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Legal aid today: **What is the future for funding litigation when state aid is unavailable?**

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Author: Elsa Booth

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The Legal Services Commission recently marked 60 years of legal aid; we ask to what extent this valuable state fund is part of the future legal landscape for civil litigation? Should we now be taking inspiration from other jurisdictions to liberate new pathways to justice by embracing alterative sources of funding?

Legal aid has always been a hotbed of debate but ever since the review of Lord Carter in July 2006 'Legal Aid: A Market-based Approach to Reform' (The Carter Review), and its trumpeting call for market drive, tendering and fixed fees, legal aid has been in a perpetual state of reform. Perhaps inevitably, the dust clouds of controversy surrounding those reforms have obscured many of legal aid's remarkable achievements. On this 60th anniversary of legal aid, while there is much to celebrate about its existence and endurance, many practitioners now take the view that as a mechanism to deliver access to justice, it is simply too narrow. While this particular debate lies outside the scope of this paper, the context for it is clear: according to statistics in a recent Legal Action Group publication ('The Justice Gap: whatever happened to legal aid'), in 1998, 52 per cent of the population was financially eligible for legally aided civil representation, a figure which has now dwindled to 29 per cent. Yet amongst all the understandable and valid fire and brimstone about this decline, a more essential question has become masked – namely, what is going to replace the shortfall in funding to widen the access of justice to all now that the coffers for further state funding have run dry?

It is this question which we attempt to tackle in this paper; in particular, whether it is now time to look beyond state aid to other forms of funding, such as legal insurance and third party funding, which could run in tandem?

Comparisons with other jurisdictions are illuminating; a snapshot comparison by the Soldan Institute in 2007 (recently quoted by Lord Justice Jackson in his Review of Civil Litigation Costs ('Jackson LJ's preliminary report')) discloses that while legal aid accounts for 13 per cent of state funding for litigation in England and Wales, in a major European country such as Germany it is only 8 per cent. This would seem to be attributable to the emphasis Germany places on alternative sources of funding such as legal expenses insurance. Funding from this insurance, along with third party funding, accounts for 35 per cent of funding for litigation in Germany, compared to 4 per cent in England and Wales. This marked differential poses the question as to whether we are being too stymied in our thinking in the UK by placing so much emphasis on state funding. With Conditional Fee Agreementss (CFAs) now rooted in our system and the recent entry into the marketplace of third party funding, litigation has entered a whole new arena – so what is the future for the funding of legal costs?

Civil legal aid

Legal aid today is subject to the Access to Justice Act 1999 (AJA 1999) which created the legal aid scheme for civil cases -the Community Legal Service (CLS) – all overseen by the Legal Services Commission (LSC). The AJA 1999 also lists those areas of law which fall outside the scope of legal aid.

If an area of law, such as social welfare, falls within the remit of the AJA 1999, then to be entitled to legal aid, an individual case must meet both a financial test and a merit test. Legal aid has always been a means tested benefit and eligibility is therefore reliant on a client's gross income, disposable income and disposable capital. Each case must also pass the merits test; the criterion relating to the merits test for each level of aid varies and are laid out in the Funding Code associated with the AJA 1999 (the Code).

The Code is described in Jackson LJ's preliminary report as the 'innovation' of the AJA 1999, as it has no equivalent in any overseas legal aid schemes. It contains the rules that govern whether or not an individual's case can be funded from legal aid and outlines the range of service levels available, running the gamut from legal help (advice and assistance) to legal help in court (representation in civil proceedings). The Code is very specific; lawyers cannot work outside the scope of the level of the help sanctioned; to do further work outside of that will necessitate applying further merits and means tests.

While individual cases are subject to the Code, lawyers are, in effect, 'licensed' to do the work via contracts to which the bulk of legal aid is now subject. For civil litigation, the Unified Contract contains all the provisions relating to how a lawyer must work with his client and the relationship which exists with the LSC and the providers. The contract is made up of three main sections (see www.legalservices.gov.uk).

- The 'standard terms': the provisions which apply to all providers in respect of the relationship with the LSC (they provide definitions of key contractual terms).
- The schedule: this contains specific provisions for each office or firm, such as payment limits.
- The specification: pertains to how the lawyer should conduct the case.

All the contracts are currently under review and will include new service conditions from 2010.

Early advice is available from the Community Legal Service, from a network of organisations that funds and provides civil legal services, ranging from general information to advice and representation. It consists of 'Community Legal Advice', which can be delivered by phone or online (*http://www.communitylegaladvice.org.uk/*), along with Community Legal Advice Centres (CLACs) in urban areas and Community Legal Advice Networks (CLANs) in rural areas – all of which are currently being rolled out. The funding for CLACs and CLANs stems from the LSC contracting with a provider, usually a locally authority, yet since the financial commitment of the latter varies from area to area, the success of this scheme is unpredictable. The LSC has agreed to publish the list of areas where it is in discussions with local authorities about setting up CLACs before 1 April 2010. The government is currently looking at trends in local authority funding.

Civil litigation costs

Within legal aid, civil litigation is broken down into categories, such as family and social welfare (which includes community care, employment and housing and benefits). Outside of family law (which also falls outside of the scope of this paper), civil litigation is paid for by prescribed hourly rates from the legal aid fund. Within this framework, the recoverability of costs *inter partes* is not limited. Hence, a successful claimant lawyer in a legal aid case can recover *inter partes* costs at the same level as a privately funded one.

The legal aid system is thus summed up in Jackson LJ's preliminary report as operating 'a form of limited contingency funding, though a less extreme funding of CFAs'. He goes on to add, 'Legal aid operates for non-family litigation as a banker, by providing payments on account as the case progresses, and as an insurer, by guaranteeing a minimal level of remuneration should the case be successful'.

In order to allow clients of restricted means access to justice, the *liability* of a legally aided client has to be strictly limited, which Jackson LJ again summarises as being 'close to complete immunity' from *inter partes* costs. This aspect of the system is sometimes criticised for being unjust towards opponents: while an opponent can apply for costs, in practice such applications are rarely made, let alone granted, as the application itself raises costs still further.

The language employed within Jackson LJ's preliminary report when discussing legal aid is significant because when viewed through the prism of such obviously commercial language – banker, contingency fund, insurance – then legal aid becomes perceived less as a part of the welfare state and more as just another mode of funding, another route to justice.

Plugging black holes

The most logical place to start addressing the question of funding alternatives to run alongside legal aid is to look at what is already – and most notably – excluded from the AJA 1999 and therefore already funded by alternative means. The list of exclusions in Sch 2, para 1 was a controversial part of the AJA 1999 – and its most notable exclusion was personal injury.

The exclusion of personal injury can be attributed to the availability of CFAs (by contrast, in Northern Ireland, legal aid is available for personal injury but there are no CFAs). The significance of the acronym, CFA, is not to be underplayed; as Jackson LJ's preliminary report states: 'CFAs are currently the dominant life form in the eco-system of litigation funding.'

Initially, they were viewed with scepticism and the tag 'no win no fee' was felt to be misleading. The principle of a lawyer's fee being linked to the outcome of case within contentious proceedings was viewed with suspicion. The suspicion was partly remedied by the Claims Management Regulation established in 2006, introduced to protect claimants. Although the success of the latter has only been only partial; there is still an increase in the payment of referral fees, with solicitors paying high sums to 'buy' personal injury claims, raising a question mark over the independence of the legal advice. Lawyers have been accused of ramping up fees and claimants tend to be viewed as being unhealthily detached from rising costs since they will never have to pay them, win or lose.

Ultimately, though, CFAs have been embraced because it is felt they have widened the gateway to justice for a greater chunk of the population. When the principle of recoverability was introduced in 2000 – which meant success fees and After the Event (ATE) premiums (the latter covering a litigant against future liability for the costs of an opposing party) could be recovered from the unsuccessful opponent – they became fully integrated. Now CFAs and ATE insurance are entwined, insurers invariably give authority to their chosen panel of solicitors to issue ATE insurance on fast track cases resting upon CFAs. However, ATE insurance is still a relatively new market with premium levels being set at varying levels.

In summary, it is not an exaggeration to say that CFAs have transformed the legal funding landscape and that this transformation has been absorbed and accepted. This state of affairs is summed up in Jackson LJ's preliminary report when he says: 'In the modern litigation world, dominated by CFAs, the private paying client has become something of a fictional character (perhaps he or she always has been).' The possibility of big gains for lawyers and the low risk element for clients has meant they have been assimilated into the system, showing that cultural change regarding funding *is* possible. CFAs have paved the way for more alternatives.

So, what are the key forms of funding that we should now be embracing; what will widen that gateway to justice further?

Before the Event insurance

We would suggest that a primary way forwards for legal funding is Before the Event (BTE) insurance: namely, where insurers pay solicitors to act for the insured when a claim arises (thereby eliminating referral fees).

Despite the clear advantages, the current insurance market in this sector has not grown as it might, especially in relation to individuals. This is perhaps due to a lack of awareness in the UK but more likely due to legal expenses insurance being an anathema to our culture. Hence the take up of the few policies that exist – such as First Assist – has been tiny. Other policies that exist, where the take up has been widespread, tend to be a minor, little more than a bolt on to motor insurance.

In the commercial world, the take up of such policies has been higher since such insurance is especially attractive to small to medium companies.(Large companies, on the other hand, tend to rely on employers' liability insurance).

Contrast general UK reticence in this area, however, with the Netherlands and Germany where such insurance has really taken off – especially in the latter country, which is perhaps partly due to the existence of a statutory scale of costs making the risk predictable for insurance companies. Hence legal expenses insurance in Germany covers the costs on the statutory scale. (The scale of legal costs in Germany is fixed, amended only by legislation). In law, the amount of costs recoverable by the parties is limited, so too the *minimum* amount a client is required to pay his lawyer. According to Jackson LJ's preliminary report, the desire to make costs reasonable and predictable in this way is due to the German constitution (the principle of equality in art 3). In practice within the litigation arena, this means the successful party cannot recover costs which are higher than the amount in dispute since the costs scale is linked to the amount in dispute.

In France, BTE insurance it is also widely used; summed up by Jackson LJ's preliminary report, ' legal expenses insurance and legal aid are to a large extent alternatives' there.

While the eligibility for legal aid in the UK diminishes, BTE Insurance for individuals and business would seem to be a positive alternative way forwards and one in tune with public policy. A similar proposition is also supported by the Bar's Contingency Legal Aid Fund Group (the CLAF group); namely that BTE legal expenses insurance should be introduced for:

- motorists, in addition to third party liability insurance; and
- employers and occupiers of business premises (required to have public liability insurance) with respect to personal injury claims that might be suffered by employees, customers or visitors

The litigant would be supported by insurers subject to a merits test. In Jackson LJ's preliminary report, he suggests this 'merits serious consideration'. We would endorse this also as a practical way forwards.

There is also a compelling argument that, like other limited forms of insurance, BTE insurrance should be made compulsory in certain areas. In a recent speech given by Desmond Browne QC, Chairman of the Bar Council, it was suggested people might be incentivised to encourage take-up of BTE insurance; he sensibly suggested an opt-out, rather than an opt-in clause, as a possibility.

In effect, a wider application of BTE legal insurance could, in theory, over the long term, plug a funding void in respect to all those who are not eligible for legal aid and thereby widen the constricted access to justice considerably. (And during a time of economic recession with litigation likely to increase, such clear and definite access to justice is needed and unlikely to be catered for by legal aid). How to promote BTE insurance, however, is one of the complex questions Jackson LJ is asking in his preliminary report; we consider the suggestion, referred to above, of making such insurance opt-out, rather than opt-in, within the categories outlined, would be an excellent interim step, or a bridge, to making it compulsory. Thereafter, the scope of BTE insurance could be widened. For BTE insurance to work successfully, however, it would probably have to go in tandem with the introduction of fixed fees since there would need to be an element of predictability in relation to costs. Please see our previous white paper in which we argue for the introduction of fixed fees: 'The Cost of Civil Justice, time for review or revolution?' (*http://www.lnbconnect.co.uk/images/the%20 cost%20of%20civil%20justice.pdf*).

Third party funding

Beyond the individual case, of course, exist the larger cases and here we would support third party funding as a way of moving forwards. By this, we mean financial support provided for litigation, where the funder recovers a percentage of the sums recovered if the action is successful, nothing if the action fails.

Relatively new in the UK, this operates pretty successfully in Australia, the US and Germany. Although in Germany it is only used in 0.4 per cent of cases – partly because of the scale of case required to make it work. In the Netherlands, third party funding is also on the increase, again in relation to large commercial cases and group litigation. In relation to the latter, the legal limits on CFAs have purportedly led to a marked increase in this source of funding.

It is no surprise, then, that in his preliminary report Jackson LJ recognised that third party funding has a big part to play in promoting access to justice in the future, perceiving it as levelling the playing field between the parties. The downside is that the minimum value of a claim is crucial, providers usually looking for at least £500,000. To invest in a claim, the funder will need to be convinced of the merits of that claim and therefore the chances of recoverability. In reality, this means more than 50 per cent. Funders require costs control and fixed budget and most attractive are therefore the large commercial cases, professional negligence and group actions. Although there is no third party funding for personal injury claims, there is a compelling case for personal injury claims to be added too if rule 9.01 of the Solicitors Code of Conduct 2007 is waived – and this is currently under review.

To give some context, at the start of 2009, according to the figures in Jackson LJ's preliminary report, the minimum value of a claim for Claims Funding International was a colossal £25,000,000 whereas First Class legal was £150,000. So while this means funding may be limited to cases above a particular level, it is still a viable alternative for that slice of the market. Indeed, the Civil Justice Council on 7 March 2009 suggested it might be a 'last resort' means of providing access to justice. To be more than a last resort, we would suggest statutory regulation of this sector is needed for it to have credibility and wide spread appeal beyond the current draft voluntary code.

Contingent funds

Across other jurisdictions, other funding alternatives exist, such as litigation assistance funds – or contingency legal aid funds (CLAF) and supplementary legal aid schemes (SLAS) – but we would not support those for the UK due to the lack of costs protection inherent in such schemes. Hence while they are pretty widespread elsewhere, they tend to have a small take up and be very limited in their application.

The Civil Justice Council in fact looked at the Hong Kong's Supplementary Legal Aid Scheme in 2006 and in 2007 suggested a SLAS should be set up in the UK operated by the LSC. Broadly speaking, under the Hong Kong scheme, applicants are means tested, with a higher eligibility to the normal legal aid scheme. The supplementary scheme claims back 6 per cent of damages of cases that settle and 10 per cent of those funded by the scheme that go to trial. The fund was started with a loan from the Hong Kong equivalent of our lottery fund and is perceived by many as providing a significant access point to justice.

As such, a scheme was also supported by the Bar's CLAF group earlier this year which suggested a number of CLAFs to run in tandem with normal legal aid. The group concluded that a CLAF fund could not co-exist with CFAs in their current format (ie that success fees and ATE premiums could not continue to be recoverable).No particular source was identified for the start-up fund but once that was established it was envisaged it would be funded from damages awarded. How this would exist in reality is a conundrum – indeed whether the fund would be big enough is another key question. For more information, see www.barcouncil.org.uk/consultations/Reports/.

Less successfully, in Australia, there are also contingency legal aid funds. Legal aid is available to people on very limited means, while the contingency funds act as back-up. Yet since the schemes offer no form of costs protection, exposing parties to liability for adverse costs orders, they have not attracted large numbers.

While it would be relatively easy in the UK to get past the barrier of the initial seeding fund – via the lottery or a benefactor – once the fund is up and running, the main impediment to the success of such funds would seem to be, as stated above, the fact that the client remains liable for other side's costs. This accounts for the relatively low volumes of cases that go through such schemes – a catch-22, since the pragmatics dictate that strong cases need to be attracted in order to generate funds.

Another weakness in this method of funding is arguably the instability of the fund itself during rocky economic times. In the US, where third party funding and contingency fees have taken root, the primary source of states' funding for civil legal aid is in the interest generated by the attorney's trust accounts, known as Interest on Lawyer Account (IOLTA). A lawyer who receives client funds, places those funds in a trust account which are deposited in an IOLTA account when the funds cannot earn enough income for the client to be more than the cost of securing that income. (The client – and not the IOLTA program – receives the interest if the funds are large enough or will be held for a long enough period of time to generate net interest that is sufficient to allocate directly to the client). IOLTA programmes purportedly generate millions to help low-income people with civil legal matters. Fifty states operate IOLTA schemes, 36 jurisdictions require lawyers to participate, 14 states allow lawyers to opt out and for two it is voluntary.

In New York, though, only recently, it was reported that the IOLTA fund has had a very unstable ride over the past couple of years, revealing its fragility. As a fund, it alone cannot survive and state support is needed too. The drop in interest rates has meant funding has fallen off a cliff.

Such funds seem both unstable and a little too akin to philanthropic schemes and no matter how well thought out or well meant, they are not the answer. Like pro bono work, while it is a fantastic addition to our legal system, it cannot be a foundation stone and dependency upon it would be a massively retrograde step.

Conclusion

While the foundations of legal aid are solid, reform has inevitably diminished its reach and thereby limited access to justice.

It seems unlikely the situation will change; in 2006 Lord Carter claimed that in the UK we spend more on legal aid per capita than anywhere else in the world and that legal aid expenditure had increased from £1.5bn in 1997 to over £2bn. More recently, at the Parliamentary Group of Legal and Constitutional affairs in July, the diamond anniversary of legal aid was given a nod via the question 'is there a future for the publicly funded practitioner'. Tellingly, legal aid Minister Lord Bach steered around this and instead advocated 'embracing change and making some pretty hard choices'.

We assert it is now time for those hard choices and the promotion of BTE insurance – to run alongside the existing legal aid scheme - would seem to be the best way forwards. To embed this within our legal system and culture, however, it would, eventually, have to be made compulsory (with interim steps leading up to this). Achieving the latter would seem to be co-dependent on the outcome of Jackson LJ's final review and the introduction of fixed fees. As is evidenced by the system in Germany, where there is a statutory scale of costs, there would need to be an element of predictability in relation to costs for this to be a viable way forwards on funding litigation.

For larger cases, we would argue that third party funding would considerably widen the gateway to justice. Statutory regulation of this will be required in order to give the system wide spread credibility.

Such alternative pathways are the reality of funding today; a view echoed by Jackson LJ in this preliminary report. While the report is awash with speculative options, he uncharacteristically diverges from this to express his own 'provisional view'; that following the retraction of legal aid 'either CFAs or some other system of payment must exist to facilitate access to justice'. We adhere to this view and endorse the pathways suggested above.