

Legal Costs: Commentary

INTRODUCTION

The harmonisation of legal costs rules at a national level is highly desirable. Legal costs regulation has suffered over many years from incremental redrafting, amendment and the periodic introduction of additional requirements on practitioners, creating uncertainty and layers of unnecessary complexity.

The implementation of new nationally consistent legislation should be directed towards the achievement of a regulatory framework that:

1. Recognises that different disclosure regimes are necessary for different circumstances, for example, for transactional work as opposed to litigation work or for clients who are experienced in engaging legal practitioners and those who are not;
2. Improves the ability of clients to understand the way in which legal costs are to be calculated, charged, billed and recovered (and if necessary independently reviewed);
3. Recognises the need to differentiate between the cost of providing legal services to clients and the cost of providing funding for legal services to clients; and
4. Empowers the proposed new Legal Services Board (LSB) to publish for the use by legal practitioners standard form disclosure statements and legal costs agreements that are appropriate in different areas of legal work with the consequence that the adoption of the standard form will be taken into account by the Legal services Commissioner in relation to any disciplinary matters and/or the Court in relation to disciplinary matters and consideration of whether or not the legal costs agreement is fair and reasonable.

COSTS DISCLOSURE

The imposition of costs disclosure requirements on legal practitioners have proven to be an effective mechanism for minimising cost disputes. The introduction of simple, over-arching rules on costs disclosure and legal costs agreements should be directed towards bringing about national consistency and reduced uncertainty.

This may be facilitated by national provisions which improve the effectiveness of costs disclosure by removing jurisdictional inconsistencies in the application of principle and language without compromising the need to provide for different solutions for different clients in different areas of legal work. The present emphasis on what accounts to in most jurisdictions as a "one size fits all approach" has resulted in "voluminous detail in costs disclosure documents for fear of (legal practitioners) failing to meet their professional obligations."¹

¹ COAG National Legal profession Reform, Discussion Paper: Legal Costs, 2009, p. 4

There are some elements of good client communication and expectation management which are common to almost all client/legal practitioner relationships. Engaging clients early in the process of understanding the nature of the client's legal needs and desired outcomes leading to the scope of work to be undertaken is well defined is an important first step in ensuring that the client engagement sets clear boundaries for the respective obligations of legal practitioners and clients.

A flaw in the current disclosure regime is that it tends to deal with legal costs as somewhat detached from the client engagement process. This may be rectified by the proposed new National Legal Practice Board setting out standards which require legal practitioners to provide clients with written Legal Costs Disclosure Statements which in plain language are directed towards providing clients with brief answers to the following questions:

- what is the legal problem and what outcome does the client want?
- what legal services is the legal practitioner able to provide?
- by what process will the legal services be provided?;
- over what period of time will the legal services be provided?;
- at what cost to the client will the legal services be provided?; and
- at what risk to the client will the legal services be provided?

Level of detail in disclosure

To avoid "voluminous detail" new legal costs disclosure standards should be developed relevant to the area of legal practice and should be client appropriate. For example, a client who is a frequent user of legal services requires a different level of disclosure to a first time, consumer user. It is therefore necessary to define a client who is a repeat user² of legal services for the purposes of costs disclosure requirements. Repeat users should be able to waive their right to detailed disclosure as generally their experience affords them adequate information and awareness of the process.

Disclosure, in so far as it is intended to protect the less experienced users of legal services should be designed to address the information asymmetry between the legal practitioner and the consumer client, the latter being often unfamiliar with the workings of the legal system, the costs and the risks involved. The unique circumstances of these consumer clients requires more detailed disclosure, presented in a clear way that they can easily understand.

Similarly, the disclosure requirements in a litigious matter will be different to what is required in a transactional matter (such as the drafting of a will). Disclosure requirements should be customised to the type of matter that is the subject of the agreement between the client and the legal practitioner.

The proposed new National LSB should be able to set standards for disclosure relevant to the legal practice area and appropriate to the type of client with the co-operation of the constituent bodies who are able to draw upon the expertise of their members in this area.

² Also referred to as an experienced user, sophisticated client, institutional client

Exceptions

An exception to the costs disclosure requirements should be permitted for matters of a certain value. Where a client is to be charged a fixed fee of \$2,500 plus GST (or less) for legal services, the costs disclosure requirements should not apply, in the interests of efficiency and reduced administrative costs. Appropriate exceptions should also apply for repeat users of legal services or sophisticated clients, as referred to above.

Form of disclosure

The form of disclosure goes to the heart of whether a client understands the scope of the legal services to be provided by the legal practitioner. In lawyer-client relationships where there is information asymmetry or a power imbalance it is vital to ensure that clients understand the meaning of the costs calculations, methodology and risks disclosed to them. The introduction of common language and definitions, combined with the removal of language that is difficult for clients to understand, will go a long way towards addressing this challenge.

Currently different terminology is used to describe legal costs (including party/party costs, solicitor own client costs, professional fees, indemnity costs, disbursements, uplift fees, etc). A simpler approach would be that legal costs be described in the proposed new national law as comprising only the following components - professional fees and out-of-pocket expenses.³ The distinction between solicitor own client costs and party/party costs should be abandoned and replaced with "total legal costs" and "recoverable legal costs", such that the latter equates to party/party legal costs as currently provided for pursuant to the Court rules in various jurisdictions.

Disclosure in languages other than English

The purpose of disclosure is to ensure that the client understands the agreement with the legal practitioner. Often where language is a barrier to that understanding, poor literacy is also a factor. Providing costs agreements and disclosure documents in different languages will often not discharge the legal practitioner's duty of disclosure to the client. A proper discharge of the obligation requires the legal practitioner to ensure that there is an understanding of the agreement, and the form that the disclosure may take, must be client appropriate, taking into account the clients particular circumstances. In simple terms prescribing that disclosure be provided in languages other than English is more likely to lead to a situation where legal practitioners rely on this to discharge their obligations rather than ensuring that clients understand the nature and content of the obligations they and their legal practitioner are entering into.

³ In the event of conditional fee arrangements there needs to be a third component, namely a success fee.

COSTS AGREEMENTS

A standard national costs agreement

The proposed new National LSB should have the power to approve standard costs agreements. Provided standard costs agreements take into account the nature of the client (i.e. a repeat user or a consumer client) and the nature of the legal matter, costs agreements in standard form will be of great assistance to legal practitioners particularly sole practitioners.

Nature of determining costs

Legal practitioners charge their clients in a variety of different ways.⁴ One or more of these costs calculation methods may, or may not be acceptable to the legal practitioner and the client. Regardless of how the costs are calculated, however, the obligation of disclosure should be the same and the factors to be taken into account in order for a Court of competent jurisdiction to assess whether the legal costs agreement should be enforceable in whole or part should be universal. In this regard the list of factors to be taken into account set out on page 12 of the COAG National Legal Profession Reform, Discussion Paper: Legal Costs dated 4 November 2009 are appropriate, however I would add that whether or not the legal practitioner is funding the legal costs in part or full ought also be taken into account.

There should be a single national reference point for principles which guide the determination of costs and that is that a legal costs agreement must be fair and reasonable. In the event of complaints or disputes, a court of competent jurisdiction in the relevant state or territory should determine, with reference to the practice standards LSB's practice standards, what is fair and reasonable on a case-by-case basis.

Contingency fees

In litigation matters, charging clients for legal services on a contingent fee basis is illegal in all jurisdictions in Australia at present. This means that legal practitioners cannot calculate what they will charge a client for their legal services is a percentage of any judgement or settlement achieved if the legal practitioner is acting on their behalf in the litigation concerned.

Other service providers are able to claim a percentage of any judgement or settlement in exchange for providing funding for litigation. Law Aid in Victoria and commercial litigation funders for example, charge a percentage of any judgement or settlement. In the case of Law Aid a government body established in Victoria to fund disbursements, a mechanism exists to allow the fund to grow and become self-sustaining in the interests of facilitating enduring improved access to justice.

⁴ Time billing, fixed fees, capped fees, contingency fees, blended hourly rates, retrospective fees based on value, relative value, task based fees etc were examples outlined in the COAG Discussion Paper: Legal costs, 2009, pp 9-10.

It is arguable that as a matter of principle the same access to justice benefit could be derived from legal practitioners offering contingent fee terms. The risk of not being paid in the event that the case is unsuccessful is borne by the legal practitioner (or legal practice), being paid to the legal practitioner whilst delivering a successful outcome for the client would result in an agreed percentage of the client's judgement or settlement in the event of success. This creates an obligation on the practitioner to carefully consider the legal merit of the case, or run the risk of non-payment. This risk is not insignificant and is of itself a strong incentive to carefully weigh all of the potential issues.

The prospect of legal practitioners being permitted to determine legal costs by reference to the amount a client recovers is considered by some stakeholders to present an insurmountable conflict of interest between the client's interests and the interests of the legal practitioner. Whilst I do not share that view, the concern should not exist in circumstances where the legal proceedings and the legal costs to be paid by litigants are supervised by the Court as is the case in respect of representative proceedings commenced pursuant to the Federal Court of Australia Act and the Supreme Court of Victoria Act. In these proceedings the Court is required to scrutinise all aspects of any settlement or disposition of the proceedings including determining the enforceability of legal costs and funding agreements by reference to what it considers to be in the best interests of all group members. In summary, in proceedings where the Court has power to supervise the impact of contingency fees on claimants the benefits from an access to justice perspective outweigh the perceived risks with such arrangements.

Conditional fees and disbursements

Legal practitioners in some jurisdictions can charge a success fee⁵ of up to 25% of professional fees, recognising the risk that some legal practitioners take in pursuing cases on a conditional fee basis for their clients.⁶ This should be extended to all Australian jurisdictions under the new national regime.

Legal practitioners, in providing conditional fee arrangements are providing a service to the community when otherwise funding the legal action is not available to the client. The risk in pursuing the matter, under a conditional fee arrangement, shifts from the client to the legal practitioner and this shift of risk should be recognised, where appropriate, at the successful resolution of the client's case in a way which protects vulnerable clients but does not restrict access to justice by discouraging practitioners from offering such arrangements.

⁵ Also known as a premium or uplift fee

⁶ A conditional fee arrangement, as opposed to a contingent fee arrangement, is one where the client is only required to pay professional fees (and disbursements in some cases) to the legal practitioner if a judgement or settlement in the client's favour is achieved.

Often in a conditional fee arrangement the legal practitioner takes on the risk of the cost of their professional time and the out of pocket expenses both immediately and in terms of the time cost of the funding provided, as well as the risk of the costs so incurred not being recovered.⁷ While it is undesirable for legal practitioners to add a margin to the cost of third party disbursements incurred on a client's behalf, it is appropriate for the legal practitioner's service to the client in incurring that cost, and the risk of non-recovery, to be rewarded. Where this is the case, it is appropriate for a success fee on disbursements to be charged to the client on successful resolution of their matter. A success fee on a conditional costs agreement should be calculated on both the professional fees component of the costs as well as the out of pocket expenses portion which is funded by the practitioner during the course of the proceedings.

If practitioners were able to charge a success fee of up to 25% on professional fees and disbursements under the new national laws, there would be no demand-driven-need to consider the introduction of contingency fees in Australia, in civil litigation except in the area of insolvency litigation or in class actions where the scale of the undertaking requires it and the Court supervision process in representative proceedings provides a proper structure in which conflicts of interests real or perceived can be dealt with.

Litigation funding

Litigation funders are one of the private sector's responses to the lack of Legal Aid funding available to Australian litigants.⁸ Litigation funding delivers access to justice for aggrieved persons who are unable to access Legal Aid, a conditional fee arrangement or pay the costs involved in pursuing their rights.

In order for litigation funding to be viable as a business, however, the return on investment potential must be balanced against the risks of non-payment in the event that the claim is unsuccessful as well as the service provided by some litigation funders in the form of provision of an indemnity for adverse costs orders.

The new national costs regime should avoid enshrining into law a ban on legal practitioners having an interest in funding litigation. This is not in the best interests of consumers as it will simply restrict competition leaving commercial litigation funders who are not bound by professional obligations to the Court, the administration of justice and clients an effective monopoly in this area.

I attach a more detailed paper on litigation funding issues for your consideration.⁹

⁷ Some conditional fee agreements relate only to professional fees, others offer conditions on both professional fees and disbursements being recoverable at the conclusion of the matter.

⁸ The availability of conditional fee agreements is another

⁹ See Annexure A

BILLING

Liability of principals for overcharging

Overcharging is a serious issue and every effort should be made to avoid it at first instance, and remedy it appropriately in circumstances where overcharging is alleged. Bills of costs should be carefully reviewed and the legal practice rendering the bill should be responsible for the bill's contents and the reasonableness of the charges contained within it.

It is appropriate that a bill is reviewed and signed by a principal of a legal practice. A principal signing a bill should be liable for the content of that bill and the reasonableness of the costs charged in that bill. However, a principal of a legal practice should not be liable for every bill sent from the legal practice. It would be unfair in the extreme to impose on principals the responsibility for supervision of every bill sent in a legal practice. Accordingly the current "carve outs" in the provisions should be maintained and where appropriate clarified and extended to ensure that a principals responsibility is limited.

Periodic billing

It is important that the standards on costs disclosure and legal costs stipulate that costs disclosure is a continuing obligation that must be discharged at regular intervals.

It has been suggested that in personal injuries matters clients should receive periodic bills¹⁰ to keep them apprised of their potential costs liability. In conditional fee matters however, a legal practitioner cannot send a bill to the client until a successful outcome has been achieved for that client. Therefore, providing periodic bills, or even estimates of costs accrued, can be confusing to a client, particularly if an arbitrary time frame (such as every three months) is prescribed.

The desire to ensure that clients are kept properly informed is already a requirement in a general sense, i.e. failing to keep clients informed is unprofessional conduct and may amount to misconduct in certain circumstances. The general obligation could be strengthened if the practice standards published by the new proposed National LSB set out guidelines for good communication strategies with clients relevant to different client profiles and different types of work, including the need for cost disclosure to be seen as an ongoing obligation.

Overhead costs

There appears to be some confusion in relation to the way in which legal practices determine the cost of legal services that are passed on to clients. Whilst there is a need for greater transparency in relation to such matters this will not be achieved by creating artificial distinctions between the labour costs component of providing legal services to clients and the overhead costs component. The proposed criteria by which a Court of competent jurisdiction should be required to assess whether a legal costs agreement is fair and

¹⁰ At least quarterly

reasonable coupled with standards published by the proposed new LSB should be adequate to address concerns in this area.

Interest on unpaid legal costs

When a bill is payable in any legal matter, the proposed new national law should require any bill to a client for legal costs to give specific notice to that client of any interest that may be applicable if the bill is not paid within a stated, reasonable period. This is currently the law in some Australian jurisdictions¹¹ and should become the nationally consistent standard.

Costs assessments

In assessing fair and reasonable costs an assessor should be able to take into account all of the matters set out on p12 of the Taskforce's Discussion paper on Legal Costs of 4 November 2009, as well as any arrangements to fund the legal costs on the clients behalf. Legal Aid funding is currently insufficient to meet civil litigants' needs. There is no reason standards against which costs can be assessed cannot be the subject of a uniform national law without interfering with the jurisdiction of State and Territory Courts to deal with legal costs either by way of assessment or taxation as the case may be, in the jurisdiction concerned.

Proportionality in assessing reasonableness of costs

Proportionality principles already exist in personal injuries matters in some jurisdictions.¹² I do not believe that it is necessary to extend such principles nationally in order to encourage nationally consistent, fair and reasonable behaviour.

However, proportionality is a very important consideration in the event that overcharging is alleged. In assessing such allegations it may be useful to consider if:

- the costs are proportionate to the risks of the case; and
- the costs are necessary and reasonable for bringing the case before the courts and adequately agitating the issues concerned.

In seeking to recover costs from an unsuccessful litigant, proportionality principles may also prove to be a useful tool, however there is no certainty that it will affect the behaviour of large institutions, in fact experience tends to suggest that it will have little if any impact.

OBSERVATIONS

1. The new national laws should make cost disclosure simpler and easier to understand for clients, while creating clear and ongoing obligations on legal practitioners. The provisions should use simple terminology and be supported by national standards including where appropriate

¹¹ See for example s. 321 (2) of the Legal Profession Act (NSW) 2004 where the period is 30 days.

¹² See Queensland's 50:50 rule where any judgement or settlement amount, less any statutory refunds, disbursements and professional fees, divided by two, should not be more than 50% of the judgement or settlement amount, or the costs will need to be reduced so as not to exceed 50%.

- pro forma disclosure statements and legal costs agreements ensuring that allowance is made for different types of matters and the experience of the client in accessing legal services;
2. In civil litigation a legal practitioner should be permitted to offer to act for a client on a conditional legal costs basis and to recover a success fee of no more than 25% of the total legal costs;
 3. In representative proceedings pursuant to Part IVA of the Federal Court Act or the Supreme Court Act (VIC) a legal practitioner ought to be able to calculate legal costs recoverable from a client by reference to the damages or compensation recovered, subject to Court supervision and approval;
 4. The Corporations Law and the proposed new national Legal Profession Act should be amended to ensure that the provision of legal services in litigation matters or litigation funding in such matters does not constitute operating or participating in a managed investment scheme; and
 5. The introduction of a nationally consistent standard against which the enforceability in whole or part of a legal costs agreement must be assessed by a Court of competent jurisdiction is overdue and should be enshrined in the proposed new national law.

Together with the introduction of appropriate management systems requirements,¹³ consumer protection mechanisms will be strengthened by a new nationally consistent cost regime.

¹³ Refer to my Business Structures paper December 2009.