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Richard Spector, who was one of the first lawyers to take on a major case under a damages-based agreement, explains the bruising experience of trying to get paid after his client won

Richard Spector is a litigation partner at London law firm ELS Legal

In August 2013, ELS was instructed to act for Harlequin Property (SVG) Limited in respect of a potential claim against a top-20 firm of accountants, Wilkins Kennedy.

Harlequin had a controversial business model. It advertised to potential 'investors' that it would buy land in the Caribbean to build hotel resorts. The investors were told that if they paid Harlequin's asking price, then the investor would get legal title to a room in the resort. The investor was told that they would be paid a rental return by Harlequin in return for Harlequin 'renting' the room from them. Harlequin could then sell the room to hotel customers for their stays in the resort.

The model became controversial because, though Harlequin raised an astounding £400m from investors, only one resort was partially built – Buccament Bay in Saint Vincent and the Grenadines. I understand that 2,000 rooms were sold to investors and, as of December 2016, only around 100 had been built. Furthermore, only 26 individuals got legal title to their rooms and there were questions as to whether Harlequin owned all of the land on which the resort was built.

Harlequin blamed many of the woes it faced on the company that was contracted to build the resort.

Wilkins Kennedy was instructed by Harlequin in 2006 and, three years later, by the contractor as well. Harlequin's claim against Wilkins Kennedy was for negligence and conflict of interest.

We considered the claim to have good prospects of success, although we knew that it was likely to be long and complex. After much consideration, ELS agreed to enter into a damages-based agreement (DBA) with Harlequin. We instructed two counsel on the case, Nicholas Davidson QC and Hefin Rees QC, who also agreed to a DBA. Up until judgment, which we won, it was a positive experience.

Harlequin was awarded damages of approximately £7.5m plus £1m in interest. Wilkins Kennedy was also ordered to pay £2m on account of costs. Wilkins Kennedy indicated that it would appeal, so it was agreed that the damages, interest and costs would be paid into a court account pending the application for permission to appeal.

Section 73 application

In the meantime, we had got wind that KPMG was being lined up as interim receivers of Harlequin. In order to protect our position, on December 14 2016 we applied successfully to the High Court for a declaration of an interim charge over the monies in court in respect of the fees we were owed under the DBA.

The basis for this application was a little-known provision at section 73 of the Solicitors Act 1973, which gives a solicitor a right to a charge over damages procured in litigation as a result of the solicitor's instrumentality in the case.

There is established case law that solicitors have a lien in respect of their fees over monies procured by their instrumentality and section 73 is enshrining that in law.

Appointment of receivers

Two days later, KPMG was appointed interim receivers of Harlequin. Despite being successful in the claim against Wilkins Kennedy, Harlequin had creditors of more than £200m who wanted a bit of the damages.

In early January 2017, KPMG requested a meeting with Harlequin's lawyers. At that meeting, we discussed the prospects of Harlequin appealing on points of interest and currency. The meeting was cordial. We were subsequently instructed by the interim receiver to defend Wilkins Kennedy's application for permission to appeal and to draft an appeal for Harlequin.

As January went on, however, the trustee started to question our right to our fees under the DBA. It did not question ELS's right to fees, but suggested that barristers did not have a lien in law over their fees – that is, they were unsecured creditors.

On January 26, Wilkins Kennedy was refused permission to appeal. Its solicitors wrote to us to say that the firm had no interest in the monies held in court and would not object to any application to remove them.

On February 2, the trustee's solicitors wrote to ELS saying that it agreed ELS's right to a lien over its fees and disbursements but did not agree that the barristers had a lien.

The barristers' lien argument always seemed bound to fail. The only reason a barrister's lien was not enshrined in law was because, until very recently, barristers could not act directly for underlying clients and therefore barristers' fees were protected by the solicitor's lien as a disbursement of the solicitor.

It seemed improbable that a court would decide that a solicitor or solicitor-advocate should be entitled to a lien over their fees but a barrister was somehow different.

On February 9, the interim receiver applied to the court in Saint Vincent and the Grenadines for permission to pay ELS in full. The unsecured creditors objected, and the court ordered that they should be able to put in their own submissions and that the hearing should be adjourned.

The largest unsecured creditor of Harlequin is the Financial Services Compensation Scheme (FSCS), which has apparently paid approximately £27m to investors in Harlequin. It wrote to ask why the interim receiver was seeking to pay ELS in full without trying to get a discount.

I find this to be an incredible statement. All of the cash that Harlequin had was the damages we won in court; if it wasn't for our work, then the monies would not have been there. The FSCS, a government organisation, was seeking for us not to be paid the monies due for the work we had done and for the very DBAs that the government had championed to be challenged.

On February 10, there was a final hearing in respect of the High Court claim. The hearing was meant to be to deal with the monies in court, but a number of parties turned up claiming a right to them. The judge ordered that the claim be transferred to the Chancery division so that the court could determine how the monies should be paid out.

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Saint Vincent and the Grenadines: Hotel resort scheme failed

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As ordered, ELS and the two barristers applied to the court for a final order in respect of our charge under section 73.

The decision to challenge the DBA

The case took a dramatic turn during the following week. The trustee had received advice from costs counsel that our DBA was unenforceable, for reasons I explain below. ELS rejected all of those arguments and also considered that this was an aggressive attempt by the trustee to negotiate a reduced payment.

Over the following weeks, there was correspondence between our lawyers (we had appointed Herbert Smith Freehills) and the trustee's lawyers about the DBA dispute. The trustee kept saying that, if we did not do a deal, then it would have to tell Wilkins Kennedy about the dispute.

The reason that Wilkins Kennedy had a purported interest was because it had been ordered to pay Harlequin's costs and had paid £2m on account of costs.

I consider that the trustee's better option would have been to deal with Wilkins Kennedy at an early stage (in January or February) by coming to a deal on costs. The trustee would have then been free to deal with us. Alternatively, I consider that had the trustee just paid us in the first place, then Wilkins Kennedy would have not been able to, at law, challenge the DBA because of the indemnity principle.

The trustee kept saying that the reason he could not pay us was because Wilkins Kennedy could subsequently challenge the DBA at detailed assessment. As I said, I don't agree that was a risk to the trustee, and because Wilkins Kennedy would have known that it would be hard to recover the money once it had been paid out.

Wilkins Kennedy had, in writing, given up any interest in the money and said it would not oppose it being paid out.

On April 5, there was a directions hearing which I consider was a key moment in the claim. The trustee had by now informed Wilkins Kennedy of the claim and it was joined to the application by the judge. The Bar Council was also given leave to intervene. The trustee had proposed that Wilkins Kennedy state its position first, that we respond and then the trustee could then state his position. We did not agree. The trustee had not openly at this stage articulated his position on the DBA. We considered that, if the trustee had issues with the DBA, then he should put them forward first. We could then respond and Wilkins Kennedy could then state its position.

The judge agreed. This was critical because it meant the trustee could not just sit back and watch us and Wilkins Kennedy fight it out. The trustee had to set out his position and, by taking an adverse position, he was putting himself at risk of costs. On April 28 2017, the trustee set out three objections to the DBA.

The termination argument

The applicant argued that the only payment to be paid by the client to the lawyers allowed under the DBA Regulations 2013 was the agreed percentage of damages, which must be net of costs and which cannot exceed 50%. We had included a termination clause in the DBA, which said that, if the client terminated the DBA, the client would have to pay us for the work we had done calculated on our hourly rates.

This made logical sense, otherwise the client could effectively engage us for three years and then after the trial but before judgment terminate the DBA without having to pay us anything.

The applicant argued that, by allowing a termination clause, we were effectively enabling a prohibited 'hybrid' DBA – if the client terminated, the lawyers would be receiving something less than their usual hourly rates.

In response, we raised four arguments. First, that the DBA regulations only controlled the sums payable while the DBA was in force. Once the DBA was terminated, the DBA was no longer in force and there is nothing to stop the solicitor charging his fees for termination with reference to his hourly rates.

Second, we said there was actually no provision regulating what a solicitor could or could not charge on termination and therefore it was open to the solicitor to include a termination clause which charged the client for the work incurred on an hourly rate basis on termination.

The explanatory memorandum to the DBA regulations clearly sets out that, while there was regulation in respect of termination clauses for DBAs in employment cases because such cases can lawfully be conducted by unregulated representatives, there was no need for the equivalent protection in litigated cases because conduct is confined to regulated legal professionals.

Parliament believed that payment on termination was sufficiently controlled by the checks and balances to which regulated professionals are subject.

Third, regulation 4(1) of the DBA Regulations 2013 is a control of the percentage payment and not of any other payments such as a termination clause.

Fourth, if there was no termination clause, then DBAs were unworkable and no solicitor would use one.

Wilkins Kennedy took all these points too and argued that a termination clause was permitted but that it must take the form of a percentage. It is hard to understand how that can work because at the time of termination there would be no figure to which to apply the percentage.

The 'net of' argument

The DBA regulations say that if the client is successful, then they are liable to pay their lawyers the percentage sum and expenses net of costs. So, if the percentage figure and expenses come to £3.5m and costs are recovered from the other side to the tune of £1m, the client is liable to pay the lawyers £2.5m.

The reason is so that the lawyers take on the solvency risk of the defendant. If the defendant cannot pay the £1m costs, then the lawyers will only get the £2.5m from the client as the client is not liable for the additional £1m.

The applicant argued that we had not written into the DBA that expenses would only be payable net of costs. As such, the applicant contended this was a breach of the regulations and that the DBA was unenforceable.

We argued that there was a misreading of the DBA. Clause 11 of our DBA expressly provided that all payments provided for are net of any sums paid or payable as *inter partes* costs including any such sums attributable to expenses.

The barristers' fees argument

The DBA regulations prohibit barristers' fees being charged as an expense. I understand that the reason for this is that either the barrister should enter into a DBA with the client or their fees should be borne by the solicitor. The upshot of this would be the lawyers taking on all of the risk.

There are no provisions prohibiting a client from instructing a barrister directly. In our case, ELS and the barristers all entered into a DBA with the client. The definition of expenses in the DBA refers to the cost of instructing 'barristers and experts'. The applicant argued that the DBA provided for barristers' fees to be an expense and that this rendered the DBA unenforceable. They argued that the law should be decided on what the DBA provided for even though we never charged a barrister's fee as an expense.

We raised a number of arguments in defence of this point. The effect of the regulations is to render the agreement unenforceable if one or more of five conditions are substantially not complied with. The inclusion of barristers' fees as an expense is not something that renders the agreement unenforceable.

We argued that it is an entirely coherent approach to drafting that some provisions only render the offending provision ineffective while other provisions are so serious as to invalidate the entire DBA. In this case, had barristers' fees been incurred as an expense under the DBA (in reality, none were), then on detailed assessment they would not have been allowed and that would have protected the client from paying inappropriate expenses.

We also argued that the DBA did not permit counsel's fees to be charged as an expense. This is because counsel were already part of the DBA. The DBA only authorised ELS to instruct those two barristers for the hearing and, if we were to instruct other counsel, we would have to do so directly at our own expense, which is allowed by the DBA regulations.

Finally, we argued that, even if it were a breach of the agreement to have a definition of expenses which includes barristers' fees, it would not be a material breach of the agreement, in line with *Hollins v Russell*.

Wilkins Kennedy and the trustee submitted that the government wanted DBAs to be strictly regulated. While the CFA regulations were largely scrapped in around 2005 because the courts got so fed up with satellite litigation, the DBA regulations contained a clause saying that a breach of the regulations would render the agreement unenforceable.

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The Bar Council submitted, and we agreed, that when drafting the DBA regulations, the Government sought a 'light touch' approach, which was that the DBA would only be unenforceable if one of the conditions prescribed by section 58AA(4) of the Courts and Legal Services Act 1990 is not substantially met (as opposed to if any provision of the regulations were breached).

We also said that the explanatory memorandum to the DBA regulations was clear that the government did not want to encourage satellite litigation.

Negotiations

As we got closer to trial, the trustee appeared to want to negotiate. The problem was that Wilkins Kennedy now had a stake, because of the £2m paid into court, and they effectively had a free ride at challenging the DBA as the trustee would be liable for the costs.

We attended a mediation, but that was to no avail. In the days before the trial, offers were made and rejected. As we got even closer to the trial, we started to negotiate a deal with the trustee. The settlement was that the trustee would pay us a lump sum in settlement of our claim. The trustee would assign us the benefit of the costs assessment process and the trustee would also accept our right to our entire claim. On the morning of the trial, the settlement was agreed.

Wilkins Kennedy was now in a position where it carried the fight itself, meaning the firm was exposed on costs. There was another important element to this. We argued that the trustee had now 'paid', and authorities like *Hollins v Russell* showed that where a party has already paid its lawyers, it was too late for the opposing party to show that there might have been a defence to that payment, rooted in the unenforceability of the retainer.

In these circumstances, the party receiving costs does not need to demonstrate a contractual obligation to pay his lawyers. The payment itself conclusively satisfies the indemnity principle. The client is demonstrably out of pocket by virtue of the payment, which is all the indemnity principle requires.

This raised a fundamental difficulty for Wilkins Kennedy. It was not a privy to the DBA. We said it had no *locus standi* to challenge its enforceability if the applicant did not. Moreover, *W v Veolia* showed that, even if it established the unenforceability of the DBA, that will not avail it in circumstances where the applicant no longer challenged the lawyer's right to payment.

The trial

As soon as the trial started, we informed the judge about the settlement with the trustee. Wilkins Kennedy asked for an adjournment to consider the position.

The trial continued, but from that moment onwards there were negotiations in the background with Wilkins Kennedy. It lasted three days. After the last day of trial had concluded, we agreed a settlement with Wilkins Kennedy.

The risk for us was that this was the type of case that could have gone all the way through to the Supreme Court and the cost of that was not worth it.

Conclusion

I do not regret entering into a DBA, but it has been a huge learning curve. DBAs are lucrative if matters settle at an early stage. In the end, we recovered less than we would have on an hourly rate basis, so there was no reward for the risk taken. The DBA was good for the client relationship and I think that is a positive.

The DBA regulations are drafted ambiguously and need clarification. The government ordered a review of the regulations, but has done nothing with the outcome.

We ended up in a stressful and expensive fight for money that we should have been paid. We worked extremely hard for nearly four years. The client had agreed to pay us a percentage of the damages and we had worked on that assumption. I have no doubt that, had the client not gone into bankruptcy, it would have paid us without argument.

In the end, it seems we had a trustee and Wilkins Kennedy combing the DBA for any irregularities which could mean that the trustee did not have to pay us and that Wilkins Kennedy would not have had to pay costs. They, and others, may argue this is no more than they're entitled to do, but it strikes me as a crazy situation where lawyers can carry out such work at the risk of being paid nothing.

Meanwhile, Wilkins Kennedy lost but its lawyers were paid more than us and were paid in full. Had the trustee paid us in full, I suspect that Wilkins Kennedy would not have been able to challenge the enforceability of the DBA for the reasons set out above.

The trustee may have also been able to recover more in costs from Wilkins Kennedy. In the end, the monies that have not gone to us as a result of us settling have just ended up in the hands of our lawyers, Wilkins Kennedy's lawyers and the trustee's lawyers. Overall, an unsatisfactory situation.

Maybe it was thought a small firm and two self-employed barristers would give in and take a low settlement. That did not happen. ■