Popping the DBA bubble

Andrew Hogan identifies some problems ahead for damages-based agreements

After years of desuetude, damages-based agreements (DBAs) are back in favour with the legal profession. Long the unwanted stepchild of the Jackson reforms, there has been a flurry of interest – particularly in large scale commercial litigation – in undertaking work under a DBA.

But such a course is not without problems, and in two high-profile cases, the potential problems with DBAs were laid bare. In *Cakebread and Levy v Arthur Panayiotis Fitzwilliam* [2021] EWHC 472 (Comm), two barristers' claims for payments for substantial sums under a DBA failed, with a significant issue being the unenforceability of the DBA in question: '7. In their Points of Claim dated 6 March 2019, the claimants advanced three causes of action. The first was that the defendant had terminated the DBA and was liable to pay under clause 9.2 for the work done based on hourly rates. The second was that the defendant was in breach of his duty of good faith in clause 8.2 by giving deceitful instructions regarding the Chescor deal, so that the claimants could terminate the second DBA under clause 9.6 and charge the defendant for the work done on hourly rates.

'8. In his Second Interim Award, the arbitrator found that the DBA was unenforceable because of breaches of the Damages-Based Agreements Regulations 2013, SI 2013/609. He therefore rejected the claimants' first two causes of action. No more need be said about them.'

Further, in the case of *Candey Ltd v Tonstate Group Ltd* [2021] EWHC 1826 (Ch), a High Court judge found that solicitors were not entitled to be paid, as their DBA did not comply with the requirements of the courts and Legal Services Act 1990, as that statute required the subject matter of a DBA to be a recovery of rather than a preservation of value: '58. This reinforces, rather than detracts from, the overall point that to be enforceable under the act, a DBA must provide that payment to the representative is a proportion of the amount recovered by the client in the proceedings… For the above reasons, I conclude that:

'(1) As a matter of construction of the DBA, it only entitles Candey to any payment from Mr Wojakovski if Mr Wojakovski recovers something in or as a consequence of the proceedings;

'(2) The fact that Mr Wojakovski has retained the shares does not, therefore, entitle Candey to any payment under the DBA;

'(3) There being no other recovery by Mr Wojakovski in or arising out of the proceedings, Candey has no entitlement to payment of anything under the DBA; and

'(4) If, contrary to the above, the shares did constitute "Proceeds" as a matter of construction of the DBA, the DBA would not be enforceable – at least to that extent. (The question whether, if some other recovery had been made, the DBA would be enforceable to the extent of those other recoveries does not arise, and I do not need to consider it.)'

DRAFTING ERRORS

The findings in the two cases above reflect drafting errors in the creation of a DBA. A prerequisite for drafting a DBA is that it must comply with the terms of the Courts and Legal Services Act 1990 and the provisions of the Damages Based Agreements Regulations 2013, otherwise the statute will deem the DBA to be unenforceable. If the DBA is unenforceable, then the client is under no obligation

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to pay her solicitors anything. That in turn means that on any assessment of costs between the parties to the substantive litigation, applying the indemnity principle, the measure of costs that the client can recover will be 'nil'. To add insult to injury, if the lawyers have paid themselves from the judgment sum or settlement, and their disbursements, they could find themselves having to refund the client that money, and stand the disbursements themselves.

But if the use of a DBA is problematic, or potentially so, for the lawyers using them, in turn they represent an opportunity for their opponent to litigation, to probe the terms of the lawyer's retainer and to seek to make enforceability arguments. If those arguments succeed, then the lawyers will recover nothing in respect of their costs. So how should such challenges be mounted?

CHALLENGING DBAs

The starting point is to scrutinise any bill of costs closely and see whether it refers to the existence of a DBA funding arrangement. This should be set against what else is known about how costs are being funded, derived from the conduct of the substantive litigation. Perhaps the firm seeking to recover its costs indicates on its website that it works under DBAs for the particular kind of case in question. Part 18 Requests can be used as necessary, to nail down the nature of the funding arrangement.

Next, disclosure of the DBA should be sought. If a genuine issue can be shown about the potential enforceability or otherwise of the retainer, then the court will put a receiving party to their election to produce the DBA. Often the genuine issue can arise simply because of a miscertification of the Bill of Costs, wrongly describing a DBA as a private retainer. Once the DBA is obtained, it should be closely scrutinised, to determine whether it complies with the Courts and Legal Services Act 1990 and the Damages Based Agreements Regulations 2013.

I see no reason why, although the agreement in question is a DBA as distinct from a Conditional Fee Agreement (CFA), the test for compliance with the statutory requirements should not be the same: that is, it is not enough to show an immaterial or trivial breach of the regulations. It must be a material breach.

The test for determining whether a CFA is enforceable or unenforceable was set out in *Hollins v Russell* [2003] 1 WLR 2487: 'The key question, therefore, is whether the conditions applicable to the CFA by virtue of section 58 of the 1990 act have been sufficiently complied with in the light of their purposes. Costs judges should accordingly ask themselves the following question: "Has the particular departure from a regulation pursuant to section 58(3)(c) of the 1990 act or a requirement in section 58, either on its own or in conjunction with any other such departure in this case, had a materially adverse effect either upon the protection afforded to the client or upon the proper administration of justice?" If the answer is "yes" the conditions have not been satisfied. If the answer is "no" then the departure is immaterial and (assuming that there is no other reason to conclude otherwise) the conditions have been satisfied.'

This test was confirmed in *Garrett v Halton BC* [2007] 1 WLR 554 to relate to the degree of non-compliance with the regulation; rather than its effect upon the client in the sense of a detriment, or whether particular financial prejudice has been sustained.

It follows that when the lawyers acting under the DBA have to defend an enforceability challenge, often the best argument that they will have is that the breach is in fact immaterial. Other arguments might be raised, but there are problems with them.

For example a common argument is that there is a 'fallback' position such as a private retainer should the DBA fail. But the concept of two parallel retainers in this context does not work. The receiving party would be surprised to be told that despite the making of the damages-based agreement, she was still liable to pay the lawyers' costs, win or lose. Any objective observer would conclude that the purpose of a DBA was to supersede any pre-existing privately paid retainer.

Another argument is that offending provisions in a DBA might be capable of severance, saving part of the DBA. This is an argument based on *Zuberi v Lexlaw Ltd* [2021] EWCA Civ 16. However, Lewison LJ was there describing the position at common law and the well-known test of severability where a contract is illegal at common law. Where statutory unenforceability is concerned, the doctrine of severance does not apply. The position in relation to statutory unenforceability is aptly stated in *Henderson v Dorset Healthcare University NHS Foundation Trust* [2020] UKSC 43 at paragraph 75: 'In relation to contractual illegality, this is explained by Underhill LJ in *Okedina v Chikale* [2019] EWCA Civ 1393; [2019] ICR 1653, para 12, drawing on the formulations set out in Burrows: *A Restatement of the English Law of Contract*: "(1) Statutory illegality applies where a legislative provision either (a) prohibits the making of a contract so that it is unenforceable by either party or (b) provides that it, or some particular term, is unenforceable by one or other party. The underlying principle is straightforward: if the legislation itself has provided that the contract is unenforceable, in full or in the relevant respect, the court is bound to respect that provision. That being the rationale, the knowledge or culpability of the party who is prevented from recovering is irrelevant: it is a simple matter of obeying the statute.

'(2) Common law illegality arises where the formation, purpose or performance of the contract involves conduct that is illegal or contrary to public policy and where to deny enforcement to one or other party is an appropriate response to that conduct…"'

A third argument is that if an agreement is unenforceable, then the court can allow a quantum meruit. But for the court to allow a quantum meruit claim on a restitutionary basis would run counter to the statutory policy of unenforceability. The case of *Dimond v Lovell* [2002] 1 AC 284, where the House of Lords refused a restitutionary remedy where a contract was unenforceable, is on point.

A fourth fallback position is that it might be argued that disbursements are still payable, even if fees are not. But this argument hinges upon whether and when the client put the solicitor in funds for the disbursements. If the receiving party did so before judgment, then the position is governed by paragraph 115 of *Hollins*, which deals with the scenario where a client puts a solicitor in funds or draws down on a litigation funding loan to do so.

In conclusion, DBAs have recently had a fresh injection of life by a number of decisions given on appeal: but some of those decisions in turn have illustrated the problems that can arise from drafting a non-compliant DBA; and also illustrated the opportunities for paying parties to take technical points, which could result in a Bill of Costs being assessed at 'nil'.

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