The Enforceability of Conditional Fee Agreements: *Diag Human v Volterra Fietta* [2022] EWHC 2054 (QB)

9 January 2023

Introduction. The High Court (the "Court") has upheld a decision finding that a law firm which charged its client nearly $3m under an unenforceable conditional fee agreement ("CFA") has to repay the money to the client.[1]

The judgment is a "*harsh*" reminder to law firms showcasing the stark monetary consequences of providing legal services under CFAs which do not comply with sections 58-58A of the Courts and Legal Services Act 1990. In summary, the Court held that: (1) non-compliant CFAs are unenforceable, (2) consequently, costs are not payable unless the offending CFA is severable from the overall contract; and (3) fees paid under the CFA must be returned to the client as of right—the law firm is not entitled to payment under an unlawful agreement.

Background. The Respondent ("Diag") hired the Appellant ("Volterra") to represent it in a bilateral investment treaty arbitration in which Diag was claiming $2.4 billion.

The initial retainer was contained in the engagement letter sent in February 2017. Volterra was retained on a discounted hourly rate basis ("Retainer One"). Approximately $107,000 was billed under this arrangement before being amended by a side letter, signed by the parties in September 2017.

The side letter created a new retainer containing a CFA. CFAs must comply with section 58-58A of the Courts and Legal Services Act 1990 to be lawful and therefore enforceable. Under the new retainer, Volterra agreed to apply a 30% discount to the fees under Retainer One, in exchange for a success fee entitling Volterra to 280% (more than double the statutory maximum of 100%) of its base New Retainer fees (the "New Retainer"). Two fees were now payable to Volterra under the New Retainer: (1) the discounted fee accrued under Retainer One and (2) a success fee.

---

[1] [2022] EWHC 2054 (QB)

In May 2019, the New Retainer was terminated with Diag in "*substantial fee arrears*" of almost $3 million—roughly $100,000 was owed under Retainer One and $2.9 million under the New Retainer.

Volterra brought a claim against Diag for payment of the arrears. Volterra did not dispute the unlawfulness of the CFA in the New Retainer, however, Volterra argued that Retainer One was severable from the New Retainer, so the fees due under Retainer One remained payable. Diag argued that the New Retainer changed the "*nature*" of the agreement from an hourly arrangement to an (unlawful) CFA arrangement.

The cost judge, Master Rowley, of the Senior Courts Costs Office ("SCCO"), found in favour of Diag. The SCCO held that:

- CFAs which do not comply with sections of the 58-58A Courts and Legal Services Act 1990 are not enforceable. A success fee potentially entitling a law firm to more than 100% of its client's base fees is therefore not enforceable.
- Unlawful CFAs are potentially severable from an overall contract. However, this was not the case on these facts. The New Retainer changed the *entire* agreement into a CFA, so severance was not possible.
- Law firms are not entitled to fees paid under an unlawful CFA. This would constitute "*unjust enrichment*". Volterra must therefore return to Diag any fees paid.

Volterra appealed the SCCO's findings and the SCCO Master granted permission to appeal on one issue, with further permission granted by the High Court on a renewed application.

The Appeal. In the High Court Foster J dismissed Volterra's appeal and upheld the SCCO's judgment and reasonings largely for the reasons given below.

In summary, Volterra submitted two questions to the High Court:

- Can the offending provisions of a contract be severed?
- Where a retainer is unenforceable, does the *Aratra* decision (addressed below) mean that a client is not automatically entitled to return of the retainer unless he or she can prove he or she is owed restitution?

Can CFAs Be Severed From a Contract? The correct test to determine whether a CFA is severable is the three-stage test under *Beckett Investment Management Group Ltd & Ors*

v Hall & Ors [2007] EWCA Civ 613 as was approved in *Egon Zehnder Ltd v Tillman* (SC (E)) [2019] UKSC 32. If satisfied, severance of the CFA was permitted. Relevantly,

> *"A contract which contains an unenforceable provision nevertheless remains effective after the removal or severance of that provision if the following conditions are satisfied:*
>
> 1. *The unenforceable provision is capable of being removed without the necessity of adding to or modifying the wording of what remains.*
> 2. *The remaining terms continue to be supported by adequate consideration.*
> 3. *The removal of the unenforceable provision does not so change the character of the contract that it becomes 'not the sort of contract that the parties entered into at all'.*

The unenforceable provision is capable of being removed without the necessity of adding to or modifying the wording of what remains.

Unlike the cases relied on by Volterra (see *Garnat Trading & Shipping (Singapore) Pte Ltd v Thomas Cooper (A Firm)* [2016] EWHC 18 (Ch*); Zuberi v Lexlaw Ltd* [2021] EWCA Civ 16), the New Retainer did not contain "*two separable work streams*" capable of being severed. Rather, the wording of the New Retainer was such that it *replaced* Retainer One. The New Retainer created *one* new contract stating that, notwithstanding the fees owed under Retainer One, the parties would move to a CFA arrangement from September 2017. Accordingly, it would be impossible to "*excise all the terms from a CFA which make it* [the] *CFA*" that the parties mutually agreed to.

The Court held that the SCCO's application of the *Becket* test was consistent with (not contrary to) both the case law on the matter and the policy incentives/statutory context behind the Courts and Legal Services Act 1990. The public policy objectives of sections 58-58A of the Courts and Legal Services Act 1990 were to prevent law firms from continuing "*…to act for a client under a conditional fee arrangement*" which was not compliant by establishing *strictly* applied rules on what could constitute a lawful CFA. The Court noted that permitting severance would "*allow virtually all defective CFAs or DBAs to be put right late in the day. This is not the effect of the statute read in the light of the earlier and subsequent caselaw. Further, it would undermine consumer protection and the administration of justice*".

Are Retainer Fees Repayable To Clients Under Unenforceable Retainer Contracts?
Volterra relied on *Aratra Potato Co Ltd v Taylor Joynson Garrett (a firm)* [1995] 4 All ER 695 to argue that it was not possible to order a repayment of the monies without Diag making a restitutionary claim (Diag had not made any such claim).

The Court held, as had the SCCO, that *Aratra* could not be understood in isolation as it had been amended by later Court of Appeal decisions such as *Garret v Halton Borough Council* [2007] 1 WLR 554 and *Awwad v Geraghty and Co* [2001] QB 570. Those two cases incorporated and explained the public policy incentive behind regulating CFAs. It was clear that "*Parliament had intended that if any of the conditions laid down for CFAs* [were] *not satisfied,* ***the CFA (and all of it) would not be enforceable and the solicitor would not be paid.*** *This was* ***tough but not irrational"***. (Emphasis added). Volterra's interpretation of the *Aratra* judgment was therefore incorrect. With the benefit of subsequent case law on the matter, "*no claim for restitution is necessary as a precursor to recovery of sums paid under the unenforceable agreement… The* ***whole agreement falls foul of the legislative regime, unless severance is possible"***. (Emphasis added). Volterra was therefore ordered to repay Diag any monies it received under the unenforceable CFA.

Takeaways. This judgment is a reminder of the "*harsh but rational*" outcomes for CFAs which fall foul of sections 58-58A of the Courts and Legal Services Act 1990. The intent of the legislation is to protect clients and encourage solicitors to comply with statutory requirements. Accordingly, unlawful CFAs and any payments due thereunder are not enforceable regardless of the number of hours put in, or whether a law firm has secured a successful outcome for their client. This will always be the harsh reality **unless** a law firm can establish that the CFA is severable from the rest of the contract.

Practitioners should be extra cautious when drafting CFAs as non-compliant CFAs can have expensive consequences.

* * *

Please do not hesitate to contact us with any questions.

We would like to thank trainee associate Adewunmi Williams for her contribution to this Debevoise Update.

LONDON

Patrick Taylor
ptaylor@debevoise.com

Doreena Hunt
dhunt@debevoise.com