

Commercial disputes are set to rise, but companies' ability to fund litigation is set to contract in tandem. **Derek Bedlow** asks whether insurance-backed conditional fee arrangements will become the funding method of choice when money is tight

Adverse conditions

In association with



Notwithstanding the relatively short history of conditional fee arrangements (CFAs) and 'after-the-event' insurance (ATE) in commercial litigation, the low take-up of the CFA and ATE combination in commercial litigation looks a little strange.

Just 7% of commercial cases are conducted using a CFA, according to the 139 commercial litigators who responded to Legal Week Intelligence's Benchmark survey, conducted in association with FirstAssist Legal Protection.

For clients, the opportunity to launch legal claims for next to no outlay, and with little risk of financial disaster in the event that they lose, looks like the proverbial no brainer. The arrangement works through the solicitor agreeing to work on a no win, no fee basis (with a maximum allowable fee uplift of 100%) while the client takes out ATE insurance against having to pay the costs of the other party and other disbursements if the case is unsuccessful.

In most cases, the premium is deferred, which means the client does not need to pay for the premium at the outset and is able to reclaim the cost from the losing party if the claim is successful. Most ATE premiums are also 'self-insured' which means that the case is not payable by the client if lost. This means, in principle, that the client faces very little outlay at the outset of a case and is almost entirely insulated from the consequences of an unsuccessful claim.

For these reasons, in some areas of litigation – notably personal injury (PI) and clinical negligence claims – CFAs and ATE have almost become the default funding option. Yet when it comes to commercial litigation, CFAs remain the exception rather than the rule.

The reasons for this are

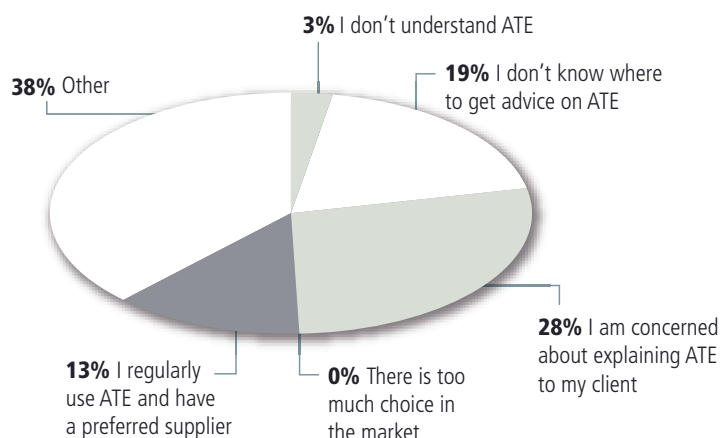
many and varied. On one level, many commercial litigators still display some scepticism about the suitability of ATE insurance for commercial litigation cases. The main concerns highlighted by the survey are uncertainty over whether policies will cover all eventualities, whether the cost of the premium will be fully recoverable in the event of success and the difficulty of finding cover in the first place. Commercial litigators also express fears that, in the event of a protracted case, extending the amount of cover will either be unachievable or prohibitively expensive.

The common theme behind these worries is that while CFAs and ATE might be suitable for more straightforward cases such as personal injury, commercial litigation is too complex and unpredictable for ATE products to cover all eventualities in a cost-effective – and recoverable – way.

"In a personal injury case, you will often have an independent police report and you are therefore better able to gauge whether the case will be successful," says David Greene, partner of Edwin Coe and president of the London Solicitors Litigation Association. "In commercial litigation, one side usually says one thing and one side says another. You are very reliant on what the client tells you at the commencement of proceedings. There are relatively few ATE providers and they are looking for a very high probability of success, but most commercial litigation is a 50:50 chance."

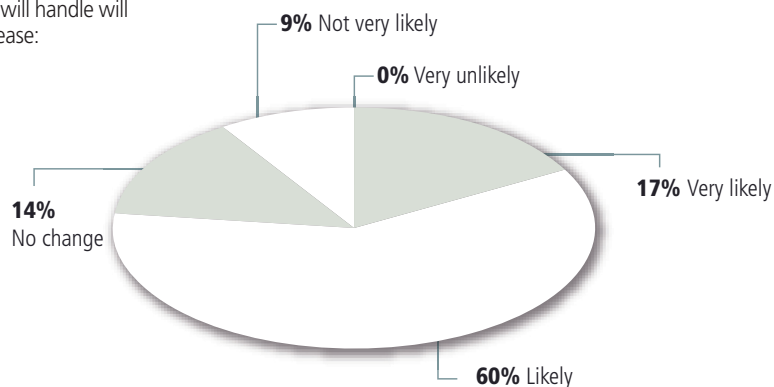
ATE insurers generally dispute these claims, says Peter Smith, managing director of FirstAssist Legal Protection, the ATE insurer. Many of these issues are yesterday's news. His own company's product, Pursuit, and some of those of his rivals have

Which statement accurately reflects your position? Source for charts: Legal Week Intelligence



What effect is the economic downturn likely to have on your workload?

The number of cases you will handle will increase:



long addressed many of these concerns, he emphasises.

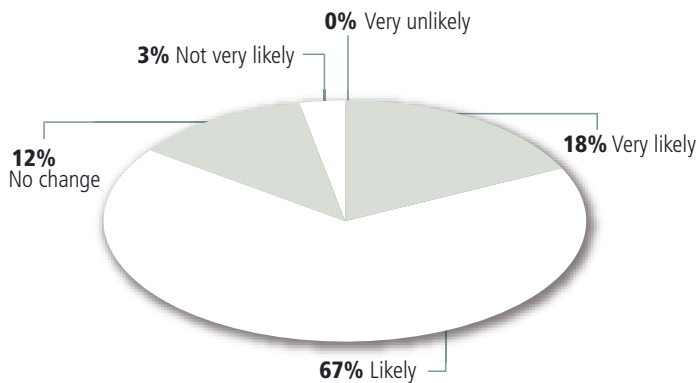
"Solicitors, understandably, want to be able to say to their clients with certainty: you will get the premium back. But recoverability, as far as we are concerned, is a non-issue," Smith says. "We have now handled several thousand cases and we have never had to ask a client to pay a premium or to make up a shortfall. We had a test case in our favour three years ago and we have always got our premium

when costs are awarded or when a case is settled and we do not see any reason why it should be a problem in the future."

When it comes to the perceived unavailability of ATE cover for commercial cases, Smith says that the perception lags reality. Almost a quarter (23%) of commercial respondents to this survey, say that ATE enables cases to proceed that would otherwise be too risky to go forward.

FirstAssist Legal Protection has been on an education

Will clients will be more interested in using CFAs and ATE to fund their cases?



campaign among commercial litigators over the past few months and Smith says that its message is being well-received at law firms large and small. Nevertheless, he still has a major hurdle to climb: persuading lawyers that it is in their clients as well as their own commercial interest to take cases on CFAs. Although lawyers are obliged to inform their clients of the existence of alternative methods of funding, many then go on to add that they will not work under a CFA themselves. ATE cover is available for non-CFA cases, but it means that clients miss out on the benefits which a CFA offers.

For many, the commercial risk of working on a CFA is too great, especially at a time when profits are under pressure and lock-up is becoming a major issue in many firms.

"Managing our businesses is something that many solicitors are not very good at and some solicitors are also not very good at estimating and budgeting for costs over two years or more," says Tony Guise, partner of Guise Solicitors and chairman of the Commercial Litigation Association. "Some solicitors are not very good at risk assessment and CFAs can be a problem. Every firm has its limits."

Although modified or partial CFAs – in which the lawyer charges a lower rate in return for a smaller uplift – are gaining popularity amongst commercial litigators, clearly jam today rather than jam tomorrow is still more attractive to the majority of commercial litigators. So if, as it seems, many lawyers will not start using CFAs unilaterally,

then the only way that CFAs will become commonplace in commercial litigation is if clients begin to demand their use.

Mark Humphries, head of advocacy at Linklaters and a long-time advocate of CFAs, says that the combination of lawyer resistance and client apathy is at the root of low CFA take-up so far.

"It's a two pronged issue with CFAs in commercial litigation,"

'Clients haven't really been interested in [CFAs] and there is no incentive for the lawyers to promote them'
Mark Humphries, Linklaters

he says. "Clients haven't really been interested in them and there's no incentive for the lawyers to promote them.

"When this first started I thought that CFAs would virtually become self-marketing. Clients would get to hear about them and would think: what's the downside? We can do 'no win, no fee' and in the event that we lose we pay nobody anything. In the event that we win, we recover all of the additional costs from the loser.

But if you have got a client who is happy to pay an hourly rate even though the lawyer has told him of the availability of CFAs, and so it is the same money for the lawyer whether you win, lose or draw, there's absolutely no reason to start trying to force the client to think further about

conditional fee agreements, no win, no fee situations. So it hasn't happened yet."

The client is king

Guise and Greene both report that they – and the commercial litigators they represent – are seeing an increase in client requests for CFAs. "There's growing resentment amongst clients towards the billable hour," says Guise – but clearly there is an education process needed for litigation clients.

In June last year, a survey of FTSE350 companies by Ipsos MORIS on behalf of Addleshaw Goddard found that client awareness of CFAs and ATE was extremely low. Only 8% of the respondents – described as senior personnel with responsibility for litigation budgets – said that they understood CFAs well, and one-third had never heard of them at all.

Nevertheless, the overwhelming majority – 85% – of respondents to the Legal Week Intelligence Benchmark survey expect the economic downturn to increase the use of CFAs and ATE and 68% of respondents say that CFAs and ATE enable cases to be brought that would otherwise not proceed for lack of funding.

So the downturn may finally kick-start the acceptance of CFAs and ATE as a mainstream option for funding commercial litigation through the development of a mutual interest between clients and their lawyers. Commercial litigators acknowledge that CFAs and ATE enable cases to be brought that would not otherwise see the light of day; clients, meanwhile, are more likely to find the cost benefits of CFAs and ATE more attractive when times are tight – if the ATE insurers can get their message across.

"The next few years are going to be a very interesting time for litigation funding," says Humphries. "You still have lawyers and clients out there who think there is something slightly unprofessional about CFAs, but I think that the tide is changing as they see that CFAs and insurance products are not really dodgy. In times of recession, more than ever before, there is a growing commercial imperative for clients to explore what other options are available other than the standard hourly rate."

MAIN FINDINGS

- Commercial litigators say they use CFAs for just 7% of the cases that they handle. This is despite the apparent fact that many commercial litigators are convinced of the benefits of CFAs and ATE insurance. Sixty-eight percent say it enables cases to be brought that would otherwise not proceed for lack of funding, while 23% say the same of cases that would otherwise be too risky to go forward.

- Only a small number of commercial litigators (3%) admit they do not fully understand ATE insurance, but almost one-in-five (19%) say that they do not know where to get advice on the suitability of policies to their cases and 28% say that they are worried about trying to explain how ATE insurance works to their clients.

- The main concerns about ATE among commercial litigators are uncertainty over whether policies will cover all eventualities and whether the ATE premium will be fully recoverable, while the availability and cost of top-up cover are also significant worries.

- An overwhelming majority of commercial litigators – 85% – expect that the downturn will increase client demand for CFAs backed by ATE insurance.

- More generally, commercial litigators expect to see a rise in the number, complexity and length of cases in 2009. More than three-quarters (77%) of lawyers involved in commercial cases expect to see an increase in the number of cases they handle in the coming year, while 37% expect to see the complexity of their caseload increase. Moreover, twice as many litigators (46%) expect cases to drag on for longer as a result of the economic downturn than the number of lawyers who expect the opposite to happen (23%).

- When considering which ATE policy to choose, the availability of conditional or self-insured, deferred premiums and recoverability are by some way the most important factors for litigators, many of whom are also keen that policies should cover their own disbursements. Finally, customer service, financial security and regulatory oversight are also key factors in lawyers' choice of ATE insurance provider.