages awarded.

7.16 The cap would not apply to appeal proceedings.

- **Consolidation**

7.17 These Regulations revoke the Damages-Based Agreements Regulations 2010 and replicate the provisions for employment tribunal proceedings in the present Regulations. Regulation 2 includes a saving provision the effect of which is that the 2010 Regulations shall continue to have effect in respect of any DBA signed before the date on which these regulations come into force.

8. Consultation outcome

8.1 The public consultation paper *Proposals for reform of civil litigation funding and costs in England and Wales*, November 2010 (Consultation Paper CP 13/10) contained proposals relating to DBAs in civil litigation. That consultation was published on 15 November 2010 and closed on 14 February 2011. The overall consultation received a total of 625 responses. The majority of respondents supported a cap on the amount of damages which may be charged as a lawyer's fees under a DBA in personal injury cases. Respondents felt that such a cap was necessary to protect claimants in personal injury proceedings. Whilst some respondents suggested that the same cap should also apply to non-personal injury cases for the purposes of consistency, others felt that it was not necessary to limit the maximum fee in those proceedings as market forces and existing regulation would govern the amounts charged.

8.2 The Government's response, *Reforming Civil Litigation Funding and Costs in England and Wales – Implementation of Lord Justice Jackson's Recommendations: The Government Response*, may be found at:
<http://www.justice.gov.uk/downloads/consultations/jackson-report-government-response.pdf>

8.3 In its Response to consultation, the Government said (at paragraph 13):

“Damages-based agreements (DBAs/contingency fees) will be allowed to be used in civil litigation...The Government will lift the restriction on their use in civil litigation. DBAs will provide a useful additional form of funding for claimants, for example in commercial claims. Successful claimants will recover their base costs (the lawyer's hourly rate fee and disbursements) from defendants as for claims, whether funded under a CFA or otherwise, but in the case of a DBA, the costs recovered from the losing side would be set off against the DBA fee, reducing the amount payable by the claimant to any shortfall between the costs recovered and the DBA fee. DBAs will be subject to similar requirements for parties to the agreement as for CFAs. For example, the amount of the payment that lawyers can take from the damages in personal injury cases will be capped (at 25% of damages excluding for future care and loss). However, the Government is not persuaded that there should be a requirement for a claimant to obtain independent legal advice in respect of a DBA.”

8.4 The Civil Justice Council further considered how DBAs should operate. They reported in July 2012 and the Government agreed with the majority of their recommendations.

8.5 As required by Section 58AA of the Courts and Legal Services Act 1990, the Lord Chancellor consulted the designated judges, the General Council of the Bar, the Law Society and such other bodies that he considered to have an interest in the draft Regulations during October 2012. A total of 20 responses were received, some of which were from individual practitioners. Along with some drafting points, which have been reflected in the Regulations, some respondents argued that the 25% cap should be against all heads of damages, and not be limited to damages for pain, suffering and loss of amenity and past loss. It was felt that protecting future loss would reduce the pool of funds to pay for lawyers, which might mean that otherwise good cases are not pursued because it would be uneconomic for lawyers to take on those claims. It was also argued that the cap should be exclusive of VAT as the inclusion could further reduce the pool of fees available to be shared between solicitor and counsel, which in turn would mean that many good cases that are currently pursued would become uneconomic. Nonetheless, for the reasons expressed at paragraph 7.5, the Government considers that both the cap on personal injury damages and including VAT within that cap should be implemented in order to protect claimants' damages.

9. Guidance

9.1 The Ministry of Justice will work with representative bodies, such as the Law Society, to consider whether any guidance is necessary to support effective implementation of the Regulations.

10. Impact

10.1 For employment matters, these regulations replicate the provisions in the 2010 regulations. DBAs cannot be used in civil litigation until 1st April 2013, and will allow for a new form of funding damages claims, subject to the requirements of these regulations. There may be some impact on business, but no direct impact on charities, voluntary bodies or the public sector. Any sectors that derive an income from civil litigation may be affected.

10.2 The impacts of the Government's programme of legal aid reform are set out in an Impact Assessment, which was updated following the LASPO Act receiving Royal Assent in May 2012. This is available at <http://www.justice.gov.uk/legislation/bills-and-acts/acts/legal-aid-and-sentencing-act/laspo-background-information>. An Impact Assessment has not been prepared specifically for this instrument.

11. Regulating small business

11.1 The Regulations apply to small business. Small firms will be affected, both as claimants and defendants. As claimants, they would have a greater choice in deciding on an appropriate funding arrangement. Small legal firms will also be affected; allowing them to enter into DBAs will allow them to offer a wider range of funding agreements. The regulatory requirements are similar to those for CFAs, which

already apply to small firms, any administrative burdens are not expected to be significant.

11.2 Regulating the maximum percentage which lawyers can charge may have an impact on small firms as they may have less ability to take on the risk of losing complex and/or risky cases by taking on a large number of simple and/or less risky cases.

12. Monitoring & review

12.1 It is intended to review the policy between three to five years after the implementations date. The review will form part of a wider review of the entire package of reform policies implemented following the passing of the LASPO Act. Further details are attached to Annex A of the Impact Assessment.

13. Contact

Vilopa Patel at the Ministry of Justice (telephone: 020 3334 3118, or email: vilopa.patel@justice.gsi.gov.uk) can answer any queries regarding these Regulations.