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Court of Appeal Confirms Enforceability of "Costs on Termination" Clauses and "Hybrid" Arrangements Included in Damages-Based Agreements

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In *Zuberi v Lexlaw Limited*,[1] the Court of Appeal confirmed that a Damages Based Agreement ("**DBA**") can include a term that permits the legal representative to charge the client on a time costs basis in the event that the DBA is terminated by the client before the conclusion of the litigation. The decision brings important clarity to the validity of such terms.

DBAs are distinct from Conditional Fee Agreements ("**CFA**"). Under a CFA, the amount a legal representative charges its client for its own fees varies depending on the outcome of the client's matter. Under a DBA, if the client is successful, the legal representative charges a straight percentage of any damages recovered, regardless of what its fees are, but recovers nothing if the claim fails (so-called "no win, no fee" arrangements). Such arrangements were previously prohibited under the common law but were made lawful by legislation in 2013 in order to promote better access to justice by allowing litigants as many funding methods as possible.

Unfortunately, the *Damages Based Agreements Regulations* 2013 (the **"2013 Regulations"**), which were introduced to govern the new regime, were considered to be so unclear that practitioners have been cautious about adopting DBAs as a standard method of retainer. One point of uncertainty was whether a legal representative could include a provision for payment on a conventional time costs basis if the retainer was terminated before settlement or trial. Also of concern was the validity of so-called *"hybrid"* DBAs, which combine a success payment with some other form of payment, such as: (i) *"sequential hybrid"* DBAs which provide for different payment arrangements for different stages of the proceedings (e.g., a success fee if the claim succeeds at trial, but time costs charges relating to any appeal); or (ii) *"concurrent hybrid"* DBAs which provide for different payment arrangements to run in parallel (e.g., charging on a time costs basis at reduced rates but with a top-up payment if the claim is successful).

The unanimous decision of the Court of Appeal in the *Zuberi* case provides much-needed certainty that DBAs remain valid if they contain provisions dealing with recovery of the legal representative's fees on a time costs basis in the event that the retainer is terminated by the client. In addition, the majority (Lewison and Coulson LJJ) confirmed the validity of *"hybrid"* DBAs, which may now give practitioners confidence to utilise this form of DBA when considering alternative funding arrangements with their clients.

The Legal Background

Retainers under which a lawyer was entitled to a share in the client's recovery in court proceedings were historically prohibited at common law on the ground that they were deemed champertous.

However, as part of the government's review of the costs regimes relating to civil litigation in England & Wales (the Jackson Reforms), it was considered that broader funding methods should be open to litigants in order to improve access to justice and take some pressure off the Legal Aid system. This was initially implemented by section 45 of the *Legal Aid, Sentencing and Punishment of Offenders Act* 2012, which introduced an amended version of section 58AA of the *Courts and Legal Services Act* 1990. This section defined a DBA as:

> *. . .an agreement between a person providing advocacy services, litigation services or claims management services and the recipient of those services which provides that: (i) the recipient is to make a payment to the person providing the services if the recipient obtains a specified financial benefit in connection with the matter in relation to which the services are provided; and (ii) the amount of that payment is to be determined by reference to the amount of the financial benefit obtained.*

The legislation also provides that if the DBA does not satisfy certain conditions contained in the legislation and any related regulations, it will be unenforceable.

Secondary legislation, in the form of the 2013 Regulations (which replaced the *Damages Based Agreements Regulations* 2010) was subsequently introduced in order to provide further conditions that must be met in order for a DBA to be enforceable.

Regulation 4(1) of the 2013 Regulations provides (emphasis added):

> *In respect of any claim or proceedings, **other than an employment matter**, to which these Regulations apply, a damages-based agreement must not require an amount to be paid by the client other than:*
>
> *(a) the payment, net of: (i) any costs (including fixed costs under Part 45 of the CPR); (ii) where relevant, any sum in respect of disbursements incurred by the representative in respect of counsel's fees; that have been paid or are payable by another party to the proceedings by agreement or order; and*
>
> *(b) any expenses incurred by the representative, net of any amount which has been paid or is payable by another party to the proceedings by agreement or order.*

In contrast, regulation 8 (which deals with employment matters only) specifically provides that if the client terminates the retainer before a settlement is reached or the tribunal hearing commences, the representative may charge for its time costs (and expenses). Consequently, regulation 4(1), which deals with all civil litigation matters except employment, does not appear to allow for time costs to be recovered by the representative on termination of the agreement. This anomaly was noted by practitioners and has led to considerable uncertainty as to what was permissible under the 2013 Regulations.

Zuberi – The Facts of the Case

Ms Zuberi had borrowed money from a bank and subsequently alleged that she had been mis-sold certain financial products. She retained Lexlaw to act for her in her claim against the bank, which she eventually settled.

The written retainer between Ms Zuberi and Lexlaw was in the form of a DBA. Clause 9.1 of the DBA provided that Lexlaw was entitled to 12% of any sum recovered plus expenses, whereas clause 10 provided that, if the claim was lost, Ms Zuberi was liable to pay expenses only.

Following the settlement, Lexlaw claimed that it was due £130,000 from Ms Zuberi under the terms of the DBA. However, the agreement also contained a termination clause, which provided that:

> *With the exception of the circumstances set out in clause 6.3 . . . you may terminate this Agreement at any time. However, you are liable to pay the Costs and Expenses incurred up to the date of termination of this Agreement within one month of delivery of our bill to you.*

"Costs" was defined as time charges at an hourly rate for time spent by Lexlaw working on the claim and *"Expenses"* was defined as the cost of instructing third parties plus disbursements.

Ms Zuberi argued that the presence of the termination clause invalidated the whole contract under regulation 4(1) of the 2013 Regulations, because her case did not relate to an employment matter. At first instance, the High Court disagreed with Ms Zuberi's position, holding that it was unlikely that the 2013 Regulations were intended to preclude a retainer which allowed a lawyer to recover their costs if the retainer was terminated by the client.

The judge in the High Court gave a number of connected reasons for this conclusion, namely: (i) a lack of any justification for such a stark difference between a lawyer in an employment matter and a lawyer in any other kind of case; (ii) interference with freedom of contract; and (iii) the deterrent effect such an interpretation of the regulatory regime would have on the adoption of DBAs by practitioners, thus defeating the object of providing a wider choice of funding methods for litigants.

Ms Zuberi appealed to the Court of Appeal. Her case that the inclusion of a termination clause in her retainer with Lexlaw was in contravention of regulation 4(1) and, as such, was unenforceable fell squarely within the lacuna in the legislation long-noted by practitioners and commentators.

The Decision of the Court of Appeal

The Court unanimously dismissed Ms Zuberi's appeal, holding that regulation 4(1) does not preclude an agreement to pay time costs on termination. However, the Court of Appeal judges arrived at that conclusion by different routes.

The majority (Lewison and Coulson LJJ) based their decision on the statutory definition of a DBA. Lewison LJ considered that there were two possible interpretations of the definition of "Damages Based Agreement" in section 58AA of the *Courts and Legal Services Act* 1990 (extracted above): one whereby the DBA constitutes the whole contract of retainer and includes a provision which entitles the legal representative to a share of any recoveries; or another whereby the DBA relates only to those provisions within the general contract of retainer which deal with payments made out of recoveries. Lewison and Coulson LJJ held that the latter interpretation was to be preferred, and accordingly the other provisions of the contract (including the termination clause at issue in this case) did not form part of the DBA itself.

One consequence of this interpretation of the definition of a DBA (and noted by Lewison LJ) was that so-called "*hybrid"* DBAs would be permissible. This would include both *"sequential hybrid"* DBAs (for example, a share of recoveries if damages are awarded at first instance and the time costs at agreed rates if the case proceeds to appeal) and *"concurrent hybrid"* arrangements (i.e., where two forms of retainer exist at the same time).

In the view of Newey LJ, dissenting from the main judgment, this narrow construction was not justified; he considered that the definition of DBA should be read to encompass the entire retainer, not just the provisions which deal with payment out of the share of recoveries. On his preferred definition, hybrid DBAs would not be permitted by the legislation. He considered that this conclusion was supported by a number of indications from Hansard and also on the basis that it would be surprising if the legislation had been intended to authorise hybrid DBAs, without including express safeguards to deal with their operation.

However, in spite of disagreeing on the construction of the DBA definition, Newey LJ also considered that regulation 4(1) would not apply to termination provisions. He reached this conclusion on the basis that, although the 2013 Regulations contained express controls relating to termination provisions in employment matters, whilst remaining silent on other areas of civil litigation, this was because employment matters can be undertaken by non-lawyers. Therefore, he concluded, they are not subject to the same professional regulation as other civil litigation matters and so there was no need for express regulation of civil litigation matters in the 2013 Regulations.

Comment

The 2013 Regulations have been criticised since their implementation for being so unclear that practitioners have been cautious about adopting DBAs as a standard method of retainer. One major uncertainty was whether a DBA could include a clause for payment on some other basis (e.g., time costs) than a share of recoveries if the DBA was terminated, or whether this would render the agreement invalid. If such provisions were held to be invalid, the practitioner faced the possibility that they might conduct a significant amount of work over a long period of time, which they would be unable to recover anything for if the client then chose to terminate the retainer shortly before conclusion of the matter. As such, there was little incentive for practitioners to embrace DBA arrangements. However, the Court of Appeal's decision confirms that such terms are unproblematic and will not impact the validity of a DBA.

Another area of disagreement was the status of so-called *"hybrid"* DBAs (i.e., DBAs which combine a success payment with some other form of payment). It has been considered that *"hybrid"* DBAs would be prohibited under the 2013 Regulations, but again the legislation was unclear. It is notable that the reasoning of the majority of the Court of Appeal in the present case would mean that both *"concurrent hybrid"* and *"sequential hybrid"* DBAs would be permissible under the 2013 Regulations. This may give some comfort to practitioners and, as a result, we may see a broader take-up of DBA arrangements amongst lawyers and sophisticated commercial clients who are willing to share the risks and rewards of litigation.

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[1] [2021] EWCA Civ 16.