EXPLANATORY MEMORANDUM TO

THE DAMAGES-BASED AGREEMENTS REGULATIONS 2010

2010 No. [Draft]

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

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 The Regulations prescribe the requirements (additional to those provided in section 58AA (4) of the Courts and Legal Services Act 1990) with which an agreement between a client and a representative must comply in order to be an enforceable damages-based agreement in an employment matter. These are:

- the matters which the terms and conditions of an agreement must specify (Regulation 2);
- the information that must be given to the client before the agreement is signed (Regulation 3);
- the form any amendments to the agreement must take (Regulation 4);
- the maximum amount which the representative may charge under the agreement, namely 35% (including VAT) of the sum recovered by the client (Regulation 5); and
- certain requirements in respect of termination of the agreement (Regulation 6).

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

3.1 None

4. Legislative Context

4.1 The Regulations are the first made by the Lord Chancellor under the powers conferred on him by Section 58AA (4) of the Courts and Legal Services Act 1990.

4.2 Section 154 of the Coroners and Justice Act 2009 amends the Courts of Legal Services Act 1990 by inserting a new Section 58AA which gives the Lord Chancellor the power to regulate damages-based agreements in employment matters. Under the provision the Lord Chancellor may make regulations prescribing the requirements with which such agreements must comply. The Regulations set out these requirements.

5. Territorial Extent and Application

5.1 The Regulations apply to damages-based agreements in employment matters in England and Wales.

6. European Convention on Human Rights

6.1 The Under Secretary of State for Justice, Bridget Prentice, has made the following statement regarding Human Rights:

In my view the provisions of the Damages-Based Agreements Regulations 2010 are compatible with the Convention rights.

7. Policy background

- ***What is being done and why***

7.1 The new Section 58AA of the Courts and Legal Services Act provides for the regulation of damages-based agreements in employment matters. The aim is to protect consumers from unfair and unclear agreements by regulating those specific aspects of damages-based agreements where there is most potential for consumer detriment. The Regulations do not set out all of the terms and conditions that would be in a damages-based agreement.

7.2 Statutory regulation was introduced following concerns (supported by evidence) 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 (e.g. through trade union representation and legal expenses insurance cover etc); and the use of unfair terms and conditions e.g. imposing unfair charges where a client wished to go to another representative or refused to accept the representative's advice to settle their claim. The Regulations prescribe specific requirements to help address these concerns.

7.3 In order to be enforceable a damages-based agreement must meet the requirements specified in the draft Regulations. Among other things this includes a cap of 35% (including VAT) on the representative's payment. The representative's payment must therefore not exceed this prescribed maximum although a lower percentage may well be more appropriate especially where the claim is one of several claims or proceedings. For this reason the Regulations require the representative to specify in the agreement the reason for setting the payment at the agreed level. The term "payment" means "part of the sum recovered in respect of the claim or damages awarded that the client agrees to pay the representative" under the agreement. This excludes "expenses" which are disbursements incurred by the representative such as Counsel's fees or the cost of medical reports. The "sum recovered" is the final amount which the client ultimately receives, not the damages awarded.

7.4 The draft Regulations only cover damages-based agreements in the employment sector because evidence suggests that different representatives – for example solicitors and claims managers – currently operate in this field under different levels of professional regulation. The Regulations introduce specific statutory requirements in respect of the agreement rather than the representative. The Regulations will introduce consistency by subjecting all representatives to the same regulatory requirements and provide uniform consumer protection regardless of the representative's professional status.

7.5 A damages-based agreement is a private funding arrangement between a representative and a client whereby the representative's fee is contingent upon the success of the case, and is usually determined as a percentage of the

compensation received by the client. Damages-based agreements are not permitted in litigation before the courts, but their use developed in employment tribunals which traditionally deal with 'non-contentious' business i.e. work which falls outside the courts. Section 58AA (2) defines an employment matter as "a matter that is, or could become, the subject of proceedings before an employment tribunal".

7.6 The new requirements will apply to solicitors and those providing claims management services (as defined under Part 2 of the Compensation Act 2006). According to the Employment Lawyers' Association, over 4800 practitioners operate in the employment sector. The claims management regulation register of authorised persons indicates that over 300 claims managers or consultants offer their services in the employment sector. The Regulations will ensure that all representatives, whether solicitors or claims managers, adhere to the requirements specified in the Regulations when providing a service under a damages-based agreement.

- ***Consolidation***

7.7 None

8. Consultation outcomes

8.1 The Ministry of Justice carried out a full 12 week consultation on the initial requirements to be introduced from 1 July to 25 September 2009. A summary of responses to that consultation was published on 27 October 2009. The majority of those who responded supported the proposed regulatory requirements for damages-based agreements. Most favoured the introduction of specific requirements for representatives: to provide specified information to their client; controlling the use of unfair terms and conditions; and limiting the payment that the representatives may deduct from the damages recovered. The consultation paper and the summary of responses can be found on the Ministry of Justice website at (http://www.justice.gov.uk/consultations/regulating-damges-based-agreements.htm). The Regulations were drafted following this consultation.

8.2 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 December 2009. The draft Regulations were also published on the above website and some individual practitioners also commented on the Regulations.

8.3 The Regulations were amended in light of the responses. The key change was an increase in the prescribed cap on the payment to the representative. The majority of those who commented on the draft Regulations considered the initial cap of 25% to be too low. In light of those concerns the cap has now been raised to 35% (including VAT). Research indicates that the average percentage which the representatives currently charge is around 33%. By keeping the prescribed cap close to the 'market rate', Regulations will help ensure that consumers are protected against larger reductions while keeping the impact on representatives to a minimum. The draft Regulations were also amended in light of responses to specify certain requirements in respect of termination with which the terms and conditions of the agreements must comply. One such requirement

is that the representative may not terminate the agreement and charge costs unless the client has behaved or is behaving unreasonably. Whether a client is behaving unreasonably will depend on all the circumstances of the individual case. It should be noted that the provisions of Regulation 6 are without prejudice to any right of either party under the general law of contract to terminate the agreement. Some other revisions were made, in light of comments received, to ensure that the Regulations are simpler and avoid duplication of requirements where possible.

9. Guidance

9.1 The Department will work with representative and regulatory bodies such as the Law Society and Solicitors Regulation Authority and others to consider whether any guidance is necessary to support effective implementation of the Regulations.

10. Impact

10.1 There will be some impact on business, but no impact on charities or voluntary bodies.

10.2 There will be no impact on the public sector.

10.3 An Impact Assessment is attached to this memorandum.

11. Regulating small business

11.1 The Regulations apply to small business.

11.2 Several small businesses (including individual practitioners) responded to both consultations on the draft Regulations. The Ministry of Justice considered whether it would be possible to exempt small businesses from these Regulations. However, it was concluded that this would be impossible both from a practical point of view and because it would reduce the efficacy of the proposals. It would also be likely to distort the market for legal services in this area. We do not consider that the Regulations impose any disproportionate burdens on businesses.

12. Monitoring & review

12.1 The Regulations will be reviewed after 12 months. We will work with representative bodies such as the Law Society and Solicitors Regulation Authority and others to monitor compliance with the new requirements.

13. Contact

Robert Wright at the Ministry of Justice Tel: 020 3334 4292 or email: robert.wright@justice.gsi.gov.uk can answer any queries regarding the instrument.

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Summary: Intervention & Options

Department /Agency: Ministry of Justice	Title: Impact Assessment of Regulating Damages Based Agreements	
Stage: Implementation	**Version:** Final	**Date:** 25 January 2010
Related Publications: Regulating Damages Based Agreements – Consultation Response Paper & Summary of responses		

Available to view or download at:
http://www.justice.gsi.gov.uk

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What is the problem under consideration? Why is government intervention necessary?

Damages Based Agreements (DBAs) are a type of 'no win no fee' arrangement which allow a representative to take a proportion of a claimant's award of damages as a fee. DBAs fund a range of cases in Employment Tribunals but have to date existed without any specific statutory regulation. Their unregulated use in Employment Tribunals is open to abuse and poses a potential risk to claimants. Government intervention is therefore necessary to prescribe some statutory requirements in respect of these agreements. This will protect claimants from exploitation for commercial gain, and help improve claimants' understanding of these funding arrangements and their cost liabilities.

What are the policy objectives and the intended effects?

The policy objective is to provide a statutorty framework for regulating DBAs in Employment Tribunals. Such a framework is currently absent. The requirements to be introduced by regulations will help to clarify the deductions made from the claimant's award. The regulations will require representatives taking on cases under DBAs to provide clear and transparent information to clients on all costs and disbursements charged and other aspects of these agreements. They will also limit the representatives' fee by introducing a cap on the maximum percentage they can take from their client's damages. This will help put in place protection for claimants against unfair or unreasonable DBAs. The regulations will also help provide a level playing field for representatives competing for DBA cases as they will all be required to comply with the same regulatory requirements.

What policy options have been considered? Please justify any preferred option.

Aside from the 'do nothing' option, the following policy options were considered as part of the consultation process:

Option 1 – Regulate the provision of information under DBAs: prescribe requirements for representatives to provide clear and transparent information in respect of these agreements on all costs, alternative methods of funding, and any settlement or other clauses which might have adverse consequences for the claimant.

Option 2 – Regulate the provision of information as above and the percentage which representatives can deduct from the claimant's damages e.g. by prescribing a maximum.

Option 3 – Regulate (a) the provision of information; (b) the percentage which representatives can deduct; and (c) other terms and conditions e.g. settlement and exit clauses.

Option 3 has been chosen for implementation with some modification following consultation. It was supported by the majority of consultees and adequately addresses the current risks associated with DBAs. The maximum cap on the representative's fee is set at 35% inclusive of VAT.

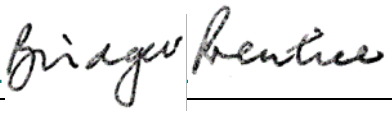
When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

The operation of the proposals will be reviewed after 12 months.

Ministerial Sign-off - For final decision stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that (i) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy and, (ii) the benefits justify the costs.

Signed by the responsible Minister:

.....  ..... Date: 26 January 2010

Summary: Analysis & Evidence

Policy Option 3	**Description:** Regulate the provision of information to clients under DBAs, the percentage which representatives can deduct from the claimant's damages and other terms and conditions (as reflected in the regulations)

COSTS

ANNUAL COSTS	Description and scale of **key monetised costs** by 'main affected groups'
One-off (Transition) **Yrs**	
£	
Average Annual Cost (excluding one-off)	
£	**Total Cost** (PV) **£**

Other **key non-monetised costs** by 'main affected groups'

Legal representatives will face minor adjustment costs through familiarisation with the new regulations. They may face minor costs associated with providing more information, and may suffer reduced income given their maximum fee is capped at 35% inclusive of VAT.

There may be some access to justice costs for claimants, if the regulations lead to representation not being offered in some cases, forcing claimants to turn to alternative routes to pursue their case. These alternatives may in some cases lead to worse outcomes for claimants. Further, the increased demand for other services (e.g. ACAS, trade union legal services etc.) may impose costs on these organisations.

Finally, monitoring that representatives have complied with the proposed regulation falls to claimants in the first instance. Claimants are therefore likely to face some administrative costs associated with monitoring and enforcement.

BENEFITS

ANNUAL BENEFITS	Description and scale of **key monetised benefits** by 'main affected groups'
One-off **Yrs**	
£	
Average Annual Benefit (excluding one-off)	
£	**Total Benefit** (PV) **£**

Other **key non-monetised benefits** by 'main affected groups'

Claimants will benefit from being provided with clear and full information on their liability and any appropriate alternatives to a DBA before they sign an agreement. The regulations will also protect claimants from exploitation by unscrupulous representatives.

The regulations will ensure a level playing field in the DBA representation market. This may make solicitors better off relative to claims managers, given solicitors already face relatively higher costs associated with oversight by their professional body.

If cases are diverted away from the Employment Tribunal to other services (e.g. ACAS), this would reduce the resources required of the Employment Tribunal for DBA cases.

Key Assumptions/Sensitivities/Risks The option assumes that funding options other than DBAs would always be available to claimants. The proposed regulations, in particular the 35% cap, may result in diversion away from the Employment Tribunal towards alternative approaches. It is assumed that such diversion would involve a more efficient allocation of resources overall, particularly in relation to less certain cases and for cases which are relatively complex given the sums of possible compensation at stake.

The task of monitoring that representatives have complied with the proposed regulation falls to claimants in the first instance. Effectiveness of the regulations assumes that claimants have enough information to monitor the regulations effectively, and that it is cost effective for them to do so.

Price Base Year	Time Period Years	**Net Benefit Range** (NPV) **£**	**NET BENEFIT** (NPV Best estimate) **£**

What is the geographic coverage of the policy/option?	England and Wales
On what date will the policy be implemented?	6 April 2010
Which organisation(s) will enforce the policy?	HMCS
What is the total annual cost of enforcement for these organisations?	0

Does enforcement comply with Hampton principles?			N/A	
Will implementation go beyond minimum EU requirements?			N/A	
What is the value of the proposed offsetting measure per year?			N/A	
What is the value of changes in greenhouse gas emissions?			N/A	
Will the proposal have a significant impact on competition?			No	
Annual cost (£–£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)				(Increase – Decrease)	
Increase	£	Decrease	£	**Net**	**£**

Key:	**Annual costs and benefits:**	**(Net) Present Value**

Evidence Base (for summary sheets)

1. Scope of the Impact Assessment

1.1 This Impact Assessment (IA) assesses the costs and benefits of regulating Damages Based Agreements (DBAs), a type of 'no win no fee' legal funding arrangement. The power to regulate was introduced by section 154 of the Coroners and Justice Act 2009 ("the Act") and enables the Lord Chancellor to make provisions in respect of DBAs in Employment Tribunals. This Impact Assessment relates to the regulations to be made under the above provision.

Scope of the proposals

1.2 The regulations apply to DBAs in Employment Tribunals. The regulations introduce the following requirements:

- that those undertaking claims on the basis of DBAs must provide clear and transparent information to clients on all costs and additional charges to be made under these agreements, alternative methods of funding available to the claimant, and any specific terms and conditions which could be disadvantageous to the client;

- that the fee which representatives can claim from the claimants' damages is limited to a maximum of 35% of those damages inclusive of VAT; and

- that the representatives undertaking claims on the basis of DBAs may not charge their clients more than their reasonable costs and expenses for the work carried out on the case if the agreement is terminated early. The regulations also specify the circumstances in which the claimant may not terminate the agreement.

Organisations affected

1.3 The regulations will affect mainly solicitors and claims managers taking cases on the basis of DBAs. These groups will be required to comply with the requirements of the regulations, which have been consulted on.

1.4 The regulations will benefit consumers by ensuring that they receive clear and transparent information on costs, other expenses and alternative methods of funding their claim. This will ensure that consumers are better informed about their options and costs liabilities when entering into such agreements. They will also protect consumers from excessive fees under DBAs which would result in them loosing a significant proportion of their damages, and prevent the use of unfair exit clauses and penalty charges.

1.5 More broadly, the proposals will be of interest to all those involved in Employment Tribunals, to all parties involved in employment-related disputes, and to other parties and organisations involved in providing other means of addressing employment-related disputes.

2. Rationale for Government Intervention

2.1 The term 'contingency fees' is used to describe all 'contingent fees' – that is agreements between representatives and their clients where the representative's fee is contingent on a successful outcome of the client's case. The term 'no win no fee' has developed over time to describe both Conditional Fee Agreements (CFAs) and Damages Based Agreements (DBAs). CFAs are statutory and are regulated under the Courts and Legal Services Act 1990 (as amended by the Access to Justice Act 1999). DBAs on the other hand were originally non-statutory and until recently not subject to specific statutory regulation. DBAs allow representatives (solicitors and others such as claim managers) to take a proportion of a claimant's damages as their fee if the case is successful. They may not receive a fee if the case is lost.

2.2 CFAs are permitted in litigation (i.e. proceedings before the courts) where they are used primarily by solicitors. In contrast, DBAs are prohibited in litigation but are frequently used in Employment Tribunals. This is because the use of DBAs is recognised and to some extent approved by some regulatory bodies. Solicitors for example, under their professional rules, can use DBAs in business other than that before a court. Barristers are prohibited from using DBAs.

2.3 The other major group that use DBAs in employment cases is claims managers. Often, consumers may not understand the difference between solicitors and claims managers. Based on the anecdotal evidence we have, claims managers sometimes offer representation at lower cost. This could be because, unlike lawyers, they are not subject to professional rules. Differences in costs might also arise from differences in the type and nature of service and support provided. Differences might also arise in relation to other aspects of each group's cost base.

2.4 The absence to date of specific statutory regulation of DBAs has raised concerns over consumer protection. Solicitor's professional rules aim to ensure that consumers are protected when represented by a solicitor in a DBA, and similarly claims managers must also comply with the conduct of authorised persons rules[1]. However, there is concern that the lack of specific statutory regulation has meant that these rules have not had the desired effect. This could lead to claimants losing a disproportionate (and unforeseen) amount of their damages award to their representatives in fees, as well as face other charges such as VAT and disbursements.

2.5 The regulations will ensure a level playing field for solicitors and claims managers competing to represent claimants in DBA cases. At the same time, regulation will ensure that DBAs continue to provide proportionate access to justice for claimants, and that claimants are given sufficient information about the terms and conditions of their DBA contracts, including in relation to charges.

Economic rationale

The rationale behind statutory regulation

2.6 A key economic issue in this area is the existence of information asymmetries between the claimant and their DBA claims manager or lawyer. These information asymmetries might lead to the DBA claims manager or lawyer not acting entirely in accordance with the claimant's wishes or expectations, including in relation to charging and service standards.

2.7 The existence of information asymmetries in principal-agent relationships such as this is common and, in itself, is not a sufficient justification for government intervention. In many cases the parties involved find an equilibrium position which might not be bettered by government intervention, or the government intervention might be excessively costly or cause other distortions.

2.8 In many instances the market itself is able to adopt solutions which tackle the information asymmetries in question. For examples trades or professions might adopt their own service standards or quality kitemarks. Providing such reassurance and protection can support consumer confidence in the market and foster market growth.

2.9 In this instance lawyers engaged in DBA claims are subject to professional rules and codes of practice established by their own professional body. The consultation exercise concluded that these rules provide a degree of consumer protection and partly tackle the information asymmetries at stake, but that more specific service standards would be desirable.

[1] *www.claimsregulation.gov.uk*

2.10 DBA claims managers are subject to a different set of rules than lawyers. The consultation exercise concluded that consumers are not sufficiently aware that some DBA claims managers are not lawyers, and are subject to the rules set by the Claims Management Regulator. Some questioned whether the requirements for claims managers to give their clients open and transparent information were adequate. The lack of awareness and transparency might lead to consumers mistakenly believing that they are subject to particular service standards when they are not.

2.11 Aside from affecting consumer protection this situation might generate competition concerns on the supply side. DBA claims managers and lawyers are both operating in the same market, and while the latter are subject to professional regulation, the former are not. If consumers fail to distinguish adequately between the two different types of supplier then in theory those who are not regulated might gain a competitive advantage. Hypothetically this might occur if the regulated entity provided a higher standard service at a higher price and if the consumer paid the same price for a lower standard service produced at lower cost by an unregulated entity. This is a purely illustrative example.

2.12 There are a number of possible solutions to this situation. First, improved consumer awareness and consumer education might enable consumers to differentiate better between the different types of service on offer in the market. A consumer might then choose to pay less for a lower standard of service if this happened to match their preferences.

2.13 Secondly, if the service standards provided by legal professional rules were suboptimal then the relevant professional body should, in theory, be able to adjust those standards to the right level. The implementation of such revised standards would continue to be monitored and enforced by the relevant professional body.

2.14 Statutory regulation would be a third possible solution, especially if the other approaches are unlikely to work quickly enough or well enough (including in relation to implementation and enforcement). Statutory regulation might be preferable if this was better at setting standards at the right level, if the implications for consumer choice and innovation were acceptable, and if the administrative resource implications for all parties were acceptable compared to the alternatives.

2.15 There is no *a priori* reason why statutory regulation should be preferable. Instead this depends upon the circumstances applying to each individual situation and established government policy is to consider alternatives to statutory regulation first. In this instance, following a consultation exercise, it has been concluded that statutory regulation is in fact the most appropriate solution.

The rationale for capping the DBA fee at 35% inclusive of VAT

2.16 Introducing a DBA fee cap as part of the new statutory regulation regime would provide consumers with additional protection from excessive charging. Whilst increased transparency should enable consumers to identify fee levels more clearly, this would not necessarily enable consumers to determine whether fees were excessive compared to the typical market rate. Although commercial fee-comparison services might address this to some extent, the consultation exercise concluded that it would be appropriate to include a DBA fee cap in the regime in order to provide additional consumer reassurance.

2.17 If DBA claims managers or lawyers were not making excessive profits then different fee levels would apply to different cases according to the likely size of the damages, the costs involved in pursuing the case, and the chances of success. If the fee cap was set too high this might provide limited additional consumer protection. If it was too low then at the margin this might reduce access to justice via the Employment Tribunal.

2.18 In particular a lower fee cap would dissuade DBA claims managers and lawyers from dealing with more uncertain cases and/or relatively more complex cases given the likely amount of damages at stake. The claimant might then either drop the case, or bring claims through self representation, or seek alternative dispute resolution avenues including the services provided by trades unions.

2.19 Research conducted by Professor Moorhead[2] found that the average (modal) percentage currently charged by representatives was 33%. Most respondents to his survey operated a lower band of 25% to 30% and an upper band of 40% to 50%. Some dropped to 5% to 10%.

2.20 A fee cap of 35% inclusive of VAT is designed to sit at the lower end of the current fee level spectrum. The rationale behind this is to provide an incentive to improve cost efficiency on the part of DBA claims managers and lawyers, and also to provide an incentive to consider alternative dispute resolution avenues (instead of the Employment Tribunal) for less certain cases.

3. Cost Benefit Analysis

3.1 This section sets out the potential costs and benefits of implementing the regulation of DBAs in Employment Tribunals (Option 3 in the original consultation Impact Assessment). The impacts presented are scored against a base case of 'do nothing'. There are no costs or benefits associated with the base case.

3.2 As Option 3 of the original consultation has been chosen, and no other options have been considered outside of those already consulted on, only Option 3 is discussed in detail in this Impact Assessment.

Description of Policy Option 3:

3.3 The regulations will ensure the provision of clear information – representatives are required to provide clear and transparent information on all costs, alternative methods of funding, and any settlement or other clauses which might have adverse consequences for the claimant under DBAs.

3.4 The regulations will also impose a cap of 35% inclusive of VAT on the maximum percentage that a representative may deduct from the claimant's damages as a fee.

3.5 The regulations will also restrict the use of exit clauses and penalty charges – if an agreement is terminated the representative may not charge the claimant more than their reasonable costs and expenses for work undertaken on the claimant's case.

Costs

Representatives

3.6 The policy will impose one-off costs on all parties offering DBA representation relating to familiarisation with the new regulations. These costs are expected to be minor for solicitors, given they currently operate under similar regulations provided by their professional body. The costs may be more significant for claims managers. In particular, the requirement to provide specified information to claimants may lead to some representatives having to revise their standard DBA agreements if the current form used does not cover the necessary information.

3.7 The requirement for representatives to supply more information to claimants imposes an additional administrative burden on representatives. However, this is unlikely to be significant for solicitors and claims managers as they are already required to provide certain information to their clients albeit to varying levels. The regulations introduce specific requirements and will provide clarity and consistency with a view to protecting claimants.

3.8 The introduction of a cap on representative's fees of 35% (inclusive of VAT) will also impose direct costs on representative businesses. Representatives who currently charge more than the maximum proscribed by the regulations will have their income in DBA cases reduced. However, research conducted by Professor Moorhead[3] shows that the mean percentage

[2] See paragraph 422 of Moorhead and Cumming (2008) – Damages Based Contingency Fees in Employment Cases: A Survey of Practitioners http://www.law.cf.ac.uk/research/pubs/repository/1996.pdf

[3] This comprises of two studies - Moorhead and Cumming (2008) – Damages Based Contingency Fees in Employment Cases: A Survey of Practitioners http://www.law.cf.ac.uk/research/pubs/repository/1996.pdf and

currently charged by representatives is 33%. Introducing a cap at close to the market rate will minimise its impact. There will still be an element of competition as representatives will need to offer percentage fees below the maximum to attract more clients.

3.9 The 35% cap may restrict the range of cases which representatives are willing to take on under DBAs, and could result in some withdrawing DBAs completely, although we think that this is unlikely to occur to a significant degree. Reducing the number of viable cases could impose costs on representatives, through lack of earnings.

3.10 The reasonable costs and expenses that representatives may charge on termination of a DBA may be lower than the fixed (possibly unlawful) exit fees which can currently be charged, particularly if the representative has not carried out much work on the claimant's case. This may result in some representatives having reduced income when agreements are terminated.

Claimants

3.11 The introduction of a maximum cap may result in some claimants with particularly complex claims being unable to find a representative to act for them under a DBA, as the restriction on their fee means the representative is unwilling to take their case on given the risks involved. This suggests that in some cases, access to justice may be restricted, which represents a cost to claimants. However, there are a number of alternatives for clients including pro-bono and trade union representation as well as the dispute resolution service offered by ACAS. It is likely that claimants would be diverted to these options, although there would still be costs if outcomes for claimants through these alternative routes were worse than under a DBA, or if the claimant was unable to use or rely upon these alternatives.

3.12 The reasonable costs and expenses that representatives may charge on termination of a DBA may be higher than the fixed exit fees which can currently be charged, particularly if the representative has carried out a large amount of work on the claimant's case. This may result in some claimants who wish to terminate their agreement paying higher charges under the new regulations than they do currently.

3.13 Finally, monitoring that representatives have complied with all aspects of the proposed regulations falls to claimants in the first instance. Claimants are therefore likely to face some administrative costs associated with monitoring that their representative has been compliant. Incidents of non-compliance may require enforcement through the legal system.

The Wider Justice System

3.14 The requirement on representatives to outline to claimant's alternative means of pursuing their claim or funding their case may result in more claimants making use of these alternative services, e.g. ACAS and trade union legal representation. This may put strain on these organisations' resources.

3.15 If the cap on the fee representatives may charge leads to a reduction in the availability of DBAs for employment cases, this may increase the number of unrepresented claimants appearing before the Employment Tribunal. This would increase both time and costs to the tribunal, although as outlined below, the net impact on the Tribunal Service of this policy is expected to be positive, resulting from fewer cases overall.

3.16 Incidents of non-compliance with the regulations may require enforcement through the legal system, which may impose costs on HMCS. It has not been possible to quantify the likely magnitude of these costs, given that it is unclear how many cases will proceed to court.

Benefits

Claimants

Something for Nothing – Claimants' Perspective on Legal Funding and Employment Tribunal Cases available http://www.berr.gov.uk/files/file51880.pdf

3.17 The regulations ensure claimants are provided with clear and full information relating to all costs and additional charges to be made under the DBA. This should ensure claimants are making a fully informed choice when signing a DBA, and are clear on what they will be liable to pay their representative. It will provide confidence to claimants and protect them from hidden charges. Requiring representatives to outline any alternative methods of funding available to the claimant will ensure that claimants are not encouraged to sign a DBA agreement when a more appropriate means of pursing their claim is available which would be less expensive or allow them to keep a greater proportion of their damages.

3.18 The introduction of a maximum cap on the percentage of the claimant's damages that representatives can deduct will prevent claimants losing an unreasonable and unforeseen proportion of their damages. It will protect vulnerable claimants from unscrupulous representatives who may seek to exploit them.

3.19 Allowing representatives to charge only their reasonable costs and expenses if the DBA is terminated will protect claimants from punitive and unreasonable penalty charges which can prevent them from ending their agreement or rejecting the settlement advice of their representative.

Representatives

3.20 The regulations will ensure that all representatives using these DBAs in Employment Tribunals adhere to the same standards which will introduce consistency. This will prevent unscrupulous representatives attracting business away from their competitors with DBAs which appear to have very low fees but include multiple hidden charges. Regulation will improve the confidence of claimants and therefore improve the reputation of representative bringing claims under DBAs in Employment Tribunal proceedings.

3.21 We consider that the regulatory changes may make solicitors better off compared to claims managers, given solicitors already adhere to professional rules similar to the proposed regulations. As a result, the adjustment costs faced by solicitors may be lower than those faced by claims managers, making solicitors better off in relative terms.

The Wider Justice System

3.22 The requirement on representatives to outline to claimant's alternative means of pursuing their claim or funding their case may result in more claimants making use of alternative mediation services such as those offered by ACAS or trade unions, and therefore may reduce the burden on Employment Tribunals.

Net Impact

3.23 It has not been possible to quantify the identified impacts associated with the policy. However, it is considered that the benefits identified outweigh the costs: the expected net benefit of this option is positive, and greater than the net benefit provided by the other options explored during the consultation period.

4. Enforcement and Implementation

4.1 Any DBA that does not comply with the requirements under these proposals will be unenforceable and open to challenge by the claimant. While the courts may form a legal judgment on this issue in disputes which proceed to court, it will be up to claimants and their representatives, or third parties acting on their behalf, to seek to enforce these regulations.

5. Specific Impact Tests

Competition Assessment

5.1 The main practitioners in this area are solicitors and persons providing claims management services. Both solicitors and claims management businesses are required to comply with the relevant rules in respect of provision of advice generally, although there has to date been an absence of specific rules in respect of DBAs. According to the Employment Lawyers' Association, over 4800 practitioners operate in the Employment sector. The claims management regulation register of authorised persons indicates that over 300 claims managers or consultants offer their services in respect of Employment claims. Recent data shows that overall 7% of claimants at Employment Tribunal had a DBA with their legal adviser, although cases involving discrimination claims and standard period cases were most likely to have such arrangements (17% and 20% respectively)[4].

5.2 Regulating the provision of information to claimants in cases under DBAs may have a positive impact on competition, given the regulations create a level playing field in the DBA market. Given most representatives should already provide similar information to their clients, the additional administrative burden imposed is not expected to be significant.

5.3 Regulating the charges which representatives may impose if the DBA is terminated should also not significantly impact on competition as research indicates these clauses are rarely used[5]. The regulations allow representatives to charge their reasonable costs and expenses if the agreement is terminated, so no representative will be out of pocket as a result.

5.4 However regulating the maximum percentage that representatives can charge in fees may have some impact on competition as some representatives may be unable to offer DBAs at all, or be unable to offer the range of cases they currently do, if their fee is restricted. This could mean the availability of DBAs for claimants would be restricted in some complex cases, cases where the chances of success are deemed low or the level of the award is likely to be low.

Small Firms Impact Assessment

5.5 The regulatory requirements will apply to those providing legal and representation services under these agreements, particularly in the Employment sector. The two main groups affected are solicitors and claims managers. The agreements are private funding arrangements between a representative and a client in an individual case.

5.6 Regulating the information which representatives must provide to claimants would not have any disproportionate impact on small firms as these costs are expected to be insignificant.

5.7 Regulating the maximum percentage which representatives 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. The potential reduction in representation described in this Impact Assessment may therefore be more likely to come from small representative firms compared to large ones.

5.8 Regulating the use of exit clauses and penalty charges may have an impact on small firms if their business model is heavily dependent on the income from these charges. Under the regulations they would only be able to charge their reasonable costs and expenses if an agreement was terminated, so any excess profit from penalty charges would be reduced.

5.9 We have considered whether it would be possible to exempt small legal firms from these proposals. However we have concluded that this would be impossible both from a practical point of view and because it would reduce the efficacy of the proposals. It would also be likely to distort the market for legal services in this area.

Legal Aid and Justice Impact Test

[4] Survey of Employment Tribunal Applications (SETA) 2008, p48

[5] See Moorhead and Cumming (2008) – Damages Based Contingency Fees in Employment Cases: A Survey of Practitioners, page 111, and Moorhead and Cummings (2009) Something for Nothing – Claimants' Perspective on Legal Funding and Employment Tribunal Cases, pages 54 – 63.

5.10 The proposals do not impact on the legal aid fund as they relate to private funding agreements in Employment Tribunals where legal aid is not available for representation.

Equality Impact Assessment

5.11 The proposals are aimed at regulating the agreements for consumer protection. The proposals will affect all claimants, solicitors and others businesses involved in Employment Tribunal proceedings. However, the proposals should not have an adverse impact on any individual or group of people rather the regulations will safeguard consumer interest generally. An initial equality impact screening considered the impact on different groups in terms of: disability; gender; age; religion and belief or sexual orientation. We do not consider that these proposals would have any adverse impacts although we are aware that women are more likely to be involved in discrimination claims and so might benefit from the additional protection the regulations would provide. However, we have no specific information on whether any other groups are more likely to be involved in Employment Tribunal cases, although these are more likely to involve lower paid workers from minorities who may require additional protection.

Human Rights

5.12 The proposals are compliant with the Human Rights Act.

Environmental Tests

5.13 The proposals are not expected to have any significant environmental impacts.

Health Impact Test

5.14 The proposals are not expected to have any significant impact on Health.

Rural Impact Test

5.15 The proposals are not expected to have any significant rural impact.

Specific Impact Tests: Checklist

Type of testing undertaken	*Results in Evidence Base?*	*Results annexed?*
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	Yes	No
Sustainable Development	Yes	No
Carbon Assessment	Yes	No
Other Environment	Yes	No
Health Impact Assessment	Yes	No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	Yes	No
Rural Proofing	Yes	No