Centre for Socio-Legal Studies, Oxford

Lincoln Law School

# LITIGATION FUNDING: STATUS AND ISSUES

**RESEARCH REPORT**

**Christopher Hodges, John Peysner and Angus Nurse**

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## Summary

Litigation funding is new and topical. It has the capacity to significantly alter the litigation scene. It gives rise to particular issues that need understanding and attention. It is relevant only in certain situations, and while it is not a possible solution to all types of claims it has the potential to significantly increase opportunities to pursue certain claims.

The basic model of litigation funding is an investment business based on securing an appropriate return on investment. It is not a banking loan as no interest is charged, and not insurance as no premium is charged. Investment is made in any case that has a sufficient prospect of success on its merits, and has a strong legal team with a convincing case strategy. In some types of offering, however, the model of litigation funding can appear to be more like the provision of legal services. This is where a funder, sometimes from a legal services background, conducts a detailed assessment of the legal merits of a case (including obtaining or providing specialist legal advice on the case) prior to agreeing to funding. Funders determine the risk, and ultimately the extent of the investment, based on an assessment of the merits of the case, the solvency of the defendant (or, in the case of a funded defendant, the resources of the claimant) and the size of the claim and likely return. However, during this research the contrary view that litigation funding is part of the legal services market has been raised. Arguably the nature of the funding being offered and background of the funder (i.e. whether legal services or insurance/financial sector) can be factor.

This research examines the current structure of the litigation funding market and the types of product on offer. Litigation funding can apply advanced banking techniques to a legal claim, treating it like any other valuable asset and applying the same risk assessment techniques in determining the level of finance offered. The initial phase of 3rd party litigation funding is an exploratory affair where both the funder and the client are seeking partners in spreading risk and distributing reward. The funder cannot make such a decision without detailed assessment of the legal and factual matrix of the case and its prospects of success (and would perhaps be foolish to proceed without such an exercise) and although the funder might share such insights with the prospective client, they are essentially the funder's work product. The development of the litigation funding market has thus merely recognised an expanded use for a new asset class (claims or defences) and opened up a new market for associated finance.

Litigation funding is currently a bespoke product tailored to the needs of the specific market and legal jurisdiction. There are thus, difference conceptions of litigation funding in the UK, mainland Europe, Australia, Canada, the US and South Africa. Within the UK there are examples of co-funding or risk spreading so that some funders may jointly fund a large case, and some arrangements may involve various companies providing different packets of finance or insurance.

The principal constraint on the development of litigation funding is traditional public policy against funding others' litigation or intermeddling in the conduct of litigation (the concepts of maintenance and champerty discussed later in this report). However, such rules are being reformed in some jurisdictions, although no consistency has

emerged over what the emerging policy and principles should be, and different jurisdictions are making different reforms at different speeds (or not doing so).

This research examines the status of litigation third party funding, the different funding models currently in use and assesses the historical development of third party funding and the legislative and policy considerations that inform the current market. In doing so, it draws conclusions on the potential of litigation funding to increase access to justice in light of current policy changes in the provision of legal services.

## Contents

**Preliminaries**

## Abbreviations

| | |
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| ABA | American Bar Association |
| ADR | Alternative dispute resolution |
| ATE | After-the-event legal costs insurance |
| BTE | Before-the-event legal costs insurance |
| CFA | Conditional fee arrangement |
| CLAF | Contingency Legal Aid Fund |
| DCA | Department for Constitutional Affairs, predecessor to the MoJ |
| LEI | Legal expenses insurance |
| MoJ | Ministry of Justice of the United Kingdom |
| SLAS | Supplementary Legal Aid Scheme |
| TAG | The Accident Group |
| TPF or 3PF | Third Party Funding |
| U.K. | The United Kingdom |
| U.S.A. | The United States of America |

## Description of this Research Project

The aim of this research is to examine the status of 'third party' litigation funding as a tool to increase access to justice and overcome some of the obstacles faced by some plaintiffs due to the high costs of litigation. The research is empirical in nature and examines the practical, ethical and regulatory issues relating to third party litigation funding. The geographical focus is primarily on the jurisdiction of England and Wales, but the analysis is illustrated by reviewing law and practice in other jurisdictions where litigation funding has emerged.[1]

Litigation funding introduces into legal proceedings an independent third party who has no other connection with or interest in the litigation. However, the extent to which the funder becomes involves prior to confirming and making their investment varies considerably, and is discussed later in this Report. The third party funder can be an insurer, specialist funding company, hedge fund, lawyer or individual, and may provide a variable amount of funding from providing the full legal costs of the proceedings, part funding, or fund only disbursements outlayed. From the outset we should say that the flexible nature of third party funding makes it difficult to define, as the product is continually developing to meet the needs of the market and there is no standard third party funding product. While we are primarily concerned with specialist litigation funding provided by companies established primarily for the purpose of investing in litigation for a return of the proceeds, this research considers a broad definition of third party litigation funding which encompasses any situation where an individual who is not one of the parties involved (i.e. neither claimant nor defendant) provides funding in respect of the litigation.

The key research questions that arise are:

1. What is litigation funding?
2. What is the extent of third party litigation funding in England and Wales?
3. How does litigation funding work? How is third party litigation funding constituted and, in particular; what contractual terms and 'cover' are used, what is the range and median of the deduction, and what is the relationship between third party funding and After the Event (ATE) insurance?
4. What are the pros and cons of litigation funding ? What issues does it raise?
5. What is the current regulatory environment for third party litigation funding in the EU and are there different regulatory mechanisms in different jurisdictions?
6. What is the relationship between the relevant parties―client(s), funder, lawyer and opponent(s)? Who chooses the funder and/or lawyer? Who controls the decisions that are necessary during the litigation, especially in relation to settlement?
7. How should litigation funding be controlled?

[1] We are grateful to the Law Society of Scotland for clarifying that speculative actions have been allowed in Scotland for several decades and while ATE insurance is not widely available in Scotland some firms doing significant personal injury work do have policies available. Until 1992 the Court controlled all fees for civil litigation whether payable by the solicitor's own client or by the unsuccessful party to the successful one. In that year solicitor/client fees were freed from this control and an Act of Sederunt (regulation) was passed, allowing an uplift (success fee) payable by the solicitor's own client, not the other party. As a result litigation funding is not a significant issue in Scotland and is thus outside the geographical scope of this study.

8. Should it be encouraged or discouraged, and in what circumstances?

In addition to considering the emergence and use of third party funding in the commercial sector, the research will consider the potential for this model of funding in other areas such as group actions, international arbitration cases, and European cross border litigation, and its limited potential for use in smaller consumer cases.

While the research is primarily focused on the emergence of and potential for third party litigation funding in England and Wales, litigation funding exists in other jurisdictions, so useful comparisons can be made, and consideration be given to whether there are any global aspects. The research will be informed by an understanding of how litigation funding operates in other jurisdictions; specifically Australia, the USA, Canada, Ireland, Germany, Austria and the Netherlands. It will evaluate whether lessons from the United States, Canada and Australia in particular can inform the development of third party litigation funding within England and Wales.

The background to this research is the perception of a gap in access to justice linked to the difficulties of and risks inherent in pursuing litigation. Litigation funding has recently emerged as a commercial phenomenon and is clearly being used and taken up. However, it seems primarily to be relevant for commercial entities with cases of a significant size; this raises questions about any remaining access to justice issues and links with CFAs, contingency fees, DBAs, legal aid or other fees arrangements. There is also an issue of the linkage with existing or future insurance for litigation costs and moves both for control of costs and to influence future policy and development. For example, Lord Justice Jackson's December 2009 report into civil litigation costs recommends re-visiting the issue of statutory regulation of third party funders and the introduction of a voluntary code for all litigation funders. His proposed package of reforms, currently being implemented by the government, gives claimants a financial interest in the level of costs which are being incurred on their behalf, and will significantly reduce the costs payable to claimant solicitors by liability insurers. This research will consider third party litigation funding in the context of these fundamental reforms of the system in England and Wales.

This project follows on from research on the Funding and Costs of Litigation led by Professor Hodges, Professor Stefan Vogenauer and Dr Magdalen Tulibacka.[2]

## Sponsorship

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[2] C Hodges, S Vogenauer and M Tulibacka, *The Costs and Funding of Litigation: A Comparative Perspective* (Hart Publishing, 2010), see http://www.hartpub.co.uk/books/details.asp?isbn=9781849461023. For details of the research see http://www.csls.ox.ac.uk/european_civil_justice_systems.php.

## Project Research Team

The Research is being carried out jointly by the *Centre for Socio-Legal Studies* at the University of Oxford, the *Centre for Dispute Resolution Compensation and Risk* at the University of Lincoln. The project researchers are:

**Professor Christopher Hodges** – Head of the CMS Research Programme on Civil Justice Systems at the Centre for Socio-Legal Studies at the University of Oxford; Erasmus Professor of the Fundamentals of Private Law at Erasmus University, Rotterdam; Life member, Wolfson College, Oxford; and a Solicitor (admitted 1979, now non-practising). He has conducted research on civil justice systems (procedural and funding systems), multi-party actions (class actions and representative/collective actions), alternative dispute resolution (ADR), EU regulation of products, healthcare law, product liability and consumer law. He has been Chairman of the Pharmaceutical Services Negotiating Committee (2007-11), a Board Member of the UK Research Integrity Office (since 2008), a member of the Academic Advisory Panel of the Department for Business on consumer law (since 2001) and a Member of the Expert Working Group of the European Commission on Directive 85/374 on product liability (since 2004).

**Professor John Peysner –** a Solicitor and Head of the Law School at the University of Lincoln, and Honorary Visiting Professor at City University, London (2006). Professor Peysner had seventeen years experience in litigation practice, including Law Centres, Legal Aid and latterly, defending medical negligence. He has conducted research on case management, costs, civil procedural systems, legal aid, judicial education, consumer attitudes to solicitor's services and testing in house against contracted legal services. He was a member of the Lord Chancellor's Committee on Claims Assessors (The Blackwell Committee) and wrote the final draft of the report. He was a member of the Civil Justice Council and chair of its Costs Committee (2001 to 2006), a Member of the Civil Committee of the Judicial Studies Board (2003 to 2008) and an Academic Adviser to the Northern Ireland Legal Services Commission (2005 to 2008).

**Dr Angus Nurse** – Visiting Lecturer in Criminology and Criminal Justice and researches access to justice, restorative justice and environmental justice and green criminology at Birmingham City University. He was Research Fellow in Compensation Culture at Lincoln Law School from January 2008 to the end of September 2011, investigating the myths and reality of the compensation culture and issues relating to personal injury and other compensation claims. Angus was Investigations Co-ordinator for the Royal Society for the Protection of Birds (RSPB) from 1990 to 1997 and was the RSPB's Legal & Data Protection Officer from 1997 to 2000. He was an Investigator for the Commission for Local Administration in England (the Local Government Ombudsman) from February 2000 to February 2008. His other research interests include judicial review, and human rights (free speech and regulation of fieldsports activities). Together with Professor Peysner he has also researched representative actions and restorative justice mechanisms in consumer cases for the UK Government's Department for Business Innovation and Skills (formerly the Department for Business Enterprise and Regulatory Reform).

## Project Methodology

The methodology of this Project was to interview all main funders and interested parties, based on a scheme of research questions and interview templates. Those interviewed are listed in Appendix 1. The principal interviews took place in April and May 2010, with some over the following twelve months. Interviewees were also invited to provide additional comments in light of the Government's 2010/11 legislative proposals prior to the finalising of this report. The authors wish to thank all those who consented to be interviewed. No commercially sensitive or confidential information is included in this Report.

- **Funders**: we have interviewed seven funders or brokers based in the UK, and one in each of USA, Germany, Belgium, Ireland and Australia, as well as spoken informally to various others from those jurisdictions. All funders have been willing to talk about the types of cases they fund, although we have maintained confidentiality on a number of commercial matters discussed: the views of individual interviewees have not been disclosed and their business practices/models are not identified.

- **Consumer and Business Representative Groups**: interviews have been conducted with Which?, Consumer Focus, the Confederation of British Industry, the European Justice Forum, the Legal Services Board and the Solicitors Regulatory Authority.

- **Policymakers**: an initial interview with the Ministry of Justice (6 May 2010) indicated that litigation funding was not a policy priority at this stage although the MoJ exhibited interest in the research and have kindly agreed to assist in follow up research into aspects of Claims Management Regulation to be carried out by Dr Nurse.

The issues were discussed at a one-day conference held on Wednesday 19 May 2010 in Oxford, which was attended by leading litigation funding companies, policy makers, judges and practitioners.[3]

[3] A note of the conference is at http://www.csls.ox.ac.uk/documents/NoteoftheConferenceonLitigationCostsandFunding.doc

## 1. What is Litigation Funding?

At its most basic level, 'litigation funding' is any means through which funds are provided so that litigation can proceed. Much—almost all—litigation cannot be pursued or defended without funding being available to cover the various costs: court fees, and fees for lawyers and any experts that may be necessary. It should be noted that although under the English rule a successful litigant should be able to recover costs this does not necessarily mean full costs. Particularly, in commercial litigation despite the Woolf reforms (which were intended to introduce issue-based costs, i.e. recovery of winning issues within a broad brush approach to the overall result of the case) the ratio of recoverable to irrecoverable costs still tends to be 70: 30. However, the amount of money involved can often be both significant for a party to litigation and disproportionate to the (financial) value of the case.[4]

The term 'litigation funding' has, however, evolved to have a more specific meaning. Here, 'litigation funding'[5] is the practice by which *a private third party* provides money to enable a lawsuit to be pursued (or defended) in return for a financial reward.[6] That deliberately wide definition contrasts two other situations that are found. First, where a party does not fund his or her case personally, funding might be provided by the state (through legal aid) or from the party's lawyer, but the situation that is focussed on here is where funding is provided by an independent private third party. The various funding options are set out further below.

Secondly, that private third party does not make a donation, but provides funding in return for a financial reward. That financial reward might take various different forms, such as a specific flat fee, a percentage of the sum advanced, a percentage of the amount recovered, some others basis, or some combination of bases. These bases of remuneration are discussed further below.

### Litigation Funding in the context of all method of funding litigation

The sources of litigation finance that are theoretically possible, but may be unavailable or restricted in a jurisdiction, are:

1. A party's own funds
2. State funds – legal aid or legal assistance
3. Shared funds – trade union or professional body

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[4] C Hodges, S Vogenauer and M Tulibacka, *The Funding and Costs of Civil Litigation: A Comparative Perspective* (Hart Publishing, 2010). See also M Tuil and L Visscher, *New Trends in Financing Civil Litigation in Europe. A Legal, Empirical, and Economic Analysis* (Edward Elgar, 2010), including discussion of the 'rational apathy' problem of people who do not claim because costs are too high.

[5] In this report we have preferred the term 'litigation funding' to 'third party funding', which is also used. The principal reason for this preference lies in the British government's move towards a regime in which almost all litigation is privately financed, with very limited legal aid, as discussed below.

[6] This definition is wider than that suggested by J Beisner, J Miller S and Rubin, *Selling Lawsuits, Buying Trouble* (U.S. Chamber Institute for Legal Reform, 2009), who describe 'the practice of providing money to a party to pursue a potential or filed lawsuit in return for a share of any damages award or settlement.'

4. Own Legal Expenses Insurance (LEI) (including before-the-event 'BTE' LEI)
5. Own *post facto* LEI (after-the-event 'ATE')
6. Own lawyer – deferred payment, success fee, contingency fee, conditional fee arrangement ('CFA') or damages-based agreement ('DBA')
7. Third party.
8. Pure Speculation

Certain of these options deserve further explanation.

**LEI** is insurance for legal expenses to bring or defend litigation. Like all insurance policies, the terms on cover vary from supplier to supplier. Most LEI policies cover both the insured's own lawyers' costs and the risk of having to pay opponents' costs. Policies always set an upper limit of indemnity, so cover is not unlimited. LEI is commonly used when referring to BTE (see below).

**BTE (LEI)** insurance is purchased in advance of any claim arising, as protection against the risk of possible future costs of litigation. A policyholder would generally pay an annual premium that would cover him or her against the fees that would be incurred in instructing a lawyer (and possibly against liability in litigation for the costs of an opponent) in the event of an accident or incident giving rise to litigation. It is frequently sold as part of household or motor insurance cover. Jackson LJ commented that BTE is under-used in England and Wales and if used more widely could benefit SMEs and individuals.[7]

**ATE** is insurance that is purchased after-the-event of a legal claim, such as an accident, so provides protection against the costs and disbursements involved in litigation. ATE is primarily used as insurance against having to pay the opponents costs in the event of losing a case and is primarily used by those without BTE. Should a case be lost, the insurance company will meet the opponents' legal costs and expenses.

**CFA** is a conditional fee arrangement for paying a lawyer in relation to litigation, under which the lawyer receives a basic fee (usually tied to an hourly rate for time spent on work done) and, if the client is successful in the case, a success fee that is a percentage of the basic fee. The arrangement is subject to statutory and professional requirements, including that the percentage uplift must be proportionate to the risk involved in the case. If the case is unsuccessful, the lawyer usually receives no payment. In commercial cases there is normally not an uplift, but a reward that is the difference between discounted costs charged in any event and full costs charged on success.

**Contingency fee.** The American model of contingency fees is a similar 'no win no fee' arrangement to a CFA but simpler. The lawyer's total payment is an agreed percentage of the amount recovered. The English **DBA** (Damages Based Agreement) follows the same principle. In America, percentages payable can sometimes increase as a case proceeds.

[7] R Jackson, *Review of Civil Litigation Costs: Final Report* (London: The Stationery Office, 2009) para 3.1.

## TRADITIONAL POLICY RESTRICTIONS ON THIRD PARTY FUNDING: MAINTENANCE AND CHAMPERY

The law of a jurisdiction might prohibit or restrict one or more of the above sources, or there may be financial constraints on the availability of funds. Traditionally under common law, the involvement of a third party was illegal under the doctrine of champerty and its related concepts maintenance and barratry. A person is guilty of *maintenance* 'if he supports litigation in which he has no legitimate concern without just cause or excuse'[8] and of *barratry* if he stirs up quarrels or litigation, or persistently instigates lawsuits. *Champert*y occurs 'when the person maintaining another stipulates for a share of the proceeds of the action or suit.'[9] The common law prohibited champerty because of fears that it would increase litigation due to the involvement of those who might encourage frivolous or otherwise unmerited litigation solely for profit. [10]

In essence, the rules of champerty and maintenance were intended to retain the purity of the litigation process and to prevent speculation in litigation by those who have no interest in the legal process or the pursuit of justice, and whose activities might amount to an abuse of process.[11] The rationale includes a fear of perjury, especially in an adversarial system. It is not difficult to see the reason in times past for concern that oral or documentary evidence, as well as tactical decisions in litigation, would be subject to undue influence, or even fraud, if outside parties were to hold commercial stakes in outcomes. In the early stage of the development of litigation (and in criminal law) it was assumed that parties would routinely break their oath and that penalties for perjury were ineffective. The courts believed they were capable of identifying and controlling against the obvious biases of the parties themselves, but not against external and possibly less visible commercial influences. In Scotland and Northern Ireland, a lawyer is allowed to work on the basis of a speculation fee, but those systems remain underpinned by legal aid since the 1950s. In some jurisdictions, the model of contingency fees recognises the need for lawyers to be involved in order to be able to institute litigation.

However, the *Criminal Law Act 1967* abolished both the offences and torts of maintenance and champerty and of being a 'common barrator' within the UK, but expressly preserved the invalidity of champertous agreements, allowing champerty to survive as a rule of public policy.  A contract could, therefore, be ruled unenforceable as a matter of public policy if the champerty is not justifiable.[12] Nevertheless, the

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[8] *Chitty on Contracts* (28th edition (1999) Volume 1, paragraph 17-050).
[9] Ibid.
[10] For a discussion of U.S. concerns about increased litigation see P Rubin, *Third Party Financing of Litigation*, paper presented at Searle Center, Northwestern University Law School, (September 24-25 2009)
[11] For discussion of these concerns and the history of the law of champerty see M Radin, *Maintenance by Champerty*, 24 Cal. L. Rev. 48 (1935), EH Bodkin, *The Law of Maintenance and Champerty*, (London: Steven and Sons, 1935), AH Dennis, 'The Law of Maintenance and Champerty' (1890) 6 Law Quarterly Review 169, PH Winfield, 'The History of Maintenance and Champerty' 35 (1919) Law Quarterly Review50.
[12] Sections 13 and 14 of the Criminal Law Act 1967, see also the Court of Appeal's consideration of the position in *Regina (Factortame Ltd and Others) v Secretary of State for Transport, Local*

rules remain potent. *Dix v Townend*[13] in 2008 decided that where a lawyer had entered a CFA but ignored ATE, the arrangement was champertous and should be struck down.

A summary of the state of English law in 2008 by Coulson J[14] was approved by Jackson LJ in his Preliminary Report,[15] as follows:

"a) the mere fact that litigation services have been provided in return for a promise in the share of the proceeds is not by itself sufficient to justify that promise being held to be unenforceable: see *R (Factortame)Ltd v Secretary of State for Transport (No.8)* [2003] QB 381;
b) in considering whether an agreement is unlawful on grounds of maintenance or champerty, the question is whether the agreement has a tendency to corrupt public justice and that such a question requires the closest attention to the nature and surrounding circumstance of a particular agreement: see *Giles v Thompson*;
c) the modern authorities demonstrated a flexible approach where courts have generally declined to hold that an agreement under which a party provided assistance with litigation in return for a share of the proceeds was unenforceable: see, for example, *Papera Traders Co Ltd v Hyundai (Merchant) Marine Co Ltd (No.2)* [2002] 2 Lloyd's Rep 692;
d) the rules against champerty, so far as they have survived, are primarily concerned with the protection of the integrity of the litigation process in this jurisdiction: see *Papera*."

Even if maintenance and champerty are no longer crimes nor a bar to recovery of costs under the English rule, the nature of funding has important consequences. A commercial funder contractually or through a court order is likely to become liable for an opponent's costs. Beisner et al. suggest that third party litigation funding—in the context at least of the United States of America—could result in 'litigation abuse' by allowing speculative or weak litigation to proceed with the aim of pressuring the opposition into a settlement from which the funder receives a share. Motive is thus an important factor in determining whether an agreement fails within the definitions of maintenance and champerty. The Privy Council, in an 1860 decision argued that '[champerty and maintenance] must be something against good policy and justice, something tending to promote unnecessary litigation, something that in a legal sense is immoral.'[16] It is clear from our interviews and from the development of the law (discussed below) that maintenance is the main concern of 3rd party funders. The continued survival of champerty simpliciter is unlikely given the extensive range of different funding models outlined in this report and in the new bill. It is realistic that maintenance is more of a problem to the administration of justice as compared to an arrangement for the straightforward share of the proceedings of litigation agreed in advance. Issues as to the day-to-day ordering decisions in the litigation, which witness to use, which document to disclose are crucial. Financing litigation is, by itself, not sufficient to constitute maintenance and similarly the fact that there may be an agreement to finance litigation in return for a share of the proceeds is not

*Government and the Regions (No 8)* 2002 EWCA Civ 932 (CA on 3rd July 2002, reported at TLR 9th July 2002)
[13] *Dix v Townend and Frizzell Financial Services* [2008] EWHC 90117 (Costs).
[14] *London & Regional (St George's Court) Ltd v Ministry of Defence* [2008] EWHC 526 TCC, 103, following Underhill J in *Mansell v Robinson* [2007] EWHC 101. For more history see R Mulheron and P Cashman, 'Third-Party Funding of Litigation' (2008) 27 *CJQ* 312.
[15] R Jackson, *Review of Litigation Costs. Preliminary Report* (The Stationery Office, 2009), at http://www.judiciary.gov.uk/Resources/JCO/Documents/jackson-vol1-low.pdf
[16] *Fischer v Kamala Naicher* [1860] 8 MOO IND APP 170

automatically champerty. Some evidence of an improper motive whether it be malicious, vexatious litigation, causing delay or abuse of process or some other form of impropriety would need to be present.[17] The intent and actions of the third party funder are, therefore at issue in determining whether third party financing is permissible under UK law in a particular case. The perceived involvement of third party funders in influencing or directing legislation thus deserves some scrutiny in defining what third party litigation funding is.

[17] *Buday v. Location of Missing Heirs Inc* [1993] 16 O.R. (3d) at 262

## 2. The Development of Litigation Funding in England and Wales

Litigation funding by third parties is an almost inevitable consequence of developments in methods of funding litigation, aimed at resolving the problem of securing access to justice for those unable to afford their own litigation costs. As well as securing access to justice for individual citizens and smaller companies third party funding performed a valuable function for those entities wishing to transfer part of their risk (and contingent reward) to a third party as part of the risk management profile. At one level it plays to the development within modern British business to outsource functions as in return for reducing the exploitation of those workers in return for profit the business reduces the contingent risk of the particular activity involved (potential health and safety claims by employees etc) and transfers the surplus value to a third party. In principle the sharing and management of risk could also work in relation to individual litigation as indeed it does in the USA. However, because of asymmetry of information and the fact that most individual citizens are not repeat players then this model isn't really suitable.

While the current litigation funding industry in the U.K. is primarily focused on funding commercial litigation (discussed in more detail later in this report) the acceptability and regulation of litigation funding owes a debt to social or community legal aid and its development as a result of changes in policy, and initiatives aimed at solving practical problems in the distribution of litigation funding. In order to understand the development of current litigation funding mechanisms, it is necessary to consider first the history of important developments in some other methods of funding and, secondly, the relevant international developments. These aspects will now be considered in this and the following chapter.

### A SELECT HISTORY OF FUNDING ISSUES IN ENGLAND AND WALES

#### Introduction: The Welfare State Legal Aid Experiment and its Demise

A fundamental principle of the U.K. constitution is that everyone is equal before the law.[18] This includes ensuring that everybody has access to law irrespective of means or status, including access both to initiate and defend legal court action (in principle at least). Legal aid was introduced into the U.K. in 1949 with the aim of providing government funding to help people gain access to the courts, when they might otherwise have been unable to do so.[19] As a matter of policy, legal aid was intended to help as many people as possible (subject to eligibility requirements) and, in theory at least, provided help for a range of legal problems including debt, legal advice at police stations and representation at court. Legal aid was theoretically available for a range of civil legal problems, providing a means for people to pursue legal action where the costs involved would otherwise prevent them from doing so. As an element of social policy, legal aid was intended to be made available only to those who needed

[18] AV Dicey, *Introduction to the Study of the Law of the Constitution* (Indianapolis: Liberty Fund, Eighth Edition, 1982).
[19] Legal Aid and Advice Act 1949.

such funding. A potential claimant would have their claim assessed according to both the merits of the claim and means testing so that the assessment would consider the reasonableness of their claim and their level of (disposable) income; to receive funding, a claimant would have to pass both these tests. However, qualifying for legal aid did not automatically mean that a claim would be cost free as some of the cost of a case could be demanded from a claimant in certain cases, providing a disincentive for some claimants to pursue cases via legal aid.

The *Legal Aid Act 1988* brought responsibility for legal aid under central Government and led to the establishment of the Legal Aid Board. The Board was abolished by the *Access to Justice Act 1999*, which established the Legal Services Commission and modified legal aid provision. Civil legal aid became part of the Community Legal Service (CLS) and criminal legal aid became the Criminal Defence Service (CDS). Firms wishing to carry out legal aid work were required to have a contract with either the CLS or CDS, and the Act also placed a cap on the amount of money that could be spent on legal aid.

While its principles were to provide funding for those most in need, legal aid was, subject to significant problems, not least a fall in its coverage towards the end of the 20th Century, as caps on eligibility failed to keep in step with rises in the costs of the legal system (principally lawyers' costs). Griffith (2008) suggests that 'eligibility levels for civil legal aid nearly halved between 1998 and 2007, with a particularly sharp decline between 2005 and 2007' so that according to the Ministry of Justice's (MoJ) estimates, only 29 per cent of the population of England and Wales was eligible for civil representation by 2009.[20] Legal aid is also expensive to run, with some estimates putting the annual cost at £2 billion a year for England and Wales,[21] although this is a modest proportion of the overall Government budget. Most of the expense of legal aid comes from crime and very little money has been saved by changes in the civil legal aid fund, as legal aid has traditionally acted as a bank.

Reliance on legal aid has come under criticism and restrictions in other jurisdictions. Recent academic analysis[22] has suggested that legal information, and easy access to a neutral forum, are more cost effective, and more likely to enhance self reliance on the market for justices services, and more likely to lead to legal empowerment. Most [money] should be spent on legal information and improving court procedures. The remainder is probably best spent on specific pockets of needs for legal aid (criminal defence, public interest litigation). However, investments in procedures for the common legal problems of the poor and legal information have to be carefully monitored.

Policy changes and cuts in the legal aid budget have also caused problems both for those relying on legal aid as a funding mechanism and practitioners wishing to carry out CLS or CDS work. The Alliance for Legal Aid has argued that cuts in legal aid

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[20] A Griffith, *Dramatic Drop in Civil Legal Aid Eligibility* (Legal Action, 2008).
[21] J Robins, *Legal Aid in 21st Century Britain*, The Guardian Online at http://www.guardian.co.uk/money/2009/mar/11/legal-aid-justice-gap accessed 23 September 2010
[22] M Barendrecht, 'Legal aid, accessible courts or legal information? Three access to justice strategies compared', (2011) *Global Jurist* Vol. 11: Iss. 1 (Topics), Article 6; and TISCO (Tilburg Institute for Interdisciplinary Studies of Civil Law, and Conflict Resolution Systems) Working paper No 24/2010.

funding have meant that there has been an overall reduction in legal aid providers, and that fixed fees for all non-crime work means that the longer and more complicated a case the less a firm will earn, providing a disincentive to take on legal aid work. Changes to personal injury legal aid, such as its withdrawal except for infant cases and clinical negligence. The reality is, thus, that there are now some areas where the availability of legal aid assistance is limited.

In April 2011 the Government consulted on further reductions to the legal aid budget and announced significant reductions in legal aid funding.[23] The Government's proposals should be seen in the context of a proposed 23 per cent cut in the Ministry of Justice's budget and acknowledgement that economic pressure is the principal driver of reform. However, the consultation document also suggested that legal aid has expanded beyond its original social remit and that it should no longer be available for certain categories of action. The consultation explained, for example, that public funding will not generally be available for claims which purely seek financial compensation, for private family law matters (excluding domestic violence), or for clinical negligence claims. The consultation document also confirmed the Government's view that legal aid should not be provided where alternative sources of legal advice are available, where an alternative dispute resolution (ADR) mechanism such as an Ombudsman exists, or where legal advice although desirable from a consumer point of view is not actually essential in order to pursue a claim.[24] The reduction in the availability of legal aid for certain types of claim will thus require claimants to be aware of alternative sources of advice and information and could impact on the ability of some claimants to pursue cases, notwithstanding the existing eligibility issues and their negative impact on some claims activity. However even though legal aid may not be available for all types of litigation, other mechanisms have been used to provide access to justice where a claimant has had difficulty meeting the upfront costs of their legal action.

## The Introduction of Conditional Fee Arrangements

By the 1980s, many of the population, referred to popularly as 'middle income not available for legal aid' (MINELAs), could not afford lawyers' hourly rates to bring or defend their rights. Rather than extending legal aid (which was by them subject to creeping restrictions in both budgets and scope), Conditional Fee Arrangements (CFAs) were introduced by the *Courts and Legal Services Act 1990* as the government's response to the denial of access to justice problem. Contingency fees remained prohibited:[25] CFAs were a regulated exception to that general prohibition. CFAs allow a solicitor to take a case on the understanding that if the case is lost he will not charge his client for the work he has done. However, if the case is successful, the solicitor can charge a success fee on top of his normal fee to compensate him for the risk of not being paid. That success fee is calculated as a percentage of his normal fee and the level at which the success fee is set reflects the risk involved. The success

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[23] Ministry of Justice, *Proposals for the Reform of Legal Aid in England and Wales, Consultation Paper CP12/10* (November 2010).

[24] Ibid, for example para 4.173-5 which explains that although legal advice is currently available to those wishing to pursue claims to bodies like the Criminal Injuries Compensation Authority, it is not strictly necessary as the process is considered to be a relatively straightforward one.

[25] Solicitors Act 1974, s 59; Solicitors' Code of Conduct 2007, Rule 2.04.

fee is recoverable from the losing side. Prior to the changes under the *Access to Justice Act 1999*, any success fee was payable by the claimant (limited by professional rules to no more than 25 per cent of damages recovered). This fee is often referred to as an 'uplift'. Claims brought under a CFA are often underpinned by 'after the event' insurance (ATE insurance, see further below). This is an insurance policy that the claimant can take out after an accident has happened, but before (or in the course of) making a claim. The benefit of ATE insurance for the claimant is that, if he loses, the insurance company will pay the defendant's legal costs and expenses.

In oral evidence to the Select Committee on Constitutional Affairs, Anna Rowland of the Law Society suggested that CFAs would allow greater access to justice for those on middle incomes who were not eligible for legal aid:

> [T]he eligibility rates for legal aid are now very low, whereas CFAs have opened up the possibility of getting redress for middle-income people who would have had no hopes of getting legal aid and they would not have had enough money to fund the case themselves, so there is a whole tranche of people who had no access there who will now be getting access.[26]

However, critics of CFAs argue that, rather than achieve access to justice, they created a situation where 'cases can be opened with very little risk to claimants and the threat of very substantial costs to defendants.'[27] In April 2011, the coalition government argued that CFAs promote frivolous litigation, and that many cases are being pursued that should not go to court. As a result, their civil justice reforms suggest some reforms to the CFA and costs system[28] with the aim of diverting people from court action wherever possible.

## Development of Litigation Insurance

ATE arose in England and Wales from 1995 to insure claimants against the adverse costs risk that appeared when CFAs largely replaced legal aid. Premiums were initially paid for by the claimant through a reduction in damages, but the rules were changed in 1999 to make the full CFA fee and ATE premium recoverable from the defendant. That change was intended to facilitate CFA funding (and 'bed it down' into wide use). Instead, however, it provoked huge costs wars, in which insurers tried to reduce their exposure to the 'triple whammy' of normal costs, success fees and ATE premiums. The media industry has been particularly vocal in complaining against the combined disproportionate effect of having to reimburse CFA success fees and high ATE premiums. Allegations of settlement blackmail have arisen. ATE is inevitably expensive, since it operates with a limited pool of premiums from cases that all involve actual litigation, and a limited number of insurers. As explained below, the Jackson Review of 2010 signalled the retreat for the CFA plus ATE experiment.

LEI potentially provides a solution to the lack of legal aid availability and covers a wide spectrum of legal problems, although it is primarily used in cases involving car

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[26] House of Commons, *Select Committee on Constitutional Affairs: Third report*, (14 February 2006)
[27] Ministry of Justice, *Solving disputes in the County Courts: creating a simpler, quicker and more proportionate system*, Consultation Paper CP6/2011 (March 2011)
[28] Ibid.

accidents, the recovery of uninsured losses from third parties, damages for minor injuries and small consumer disputes.[29] LEI can fund both claimants and defendants.[30] In 2007 the MoJ concluded that LEI was underused and that many consumers did not fully understand the availability of LEI, it's potential for use in their legal disputes or have understanding of their LEI cover where it had been provided. The MOJ recommended that both consumer and industry groups needed to do more to communicate the benefits of LEI to consumers and that there should be an extension of the LEI product to include employer provision of LEI to employees and housing association provision of LEI to tenants.[31] Consumer Focus, however, concluded that there are low levels of satisfaction with LEI.[32] Their research showed that only 48 per cent of those who had successfully used LEI were satisfied with the product and 37 per cent thought the claim process took too long.

## The Costs War

Lord Justice Jackson has commented that litigation over costs has increased substantially in recent years.[33] The initial pre-1999 CFA regime allowed lawyers to make CFAs with their clients and charge success fees. The result of this change in the way litigation was funded was that losing parties, usually backed by large liability insurers, found themselves liable to pay, not only the normal costs of the litigation, but also a success fee which could be up to 100 per cent of the solicitor's profit costs and counsel's fees, and also an ATE insurance premium. While this scheme arguably increased access to justice by allowing those who could not typically afford lawyers' fees to enter into agreements without requiring excessive capital to pursue a case, the eventual fees involved could be out of all proportion to the damages claimed.

The introduction of CFAs with recoverability of success fees and ATE insurance premiums materially increased the contingent cost liability of defendants (normally insurers). In a series of cases insurers challenged the contractual basis of the retainer between clients and their solicitors which was the basis for the recovery of normal costs and additional items i.e. success fees and ATE insurance. (Exploiting the indemnity principle). Insurers were successful in such technical challenges then no costs could be recovered at all. War was declared. The Civil Justice Council concluded that 'the 'costs war' broke out because a considerable extra financial burden had been passed to the liability insurance industry when success fees and ATE

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[29] Financial Ombudsman's Service, *Ombudsman News*, Issue 26 (March 2003)

[30] WH van Boom, 'Juxtaposing BTE and ATE. On the role of the European Insurance Industry in funding civil litigation' Rotterdam Institute of Private law, Working paper, (2010) available at http://ssrn.com/abstract=1544145.

[31] The MOJ concluded that although 59% of the population had some form of legal expenses insurance, less than one in four consumers had ever heard of BTE or ATE insurance and lacked knowledge of the cover that they had. See *The Market for 'BTE' Legal Expenses Insurance* (Fwd Thinking Communications, 2007) http://www.justice.gov.uk/publications/docs/market-bte-legal-expenses-insurance.pdf accessed 25 October 2010.

[32] L Bello, *In Case of Emergency: Consumer Analysis of Legal Expenses Insurance*, (Consumer Focus, 2011).

[33] For a summary of the costs war see Chapter 3 of R Jackson, *Review of Litigation Costs. Preliminary Report* (The Stationery Office, 2009), at http://www.judiciary.gov.uk/Resources/JCO/Documents/jackson-vol1-low.pdf.

premiums had been made recoverable, and there was no transparency as to the levels of success fee claimed or ATE premiums charged.[34]

## Lord Woolf and Access to Justice Concerns

Lord Woolf's *Access to Justice Report* (July 1996) had identified a number of problems with the civil justice system, namely:

(a) pursuing justice was too expensive as the costs often exceed the value of the claim;
(b) the civil justice process was too slow in resolving cases;
(c) the system was unequal so that the system favoured the powerful, wealthy litigant and the under resourced litigant;
(d) the difficulty of predicting the costs of litigation and how long it will last makes the system unpredictable and induces the fear of the unknown;
(e) the legal system was incomprehensible to many litigants;
(f) the system is complex and fragmented because there was no one with clear overall responsibility for the administration of civil justice; and
(g) the system was too adversarial as cases are run by the parties, not by the courts and the rules of court, all too often, are ignored by the parties and not enforced by the court.

Lord Woolf particularly identified that litigation was so expensive that the majority of the public could not afford it unless they received financial assistance. He concluded that fear of costs would prevent some people from litigating when they would be entitled to do so, and would also compel other litigants to settle cases when they did not wish to. The cost of legal action thus became a determining factor in litigation rather than the merits of the claim, and Woolf concluded that 'it enables the more powerful litigant to take unfair advantage of the weaker litigant.'[35] Woolf's analysis was thus prescient in highlighting that some form of litigation funding product would be necessary in cases where a potential litigant needed sufficient funds to maintain a case against a more financially powerful opponent.

Almost all of Woolf's recommendations were designed in part to tackle the problem of costs, and culminated in the *Access to Justice Act 1999*. The reforms in the *Access to Justice Act 1999* prepared the ground for the later abolition of legal aid for personal injury claims and modified the CFA model, allowing for the recoverability of insurance premiums and success fees.

Following this, a new breed of intermediaries, namely claims management or accident management companies, arose to carry out dispute resolution and recovery work, which was traditionally seen as law firm activity and in most jurisdictions could only be carried out by law firms. This market place was originally not regulated and produced the chaos of the rise and fall of Claims Direct and The Accident Group (TAG).

[34] Civil Justice Council, *Improved Access to Justice – Future Funding of Litigation* (2007).
[35] *Woolf, Access to Justice: Final Report,* By The Right Honourable the Lord Woolf, Master of the Rolls (July 1996).

### The Accident Group, Claims Direct, and Claims Management Problems

TAG and Claims Direct were two of the most prominent claims management companies that appeared after 1999, and between them began to dominate the market for personal injury claims.

TAG's business model was based around selling LEI primarily on a no-win, no-fee basis.[36] The claimant signed up for LEI and, if he won the case, then the cost of the insurance policy and a percentage of the claim was taken out and recovered by TAG. In interview for this research a former TAG employee explained that the policy was sold on the basis of the likely damages that the claimant would receive were calculated on an expected tariff that TAG worked to. The client paid nothing up front other than the cost of the policy. TAG generally worked on the basis of signing up claims that were worth £1,500 or above, since any claim below that level was unrealistic for TAG to pursue. Solicitors who were instructed to pursue the claims received a percentage of the damages but initially did not receive a fee; however, there is evidence that as the business model developed 'investigation fees' were charged.[37]

However, in 2003 TAG collapsed with reported debts of £100 million. Reasons given for the company's collapse include: inadequate screening of weak cases, fraudulent reporting of claims and problems with the company's referral process. Evidence suggests that the business failed to adequately ensure the viability of the claims that it pursued and failed to process a sufficient number of quality claims. From a consumer perspective, while such claims management companies represented a low or no cost mechanism for pursuing a claim, the business models in operation at the time meant that in extreme cases the claimant could be successful in their case yet see the majority of his settlement negated by excessive fees. BBC News, for example, reported in June 2004 on a number of cases where successful claimants had ended up in debt as a result of interest on the loans they had taken out in pursuing their claims, excessive insurance premiums and hidden or non-obvious additional fees.[38]

While it is not the scope of this report to deal in detail with the collapse of TAG, the original Claims Direct or other claims management companies, these incidents highlight the potential problems of an unregulated business model for litigation funding (albeit a model that is significantly different from the models currently in use and considered by this report) and problems that can be caused by lack of capital adequacy. In October 2004, The Telegraph reported that around 500 law firms would

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[36] However, the Daily Telegraph has reported that TAG supplied claimants with a personal loan provided by banks, normally HBOS or First National to buy their LEI and that the loans [which varied in size between £900 and £2,000] were frequently only worth a fraction of the price of the loans. The Telegraph claims that TAG booked the difference between the value of the loan and the cost of the insurance premium as profit. See *This Disaster was no Accident* at http://www.telegraph.co.uk/finance/2854197/This-disaster-was-no-Accident.html (accessed 15 September 2010.)

[37] P Aldred, (2004) *No win, no fee lawyers must repay £50m*, The Telegraph online, (14 October 2004) at http://www.telegraph.co.uk/finance/2897112/No-win-no-fee-lawyers-must-repay-50m.html (accessed 15 January 2011).

[38] P Abrams, *'No win no fee' catch leaves poor in debt*, BBC News Online (22 June 2004) – Available online at http://news.bbc.co.uk/1/hi/uk/3827419.stm (accessed 15 January 2010).

have to pay back the TAG investigation fee, which was, in reality, a referral fee paid by lawyers to TAG.[39] The Court of Appeal subsequently declared this fee to be unlawful and the Law Society concluded that it should be repaid.

Problems also arose over the operation of ATE insurance. One insurer sued 89 of its panel firms of solicitors for negligence and breach of contract in accepting some 26,000 claims where it had delegated the right to accept cases for such insurance provided the prospects of success were at least 51 per cent and the damages awardable at least £1,000.[40]

Complaints and public concern about the actions of claims management companies, and about an alleged 'compensation culture', eventually resulted in action by the Government to regulate the sector.

## The Compensation Act 2006

Regulation of claims management companies was introduced from April 2007 under the *Compensation Act 2006*, after the TAG and Accident Line scandals gave rise to a need for significant consumer protection. The MoJ introduced a regulatory regime for claims management companies under Part 2 of the *Compensation Act 2006*, which required them to register and pay a not insignificant level of registration fees.[41] The fees vary with turnover: the application fee varies from £450 to £900, and the annual fee from £100 to £25,000.

With effect from 23 April 2007 it became an offence for businesses to offer claims management services in regulated areas without authorisation. Almost any activity relating to claims management, from simply referring claims through to representing clients, is covered by the Act and requires that the company or individual to be registered in accordance with the scheme administered by the MoJ.[42] Regulation applies to a wide range of claims including 'personal injury, criminal injuries compensation, Industrial Injuries Disablement Benefit, employment, housing disrepair and financial products and services.'[43] The Act also specifies certain activities as requiring registration namely:

(a) **advertising** for, or otherwise seeking out (for example, by canvassing or **direct marketing**), persons who may have a cause of action;
(b) **advising a claimant** or potential claimant in relation to his claim or cause of action;
(c) **referring details of a claim** or claimant, or a cause of action or potential claimant, to another person, including a person having the right to conduct

[39] P Aldred, *No win, no fee lawyers must repay £50m*, The Telegraph online, (14 October 2004) at http://www.telegraph.co.uk/finance/2897112/No-win-no-fee-lawyers-must-repay-50m.html (accessed 15 January 2011).
[40] *Axa Insurance Ltd v Akther & Darby Solicitors* [2009] EWHC 635 (Comm).
[41] *Claims Management Regulation. Fees Determination 2010-2011* (Ministry of Justice, 2009).
[42] The regulatory unit sub-contracts some functions to Staffordshire County Council, and works with other regulators such as the Office of Fair Trading, police services and the Insurance Fraud Bureau.
[43] Ministry of Justice, *Claims Management Service Regulation: Who needs to be authorised under the Compensation Act 2006*, London: Ministry of Justice (Ministry of Justice Guidance Note July 2009)

litigation (but not if it is not undertaken for or in expectation of a fee, gain or reward);

(d) **investigating**, or commissioning the investigation of, the circumstances, merits or foundation of a claim, with a view to the use of the results in pursuing the claim;

(e) **representation of a claimant** (whether in writing or orally, and regardless of the tribunal, body or person to or before which or whom the representation is made).

Legal practitioners are exempt from the requirement to register if acting in accordance with their normal business practices and subject to professional rules. However, where a legal practitioner has established a separate corporate body, for example to market its services or to provide an administrative function in respect of case or claim management, this would not be exempt.

The MoJ stated in 2007 that 'personal injury claims cost around £6 billion a year, motor accounting for nearly 70%, employer's liability for 20% and general liability for 10%.'[44] The review of the market (carried out by the Ministry's predecessor, the Department for Constitutional Affairs ('DCA')) also concluded that solicitors would pay around £600 for a good personal injury case. The DCA 2007 baseline study suggested that there were around 1,000 intermediaries in the market (mainly claims management specialists, but also over 200 accident management companies) and that the annual turnover was around £190 million. As of September 2010, there were 3,305 authorised businesses registered on the Claims Management Regulation database.[45] That figure has grown significantly since regulation was introduced,[46] although over 450 businesses that paid the application fee for authorisation chose not to pursue their applications, and over 650 businesses voluntarily surrendered their authorisation.[47] A 2011 review concluded that regulation had effectively dealt with overt malpractice in the market for claims management services at a very modest cost (£2.3 million in 2009/10).[48] A Better Regulation Executive review concluded that: "Claims management regulation is a good example of how regulation can be introduced quickly, efficiently and at low cost, with the support of the industry concerned, to protect consumers."[49]

Regulated claims management companies are likely to enter the market to provide a broader range of dispute resolution services. Rather than just acquiring and farming out cases to law firms for a referral fee, they will acquire cases and then carry out the work themselves. While, this would initially have to be done under the supervision of an externally regulated lawyer, it would allow, as it does now, a range of different

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[44] *Claims Management Services Regulation: Baseline Study*, Department for Constitutional Affairs, April 2007.
[45] This figure does not include companies who have cancelled their registration, had it suspended or surrendered their registration.
[46] According to Ministry of Justice figures from July 2009, the number of authorised businesses increased from 951 in June 2007 to 1,778 in July 2008, 2,456 in January 2009 and 2,928 at 30 May 2009.
[47] M Boleat, *Claims Management Regulation. Impact of Regulation. Third Year Assessment* (Ministry of Justice, 2010), available at http://www.justice.gov.uk/publications/docs/cmr-impact-assessment-0710.pdf.
[48] Ibid.
[49] *Better Regulation, Better Benefits: Getting the Balance Right Case Studies*, (BIS, 2009).

models, employing high levels of gearing with a small qualified legal staff running a large operation of paralegals tied in to an all-pervasive and powerful case management system.[50] The aim of the *Compensation Act 2006* is to control the activities of claims management companies and to provide for a level of scrutiny. The Government argues that 'the claims management sector needs to be subject to direct regulation to tackle the bad practices of some companies including misleading marketing, high pressure selling, unfair contracts, poor customer services, outright scams and fraud.'[51] The DCA's Baseline Study identified five main problems with the pre–*Compensation Act 2006* claims management industry; misleading advertising; improper acquisition of business; opaque contracts; cases being run for the benefit of the intermediary not the client; and fraud.[52]

The Claims Management Regulation Unit in the MoJ sub-contracts some functions to Staffordshire County Council, and works with other regulators such as the Office of Fair Trading, police services and the Insurance Fraud Bureau.[53] The 2009 annual report of the MoJ's regulatory unit[54] announced that significant improvements had been made in market practice, including:

- significant reduction in cold calling (organised cold calling having been stopped);
- unauthorised marketing in hospitals has been virtually eliminated;
- previous widespread misleading use of the expression "no win no fee" by companies in marketing or contracts has been addressed;
- websites have been brought into compliance with conduct rules;
- improved transparency of fees and services;
- removing unfair terms in contracts;
- tackling misleading advertising and marketing of services related to challenging consumer credit agreements.

The MoJ 2009 review of the impact of claims management regulation, two years after the Act was introduced, concluded that while misleading advertising, organised cold calling and unauthorised marketing in hospitals had largely been dealt with, 'a different type of cold calling – through call centres – has emerged which is proving difficult to deal with. And misleading advertising has been replaced by misleading information being given in sales calls.'[55]

[50] Jackson suggests the de-skilling of calculations of personal injury by moving to a system of agreed software to calculate general damages, which will fit well into this system.
[51] Ministry of Justice, Claims Management Regulation: Annual report 2009/2010, London, Ministry of Justice (July 2010).
[52] *Claims Management Services Regulation: Baseline Study*, Department for Constitutional Affairs, April 2007.
[53] See *Claims Management Companies and Financial Services Complaints. A joint note from the Claims Management regulator (the Ministry of Justice), the Financial Services Authority, the Financial Ombudsman Service and the Financial Services Compensation Scheme* (Ministry of Justice, FSA, FSCS and FOS, 2011).
[54] *Claims Management Regulation. Annual Review 2008/2009* (Ministry of Justice, 2009).
[55] M Boleat, *Claims Management Services Regulation: Impact of Regulation Assessment -Update*, Ministry of Justice (July 2009).

Businesses authorised under the *Compensation Act 2006* are subject to a range of statutory conditions, including compliance with conduct rules geared firmly towards consumer information and safeguards. Businesses that do not comply with the conditions of authorisation, including conduct rules, are subject to appropriate enforcement action which includes; refusal, suspension or withdrawal of authorisation. Conditions can also be attached to an authorisation where there. Regulatory audits can also be used to investigate compliance with the rules and to determine how businesses operate and businesses can be required to provide information or take remedial steps after an audit.

Litigation funding has thus developed in the context of an environment where the principle of claims management has been established and is now regulated by the MOJ. Concerns about maintenance and champerty notwithstanding, third parties are actively involved in the handling of a range of everyday claims. Litigation funding, however, has developed to provide a means of funding larger claims and the courts (and the Civil Justice Council) have considered the involvement of professional funders who have entered the market.

## The Civil Justice Council Reports 2005 and 2007

The Civil Justice Council ('CJC'), an Advisory Public Body established under the Civil Procedure Act 1997 and with responsibility for overseeing and co-ordinating the modernisation of the civil justice system, is broadly positive towards litigation funding and views it as an effective future means of providing access to justice, alongside contingency fees.[56]

The CJCs second report in June 2007, shortly after the Australian *Fostif* decision,[57] concluded that third party funding should be recognised as an acceptable funding option for mainstream litigation.[58] The CJC noted that third party funding had at that time already become established in England and Wales following the decision in *Arkin*, in which the Court of Appeal examined the issue of third party litigation funding in detail.[59] Mr Arkin was a claimant without means who alleged breaches of competition law by Borchard lines and others whom he claimed had caused the collapse of his shipping company BCL Shipping Line (BCL). Arkin commenced litigation against Borchard Lines and others claiming that they had acted collectively to abuse a dominant position by unlawful predatory price fixing. Arkin had initially obtained legal aid but this was withdrawn shortly after he commenced proceedings. He had no funds to pursue his proceedings but was able to persuade his lawyers to act for him on a CFA. He was also able to obtain funding from a professional funder, MPC, for the payment of expert fees and other disbursements. The agreement was that MPC would only be paid if the claim succeeded, in which case they would

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[56] See R Moorhead and P Hurst, *"Improving Access to Justice" Contingency Fees. A Study of their operation in the United States of America. A Research Paper informing the Review of Costs* (Civil Justice Council, 2008).

[57] *Campbell v Cash & Carry Pty Ltd v Fostif Pty Ltd Mobil Oil Australia Pty Ltd v Trendlen Pty Ltd* [2005] NSWCA 83. See ch 3 below.

[58] The Civil Justice Council, *The Future Funding of Litigation – Alternative Funding Structures* (June 2007).

[59] *Arkin v Borchard Lines Ltd & Ors* [2005] EWCA Civ 655 (26 May 2005).

receive a share of the damages recovered. MPC took no part in decision-making in Arkin's case, but their consent was required in the event of settlement or compromise.

Arkin's claim failed and his lawyers recovered nothing. The defendants sought their full costs from MPC and the Court concluded that a professional funder, who finances part of a claimant's costs of litigation, should be potentially liable for the costs of the opposing party to the extent of the funding provided. However the Court also gave tacit approval to litigation funding stating:

> "If a professional funder, who is contemplating funding a discrete part of an impecunious claimant's expenses, such as the cost of expert evidence, so to be potentially liable for the entirety of the defendant's costs should the claim fail, no professional funder will be likely to be prepared to provide the necessary funding. The exposure will be too great to render funding on a contingency basis of recovery a viable commercial transaction. Access to justice will be denied."[60]

MPC were ordered to pay £1.3 million as a contribution to defence costs rather than the full £6 million costs, thus their support for Arkin's claim cost £1.3m for no return. The CJC subsequently concluded that third party funding should be encouraged subject to the constraints set out in *Arkin* and the introduction of suitable regulation of commercial third party funders. The CJC recommended that appropriate rules of court should be introduced so that third party-funding can be 'effectively regulated and rigorously controlled by the courts'. Alternatively, it suggested that regulation through the financial services regulation system or the *Compensation Act 2006*'s claims handling process could be appropriate to third party funding. The CJC concluded that regulation should ensure consumer protection and retain the integrity of the lawyer and client relationship, and clients' control of their litigation. Regulation of the current litigation funding market is discussed at chapter 9 below.

## Restricting CFAs and Contingency Fees

Conditional Fee agreements could only be used in courts, where costs (and the success fee) could be recovered. Thus, they were not available outside litigation, i.e. in employment tribunals and the tax chamber. However, the needs of access to justice and the market promoted the increased use of an alternative model: the contingency fee. In this type of no win no fee model, the lawyer's reward is not an increase in the normal fee but a pre-determined cut of compensation recovered. No success, no recovery, no reward. These agreements were not creatures of statute and were not regulated, and were regarded by government as of little interest compared to the travails of CFAs. Their increasing use brought them more into the policy arena, and under a new term of art – Damages Based Agreements – they became regulated. (The term 'Damages Based Agreements' was possibly coined to spare the blushes of the judiciary, who dislike the concept of contingency fees and the implication of U.S. style aggressive claimant lawyers.)

[60] *Arkin v Borchard Lines Ltd & Ors* [2005] EWCA Civ 655 (26 May 2005), para 40.

However, in July 2009 the government initiated a consultation on regulating DBAs[61] stating:

‘There is a clear and growing body of recent evidence that highlights concerns about consumer protection issues for claimants using Damages Based Agreements (DBAs). The research points to particular concerns about:

1) a failure to inform claimants of alternative methods of funding their claims; and
2) a lack of clarity and understanding of fee arrangements and the likely costs which claimants have to pay.

The Government proposes to regulate to address these issues ... We believe that there is a strong case for taking these steps now. It is clear that a significant number of claimants in Employment Tribunal cases – many of whom are of modest means, and unfamiliar with legal proceedings – are not given proper information by their representatives. This prevents claimants from making the best decisions about the handling of their claims, and having a fuller understanding of the likely costs implications for them of pursuing a claim.’

The government’s consultation paper sought views on statutory regulation of DBAs (contingency fees) and explained that:

‘Concerns have been growing around the potential for consumer detriment in the absence of a statutory framework for regulating DBAs. There is evidence that many do not understand these fee arrangements that could sometimes include terms that might be unfair to consumers. The Government believes that a statutory framework for regulating these agreements would help provide a level playing field between consumers and representatives and remove the unfairness to consumers that can otherwise exist.’

The *Coroners and Justice Act 2009* was brought into force in November 2009,[62] and included

- a regulatory framework for DBAs in employment disputes, subject to detailed Regulations to be made by the Lord Chancellor;
- powers for the Legal Services Commission, which controls (residual and limited) public funding to introduce pilot schemes and pilot provisions, thereby testing innovative ideas on funding, sometimes on a local basis.

The government subsequently introduced *The Damages-Based Agreements Regulations 2010*,[63] which came into force in April 2010 and regulated the use of DBAs in employment tribunal work. The regulations prescribe the formal regulatory requirements with which an agreement between a client and his or her representative must comply so as to enable it to be a damages-based agreement relating to an employment matter under section 58AA of the *Courts and Legal Services Act 1990*. Importantly, the Regulations specified that the amount of the payment to the lawyer must not exceed 35 per cent of the sum recovered by the client. This sets an important

[61] *Regulating Damages Based Agreements*, Consultation Paper 10/09 (Ministry of Justice, 2009) available at http://www.justice.gov.uk/consultations/docs/regulating-damages-based-agreements.pdf
[62] http://www.opsi.gov.uk/acts/acts2009/pdf/ukpga_20090025_en.pdf
[63] The Damages-Based Agreement Regulations 2010/1206 at http://www.opsi.gov.uk/si/si2010/pdf/uksi_20101206_en.pdf. See Practice Note at http://www.lawsociety.org.uk/productsandservices/practicenotes/damagesbasedagreements.

public policy baseline in relation to ongoing issues over the level of fees paid to third party funders or lawyer funders.

In January 2010 the government also proposed to reduce the maximum 'success fee' that may be charged in defamation proceedings funded under conditional fee agreements from 100 per cent to 10 per cent of base costs.[64] This proposal was stated to reflect the Government's commitment to reducing the impact of high costs in defamation cases and was intended to complement changes introduced on October 1, 2009 to control the costs of individual cases. However, the proposal was dropped just before the general election.[65]

From 2010, therefore, the DBA became the statutory term for a regulated contingency fee.[66] A DBA is similar to a CFA in permitting a regulated success fee, but different in that the success element is calculated by reference to the damages awarded. From 2011, DBAs were extended to general litigation (see below).

## The Jackson Costs Review 2010

Lord Justice Jackson was appointed by the Master of the Rolls to undertake a major review of the costs provisions in all types of civil litigation, since there was widespread concern that costs were too high and disproportionate. Whilst the Woolf reforms of civil procedure solved problems of delay, they shied away from effective cost control through fixed costs and budgeting and, although some of these deficiencies were met by solutions mediated by the CJC (such as the fixed cost Road Traffic scheme), the picture was unsatisfactory overall. Inevitably, such a review had to look at the available methods of funding litigation. In his 2010 *Review of Civil Litigation Costs*,[67] Lord Justice Jackson proposed that CFA success fees and ATE premiums should no longer be recoverable from defendants. The idea was that cost shifting of the additional items (success fee and ATE) would revert to its pre- 1999 status and, unlike normal costs, they would not be recoverable. To suppress what was felt to be the unnecessary purchase of ATE insurance in personal injury cases, claimants would be protected against having to pay defendants' costs except in exceptional circumstances where, for example, a claimant had failed to beat an offer to settle (i.e. Qualified One Way Cost Shifting (QOCS)).ATE insurance would not be banned but the sector would be expected to shrink, and expand into BTE[68] or private funding products.

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[64] The text is available at http://www.justice.gov.uk/consultations/costs-defamation-proceedings-consultation.htm.

[65] C Baksi, 'Government abandons libel fee cut bid' (*Law Society Gazette*, 9 April 2010), 2. The prior consultation was at http://www.opsi.gov.uk/si/si2010/draft/pdf/ukdsi_9780111496510_en.pdf.

[66] 58AA of the Courts and Legal Services Act 1990, as amended by section 154 of the Coroners and Justice Act 2009.

[67] R Jackson, *Review of Civil Litigation Costs: Final Report* (The Stationery Office, 2010), at http://www.judiciary.gov.uk/about_judiciary/cost-review/jan2010/final-report-140110.pdf. See also R Jackson, *Review of Civil Litigation Costs: Preliminary Report* (The Stationery Office, 2009), at http://www.judiciary.gov.uk/about_judiciary/cost-review/jan2010/vol1-low.pdf, ('Final Report'). For commentaries see chs 7, 8 and 9 by J Peysner and C Hodges in C Hodges, S Vogenauer and M Tulibacka, *The Funding and Costs of Civil Litigation: A Comparative Perspective* (Hart Publishing, 2010).

[68] However, a 2007 review for the Ministry of Justice found that although market penetration had reached 59%, there was unlikely to be sufficient demand from consumers to warrant promoting a

The Jackson Review criticised the recoverability of CFA success fees and ATE premiums because the regime produced unfortunate unintended consequences, namely (a) litigants with CFAs had little interest in controlling the costs which were being incurred on their behalf and (b) opposing litigants faced a massively increased costs liability. The same was true of legal aid cases where claimants who were not liable to make contributions, since all legally aided claimants were effectively insulated from adverse costs orders: the result was referred to as 'legal aid blackmail' by defendants.

Contemporaneously, the government implemented the two further restrictions on funding arrangements referred to above. Success fees under CFAs in defamation cases were capped at 10 per cent[69] and, as noted above, any fees based on a percentage of damages in employment cases (which was almost the only area where contingency fees were permitted) must not exceed 35 per cent of the damages.[70] Requirements to inform clients were strengthened in such employment cases.[71]

In order to give effect to the social policy that certain types of claimants should be protected against the risk of adverse costs,[72] Jackson proposed that there should be a qualified one-way cost shifting (QOCS) rule for them,[73] instead of the normal two way rule. The 'one way' aspect means that if a member of a privileged class of claimant succeeds, she will recover her costs, but if she fails she will not have to pay costs. The 'qualified' aspect means that if she is wealthy, or subsequently becomes wealthy, she could be ordered to pay all or part.[74] The qualified approach enables targeting of the protection on those who need it, and gives them a stake in the outcome so as to exert some control on costs. This was the approach that had operated successfully under the legal aid regime.[75] The protection should apply to cases where there is an asymmetric relationship between the parties, so it should apply in personal injury cases and defamation cases,[76] and there should be further consultation[77] on its application to housing disrepair, actions against the police, claimants seeking judicial review, and individuals claiming defamation or breach of privacy.

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separate stand alone BTE product; or ability from supply side to provide at attractive price: FWD, *The Market for 'BTE' Legal Expenses Insurance* (2007).

[69] The Conditional Fee Agreements (Amendment) Order 2010.

[70] The Damages-Based Agreements Regulations 2010.

[71] The Damages-Based Agreements Regulations 2010, Section 4 stipulates the information that must be given to the client before a DBA is signed. This information includes written information about the circumstances in which the client may seek a review of the costs and expenses of the representative and the procedure for doing so, and the availability of other means of pursuing or financing the claim including whether legal expenses insurance would be possible, available or appropriate.

[72] and in the light of data that suggests that most personal injury claims are valid.

[73] Final Report, chs 9 and 10.

[74] Final Report, ch 19.

[75] Still enshrined in the Access to Justice Act 1999, s 11(1): 'Costs ordered against an individual ... shall not exceed the amount (if any) which is a reasonable one for him to pay having regard to all the circumstances including – (a) the financial resources of all parties to the proceedings and (b) their conduct in connection with the dispute…'

[76] Final Report, ch 32.

[77] Final Report, ch 30.

Lord Justice Jackson proposed that personal injury claimants would in future have to meet success fees out of their damages.[78] In order to assist this, there would be three responses. Firstly, the level of general damages for pain and suffering and loss of amenity would be increased by 10 per cent. It was calculated that that figure would leave the great majority of claimants no worse off (although that assertion was contested). Secondly, the amount of success fees that lawyers may deduct would be capped at 25 per cent. For similar reasons, the general level of damages would be raised by 10 per cent for defamation and breach of privacy cases.[79] Thirdly, the reward for making a successful claimant's offer to settle, which the defendant fails to beat at trial, would be enhanced. This would also address a generic problem of late settlements: earlier settlements would be promoted through greater certainty about the effect of offers to settle [Part 36 offers], so that claimant offers have more 'teeth'.

Lord Justice Jackson made clear that he wished to maximise alternative options for funding litigation.[80] He favoured increasing the legal aid budget and eligibility, but accepted that these were political matters outside his control and that change was unlikely in the prevailing economic conditions.[81] As outlined below, Jackson's concerns here have been superseded by government cutting legal aid, and reducing its scope.

Jackson favoured the encouragement of BTE insurance by both householders and SME businesses as a low cost source of finance ('the many pay for the few')[82] and this was also endorsed in both Lord Young's 2010 review of health and safety laws[83] and in the government's legal aid proposals.[84] Jackson also approved of the recent availability of third party commercial funding, subject to suitable practice in relation to aspects such as capital adequacy.[85] He agreed with criticism of the *Arkin* decision[86] that such funders should be liable for the costs of opposing parties only to the extent of the funding provided, and favoured such liability to be a matter for the discretion of the judge in the individual case, without limit. He did not favour repeal of the statutory restrictions of maintenance and champerty, but would permit third party funders who comply with regulatory requirements, which might be self-regulatory requirements in the first instance. However, he came down strongly against the payment of referral fees by lawyers.[87]

Jackson also favoured both solicitors and counsel being permitted to enter into contingency fee agreements, on the Ontario model of generally maintaining the loser pays rule.[88] However, he considered that various safeguards were necessary against

[78] Final Report, ch 10.
[79] Final Report, ch 32.
[80] Final Report, ch 12, para 4.2.
[81] Final Report, ch 7, para 4.1.
[82] Final Report, ch 8, para 4.1.
[83] Lord Young of Graffham, *Common Sense, Common Safety, London:* (The Cabinet Office, 2010).
[84] Ministry of Justice, *Proposals for the Reform of Legal Aid in England and Wales, Consultation Paper CP12/10* (November 2010).
[85] Final Report, ch 11.
[86] *Arkin v Borchard Lines Ltd* [2005] EWCA Civ 655: see above.
[87] Final Report, ch 20. It has been suggested that such fees may simply go underground.
[88] Final Report, ch 12. His reasoning for proposing the widening of DBAs has been referred to as 'not extensive', and a study found that use of DBAs in employment tribunals, where the 'loser pays' rule is rarely applied, had been 'very modest' and not constituted an explosion: R Moorhead, 'An American Future? Contingency Fees, Claims Explosions and Evidence from Employment Tribunals' (2010)

the potential for abuse. No contingency fee deducted from damages should exceed 25 per cent of the damages, excluding damages referable to future costs or losses. There should be agreement at the outset of a case on who would be responsible for any adverse costs order and for disbursements. No contingency fee agreement should be valid unless it was countersigned by an independent solicitor who certified that he had advised the client on the terms of the agreement. (Responses to the last proposed restriction included that it would either cool the spread of contingency fees, or be itself abused). He also favoured a Contingency Legal Aid Fund (CLAF) or a Supplementary Legal Aid Fund (SLAS) financed by a levy on damages of 10 per cent or so, but had difficulty determining how one would be established, and suggested further modelling.[89]

Following the Jackson Review, there was concern that his recommendations would merely lie on the shelf, or that some items would be implemented by the courts whilst others that required legislation would be ignored. The judge himself issued a paper insisting that his recommendations were designed to be an integral package, and so should not be subject to cherry picking.

### The Coalition Government's 2010 and 2011 Reform Policies

The coalition government decided to accept the Jackson recommendations almost in full, subject to a few limited amendments of detail. This constituted major redirections in policy, implemented by legislative reform of the funding and costs of litigation. Consultation papers were issued in November 2010, and the government's Response to consultation in March 2011, after which the Legal Aid, Sentencing and Punishment of Offenders Bill 2010-11 was introduced.

In accordance with the government's overriding policy of reducing public expenditure in the aftermath of the global economic crisis, the first consultation was on the proposal to take a further major step in deconstructing legal aid.[90] In order to compensate for this, it adopted two policies. First, people were encouraged to resolve disputes through alternative dispute resolution mechanisms. Institutional arrangements emphasising and expanding ADR for consumer claims against businesses were proposed in contemporaneous consultations.[91] Secondly, all available

73(5) MLR 752. See also R Moorhead and R Cumming, *Something for nothing? Employment Tribunal claimants' perspectives on legal funding* (Department for Business Innovation & Skills, 2009).

[89] Final Report, ch 13.

[90] *Consultation paper, Proposals for Reform of Legal Aid in England and Wales*, November 2010, available at: http://www.justice.gov.uk/consultations/legal-aid-reform-151110.htm

[91] *Better Choices: Better Deals. Consumers Powering Growth.* (Department for Business Innovation & Skills and Cabinet Office Behavioural Insights team, 2011), at http://www.bis.gov.uk/assets/biscore/consumer-issues/docs/b/11-749-better-choices-better-deals-consumers-powering-growth; *Empowering and Protecting Consumers. Consultation on institutional changes for provision of consumer information, advice, education, advocacy and enforcement* (Department for Business Enterprise and Skills, 2011), at http://www.bis.gov.uk/Consultations/empowering-and-protecting-consumers; http://www.bis.gov.uk/assets/biscore/consumer-issues/docs/e/11-970-empowering-protecting-consumers-consultation-on-institutional-changes.pdf.

means of private funding for claims within the court system were to be encouraged, ranging from BTE LEI[92] to DBAs and third party funding, discussed further below.

The second proposal was on implementation of many other Jackson proposals, notably QOCS for personal injury and various other types of claims, under which claimants would not have to pay opponents' costs unless they had appreciable assets or behaved badly in the litigation process.[93] An associated Report to the Prime Minister was published on 15 October 2010 by Lord Young of Graffham, primarily concerning reducing burdens on business of health and safety law, but containing a strong attack on a perceived 'compensation culture' and supporting the Jackson recommendations.[94]

The various reforms in relation to funding issues were as follows. A voluntary code had been drawn up for providers of to third party funding, on which consultation closed on 3 December 2010.[95] The experiment with CFAs and associated ATE insurance was to be curtailed, implementing the recommendations of Lord Justice Jackson that CFA success fees and ATE premiums were no longer to be recoverable from opponents. Claimants would in future have to deduct such costs from their damages recovered. This had been the position in Scotland, where it did not cause difficulty.[96] Additional pressure had been exerted by the decision by the European Court of Human Rights in November 2010 that the U.K.'s regime of recoverable success fees breached defendants' article 10 rights on freedom of speech by being disproportionate for defendants.[97]

The government proposed to permit DBAs in general litigation, extending them from previous use only in tribunals. It noted that Jackson had rejected the argument that DBAs create a greater threat of conflict of interest between lawyers and their clients than CFAs.[98] He had recommended that:

'under the regulations governing DBAs in the Employment Tribunal, the maximum percentage of damages that a representative may take as a fee is 35% (including VAT). In

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[92] LEI was particularly encouraged for housing and employment cases. See also Jackson Consultation, para 265-267; Legal Aid Consultation, para 9.42. BTE has also been championed for motor vehicle claims, which represent three-quarters of all tort claims made for personal injury: r Lewis, 'Litigation Costs and before-the-Event Insurance: The Key to Access to Justice?' (2011) 74(2) *MLR* 272. In a 2011 sample, 7% of people were found to have made a legal claim against another person or organisation on a "no win no fee" basis, an estimated 2,887,892 people in past 5 years. Rates of BTE penetration were found to rise with income, and those with BTE policies were disproportionately represented in NWNF cases (71%): *No Win – No Fee Usage in the United Kingdom* (ICD Research, 2011).

[93] *Proposals for Reform of Civil Litigation Funding and Costs in England and Wales. Implementation of Lord Justice Jackson's Recommendations*, (Ministry of Justice, 2010), Consultation Paper CP 13/10, ('Jackson Consultation') available at http://www.justice.gov.uk/consultations/docs/jackson-consultation-paper.pdf,.

[94] *Common Sense, Common Safety. A report by Lord Young of Graffham to the Prime Minister following a Whitehall-wide review of the operation of health and safety laws and the growth of the compensation culture*, (HM Government, 2010), available at http://www.number10.gov.uk/wp-content/uploads/402906_CommonSense_acc.pdf. Lord Young resigned as the Prime Minister's advisor of business on 19 November 2010 shortly after publication of this report for unrelated political reasons.

[95] Jackson Consultation, para 270.

[96] Lord Gill, *Report of the Scottish Civil Courts Review* (2009), para 96.

[97] *MGN Ltd v the United Kingdom* [2011] ECHR 39401/04.

[98] Jackson Consultation, para 228.

respect of CFAs, Sir Rupert proposes that in personal injury claims the maximum percentage of damages, excluding damages awarded for future care or losses, which can be payable as a success fee should be 25%. Sir Rupert says that the cap on deductions should be the same for DBAs. He recommends that no contingency fee deducted from damages under a DBA should exceed 25% of claimant's damages, excluding damages referable to future care or losses.'[99]

The government said:

'Sir Rupert believes that solicitors should be entitled to charge a higher percentage fee under a DBA than they otherwise would if they accept the risk of liability for their client's adverse costs in the event that the case is lost. He also believes that solicitors should be entitled to a higher percentage fee if they fund the client's disbursements. If either is funded by the client the solicitor should be entitled to a lower percentage fee. The disbursements in DBAs could include counsel's fees, or counsel could be allowed to act under a DBA and be entitled to a specified percentage of any sums recovered. If the latter is the case this must be clearly set out in the DBA itself.' [100]

The Legal Aid, Sentencing and Punishment of Offenders Bill (2011) section 24 inserts into section 58 AA of the Courts and Legal Services Act (1990) a new section 6 (a): rules of court may make provision with respect to the assessment of costs in proceedings were a party in whose favour a costs order is made has entered into a damages-based agreement in connection with the proceedings. Costs would be recovered from the opponent on a conventional basis, as on the Ontario model. Any excess over the sum recoverable on a normal hourly rate basis would be paid by the client.[101]

The government did not consider that a new approach towards regulation of DBAs was necessary:

'… in principle there would be little difference between CFAs (as reformed) and DBAs if introduced on the basis proposed by Sir Rupert. The Government is therefore not convinced that, aside from a cap on damages in personal injury cases (as with CFAs), separate detailed regulation of DBAs would be necessary and that the existing requirements in the professional rules of conduct for solicitors, for example, could be extended to cover the use of DBAs in litigation.'[102]

After the consultation period on the above policies, the government made a series of announcements on 30 March 2011 on implementation of these reforms of funding[103] and reform of the civil justice system.[104] A major rationale for introducing the QOCS

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[99] Jackson Consultation, para 232.
[100] Jackson Consultation, para 233.
[101] Jackson Consultation, para 234.
[102] Jackson Consultation, para 237.
[103] *Reforming Civil Litigation Funding and Costs in England and Wales – Implementation of Lord Justice Jackson's Recommendations. The Government Response* (Ministry of Justice, 2011), available at http://www.official-documents.gov.uk/document/cm80/8041/8041.pdf
[104] Consultation paper CP6/2011, *Solving disputes in the county courts: creating a simpler, quicker and more proportionate system. A consultation on reforming civil justice in England and Wales* (Ministry of Justice, 2011), available at http://www.justice.gov.uk/consultations/docs/solving-disputes-county-courts.pdf.

regime was said to be that many claimants would no longer need to take out ATE insurance.[105]

DBAs were to be allowed in civil litigation generally. A major reason for this was that the government felt it necessary to balance its recent further large cut in legal aid. The government considered that 'the principle of no win no fee litigation has been well established by CFAs' and that a ban 'is no longer appropriate in a modern litigation system' provided DBAs are appropriately regulated.[106] Defendants would only be liable for normal base costs, and claimants would have to pay the excess out of their damages. DBAs would be subject to the 25 per cent cap in personal injury cases.

Debate on the Legal Aid, Sentencing and Punishment of Offenders Bill has given rise to lobbying by U.S. business that thrd party funding should be regulated so as to avoid conflicts of interest, and a 'costly American-style compensation culture'.[107]

## IMPLICATIONS FOR FUTURE POLICY ON LITIGATION FUNDING

The implementation of the Jackson Recommendations constitutes major reform in policy on funding of litigation, with profound implications for access to justice. The most obvious point is that a 'mixed economy' of different funding options is favoured, encompassing funding from insurers (BTE), from individuals (where they have the means), from independent investors (litigation funding) and from legal intermediaries (DBAs and CFAs, the latter being less attractive than before because of the shift back to irrecoverability of more than normal costs), and from the state (but very limited).

BTE insurance is given further encouragement, not least by the extension of fixed costs in the fast track and upwards in some or all parts of the multi-track. The principle that damages should not be reduced by fees is effectively demolished: funding from independents and intermediaries would not be possible with such a rule. Contingency fees are introduced, albeit with some political 'sleight of hand', under the camouflaged name of DBAs.

Jackson supported the idea of a CLAF and/or a SLAS, but the likelihood of either arrangement materialising seems remote. The Bar Council has produced a series of Reports arguing for a CLAF to be set up.[108] It would be a stand-alone fund, financed by a levy of a percentage of the damages recovered from cases that it supported, and might operate in conjunction with other means of funding. One initial hurdle has been the need to provide seed funding, which has never been forthcoming, despite a number of discussions with commercial funders. The Bar Council and the Law Society collaborated post-Jackson on examination of a CLAF. However, there is no likelihood of the government providing seed funding. Moreover, the key point is that

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[105] Although the government was 'not persuaded' by Jackson's ideas about extending QOCS to types of cases other than personal injury: *Reforming Civil Litigation Funding and Costs in England and Wales*, above, para 27.
[106] para 29.
[107] J Ames, 'Litigation financing "needs crackdown"', The Times, December 15 2011.
[108] See *The Merits of a Contingency Legal Aid Fund. Second Discussion Paper* (The General Council of the Bar, 2009).

a CLAF could not survive commercially alongside other forms of litigation funding, in view of the need to avoid the best cases being skimmed off.

Litigation funding from non-parties has now received official approval from Jackson and *de facto* official encouragement as a result of the government's implementation of the Jackson package. Lawyers may continue to provide funding if they so wish, with DBAs set to replace CFAs as the preferred option. Independent funders are also given the green light.

The factors that have brought about this seismic shift appear from the history given above. The post-war welfare state emphasis on the concept of state-funded legal aid turned out to be unsustainably expensive. The only option for the government was to continue on the path of expanding private funding so as to maintain access to justice, and radical liberalising measures were required when further severe cuts were made in legal aid in 2010.

Ancient rules, such as the historical prohibitions against sharing part of the winnings (champerty), and on the indemnity rule (the loser should not pay more than the opponent is actually liable to pay his lawyers) have fallen, with minimal opposition, when faced with governmentally pronounced economic necessity. Neither Jackson nor the government's policy papers address the extent to which interference with litigation (maintenance) and some form of champerty might remain in relation to litigation funding. It appears that champerty has collapsed but maintenance remains. In other words, independent funders may support litigation but may not direct it. This distinction might not in theory directly affect a funder's business model or decision whether to fund an individual case on its merits, but it will have practical importance that is bound to have some economic impact and shape current practice. As will appear from our findings set out below, funders in England and Wales are currently careful to remain at arm's length from clients, and clients retain powers of decision-making in their litigation. In contrast, funders in Australia and some parts of Europe effectively take over both funding and running the litigation. To the extent that maintenance remains in some form, it constitutes a threat to development in the litigation funding market.

Whether the risks that concerned our forebears have evaporated in contemporary society and its litigation system, or whether they remain to surface as significant problems that will have to be faced again in the new world, remains to be seen. The distressing recent history of the widespread consumer detriment produced by the Claims Direct and TAG saga should sound strong warnings of trouble to come.

The question therefore arises, and will be returned to later in this Report, what controls should be imposed on funding by lawyers or by externals. Of the two principles, maintenance is more important: a ban on interfering with litigation is important in an adversarial system. In contrast, if lawyers and clients' bankers are able to finance litigation, why should third party investors not be equally so permitted, as a matter of principle?

The nature and attitude of the professions is relevant. Judges have little experience of funding and an inherent dislike of client risk-sharing. However, a change occurred in

2002 with the *Factortame* case,[109] in which Grant Thornton funded the Spanish fishermen in order to establish quantum, in return for 8 per cent of the recovery. The arrangement (to cover the costs of forensic accountants) was held to be lawful. In 2004, *Arkin* was a follow-on damages claim after a shipping cartel but the lawyer lost and the backer was held to be liable for adverse costs, including those of the defendants' lawyers, on a simple basis of £1 in costs for every £1 invested.[110] That was a pragmatic decision, representing a safe passage between the Scylla of unrestricted external funding and the Charybdis of strangling access to justice and a nascent industry. In short, judicial attitudes towards the rules of costs are having to change so as to keep up with changing policy on funding mechanisms.

It is interesting to consider the implications of the criticisms that Jackson LJ levelled at the 1999-2000 CFA and ATE recoverability regime. He considered that regime to possess four significant flaws: it was not targeted on persons who merited financial support with their litigation; it did not require an assisted person to make a contribution towards costs if they were able to do so (in both cases, unlike the legal aid regime); it placed a burden on opposing parties that was simply too great; and it presented an opportunity for some lawyers to make excessive profits, through cherry picking and thereby demeaning the profession in the eyes of the public.[111]

These features lead to important consequences if applied to litigation funding. Litigation funding generally seems to satisfy Jackson LJ's second prerequisite, in requiring an assisted person to contribute to the costs of his own case, and hence maintain an appropriate level of interest in it. Litigation funding does not on the face of things impose an increased burden on an opponent (the third flaw), nor create an opportunity for some lawyers to make excessive profits (the fourth flaw; indeed funders would appear to control process costs), although litigation funding would not appear to do much to target impecunious individuals or companies (the first flaw).

The questions raised above are relevant to determining the regulatory regime for third party litigation funding, but are not barriers to the provision of third party litigation funding. Before considering further the benefits of formal (public) regulation as opposed to self-regulation, it is necessary to review the facts as to the current state of the market and arrangements on litigation funding in those jurisdictions across the world where it has made an impact and then in England and Wales.

There are several important potential changes in the environment to consider:

a. Implementation of the Jackson proposals of non-recoverability of CFAs and ATE elements should result in ATE becoming more expensive and less available.

b. What effect will Alternative Business Structures (ABS) – injection of private capital into lawyers – have from 2011? Are any controls required? Will ABS lead to all litigation being funded by 'third parties', whether 'independently' or through lawyers on CFAs etc?

[109] *R (on the application of) v Secretary of State for Transport* [2002] EWCA Civ 932 (3 July 2002)
[110] *Arkin v Borchard Lines Ltd & Ors* [2005] EWCA Civ 655 (26 May 2005).
[111] Jackson Final Report, ch 10, paras 4.5 *et seq*.

c. What effect would the appearance of a SLAS or CLAF onto the scene have? What degree of regulation would be needed?

# 3. Litigation Funding in Other Jurisdictions

## INTRODUCTION

**Litigation funding is an important and recent development.** Developments on litigation funding do not occur in a 'national vacuum'. On the contrary, the context for litigation funding is very much an international one, in which arrangements, rules and developments in one jurisdiction can have a major impact on others. In considering the litigation funding situation in England and Wales, one has to bear in mind the state of development of policy on funding of litigation within the global common law community and within the European Union legal community.[112] Litigation funders are investing in cases outside their home jurisdictions, and in international arbitration.[113]

Across the world, there is widespread concern that the cost of litigation is high and disproportionate.[114] Considerable reform is taking place in the mechanisms for funding litigation in several leading jurisdictions across the world. Legal aid is, with a few exceptions,[115] in retreat as an unsustainable public expenditure programme, and is being replaced by various forms of privatised funding. Success fees are surprisingly widely permitted, although American-style contingency fees are far more controversial and currently fairly rare from a global perspective. Private funding is a recent development but spreading quickly in some jurisdictions.

Although litigation funding has existed in restricted form for some years in USA, it has grown quickly in the past decade in Australia and Canada. In Australia the funding void left by a continuing ban on contingency fees has been filled by commercial funding, which is now vibrant and has gravitated towards the large returns available from supporting class actions. Australian funders and experience have ignited interest in England and Wales, where the market is developing strongly. BTE LEI litigation funding has also developed in Germany, Austria and Belgium within the past decade. The local legal prohibitions and commercial conditions have meant that the permissibility of litigation funding differs in every jurisdiction, and hence the opportunities for its establishment, use and development have differed, with the result that litigation funding adopts a different format in every jurisdiction. The main features of some of these different jurisdictions and formats are considered below.

The position on the funding of litigation in U.S.A. is almost the converse of England and Wales: the U.S.A. has widespread contingency fees and so far relatively limited litigation funding, whereas England and Wales have no full-blown contingency fees but forms of litigation funding are expanding.

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[112] The European Commission has studied whether to create a European Patent Litigation Insurance Scheme; see *Patent Litigation Insurance: a study for the European Commission on possible insurance schemes against patent litigation risks* (CJA Consultants Ltd, 2003).
[113] C Albanese, 'Class of its own' *Commercial Dispute Resolution*, July 2010, 14.
[114] See C Hodges, S Vogenauer and M Tulibacka, *The Costs and Funding of Civil Litigation* (Hart Publishing, 2010).
[115] The exceptions seem to be New Zealand, Japan and the Netherlands.

We look below at the general position, illustrated by information on some of the largest funders, in Germany, the United States, Canada, Australia, Ireland and Belgium. At least one funder operates in South Africa[116] and Ecuador.

## GERMANY and AUSTRIA

In Germany and Austria, litigation funding has developed as a natural extension of the business models of well-established LEI insurers.[117] The architecture of the civil justice system in Germany encourages BTE insurance. Under the German civil procedure system, as codified in the late 19th century, legal costs have been highly predictable, since tariffs apply for client-and-lawyer costs (which are not binding but widely observed in claims by individuals) and for the costs that are shifted under the 'loser pays' rule. This situation enabled LEI to develop, and it has been widely purchased by individuals,[118] especially since the 1980s.[119] By 2006 19.46 million LEI contracts, with a total premium income of €3.066 billion, covered 43 per cent of the population and 35 per cent of litigation.[120] The number of claims funded by LEI contracts was 3.55 million, being a claims rate of 18%, and a total of €2.223 billion was paid out, being a loss ratio of 72.4%.[121] Various forms of LEI policy exist, but most insurers use the uniform conditions on legal expenses insurance (*Allgemeine Bedingungen für die Rechtsschutzversicherung – ARB 2000*).[122] Economic models have been developed on how litigation funding may operate and achieve rational settlements.[123]

Germany is the largest LEI market in the world: in 2008, it had a 44 per cent share in the overall premium income generated in a study of 22 European countries (including the United Kingdom, Netherlands, Spain, France and Italy).[124] The average premium

[116] Litigation Funding SA. In *PricewaterhouseCoopers Inc and others v National Potato Co-operative Ltd* [2004] (6) SA 66, the Supreme Court of Appeal of South Africa held that the need for the rules of maintenance and champerty had been diminished as a result of the right of access to justice enshrined in section 34 of the Constitution of South Africa, and the Contingency Fees Act 1997, which introduced a 'no win no fee' regime similar to an English CFA.

[117] For an overview of the situation on funding and costs see B Hess and R Hübner, 'Germany' in C Hodges, S Vogenauer and M Tulibacka, *The Costs and Funding of Litigation: A Comparative Perspective* (Hart Publishing, 2010).

[118] AAS Zuckerman, 'Lord Woolf's Access to Justice: Plus ça change…' (1996) 59 *Modern Law Review* 773, 791-795; M Kilian, 'Alternatives to Public Provision: the Role of Legal Expenses Insurance in Broadening Access to Justice: The German Experience' (2003) 30 *Journal of Law and Society* 31, also in R Moorehead and P Pleasance, *After Universalism: Re-engineering access to justice* (Blackwell Publishing, 2003).

[119] In 2002, German insurance companies earned approximately € 2.8 billion in LEI premiums from issuing about 25 million policies (the total German population is about 80 million people).

[120] C Hommerich et al, 'Anwaltschaft und Rechtsschutzversicherungen' (2006) *Anwaltsblatt* 200.

[121] C Hommerich, M. Kilian and R Dreske, *Statistisches Jahrbuch der Anwaltschaft 2007/2008* (Soldan Institut für Anwaltmanagement, 2008), Tables 7.2. and 7.2.2.

[122] www.gdv.de/Downloads/allg_Bedingungen_pSV/ARB_2000_06_Juni.pdf.

[123] R Kirstein and N Rickman, '"Third Party Contingency" Contracts in Settlement and Litigation' (2004) 160 *Journal of Institutional and Theoretical Economics* 555.

[124] M Killian, 'Legal Expenses Insurance: Preconditions, Pitfalls and Challenges, experience from the world's largest legal expenses insurance market' presentation at the 8th Legal Services Research

for a standalone LEI policy in Germany was €157 a year in 2009, although the actual costs of an individual policy are influenced by its coverage and the excess it carries.[125] In 2010, LEI was offered by 50 insurance companies in Germany.[126]

Financing by lawyers, commercial lenders or other professional investors account for only approximately 10 per cent of the financing sources.[127] Banks would not provide funding for cases without security. Contingencies fees have not been permitted in Germany, although there has been a recent but very limited permission for contingency fees,[128] which may lead to a rise in lawyer funding.[129]

LEI in Germany is a product that is not directed at, or generally held by, smaller companies ('SMEs'). Litigation funding arose in Germany around 2000 when companies' general liability insurers developed a product for their corporate clients, especially SMEs, which would enable them to bring cases as well, given the absence of BTE cover for commercial claims.

The concepts of maintenance and champerty have never applied in Germany. If they had, insurers would never have been able to develop BTE LEI. Instead, there has always been a ban on anyone other than a lawyer giving legal advice. That rule prevents litigation funders from giving legal advice and also explains why litigation funders are careful not to overstep the mark in making decisions in cases, remaining 'passive funders'. Litigation funders do not make or interfere with a client's choice of lawyer, or the way cases are run.

There are currently around 12 companies offering litigation funding, including a 'big five' (Allianz,[130] DAS,[131] FORIS, Roland,[132] and Juragent) that have around 90 per cent of the litigation funding market.[133] Around 50 per cent of litigation funding clients are consumers and 50 per cent are companies (mainly SMEs). Cases funded are mostly individual cases, but there are some class actions.

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Centre International Research Conference 2010 at Downing College, Cambridge, 30th June to 2nd July 2010.

[125] Premiums for a basic policy can be less than €100 a year, whereas premiums for a comprehensive policy can cost more than €400.

[126] L Bello, *In case of emergency. Consumer analysis of legal expenses insurance* (Consumer Focus, 2011) at http://www.consumerfocus.org.uk/files/2011/07/In-case-of-emergency.pdf

[127] It is estimated that commercial financing accounts for less than 1% of the funding portfolio, cf C Hommerich and M Kilian, 'Die Finanzierung von Rechtsverfolgungskosten durch die Bevölkerung' (2007) *Anwaltsblatt* 523, 524.

[128] Contingency fees were permitted in 2008 as an exception in an individual case where the client would otherwise be prevented due to his financial circumstances from pursuing his legal rights (i.e. impecunious, or could not take the financial risk). Such agreements must be in writing. They may permit 'no win no fee', or a reduced fee, if there is a reasonable supplement payable for success. See B Hess and R Hübner, 'Germany' in C Hodges, S Vogenauer and M Tulibacka, *The Costs and Funding of Litigation: A Comparative Perspective* (Hart Publishing, 2010).

[129] M Kilian, 'Zugang zum Recht' (2008) *Anwaltsblatt* 236, 239.

[130] But, as noted at p 63 below, Allianz decided to exit this business in October 2011. This was followed by Ergo's subsidiary Legial announcing a plan to "seize this opportunity" to acquire the freed-up market share, tripling its turnover in three years: Handelsblatt, 21 December 2011, p 36/37.

[131] DAS operates in the UK funding ATE policies for personal injury claims. Calunius' Chairman, Leslie Perrin, is a non-executive Director of DAS.

[132] a smaller insurance company that concentrates on the legal market.

[133] The statistics here and below were kindly supplied by Dr Matthias Kilian. See the chart at http://www.test.de/themen/steuern-recht/meldung/-Prozessfinanzierer/1696438/1696438/1696966/.

Litigation funding is widely known by lawyers but seldom used by them in practice (only 5 per cent of Allianz's cases came from lawyers). The general public, however, has limited knowledge about litigation funding due to a lack of publicity, and the fact that products are marketed essentially to companies. Funding has been provided to consumer associations to bring mass claims for enforcement of consumer law: such associations (and trade associations) play a prominent role in consumer enforcement in Germany and Austria.

When this market started, around 2000, the minimum claim value covered by funding agreements was around €50,000 to €100,000. The tariff system means that if a claim has a value of €100,000, the costs, and costs recoverable, will be roughly €20,000. The litigation funding fee might typically be 25-30 per cent of the claim value.

In 2008, after-the-event litigation funding was only used in approximately 0.4 per cent of cases.[134] Its limited use appears to be a consequence of three factors. First, it is relatively expensive, and is only economical for monetary claims above a certain value (usually around €50,000, but sometimes higher, although some companies are prepared to accept claims worth €20,000-€30,000). Secondly, funders usually only agree to accept cases that have a strong chance of success, and they are incentivised to check the merits of a proposed claim thoroughly before agreeing to invest and provide cover. Thirdly, the widespread use of LEI obviates much demand for third party cover by individuals—save for cases that might be excluded from cover.

In 2007 ten of the twelve companies in the litigation funding market provided information that the minimum value insured ranged between €10,000 and €500,000.[135] There were 2 companies with a minimum of €10,000, 1 with €25,000, 3 with €50,000, 1 with €100,000, 1 with €200,000 and 2 with €500,000. The market leaders (subsidiaries of LEI companies) had a minimum of at least €50,000. Those with a lower minimum were probably trying to buy market share. When commercial litigation funding was introduced in Germany, the minimum was €50,000 and the pioneer has since increased the minimum to €200,000: this may be an indicator that in lower value cases the return on investment is simply too small. The *quota litis* (percentage paid to the funder) charged depends on the value of the claim. The lower the value is, the higher the percentage. For coverage below €50,000, the percentage of the recovery taken is mostly 50 per cent (although a court has yet to decide whether this is reasonable), and above €500,000, the percentage withheld can get as low as 20 per cent.

There is a loser pays rule in Germany, Austria and Switzerland, but the costs that are shiftable are specified on official tariffs and tend to be around 10-20 per cent of the level of costs in UK. By contrast, the higher level of shiftable costs in England clearly has an impact on the economic viability of litigation funding for the companies that operate there. However, the growth of the litigation funding market in England and Wales indicates that the adverse costs rule is not an impediment to bringing cases: the key consideration is the merits of a given case.

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[134] C Hommerich and M Kilian, *Mandanten und ihre Anwälte: Ergebnisse einer Bevölkerungsumfrage zur Inanspruchnahme und Bewertung von Rechtsdienstleistungen* (Soldan Institut für Anwaltmanagement, 2007).
[135] Information from Dr Matthias Kilian.

Opponents do not have to be informed of the existence of a funding agreement. The absence of such an information rule may be influenced by the relatively low level of shiftable costs in the German-speaking jurisdictions. Similarly, a litigation funder may withdraw from a funding agreement if there is a material change for the worse. It is rare that funders withdraw although where this happens, the funds previously advanced are not repaid, and the funder's interest in the funds remains if the case is won.

Allianz ProzessFinanz GmbH, until 2011 one of the leading companies (see page 62 below), has to date assessed around 5,000 claims, worth around €500 million. Every case is assessed by a risk assessment committee. The tariff system for lawyers' fees in Germany means that it is simple to assess costs. The loss rate is roughly 1 in 10. 90 per cent of cases are settled before judgment. Profit is usually around 30 per cent.

FORIS, established in 1998, has examined around 10,000 cases, and invested in 500 (5%), with a typical dispute involving around €1 million. It funds all types of cases, and operates in Germany, Austria and Switzerland. Since 2001 its fee has been in the range 20-30%. Its model is to fund single cases, but it has bundled multiple cases on an assignment basis for the Austrian consumer association on one occasion. It will not invest in a class case under the German Financial Group Actions Act (KapMuG) since the procedure takes far too long.[136]

Some funding companies operating in Germany specialise in particular types of claims, and some are based abroad. An example is Cartel Damage Claim Services SPRL ('CDC'), which was established by Dr Ulrich Classen as a private company in 2003 to fund cartel damage claims in Germany, especially in the cement and chemicals sectors. CDC came into existence in order to satisfy the demand of a group of German chemical companies who wished to pursue damage claims against a number of larger companies that had been found by the Bundeskartelamt (competition authority) to have rigged prices. After a restructuring plan for the sector, drawn up by the Bundeskartelamt and facilitated by Dr Classen, collapsed when two companies held out for too much for too long, CDC was established to pursue the claims of the smaller companies. CDC was located in Belgium, partly because of tax advantages and partly because the German laws on service companies giving legal advice and services were at that stage too restrictive.

The model is for companies to assign their claims to CDC, which then pursues them in its own name. The companies pay a nominal price on assignment, and are entitled to around 75 to 80 per cent of the eventual recovery. CDC has developed a highly sophisticated computerized process for collecting and analyzing all the relevant data. The assignment model was confirmed by the German Federal Court in 2009.[137]

CDC finds that companies do not want to pay to run the case, sometimes for reasons of financing it, or management time or maintaining ongoing commercial relations with the (usually larger) defendants. CDC has assembled considerable in-house

[136] Information given by Dr G Meincke, Leiter Prozessfinanzierung/Recht of FORIS AG, at the 5th Annual Class Actions Conference, The Hague, 8 December 2011.
[137] BGH Apr. 7, 2009, Case KZR 42/08, Decision of 7 April 2009, Betriebs-Berater 2009, at 905; see T Schreiber, 'Private Antitrust Litigation in the European Union' [1020] *The International Lawyer* 1157.

expertise in technical competition damages claims, and has economies of scale in preparing such cases. All source documents, such as invoices and purchase and delivery records, are bar coded and scanned into its computer, so there is a full databank of evidence and an audit trail, available on a spreadsheet. The database is now sufficiently comprehensive over several decades for price data for the cement sector to be able to identify price fluctuations across the entire market. CDC has been talking for four years to the British Aggregates Association about developing a similar model for them.

CDC has been asked to take on various cases, but is selective and has only commenced four actions, all of which are ongoing and as yet unresolved. Two are being litigated in Germany, one in Finland and one in the Netherlands. It sticks to commodity cartel cases, and does not envisage branching out into funding other types of claims.

1. The initial German cement case is proceeding in Düsseldorf. It is a follow-on case based on the infringement finding by the Bundeskartelamt. In 2009 it went to the Bundesgerichtshof on the issue of admissibility, which ruled in favour of CDC. At time of writing the hearing back in Düsseldorf is postponed.
2. The second German case concerns a pan-EU cartel involving hydrogen peroxide, with companies in 13 Member States. CDC has taken assignments from 32 companies, representing over 50% of the EU market. The case was started in Dortmund in 2009.
3. The case in Finland also involves hydrogen peroxide, in which assignments from various Finnish companies are being pursued against a single large Finnish company.
4. The case in the Netherlands involves sodium chlorate on behalf of the paper and pulp industry, and follows an EU infringement decision. Nine large groups of companies have assigned; the defendants are one large Dutch company plus others in France, Sweden and Finland. CDC retained an experienced litigation partner at BarentsKrantz (expertise is needed on assignments and on litigation, rather than competition law, which is in-house).

CDC has no shortage of cartel damages cases that it could in theory support, but it prefers to specialize in commodities and chemicals. Large purchasers might prefer to negotiate themselves, and agree lower prices for a future period. Such solutions depend on the structure of the particular market and type of product. There is some concern that if damages were pursued strongly in some markets there would be some structural damages; for example, after the car glass cartel the market reduced to three main suppliers.

## U.S.A.

In the United States, the working capital cost of running litigation is provided by the plaintiff law firm, which may draw on its own capital reserve or bank financing provided to the firm. The leading successful U.S. law firms have built up their own capital for use in further cases, but they can use their portfolio of cases as security for a bank loan for funds to invest in cases. Although firms can charge on an hourly rate basis, the classic model of funding most damages claims is the contingency fee,[138] which is an individual contract, usually governed by State law, which regulates the fee and issues such as disclosure of with whom the fee is shared by the attorney. The standard method for funding class actions is the court-approved fee.

The system is notably simple in conception and operation: cost shifting rules are rare[139] and the contingency fee combines a 'no win no fee' concept with a success fee concept.[140] Calculating the funder's exposure is significantly easier than in other jurisdictions that apply loser pays rules, especially where the cost so shifted is not based on a tariff but on hourly rate fees.

The widespread availability of lawyer-finance has satisfied the litigation finance demand in U.S.A. for well over a century,[141] but third party financiers appeared some decades ago,[142] who seem to focus on either the small consumer claim sector, on the corporate litigation sector, or on providing a new source of finance to law firms.[143] The first phenomenon has been referred to as 'pay-day-loan lenders' funding or pejoratively 'legal loan-sharking'.[144] Lenders offer short term loans to finance small claims, typically medical 'cash for crashes' or housing claims, and although the costs might be $1,000-2,000, some have charged monthly compound interest (perhaps 500 per cent), which has resulted in very high costs to consumers. By 2010, some seven states had introduced consumer protection regulation of such practices, and proposals were being considered in various other states. Professor Deborah Hensler described the situation as follows:[145]

'These funders appear to target lower-income plaintiffs who are willing to trade earlier (and certain) cash payments against an ultimate larger recovery that may not materialize at all or for several years. Some observers have suggested that funders offer 'advances' rather than

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[138] A 1989 national survey of accidental injury victims found that 87 percent of those who hired lawyers to pursue claims were represented on contingency fee contracts. See D Hensler et al., *Compensation for Accidental Injuries in the United States*, (Rand, 1991), Table 5.11, p 136. For the lengthy history of contingency fees see S Landsman, 'The History of Contingency and the Contingency of History,' (1998) 47 *DePaul Law Review*.
[139] One way cost shifting is provided for under a number of statutes: see S Farhang, *The Litigation State. Public Regulation and Private Lawsuits in the U.S.* (Princeton University Press, 2010).
[140] See eg DR Hensler, 'The United States of America' in C Hodges, S Vogenauer and M Tulibacka, *The Costs and Funding of Litigation: A Comparative Perspective* (Hart Publishing, 2010); HM Kritzer, 'Seven Dogged Myths concerning Contingency Fees' 80 Wash. U. L. Q. 739-794 (2002).
[141] Contingency fees were reportedly first used in 1848 in New York and 1878 in New Jersey: AD Youngwood, 'The Contingent Fee—A Reasonable Alternative?' 28 (1965) *MLR* 330.
[142] GS Swann, 'Economics and the Litigation Funding Industry: How Much Justice can you Afford?' (2000) 35 *New England Law Review* 805.
[143] S Garber, *Alternative Litigation Financing in the United States. Issues, Knows, and Unknowns* (RAND Corporation, 2010). Some 29 companies were identified in early 2010. Developments may also occur in the use of third party funding, perhaps integrated with public or other private or lawyer sources, for large claims brought by public authorities: per Paul Huck, Colson Hicks Eidson, formerly of Florida State Attorney General's Office at the 4th Annual Global Class Actions Conference, Florida International University, Miami, 10 December 2010: note of file with the authors.
[144] B Applebaum, 'Lawsuit Loans Add New Risk for the Injured', *The New York Times*, January 16, 2011.
[145] D Hensler, 'The United States of America' in C Hodges, S Vogenauer and M Tulibacka, *The Costs and Funding of Civil Litigation* (Hart Publishing, 2010). See also DR Hensler, 'Financing civil litigation: the US perspective' in M Tuil and L Visscher (eds), *New Trends in Financing Civil Litigation in Europe. A Legal, Empirical, and Economic Analysis* (Edward Elgar, 2010).

'loans' to escape usury restrictions that might otherwise curtail interest charged.[146] By funding parties rather than their attorneys funders may also intend to avoid strictures against 'fee-splitting' between lawyers and non-lawyers. Interest in financing complex litigation appears to be growing, particularly among investors seeking alternatives to traditional financial instruments.'

In contrast, the second phenomenon in which litigation funding has arisen in the United States arises out of the matching of demand for financing of litigation (whether as plaintiff or defendant) from external sources that can share the costs or avoid the need to draw on fixed corporate law department budgets, with supply of large sums of capital by investment vehicles.[147] The demand side appears to be potentially considerable, anecdotally especially by SMEs. Such litigation funding has proved to be particularly attractive to parties in international litigation and arbitration.

Corporate funders emerging recently include Juridica, Aga Capital and Burford.[148] Burford's and Juridica's funding came primarily from fund managers, including a large stake from one fund manager with a substantial stake in both companies.[149] Some ultimate investors remain unaware of the claims in which their money is invested by the litigation managers.[150] The size of the potential market is unknown: one anecdotal estimate put it at $80 billion in 2009. The corporate commercial funders, whose services are sought by both large and small companies, tend to adopt a model that is firmly based on investment management techniques and sophisticated risk assessment. Litigation is viewed as involving an asset: it can be traded as a matter of contract, no different from a share of stock, and ideally able to be bought, sold or pledged. The merits of cases are thoroughly assessed before funding is agreed. Their attitude to the terms on which funding is provided is flexible, and sometimes strongly negotiated. The funder might assume complete control of running a case, instructing the lawyers, insurance broker, and insurance company. Funding can be made available for costs already spent, for future costs, and for business finance. Alternatively, the client might assign the liability. Typically, the lawyer would not work on a contingency basis, since the funder assumes the risk, and would take an agreed percentage if they win: lawyer is remunerated on a negotiated contract basis. Funders' 'repeat player' status enables them to negotiate favourable arrangements and rates with favoured law firms. Such corporate funders perceive problems in funding class actions, which are viewed as too complicated compared with the many other possible investments that can currently be made, although there is no reason in principle why they should not fund a class action.

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[146] JL Hyman and P Frumkin, 'Contingent Advances' (2003) 82 *Sep Michigan Bar Journal* 28 available at www.michbar.org/journal/Art.cfm?ArtID=613&volumeID=47.

[147] L Jones, 'Litigation Funding Begins to Take Off' *National Law Journal*, 30 November 2009.

[148] Burford raised $100 million in 2009. By 2011 it had funded some five cases. It is particularly interested in commercial arbitration cases, perhaps with an international element: Press release 23 November 2009. Burford subsequently agreed to take over Firstassist Legal Expenses, the leading U.K. ATE litigation insurer, from which to build a leading U.K. litigation funding business: Press release 12 December 2011. Burford announced at the same time receipt of an investment with an internal rate of return of over 50%.

[149] Burford's initial public offering attracted 45% from Invesco U.K., and 10% each from Fidelity International and Baillie Gifford.

[150] R Parloff, 'Have you got a piece of this lawsuit?' June 28, 2011 at http://features.blogs.fortune.cnn.com/2011/06/28/have-you-got-a-piece-of-this=lawsuit-2/

Some funders emphasise that their approach to investment risk leads to a situation in which they tend only to support cases where they believe there is a strong chance of recovery. The fact that a funder is supporting a case, especially where a 'loser pays' rule applies to costs, can be claimed to be helpful in sending a signal to opponents that an independent expert assessment believes that a case has merit, and this may tend to assist earlier settlement.

However, different rules apply in different U.S. states on maintenance and champerty, and State rules are contested in the courts.[151] Notwithstanding some legislative regulation on consumer protection issues, noted above, the emerging rules on litigation funding are based on the existing court systems and the opinions of judges. For example, a Florida court struck out a sham case and imposed penalties on both the funder and client.[152]

Independent sources of finance other than banks have now become sufficiently established that they have grown to become a mainstream source for law firms, as described by a leading attorney:[153]

'Law firms can get working capital from (1) cash flow, i.e. a portfolio of other cases and accumulated wealth, (2) lines of credit from commercial banks, secured by partners' personal guarantees, (3) private 'third party' funding, i.e. entrepreneurs (many are plaintiff lawyers), including organizations such as LawCash and Counsel Financials Group. Esquire Bank was started by plaintiff lawyers and is now the go-to source of funding for firms who are members of the leading plaintiff trial lawyers' associations. Third party funding can involve a loan to clients, rather than attorneys, with interest rates of 18-24%, and repayment being tied to the ending of the case. Hedge funds and other entities are increasingly players. Numerous legal and ethical issues arise with TPF, such as influence, conflicts and indebtedness. Corporations are increasingly using contingency fees to remunerate their external litigation attorneys.'

Litigation funding is controversial in U.S.A., mainly attracting criticism from the business community.[154] The 2009 report *Selling Lawsuits*[155] by the Institute for Legal Reform of the U.S. Chamber of Commerce, encapsulates the business concerns about third party litigation funding. In particular it argues that:

1. If litigation funding becomes more prevalent, it will pose substantial risks of litigation abuse.

[151] See DR Richmond, 'Other People's Money: The Ethics of Litigation Funding' [2004] 56 *Mercer Law Review* 649; JH McLaughlin, 'Litigation Funding: Charting a Legal and Ethical Course' [2006] 31 *Vermont Law Review* 615; CB Bushnell, 'Champerty is Still No Excuse in Texas: Why Texas Courts (and the Legislature) should uphold Litigation Funding Agreements' [2006] 7 *Houston Business and Tax Law Journal* 358; S Lorde Martin, 'Litigation Financing: Another Subprime Industry that has a Place in the United States Market' [2008] 53 *Villanova Law Review* 83.
[152] S Garber, *Alternative Litigation Financing in the United States. Issues, Knowns, and Unknowns* (RAND Corporation, 2010).
[153] Presentation by Steve Fineman, Managing Partner of Lief Cabraser, at the 4th Annual Global Class Actions Conference, Florida International University, Miami, 10 December 2010: note on file with the authors.
[154] R Parloff, 'Have you got a piece of this lawsuit?' (*Fortune*, 28 June 2011), at http://features.blogs.fortune.cnn.com/2011/06/28/have-you-got-a-piece-of-this-lawsuit-2/
[155] J Beisner, J Miller S and Rubin, *Selling Lawsuits, Buying Trouble* (U.S. Chamber Institute for Legal Reform, 2009).

2. Third-party litigation funding increases a plaintiff's access to the courts, not to justice. But increasing plaintiff access to the courts also increases the likelihood that any potential defendant will be hauled into court on a meritless claim.
3. Third-party litigation funding encourages frivolous and abusive litigation.
4. Third-party litigation funding raises ethical concerns about interference in litigation.

Corporate concern about excessive litigation in the United States has to be understood in the context that the American legal system relies heavily on private litigation not only as a means of enforcement of private rights but also to enforce much public law,[156] and to achieve rule changes other than through political processes.[157] Such a system incurs considerable transactional costs, as well as comparatively more litigation than many other jurisdictions. Hence, the corporate community is strongly opposed to any development that might significantly increase the volume and cost[158] of litigation, especially of class actions. Recent academic comment has speculated that litigation funding in the United States will lead to an increase in speculative litigation and 'strike suits'.[159]

Questions are being debated about the amount of control of litigation funding, as well as its high rate of return.[160] In relation to the concern about funders supporting sham cases, funders currently respond that the reality is that they will not back such cases since they are bad investments. That assertion does not ring entirely convincingly, since any litigation lawyer has experience of situations in which settlements can be influenced by the amount of the money at stake as well as the intrinsic merits, and the larger the former the greater its influence may be.

## CANADA

Canadian Provinces, like England and Wales but unlike the United States, retain loser pays rules, which have a dampening effect on litigation rates and complicates risk assessment for advance assessment of litigation costs.[161] Laws proscribing maintenance and champerty were repealed relatively recently in order to widen access to justice[162] through permitting contingency fees.[163] An unusual option is the Ontario

[156] C Hodges, 'Objectives, mechanisms and policy choices in collective enforcement and redress' in Jenny Steele and Willem H van Boom, *Mass Justice* (Edward Elgar, 2011).
[157] M Steinitz, 'Whose Claim Is This Anyway? Third Party Litigation Funding' (2011) 95 Minnesota Law Review 1268.
[158] In an investment on one case, the funder's return was said to be between 35% and 67% of recovery, and in another a payment of three times its investment of $2.3 million: Burford Capital Press release, 23 November 2009.
[159] GJ Lysaught and DS Hazelgrove, 'Economic Implications of Third-Party Litigation Financing on the U.S. Civil Justice System', paper presented at a conference organised by George Mason University, October 5-6, 2011. Strike suits are claims pursued solely to induce a settlement offer rather than as litigation based on underlying merit.
[160] S Lorde Martin, Litigation Financing: Another Subprime Industry that has a Place in the United States Market' [2008] 53 *Villanova Law Review* 83.
[161] Quebec has a civil law system that is different from the rest of Canada, and operates a 'fond', which is a CLAF or supplementary legal aid fund.
[162] *McIntyre Estate v Ontario (Attorney General)* (2002) 61 OR (3d) 257 (CA).

Class Proceedings Fund, which takes a premium of 10 per cent of recoveries in class actions, and is widely used. Representative plaintiffs are subject to the cost shifting rule,[164] but Canadian lawyers are now giving indemnities to their clients to cover this risk, so as to avoid the need for clients to take independent legal advice on the costs risk, which would threaten the viability of actions.

Knutsen and Walker observe:[165]

'Third-party financing of civil litigation, other than for class proceedings, is relatively new in Canada.[166] Since 2004, two or three firms have been making loans to plaintiffs on the basis of pending awards. Generally, these firms charge interest on the loans and they do not take a portion of the award because of the concerns of champerty and maintenance. They rely upon an assignment of the proceeds to secure the loan and, in some cases, they operate on the basis that "nothing is owed if the case is lost".[167]'

The law firm Siskinds is one that funds cases, in one of which the court held that a 6 per cent premium was reasonable for a recovery of C$10 million but not if it were C$3 million.[168]

## AUSTRALIA

Litigation funding is well-established and thriving in Australia. It has grown since the mid-1990s from origins of supporting insolvency claims into a thriving service sector funding class actions. However, unlike the United States, funders do not regard themselves as having a quasi-regulatory enforcement function akin to 'private attorneys general'.[169] Insolvency practitioners have, since 1995 under statutory powers of sale,[170] been permitted to contract for the funding of lawsuits, if these are characterised as company property.[171] Funders have expanded into the functions of financing and managing class actions.[172] Most of the funded cases are securities class

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163 ES Knutsen and J Walker, 'Canada' in C Hodges, S Vogenauer and M Tulibacka, *The Costs and Funding of Civil Litigation* (Hart Publishing, 2010). See Ontario's Rules of Professional Conduct), Rule 2.08 and Ontario's Solicitor's Act, RSO 1990, c S-15, as amended by SO 2002, c 24, Sch A.

164 See also D Collins, 'Public Funding of Multi-Party Litigation' (unpublished, 2011) available at http://ssrn.com/abstract=1556666.

165 Knutsen and walker, above.

166 P Puri, 'Financing Litigation by Third Party Investors: A Share of Justice' (1998) 36 *Osgoode Hall LJ* 515 (arguing that, in the interests of access to justice, the Canadian legal market should allow greater participation of third party investor financing in litigation).

167 A Ceballos, 'Third party litigation funding: will it increase access to justice in Canada?' *The Lawyer's Weekly* (Ottawa/Toronto, 7 March 2008).

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169 A Lin, 'Australia's Litigation-Funding Giant Looks Abroad' *International News* , 7 June 2011, quoting Hugh McLernon of IMF 'We're not in this to right any wrongs or punish people. It's just business for us'.

170 See e.g. the powers of disposal given to a receiver to dispose of a company's property under the *Corporations Act* 2001 (Cth) s 420(2)(b) and (g) and the powers of disposal accorded to a liquidator by *Corporations Act* 2001 (Cth) s 477(2)(c).

171 *Movitor Pty Ltd (in liq) v Sims* (1996) 64 FCR 380 and *Re Tosich Construction Pty Ltd* (1997) 73 FCR 219.

172 IMF funded the claim by shareholders against Aristocrat Leisure Ltd, which resulted in a confidential settlement but which was reported to be in excess of A$140 million and the largest class action settlement in Australia at that time. J Walker, S Khouri and W Atrill, *Funding Criteria for Class Actions*, (IMG (Australia) Ltd, [2010]).

actions with large numbers of class members,[173] some of whom are sophisticated institutional investors and some are not. Other categories of cases are financial services, competition and other cases. They generally do not fund claims for personal injury or those with a relatively small value because of the risks and costs relative to potential return.[174] By the end of 2009 commercial funding financed over 21 class actions involving 35,000 class members and claims totalling A$2.6 billion. Funders from Canada, the United States and Europe have been showing an interest in joining the market.

Both the fortuitous development and the mode of operation of litigation funding in Australia has been influenced by its particular regime on costs: there is a cost shifting rule and a prohibition against lawyers charging contingency fees. No developed market exists for ATE insurance.[175] In simple terms, commercial funders have filled the gap that lawyers were not permitted to enter.

### The State of the Market

There are around seven commercial funders.[176] The law firm Maurice Blackburn is behind one prominent funder. The largest, IMF (Australia) Ltd ('IMF', listed in 2001) and Hillcrest Litigation Services Limited, are listed on the Australian Securities Exchange. Listing involves greater transparency of the affairs of a company, and hence disclosure of the state of investments and disinvestments.[177] Continuous public disclosure requirements for public companies produces transparency of information but can lead to disclosure of information about a case that may be tactically disadvantageous to a party where, for example, funding is withdrawn. Various licences are required under different state laws, some covering investigation or debt collection.

There are no statistics on the size of market. IMF has grown in capitalization from A$ 10 million in 1996 to A$ 200 million in 2010. During 2009 it had over 30,000 clients. In 2006, IMF had a claim value of A$144 million in insolvency investments, A$274 million in commercial investments, and A$526 million in group actions. In 2008 the figures were A$132 million in insolvency investments, A$280 million in commercial investments and A$928 million in group actions.[178] In the financial year ended 30 June 2009, IMF received net income from litigation funding in the sum of A$35,246,957, and total net income of $38,748,833. This represented a 21% increase

[173] M Legg, 'Shareholder Class Actions in Australia - The Perfect Storm?' (2008) 31 (3) *UNSW Law Journal* 699 at 704 - 705.
[174] ibid, p 4.
[175] C Cameron, 'Australia' in C Hodges, S Vogenauer and M Tulibacka, *The Costs and Funding of Civil Litigation* (Hart Publishing, 2010).
[176] See S Dluzniak, 'Litigation Funding and Insurance' (March 2009), p. 2, at http://www.imf.com.au/pdf/Paper%20-%20Dluzniak.pdf
[177] For information on IMF see www.imf.com.au. Some requirements are the Principles of Good Corporate Governance and Best Practice Recommendations (2003) of the ASK Corporate Governance Council.
[178] W Attrill, Litigation Funding: Access to Justice in a Time of Economic Crisis, presented at Globalaw Asia Pacific Regional Meeting, Auckland (20 February 2009) at http://www.imf.com.au/pdf/Globalaw%20Conference%20-%20Feb%202009.pdf .

in profitability from the previous year.[179] At 31 December 2009, IMF had about AUD 55 million in cash and AUD 36 million invested and no debt. It planned to grow investments to AUD 2 billion by 30 June 2011.

### Policy on the Legality of Litigation Funding

The regulation of funders that has occurred thus far has been in the form of *ad hoc* judicial decisions and funder self-regulation. The expansion of litigation funding of class actions was strongly challenged by corporate defendants in the mid-2000s, but the courts upheld the validity of litigation funding on access to justice policy grounds, after which market activity grew. However, there has remained some uncertainty over what mode of key regulation should exist.

The revolutionary change in policy occurred when challenges to litigation funding based on common law prohibitions of maintenance and champerty were resolved by the High Court of Australia in 2006 in the *Fostif* case in favour of legitimising the role of funding.[180] The High Court listed the following arguments in favour of this change:

a. ‘the social utility of funded proceedings’;[181]

b. its potential to foster the aims of Australian class action legislation;[182]

c. ‘inject a welcome element of commercial objectivity into the way in which [litigation] budgets are framed’;[183] and

d. increase the efficiency with which litigation is conducted.[184]

e. The High Court considered that existing doctrines of abuse of process and the courts' ability to protect their processes would be sufficient to deal with a funder conducting themselves in a manner 'inimical to the due administration of justice'.[185]

f. ‘In jurisdictions which had abolished maintenance and champerty as crimes and torts, New South Wales, Victoria, South Australia and the Australian Capital Territory, there were no public policy questions beyond those that would be relevant when considering the enforceability of the agreement for maintenance of the proceedings as between the parties to the agreement.[186] In other words, once the legislature abolished the crimes and the torts of

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[179] See IMF (Australia) Ltd, 2009 Annual Report (2009), p. 4, at http://www.imf.com.au/announcements/Appendix%204E%20and%202009%20Full%20Year%20Annual%20Report%20-%2026%20Aug%2009.pdf
[180] *Campbells Cash and Carry v Fostif* [2006] HCA 41.
[181] *Fostif v Campbells Cash and Carry* [2005] 63 NSWLR 203. Upheld *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd* (2006) 229 CLR 386.
[182] *Kirby v Centro* [2008] FCA 1505.
[183] *QPSX Limited v Ericsson Australia Pty Ltd* [2005] FCA 933, at [54].
[184] *QPSX Limited v Ericsson Australia Pty Ltd* [2005] FCA 933, at [54].
[185] *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd* (2006) 229 CLR 386 at [93]. See also *Jeffery & Katauskas Pty Limited v SST Consulting Pty Ltd* (2009) 239 CLR 75 at [26], [29]-[30].
[186] *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd* (2006) 229 CLR 386 at [84]-[86].

maintenance, these concepts cannot be used to found a challenge to proceedings which are being maintained. Their only relevance is in a dispute between plaintiff and funder about the enforceability of the agreement.'[187]

Support for commercial litigation funding has also come from the Law Council of Australia and the Law Institute of Victoria.[188] Nevertheless, the judge-led reform has not been without some strong criticism of the role of litigation funders and litigation funding, on the following grounds:[189]

a. The doctrinal concern that the judicial system should not be the site of speculative business ventures.

b. The primary aim was to prevent abuses of court process (vexatious or oppressive litigation, elevated damages, suppressed evidence, suborned witnesses) for personal gain.

c. Concern has been voiced that litigation funding may turn into protection rackets, where cases are filed and disappear if the defendant pays the funder or law firm.

## Regulation

Certain licenses have been required for funders:

a. In Western Australia IMF is licensed as an investigator under the Securities and Related Activities (Control) Act.
b. When a funding agreement deals with debt, a debt collection licence is required under each state regime.

In addition, the court controls its process, and certain statutory requirements apply to class actions.[190] The Australian Standing Committee of Attorneys General has inquired into possible regulation of litigation funding.[191]

The Full Federal Court ruled in *Brookfield Multiplex*[192] in 2009 that the arrangement between the commercial litigation funder, the law firm representing the class, and the members of the class was a managed investment scheme as defined in the

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[187] M Legg, L Travers, E Park and N Turner, 'Litigation Funding in Australia' paper at the Law Society of New South Wales Young Lawyers' 2010 Annual Civil Litigation One Day Seminar, 13 March 2010.
[188] See Law Council of Australia, 'Submission to Standing Committee of Attorneys-General', 14 September 2006; J North, 'Litigation Funding: Much to be Achieved with the Right Approach' (2005) 43 Law Society Journal 66, 69.
[189] see J Eyers, 'Regulate litigation funders, judge urges' *Australian Financial Review* 24 January 2011, 3, quoting Chief Justice Keane of the Federal Court; also Keane JA, Judge of the Queensland Court of Appeal, in *Access to Justice and Other Shibboleths*, speech on 10 Oct 2009, available at www.jca.asn.au/attachments/2009AccesstoJustice.pdf.
[190] eg Federal Court of Australia Act 1976 (Cth), s 33C in class actions.
[191] http://www.scag.gov.au/lawlink/SCAG/ll_scag.nsf/pages/scag_meetingoutcomes.
[192] *Brookfield Multiplex Limited v. International Litigation Funding Partners Pte Ltd (No 2)* [2009] FCAFC. This was a representative proceeding (i.e., a class action) by shareholders against Brookfield Multiplex for damages for losses allegedly caused by the company's belated disclosure of cost problems related to the construction of the Wembley Stadium.

Corporations Act.[193] One result of that decision was that the funding arrangement should have been registered under the relevant provisions of the Corporations Act. Another result was that other class actions underway at the time were also affected. At the time, only IMF was registered and held an Australian Financial Investment Services licence issued by the Australian Securities and Investments Commission (ASIC). The Australian Securities and Investments Commission then intervened to grant an exemption (limited in time to 30 June 2010) to ongoing class actions affected by the decision.

In May 2010 the government announced that it would exempt litigation funding from full licensing and consider a light touch regime, in view of the importance of litigation funding for access to justice. The government noted that the decision had effectively halted all existing class actions and announced that regulations should be made carving out class actions and proof of debt arrangements from the definition of a managed investment scheme.[194] The Minister did not consider that the previous arrangements expose consumers to such high levels of risk to justify imposing licensing and other onerous requirements on class action funders. The rationale was to 'reduce the administrative burden and red-tape' and on the basis that 'class actions have become an important part of the Australian justice system.' Between 1992 and 2009 over 240 class actions were brought in the Federal Court. As at 4 November 2009, at least 21 funded class actions were in train, involving 35,000 class action members, and claims totalling an estimated A$2.6 billion. However, the government considered that the area of potential conflicts of interest arising in assessing awards or settlements need to be properly addressed in order to enhance consumer protection.

Professor Camille Cameron has noted that 'Other judges have endorsed commercial litigation funding for its potential to foster the aims of Australian class action legislation[195], 'inject a welcome element of commercial objectivity into the way in which [litigation] budgets are framed'[196] and increase the efficiency with which litigation is conducted.[197,198] However, the position is still in flux: the New South Wales Court of Appeal held in 2011 that a litigation funding agreement constituted a 'financial product' and could be rescinded because the funder was not licensed to deal in such products.[199]

Against this background, it is interesting to note that Australian Federal Government policy is moving towards both *expansion* of the available pathways of access to justice and reviewing the options so as to provide the most *cost-effective* and appropriate pathways for particular case types. The *Commonwealth Access to Justice Report 2009* approached 'access to justice' to mean access not only to courts and legal advice but also to information and a range of appropriate dispute resolution

[193] *Corporations Act 2001* (Cth). At first instance, Finkelstein J had ruled that the funded class action was not a managed investment scheme.
[194] Address by the Hon Chris Bowen MP, Minister for Financial Services, Superannuation & Corporate Law & Minster for Human Services, 4 May 2010.
[195] *Kirby v Centro* [2008] FCA 1505.
[196] *QPSX Limited v Ericsson Australia Pty Ltd* [2005] FCA 933, at [54].
[197] *QPSX Limited v Ericsson Australia Pty Ltd* [2005] FCA 933, at [54].
[198] C Cameron, 'Australia' in C Hodges, S Vogenauer and M Tulibacka, *The Costs and Funding of Civil Litigation* (Hart Publishing, 2010).
[199] *International Litigation Partners Pte Ltd v Chameleon Mining NL* [2011] NSWCA 50.

options.[200] It prefigured a review of public expenditure and evaluation on *all* available pathways, to evaluate them all.

## Mode of Operation

The primary model is full assignment of the right of action by client to funder. Funders typically undertake full investigation of a case, and replace clients in choosing the lawyer and giving instructions to the lawyer, taking full management decisions. Agreements can be lengthy but there is considerable standardisation. In a typical litigation funding arrangement, the funder (usually a commercial entity) will enter into an agreement with one or more potential litigants. The funder pays the costs of the litigation (such as the lawyer's fees, disbursements, project management and claim investigation costs) and usually underwrites the risk of paying the other party's costs in the event that the claim fails through providing the plaintiff with an indemnity.

In return, if the claim is successful, the funder will receive (a) reimbursement of costs spent as a first slice, (b) an agreed percentage of any funds recovered by the litigants, either by way of settlement or judgment, and (c) a management fee. The litigants will assign to the funder the benefit of any costs order they receive. The share of the proceeds is agreed with the litigants, and is typically between one third and two thirds of the proceeds (usually after reimbursement of costs).[201]

Funders act as economic rationalists, investigating the merits of cases carefully through a risk assessment procedure, before accepting a case as an investment. Cases are not taken if merits are under around 60 per cent. Certain types of case satisfy funders' criteria, and some do not. Some types are also more commercially attractive than others. The attractive types are: claims for money damages (not injunctions) against solvent defendants, notably breaches of market protection legislation especially continuous disclosure obligations to shareholders, commercial breach of contract or licensing claims (often SMEs against larger companies), product liability, investor or antitrust class actions, and competition law especially cartel activity.[202]

IMF invests in claims greater than A$ 2 million for single commercial and insolvency claims, and will not invest more than 10% of its capital in any single case without Board approval. IMF will generally only fund multi-party litigation with a claim value in excess of A$ 10-20 million.

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[200] Australian Government, Attorney-General's Department, *A Strategic Framework for Access to Justice in the Federal Civil Justice System,* September 2009, ('Commonwealth Access to Justice Report 2009').

[201] C Yung, 'Litigation funding: officious intermeddling or access to justice?' (2005) 15 *Journal of Judicial Administration* 61 at 62 and V Waye, 'Conflicts of Interests Between Claimholders, Lawyers and Litigation Entrepreneurs' (2007) 19 (1) *Bond Law Review* 225 at 297. See *Jeffery & Katauskas Pty Limited v SST Consulting Pty Ltd* (2009) 239 CLR 75 for an example of a litigation funding arrangement that did not include an indemnity for adverse costs.

[202] J Walker, S Khouri and W Atrill, *Funding Criteria for Class Actions*, (IMG (Australia) Ltd, [2010]).

The litigation funder is able to spread the risk associated with a particular proceeding by adopting a portfolio approach to its inventory of cases.[203] If the funder is going to fund a claim involving novel theories of liability, and therefore take a greater risk, it can offset the risk by also funding a low risk case where liability is clear. Clearly some funders have backed some cases in order to try to provoke decisions that will be favourable for the development of their business (and vice versa). Funders take into account the practice of defendants applying for costs orders against plaintiffs. However, the High Court has precluded a defendant from seeking a costs order against the funder under the NSW rules of court where the funder has not indemnified the plaintiff against the defendant's costs.[204]

In order to be able to invest in a case, a funder must have sufficient information to enable a robust risk assessment to be made. Funders undertake careful and sometimes long due diligence processes before accepting cases. They look at the value of a case by its future discounted cashflow settlement value. The existence of the 'loser pays' rule means that careful assessment by a lawyer of the merits of a case, and the prospects of recovery (availability of assets, and aggregation) is essential. Cases funded tend to be ones that depend on clear written evidence and not oral evidence. IMF's risk management process comprises the following steps:[205]

1. IMF will investigate the facts, at its cost.
2. IMF obtains an external legal opinion.
3. Investment decisions are made by the internal Investment Committee, requiring a unanimous vote.
4. Assessment is made of :
    a. the likelihood of the claim being successful;
    b. the time it will take to establish the claim;
    c. the costs involved in pursuing the claim;
    d. the likely cost of failure; and
    e. other risks inherent in the litigation such as the inability of the defendant to pay all or part of the judgment.
5. Case selection is made on the basis of 'virtual certainty of success – expressed as a percentage, no case should be taken unless it is thought that it has at least an 85% chance of success or there are special reasons that the committee thinks justify a deviation from this approach'.[206]
6. In assessing the contingent liability represented by all adverse cost cover, IMF works on the basis that its maximum contingent liability under all adverse cost orders at any given time is represented by 66% of the cash payments made on behalf of clients in relation to those funded cases and that the liquidity buffer required to be kept by the company is 20% of that figure.[207]

[203] A portfolio approach means that it is not enough to look at the expected risk and return of one particular investment. Investors can reduce their exposure to individual asset risk by holding a diversified portfolio of assets. Colloquially this is described as not putting all of your eggs in one basket. See E Carew, *The Language of Money* (3d ed 1996) 257.
[204] *Jeffery and Katauskas Pty Limited v Rickard Constructions Pty Limited* (2009) 239 CLR 75.
[205] Corporate Governance Manual (18 January 2010), para 2.1.
[206] Corporate Governance Manual (18 January 2010), para 4.18.6.
[207] Corporate Governance Manual (18 January 2010), para 4.18.10.

Cases are rejected on certain criteria, including if [208]

i. Liability evidence is irremediably too weak, too dependent on oral evidence, or requires a factually-rich and complex forensic inquiry.
ii. The claim is made up of too many small claims.
iii. The likely cost is too large.
iv. The defendant is unlikely to be able to meet any judgment.

Issues over confidentiality and privilege (discussed later in this report) have arisen in Australia. Obstacles may arise in circumstances where the litigant is unwilling to provide such access, or the funder faces opposition to gaining access to documents discovered by the defendant in the funded litigation.[209]

**Control**

The litigation funder provides the instructions to the lawyer (and manages its exposure on a daily basis) but the client/lawyer can override them. Where a class has different views, IMF has polled the class to ascertain what they think (this can be done efficiently and speedily by email). IMF's experience is that most people do not have a view and are content for IMF to suggest decisions. To provide some oversight, IMF has invited institutional clients to form a committee of overseers on a case. At other times, the funding agreement specifies that decisions on settlement may be taken by Senior Counsel.

IMF may cease funding at its discretion and will do so if it considers that a claim is no longer meritorious. Rights to terminate are set out in the following funding agreement clauses:

> '11.6 In recognition of the fact that IMF has an interest in the Resolution Sum, if the Claimant:
> 11.6.1. wants to settle the Claims or the Proceedings for less than IMF considers appropriate; or
> 11.6.2. does not want to settle the Claims or the Proceedings when IMF considers it appropriate for the Claimant to do so;
> then IMF and the Claimant must seek to resolve their difference of opinion by referring it to counsel for advice on whether, in counsel's opinion, settlement of the Claims or the Proceedings on the terms and in the circumstances identified by either IMF or the Claimant or both, is reasonable in all of the circumstances.
>
> 16.1 IMF is entitled, at its sole discretion, to terminate its obligations under this IMF Agreement, other than accrued obligations, by giving 7 days written notice to the Claimant …'

IMF's pricing is

a. Reimbursement of costs expended.

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[208] J Walker, S Khouri and W Atrill, *Funding Criteria for Class Actions*, (IMG (Australia) Ltd, [2010]).
[209] See W Attrill, 'Ethical Issues in Litigation Funding' (presented at the Globalaw Conference on 16 February 2009), at http://www.imf.com.au/pdf/Ethical%20Issues%20Paper%20IMF09%20-%20Globalaw%20Conference.pdf, p. 8.

b. A percentage of the Resolution Sum, which increases over time, i.e. the percentage increases the longer a claim takes to resolve. It is usually between 20% and 35%, plus a return of the outlay on own-side's costs.

c. A Project Management Fee, calculated as a percentage of the costs of the litigation, as compensation for the higher costs involved in managing more complex and hence more expensive litigation.

The existence of a litigation funding contract is disclosed to a defendant. Funders argue that there should also be disclosure by defendant to plaintiff of the existence of insurance, since that would prevent unnecessary litigation.

The existence of litigation funding has provoked some controversial decisions. After a decision that a shareholder, who challenged the validity of his investment purchase under consumer protection legislation regulating misleading disclosure, ranked in insolvency in priority to other shareholders[210] the government announced that it is to be overturned by subsequent legislation.

## Class actions

Recognition that private litigation funding is the major funding source for bringing class actions has led to significant change in the procedural regime for class actions. For its first two years, IMF preferred to fund (informal) group actions rather than statutory class actions.[211] The class action model under the legislation for Federal[212] and State class actions specifies an opt-out rather than an opt-in regime at the stage of declaration of a class. However, an opt-out model is simply unworkable for litigation funders. Funders need to be able to carry out a risk assessment on whether to make a potential investment, and this requires certainty over the number of members of a class from whom they can recover their costs and fees. Absent legislative change that would enable a funder to recover from all members of a class (and such a rule would be highly questionable on constitutional grounds), the right to recovery has to be contractual. Thus, funders need to have contracted with all, or at least a sufficient number, of class members before committing their money. If a significant number of class members are not contracted to the funder, a 'free rider' problem arises.

The courts have effectively changed this by accepting limited numbers of claimants in opt-in classes, where the clients are restricted to those who have all signed up with the funder who is backing the case, interpreting the legislation as permitting representation of 'some or all' of the full class of members. The Full Federal Court of Australia held in 2007:[213]

'This comprised a claim by 40 corporations who alleged that the Multiplex parties had failed to disclose delays and increased costs in the Wembley stadium construction contract. The claimants' group had signed a litigation funding agreement with International Litigation Funding Partners, Inc. (ILF), under which ILF would assume any liability of the funded parties for fees, costs or disbursements, in return, if the case was successful, for ILF obtaining

[210] *Sons of Gwalia Ltd v Margaretic* (2007) 231 CLR 160.
[211] J Walker, S Khouri and W Atrill, *Funding Criteria for Class Actions*, (IMG (Australia) Ltd, [2010]).
[212] Pt IVA of the *Federal Court of Australia Act 1976* (Cth), s 33J.
[213] *Multiplex Funds Management Ltd v P Dawson Nominees Pty Ltd* (2007) 164 FCR 275.

reimbursement of its expenditure on costs and disbursements and receiving 30-40% of the recovery. The funding agreement terminated if a funded party settled its claim or opted out of the proceedings, but the funded part would remain liable to apply any payment received as provided under the agreement.'[214]

The court based its decision on interpretation of the statutory provision that a representative party could represent 'some of all' of the class. Accordingly, the action need not be brought on the basis that all the possible members of the class were represented. The court distinguished between the Aristocrat class action, which impermissibly defined the group by reference to persons who retained MBC both before and after the commencement of the relevant proceeding, and the Multiplex class, which limited the group at the time the proceedings were commenced.

This decision raises issues of exclusivity. Australian funding agreements typically provide that clients will not be liable for adverse costs, and that the risk is covered by the funder. Professor Cashman has argued that if a representative plaintiff turns out to have a bad case and has to drop out, the lawyers assume liability for costs and are prevented from proceeding with other good cases in the class, so it would be preferable for the lawyers to have no liability for costs and not get into funding cases.

There is debate over whether litigation funders should be able to provide a 'complete service' to a client. John Walker of IMF argues that many clients wish to hand all decisions over to the litigation funding, who is in a position to provide an expert service in handling a case, and capable of taking all decisions. Some argue that this may be a step too far from client autonomy and control over their own affairs.

## IRISH-BASED FUNDING OF CLAIMS IN OTHER EUROPEAN JURISDICTIONS

An Australian-owned firm based in Ireland, Claims Funding International (CFI),[215] is funding claims for damages against airlines based on the European Commission's November 2010 Decision that a cartel existed in fuel surcharges for air freight between December 1999 and February 2006. Preparations were started after the start of the investigation by the European Commission DG Competition since December 2007.

CFI was started as a joint venture between the Melbourne-based law firm Maurice Blackburn and the Australian litigation funding company IMF. As a result of the 2009 financial crisis, IMF discontinued and Maurice Blackburn continued as sole owner. CFI considers that litigation funding is new in Europe and not yet established as a commercial phenomenon or within general policy, so its approach is careful and

[214] M Legg, L Travers, E Park and N Turner, 'Litigation Funding in Australia' paper at the Law Society of New South Wales Young Lawyers' 2010 Annual Civil Litigation One Day Seminar, 13 March 2010.
[215] Presentation by Peter Koutsoukis at the 4th Annual Global Class Actions Conference, Florida International University, Miami, 10 December 2010. The finance comes from Maurice Blackburn, a plaintiff's law firm in Australia, where they have had experience of running class actions and assessing costs since 1992. It decided to expand into other markets, initially with other partners who subsequently dropped out, and chose Ireland because of the low 12% corporate tax rate.

tentative, on the basis that creation and development of the right rules and acceptance for litigation funding should not be jeopardised.

CFI is established in Ireland for tax reasons, but carries out no funding business in that jurisdiction, so does not need any Irish licenses. There are no regulatory requirements for assignment of claims in Europe. Assignment of tortous rights is not permitted under English or Irish law.

There is both competition and collaboration between claimant lawyers/funders. The London office of the U.S.-originated law firm Hausfeld brought a claim in the English High Court (not the Competition Appeal Tribunal) that sought to invoke the representative action procedure, but the Court of Appeal held in 2010 that that procedure was not applicable.[216] (Hausfeld represented some 183 clients, many being subsidiaries of the same company, and CFI has 300 in its group in 11 jurisdictions.) It is thought unlikely that an NGO could fund this claim, since it is far too large. Some major corporations might seek to claim by themselves, perhaps seeking to settle without attracting publicity. CFI seeks to offer a complete service to companies for a complex claim. There are 14 airlines as potential targets (none are U.S. based), with Lufthansa as the primary target, since it admitted the infringement to the European Commission in being the first company to seek a reduced penalty under the leniency programme. Hence, the strategy is based on the theory that Lufthansa would find it difficult if not impossible to deny civil liability, and to avoid joint and several liability for the other airlines' liabilities to claimants. CFI anticipated that the litigation would cost €14 million, and last between 3 to 5 years of fierce litigation, covering alleged infringements in 11 Member States, and complex legal issues over which law applies to the tort and damages. No discovery assists quantification. CFI was in 2010 not anticipating any prospect of settlement, recognising that the airlines need a final, comprehensive settlement, and that will involve getting all claimants together.

CFI has itself funded and carried out the initial investigation of the claim and selected the lawyers, holding beauty parades. Claimants will have to prove their individual losses during the cartel period. That raises causation and quantum issues. CFI has a team of economists working on preparing a report to submit to the Court in evidence. CFI expects conflict of law issues to arise, such as which law should apply to a Swedish company claiming in the Netherlands for loss under a pan-EU cartel.

The strategy is to launch a series of test cases, involving one client based in each of Sweden, Belgium, Netherlands and France. Four major companies have been signed up. They are substantial companies but their identities are confidential for the present. When the court is faced with some test cases, the aim is to get decisions that would inform the parameters for settlement of others on similar lines. In UK the test cases would be in the Competition Appeal Tribunal. However, there is some concern over whether the airlines would be able to pay all the damages that could be claimed throughout the EU. The expectation is that the airlines would negotiate settlements.

CFI carried out due diligence on four forums over selection of the best jurisdiction for bringing a follow-on damages claim. They assessed Sweden, France, the Netherlands and the United Kingdom, on the criteria that those jurisdictions had companies that

[216] *Emerald Supplied Limited v. British Airways* [2010] EWCA Civ. 1284.

were substantial purchasers of air freight services, had experience with cartel damages litigation and were perceived to be favourable to further development of such claims. Factors against France a reluctance by French companies to sign up to the litigation, legal difficulties over proof, a significant language barrier and concern over whether the courts would be sufficiently independent, particularly in the Commercial Court where judges may not be legally qualified, can be appointed by business organizations and can work part time and/or pro bono. The adverse costs risk in the Netherlands is only around €300,000. The Netherlands has also in its favour that it has a working party of 30 judges that has been looking at relevant issues, it has a reputation for independence, people speak good English, there is a history of experience with class actions and an associated settlement culture including a pan European settlement mechanism contained in its civil code. In England and Wales, the adverse costs risk is 3 or 4 times greater, and hence there is a need for ATE insurance, which is expensive. Signup in the UK has been poor. Sweden has high adverse costs but was attractive in other respects. Litigation funding has some foothold in the UK, and a self-regulatory regime is developing. CFI expects that there will eventually be some regulation of financial aspects, so as to prevent risks such as a funder going broke. As the concept succeeds and the market grows, it is inevitable that rogues will appear.

All clients in its group have considered all the issues and have decided to opt in to CFI's group. The model involves an assignment of rights by companies to a special purpose vehicle (a Dutch Foundation) owned by CFI, with payment deferred, being 25 per cent of whatever is recovered as damages in the event of success. CFI is funding all investigation costs (it outsources collation of evidence on individual claims, and uses an economist and econometrist). In September 2010 it instituted some test cases in the Netherlands, lead by Philips Electronics, which it hopes the court will accept. At a hearing on 30 March 2011, CFI filed a statement of claim updating the Court on the European Commission decision and provided an updated list of companies that had assigned their claims to CFI (via its company Equilib). At the hearing KLM, Matinair and Air France served a writ seeking orders that the other cartelist airlines be joined either as defendants or third parties to the action. This issue needs to be decided by the Court before orders can be made about when defences must be filed. CFI recognizes that there is no guarantee that the assignment model will work. There is a German decision that is helpful.

Many of the claimant companies do not want publicity: These are typically big companies suing other big companies and they do not want to be seen as involved in class actions. In the Netherlands, some degree of confidentiality can be maintained, since names of assignor-plaintiffs can be restricted to an annex to the court documents which is not made public and the claimant in the proceedings is the special purpose vehicle company owned by CFI.

In any UK litigation there will be a committee of representatives of claimants to give instructions to the lawyers. CFI seeks not to interfere in the client-lawyer relationship. Its role is specified in the funding agreement as one of ‘supervision’. It aims to ensure that the claim remains meritorious. It maintains close liaison with the lawyers, including over choice of expert and settlement.

The Funding Agreement with clients covering UK runs to some 45 pages, which mainly deals with compliance on issues surrounding maintenance and champerty, with the aim of avoiding breaking those rules.

The position in the Netherlands is completely different – and easier. In the Netherlands, since cartel damages constitute a tort, and a tort claim is assignable, the cases will be brought on an ‘assignment of rights’ model. CFI has established a special purpose company (Equilib) to accept the assignment and carry out the litigation. This model has the advantage that instructions from the victim are not required, and there is freedom of choice over the jurisdiction of the claimant of litigation. CFI will continue to cooperate with the four large companies concerned, keep them informed and seek their opinions on settlement.

CFI’s commission ranges from 25-35 per cent. In UK the commission is tied to the timeframe of the outcome, but not elsewhere in the EU (i.e. the commission rises depending how long the case continues). Clients do sometimes seek to negotiate a reduced commission: CFI is more likely to agree to some reduction with big companies, and has only done so twice. CFI obtained endorsement from the European Shippers Council, partly in order to gain publicity and claimants, following which members can benefit from a discounted commission.

CFI is constantly debating whether and when to take action on other cases. It receives many applications for funding, and rejects most. The expertise of Maurice Blackburn is in cartel and other corporate misconduct cases, and they intend to focus on those. There have been 27 positive cartel decisions issued by the European Commission since 2005, although some are too small to make funding viable. Some cases involve countries where it would be difficult to recruit clients, even if only for language reasons, such as Poland. CFI has been working on the current case for a long time: initial recruitment took 18 months. Investigation of other cases would probably involve a similar lead-in time, so the business decision is when to divert resources to scooping other potential cases.

## CONCLUSIONS

- Litigation funding may first have appeared in the United States some time ago, where it has had an undistinguished history that includes consumer detriment and resulted in the need for State regulation.

- Litigation funding has a reasonably lengthy history in Germany, where it has been a natural development in providing legal costs insurance for SMEs that mirror the widespread BTE market for individuals.

- Litigation funding has exploded as a commercial phenomenon in Australia, where traditional prohibitions were swept aside by the courts in order to retain access to justice for a newly introduced class action regime. The regime is now probably the most liberal of any common law jurisdiction.

- Funders operating in Europe can be based in a jurisdiction that has tax advantages whilst funding claims in other jurisdictions. The validity of the funding contract must be established under the law of the jurisdiction in which the litigation is proceeding. Since national rules on litigation funding vary, funded litigation has emerged in some jurisdictions and not others. Further, variations in the national rules also dictate the nature of the funding arrangement—principally whether it follows an assignment model or an investment model—and the extent to which the funder may intervene or even control the tactical decisions that are taken in the litigation.

- Some specialisation is appearing amongst funders, such as for EU competition cartel damages cases, and securities investors' class actions in Australia.

# 4. The Current Litigation Funding Market in England and Wales

This chapter summarises the basic facts about the principal elements of the litigation market currently operating in the UK. Section A will describe some of the leading funders, their origins and general modes of operation, and Section B summarises the key issues that arise from the current state of the funding market. Table 1 provides an overview of the key companies.[217] Veljanovski's 2011 study identified 15 dedicated funders, whose total funds raised and invested in the UK exceed £457 million.[218] The total invested in litigation support by third party companies in Europe is unknown, but is probably in the tens of millions of Euros.

Table 1: Principal Litigation Funders in UK

| **Company** | **Management** | **Capital Range** |
|---|---|---|
| Allianz Litigation Funding[219] | Timothy Meyer, CEO<br>London, WC1V 7QT (Munich) | £10 to £20 million |
| Harbour Litigation Funding Ltd | Susan Dunn, Head of Litigation Funding<br>London W1K 4LR | £40 to £70 million (2009 figures) |
| IM Litigation Funding Ltd | John Walker and Wayne Attrill<br>London | £2 million in UK |
| Commercial Litigation Protection Ltd | Brian Raincock and Richard Sheehan<br>London EC3V 9LJ | Unpublished |
| Claims Funding International | Peter Koutsoukis<br>Dublin 2<br>Republic of Ireland | Unpublished |
| Burford[220] | Sir Peter Middleton<br>Christopher Bogart<br>(formerly Selvyn Seidel)<br>Bermuda, New York | $200 to $400 million |
| Juridica Investments Ltd [Invesco, Jupiter Asset Management] | Richard Fields, CEO<br>Swidler Berlin and Dickstein Shapiro<br>Guernsey, London | £600 to £800 million (2007 figures)<br>£10 to £40 million (2009 figures) |
| Calunius Capital | Leslie Perrin, Chairman<br>Christian Stuerwald, Partner<br>London | £10 to £40 million |
| Therium Capital Management Limited | Neil Purslow<br>London W1K 6JQ | £40 to £70 million |
| Vannin Capital | Michael Riegels QC, William Evans, Matthew Cox, Nick Rowles-Davies<br>Isle of Man | £25 million annually for five years from 2011 |
| ILF Advisors | Neil Brennan, | £10 million |

[217] See also C Veljanovski, 'Third Party Litigation Funding in Europe' (Case Associates, 2011), paper given at George Mason University, 5 October 2011.
[218] C Veljanovski, 'Third Party Litigation Funding in Europe' *Journal of Law, Economics & Public Policy* forthcoming, available at http://ssrn.com/abstract=1971502; *Third Party Litigation Funding. Facts and estimates for the UK*, Case Associates, 2011.
[219] This company ceased new business in late 2011, as noted below.
[220] In December 2011, Burford agreed to pay £10.3 million to Equistone Partners (formerly Barclays Private Equity) to purchase Firstassist Legal Expenses, the leading U.K. ATE litigation insurer, from which to build a leading U.K. litigation funding business: Press release 12 December 2011. Burford's principal investors are Invesco UK 45%, Fidelity International 10%, Baillie Gifford 10%.

| | | |
|---|---|---|
| | London W1J 6ER | |
| The Judge [broker] | Matthew Amey, James Blick, | |

Litigation funders are drawn primarily from the legal services market i.e. firms developed by lawyers or from the financial services (insurance or investment) market. A brief summary of the principal players in the UK litigation market follows.

## A. SOME COMPANIES

### ALLIANZ

Allianz Litigation Funding ('Allianz') is a division of Allianz ProzessFinanz GmbH, based at Munich, which is part of the leading German-based insurance company Allianz Insurance. The position until recently was that Allianz operates in Germany, Austria and Switzerland as well as the UK. There was no substantial difference in the core funding model between the UK and Germany. However, in October 2011, Allianz's parent company decided to cease investing in new court or arbitration claims. It will continue to honour pre-existing obligations. Press comment gave the reason for the discontinuance as 'irresolvable systemic conflict' between the interests of the parent company's insurance clients as defendants and the interests of funded claimants.[221]

Allianz has funded all or part of a claimant's litigation costs in return for a share in the proceeds (damages). The exact share taken by Allianz was dependent on the percentage of the legal costs funded and other factors such as the claim value, length of proceedings, and when settlement is achieved. However, Allianz bore the financial costs if a claim fails and so rigorous assessment of a claim prior to commitment was essential. Allianz' experience of funding dates back to 2002 in Germany. The slight difference in the business model between the UK and Germany was primarily due to the fixed-costs regime in Germany and the existence of court tariffs, meaning that lawyers are restricted in what they can charge and costs have a level of predictability that is difficult to achieve in English courts.

There is no standard litigation funding product although there are some standard contractual terms running to approximately 15 pages. Allianz examined the cost-reward ratio and decides how much to invest and on what terms. Funding was a bespoke service, tailored to the specific needs of the client and case. There was a range of options for funding including disbursements (including solicitors' and Counsel's fees, expert's reports), funding for ATE premium (if required) and security for costs. Terms could vary between cases. It might contribute all or only part of the funding for a case (e.g. disbursements only). Cases were usually funded in part on a CFA, for which uplifts were typically 50-80%. Potential liability for opponents' costs was usually covered by separate ATE insurance policies (e.g. QBE), for which the insurers would carry out their own risk assessment. Around one-third of its funds were invested in multi-party cases, and two-thirds individual cases. In practice, all

[221] S Grene, 'Debate on the ethical issue of investing in lawsuits', *Financial Times*, 13 November 2011.

clients were claimants, although there was no theoretical reason why defendants could not be funded.

Clients chose their own lawyers first: Allianz stayed away from doing this. Clients and lawyers approached Allianz once they had investigated a case and had a convincing case plan. This meant that there must be some initial source of funding for investigation.

## CALUNIUS

Calunius was established in 2007 as a broker for large commercial cases. In 2010 it raised a private fund of £40 million so as to be able to fund cases itself.[222]

Roughly 3 out of 4 of Calunius' cases are brought to it from law firms who are already instructed by their client companies. Media coverage in recent years, especially in the *Financial Times* and *Times* has made Calunius fairly well known. Many of Calunius' clients are smaller companies who are in dispute with bigger companies.

## HARBOUR LITIGATION FUNDING

Susan Dunn established IML in 2002 to provide funding in insolvency cases. The law had been clear on funding insolvency cases for 100 years, and there were no regulatory challenges. IML was established to take assignments of claims, but that model was hardly used then and has not been used since. It was found that people wanted funding for statutory claims, which cannot be assigned. In any event, the assignment model has disadvantages: if people are paid, they have no incentive to provide the funder with ongoing assistance, information or documents, which they do have if they maintain a stake in the claim. IML looked at around 500 claims and funded 50.

There is ongoing demand for litigation funding. The main market is from SMEs, insolvency practitioners and law firms. In response to the increasing demand, and a desire to be able to fund more and larger cases, Ms Dunn established Harbour in 2007 with two wealthy individuals, Brett Carron and Martin Tonnby. Harbour's business has broadened, and a second fund was established in April 2010 with a further £60 million. For that fund, there is a 2 year investment period, so Harbour has to invest £30 million in each of the two years. It expected its portfolio to comprise 25 cases at a minimum claim value of £3 million each.[223]

Clients are often SME companies and Harbour funds primarily in common law jurisdictions, but Harbour now has international inquiries for the U.S.A., Singapore, Australia and New Zealand. Some multinationals now seeking funding, and while Harbour has yet to fund a multinational corporation case this could increase: the point

[222] One case funded in 2010 is Elvis Presley Enterprises, Inc v RCA claiming in Germany under a 1973 recording buyout agreement: see Calunius press release 30 August 2011.
[223] Harbour Litigation Funding Ltd, Press Release, May 2010.

is to give companies a choice of funding options and the added advantage of securing the input of a highly experienced litigator. The flexibility is often not realised by solicitors, who assume that because companies have always paid the bills they are not interested in any other funding options. However there is increasing interest from in-house lawyers who now realise that they are able to use litigation funding rather than continue to use a commercial firm and pay their bills.

Harbour does not publish its results: it is a private fund. Harbour's solvency is, therefore, not transparent: if any potential client asks about this, it is answered on an individual basis. There is no difference here between the position of lawyers who fund cases on CFAs, or commercial transactions involving accountants or any other supplier. It asks why litigation funders should be subject to any more onerous rules. The real question is not how many claims are won or lost but whether costs have been covered.

## THERIUM

Therium was started by lawyers from different backgrounds who initially started looking into the litigation funding business at the beginning of 2007 before eventually forming a new company in February 2008 to provide third party litigation funding. The company formally began operations until 2009.

The company background indicates that it is very difficult to raise funds in the UK for new third party litigation funds, despite considerable enthusiasm for the business. Normal fund managers do not seem interested in investing in funds for 3PF in the UK as it is a new asset class and people do not know how it is going to perform. Raising funds can be difficult. Therium views litigation funding as being well established in America and Australia but new in the UK, where it has not been established as a phenomenon, either as a clear investment opportunity or a source of funding that lawyers understand.

At Christmas 2010, City of London Group plc provided both equity investment, which provided the working capital for Therium, and seed monies for case funding. Therium has continued its fundraising off the back of that, fundraising from wealthy individuals. City of London Group's focus is to invest in fund managers and more generally investing in professional services.

### Business and Funding Model

Therium funds claimants but is really investing in the law firm and their handling of a case. In the U.S., funding is sometimes provided via a loan to the law firm and this could translate into the U.K. if the law firm is prepared to work on a contingency (if and when the rules change to allow this). Therium would then provide the working capital to pursue a case. Therium's view of the market is that you need to be flexible in how you deliver funding.

The business model is effectively an inverse Christmas tree. Therium works as a small team offering funding to lots of law firms. Therium is developing a firm base and has not needed to market its services, since it has grown partly through word of mouth and also through broker recommendations. The relationship with law firms is a key part of its approach as once it has dealt with a firm they tend to come back for further cases. One challenge of the market is the lack of awareness that lawyers have of the funding options, but through Therium's model and its emphasis on good relationships with the law firms, lawyers are learning how to bring funding in as part of their assessment and planning of a case and their work for their client.

Therium's model fits within the pure funding model adopted by other UK funding companies. The company does not provide any ancillary services, does not levy any assessment or investigation fee, and simply provides funding for a case via a contract with the claimant rather than the law firm.

Therium's pricing is at the lower end of the litigation funding model and while the company could charge more it is looking at a long term business model and becoming the funder of choice. The aim is that law firms will recommend Therium as a flexible and professional funder so that the client receives the best result. To facilitate this Therium doesn't pursue the biggest possible return, in order to encourage firms to bring the best cases to them which reduces Therium's risk. It helps that Therium's principals are all lawyers who are still primarily interested in achieving successful litigation, just with an emphasis on the funding and costs of litigation.

## LITIGATION PROTECTION LIMITED/COMMERCIAL LITIGATION FUNDING LIMITED

The Commercial Litigation Funding Limited ('CLFL') Access to Justice Group has constructed a business structure that aims to avoid conflicts. It comprises three principal elements: litigation funding, ATE insurance, and (recently) litigation management.

First, Brian Raincock founded an ATE business in the 1990s. He later sold part of this to DAS, but retained the right to provide ATE in connection with litigation funding so as to hedge the risk. ATE is provided through Litigation Protection Limited, which arranges cover with a pool of insurers.

Secondly, CLFL markets litigation funding, carries out due diligence on cases, arranges ATE and litigation funding. In every case, a package is assembled that is put to funders, namely LitFUND PCC in Jersey. At LitFUND PCC, and Case Review Panel (members are paid and provide independent judgment: Nick Rochez, Patrick Burgess who is strong on 'quicksand issues', and Reg Brown) reviews every case before it is put to the independent Board. LitFUND PCC decides funding policy. It comprises different investment cells. If a case is accepted creates a discrete funding cell for it, from a particular mix of investors on a *pari pasu* basis. Investors may have different requirements, which can be catered for through using different funds and cells.

Thirdly, they have found that more individual claimants have a need for advice on how to approach and manage claims, so Litigation Management Limited has been created to respond to this need. Its role is somewhat tentative and developing. It is intended to recruit claimants for group cases, and manage such cases on their behalf and on behalf of the solicitor. The emerging role is somewhat akin to a client's friend: assisting in decisions on which lawyer to appoint, how to arrange funding etc. It remains to be seen how the management cost should be paid for. The management function could be carried out more cheaply than by lawyers. Should it be a recoverable cost? Should it be a disbursement of the solicitors? It is currently not recoverable.

The ownership of all these funds is private. Different investors are involved, although perhaps three individuals are the principal owners. Control over investment decisions, however, is carefully diversified, so as to facilitate a balanced approach.

Brian Raincock used to have a business (Resolve) that funded clinical negligence cases up to £10,000 damages (which would by now have been extended to £50,000) but this was made unviable as a result of the change in NHS Litigation policy. However, the proposed NHS Redress scheme has never been brought into operation, so there is a gap in cover for such claimants. Cases against the NHS funded by Resolve were evaluated by a medico-legal expert, after which they settled very quickly.

The argument that the funder should have a right to influence decisions in a case is that it involves its money. Further, the 'funder' might in fact be using the funds of what might be a potentially large number of investors. The litigation might not be viable absent such funding. So the 'funders' would maintain that they have a legitimate interest in how their money is used. The position would be akin to how the legal Aid Board operated: decisions on use of public funds were subject to continuous reporting, review and right to withdrawal. CLFL has been operating since 2007. 85 per cent of clients are individuals with individual cases. Many are SME companies.

## THE JUDGE

The Judge is an independent broker for litigation insurance and funding. It was formed in 1999 to service the expanding new ATE market that was needed to support recoverability of CFA success fees and ATE premiums. The types of claims involved were personal injury and low level disputes for individuals, whose solicitors acted on CFAs. The business has evolved during the decade into third party funding and insurance to cover commercial litigation.

Demand from business customers is increasing. Enquiries come both from company clients and from solicitors. The service is essentially the same for ATE or for third party funding inquiries: the broker obtains quotes from insurers or funders and attempts to put packages together that might include funding, ATE insurance and a discounted CFA. The addition of ATE can reduce the level of a funder's success fee. The broker will be paid by the funder out of its commission charged. It therefore retains an interest in the outcome of the litigation, and will remain copied in on correspondence but will not be particularly active in the conduct of a case. The current rule in England is that the premium can be recovered *inter partes*. The broker's revenue stream therefore comes from business written 2 or 3 years earlier. Accordingly, it is difficult for others to break into the market.

## MARKET ACTIVITY

The market is dynamic and developing quickly. In late 2011, Burford announced the takeover of Firstassist (noted above), and two new funds were launched: Caprica,[224] which focuses on the lower end of claims, worth a minimum of £50,000 as opposed to others' far higher threshold, and Managed Legal Solutions, for claims worth over £1 million.

## B. KEY ISSUES IN ASSESSING THE OPERATION OF THE MARKET

Our analysis involved semi-structured interviews with the principal players in the litigation funding market to understand the current operation of the market and how the perceived conflicts identified in other jurisdictions (see above) had been addressed in the emerging UK market. For reasons of confidentiality we do not identify individual companies when discussing the detail of market operations, and report anonymously on their activities using the anonymised terms Funder A, B, C. etc. when referring to specific comments drawn from our extensive discussions with the main litigation funding companies, their views on the operation of the market and detail on the types of cases that they fund.

The main issues addressed in these discussions were:

1. The nature of funding
2. Types of Claim funded
3. Claim Values
4. Risk Assessment issues
5. Client Control and Client Contact issues
6. Settlement issues and Withdrawal of Funding
7. Regulation
8. Future Development of the Market

Our analysis identified that while litigation funding is a bespoke product tailored to the specific needs of the market, shared practice has almost inevitably developed among the principle litigation funding players.

### The Nature of Funding

There is no litigation funding product – it is a bespoke service, in which every case is evaluated individually. In every case, there is a range of options for funding, and an appropriate solution is selected and negotiated.

There is no standard litigation funding fee across the market and funders indicated that each agreement has different terms. Funders have standard boilerplate clauses but there is no industry standard. Every agreement will have its own special conditions, which can change the standard terms significantly. Negotiations over terms are

[224] Launched November 2011, set up by investment management firm Thomas Millar.

frequent. If a client has a good claim, it will want to negotiate a lower funder's fee. So, as a general rule, very good cases get cheaper funding. But the converse is not necessarily true.

The litigation funding market is still maturing. Funder A indicated that funders have not yet fully embraced the idea of competing on price on a case by case basis, in the same way that insurers have. Claimants can be of any size. Even large companies can find it difficult to fund litigation, because their litigation budgets are limited. Some cases are too large for law firms to take on a CFA. Defendants know this and can try to stifle claims by putting up robust and costly defences. Most clients are companies. The market used to be in impecunious companies or individuals, but it has moved towards wealthier ones. Clients are attracted by the opportunity of risk- and cost-free litigation, and are happy to bank 60% of their winnings, rather than a larger percentage. Groups of investors are increasingly appearing, and the model works well for them. There can be some tensions between richer and poorer members of classes over issues of settlement, such that some want to hold out for more whereas some want to bank any sum on offer. In this respect, the existence of an independent third party funder has a useful levelling function. Funders are increasingly selling a litigation management function.

Funders would want to see chances of success of at least 60%. A 50% chance of success would not be enough. The application of rational economics means that funders simply do not fund unmeritorious cases. Funder B's objective is to obtain a level of return on its business investment that is at an acceptable level. This will be achieved as a result of enforcing legal rights. The result may be that compensation is obtained in more cases, and is obtained more quickly that it would otherwise be. These consequences would uphold both the economy (rather akin to the late Payments Directive) and the law. But funders are not interested in 'law enforcement' as such.

Funder B makes clients pay for ATE cover up front. A funder makes more money than an ATE insurer: Jackson's recommendations would change the rules on are ATE recoverability, and that would affect the ATE market and size of premiums. Some cases come from lawyers (both solicitors and barristers). Some cases come from accountants (e.g. insolvency cases, where accountants have rights of audience so no lawyers might be involved, or against the government). Professional negligence cases are tricky because there are few insurers who are not conflicted: some insurers refuse to cover cases against their client sector, eg banks. Some solicitors are prepared to work on a 100 per cent CFA.

Funding is inherently high risk and Funder C explains that its model is to fund the best cases with the strongest possibility of success and which will work out best for the funder and funded company. Claims cannot be pursued without the claimant and thus Funder C puts its litigation funding on the side of the claimant so that the outcome must work for both funder and claimant. Such close alignment with the claimant prevents any possible abuse of process. The model also is intended to stabilize the litigation making life easier for litigator and client.

Funder C's model is very much one of providing financial services by way of investment facilities that allow for the capital concerns of litigation to be managed. But the funding product is also part of legal services provision as its funding pays the legal bills which enables the client to access the legal advice and Courts and means that lawyers don't have to worry about the funding the cases. Funder C never buys cases from people. Its return on funding would, at maximum, be 50% of a claim. There is no standard funding package, bespoke funding is provided based on the demands of a case and the client's needs. Funder C will co-fund alongside the client, may pick up unpaid WIP or bills at the point of funding.

Funder C sees the delivery of funding in an appropriate way as one of a number of services that may be needed to make the litigation successful. Conversely, funding delivered in an inappropriate way or in inappropriate circumstances may itself prejudice the success of the case. In Funder C's view, hedge funds don't deliver funding very well because of a lack of understanding of the litigation process and what is required to support that. Litigators may be nervous about the demands of that type of funding but the benefit of Funder C's model is that the funding is clearly agreed and then monitored under contractual terms that ensure that the legal bills can be met and the case is supported appropriately.

Funder D explains that it can co-fund cases with lawyers, such as through a CFA. Lawyers in UK are concerned about financial over-stretching and do not want to risk financial collapse: solicitors are inherently conservative. They are not trained about funding options, and this should be mandatory, since they need to offer clients advice on funding and on budgets. Funder D often puts budgets *up*, since lawyers assume that either Funder D or clients would not take a case if they told them the real potential cost. Funder D wants to budget on the basis of what might realistically be the cost of a case, not what the best position might be, so to include security for costs and strike out applications etc. There is also the problem that the economic model of law firms runs on billing totals and hourly rates, so there is limited freedom for individuals to adopt flexible solutions, which have to be approved by law firm internal risk committees.

Funder F explains that in longer cases there is too much risk that it could be a target for adverse costs so the company almost always requires the client to cover that risk by way of the obtaining of ATE insurance. Deferred premiums are paid if the case succeeds and there are various ways that Funder F can structure a deal with the ATE provider; sometimes lawyers taking cases on CFA may already have ATE in place.

Both a litigation funding arrangement and a contingency fee take a percentage of the client's money. So there is no difference in principle between them. But there are more conflicts in a lawyer having a percentage interest than without. Conflicts do occur. There is no mechanism of oversight over decisions, and no means of overcoming the problem. A lawyer's interest is clearly greater with a percentage or success fee than with an hourly rate.

Most funders encourage the client to take out ATE insurance. The premium can be deferred, which simplifies funding requirements. The premium can currently be recovered from the opponent, but if the Jackson Proposals are implemented this would no longer be the case, so in most cases clients would have to bear this cost, as is the position in Germany. If the change occurs, the market will react. A funder should hold sufficient reserved funds to cover potential liability for adverse costs awards where cases are lost, because ATE is pooled.

**Types of Claims**

There is some variance on the types of claim funded although litigation funding is primarily used almost exclusively for commercial claims; there is a broad definition of what this includes.

All funders confirmed that they generally do not fund consumer cases. They are simply too small to make sensible commercial propositions (discussed further in value of claims below). Litigation funding has a threshold of economic viability. Many commercial litigation cases involve costs on either side of £100,000. Accordingly, the following would be suitability ingredients:

1. a claimant
2. a substantial claim
3. a good chance of success
4. a defendant who is good for the money.

Funder A indicated that certain types of case lend themselves more easily to litigation funding:
- insolvency
- shareholder disputes
- contract interpretation

Others types of case are more difficult, however funding can still be structured for the right case, e.g. patent disputes, royalty or licence fees, which can be difficult to quantify. Certain types of cases are clearly not brought, because they are unattractive or unviable.

Funder B indicates that typical cases are breach of contract, patents (which a number of funders agreed could be difficult because they can turn on highly technical points e.g. challenges to the value of a patent which can cause the case to spiral out of control extending the length of time the litigation takes to resolve and the costs involved in pursuing a case. ), passing off, some trademark infringement, and construction (if large enough) and that some of its cases come from other funders (especially if they don't understand ATE). Other cases include international arbitration, investment frauds involving trusts and some intellectual property cases (licence agreements for instance). As the business model has as its basis damages and recovery being made, patent cases are less attractive to investors. The cost of experts in IP cases can also be an issue making these cases less predictable and the costs of pursuing a claim unattractive against the likely damages.

Funder C also confirmed that while funding might be provided for the full range of commercial litigation, this has a broad definition. Funder C has declined to handle divorce cases that have been presented partly because they don't wish to be perceived as a greedy funder (the risks in a big money divorce case would not generally justify the returns typically sought, even though those might be available) but also because clients in divorce cases are hard for their lawyers to control and may well not be rational clients. The risks in divorce cases do not usually justify the return for litigation funding. There have been large cases where a wife has been suing her husband and a complete risk approach could be taken but a funder would not lose in such a case as the wife would probably always get something.

Some funders confirmed that employment cases are taken, mainly contract disputes but these are not run-of-the-mill disputes instead they are Chief Executive's or City Bankers where the dynamics of the case are commercial and similar to any other litigation case involving hundreds of thousands (or usually millions) of pounds. Clients in such cases are inevitably commercially sophisticated individuals. One employment example involved a claim value of £5 million for an equity partner. Very few employment cases have been funded already but Funder C expects to see this area expand because city firms may well be vulnerable to claims of sexual and racial discrimination in their employment arrangements.

Funder D indicatesthat much of the increase in demand that it sees is now coming from non-insolvency cases There has not been the growth in insolvency cases, one might have expected in light of the recent financial downturn, this is in part because there is typically 6 years in which to bring a claim and litigation tends to come quite some time after the initial crisis has blown up.

Funder D confirms that it has funded breach of contract disputes, tax claims, insolvency claims, fraud and breach of fiduciary duties claims. Intellectual property cases are not funded often because they often involve more science than law. Funder E indicates that most of its funded cases are contract disputes, such as licence disputes and supply contracts. Constructions cases are difficult to accept, as they are expensive and complex. Some intellectual property cases are funded, but generally not patent cases, which depend on highly technical points. In other words, the market selects those cases that are easier to evaluate and predict, and some types of case would tend not to be attractive as funding propositions. Funder F confirms that it has funded some investment fraud work including issues like share-sale misrepresentation. The model effectively dictates the cases that are attractive funding propositions and ease of evaluation and predictability are factors. Professional negligence cases, for example cases involving a lawyer giving poor advice, would also be looked at within the funding model and could be attractive for funding. Funder F also confirms that it would consider funding collective (class) actions but had not done so at the time of interviews. Funder B, however, confirms that it is funding a number of group actions. These can typically be investment, property or probate cases. They can be brought as GLOs or some other procedure. From a funder's perspective, the risk is unclear if group members can opt out, or not be involved and later benefit from success (free riders). In such cases, defendants are less willing to settle. Funding agreements provide cost consequences for people who leave half way through. Examples of such groups are Claims Direct claimants, Alder Hey organ victims, travelers and increasingly investors. Unfair contract terms might also be involved. Funder B does try to 'book build' by identifying and securing claimants to opt in to a group. It has not attempted to identify classes from the activities of regulators. Funder B expresses the view that personal injury cases are more difficult, especially clinical negligence. These can now be funded by solicitors on 100 per cent CFAs. Jackson has proposed a solution to the concern that the success fee would have to come out of the damages by a 10 per cent rise in damages.

Several funders consider that litigation funding facilitates access to justice for certain types of cases. It necessarily improves the prospects of settling a meritorious claim by putting a claimant on a level paying field with a deep pocketed defendant.

## Claim values

The general view of funders was that claims under a value of £100,000 would be unlikely to attract funding although in further discussion it emerged that in practice the threshold is higher. The value at stake and recoverable in a case must be enough to enable repayment of the claimant's costs and the cost of any ATE premium, net of any costs recovered from opponents, and above that a sum sufficient to enable the funder (and broker) to take a sufficient commission and leave enough for the client. A case valued at £1 million can work, but the realistic settlement value might be less. Funder A suggested that cases of around £500,000 are hardly realistic while Funder B explained that it does not look at cases under £2 million; all funders agreed that litigation funding is difficult to utilise in smaller value commercial claims. The state of the market is that litigation funders wish to focus on big cases, so as to maximise the returns for their investment. For example a claim valued at c. £100,000 could incur £50,000 in costs and given most funders preferred investment returns the ratio of costs to recovery means that such claim values are difficult to accommodate within those financial parameters. In smaller cases one would consider funding by lawyers under CFAs and deferral of their payment.

In practice, claims of £1 million fall more comfortably within the business model so that, for example, an investment of £150,000 in such a larger claim is viable. Funder E considers that litigation funding providers aim to invest one-tenth of the claim value, but not more than one-sixth. For example, for a claim worth £1 million, an investment of £100,000 towards the claimant's costs might be made, which should ultimately be returned by the loser, for which the fee would be 30 per cent of the recover (hopefully £300,000). The funder would spread his risk, and balance the different amounts of his fees, across a portfolio of cases. Hence, his decision to accept a case with a certain risk or outlay at any one time may be affected by the state of his portfolio of other cases at that time.

Funder F explains that historically claims dealt with by the company have been at the level of £1 million plus, (a value shared by other funders) and the share of proceeds recovered has been between 10% and 30% or 1.5 – 3 times the funder's investment plus invested costs. But Funder F acknowledged that it would consider funding lower value claims. Indeed, we note the development in the market in late 2011 as a new entrant targets claims over £50,000.

## Risk Assessment

A common theme in litigation funding is the requirement for a high level of confidence in both the legal team and the case before deciding on funding. Funders usually require initial investigations on the evidence and merits of a claim to be completed, and an application for ATE insurance to be in train, before they will assess a proposal as a package. But the extent to which funders investigated claims or assessed the merits of any case strategy before deciding whether to fund a case varied.

Funder B requires a 60 per cent prospect of success. There is no investment logic in investing in a claim to lose money, or not obtain a projected level of return. It is possible that a funder who has sufficient assets could agree to speculate on a case with a lower prospect of success, as a punt. There is a relationship between size and merits of a case. If a case has lower merits, the fact that it has sufficient size may still equalize its chances of achieving an acceptable return, since a defendant's risk would be larger. On the other hand, so would the claimant's funder, but pricing can offset this to some extent if the portfolio is strong enough.

A funder must be in a position to make a clear assessment of the risk of investment. Funder B relies heavily on the advice of the party's solicitor and counsel. It is choosy over who the lawyers are. Funder B knows around half of the solicitors who make applications. If the funder does not like the client's lawyers, this can raise difficulty: it has been known for funders to say that they would fund a case but only if the lawyers are changed. So there is some patronage, but it is risk based. It is particularly important for a funder to have confidence in the lawyers where the funder does not have the right to control the lawyers' selection or the ability to make decisions on conduct and settlement. The suggestion by Jackson that funders should not be able to withdraw is unrealistic. Funders must be able to protect their investment, and the continuation of hopeless cases would merely bring the legal system into disrepute. Funders have no incentive to withdraw from cases where the prospects of success remain positive.

In some cases, clients have already spent a certain amount on investigation and conduct. Funder B is prepared to make available 'early case funding' for investment and assessment, say of £5,000—£10,000. If this 'pump priming' funding is made available, it is recoverable as a first slice. The initial budgeting function is an essential discipline to get right. Funder B insists on clear case and budget plans. It sometimes gets experts to look at cost budgets, and can find major errors, such as that all disbursements have been omitted. If lawyers say they need more funds during a case, the first instinct is to see whether the lawyer's initial budget was at fault and make the lawyer bear some or all of the extra cost. Funder B can provide additional funding if it is justified, but the rate would be higher.

It is essential for a funder to have access to full information in order to assess risk, at the start and during a case. Issues over access to confidential documents, whether of clients or opponents, have not arisen. It is entirely in a funder's interests that confidentiality is maintained.

In the first case that Funder C funded, it became involved approximately two weeks before trial on a claim worth several million pounds. The claimant was extremely pressured on finance and Funder C offered a guarantee for payment of Counsel's fees (without which the claimant would have been unable to brief counsel and the claim would have foundered). With the benefit of good counsel, the case was settled on the second day of trial.

Typically assessment of cases involves reviewing the papers including pre-action letters and possibly Counsel's opinion. Funder C always meets with the claimant, usually also meets with the lawyers and sometimes with Counsel or experts. The assessment process involves considering:

1. Due diligence – assessing the quantum, the merits of the claim and strategy, and the solvency of the defendant.
2. Why does the claimant want funding? Why is s/he bringing the litigation and what are his/her objectives and settlement expectations? At this stage Funder C is assessing the claimant's commitment to go all the way if necessary, and whether the claimant has a reasonable approach to settlement. The best outcome for both the claimant and the funder in the majority of cases is a lower result, i.e. a settled case at an earlier stage before all the costs have been incurred.

Soft assessment of the claimant is intended to weed out those people who have a point to prove and are hell bent on going all the way with a case to the extent that they may be unwilling to consider/accept settlement advice. People who won't put any of their own money in but will have a punt with somebody else's money are potentially high-risk claimants and Funder C is perhaps less speculative than some other funders. This reflects their approach of aiming to pursue the most meritorious cases, even if they could seek ostensibly what would be a higher return on a more speculative case.

Funder D explains that a proposal is considered first by its in-house team although advice may also be sought from members of an Advisory Panel, who are paid on an hourly rate basis to give a sense of the issues that might arise in a case. Funder D always conducts its own investigation into a claim but claimants do not currently pay fees for the funder to look at a case. Evaluating a proposal might take anything between 5 minutes (to say no) and 40 hours. The time depends on how well organised the proposal and the nature, complexity and reliability of the available documents. A client must have a legal adviser in place who has given an evaluation of the case. Harbour takes its own view on the aspects of liability, duration, strength of case, budget and value.

Funder D explained that proposals could be presented for its consideration at any stage of a case, even shortly before trial. Conditional approvals are sometimes granted such that a case will be accepted if a shopping list of requests (e.g. for evidence) is achieved. Funder D would pay for that work, but recover it in the ultimate bill. If the case is not taken on, the cost would be lost, but this does not happen often.

Roughly 3 out of 4 of Funder E's cases are brought to it from law firms who are already instructed by their client companies. Funder E requires proposers to put forward a package for evaluation that comprises three elements:

1. the case lawyers' opinion on merits;
2. the budget to end of trial;
3. key documents.

Proposed cases are evaluated by a funder's in-house legal expertise, sometimes with the assistance of outsourced expert opinion. A funder might seek an opinion from a barrister (who can be instructed direct), for example in a case such as breach of trust where expert knowledge would not reside in-house. The funder would pay the barrister up front for this advice, which would not normally be available to the client. In some cases, funders have arranged a joint conference between the client's legal team and the funder's, which can result in a debate over the strengths and weaknesses of a case. The objective is not to identify the strengths, which are usually readily apparent, but to test weaknesses and counter-arguments. In one case, a proposer and its legal team were convinced of the strength of their case, but the advice of the funder's barrister was that the case rested on a single legal argument, and the funder insisted that a secondary argument was also raised o as to strengthen the overall chances of success.

The lawyer and legal team must have a good reputation and appropriate experience, and command the confidence of the funder. Several funders indicated that while the responsibility for legal advice rests with the client's solicitor, the evaluation and case plan must be entirely convincing. For some funders, the company must have done a certain amount of work in investigating its case, at its cost, before a convincing proposal can be made to a funder. Assessment of the case may identify issues that the client needs to investigate and resolve, thus a funder's response to a proposal is sometimes that more investigation or analysis needs to be done before the proposal can be evaluated and a decision made.

Funder F requires the client to have committed sufficient funds to put the case in the position where Funder F is able to undertake its own risk analysis. Cases in which a client has invested a sizeable amount to that end also indicates merit in the claim concerned. Ideally Funder F looks for the lawyers (usually the solicitor though ideally Counsel too) to be prepared to pursue the case on some form of CFA. This is a good indication that the case has merit and the lawyers are both confident in it and prepared to take some of the risk on its success rather than expecting Funder F to meet all legal costs with no risk on their part. Risk has to be managed on Funder F's investment and so the company may require the lawyer to consider discounted CFAs. Some clients do hawk cases around and hedge funds, for example may be less risk averse but Funder F's threshold has to be quite high in managing that risk.

For funding to be considered for a collective action, Funder F would expect that the claimants and their lawyers had 'put the house in order' before a case is referred to it for consideration. A fully prepared case complete with appropriate legal team would need to be in place so that the case could be fully evaluated and the lawyer involved would need to have appropriately evaluated the case before referring the same to Funder F as the funder does not generally fund the preparation costs (historic costs). But where Funder F likes the case, has confidence in the legal team and wishes to fund it, there is room for negotiation.

The initial operational concern is to establish whether Funder F has a conflict in investing in supporting a company against another customer or its own major interest. This is exactly the same issue as faced by any law firm and was an issue raised by several funders as part of their risk assessment operation.

Funder F has a funding commitee comprising eight to ten individuals. A decision on funding requires unanimity. Resolution by committee is a key part of its due diligence and can result in an issue raised by a member of the committee that requires further investigation by the client; this attempts to ensure that the funder is satisfied that all points are covered before the company invests in a claim. The client's response to any points raised may be the basis for agreeing terms and any advice provided by the funder. Those funders that were part of larger companies indicated that use of internal experts available to the funder can be part of a case. Those cases where the evidence can be readily evaluated are more likely to be funded. As above the historical costs required to evaluate a case *may* be met in some circumstances if the client has gone away and spent money on satisfying the funder's concerns.

On some occasions as part of its due diligence several funders sought Counsel's opinion, particularly in "niche" areas like trust law and tax. This expense is often borne solely by the funder, though it may be treated as a "cost" and repayable by the client upon success.

Funder F commented that it was unlikely that funders would currently invest in cases with poor chances of success or pursue cases abusively. The loser pays rule imposes considerable incentive to act commercially. Funding is not securitised as yet, but could perhaps be.

### Client control and Client Contact Issues

All funders indicate that they prefer to adopt an arms length approach, preserving the relationship between the client and lawyer. Lawyers are usually chosen by clients preventing any risks of champerty and, as outlined above, confidence in the legal team is an important factor in funding decisions. Funder A believed that funders' control is limited to the budgetary aspects rather than operational aspects, although they can seek to influence decisions. The demarcation of roles and responsibilities is a healthy way of doing business: ultimate decisions are better left to clients.

The funder's client is the company, not its lawyers. The roles and responsibilities of client, lawyer and funder are separate and clearly differentiated. Companies have patronage over selection of their lawyers and often also have in-house legal expertise, even though it will not be specialist in smaller companies.

On an operational basis, however, funders could be in weekly or even daily contact with the lawyer, to a far greater extent than would be the case for normal insurance companies. The funder is, in effect, like an 'informed client'. Prosecuting a case will be a team effort, with the funder making available, for the client's benefit, its finance but also expertise. Cases are owned and run by clients. A funder can offer views but not insist that they be implemented. A funder cannot insist that a client runs a case in a particular way, or does or does not do certain things. But it can be a precondition of funding, even if not written explicitly into the funding agreement, that certain steps are taken. The extent to which funders saw themselves as 'involved' in cases varied greatly.

Funder C primarily receives cases from the law firm and this is their preference. Law firms appreciate the funding model because it structures funding at the beginning of a case and makes it easy to manage the expenditure and budgeting of a case. Funder C explains that its provision of capital is entirely transparent to its clients and heavy handed regulation on capital adequacy which increases the cost of providing the funding could have a negative effect on the model which is a financing product which makes legal services work. While claimants would initially approach the firm via brokers, the company's position is now such that some law firms are aware that it is a potential source of funding and make the approach direct with a case in mind. A main advantage of the law firm approach is that firms tend to sift claims before they are brought to the funder. The quality of cases originally brought direct by claimants was quite poor and Funder C has not funded any claims from direct client contact. Law firm sifting of cases helps to weed out the weak cases. However, Funder C continues to see strong deal flow from brokers who have a useful role to play, particularly in sourcing the ATE insurance to sit alongside funding.

Funder D suggests that claimants are not experts in litigation. They like their hands held by independent claims specialists who have, like them, an interest in the outcome - unlike lawyers, whose primary goal is to get paid, regardless of the outcome, save of course where they are acting on a conditional fee agreement where their payment is wholly or partly dependant on the outcome of the proceedings. Solicitors are not as motivated as their clients and litigation funders to get the best result. Funder D explains, however, that it does not want to meddle in how cases are run. It will go to key meetings, but not to settlement meetings. It will not set minimum settlement values. It will seek to ensure that those running a case have thought through the various scenarios. It will receive a monthly report on a case, and will ask why next steps have not been taken if they have not been completed. It finds that lawyers tend to 'pull their finger out' as a result of this scrutiny, so as to make cases run faster. This approach does not seek to cut costs, but does seek timely progress. Funder D seeks to ensure that whatever needs to be done to run the case to best effect for the claimant, is done

While the lawyer is responsible for running the case and funders generally do not intervene, Funder F confirms that it can have contact with both the client and lawyer to exchange views. The standard contractual terms include a condition that the client waives their right to privilege so that as an investor Funder F is entitled to access all information relevant to the case. Thus, Funder F receives all the same information on a case as it proceeds as the litigation party would. It attends case conferences and hearings. It expresses views on the conduct of a case, but these are not binding and it has no formal right to make a client's decisions. The client remains in charge, and the litigation funder acts in a very similar capacity to a commercial insurer, albeit without an insurer's subrogation rights. The support is a team effort. Funder F always insists on seeing the client, which provides the client with some confidence that they know the funding team and any views that Funder F may have on their case.

The fact that a funder is supporting a case is usually made known to an opposing party in the litigation. This is not a regulatory requirement. But the experience is that the fact of funding usually serves to expedite resolution of a case and also increases the recovery. Opponents know that an independent merits assessment has been undertaken, which supports the claimant, and that the claimant has sufficient funds to see the case through.

The funder has a contractual right to pull the plug on its involvement at any stage, which will limit its exposure at that point. Any funds advanced to that time are written off. If the claimant is able to run the case to a conclusion and succeeds, the funder will recover its investment but will not receive any profit.

Simple disagreement is not enough to terminate the contract. The funder's only sanction is to withdraw further funding. A clause that the funder may withdraw in the event of 'material deterioration' in the case would always be included in funding agreements. However, withdrawal is an ultimate weapon and would be unattractive to operate, for reasons of both reputation and commercial investment.

All evidence that a funder sees, from whichever party, remains confidential. There has not been an issue about this issue in UK. A funder that was found to have breached confidentiality would be committing commercial suicide. Confidentiality has been a far greater issue in U.S.A. Litigation funding would simply not be able to operate unless a funder had access to all evidence that was relevant to the merits of a case. The same principle applies as for an insurer or a public legal aid funder. If a rule were to be introduced that funders should be subject to confidentiality obligations, this would not change behaviour in Europe, and would be acceptable to the market.

### Settlement Issues and Withdrawal of Funding

Differences of opinion over conduct or settlement can arise between clients, funders and all lawyers involved. It is the solicitors' job to manage the expectations of clients. This is a key role. It is even more important where more parties or funders/insurers become involved.

Funder B does not like mediation as a means of settling funded cases. Cynical defendants, especially insurers, can play on inexperienced clients and wear them down psychologically and emotionally, to get them to settle more quickly for less than a case is worth. Mediators see their role as to produce swift settlements, so they can exerts uncontrollable and untransparent power. As a result, funders' expectations of levels of return can be upset. Funder B now insists that clients undergo mediation training in advance, and are told not to anticipate that settlements are necessary at that stage.

It is the client's decision on whether to settle but they must act in accordance with legal advice. Funder C's funding agreement obliges claimants to act within the parameters of legal advice, these provisions makes the client act rationally and accept settlement in accordance with legal advice. Beyond this, it is up to the client to decide when to settle and Funder C recognizes that there may be a number of drivers as to why the claimant may wish to settle, beyond the pure financial return. This is accepted and Funder C's pricing is deliberately structured to leave the client with the maximum flexibility over when and at what level to settle.

As a matter of practice all funders indicated that they do not jump in and out of cases. Funder C acknowledged that it has a very low degree of control over its investment in a case and inevitably has to have a high degree of trust and confidence in the claimant and their lawyers to be able to pursue the case to a successful conclusion. Its contractual terms reflect this lack of control and specify rights to withdraw and detailed termination provisions are intended to keep the lawyer and claimant on track. The main provisions are:

*Unilateral right to terminate* – Contracts contain this provision which ensures that, where Funder C considers that a case ought not to be pursued any further, the company retains the right to terminate its funding and protect its investment. However, if it does so it loses any investment made up to that point which gives the claimant the best chance of obtaining alternative funding to continue if an alternative funder considers that this is justified. The company thus has a concern about Jackson's suggestion that funders must stay in.

*Termination on deterioration of merits* – Funder C can terminate a funding agreement in the event that the merits of a case deteriorate but its money stays in and if the case proceeds to success the funder's principal is returned but it has no interest in the proceeds.

*Terminate in event of law firm change* – Funder C is passive in the running of cases and so the choice of law firm is critical. Funder C does not change the law firm prior to funding but has turned cases down if the law firm isn't up to handling the case. The provision protects Funder C in the event that the client terminates the retainer with the original firm and appoints a firm in whom Funder C do not have confidence. But if it pulls out of a case using this provision, it may receive its original investment and interest but no cut of the proceeds. The importance of the law firm (and particular lawyers or the team) is comparable to a private equity investment case where the management team is essential to any investment. A change in the law firm can thus be critical and a reason for termination.

There is also the option to terminate funding if the other side breaches any agreement.

## Regulation

While funders were generally of the view that the current code represented an appropriate form of self-regulation and that the rules of litigation funding were clear, there was also broad general support for regulation of the litigation funding market as a means of protecting the market. Funder A suggested that regulation of litigation funding will be necessary as current financial and insurance regulation is heavy handed and burdensome. Nevertheless, a funder's risk of lack of capital adequacy is a large issue and needs to be covered. Funders keep details of their financial arrangements close to their chests. The Moore Stephens case[225] shows that where a case is lost the investment that will be lost and the costs that have to be paid to successful defendants can be large. It can be expected that less trustworthy elements would enter the market absent regulation. It is interesting to consider whether a client should be able to withdraw from a case if the risk becomes apparent that he would have to bear all the costs on the basis that the funder is insolvent. A better solution would be that all funders should have to cover such risk by compulsory payment into a Financial Services Compensation Scheme.

[225] *Moore Stephens v Stone Rolls Ltd* [2009] UKHL 39.

Funder B agreed that regulation will ultimately be needed and was cynical of the ability of the FSA to carry out its function (asking where does it get quality personnel?). Funder C feels there is a major risk of a rogue funder poisoning the funding pool and regulation being imposed on the market unnecessarily, a concern shared by some others. While Funder C was happy that the courts retain discretion to make a funder liable for adverse costs as part of a judgment on a case, it would be opposed to any legislation/code that imposed as standard the funder's liability for adverse costs. Funder C insists on the claimant taking out ATE as this provides the most efficient and cheapest way of providing for adverse costs risk and it is not in the claimant's interests to pay Funder C to carry that risk. Requiring funders to carry this risk would increase the capital which funders have to allocate to each case and therefore increase the cost of funding. Similarly, Funder C was not in favour of law or regulation dictated the terms under which a firm could withdraw from funding – the fairness of the provisions (and the way these are being exercised) needs to be seen in the round (particularly in the context of the consequences for the funder in using those provisions) and on the facts of a particular case. The reality is that the funder has little if any control over its investment and the funder may be reliant on the ultimate sanction of terminating the funding as the way of keeping the claimant and his / her lawyers "honest". It is in no-one's interests for funders to be tied into funding cases which should no longer be pursued. How Funder C prices costs and works out funding involves assessment of risk. Jackson got this broadly correct but Funder C would oppose capped returns. The courts are not best placed to assess the commercial reasonableness of the funding arrangements in the context of the investment environment in which funder's operate and raise their funds.

As regards who should regulate, there is some merit to the idea that regulation should be considered under the legal services regulatory regime even though the business model is primarily financial services based. Regulation by the FSA would in principle be fine but there is a danger that the strict requirements of FSA regulation would be a barrier to entry into the market for new funders. The financial side of the business and those who provide Funder C's funds are, however, already covered by FSA regulation The Ombudsman/Consumer Advocate approach potentially has some merit as Funder C operates within the legal services market and is client-outcome focused.

However there is a distinction between funders and those firms that come from an insurance product background look at volume whereas lawyers and others from a professional service background do lower volumes and look at the quality and success of the litigation. Funder C suggested that any regulation needs to consider the distinction between different business models rather than attempting a one-size-fits-all approach to regulation.

There is a danger, if capital adequacy limits were to be set at too high a level, that a number of funders would be excluded. Harbour does not leverage its cash, when funds have been allocated to a case (and Harbour sets aside the entire amount, all the way through trial, when the case is first signed up). Harbour is authorised by the Financial Services Agency and is run in accordance with FSA standards. But if any funder collapsed, clients could still go down the road and get funding from a competitor.

It would not be helpful if external regulation sought to fix terms, such as through an ombudsman. Terms are negotiated commercially, and can differ between cases. This is a commercial market, in which the regulation is provided by freedom of choice for punters to go and talk to competitors. It would also not be helpful to regulate how funders process and approve case.

There is no problem about other entrants to the market, since it is more than big enough. Reputation is important, and underpinned by trust and this also provides a level of self-regulation.

Freedom to contract is also an important issue in providing funding. If liabilities are imposed it's likely that the client will end up paying more to compensate for this. Much of Funder C's work with clients is in trying to get the overall cost of the case, including the legal fees, insurance and funding cost, down in order to make the litigation as workable and stable as possible and to enable smaller cases to be pursued. Imposing additional costs on funders will only narrow the pool of cases which can be funded economically or distort the way the cases have to be pursued in order to be economic. Freedom of contract on adverse costs is also a necessity because Funder C insists on ATE and it is unworkable for some funders to be required to make provision for adverse costs

Regulation should also consider not just the client and client-lawyer relationship but also protection of the funder and integrity of the funding agreement. In some cases defendants are hostile to the funder and funding agreements. Funder C is against disclosure of the funding arrangement and particularly the detail of funding arrangements as this invites the defendant to probe the funding arrangement or seek to bypass it inappropriately. Funder C has direct experience of defendants seeking agreement from the claimant to cut the funder out in settlement negotiations as a way of reducing the cost of a settlement. While Funder C allows the lawyer/client to disclose its involvement in a case this can cause problems where the defendant sees this as a means through which to frustrate the litigation or where it becomes a distraction from the merits of the litigation itself.

## Future Development of Funding

Litigation funding has clearly increased access to justice. Many cases funded would simply not have been brought otherwise. The services that facilitate this increased in civil enforcement are not just access to funding but also assistance with the organization of a claim.

Decent funders add value to the legal services market and facilitate the handling of litigation but do not encourage litigation. There are some new funders specifically funding in the financial services and mis-selling areas but these are close to the personal injury/TAG approach and this is not the market that funders are primarily concerned with. Instead most funders focus on low volume – high value cases primarily of a commercial nature.

Funders add value not just from the perspective of funding provision but also by providing expertise in the costing and funding of litigation. The main issue is how to make people more aware of litigation funding, and to dispel myths. Litigation funding has to be differentiated from ATE, which attracted a bad name in the early 2000s. There is no sign that companies are taking out much, or more, LEI.

The litigation funding model is extendable to smaller value cases over time and Funder A indicated that a shift to smaller cases is discernable in some areas as insurance providers tend to prefer a large portfolio of individual cases with modest size, accepting a given loss ration, rather than a small portfolio of large cases: their business risk is lower with the former sectors. Any shift would need small claims to be homogeneous and permit commoditisation through computer models. It is likely that the market will develop, and that certain funders will develop niches and specializations.

It is essential that people understand the mechanisms and the options, if any funding mechanism is to work. Litigation funding involves inherent complexity and transparency. But a CFA is very complex, and difficult for parties to understand.

Funders may become a pressure to reduce litigation costs (lawyers and courts) and improve efficiency in processes and speed to resolution.

Implementation of the Jackson proposals that CFA success fees and ATE premiums will no longer be recoverable will erode the current ATE business model but not eradicate it: the market would respond and new insurance structures would emerge. Big ticket cases produce global settlement sums, rather than clearly-differentiated amounts for damages and costs, so losing recoverability of additional liabilities may have limited relevance. However, the reform might make litigation funding more attractive, however funding remains limited in scope because of the levels of contingency fees charged. Hence, SMEs would lose out since their exposure for absorbing costs is less.

## 5. Funding Models

This research has identified that there is no single litigation funding product. Instead litigation funding is a bespoke product in which every case is evaluated individually. There is a range of options for funding, and the funding offered is evaluated according to a range of factors. Our research has identified that there are core models for funding as follows:

- Assignment – where rights to a claim are assigned to a funder who takes over responsibility for running the claim.
- Full Funding, legal team in place, case brought to funder by lawyer.
- Variable Funding – Funder 'active participant'.
- Brokerage of funding solutions – client has case, lawyer not necessarily in place approaches funder for options.
- Lawyer Funding.

Our analysis of the funding models discussed by litigation funders, together with our analysis of the literature on litigation funding, has allowed us to develop some funding models that illustrate these different options available for litigation funding.

**A - Assignment**

In assignment cases, the rights to the claim are assigned to a third party who will be responsible for pursuing the claim. In this model the funder may also carry out the initial investigation of the claim and will select the lawyers, holding beauty parades, as well as having considerable input into (or even determining) the strategy for the case. The funder instructs a firm to accept the assignment and carry out the litigation.

Model A is used in Australia and the United States, and for some cases in Europe,[226] but we have as yet found no evidence to indicate that assignment is utilised as a funding model in the U.K. The Model differs from the long-established commercial practice of factoring debt, since although the assignor can be paid a sum of money at the time of assignment (particularly in Europe), the arrangement is typically that the client is only paid most or all of the value of the recovery at the conclusion of the case when the funder receives payment from the opponent.

This Model has the advantage that instructions from the victim are not required, and there is freedom of choice over the jurisdiction of the claimant of litigation. Funders who use this Model argue that many clients find it attractive because they do not want to be involved in either funding or running the litigation, and they merely seek the outcome of a successful financial return at the end. Accordingly, this Model may be

[226] See A Pinna, 'Financing civil litigation: the case for the assignment and securitization of liability claims' in M Tuil and L Visscher (eds), *New Trends in Financing Civil Litigation in Europe. A Legal, Empirical, and Economic Analysis* (Edward Elgar, 2010).

attractive to for clients who wish to avoid the management time necessary to run the case, or who not possess the necessary expertise. Such types of case would range from commercial companies (especially SMEs) to small consumer claims. This insight explains why external (lawyer) funding is popular in the United States of America, especially for class actions, for which the level of involvement and expertise are recognised to be high.

But this Model is more difficult to operate in types of cases where greater involvement by the client is needed. One example of such as situation is where the nature and extent of the oral or documentary evidence is extensive; another example is where the tactical decisions in the litigation need the ongoing input of the client, perhaps because of the client's expertise or because of the client's desire to maintain an ongoing relationship with the opponent.

In common law jurisdictions, there is a question over whether assignment of rights might amount to *barratry* which, although abolished as an offence in England and Wales in 1967, could cast doubt on whether the client's interests are being served in the handling of the case and raise concerns about the 'selling' of a claim rather than pure investment in it. Its legality in the UK is doubtful given the retention of concerns about maintenance and champerty as matters of public policy following the Arkin case. In determining whether a litigation funding agreement is contrary to public policy, the courts will consider the nature of the funding relationship and, in particular, at who was really controlling the litigation.[227] Assignment arguably strays too far into maintenance to be permissible under UK policy by allowing the funder to choose the lawyer and direction of the case, making the lawyer accountable to the funder.[228]

The more straightforward funding model in operation is typified by Model B.

**B – Full Funding, legal team in place**

In this model the case is primarily brought to a litigation funder by a lawyer who has provided the client with advice on the case and made a preliminary assessment of the costs of pursuing the claim. Based on this the lawyer seeks funding to cover the likely costs and approaches a known litigation funding firm to invest in the case in return for a share of the damages.

Assuming the lawyer has carried out an appropriate assessment the litigation funder carries out an assessment based on the lawyer's preliminary advice and the available evidence.

The funder may require the lawyer to assume some co-funding commitment, hitherto by taking the case on a CFA basis assuming that ATE cover can be obtained. The funder may enquire into the solvency of the defendant.

[227] See *Arkin v Borchard* [2003] EWHC 2844, Coleman J. at para 21.
[228] See also Lord Justice Jackson's comments at the sixth lecture on civil litigation costs review implementation (23 November 2011) that ceding control or conduct of the dispute to the funder usurps the principles of *Arkin*.

All tactical decisions in the litigation are taken by the client: the funder adopts a a 'hands off' approach.

Model B illustrates a relatively straightforward funding model where the funder is asked to assess the merits of the case and the existing legal strategy and to make a straight funding assessment based on a pre-existing determination of the case and its merits. The funder may require the client and legal team to clarify some aspects of the case and may offer advice on additional evidence or strategy but primarily are making an investment in the case on the basis of existing strategy.

Funders in Model B adopt a 'hands off' approach and are purely investors in the case in return for a share of the proceeds and thus are not active participants. Accordingly, the funder's confidence in the legal team is an important factor, albeit not the sole factor. The evidence and planned legal strategy established by the legal team are also factors influencing the funding decision, meaning that funding is more likely to be obtained for a good case with an experienced legal team known to the funder or recognised as having expertise and with a clear strategy in place for the case.

Model C illustrates a funding model where the funder is more involved in determining the strength of the case, and in some cases of the legal team, prior to agreement on funding being reached.

**C – Variable Funding, Funder Active Participant**

The case is brought to a litigation funder either by a lawyer who has provided the client with advice on the case and made a preliminary assessment of the costs of pursuing the claim, or direct by the client (including the in-house legal department or corporate MD). The funder carries out formal investigation of the claim and may seek independent advice (e.g. Counsel's opinion) on the merits and legal strategy.

In this model, the funder may require further evidence or investigation of perceived inadequacies in the claim before offering funding and may make recommendations concerning possible strategies to be employed in pursuing a claim.

The funder may meet some of the costs of investigating a claim.

Although those funders we interviewed for this research were clear in indicating that, given concerns about maintenance and champerty, they have not been involved in the running of a claim, Model C reflects the funder as a more 'active participant' in the assessment of the claim and legal strategy and a more inquisitorial due diligence process. Hence, whereas in Model B a funder would typically be approached after the client had carried out the initial investigation, and maybe even after litigation has commenced, in Model C the funder plays a role in the initial investigation and assessment. Approval by funder may, therefore, act as a key barrier in whether or not the case is commenced. Thus, this independent assessment stage constitutes either a barrier to access to justice or a safeguard, depending on whether the merits of a case or strong or weak.

In Model C, the client may waive legal privilege so that the funder has access to and can scrutinise the legal strategy and merits against its own independently obtained legal and expert advice and this is reflected in the funding offered and the funder's monitoring of the claim which is more 'hands on'. Model C raises issues about the management and 'supervision' of claims.

Model D, however, provides for an almost entirely 'hands off' approach with the funder acting solely as broker to secure funding.

**D - Brokerage**

In this model the client has identified a need for funding and approaches a broker for advice on the funding options. Enquiries to the litigation funder/broker in this model are made either direct by the client or from a solicitor acting on behalf of the client.

The service is essentially the same as for ATE or for third party funding inquiries: the broker obtains quotes from insurers or funders and attempts to put packages together that might include funding, ATE insurance and a discounted CFA. Funding can be partial or 100% and can come from several sources, including hedge funds. The addition of ATE can reduce the level of a funder's success fee. The broker will be paid by the funder out of its commission charged. The broker therefore retains an interest in the outcome of the litigation, and will remain copied in on correspondence but will not be particularly active in the conduct of a case.

Where the client receives funding advice but does not have a legal team in place, it remains for the client to choose an appropriate lawyer. The broker can give informal advice on appropriate law firms and may recommend several firms for the client to choose from. The funding package recommended is also likely to consist of several options for the client to consider. Funders usually require initial investigations on the evidence and merits of a claim to be completed, and an application for ATE insurance to be in train, before they will assess a proposal as a package. Funders' control is limited to the budgetary aspects rather than operational aspects, although they can seek to influence decisions.

Model D involves 'pure' brokerage to determine the best funding solution where third party funding is part of a funding package rather than a single case funding solution. Our interviews indicate that brokerage is being used in pursuing group cases such as shareholder claims due to the known quantum and predictability of the claim. However one can expect the type of case funded by this type of independent funding to change and cover smaller cases and indeed our interviews reveal that a shift towards smaller cases is already discernable.

Case threshold for brokerage for third party funding is generally £200,000 although our interviews indicate that in practice cases with a claim value under £250,000 may not be viable for brokers.

**E – Lawyer Funding**

In this model, funding for the claim is provided by the lawyer who is pursuing the case.

Our research has thus far not identified widespread use of lawyer funding as a third party funding mechanism in England and Wales. Success fees are permitted in Scotland and Northern Ireland, and appear to be used for individual cases of modest value but not for larger commercial cases.

Model E does, however, raise considerable concerns about the possibility for a conflict of interest impacting on settlement of a claim. Such concerns include the possibility of unfair contract terms and the lack of understanding that clients may have concerning the fees they are paying. Conflict of interest is also a major issue as the lawyer occupies dual roles, the funder seeking to make a return on investment in the case and legal adviser who represents the client's interests in pursuing a case.

## 6. Privilege and Third Party Funding

Confidentiality and its legal 'twin' privilege against disclosure are vital to the future development of third party funding. The issue of protection should include both entities that wholly or in part or at some stage fund the instant case and also funders who have been approached and to whom disclosure has been made but decline involvement.

The default position in English civil litigation is that a cause is a matter that concerns only the parties and the court. In general terms parties initiate litigation and non-parties cannot interfere with the launch or progress of the litigation.

This 'hands off' position is subject to specific exceptions, particularly in relation to the distribution of costs under the English rule. As discussed above, under the existing substantive law doctrines of maintenance and champerty, a non-party who has become involved in the litigation may taint the litigation so as to prevent its progress or, more importantly for our purposes, put themselves in harm's way in relation to costs under CPR 48.2. The leading authority in relation to costs orders against (or even in favour of) non-parties is *Symphony Group v Hodgson*,[229] which lays down broad principles as to when a non-party might exceptionally have to pay costs, in particular where the non-party has managed or financed the action. In relation to the latter, *Arkin* (see page 24) establishes the extent of any liability found.

In cases such as the 'pure funding' arrangements (i.e. supporters assisting a party out of sentiment not for profit and not controlling the litigation), such as *Hamilton v Al Fayed*,[230] the information will be readily available as there will have been a process of canvassing support and setting up a fighting fund to be used to support the claim and as a potential target for cost recovery. In such a case the existence of a fund suggests the existence of a list of donors whose identity could be obtained through a disclosure application. In other cases, it may be known that an individual or a fund is prepared to support causes. The best example of this is the late Sir James Goldsmith, who invited those with grievances against the magazine Private Eye, with whom he had a long running battle, to seek his financial support. In cases such as *Symphony Group* the involvement emerged from the facts of the case. The defendant had left the employment of the claimant to join a competitor. Although the competitor was not a party, one of its company officers gave evidence for the defendant, placing the competitor 'in the frame'.[231]

This report is focused on the more mainstream position of the funding of litigation where there is no overriding motivation other than the vindication of rights and/or the recovery of damages. Historically, the funding position in such standard cases would be that, for individuals, legal aid will be the first port of call, supplemented by legal

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[229] [1994] QB 179 CA.
[230] [2002] EWCA Civ 665.
[231] Another example in the context of pre-action proceedings is *Totalise plc v Motley Fool Ltd* [2001] EWCA Civ 1897. The non-party hosted a financial information website on which an allegedly defamatory posting was made.

expenses insurance (BTE). In addition there would be a substantial, if low-key, funding model, whereby solicitors assist clients on a purely speculative basis, i.e. if the case was unsuccessful then no own client costs would be charged other than disbursements.[232] For commercial cases, funding would be the client's responsibility or, to an extent, BTE might be utilised, often supplied through a trade association.

## GENERALLY: PRIVILEGE AS A SHIELD

Communications between a client or prospective client and a third party funder will normally be protected by contractual terms of non-disclosure.[233] Indeed, it may be common for a client, or his lawyer, to approach a series of third party funders, keeping each sequence in a closed capsule. Equally, simply letting it be known that a client has obtained support from a Third Party Funder, or is talking to a Third Party Funder, is not in itself a waiver of privilege on documentation—subject to the issue of notification discussed below.

However, such contractual non-disclosure terms could potentially be breached by a court order for disclosure (discovery) of documentation. The more relevant question is the extent to which confidential communication between a client and his agents (lawyers and/or funders) is protected by privilege against all comers irrespective of the contractual position. What follows is a general discussion on privilege and funders, which in this context is directed to Third Party Funders. However, the general argument could relate equally to ATE insurers. (In fact, such case law as exists is generally limited to ATE insurance funding, reflecting its longer history: the fact that the premium may be recoverable makes it of more interest to the potential payer). This is particularly so when the policy is specifically tailored for the client rather than being a general policy available to a class of clients (for example, claimants in road traffic cases, where authority to sign up the client to the policy has been delegated to the client's solicitor). Disclosure is not really an issue here as the generic policy details are likely to be widely available.

### The Legal Position

Any communication, including documentation relating to legal advice or in connection with potential or actual proceedings, may be protected by the common law right of legal privilege.

Legal advice and litigation privileges overlap but occupy three areas:

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[232] This has to be carefully handled. While, a solicitor can always agree not to enforce the cost retainer *ex post facto*, an agreement *ab initio* may mean that the arrangement is a contingency fee unenforceable at common law (*Awwad v Geraghty & Co* [2001] Q.B. 570).

[233] The voluntary Code of Conduct for Litgation Funders of the Association of Litigation Funders of England and Wales (November 2011) states in paragraph five: 'A Funder will observe the confidentiality of all information and documentation relating to the dispute ***to the extent that the law permits***, and subject to the terms of any Confidentiality or Non-Disclosure Agreement agreed between the Funder and the Litigant.' (Emphasis added)

*'a) Communication between client and lawyer for the purpose of obtaining and giving legal advice.*
*b) Communications between client and lawyer, **or between them and third parties,[234]** for the purpose of preparing for pending or contemplated legal proceedings;*
*c) items enclosed with, or referred to, in advice or litigation communications as defined in (a) and (b) but only if they were created for the purpose of obtaining advice or in connection with preparation for litigation.'[235]*

Any information that has been recorded,[236] for example a witness proof, report or expert opinion, may be immune from an application to the court for disclosure. Such applications can be made during the currency of proceedings or as a pre-emptive strike before proceedings. The same protection may extend to material that is inadvertently disclosed when an injunction can be sought to recover the material and prevent it being used, for example, in cross-examination. These protections relate to the need to ensure that legal advice is obtained free from interference (legal advice privilege) and that there is equality of arms in the trial process (litigation privilege). With regard to legal advice privilege, in so far as it is disclosed to a third party in full or in edited form, privilege is capable of being attached to the communication, subject to waiver.[237] In principle, legal advice privilege trumps other public interests and this extends to situations when the privileged document is disclosed for a limited purpose with privilege being retained.[238]

It goes without saying that for an opponent to have access to the legal advice given by a lawyer to a client, or the client's communication to the lawyer of his own view of the merits of the case, or indeed any material matters about the case, or any documentation of the like, could be very useful in bringing or defending a claim. Equally, any communication between a third party funder, client and lawyer would be of value to the prospective or actual opponent. This might include the client's lawyer's view of the merits communicated to the funder; the funder's view of the merits (as part of an explanation of their decision as to what cut of damages they thought was reasonable) and so forth. The same would apply to a previous third party funder, who had been approached but declined to invest. The business model mentioned elsewhere in this report suggests that, in the latter case, communications with funders may take place in two situations: (less frequently) before litigation is launched or when a client contacts a third party funder directly, or (more commonly) when a lawyer, already instructed in a potential or actual claim, approaches a funder for support in actual or prospective litigation.

## Common Interest Privilege

[234] Emphasis added
[235] A.A.S. Zuckerman, 'Civil Procedure' Lexis Nexis, London, 2003, p531. The claim for privilege is limited to documents created for a dominant litigation purpose.
[236] The definition of a document is at CPR 31.4. If a client has a Sykpe conversation with a funder that is recorded, this would appear to be a document for these purposes.
[237] *USP Strategies plc and another v London General Holdings Ltd and others*, [2004] All ER (D) 132 (Mar).
[238] *B and others v Auckland District Law Society and another* [2004] 4 All ER 269. See also Lord Scott in Three Rivers DC v Bank of England (No 6) [2005] 1 A.C. 610 at 646.

Parties who jointly instruct a lawyer share the same joint privilege. However, circumstances may arise where there are communications between parties short of joint privilege where parties share a common interest. Clearly, a client and a prospective or actual third party funder share a contingent or present interest—is common interest privilege relevant to this relationship?

Common interest privilege is a tentative concept that may well overlap with legal advice privilege or litigation privilege and occupies an uncertain territory outside these two areas.[239] This might be particularly difficult in the early stages of negotiations between a prospective client and a third party funder. For a funder to make a decision, there has to be an exchange of information over and above standard terms and conditions—both parties need to understand the aims and objectives of the other in relation to a possible dispute. Almost certainly these arrangements will be covered by litigation privilege as the dispute is in contemplation. However, this is not invariably the case and, therefore, uncertainty can be created. It would be extremely damaging to the development of this market if opponents or other interested third parties could insert a lever between the client and the third party funder by an aggressive pre-action disclosure application (within the currency of the proceedings) whether or not a contract to offer funding has been agreed.

Lord Denning in *Buttes Gas and Oil v Hammer (No.3)*[240] introduced the idea of common interest privilege as a practical means of expanding the area of protection from those who instruct a lawyer in ongoing litigation to those with a similar interest but who have as yet not instructed the lawyer.

This concept has been expanded, although not yet definitively outlined, in a number of cases. *Formica Ltd v Secretary of State acting by the Export Credits Guarantee Department*, [241] is helpful in the context of this discussion because it relates to an arrangement between plaintiff and defendant were they had a common interest in the outcome of a dispute with a third party (an indemnity to protect one party against losses arising from the failure of a third party) and their common interests in the recovery (or the extent of the indemnity) were in the proportion, in this case of 90:10.[242] The headnote states:

> To determine whether documents were covered by common interest privilege, the essential question to be asked was whether the nature of the parties' mutual interest in the context of their relationship was such that the party to whom the documents were passed received them subject to a duty of confidence which the law would protect in the interests of justice.
>
> Where the respondent to the application for discovery relied on common interest privilege, he would frequently be able to establish that the provision to him of the documents occurred because his relationship with the recipient of legal advice was, in all the circumstances, such as to give rise to a mutual interest in the subject-matter of the advice.

[239] It is apparently practice for practitioners to claim all relevant (or possible) privileges in the heading of communications to reflect this.
[240] [1981] Q.B. 223 at p 243.
[241] (Commercial Court), [1994] C.L.C. 1078 (Coleman J).
[242] Export credit is a form of insurance against loss and it incorporates an excess – in this case 10%.

However, the case is helpful about disputes between parties (e.g. third party funder and client) and in relation to legal advice privilege, rather than issues of protection against applications for disclosure by a third party, which might be the more common problem.

It follows that contact between a client and a third party funder directly, or arranged through a broker or, less likely, 'cold calling' by a funder which raises the possibility of a claim (for or against the client), will *not* be covered by legal advice privilege if the contact is with the finance arm of the funder.[243] (Presumably, contact could be made with a third party funder's in-house lawyer, but such lawyer would be unlikely to offer legal advice, not least for professional indemnity insurance reasons, but would refer the potential client to their own lawyer or suggest a lawyer.) Conversely, contact between a party and a lawyer to obtain legal advice, not necessarily in contemplation of litigation, would be covered by legal advice privilege.[244]

The second part of the formula above:

> *b) Communications between client and lawyer,* ***or between them and third parties,*** *for the purpose of preparing for pending or contemplated legal proceedings;*

would seem to be apposite. However, unsurprisingly, the general issue of privilege as it pertains to ATE insurance has been contentious and has been dealt with in a number of cases including *Barr* and *Arroya* (see below). There is no decision exactly on the point in the Court of Appeal but a robust judgment of the Senior Master in *Arroya* suggests that the actual ATE policy was not discoverable on both on the bases of legal advice *and* litigation privilege. He drew particular attention to the unfair tactical advantage that might accrue to an opponent if he was aware of the lawyer's and funder's view of the risks of the litigation. In relation to legal advice privilege he states:

"Equally, the policy will have come into existence for the purpose of supporting litigation, as its purpose is to obtain legal advice or to conduct or aid in the conduct of litigation' Lord Edmund Davies in *Waugh v BRB* [1980] AC 521 (HL). It is therefore in my judgment, subject to litigation privilege in any event.'[245]

It seems highly arguable that Third Party Funding, which is not recoverable as an additional liability, should fall squarely and fairly within the same argument and be privileged.

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[243] This argument is supported by *R (Prudential plc and another) v Special Commissioner of Income Tax and another*, [2009] EWHC 2494 (Admin) where the Court of Appeal declined to extend legal advice privilege to accountants giving tax advice. The Supreme Court heard the appeal of this decision in November 2012.

[244] What, if the third party funder was present at such a meeting: could privilege then be lost because of the presence of the third party? To be privileged the communication must be confidential, so would it be helpful to bind all parties by conditions of confidentiality? In any event, the advice might be that the problem could be solved by taking court proceedings, at which stage, once assimilated and accepted by the client, the position overlaps with litigation privilege.

[245] At paragraph 59.

### Common Interest Privilege as a Sword

The discussion in this section is focused on the way in which a client can have a full and frank discussion with a funder, engaging documents and visa versa, both pulling together in a common effort. However, not all stories end happily and consideration must be given to the position if the funder and the client fall out. Might the funder claim that the client has been less than frank and then wish to decline the 'cover'? In such a situation, existing documentation, including legal advice and, for example, unused witness material, might become highly relevant. An obligation for full and frank disclosure will be part of the contractual matrix between the parties but how will privilege engage within this? *Winterthur Swiss Insurance Co v AG (Manchester) Ltd*[246] was a case brought by assignees of ATE insurers in relation to the fall out from the failed TAG claims management group. Subject to the wording of the contract, the case suggests it will not be difficult for a funder in such a dispute to brush aside a claim for privilege.

## COULD THE PRIVILEGED DOCUMENTS BE DISCLOSED?

This, then, invites consideration of the issue of whether details of funding might be disclosed either through a notice regime or through deliberate or accidental waiver of privilege.

## NOTIFICATION OF FUNDING: THE EFFECT OF DIFFERENT FUNDING REGIMES

### Generally

In most cases there is no reason why a litigant should inform other parties if his involvement in litigation is funded by means other than cash resources in the bank. After all, the litigant in commercial litigation might be using an overdraft or obtaining extended credit from his legal supplier—it is nobody's business but his own. In *West London Pipeline & Storage Ltd v Total UK Ltd*[247] the applicants applied for information and disclosure in respect of the insurance arrangements of a third party against whom they sought a contribution in respect of potential liability that might accrue to the applicants arising out of the Buncefield oil storage explosion. The court held that disclosure was not available under CPR Part 31—it was not related to the issues in the case and the court had no jurisdiction to make the order. Specifically in relation to cases funded by a Third Party Funder, *Reeves v Sprecher*[248] established that the court could, under its inherent power, order a respondent to disclose the identity and address of a third party and whether that third party had agreed to contribute to costs in return for a share. However, beyond this bare information (in the instant case it had already been volunteered by the respondent) the court had no power to order disclosure of the agreement itself.

[246] [2006] All ER (D) 196 Apr.
[247] [2008] Lloyd's Rep. I.R. 688.
[248] [2007] EWHC 3226 (Ch); [2009] 1 Costs L.R. 1.

## Legal Aid

In legally aided cases the existence of the funder (the Legal Aid Board, now Legal Services Commission) would be known to the parties because of the requirement that the assisted party should notify the other parties. The practical effect of such notification was that, in rare contentious cases (often group actions), the prospective paying party might lobby for the withdrawal of legal aid, or, in the event of the non-legally aided party being successful in the litigation, then in limited circumstances costs could be claimed against the legal aid fund.

## BTE insurance

Notification is not required when litigation is supported by BTE. There is no statutory procedure whereby the legal expenses insurance company could be lobbied to withdraw support (although, no doubt such approaches were made), nor would the BTE provider be liable to pay costs beyond the limit of cover except in exceptional circumstances, such as if they had interfered with the conduct of the litigation.[249]

## CFA with Recovery of Additional Liabilities

Under the recovery regime of the Access to Justice Act 1999 the prospective paying party had a contingent liability to pay normal costs and disbursements in every case but, if the receiving party had entered into a CFA agreement with his solicitor incorporating a success fee and ATE insurance, then the success fee and the premium could be recoverable as additional liabilities.

Funding was provided by the parties' solicitor. The funding element was that the solicitor would not charge, or charge under the normal rate, if the client lost the case. If the client won the case, then under the English rule normal costs would be recovered and, in addition, a success fee would be added to normal costs. This produced the bizarre result that the client obtained funding, via his own solicitor, but paid by another party (normally the defendant). The whole scheme was tied together by ATE insurance.[250]

It is the current requirement of the scheme that the existence of a conditional fee agreement with a success fee be notified to the potential paying party, as well as the existence of ATE, with the name of the insurer and the extent of cover.[251] This scheme means that the other party (normally a defendant) is aware that the case was supported and that, in the event of the claim being successful, a success fee could potentially double costs and the ATE premium could also be hefty. However, information as to the percentage uplift of the success fee, or the amount of the ATE premium, does not have to be disclosed: the argument being that to do so could

[249] *Murphy and Another v Young & Co.'s Brewery and Another* [1997] 1 W.L.R. 1591.

[250] ATE insurance normally covers only adverse costs and both sides' disbursements. 'Both sides costs' ATE insurance is potentially available, which will cover the client's own solicitor's costs, but it is expensive and not much used nowadays.

[251] See s 19 of the Practice Direction PROVIDING INFORMATION ABOUT FUNDING ARRANGEMENTS: Civil Procedural Rule 44.15.

indicate the confidence or lack of confidence of the solicitor and/or counsel and/or the ATE underwriter in the likely success of the claim.[252]

**Can a potential paying party go behind the notice?**

The bare bones of the notice requirement are important to a prospective payer but, in terms of the tactics of litigation, more information would be very useful. In principle, the bare bones would not seem to go much further than a general reference to the fact that the client is talking to a funder, or is working with a funder—documents are not engaged whether privileged or otherwise.

Despite this, there have been a number of cases in which parties have attempted to seek disclosure of an extended range of information. In *Barr and Others v Biffa Waste Services Ltd and Another (Westmill Landfill Group Litigation)*[253] in the High Court, the judge drew particular support from an earlier case, *Marion Henry v British Broadcasting Corporation*.[254] These cases concerned Group Litigation (*Barr*) and cost capping in the context of defamation proceedings (*Henry*), both areas where the issue of additional liabilities and the ATE cover are particularly contentious. The judge found that the general rules for disclosure of a party's insurance cover (see *Westmill* above) might be approached differently if the cover was ATE insurance and, in the context of Group Litigation, it should be disclosed.[255]

These issues were canvassed again in the later case of *Arroya v BP*,[256] a case in the High Court Cost Office before the Senior Master. In this case a different view was taken of disclosure.[257] Again, this was in the contentious area of Group Litigation, this time with the added issue that the claimants were foreign nationals. The Judge found that insurance cover, whether it related to liability or ATE, should be treated equally and there was no jurisdiction to force a party to disclose his cover.

These cases deal with an attempt to pry open the funding arrangements between an opponent and the funder. These arrangements, in so far as they have been reduced to documentary form, may or may not attract a claim of privilege. *Barr* and *Arroya* dealt

[252] In practice this is somewhat disingenuous. Solicitors tended to charge the maximum success fee in any event, so as to give head room if it becomes necessary to reduce the percentage in the process of negotiating a settlement. Further, as the Access to Justice arrangements were reformed, a series of set success fees were introduced in specific areas (such as road traffic and industrial disease), which determine the percentage according to the stage at which the case had reached, e.g. settlement before trial or judgement at trial.

[253] [2010] 3 Costs LR 291.

[254] [2005] EWHC 2503 (QB).

[255] A special issue in Group Litigation deals with the issue of cost sharing. In 'normal' litigation the assumption is that parties, in the absence of a security for costs application, are, jointly and severally, 'good for the money'. In Group Litigation the basic premise is that individual claimants *cannot* afford the litigation costs on their own and grouping cases potentially reduces their liability for costs and, crucially, in the context of CFA funding disbursements. If the Group starts out with ATE cover the particular issue is whether, and to what extent, the ATE cover continues for members of the Group who drop out and would normally retain some cost or disbursement liability but are inherently 'not good for the money'.

[256] Case Number HQ08X00328 (The Ocensa Pipeline Group Litigation) (Unreported).

[257] In cost cases the decisions of a Senior Master and a High Court Judge are both equally decisions of first instance judges in the High Court and neither has precedence.

with the issue of the potential for a general claim that a prospective payer had a right to see the funding arrangements. They also dealt with the specific issue of privilege, with the decision being on the particular circumstances to disclose (*Barr*) or not (*Arroya*). It is clear that the situation is still fluid. In the very recent case of *Germany v Flatman*,[258] the issue was whether a winning defendant facing an impecunious claimant with no ATE cover could recover costs against the claimant's solicitor who appeared to have funded the case by paying the disbursements. In considering whether information and/or documents should be disclosed by court order, Eady J stated: 'In these circumstances, it falls to me to exercise the court's discretion afresh on the information before me. …I consider that there is sufficient material available to justify ordering the disclosure of the documents and/or information which the Defendants now seek. *Subject to any genuine issues of legal professional privilege, I consider that openness is the best policy…*'[259]

**Post Recovery**

When the Legal Aid, Sentencing and Punishment Bill (2011) and associated court rules and regulations becomes law, the success fee and ATE premium will no longer be recoverable for most types of claims.[260] It seems likely that the new style non-recoverable CFAs (and contingency fee agreements—damage-based agreements) will not have a notification regime, since a defendant will only be responsible for normal costs and disbursements.[261] These arrangements will fall behind the regulatory curtain.

As well as new style CFAs and damage-based agreements, the new bill deals with third party funding under the style of litigation agreements (see page 33 above). For the same reasons as outlined in the paragraph above, it seems likely that there will be no requirement for notification of this type of funding whilst the main action is in progress. However, if the defendant is successful, it seems inevitable that defendants will want details of the third party funding arrangements when their costs fall to be assessed.

Indeed, information about the funding in place may be sought, and perhaps may need to be disclosed, during the course of the litigation, to resist a defendant's application for security for costs (although the scope for making such applications is limited).[262]

## WAIVING PRIVILEGE: SHIELD AND SWORD?

[258] [2011] EWHC 2945 (QB).
[259] Paragraph 39 edited and emphasis added.
[260] Clinical negligence, defamation and privacy cases may still retain recoverability to an extent.
[261] This will return the position to that of CFAs under the original scheme under the Courts and Legal Services Act 1990, before recoverability was introduced. The client who was successful funded by a CFA and ATE paid the success fee and premium.
[262] CPR 25. Classically, a failing or failed company may have a chose in action (debts, IP rights, claims against a former employee etc.) that may be attractive to a funder.

The discussion of privilege above is on the basis that the funded party does not want to disclose the funding arrangements or any documents that would give an insight into them. An insight into the funder and funded party's views on the risks of the case and the likely quantum and costs is interesting to an opponent. It might also assist an opponent who wishes to start an enquiry into the extent to which the funder is controlling the litigation, with a view to alleging maintenance.

However, it is possible that the privilege may be waived in a variety of ways.

The funding documentation may be referred to accidentally in a witness statement or in correspondence or, indeed, sent by mistake to another party. Normally, privilege can be maintained through injunction proceedings launched by the accidental discloser. Of course, once the information is released it cannot be 'unreleased', but it could not be the basis of cross-examination or start a train of enquiry leading to fresh documentation, so it will be of limited use.

More importantly, the funding party may wish to disclose the existence of the funding but only up to a point. Here there may be difficulties. Third Party Funding is normally a shield but it may be a sword. What if the litigant decides to disclose the existence of the external funder on a tactical basis: 'I think I've got a good case and so does Acme 3PF'? What if the litigant goes further and refers to documentation passing between various parties (litigant's lawyer, funder and the litigant himself), which links the decision to fund to positive legal advice? If a claim for privilege could be made about these documents or extracts, is privilege being waived?

The leading discussion on waiver is *Brennan and others v Sunderland City Council and others*,[263] in circumstances where the allegation was that a party prayed in aid legal advice without fully disclosing by redaction, but then resisted an application to disclose the whole of the advice. Whether or not there had been waiver was an issue as to the extent that the advice had been relied on, but crucially was one of fairness—was it fair for a party to gain an advantage by lifting the veil slightly but refusing to draw it aside fully? Further, 'cards on the table litigation' predicated that parties should be prepared to be candid and open to assist the court and the process, without feeling they were opening themselves up to a wide-ranging enquiry. *Digicel (St. Lucia) Ltd and other companies v Cable and Wireless plc and other companies*[264] suggests that in considering the question of waiver, the balance should be against disclosure, in order to protect the vital privilege of access to confidential legal advice (and, presumably, the same approach would be taken to litigation privilege[265]).

## PROPOSAL

[263] [2008] All ER (D) 192 (Dec).
[264] [2009] All ER (D) 44 (Jul).
[265] *Cadogan Petroleum plc and others v Tolley and others* [2011] All ER (D) 53 (Sep) makes it clear is that an assertion of litigation privilege by a party will normally definitive unless there was evidence that the claim was ill founded.

It is likely that judges facing arguments over disclosure in this area will be guided in their policy thinking by the emerging voluntary arrangements for this sector[266] with its emphasis on the importance of confidentiality. The future secure development of this type of funding will be assisted by a regulatory notice regime which informs defendants of the core details of the funding upon either a case being discontinued or dismissed at trial. As indicated in this report many funding packages contain elements of third party funding *and* ATE. Thus, the third party funding information could include the name and address of the funder and, to borrow from the ATE position, the extent of the cover. The ATE information should include cover against adverse costs (cover against disbursements and own side costs not being relevant). In other words information that is clearly relevant to an opponent − would an adverse cost order be paid − without going further. On the analogy of currently recoverable ATE insurance, this would seem to put the rest of the information about funding and the documentation behind the regulatory wall. If the client went further and averred to privileged documentation then the client must accept the potential risk that privilege may be waived.

[266] See footnote 351 below.

## 7. Economic Operational Requirements for Litigation Funding

Litigation funding is a business that decides whether to fund cases based on risk and return.[267] From the perspective of any funder of litigation, whether litigant, intermediary or external funder, it is necessary to be able to ascertain the size of their risk. Indeed, that economic reality is the foundation of the rules on cost shifting and the policy of encouraging settlement and deterring claims with insufficient merit. The financial risk and its size and proportionality drive whether to commence, fight or settle litigation. In such a system, all those who have a financial interest need full and timely information on the merits and costs so as to evaluate their financial risk.

Some civil procedure systems can impede such risk assessment. One rationale for the Jackson Costs Review was that costs are inherently difficult to estimate in the classic common law litigation system. In contrast, the German system of a tariff for shiftable costs makes it much easier to assess the size of the adverse costs risk. The German system is a classic *ex ante* system of regulation, which provides far greater certainty than the English *ex post* system of costs taxation at the end of a case.

An obvious example of the need to evaluate the quantum of a case arises in litigation funding in view of the economic reality that this mechanism is only practicable for cases in which the damages are over a certain threshold. The U.K. market is currently unable to support cases involving damages under £100,000. In practice, most cases involve over £500,000, and most are in the range of £1 million to £50 million (see Section 4 of this report). This contrasts with Germany where a €100,000 case works well with costs of around €15,000, under the predictable tariffs for lawyers' fees and recoverable costs.

The potential liability in all jurisdictions except U.S.A. for opponents' costs needs to be factored in. This risk may be off-set by insurance, such as ATE.

Any change in the English rules of procedure or cost recovery and effectiveness would affect the cost-effectiveness of investing in this jurisdiction. Such changes are currently being put in place, and the possible economic effects are unclear.[268] The broad introduction through DBAs of the principle that clients should accept a reduction in their damages will help market development generally. The widening of DBAs, in addition to CFAs, will help risk spreading with lawyers, and the 10 per cent rise in damages for personal injuries will assist. But the anticipated restriction in the ATE market will require adjustments to financial models.

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[267] See C Webb, 'A man named sue', *The Sunday Age*, 17 September 2006 p17 and Patrick Coope, 'Litigation Funding' (Paper Presented at The Australian Institute of Judicial Administration Conference - Affordable Justice, Adelaide, 15-17 September 2006) at 5 ('Our sole focus is to generate the best possible rate of return on our capital.').

[268] The Impact Assessments that supported the government's 2010 and 2011 proposals quoted almost no figures, and merely asserted that some changes would benefit claimants and other defendants: see http://services.parliament.uk/bills/2010-11/legalaidsentencingandpunishmentofoffenders/documents.html

The above economic realities of litigation funding lead to the conclusions that if it is to work, the funder needs to have complete and timely access to all the information that is available to the client on merits and costs. There needs to be an obligation of full disclosure on the client and lawyer. That principle applied under the legal aid system, modified only by the pragmatic and economic considerations of avoiding constant communication.

## What are the commercial conditions that are required for Litigation Funding to operate?

The following

**Operational Pre-conditions**

1. Capital adequacy
2. Governance: internal and external
3. Risk assessment system and access to expertise
4. Proper persons: Criminal Record Bureau checks
5. Data protection registration
6. FSA registration
7. Policy on risk

**Mode of operation**

8. Advertising
9. Agreement on terms
10. Full information flow to principals
11. Roles and responsibilities between principals, lawyers, funders, insurers
12. Potential for handling conflicts

## 8. Findings on the State of Litigation Funding

The research reported above has found the following facts:

- **Litigation funding by third party investors who are not involved as parties has been established in England and Wales as an identifiable phenomenon in the past decade.** There is a limited but clear and expanding market. Many of the litigation funding businesses were started by entrepreneurial individuals, whether investors or lawyers. However, most funds now operate with capital provided by others, so are investment businesses specialising in investment in litigation assets and risks.

- **Support for Claimants.** To date, most funders direct their money at investing in claimants, but some, especially in the United States of America, are willing to support defendants, dependant on the size and nature of the claim.

- **Different funding models.** There are various different models for litigation funding. The extent to which particular models appear within a jurisdiction depends not only on the state of the market (i.e. the supply of capital) but also on the local rules on maintenance and champerty.

- **The business model of all litigation funders is entirely commercial, and not philanthropic.** There must be an outcome that delivers a clear rational prospect of money or an asset with a market value. Third party funders may calculate profit in a variety of different ways so that agreements may stipulate a return based on a multiplier of the investment provided e.g. the funder provides £*x* and requires £*x* multiplied by *y* as a return on the investment, or alternatively may require a percentage contingency, possibly in addition to any costs recovered from the third party. Litigation funding can apply advanced banking techniques to a legal claim, treating it like any other valuable asset and applying the same risk assessment techniques in determining the level of finance offered. The development of the litigation funding market has merely recognised an expanded use for a new asset class (claims or defences) and opened up a new market for associated finance.

- **Risk assessments.** Funders carry out sophisticated risk assessments on the prospects of success of a proposition before agreeing to provide funding. This means that, in England and Wales, sufficient case investigation must usually already have been funded by the client, and a convincing case plan have been made, although some funders advance funds for investigation.

- **Trust in the lawyers.** Given the English rule against controlling litigation, the funder also relies on the lawyers in the case. Accordingly, in addition to adopting an independent empirical risk assessment on the merits of a proposed case in selecting cases for investment, funders place strong reliance on the quality of the lawyers' case plan and also on the experience and judgment of the legal team themselves. The funder must have confidence in the lawyers and trust their judgment.

- **Flexible funding packages are available.** There is no single litigation funding product. Claims are evaluated individually. Funding can be provided as part of packages with other means of funding, and can be provided in tranches at different stages of cases.

- **Demand for funding currently far exceeds supply**, although the market is expanding. Accordingly, in the current state of the market, funders are able to select cases that offer the best profit returns. There appears similarly, as would be expected in such a market, limited price competition, and high prices. Allianz only has a fund of around £15 million; Harbour has invested £80 million. Litigation funding is time-intensive.

- **Terms are negotiated individually.** Within all the available models, our research indicates that there is considerable room for negotiation by clients with a strong case and high value claim, but less room to negotiate where the client has a weaker case. In effect, the funding models currently employed by litigation funders in the U.K. are self-policing, weeding out bad or frivolous cases, since these are not commercially viable.

- **Market preference for good investments.** The strength of a case may have an impact on both the amount that a funder may be prepared to invest, and on the premium demanded by the funder. However, funders do not currently invest in cases with poor chances of success. This is partly because they do not wish to risk their money on speculative cases (and this particularly applies where the 'funder' is in fact operating not with his or her personal funds but as an investment manager of other investors), and partly because there are plenty of cases from which to choose.

- **Future speculation?** It is possible that, as the market matures, investors may choose to support cases with greater risk. There may be individual investors who feel that certain cases should be supported as a matter of principle. One precedent for such philanthropy occurred in the Opren litigation in 1987.[269]

- **Essentially only commercial cases are funded**. The funding models dictate the types of cases that are suitable for different types of funding. There is a huge variation of types of case that may theoretically be funded by commercial litigation funding, including contract, competition, tort, intellectual property, construction, and insolvency disputes. However, litigation funding currently operates—at least in all European jurisdictions—almost exclusively in relation to commercial claims for damages by companies (often SMEs) against other companies. (Larger medical negligence cases are funded in Germany but not so far elsewhere. The only experience with consumer claims has been in the United States, where it has given rise to considerable issues of consumer detriment and even fraud.) Since litigation

[269] A Ware, 'Opren Litigation', in C Hodges, *Multi-Party Actions* (Oxford University Press, 2001), para 18.24.

funding functions on making a commercial recovery through awards of damages or financial settlements, no funders support injunction claims.

- **Access to justice enfranchisement for SMEs.** Accordingly, the phenomenon of commercial litigation funding represents a significant extension in access to justice in an area that has been consistently overlooked by commentators, lawyers and policy makers, who have concentrated concern and analysis almost exclusively on low value claims by consumers and individuals. It appears that many SMEs have hitherto been unable to bring or defend claims, and that the advent of third party funding has solved that access to justice problem.

- **There is a threshold of cases that are commercial viable for funding.** The general threshold for most cases that are funded in England and Wales, given its level of litigation costs, is currently not less than £100,000: cases below this threshold are not viable for funding. Yet in practice a higher threshold is operated by funders, with some only funding cases with a claim value in excess of £1 million. The primary factor that affects the level of the threshold is the prevailing level of litigation costs (primarily lawyers' costs but including experts' and court costs), including the risk of exposure to opponents' costs. Given that general cost level, funders seek to identify cases that are of sufficient size to deliver a sufficient level of return on investment—and they select cases that offer the highest return, given the size of their available fund. The threshold of viability for litigation funding in England and Wales is higher than in Germany because the level of costs is higher in the former jurisdiction. Costs are far more predictable in Germany, although the costs in England and Wales can be predicted by experts with reasonable business certainty. The commercial incentives push litigation funders to concentrate on high value commercial cases.

- **This means that commercial funding for individual small cases will be highly unlikely to be available**. It could only operate if the proportionality between investment and return could be made more attractive. That risk-return ratio could theoretically be improved if individual cases could be aggregated or commoditised in some viable fashion, or if there were no cost shifting rule, either of which technique would lower cost exposure and hence raise return ratioo. Whilst funders in the United States may be prepared to support the established procedure of class actions there, funders in England and Wales show little interest in funding collective litigation, which currently has too many technical uncertainties, besides less attractive investment risks on merits than available individual commercial contract cases. If fixed fees were to be extended to higher value cases on the multi-track in England & Wales, then in particular insurers' subsidiaries would be able to develop the ability to finance a large portfolio of smallish cases by commoditising them with the aid of claims-handling software and spreading risk across a wide pool of cases, whilst delivering an acceptable level of return on investment if the size of the pool were large enough. Without these prerequisites of fixed fees, litigation funding for almost all consumer claims remains unviable.

- **Funders in England and Wales do not interfere in litigation strategy: they advise but do not control litigation, so as to avoid the prohibition against maintenance.** Funders vary in the extent to which they monitor and get close to cases, but the prohibition against control has not been a commercial impediment to cases being successfully run and satisfactory returns on investments being realised. As the market matures, and some funders invest in cases that have lower merits or less advantageous rewards, the pressure to seek to control cases will increase, so as to defend investments and seek to maximise them.

- **Benefits in Settlement.** Our research suggests that the involvement of a litigation funder may influence the settlement of a case by providing 'notice' that a claimant cannot be intimidated by a larger firm. Interview respondents indicated to us that many of the cases suitable for litigation funding are of a David vs. Goliath nature, where the provision of funding allows a claimant to pursue a case effectively whereas without third party funding many claims might not be pursued. We have found no evidence in England and Wales that the availability of litigation funding has *encouraged unmerited* litigation and the preliminary evidence of this research does not support any such conclusion.

- **Benefits in increasing efficient procedures.** Litigation funders have a useful role to play in facilitating settlement of cases. One issue raised in our research is the use of mediation during the settlement process which can be a daunting and time-consuming process for the SME involved in litigation who may also be at a disadvantage when dealing with professional mediators and larger corporations experienced in the ADR process. The involvement of litigation funders can benefit the inexperienced SME client by providing for (and funding) assistance and training in the mediation process as part of the supervision of a case as an interested party. We also consider that litigation funders have an interest in increasing the efficiency of dispute resolution and court processes and improving the speed at which cases are determined whether through the court process or ADR.

- **Transparency.** Litigation funders favour transparency of the existence of a funding agreement. One reason for this is that where the existence of a funding arrangement is known by an opponent this tends to encourage earlier settlement, thereby speeding the return of the funder's investment. It will also save public or general resources. However, funders that are public entities have public disclosure requirements under stock exchange rules. This can raise problems. Changes in evaluation or risk, or withdrawal, must be reported. In many corporate claims clients seek confidentiality. Calunius has found that corporate clients are reluctant to approach publicly quoted funders.

- **Confidentiality and privilege.** Independent funding will not be able to operate unless there is full disclosure between client, lawyer, funder and prospective funders. Breach of confidentiality outside that group on any matters of evidence or risk assessments would also undermine the relationship and the client's tactical position. Such information should therefore remain fully privileged and confidential.

- **National variations.** Some funders, notably those in Germany, Belgium and the Netherlands, where bans on maintenance and champerty do not exist, operate assignment models rather than arm's length funding models. The assignment enables the funder to control the case that he has bought. Whilst factoring of debts is well-established in England and Wales, the assignment model is not generally operated by third party litigation funders here and its lawfulness is doubtful.

- **Control is the key issue.** The principal variable within the models is the extent to which the funder controls the tactical decisions with the litigation. Thus, where the rules on maintenance and champerty do not apply, as in Australia or the German cement cartel cases, the funder may have complete control over the litigation (whether through assignment or contract). In contrast, where the ban on maintenance remains, whilst third party funding is permitted (i.e. champerty no longer applies), a third party may provide funding for a claim but the funder remains at arm's length and does not take the tactical decisions, although he may express opinions. Hence, the key issue going forward is not *whether* third parties may provide finance for litigation but the extent to which they may *control* a case.

- **Need for public policy debate and decisions in Europe and the U.K.** Third party litigation funders in the U.K. have so far been careful not to overstep the ban on controling (intermeddling) in clients' litigation strategy and decisions. However, given the reforms in the national policy on funding and costs issues that are occurring in England and Wales at this time, which are of seismic proportions, there is an urgent need to debate and review the extent to which the historic rules on maintence and champerty should still apply. We now turn to these policy issues.

# 9. Issues on General Funding Policy

## INTRODUCTION: THE IMPORTANCE OF NATIONAL POLICY ON THE LEGAL SYSTEM

Questions on whether any particular form of funding is acceptable, under what circumstances, and subject to what conditions, can only be answered in the wider context of the prevailing national policy and environment on the principles that ally to the particular legal system and its mode of operation. Fundamental issues here include the following policy issues:

a. on 'access to justice';
b. on how many dispute resolution pathways are encouraged and which of them are prioritised in what circumstances;
c. on what costs shifting rule applies;
d. on how many and what methods of funding claims are appropriate and in what circumstances.

Decision on these issues vary between different jurisdictions, sometimes to a considerable extent, as has been illustrated above in relation to England and Wales, the United States of America, Canada, Australia and Germany. In order, therefore, to consider litigation funding, or contingency fees, in the context of England and Wales, it is necessary to state what national policy is on the above issues, to which we now turn.

## WHAT IS PUBLIC POLICY ON DISPUTE RESOLUTION, ACCESS TO JUSTICE, AND FUNDING OF LITIGATION?

As appears from chapter 2 above, it is currently possible to state the policy that applies in England and Wales on dispute resolution, access to justice, and funding of litigation, as a result of the extensive analysis by Jackson LJ and the subsequent government reforms. The rules form a relatively clear matrix, from which national policy, which would normally not be stated coherently in concise official documents, can be identified, especially when coupled with the associated analyses of what policy should be in the Jackson Reports the government's consultation documents and subsequent proposals for implementing Jackson.[270] We summarise the policy as follows:

1. Provision of access to justice is an important constitutional and fundamental right. However the principle is subject to the following qualifications.

2. Claims with good merits should be encouraged, but the principle of 'access to justice' does not stretch to encouraging claims with poor merits. There is limited tolerance for speculative litigation aimed at testing the boundaries of the law, although test cases that clarify uncertainties in the law that have wide

[270] See, for example the Legal Aid, Sentencing and Punishment of Offenders Bill 2011.

practical affect are permitted. The major forum for addressing reform of the law is Parliament rather than the courts.

3. Public funding for legal services for civil litigation is severely limited. Instead, private sources of funding are encouraged. The most favoured funding method is BTE, followed by DBAs, CFAs and commercial litigation funding. The Jackson Costs Review, which the government have adopted, stated that the policy should be that a 'mixed economy' of different forms and sources of funding is required.

4. For similar reasons of reducing expenditure, the traditional model that all disputes should be resolved through the court or judicial process has been replaced by making available a range of alternative dispute resolution pathways, and pathways that are appropriately designed for particular disputes, with the courts as last resort.[271] This diversification in access to dispute resolution involves a new understanding of the meaning of access to, or the delivery of, what is meant by 'justice' in some types of dispute. It reverses the place of the courts from sole, or at least primary, arena for vindicating rights and delivering justice, to a long-stop role in the context of many claims being resolved in other for a, notably tribunals, public[272] and private sector ombudsmen and other ADR approaches.[273]

5. The cost shifting regime should apply to court litigation as a general principle, subject to two caveats.

    a. First, the regime should contain elements that deter against bringing frivolous claims or applications, and incentives for claimants to accept reasonable offers of settlement.[274]

    b. Secondly, in order to give effect to the social policy that certain types of claimants should be protected against the risk of adverse costs,[275] there

[271] Mediation is enshrined as both a normal preliminary step before instituting a court claim, and as an integral part of English civil procedure: CPR Practice Direction—Pre-Action Conduct. At EU level, see Directive 2008/52/EC of the European Parliament and of the Council of 21 May 2008 on certain aspects of mediation in civil and commercial matters.

[272] See a series of Reports indicating an expansion of ombudsmen for citizen-state disputes in preference to litigation: *Common Sense, Common Safety* (The Young Review) October 2010; *Complaints & Litigation*: Health Select Committee proposals for Health Service Ombudsman reform, June 2011; *Open Public Services*, Cabinet Office White Paper, July 2011; *Public Services Ombudsmen Project*, Law Commission, July 2011. See T Buck, R Kirkham and B Thompson, *The Ombudsman Enterprise and Administrative Justice* (Ashgate, 2010).

[273] See *Empowering and Protecting Consumers. Consultation on institutional changes for provision of consumer information, advice, education, advocacy and enforcement* (Department for Business Enterprise and Skills, 2011). ADR in consumer disputes is set to take centre stage in replacing courts under recent EU proposals: Communication from the Commission. Consumer solutions in the Single Market, COM(2011) 791/2; Proposal for a Directive of the European Parliament and of the Council on alternative dispute resolution for consumer disputes and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC (Directive on consumer ADR), COM(2011) 793/2; Proposal for a Regulation of the European Parliament and of the Council on online dispute resolution for consumer disputes (Regulation on consumer ODR), COM(2011) 794/2. See C Hodges, I Benöhr and N Creutzfeldt-Banda, *Consumer ADR in Europe* (Hart Publishing, forthcoming 2012).

[274] Final Report, ch 19, para 4.5.

[275] And in the light of data that suggests that most personal injury claims are valid.

should be a qualified one way cost shifting rule for them,[276] instead of the normal two way rule. The qualified approach enables targeting of the protection on those who need it, and gives them a stake in the outcome so as to exert some control on costs. This was the approach operated successfully under the legal aid regime.[277] The protection should apply to cases where there is an asymmetric relationship between the parties, so it should apply in personal injury cases and defamation cases,[278] and there should be further consultation[279] on application to housing disrepair, actions against the police, claimants seeking judicial review, and individuals claiming defamation or breach of privacy.

6. The economic realities of litigation costs lead to a necessity that the traditional position that successful claimants should receive damages in full is modified so that claimants can be expected to pay some costs out of their damages.[280] However, the amount of success fees that lawyers may deduct is capped at 25 per cent.[281]

The current and future options for funding litigation can now be considered in the light of the policy statements set out above. Some of the above policies have implications that are beyond the scope of this Report, notably the issues about ADR and the courts.[282]

## ACCESS TO JUSTICE POLICY AND THE NEED FOR FUNDING

The first point that needs to be accepted is that funding is required in order to achieve access to justice—or, at any, rate, it is for use of the courts. Even if certain ADR pathways involve no cost to users,[283] there will be some cost in any activity on institutionalised dispute resolution. Some claimants might not be able to afford to prosecute their claims. Some defendants might not be able to afford to defend claims against them. The litigation process has a cost, and there has been growing concern that the costs of some types of claims are too high and disproportionate.[284]

A party to litigation might be able to borrow money for litigation from a friend, or a bank, or from the state through a legal aid fund, or in effect from the lawyer, if the lawyer is prepared to act on a 'no win no fee' basis (especially if a success fee is also

[276] Final Report, chs 9 and 10.
[277] Still enshrined in the Access to Justice Act 1999, s 11(1): 'Costs ordered against an individual ... shall not exceed the amount (if any) which is a reasonable one for him to pay having regard to all the circumstances including – (a) the financial resources of all parties to the proceedings and (b) their conduct in connection with the dispute…'
[278] Final Report, ch 32.
[279] Final Report, ch 30.
[280] Protection of personal injury claimants by a one-off rise in the level of general damages for pain and suffering and loss of amenity would be increased by 10 per cent.
[281] Final Report, ch 32. But the general level of damages would be raised by 10 per cent for defamation and breach of privacy cases.
[282] Further research is in progress on those issues.
[283] Many ombudsman and similar schemes that handle consumer complaints about businesses are free, or very low cost, for complainants, the cost being shouldered by the business and/or its trade association.
[284] That was the whole purpose of the Jackson Costs Review.

involved). Some companies might have total assets that can cover funding litigation but may prefer to use external funding, for example where internal budgets might not be sufficient to cover a case.[285]

It will be seen from these examples that the extent of 'access to justice' that is being enabled by any internal or external funds can vary in importance, both to the parties and to society. Some litigants might not be able to vindicate their rights (as claimants or defendant) without external funding, whether in the form of pre-arranged insurance or specially arranged funds. Other litigants may be able to vindicate their rights by using their own assets but may prefer to use external funds to do so. Some actors may view the infringement of their rights as minor or for other reasons not worth pursuing through formal channels (such as to preserve a relationship).

Overall, however, the choice of whether to seek formal vindication of rights, and compensation or other redress, should be a matter of choice for the individual actor. In a modern democracy, a citizen and business should be able to access adequate funding so as to seek justice if that is so wished. Thus, the state should ensure that some appropriate means of funding is available for claims to be made and resolved, whether such funding emanates from public or private sources, or a combination of them, or is pro bono.

Further, the amount of funding that is necessary to achieve justice should not be excessive. In other words, the transactional costs of litigation should be reasonable and proportionate. Thus, the civil procedure system should be efficient, and result in reasonable and proportionate costs.

Funding may be necessary for the entirety of a case, or only certain parts. For example, a premium may be necessary to cover purchase of a policy that covers all or part of an adverse costs risk. Or funding may be necessary for accrued or future lawyers' or experts' costs, or the cost of investigation into the merits of a case. A company might also wish to secure credit or funds to use in its business during litigation. Or a company may need funds to enable it properly to defend a claim against it that has poor merits but would otherwise be too expensive to resist, forcing it into an unfair settlement or insolvency or being taken over. We have found examples of all of these situations.

## POLICY ON THE NUMBER OF FUNDING OPTIONS

Granted a need for a state to ensure that funding is available for dispute resolution, how many funding options should be encouraged in a legal system? Chapter 2 above has shown that the historical experiment with public funding in England and Wales failed. It is interesting to speculate whether the outcome would have been different if effective reform of the civil procedure system had occurred from say the 1970s, such that the procedural costs and/or lawyers costs were lowered, with the result that the ratio between costs and values in dispute did not become vastly disproportionate. However, the historical outcome was that successive governments cut legal aid as procedural costs continued to rise, most individuals and SMEs had no means of

[285] See the comments by Burford above.

litigating, and successive governments turned increasingly to private funding options, in the form of CFAs and then, when legal aid was effectively almost made extinct, to DBAs and private third party funding.

The Jackson Costs Review proposal that CFA success fees and ATE premiums should no longer be recoverable from opponents would affect the extent of legal enfranchisement.[286] It was presumably at least partly for that reason that Jackson recommended that the options for funding should be maximised,[287] and in particular that contingency fees and litigation funding should be encouraged. However, Jackson did not make clear his reasoning for a policy of maximising sources of funding.

Moreover, there has been no explanation of, or public debate on, *why* a mixed economy policy is appropriate as a general rule, nor of which individual funding methods might be more or less appropriate in particular situations. It appears to be intended that different funding methods would tend to become more attractive for particular types of case. But how that differentiation might occur is left to the market. There has also been no examination of what effects would be produced by the interaction between different sources of funding, in circumstances where several are new or relatively new. Some individual methods of funding may be entirely inappropriate when used in particular situations.[288] The introduction of a mixed economy policy is driven solely by the overriding national policy of cutting public expenditure quickly and trying to ensure continued access to justice by any means possible. National funding policy, therefore, takes significant steps into the unknown.

It is axiomatic that, in general, providing user choice is a good thing in a market, and induces competition, best practice and lower prices. However, given the policy that some claims are better dealt with through ADR than through the courts (and costly lawyers), factors that should be considered in deciding on how many options are needed are: what types of claims need to be encouraged by funding, how many such claims are there, how important is each type of claim, what options exist for resolving it, and what are the advantages and disadvantages of each option?

In any event, not every funding mechanism will be suitable for every type of case. For example, under current conditions, litigation funding does not provide a solution for non-monetary claims or small claims. Some funding mechanisms may also tend to favour particular pathways that may be inappropriate for particular disputes. Funding by lawyers or litigation funders may tend to push claims towards the courts or

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[286] Final Report, ch 10; Consultation paper CP6/2011, Solving disputes in the county courts: creating a simpler, quicker and more proportionate system. A consultation on reforming civil justice in England and Wales (Ministry of Justice, 2011), available at http://www.justice.gov.uk/consultations/docs/solving-disputes-county-courts.pdf.

[287] Final Report, ch 12, para 4.2.

[288] Without examining the merits of this issue, an example where there is considerable debate is the extension of contingency fees, or DBAs plus QOCS, in conjunction with new procedures for judicial collective redress, where business argues that a 'toxic cocktail' of abuse could be created along the alleged lines of American class actions: see the policy statements by European Commissioners in relation to the aim that the European Union intends to avoid producing such abuse in its developing policy on collective redress; *The joint public consultation "Towards a coherent European approach to Collective Redress"* (European Commission, 4 February 2011), available at http://ec.europa.eu/dgs/health_consumer/dgs_consultations/ca/collective_redress_consultation_en.htm; see also D Kelemen, *Eurolegalism. The Transformation of Law and Regulation in the European Union* (Harvard University Press, 2011).

arbitration: this may be inappropriate in those cases that can be better resolved by an ombudsman, business scheme or regulator. Should there be a strengthened rule that the courts may only be accessed if alternative pathways are inappropriate? That rule would not prevent raising or resolution of disputes, but it would prioritise the availability of pathways.

So an image of the legal system in which all funding types are available for all types of claim is inaccurate. It assumes a view of the dispute resolution pathways and types of dispute that is too generalised. Accordingly, what is needed is a more detailed analysis of which funding mechanisms, individually or together, may be applicable to particular types of dispute and dispute resolution procedures. For example, the irrecoverability of costs for the small claims track means that funding for representation is unnecessary and not encouraged. Such a detailed analysis is beyond the scope of this inquiry. But it indicates that the case for a shift towards contingency fees, litigation funding or any other option for funding litigation should not be taken as necessarily justified. National policy might decide, for example, that certain types of litigation, and certain dispute resolution pathways, are or are not in need of prioritisation. If it were decided that a particular funding mechanism encouraged too many particular types of claims,[289] or encouraged them down an inappropriate pathway, or did not encourage enough of other types of claims, then certain policy decisions would follow.

In summary, there needs to be analysis of what demand exists for different types of claim, followed by an analysis of which types of funding are appropriate for each different type of case. Courts, and hence funding for litigation, are not needed for some types of claims.

## ANALYSING THE AVAILABLE SOURCES OF FUNDING

Having accepted that funding is required for court-based dispute resolution processes to operate, the next step is to analyse the various available sources of funding, as identified in chapter 1 above. Since the focus of this Study is third party litigation funding, detailed analysis of that phenomenon will be deferred to the following chapter, but some analysis of lawyer funding in the context of litigation funding is appropriate in this section.

### Categorising Funding Sources

For the 50 years since 1949, the relevant categorisation was whether funding was provided by the state or by the litigant personally—funding by the lawyer or any other intermediary being illegal. There was an experiment of roughly 15 years from 1995 when some funding by a lawyer was provided, on a regulated basis. However, the position now is that a new categorisation is required. Funding for litigation can now

[289] Deborah Prince of Which? expressed the view at the Conference on this research project on 19 May 2010 that it is important to remember that the consumer always pays for the system, and accordingly that total access to justice is not necessarily a good thing: there is a utilitarian argument that certain cases should not be encouraged.

be categorised into whether it comes from the litigant's own funds or from some external source. However, that division is not as clear-cut as it may seem, for three reasons. Firstly, a litigant's 'own' funds may come from, or include element of, funding from others, such as loans from banks.

Secondly, a party's funding of litigation costs may come from *multiple* sources, mixing personal and external funds. A well-established example of co-funding from multiple sources is where the state loans legal aid to a litigant's lawyer and the litigant pays a contribution. Our research shows that there is widespread pooling of funding between litigants and external owners of capital, in relation to both specific litigation transactions and on a general cost-risk-sharing basis. The following options for co-funding are common:

(i) Funds are pooled in advance: trade union, purchased insurance (liability insurance for defendants, BTE LEI for claimants).
(ii) Funds are pooled for a specific transaction, between some or all of the following sources: legal aid, bank loan, CFA from the lawyer, ATE for costs risk only, and now maybe also litigation funding.
(iii) Funds are provided by an intermediary involved in a specific transaction: lawyer, funder, insurer.

## Lawyer Funding: Contingency Fees

Examples of *lawyer funding* include deferral of fees, waiver of fees if a case is lost, and fixing fees at the end of a case depending on outcome. These three options have long been practised by lawyers everywhere, whether permitted or not.

The American model of *contingency fees* goes further and includes payment of a larger element in the event of success, explicitly linked to the size of the recovery. At first sight, the payment of a success premium to the lawyer will reduce the net damages recovered by the client, but this effect is reduced where the prevailing level of damages is high, and where one-way cost shifting rules are applicable (many such rules apply in consumer-to-corporation litigation).[290] The Oxford Study summarised the use of contingency fees thus:[291]

'The American model of contingency fees goes further and includes payment of a larger element in the event of success, explicitly linked to the size of the recovery. This is argued to align the incentives of the client and the lawyer in the same direction of recovery maximisation.[292] But it has also been criticised as reducing the maximisation incentive after a certain level of investment of time because of asymmetric incentives over settlement, although empirical evidence of such practice in the United States is difficult to find.[293] This is argued to align the incentives of the client and the lawyer in the same direction of recovery

[290] S Farhang, *The Litigation State. Public Regulation and Private Lawsuits in the U.S.* (Princeton University Press, 2010).
[291] C Hodges, S Vogenauer and M Tulibacka, *The Costs and Funding of Litigation: A Comparative Perspective* (Hart Publishing, 2010), pp 96-97.
[292] Amongst numerous commentators see HM Kritzer, *The Justice Broker: Lawyers and Ordinary Litigation* (Oxford University Press, 1990).
[293] See A Tabarrok and E Helland, 'Two Cheers for Contingency Fees' (Washington DC, AEI Press, 2005).

maximisation.[294] But it has also been criticised as reducing the maximisation incentive after a certain level of investment of time has been reached, because of asymmetric incentives over settlement, although empirical evidence of such practice in the United States is difficult to find.[295] Kritzer has found that the type of fee arrangement is related to the type of client. A contingency fee is the arrangement of choice for individuals, whereas hourly rates or fixed fees are favoured by business clients.[296] A lawyer who works on a contingency fee case combines the roles of professional legal adviser, advocate, financier and insurance broker.[297] His effort is strongly influenced by how he is being paid,[298] and he will reject cases that do not satisfy his risk-to-return criteria.[299] The rejection rate of cases from potential clients appears to be around 50 per cent.[300] In the long run, compensation for professional services is dependent on performance.[301]'

The Oxford Costs and Funding Study found that contingency fees are widely accepted in the United States,[302] but otherwise rare from a global perspective.[303] In those other jurisdictions where they are permitted, they are not a principal source of litigation funding anywhere except in the United States, and are often controversial.[304] That Study found:

'The difference between a success fee and a contingency fee is (normally) that the former may be any sum whereas the latter is specifically linked to the amount recovered. The latter is intended to incentivise the lawyer to maximize recovery, and to align the economic interests of the client and the lawyer.

There is a strong cultural resistance in many states to fees in which a lawyer can be paid a percentage of the money recovered (*pactum de quota litis*). Such an arrangement is banned in Australia (except for commercial cases), Austria, Belgium, Cyprus, the Czech Republic, Denmark, France, Greece, Ireland, Luxembourg, Malta, the Netherlands, New Zealand, Norway, Poland (but found in practice), Portugal, Romania, Russia (unenforceable but used), Singapore, Sweden (but permitted in special circumstances, e.g. class action), and

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[294] Amongst numerous sources see HM Kritzer, *The Justice Broker: Lawyers and Ordinary Litigation* (Oxford, Oxford University Press, 1990).
[295] See A Tabarrok and E Helland, 'Two Cheers for Contingency Fees' (*The AEI Press*, 2005).
[296] See HM Kritzer, *Risks, Reputations, and Rewards: Contingency Fee Legal Practice in the United States* (Stanford University Press, 2004).
[297] HM Kritzer, 'The Wages of Risk: The Returns of Contingent Fee Legal Practice' (1997) 47 *De Paul L Rev* 267; HM Kritzer, *Risks, Reputations, and Rewards: Contingency Fee Legal Practice in the United States* (Stanford University Press, 2004).
[298] See HM Kritzer, *The Justice Broker: Lawyers and Ordinary Litigation* (Oxford, Oxford University Press, 1990), 126.
[299] HM Kritzer, 'Seven Dogged Myths concerning Contingency Fees' (2002) 80 *Wash U L Q* 739.
[300] HM Kritzer, *Risks, Reputations, and Rewards: Contingency Fee Legal Practice in the United States* (Stanford University Press, 2004), ch 3.
[301] WJ Lynk, 'The Courts and the Market' (1990) 19 *J of Legal Studies* 247.
[302] Although the general public views the fees charged in the legal profession with skepticism: Leo J Shapiro & Associates, *Public Perceptions of Lawyers: Consumer Research Findings* 14 (2002). They remain controversial there: for recent criticism and reform proposals see ; JE Barry and BW Rein, *The Case for Abolishing Contingent Fee Arrangements* (1999), http://www.wileyrein.com/publications.cfm?sp=articles&id=2977; JD Sweet, 'Determining a Reasonable Percentage in Establishing a Contingency Fee: A New Tool to Remedy an Old Problem' 77 (2010) Tennessee Law Review, 653; L Brickman, *Lawyer Barons: What Their Contingency Fees Really Cost America* (Cambridge University Press 2011)..
[303] C Hodges, S Vogenauer and M Tulibacka, *The Costs and Funding of Litigation: A Comparative Perspective* (Hart Publishing, 2010), pp 25-27, 106.
[304] As found in Europe by M Faure, F Fernhout and N Philipsen, 'No cure, no pay and contingency fees' in M Tuil and L Visscher (eds), *New Trends in Financing Civil Litigation in Europe. A Legal, Empirical, and Economic Analysis* (Edward Elgar, 2010).

United Kingdom. Contingency fees are permitted in Canada, Estonia, Finland (rarely used), Germany (in fairly rare circumstances), Hungary, Italy, Japan, Lithuania, Slovakia, Slovenia, Spain (rarely used), Taiwan and notably in the United States of America. In China, contingency fees were permitted until 2006, since when they have been prohibited in collective actions, criminal cases and administrative litigation. In other kinds of cases the contingency fee is now capped at 30 per cent of the recovery.'[305]

The widespread use of contingency fees in the United States is explained by the fact that they a particular role in the architecture of the civil justice system there—and a role that appears to be unique in civil justice systems across the world. The United States system places strong emphasis and encouragement on private enforcement of both private and public law.[306] That approach requires citizens and intermediaries to have no cost bar to instituting action aimed at seeking out and prosecuting illegal acts. The result is that the rules form a coherent matrix, in which some key features are: no cost shifting rule other than a one-way rule for the defendant to pay in some circumstances, and methods of funding that do not require clients to pay their lawyers, save out of any winnings.

The consequence of the American policy is that contingency fees are a *required* source of litigation funding in the United States, whereas in other jurisdictions they might be either acceptable, or positively contrary to public policy. The answer depends on what the public policy is: what is the function of private enforcement of law in each legal system? Is private enforcement through litigation encouraged or not, for what types of law, and in what circumstances? Some jurisdictions might, for example, want only a limited role for private litigation, since they have other mechanisms for solving disputes over public law (e.g. ombudsmen, tribunals, public enforcement agencies) and they might want resolution of private law disputes to be prioritised through negotiation (perhaps facilitated by mediation, conciliation or other ADR techniques) or through non-court pathways (such as private sector ombudsmen or business complaint handling schemes). As has been noted in chapter 2 above, all of those features are now U.K. government policy, so encouragement of litigation—whether funded by lawyers or intermediaries—is not a high priority within public policy. As noted above, however, there remain some unanswered questions (which are beyond the scope of this Report) on what *types* of cases are best suited to be dealt with through litigation, for which funding mechanisms might be needed. One finding of this Study is that commercial claims—especially be SMEs—appear to be one such category, at least in the current absence of appropriate ADR alternatives.

A significant level of lawyer funding has not been necessary in the civil law world, where there are lower lawyer costs than the common law world, because of the architecture of civil procedure systems and the use of tariffs. The Oxford Study clearly showed that predictable costs encourage the availability of insurance, and the

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[305] Ibid, p 25-26.

[306] This key difference in enforcement policy and legal architecture between the United States and other jurisdictions has been recognized only recently. See F Cafaggi and H-W Micklitz (eds), *New Frontiers of Consumer Protection: The Interplay between Private and Public Enforcement* (Antwerp, Intersentia, 2009); S Issacharoff, 'Regulating after the Fact' (2007) 56 *DePaul Law Review* 375; C Hodges, S Vogenauer and M Tulibacka, *The Costs and Funding of Litigation: A Comparative Perspective* (Hart Publishing, 2010), p 79 et seq.; C Hodges, 'Objectives, mechanisms and policy choices in collective enforcement and redress' in Jenny Steele and Willem H van Boom, *Mass Justice* (Edward Elgar, 2011).

low level of many national tariffs enhance the attractiveness of LEI through its low cost.[307] So BTE LEI insurance is the structural solution in civil law states whereas contingency fees are the American solution. The former may still have an access to justice problem for the poor, but that may be containable by some limited legal aid, public advice bureau, employee insurance, or lawyer *pro bono* work. Access to litigation by larger companies does not present the same barriers, since they have the resource to pay lawyers or buy insurance. There does, however, appear to have been a gap in funding for companies—especially SMEs—in Germany, which is why the insurance companies developed litigation funding options from the 1990s onwards there (see chapter 3 above). It would be useful to have more data on these issues. Just how much of an access to justice gap is there, and for individuals or SMEs? It is also interesting to speculate whether a Jacksonian shift by non-American common law states towards tariff or fixed fees for low value claims would remove a need for lawyer funding such as contingency fees.

The U.K. has experimented with controlled lawyer-funding through CFAs, and although the regulatory rules on CFAs themselves are not to change, their use in future is likely to be restricted, as noted above, because of the reform that the success fee element and the ATE premium is no longer to be recoverable from opponents. However, lawyer-funding is to undertake a major expansion with the authorisation of DBAs for all types of litigation.

## ECONOMIC ANALYSIS

Viewed simply as sources of finance, there is little difference between own funding and any form of external funding. Clients may be able to fund a case from their own resources or not. They might have bank facilities or insurance, or obtain financial support from family or friends, for some or all aspects (such as ATE for the adverse costs risk). Any form of external financial support should lead to a higher level of claiming and, if it is known to the opponent, higher and more favourable settlement rates and outcomes. However, the number and complexity of the relevant factors in litigation make theoretical modelling a sometimes unreliable basis for prediction.[308]

It is interesting to compare legal aid and litigation funding, since both involve 'external' funding, i.e. funds not provided from the client's personal assets. Legal aid involves a loan of public funds to a litigant by the state, with no expectation of payment of interest, but with the expectation of repayment from the opponent out of any damages recovered, whilst limiting further exposure through suspension of the adverse cost rule against the state and effectively against funded parties. In contrast, litigation funders aim to invest their capital in either prosecuting or defending litigation assets, but with a contractual right to repayment of capital, costs plus a success fee, whilst accepting the adverse cost risk (or off-setting it through purchase of an insurance policy). Co-funding between a lawyer and/or another funder, as well as insurance providers, is well established.

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[307] C Hodges, S Vogenauer and M Tulibacka, *The Costs and Funding of Litigation: A Comparative Perspective* (Hart Publishing, 2010).

[308] L Visscher and T Schepens, 'A law and economics approach to cost shifting, fee arrangements and legal expense insurance' in M Tuil and L Visscher (eds), *New Trends in Financing Civil Litigation in Europe. A Legal, Empirical, and Economic Analysis* (Edward Elgar, 2010).

The essential objective of a funder is to secure a return on investment. In this respect, the financial objectives of persons funded and of funder are aligned.[309] Alignment of the interests of client and funder is in general considered to be a good thing, since the objectives and interests of the client and funder are the same, and potential for conflicts of interest is reduced. As noted above, theoretical analysis, however, argues that the marginal incentive for the funder (in the American context, the lawyer) decreases up to a threshold of return on a case, as the marginal increase in fees is not worth the effort. At the margin, the lawyer has a greater incentive to settle than the client.[310] There is no empirical evidence that any type of fee arrangement increases the likelihood of unethical behaviour, although the specific nature of unethical conduct most likely does vary depending on the type of payment structure.[311] A recent law and economics review of the literature concluded that the effects of the introduction of contingency fees are hard to predict, since diverse factual situations exist and much depends on lawyers' behaviour, and one fee system is not by definition better than another as concerns giving the right incentives to both lawyers and clients: [312] the same should apply to independent funding. A recent American analysis suggested that the ancient prohibitions on third party funding should be replaced with a more fine-tuned set of rules that distinguish socially beneficial from socially harmful instances of such funding.[313]

A specific criticism of the recoverability of CFA success fees and ATE premiums was that litigants with CFAs had little interest in controlling the costs which were being incurred on their behalf, and this underpinned Jackson's recommendations of reducing shifting, accepting the principle that client's damages may be reduced by fees, and widening use of DBAs.

Litigation finance may be expected to influence various economic aspects of a case, in particular case screening, case outcome (including and settlement amount), settlement timing, the volume of litigation, and potential conflicts between lawyer and client.[314] One theoretical economic model predicts that having LEI increases a plaintiff's expectation on settlement amount, but its effects on settlement probabilities and care levels depend on the distribution of the accident loss.[315]

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[309] The Corporate Governance Manual of IMF states that 'it is almost impossible that there will be a conflict of interest between officers and employees on IMF on the one hand and any particular client of IMF on the other': Schedule to Addendum 1, para 8.1. See also D Dana and M Schazenbach, 'How Would Third Party Financing Change the Face of American Tort Litigation? The Role of Agency Costs in the Attorney-Client Relationship' (unpublished, 2009).
[310] A Tabarrok and E Helland, 'Two Cheers for Contingency Fees' (*The AEI Press*, 2005).
[311] HM Kritzer, 'Lawyer Fees and Lawyer Behaviour in Litigation: What does the empirical Literature really say?' 80 Tex. L. Rev. 1943 (2002).
[312] M Faure, F Fernhout and N Phipsen, 'No cure, no pay and contingency fees' in M Tuil and L Visscher (eds), *New Trends in Financing Civil Litigation in Europe. A Legal, Empirical, and Economic Analysis* (Edward Elgar, 2010).
[313] KN Hylton, 'The Economics of Third-Party Financed Litigation' Boston University School of law Working Paper No 11-57, December 12, 2011, available at http://www.bu.edu/law/faculty/scholarship/workingpapers/2011.html.
[314] P Fenn and N Rickman, The empirical analysis of litigation funding' in M Tuil and L Visscher (eds), *New Trends in Financing Civil Litigation in Europe. A Legal, Empirical, and Economic Analysis* (Edward Elgar, 2010).
[315] Y Qiao, Legal-Expenses Insurance and Settlement' 1(1) (2010) Asian Journal of Law and Economics, article 4.

In summary, from an *economic* perspective, there is little difference whether the source of the funds used in the litigation process, on either side, originate with parties, their shareholders, bondholders, private lending financial institutions, the state, lawyers, or external funders that subsidise litigation. The use of any independent sources of funding constitutes risk spreading. But there are differences between the different sources of finance from the *public policy* perspective, to which we now turn.

# 10. Issues with the Control of Litigation by Non-Parties

It has been found above that a Rubicon has been crossed over the general acceptability of provision of finance to support litigation. However, the extent of the bridgehead on the far bank of the Rubicon is not yet clear. Certain issues exist when finance is provided by non-parties. The issues of who controls litigation, and whether litigation is about rights and people, or about hard-nosed investment, are of some fundamental importance to the legal culture of a nation. These issues arise whatever the source of the external funding—whether it be banker, lawyer or investment fund, as well as the state. Hence, the principles and rules should be consistent in all circumstances. There has been remarkably little public debate on such issues, which is curious given the extent of the possible transformation in the national style in legal culture that may be occurring. This section examines these issues.

## THE ISSUES THAT ARISE FOR PUBLIC POLICY WITH LITIGATION FUNDING

Various concerns over the role and practice of funding for litigation have arisen from our research interviews, noted above, and from the literature. We have identified three series of questions: one arises with any service activity, especially involving consumer services; the second arises with every provision of financial services; and the third arises with services provided with the context of the litigation system. The issues are:

A. **Acceptable commercial activities**. Should there be controls over the business activities of service providers, so as to provide consumer protection against improper advertising, unfair contract terms etc., similar to any other service to consumers? Should such controls also protect small and/or large company clients?

B. **Financial prudence and the reliability of the funding source**. Should there be controls over the financial services aspects of any funder, to ensure that the funder has adequate financial probity?

C. **Acceptable behaviour within the legal process: maintaining the integrity of the legal system**. Should there be controls over the activities of all those involved in litigation, whether lawyers, funders or experts, to ensure that the legal process is enabled to operate without improper commercial pressures?

These issues will be examined in turn.

### A. ACCEPTABLE COMMERCIAL ACTIVITIES

The risk here is that some funders or intermediaries may operate in ways that break standard trading law, particularly that on consumer protection. The aims here are no different from any normal consumer protection objectives: the provision of adequate, true and timely information to investors and clients; of appropriate marketing and selling activities; of appropriate terms; especially of fair prices; and the avoidance of unfair commercial behaviour.

Two historical examples give considerable cause for concern: the English fiasco over mis-selling and consumer detriment that surrounded claims management companies (claims farmers) that arose to take advantage of the post-1999 CFA+ATE regime typified by Claims Direct and TAG (see chapter 2 above), and the report from the United States of America on the activities summarised as 'pay day loan' sharks involving preying on vulnerable individuals and contracts with excessive prices. Both these activities were driven by the desire for fast and excessive profits in new products or markets, and were not controllable under pre-existing consumer protection legislation or regulatory enforcement systems, and required the legislative enactment of specific new regulatory regimes and, in the U.K. at least, the creation of new regulatory bodies.

The risk of history repeating itself with mis-selling, ripping off consumers, and general consumer detriment is clearly high. It should, therefore, be clearly anticipated that legislation establishing formal regulation, backed by a specific enforcement regime, will be needed to give adequate consumer protection if and when litigation funding is provided on any scale to consumers, as opposed to companies, as present.

However, given that third party litigation funders currently sell almost entirely to companies and not to consumers, the risk of consumer detriment in the United Kingdom is currently low, and will remain so for as long as litigation funders do not seek to sell to consumers, whether individually or collectively. That empirical position underlies the relaxed approach that the Jackson Review and the government took towards the introduction of regulation of litigation funding: it is currently not a high priority given the state of the market. But some U.K. funders do already have individual clients, such as investors in securities, who are either bringing similar claims to others or who are formally pooled in some way. The specific position of funding of collective claims is discussed further below.

Is there also a need to control the financial returns of funders whose clients are companies, especially SMEs? Smaller companies are, after all, in the same poor bargaining position as individual consumers, with limited ability to negotiate away onerous terms, whether on prices, coverage or other terms. On the other hand, protection of SMEs remains subject to the principle of freedom of contract, and no current legislation would protect them, other than the long-stop provisions on usury.

Are litigation funding terms that prevail in the market currently fair—especially the cost? Classic economic analysis suggests that where the market has sufficient competition, there should be little concern over such matters. Concern would increase where there is asymmetry between providers and buyers, especially where buyers are consumers, where there may be disparities of information, bargaining power. In such conditions a need for external regulation may arise. This Study has found that the market is at an early stage of development, and that demand considerably exceeds supply. According, there should be (and is) concern over levels of pricing.

The empirical evidence is that governments or markets are increasingly imposing caps on percentages on uplifts for lawyers' fees:

- Australia: Funders' fees are typically between 20 and 40 per cent of recovery. Australia has significantly reduced legal aid (a reduction in expenditure since 1995-96 of 78 per cent has driven a third of providers from the market) and instead has removed the traditional common law ban on contingency fees (capped at 25 per cent) in 2006 and has permitted third party commercial litigation funders to flourish.

- Canada. The Ontario Class Proceedings Fund takes a premium of 10 per cent of recoveries, and is widely used. The Canadian law firm Siskinds funds cases and a court has recently held that a 6 per cent premium was reasonable for a recovery of C$10 million but not if it were C$3 million. Representative plaintiffs are subject to the cost shifting rule, but Canadian lawyers are now giving indemnities to their clients to cover this risk, so as to avoid the need for clients to take independent legal advice on the costs risk, which would threaten the viability of actions.

- USA: the typical contingency fee may be around one-third, but there is a substantial variation in the contingency fees charged.[316]

- In some European jurisdictions (Austria, Germany, Ireland, the Netherlands) the fee can be 25-40 per cent of the recovery. The fee is not recoverable under the civil law tariff systems, so is deducted from the sum awarded or recovered.[317]

- Poland permits contingency fees only in collective actions, but limits them to 20 per cent of recovery.[318]

- The Jackson Review recommended that no success fee deducted from damages should exceed 25 per cent of the damages, excluding damages referable to future costs or losses.

- The payment to the lawyer in English DBAs in employment cases must not exceed 35 per cent of the sum recovered by the client.[319]

- In 2010 the government proposed to reduce the maximum 'success fee' that may be charged in defamation proceedings funded under conditional fee

[316] H M Kritzer, 'Seven Dogged Myths concerning Contingency Fees' 80 Wash. U. L. Q. 739-794 (2002).
[317] C Hodges, S Vogenauer and M Tulibacka, *The Costs and Funding of Litigation: A Comparative Perspective* (Hart Publishing, 2010), p 27.
[318] Act on Class Actions of 2009.
[319] Courts and Legal Services Act 1990, s 58AA. The proposal and rationale is at http://www.opsi.gov.uk/si/si2010/draft/pdf/ukdsi_9780111491669_en.pdf. The Draft Explanatory Memorandum is available at http://www.opsi.gov.uk/si/si2010/draft/em/ukdsiem_9780111491669_en.pdf.

agreements from 100 per cent to 10 per cent of base costs,[320] although the proposal was dropped.[321]

It is clear that the U.K. government is increasingly imposing limits on percentage uplifts in lawyers' fees. Some of the regulated maximum uplifts or prices of some funds are lower than current market prices for commercially available litigation funding.

UK commercial funders aim for 30 per cent of the sum recovered, apparently typically achieving within a range of 20 to 40 per cent. This bears something of a resemblance to the, perhaps mythical, rule of thumb that the starting point for contingency fees in the United States is also 30 per cent. A 30 per cent return on capital, especially where it is after reimbursement of expenses, is clearly a very healthy investment. In other words, litigation funders are, assuming they are successful in their investments, reaping handsome rewards.

Funders would argue that they are assuming significant risk as pioneers in unknown and risky territory, and deserve an element of premium prices whilst the market is in this innovative and developmental stage. They would argue that entrepreneurs deserve an incentive to innovate, and seek ways of satisfying demand where there are few if any other alternatives. Funders are assuming, like any commercial business, elements of uncertainty and risk. In setting prices, they need to take into account the risk that their assessment of the risk of investment in any given case may be wrong, or that the investment might fail for reasons beyond their control. Accordingly, the principles of market forces and contractual negotiations should not be interfered with.

A whole sequence of questions arises. What size of uplift is appropriate? Are fees proportionate to risk? Should the market decide in commercial cases? Is the market large enough? Will it mature, how soon, and to what size? If the target clientele remains SMEs, will they have limited negotiating power? Should there be controls in consumer cases, or are existing rules on unfair contract terms or unfair commercial practices enough? What about the failure of ex post litigation over bank charges—is *ex ante* regulation needed? Does litigation funding save money in the transactional costs of those cases where it applies?

What is the actual cost of funding litigation (cost of capital) and do funders lead to lower legal costs? Should profits be transparent? Should there be transparency of the actuarial calculations on cost of capital and profit margin? What basis of charging is appropriate? For example, is it fair that outlay is reimbursed as a first slice, and that fees are then a second slice, usually as a percentage of the Resolution Sum? Is it fair for some funders also to charge a management fee? Would a 30 per cent be an unfair commercial practice in a consumer context? Will prices fall and calculations become more transparent as the market matures?

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[320] The text is available at http://www.justice.gov.uk/consultations/costs-defamation-proceedings-consultation.htm.

[321] C Baksi, 'Government abandons libel fee cut bid' (*Law Society Gazette*, 9 April 2010), 2. The prior consultation was at http://www.opsi.gov.uk/si/si2010/draft/pdf/ukdsi_9780111496510_en.pdf. The text of the proposal is available at http://www.justice.gov.uk/consultations/costs-defamation-proceedings-consultation.htm.

At this stage, we refrain from drawing any conclusions on the pricing or transparency issues, but we flag them as important issues for all involved to keep under review.

## B. THE RELIABILITY OF THE FUNDING SOURCE: FINANCIAL PRUDENCE

One risk is that a funder becomes illiquid, leaving its portfolio of claims without further funding and possibly at risk of adverse costs, also undermining clients' tactical and negotiating positions. Australia has a rule that litigation funders have to have 3 months' liquidity, but Jackson thought that that is not long enough.

Failure of an external source of finance might be viewed as a normal commercial risk, but in the context of litigation two further considerations arise. Firstly, the legal system itself would be undermined. Secondly, a significant population of claimants will be impecunious, vulnerable and in need of legal redress, so not only unable to bear the insolvency of a funder but also exposed to consequential financial risk that is unaffordable and, in particular need of protection by the legal system. Those two factors may be thought to justify a requirement for particular measures to ensure reliance on external sources of funding for litigation. Insurance companies and banks are regulated in relation to issues such as maintenance of capital adequacy, reserve policy, and liquidity. Exactly the same issues arise for litigation funders and lawyer funders: there should be consistency, so as to provide both client protection and a level playing field for all providers.

Litigation funding does not involve particularly quick returns on investment. This fact itself should mean that it is not that attractive to rogues who would give rise to consumer detriment. Litigation funding also requires considerable expertise, both legal and financial. It is not at all the same as the general claims farming function (which involved simple marketing and signing people up) that gave rise to extensive problems in the early 2000s (due to a failure of proper or any investigation). It would currently be too risky for litigation funders to engage in an alternative commoditised business model.

While consumer groups have indicated some concern about whether litigation funders might have sufficient capital adequacy, and the risk that the collapse of litigation funding firms would create the possibility of consumers being left with a debt, the current business model adopted by the main litigation funding firms interviewed in this research appears to make this a low risk. The litigation funders we have spoken to are primarily working with large funds, are corporate entities rather than smaller funders and, in several cases, bring experience of litigation funding in other markets (e.g. Germany and Australia) to their U.K. operations, adapting a tested business model to the UK legal system. Of course, any firm may find itself exposed if more than one adverse risk materialises simultaneously. We have not been given access to any funder's figures or financial situation, and do not express any view on individual companies. However, it appears that funders seek to put in place control mechanisms. However, we would have concerns should there be an expansion of litigation funding into the consumer market with smaller funders entering into the market.

We discuss financial prudential regulation further below.

## C. ACCEPTABLE BEHAVIOUR WITHIN THE LEGAL PROCESS: MAINTAINING THE INTEGRITY OF THE LEGAL SYSTEM

### The Importance of Maintaining the Integrity of the Legal System

The underlying principle of public policy is that the principles of justice must be scrupulously maintained, and unaffected by any unethical or inappropriate commercial behaviour. It may even be said that the even the possibility of inappropriate interference in the judicial process is unacceptable: justice must not just be done but be seen to be done. The Jackson Review noted[322] that the current English case law aims at

> 'whether the agreement has a *tendency to corrupt public justice* and .. such a question requires the closest attention to the nature and surrounding circumstances of a particular agreement'[323] and 'the rules of champerty, so far as they have survived, are primarily concerned with the *protection of the integrity of the litigation process*'[324] [emphasis added].

So the practical issue that arises is to insulate and protect the judicial process from inappropriate behaviour that might undermine confidence in justice and the impartiality of the judicial process.

### THE CIRCUMSTANCES THAT ARE OF CONCERN

Practical examples that may undermine the integrity of the litigation process would exist where there is an opportunity for undermining the capacity of the litigation system to produce a just decision through:

a. **inequality of arms**, affecting ability to investigate merits, assemble evidence and present case with appropriate expertise in expert evidence and legal skill. Inequality of arms will offend against the fundamental common law right to a fair trial, which is also enshrined, through the Human Rights Act 1998, in Article 6 of the European Convention on Human Rights.[325] It will also offend against the overriding objective of the Civil Procedure Rules for England and Wales of 'enabling the court to deal with cases justly',[326] which specifically includes 'ensuring that the parties are on an equal footing'.[327] As an example of that principle, the courts are required to deal with cases in ways that are

[322] Preliminary Report (2009) ch 15; see ch 1 above reference to the 'tendency to corrupt public justice' test in *London & Regional (St George's Court) Ltd v Ministry of Defence* [2008] EWHC 526 TCC, 103.
[323] *Giles v Thompson* [1994] 1 A.C. 142.
[324] *Papera Traders Co Ltd v Hyundai (Merchant) Marine Co Ltd No 2)* [2002] Lloyd's Rep 692.
[325] See A Zuckerman, *Zuckerman on Civil Procedure. Principles and Practice* (Thomson, 2ed 2006), ch 2.
[326] CPR 1.1(1); see A Zuckerman, above, ch 1.
[327] CPR 1.1(2)(a).

proportionate to 'the financial position of each party'.[328] Procedural aspects of the rule of law have to do with 'natural Justice' or 'procedural due process'.[329]

One of the policy concerns in maintaining the legal aid system was to support 'the little man' against the Goliath of the state or a large corporation. That consideration remains today in a post-legal aid world, for example if litigation funders were minded to finance individual claims. However other considerations also arise. The balance of power can be tilted in the opposite direction by means other than funding, such as where a collective procedure (class action-type) or a one-way cost shift rule (such as QOCS) is available. It is difficult to maintain a balanced equilibrium between defendants with large resources and claimants with financial support and powerful procedures. Arguments over 'legal aid blackmail' and 'class action blackmail settlements' are well-known.

The extent to which litigation funding might affect the balance between the parties in different types of litigation, and might lead to either an increase in access to justice for good claims or an increase in blackmail or other undesirable claims and settlements can only be answered (a) on the basis of empirical evidence and (b) by looking at different types of claims individually. We have found above merely that the existing use of litigation funding in claims brought by SMEs and in corporate litigation generally appear to constitute an increase in access to justice.

b. **improper pressure** on a party from its own advisers or funders: lawyer or funder who needs cash flow, or has reached personal optimum level in balance of reward and return, and so might importune the client to make strategic decisions that are not in his or her interest, such as not investing further in investigation, expertise or preparation, and particularly in settling too early or for an under-value.

In order to consider further the issue of improper pressure, it is first helpful to analyse the differing interests of the various parties to litigation.

## THE INTERESTS OF THE VARIOUS PARTIES AND THE PUBLIC INTEREST

The objectives and interests of the various parties involved in litigation are as follows.

**Funded party.** A party might not have sufficient funds to pursue or defend a claim. That situation would result in a failure or travesty of justice, either because valid rights were not vindicated when they had been infringed or because valid defences were not asserted when they were applicable. Relevant factual evidence or expert opinion might not have been discovered or produced, and arguments not advanced with sufficient learning or force.

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[328] CPR 1.1(2)(c)(iv); see Zuckerman, p 5.

[329] J Waldron, 'The Rule of Law and the Importance of procedure', *NYU School of Law, Public Law Research Paper No. 10-73*.

A further situation might also be that a party has sufficient personal assets to fund a claim, but chooses to arrange extraneous funding, such as a loan from a bank, a claim on an insurance policy, a loan of donation from the state or some other third party.

The primary need of the party is for adequate funding. The party might choose to spend the money on pursuing or defending a claim that has sounder or weaker merits, or might not know, at least at the start of the process, how good the merits are. There might be points of principle involved that a party considers are more important than the monetary value of the claim or its merits.

In any event, the party is normally concerned with achieving a correct and fair outcome. He or she wants to receive adequate unbiased and objective advice, and have adequate representation.

**Funded party's lawyer.** The lawyer is an intermediary who provides services in the litigation transaction.[330] His primary and over-riding objective is commercial—that his work should make a profit. However, his professional objective, and the basis on which he will attract reputation and more business, is that of achieving the best results for his clients. Lawyers may be subject to professional codes of ethics that require standards of good practice.[331] It will immediately be seen that the commercial and professional objectives of the lawyer inherently conflict.

**Funder.** An independent funder, whether it be the state through a legal aid fund or a private party who provides a loan, has the over-riding financial objective of being repaid, together with a profit on the invested loan. As discussed below, the state may well also have a wider public objective of seeking to assist citizens to bring claims that assert their rights whether they win or lose, especially for example so as to be able to challenge the decisions of the executive branch of government and to clarify the law. But that wider public policy objective is less likely to be a real objective of an independent commercial entity, whose business model is to make money by investing in litigation. The exclusive objective of such a private entity is to seek the highest return on its investment.

**Opponent, and opponent's funder.** The primary self-interest of an opponent (the second party to litigation) is in winning the contest. In some situations, a litigant wants 'peace' and restoration of trading or amicable relations, perhaps irrespective of the legal merits of the dispute. At a more detached level, the litigation interest should be to reach a legally valid and merited outcome, reflecting the balance of rights and obligations between the parties as set by the law. Hence, the second party's financial interest lies in ensuring that his resources are adequate for the task: this equates into the principle of equality of arms again. The second party does not want to fight against a first party who has vastly superior resources, or to find that the resources were vastly larger than expected, or that his potential exposure to liability for costs (whether he wins or loses) is extensive and/or disproportionate. He also wants to know that his opponents and their intermediaries and financers are observing appropriate and predictable ethical rules and playing fairly.

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[330] The same applies to other intermediaries, such an as expert witness.

[331] See The Code of Conduct, Bar Standards Board, 8th edition, available at http://www.barstandardsboard.org.uk/regulatory-requirements/the-code-of-conduct; also Solicitors Regulation Authority Handbook, available at http://www.sra.org.uk/solicitors/handbook/welcome.page.

**The state and civil society.** The primary interests of society are to see that rights are upheld and that disputes are resolved in a timely and orderly fashion. In other words, the fundamental objective is to uphold the rule of law.[332] Other considerations also arise, such as that constitutional rights and fundamental principles of good order should be observed, such that disputes, especially those that are resolved in the forum of the state's courts, should be resolved in a timely, fair and proper fashion. The state may also have the economic objective that funding for some—or many—disputes should come from the private parties involved or, if not, from private funders, rather than from public funds.

Overall, therefore, in view of the differing interests identified above, it is in the interests of the state and of the parties that the principles and rules be set out and observed. Such principles and rules need to be enforced by the judges and relevant officials, and by the professionals involved under their professional codes of ethics.

As noted above, the state's objectives in relation to litigation are to ensure that the playing field between the parties is subject to principles that include equality of arms and the absence of improper pressure. In relation to ensuring an absence of improper pressure between parties and their supporters or advisers in relation to the issue of funding, the objective is to balance the provision of independent private funding and advice for dispute resolution with the principle that conflicts of interest or other abuse do not interfere with the delivery of justice.

## MODELS OF RELATIONSHIPS IN LITIGATION AND THEIR CONFLICTS

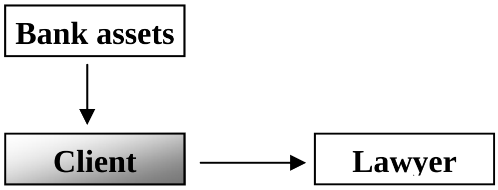
The next step is to analyse the conflicts of interest that arise in relation to litigation funding. In order to do this, it is instructive first to consider the various models in which different configurations of relationships exist.

The simplest situation is where a *litigant acts in person*, and is self-funding. He or she has no conflicts of interest.

The traditional model of litigation involves a *litigant and a lawyer* (on each side). The lawyer may be chosen by the litigant, but choice can be imposed or limited by an insurer or restricted by the legal aid authorities. The classic position is that the lawyer is independent of the funder, and has no interest in the financial interest of any external funder, so the legal advice is not subject to a conflict of interest between lawyer and funder (see Figure 1). However, there are two caveats. Firstly, the commercial interests of the lawyer may differ from those of the client, and the extent to which that is so will depend on whether the lawyer is paid on an hourly rate basis (which incentivises quantity of work but not proportionality between cost of work and value in dispute, and does not align the interests of client and intermediary) or payment by results, especially if linked to amount of damages recovered (which does align the interests of client and intermediary, by incentivising outcomes and proportionality) or some combination or alternative approach.

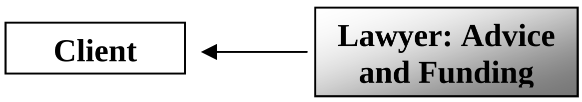
[332] See generally DJ Galligan, *Law in Modern Society* (Oxford University Press, 2007).

**Figure 1**




Secondly, the ideal of independence does not apply where the *lawyer provides some or all of the funding* (see Figure 2). This situation has long existed in the United States of America where contingency fees are used, and DBAs are now to be extended in England and Wales to all litigation. However, where the roles of adviser and funder are fused, it is easy to see the potential for conflicts of interest to arise between the two functions, such as over how much work to invest or when and how much to settle for. Americans might say that the level of risk is low and acceptable in their legal environment. Professor Bert Kritzer's detailed and extensive work on lawyers and contingency fees (see chapter 3 above) is very helpful in this respect. One of his key findings is that lawyers maintain a portfolio of cases, so incentives to act inappropriately in any one case are lessened. But in an English jurisdiction, where contingency fees are (and would not be) the only or main source of funding, a different environment and different values might evaluate the risk of conflict from lawyer-funding differently to U.S.A.

**Figure 2**



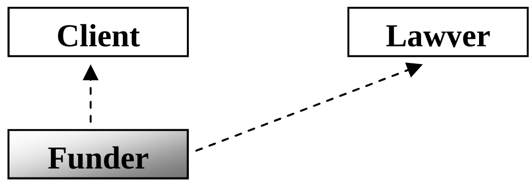

It will be seen that the extent to which there is a conflict of interest between client and lawyer varies depending on the nature of the funding arrangement and other factors. Situations in which conflicts of interest can theoretically arise have been in existence in England and Wales for some decades at least, without apparently giving rise to problems in practice.

A simple model of *third party litigation funding* has three players, each with a separate and distinct function (see Figure 3):

- client (who takes all decisions),
- lawyer (who provides legal services, including giving independent and objective legal advice, especially on the merits of the case and whether a settlement proposal is satisfactory or not) and

- funder (who provides funding, and who requires its own full information so as to undertake its own risk assessment for its investment, but does not have decision rights).

**Figure 3**




The independent funder model is well familiar in England and Wales from the old legal aid system. In a simple version of the new model the client is an intelligent commercial company, perhaps not heavily resourced. It might obtain legal services or advice from internal and/or external lawyers. It would traditionally need to fund litigation from its own resources or from borrowing. It can now service such function from an independent funder. Clear business advantages can be seen in that arrangement.

So far, the roles of the three players have been kept carefully separate in England and Wales, with funders being careful not to take decisions. That may be acceptable where funded parties are companies of some sophistication, but not where they are unsophisticated SMEs or individual consumers. Where the client is unsophisticated and with limited personal resources, all the familiar consumer protection issues arise that occur in the provision of any external, and especially complex, service to consumers. Issues arise of supply of adequate information, and protection from mis-selling, unfair terms, and oppressive behaviour—all referred to in relation to the need for equality of arms (see page 145 above). Extensive legislation on unfair contract terms, unfair commercial practices and so on is required to control against this.

As noted above, there is a public interest in maintaining the integrity of the judicial process, and preventing parties from undue influence. The above models show that conflicts of interest arise

a) where the function of effective control is exercisable by someone other than the client, and also
b) where a non-party has both a financial interest and an advisory interest.

It will be seen, therefore, that there will be a level of concern about improper behaviour either where effective control rests with a lawyer or funder (Figures 2 and 3), and also where a lawyer adopts the roles of both adviser and funder (Figure 2) or where the funder provides advice in addition to funding (Figure 3). This simple analysis explains the historical concern with having a financial involvement in a suit (champerty), supporting litigation without legitimate concern (maintenance) and stirring up litigation (barratry).

A conclusion is that lawyer-funding (such as contingency fees, CFAs or DBAs) inherently gives rise to a conflict of interests, whereas where the roles of adviser and funder are kept separate there is less potential for conflict. However, if the funder provides services that control the litigation, a conflict arises and there is potential for abuse. It can, therefore, be argued that litigation funding has certain advantages over lawyer-funding where the roles remain separate. If so, should lawyers' funding be removed – in some situations or totally – if private funding is available? Or is there some advantage in lawyers (albeit funded) remaining on risk to some extent to protect both client and funding, as was the model for most CFA/ATE funded commercial cases?

It will also be seen that where a claim is assigned by the claimant (or defendant) to the funder, no further issue of conflict arises between them, since control is ceded entirely to the funder, even if the terms are such that the client is later paid a proportion of the proceeds: hence, such factoring arrangements do not concern us further.

## THE CURRENT POLICY DILEMMAS

It was concluded in chapters 2, 3 and 4 above that policy has now changed in England and Wales such that funding of litigation by lawyers or third parties is in principle acceptable. Lawyers are subject to ethical rules that require them to give independent, dispassionate advice in the client's best interests, and not to pursue their own personal financial interests. We remain sceptical over the effectiveness of such a rule. However, no such professional rules apply to other commercial litigation funders.

Further, it was found that although many jurisdictions maintain a ban on lawyers being paid on a contingency fee basis (*pactum de quota litis*: fee based on a share of the proceeds), such fees have long been widespread in the United States, and are being introduced in some other countries, sometimes tentatively. Also, litigation funders are well-established in some jurisdictions, as different as Germany and Australia.

The American contingency fee is accepted within the national legal architecture, which encourages widespread private enforcement of private and public law, and seeks to incentivise citizens and lawyers to act as 'private attorneys general' to seek out wrongdoing and take perpetrators to court, with considerable emphasis on providing general deterrence.[333] In that context, Americans value law enforcement by private actors above the potential for conflicts of interest.

Australians have reached the point where private funding is necessary in order to facilitate class actions, which are again seen as important means of private enforcement of law against large corporations. Hence, the national policy on the purpose and functionality of the legal system favours a particular balance of concern in relation to potential conflicts of interest on the part of litigation funders, who are freely permitted to have full control of class litigation instead of the individual claimants.

[333] Similarly, Garber's study analysed what effect litigation funding had on deterrence in the United States (he thought it would reduce it): S Garber, *Alternative Litigation Financing in the United States. Issues, Knows, and Unknowns* (RAND Corporation, 2010), p 29.

England and Wales has not, so far at least, adopted a policy of private enforcement of public law obligations, or of class actions for enforcement of either private or public law. Hence, one would expect the balance of public interest to differ in this jurisdiction from that of U.S.A. or Australia. The New Labour government's policy in 2009 was cautious about introducing collective actions, and wanted to explore regulatory and ADR solutions as alternative priorities,[334] and proposed to establish a Consumer Advocate.[335] The coalition government has to date announced no role for collective litigation in its extensive proposals on reform of the legal landscape, but has continued with extension of ADR.[336]

These considerations highlight that the national context of the policy and architecture of the legal system is highly important in indicating what rules are appropriate on issues of litigation funding and costs. It should not be expected that the same rules should apply in every jurisdiction. Different jurisdictions will have different objectives, and will reach different decisions on the balance to be struck between encouraging litigation, and private funding of litigation, and who is able to control it, and what degrees of conflict of interest and risk of abuse are acceptable.

A state might have a strong need for access to justice through litigation, perhaps because it wishes to escape from a culture of corruption, the principles of integrity may have to take second place to pragmatic considerations of provision of access to justice. Alternatively, the level of access to justice may be sufficient to permit maintenance of the primacy of the principles of integrity, to which exceptions can only be made provided satisfactorily convincing empirical evidence can be produced that the principles are not in practice diluted if litigation funding is permitted in certain circumstances. The policy might be that many types of disputes should be resolved by ombudsmen, regulators or ADR rather than by litigation, so funding for litigation might not be a particular priority for such cases as are dealt with by the other methods. In short, the context needs careful examination.

Accordingly, the issues that arise are:

1. **What is the national policy on enforcement of law through private litigation?**

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[334] UK Government's Response to the Civil Justice Council's Report: 'Improving Access to Justice through Collective Actions', Ministry of Justice, July 2009. See also Consumer White Paper, *A Better Deal for Consumers. Delivering Real Help Now and Change for the Future,* Cm 2669; *Representative Actions and Restorative Justice: A Report for the Department for Business, Enterprise and Regulatory Reform (BERR),* J Peysner and A Nurse, Lincoln Law School, University of Lincoln, December 2008.
[335] See Consultation issued on 2 December 2009 at http://www.berr.gov.uk/consultations/page53813.htm. The Consumer Advocate initiative has ultimately been supported by Consumer Focus: see L Bello, *Waiting to be heard: Giving consumers the right of redress over Unfair Commercial Practices* (Consumer Focus, August 2009).
[336] Lord Young of Graffham, *Common Sense, Common Safety, London:* (The Cabinet Office, 2010); *Consultation paper, Proposals for Reform of Legal Aid in England and Wales*, November 2010; *Proposals for Reform of Civil Litigation Funding and Costs in England and Wales. Implementation of Lord Justice Jackson's Recommendations*, (Ministry of Justice, 2010), Consultation Paper CP 13/10; *Empowering and Protecting Consumers. Consultation on institutional changes for provision of consumer information, advice, education, advocacy and enforcement* (Department for Business Enterprise and Skills, 2011).

2. **Is funding provided by either or both of third parties and lawyers needed for certain types of case?** If so, in what circumstances and subject to what constraints?

3. **Do certain situations give rise to conflicts that cannot be satisfactorily controlled and should be banned?**

4. **If there are situations in which the degree of conflict is acceptable, but should be controlled, what means of control are appropriate?**

For example, where the lawyer provides *both* independent professional advice and services and funding services, this situation inherently raises the potential for conflict of interests.[337] However, lawyers will argue that having a stake in a case does not in practice suborn their behaviour, as witnessed by the general history of CFAs and contingency fees, in view of their high professional ethical standards. So how significant are the conflicts that arise in practice? Do the conflicts that arise differ in intensity, such that in some or all situations the potential for abuse is an acceptable risk and can be controlled by other means, such as through professional ethical requirements? Is there a difference say between large commercial cases and small consumer cases, or between individual cases and class actions? Should there not be more reliable evidence of what actually happens in practice?

We suggest that questions 1 and 2 above have received little consideration hitherto, and deserve far greater consideration than is possible here. It will be seen that questions 2, 3 and 4 rely to a considerable extent on empirical evidence (how many types of case, how serious are the conflicts, what works best?), which is currently unavailable. However, we suggest the following analysis of questions 3 and 4.

## THE ISSUE OF WHO CONTROLS TACTICAL DECISIONS

In order to examine the extent to which conflicts of interest might give rise to more or less concern, we should consider the practical situations in which problems are likely to arise. The functions that have to be examined are:

- Who investigates a case?
- Who assesses merits?
- Who selects the lawyers?
- Who instructs the lawyers, and on what issues?
- Who controls the strategic conduct of the case?
- Who has what control over settlement of a claim? Who decides what offers to make, accept or reject, and when?
- Can the funder withdraw?

The core policy conflicts to be balanced are between the following factors. On the one hand, there is the public policy concern discussed above that there should not be

[337] The proof of this pudding is in the view that a solicitor has ‘a real possibility’ of a conflict of interest if he has a financial interest in a funder: *Self-Regulatory Code for Third Party Funding. CBI response to Civil Justice Council’s consultation paper* (Confederation of British Industry, 7 September 2010).

undue interference in the collection or presentation of evidence or of a case or in relation to settlement, since this would undermine the fairness and objectivity of the legal process and decisions, and interfere with the free choice of litigants.

On the other hand, the arrangement represents an investment decision by the funder, who should be able to take steps to protect his investment, and cut losses if and when that seems prudent. Investors holding a 30 per cent stake through shares in a company or other venture would be so entitled to act in their interests so, it is argued, what is the difference here? Similarly, a bank supporting a litigant would be able to act autonomously in deciding whether or not to extend or continue credit to its customer, and if its decisions were to affect the customer's ability to continue a litigation case, or the amount of budget available for the case, then so be it. Funders would wish to be able to exercise investment management. These points view the provision of funding dispassionately from the point of view of economics and who has what financial risk.

Australian and other funders argue also that their expertise is positively sought by some clients, where the clients just want the funder to provide a complete litigation service and pay over whether the net recovery is at the end, without being involved in any managerial capacity. Hence, this service should be available as under the principle of freedom of contract, and that unwarranted interference would be opposed to the ability of both clients and funders to contract in a competitive market. It is a matter of freedom of choice.

There is also the public policy argument that in England and Wales there is a public interest in maintaining a viable commercial litigation funding industry, since this is necessary for maintaining access to justice in view of the fact that public funds are no longer available.

Fears that protection for the consumer through erosion of the lawyer-client relationship currently seem groundless in England and Wales, since funders' modes of operations maintain a barrier between them, clients and lawyers. Our research identifies that confidence in the legal team and the lawyer retaining independence in their relationship with the client are integral to an assessment of the funding needs and the operation of a claim. The issues, therefore, is whether that situation should change, and what the position would be if it were to erode.

One point is not controversial. There is little objection that funders should be entitled to full information over the developing risk, in the same way that shareholders are entitled to disclosure of accurate and timely information on the value of their investments. But to what extent should funders be permitted closer access to the running of the enterprise, and be in a position to influence behaviour and decisions, and control the litigation? The issue is over control, not over information. Let us examine the factual situations further.

- In *investigating a case* and *assessing merits* at the start of a case, the interests of client and funder should align. There may be concern that one or the other would not devote sufficient time or expense to these functions where the case is small, but that does not seem to be a current problem.

- In *selecting a lawyer*, the concern is that where the funder selects, he may select a lawyer who will have incentives to favour the point of view of the funder where that may conflict with the interests of the client. The funder may also select a cheap lawyer, who does not have appropriate expertise, or who would not be selected by the client. On the other hand, the funder has an incentive to select a lawyer with adequate and suitable expertise.

  Insurers currently direct clients to lawyers from their panel,[338] although the law provides that a client shall have freedom of choice of lawyer.[339] But this is interpreted differently in different Member States. In U.K., the requirement for choice arises only at the time at which proceedings are issued, and this has been confirmed in the courts[340] and by the Legal Services Ombudsman and the government.[341] That is usually some way into the funding arrangement, and the client will have been directed to the funder's lawyer from the start. The result in practice is that the insurer must give the client a choice at the point of launching proceedings, but it is not in clients' interests to change lawyers at that point. The French have interpreted the requirement to provide freedom of choice of lawyer more widely, and this will have the effect of restricting the development of litigation funding in their market.

- In *instructing the lawyer* and *controlling conduct* the concern is that decisions that might protect or maximise the investment may conflict with decisions on the solutions and outcomes that may be sought by the client. For example, the client may be less concerned with the size of damages recovered than with establishing a principle or right, or good working relations with the opponent. The two situations in which there will be most concern are as follows.

- In *deciding on settlement*, the concern is that the funder may force settlement below proper value, and limit the effective enforcement of the law. On the other hand, a rational funder may be more objective about the chances of success, and hence prevent meritless litigation by forcing settlement or cessation.

- If a funding contract provides that a *funder can withdraw* where it sees fit, the concern is that would this undermine the negotiating position of the plaintiff, and frustrate the enforcement of law. An example that was cited to us is Harbour's withdrawal of funding in the Young divorce case. Harbour decided that the investment and case was not worth pursuing when, some way into the case after committing £1 million, it discovered that the defendant had no assets. Harbour considered that it was obliged to announce that it was ceasing to fund the case. Inevitably, that announcement had a strong effect in diminishing the funded client's negotiating position. On the other hand, most litigants would have come to the view that the case was not worth pursuing.

[338] H Blundell, 'Free to Choose? BTE Legal Expenses Insurance and Freedom of Choice' [2004] *J Personal Injury Law* 93.
[339] Directive 87/344/EEC on Legal Expenses Insurance, implemented by the Insurance Companies (Legal Expenses Insurance) Regulations 1990, SI 1990/1159.
[340] Case C-199/08 *Erhard Eschig v INIQA Sachversicherung AG*; *Pine v DAS Legal Expenses Insurance Company Ltd* [2011] EWHC 658 (QB).
[341] Letter from the Director, Insurance Sector, 12 August 2010.

> So issues are whether contract terms should be regulated over provisions on in what circumstances a right of withdrawal may be exercised, if at all, what requirements on giving reasons and notice should be required, and whether any public statement is appropriate, that would inform the funder's investors (as would normally be required for public companies) but also opponents? Should a funder be able to withdraw? If so, what should be the consequences? Should there be a process that a funder and client should go through before the former is able to withdraw or announce withdrawal? Should this be mediation or arbitration? What information should each party have? What information should investors in the funder have, and the general market if the funder is a public company? How can clients, and investors be protected?

The level of concern about conflict is not high where litigation funding is made available to large and sophisticated commercial companies, and some individual investors, who are able to look after their own interests, but rises where SMEs and especially individual consumers are involved. This insight indicates that the extent to which the potential for conflicts of interest to be of concern from a public policy viewpoint differs depending on the sophistication of the client, and that different rules should apply at opposite ends of the spectrum.

Thus, in the 'sophisticated commercial client' model, it may be acceptable that the litigation funder investigates the case, instructs the lawyer, and manages its exposure on a daily basis, including making settlement decisions. Issues of maintenance and champerty would not apply. This is the position in Australia at present, where the client/lawyer can override the funder's decisions, but rarely does so, and the funder may cease funding at its discretion. Contracts provide for counsel's opinion to resolve differences of opinion on settlement.

Alternatively, in the 'unsophisticated small client' model, the client would retain the sole rights to select the lawyer and the funder, and give all instructions to the lawyer, although the funder may voice opinions. The only ultimate sanction for funder would be to withdraw, subject to contractual notice requirements, but commercial pressure might make that a rare event. So although champerty may no longer be relevant, maintenance still is. Perhaps the terminology of 'maintenance' and 'champerty' is unhelpful, but the concepts remain relevant and it is important to consider what public policy should be.

It may be noted that in effect the former model is found in Australia and the latter currently in England and Wales. This may be entirely appropriate given the types of litigation with which those models are associated: the Australian model was introduced expressly to support access to justice for class actions (especially by investors), whereas the English market developed to fund predominantly large commercial claims. Neither model was intended for, or has so far particularly been applied to, small consumer claims, although we have found that a significant number of SMEs have found the facility to be useful. Thus, the current concern may be whether or not SMEs are being disadvantaged.

There is an interesting issue over what happens where there is no competent client, such as in certain models of a class action.

## MODELS OF LAWYER FUNDING

If litigation funding is acceptable in principle, what is the difference between funding from independent parties and by lawyers engaged in the case? The simple difference is that a person who provides advice on tactical decisions and who has a personal stake in the outcome may have a conflict of interest. The greater the financial interest, the greater the conflict. Such conflicts cannot be denied: they may be considered to be insignificant in practice, or acceptable because less important in principle than other goals, such as achieving sufficient funding for litigation.

Comparing the alternative funding sources of public, lawyers' and private investors' funds, more conflict issues inherently arise with lawyers' funding (DBAs, Model 5 above) than with the other two sources. There are concerns where lawyer funding is the mechanism used for funding cases due to the dual role of investor and client adviser/representative that lawyers have in such cases.[342] This dual role creates considerable potential for a conflict of interest; the lawyer seeking to maximise a return on his investment could reach a different view on the merits of a settlement than the lawyer representing his client's best interest.

This suggests that private litigation funding, if it is subject to adequate constraints, is theoretically preferable to lawyers' funding. It also raises the issue of whether lawyers' funding should be prohibited—in some situations or totally—if private funding is available. There should be further independent review of whether conflicts are of concern in particular types of cases, such as where there are large fees at stake, in large commercial of collective actions.

Lawyer funding is now a reality. As noted above, the introduction of CFAs, the reversal of the recoverability of CFA success fees and of ATE premia, and the introduction of universal DBAs, plus QOCS, have all been justified on pragmatic grounds rather than as matters of principle. The latest changes have huge potential to transform the litigation landscape, and their effects are largely unpredictable.

In the United States there is considerable familiarity with contingency fees, and general acceptance that conflicts do not arise or are acceptable, but some criticism.[343] There is considerable debate about the effect that large fees play on attorneys' behaviour in class actions.[344] Only recently has a principled basis been proposed for distinguishing an attorney's self-interested conduct that violates the fiduciary duty

[342] When CFAs were introduced, they were attacked as raising 'inevitable and serious conflicts of interest between clients and lawyers, and between lawyers' financial interests and their duties to the courts': *The Ethics of Conditional Fee Arrangements* (The Society for Advanced Legal Studies, 2001).
[343] L Brickman *Lawyer Barons: What Their Contingency Fees Really Cost America* (Cambridge University Press, 2011).
[344] Technically these are not contingency fees but awarded by the court, usually on a percentage of recovery basis. Amongst a mass of literature see HM Kritzer, 'Advocacy and Rhetoric vs. Scholarship and Evidence in the Debate over Contingency Fees: A Reply to Professor Brickman' 82 Washington U. L. Q. 477-507 (2004); T Eisenberg and G P Miller, 'Attorney Fees in Class Action Settlements: An Empirical Study' *Journal of Empirical Legal Studies* Vol 1, Issue 1, 27-78, March 2004; GL Priest, 'What We Know and What We Don't Know About Modern Class Actions: A Review of the Eisenberg-Miller Study' *Civil Justice Report* No. 9, February 2005.

from similar conduct that is a proper assertion of a contractual payment right.[345] There is a clear argument that the architectural policy of private enforcement in the United States over-rides considerations of the potential for conflict, on the basis that it is considered to be in the public interest that litigation should be widely brought, and that intermediaries should play a strong role in controlling litigation on behalf of multiple diffuse parties in class actions.

Is the ethical regime within the legal profession in England and Wales strong enough to withstand the conflicts that are likely to arise? How will the spread of fixed costs affect the situation? Can lawyers withdraw from a case, particularly if they are on the record? This is a highly complex topic that is beyond the scope of this report.

What effect might impending changes in ownership of legal services have? Under the Legal Services Act 2011, the introduction of multi-disciplinary firms, external capital into law firms and, more importantly, corporates directly providing legal services, will have a profound and uncertain effect on the whole of litigation financing. In relation to Third Party Funding it is likely that a corporate providing commercial legal services may well be interested in putting its own capital (through a subsidiary or through an established partner or outsourcing vehicle) on risk to support litigation, as long as the dangers of maintenance and conflict of interest are addressed.

There is a case for reviewing the rules on these issues.

## FURTHER MARKET DEVELOPMENTS

Litigation funding is primarily an investment business based on securing an appropriate return on investment. It could arguably also be described as part of the provision of legal services in those instances where a funder from a legal services background conducts detailed assessment of the legal merits of a case (including obtaining or providing specialist legal advice on the case) prior to agreeing to funding.

Developments may occur in the financial and legal services markets that may affect the issues discussed here. It is conceivable that litigation assets could be commoditised or form derivatives and Susskind (2010) has already speculated that legal services will become commoditised, driven by the demand for lower cost and more efficient services.[346] Litigation funding as a bought product along with legal services thus potentially represents a neat efficient way to afford litigation without a claimant risking his or her own money.

There are already examples of co-funding or risk spreading. Some funders may jointly fund a large case, and some arrangements may involve various companies providing different packets of finance or insurance. An important element that can be involved in a funding package is insurance cover against the risk of liability for opponents' costs in the event that a claim is lost: this liability might be self-insured by a client, or might be undertaken as part of the package provided by the funder, or might be

[345] Lynn A Baker and Charles Silver, 'Fiduciaries and Fees: Preliminary Thoughts' [2011] 79 *Fordham LR* 1833.
[346] R Susskind, *The End of Lawyers* (Oxford University Press, 2010).

outsourced through the purchase of ATE insurance cover, as is familiarly used with lawyers' CFAs.

Litigation funding could have a major impact on class or collective litigation. In Australia, funders have replaced lawyers in funding class actions: they identify a potential claim, 'build a book' of claimants, select lawyers and run the case. In Germany, the Netherlands and some other European States, funders have also expanded into running mass cases, hitherto limited to cartels and investor cases. There appears to be limited but growing interest in London for funding mass litigation. However, a lengthy debate has occurred about the level of demand for mass claims (especially consumer claims), the potential for abuse by intermediaries if their interests conflict with those of clients to too great an extent (especially in the context of large sums of money), and whether alternative means of resolving such issues should be pursued. It may be that in some European jurisdictions that ban contingency fees, commercial enterprises are emerging in the absence of regulation to fund cases where lawyers are banned from doing so.[347] In England and Wales, the proposal to extend DBAs and permit QOCS for personal injury claims would clearly increase the financial incentives for funders: it is difficult to predict whether the proposed caps on DBAs (which are designed with individual cases in mind) would constitute a balance between ensuring sufficient access to justice for meritorious claims, or whether the combined financial inventives under the new regime would, in aggregated litigation, give rise to issues of unacceptable conflict and 'blackmail settlement' of less meritorious claims. We draw attention to this issue as one for close observation.

Funders may exert pressure on reform of civil procedure. They have an interest in reaching swift solutions, or rather an interest in avoiding unnecessary cost and delay in dispute resolution. Hence, they have an interest in pressing not only for efficiency within individual cases, but also for reform of litigation, arbitration or other dispute resolution procedures. This also includes judicial efficiency, case management and costs management.

## WHAT ANTI-ABUSE MECHANISMS?

If a pure solution cannot be implemented, in which both lawyers and funders have no conflicts of interest, but instead for pragmatic reasons some level of potential for abuse may exist, can safeguards be devised that would control against the risks? Various techniques might be adopted that would aim to exert pressure on the lawyer and/or funder. Possible solutions might be to act either on professional or economic behaviour:

- Clear definition of the ethical roles of each player, supported by professional requirements: a self-regulatory solution.
- Maintaining the loser pays rule. This would involve reconsidering the current Jacksonian policy of permitting QOCS in some circumstances.
- Banning success fees for lawyers in circumstances that involve a separate litigation funder.
- Imposing a legal fiduciary duty on funders.

[347] This point was made at the 5th Annual Class Actions Conference, The Hague, 8 December 2011.

- Imposing formal regulation, backed by public sanctions.

## MEASURING THE SIZE OF THE PROBLEM

The above discussion has identified certain theoretical problems. But to what extent are they problems in practice? if they are, to what extent might controls be appropriate, and which of them? These questions cannot be answered by theoretical inquiry alone, since it requires the need to strike a balance between competing principles: some empirical evidence is needed to assist in determining how big any problem is. The compilation of empirical evidence on these issues is beyond the scope of the current Study. But it would be prudent to avoid making policy decisions in the absence of further empirical study, and of establishing a framework for identifying data on an ongoing basis, since it is entirely predictable that some problems may arise given the irreconcilable nature of the competing principles at a theoretical level.

## CONCLUSIONS

- The central issue is the potential for conflicts of interest to arise.

- This issue arises for *all* types of third party funding, such as that provided by lawyers under contingency fees or other mechanisms, for that provided by the state under legal aid, and that provided by private investors.

- The essential conflict that needs to be balanced in any situation in which an independent party provides funding to another who is a party to litigation is between the interests of enabling justice to be accessed as a result of the availability of the funding, of recognising the commercial interests of the investing funder, of protecting the interests of the litigant from unfair pressure, and of protecting the integrity of the legal process.

- The simplest model is that in which the differing functions are exercised by different people: party (decision maker), lawyer (expert adviser and provider of process services), and funder (financier). Conflicts of interest should not arise in that model.

- Different jurisdictions may reach public policy decisions that differ in the balancing of the various interests, thereby accepting a greater or lesser role for external litigation funders depending on the need to provide access to courts for certain types of cases.

- In or view, contemporary public policy in England and Wales accepts third party litigation funding subject to:

  1. the client retaining control over their litigation;
  2. the integrity of the lawyer-client relationship remaining intact;
  3. the integrity of the court process and cases being pursued on legal merits remaining core factors in any litigation; and

4. the client understanding the terms of any agreement that they enter into with a third party such that they are making an informed decision on whether to accept third party funding.

- We would argue that if the four principles above are observed it is unlikely that an agreement between a third party funder and the litigant would give rise to significant conflict or abuse issues. We recommend that these four principles should be adopted as policy rules.

- There needs to be a solution to privatized funding. In larger commercial cases, where funded parties are more sophisticated companies, it may be more acceptable that the market provides regulation. But in consumer cases, there is a far clearer need for protection through regulation. To what extent problems arise in the commercial context remains unclear, and there are not enough cases yet for an empirical answer.

There remains the issue of whether the litigation funding market should be regulated. If it should, how best can this be achieved to provide adequate protection for claimants and the litigation process as the market expands, and enable new entrants with different business models to develop different litigation funding products?

Our research has specifically considered both the policy and practical aspects of regulating the third party litigation funding market. This reflects the concerns of the litigation funding industry about imposed regulation, and the potential risks to claimants of an unregulated or incorrectly regulated industry. In addition to our analysis of the existing policy debate on regulation,[348] interviewees were asked specific questions concerning: whether the market (and those funders offering services within it) should be regulated, the form that any regulation should take, and the objectives that any regulation would need to meet. Our analysis of the issue thus far concludes that in general both funders and consumer groups are in favour of regulation, although different perspectives exist on the reasons for regulation, the form that any regulation should take and on who the regulator should be.[349] Lord Justice Jackson's conclusion on regulation was that in the first instance a 'satisfactory' voluntary code would be acceptable to meet regulatory requirements, but that if the use of third party litigation funding expanded a full statutory code could be required.[350]

The voluntary code to which Jackson referred was published in draft in 2011 and adopted in November 2011.[351] The code covers basic standards of good conduct, specifically addressing minimum standards for contracts, the criteria for assessing claims, capital adequacy requirements, the client-solicitor arrangement, disclosure, and confidentiality and dispute resolution. However, the nature of the different funding models in existence (referred to elsewhere in our report) is such that there remains doubt that all funders will subscribe to the code.  The code applies to members of the Third Party Litigation Funders Association (the Association) but the evidence of our interviews is that the market is expanding and that funders already have plans to extend the use of litigation funding into new markets (e.g. class actions) and to raise new funds to widen the size of the market. There is, thus, scope for new

[348] See for example Lord Justice Jackson's (2009) analysis and proposals on regulating litigation funding.
[349] An issue of current policy focus given the proposed restructuring/break-up of the Financial Services Authority and creation of the Consumer Protection and Markets Authority, see http://www.hm-treasury.gov.uk/reform_and_regulation.htm (accessed 12 July 2010)
[350] R Jackson, *Review of Civil Litigation Costs: Final Report* (London: The Stationery Office, 2009).
[351] *The Association of Litigation Funders of England and Wales: Code of Conduct for Litigation Funders* (Civil Justice Council, November 2011), available at http://www.judiciary.gov.uk/NR/rdonlyres/75D4F49E-BDC6-40BC-B379-B5A1DA82BED9/0/CodeofConductforLitigationFundersNovember2011.pdf. A final copy of the code is attached to this report at Appendix 2. Details of the consultation are at: http://www.civiljusticecouncil.gov.uk/files/TPF_consultation_paper_(23.7.10).pdf. A Summary of the consultation responses is at: http://www.judiciary.gov.uk/Resources/JCO/Documents/CJC/Publications/consultation%20responses/CJC%20TPF%20Summary%20of%20Responses%20Final.doc

entrants to develop the market in ways not envisaged by the Association and during interview, funders have already identified to us niche funding activities that deal with specific activities, such as mis-selling of personal payment insurance (PPI) that may fall outside the terms of the existing voluntary code, thus the voluntary code may already be unable to adequately cover the growing range and practices of the market. For example, during interview, funders confirmed that they invest in claims but do not request that clients assign ownership of a claim to the funder. Para 7.3.2 of the draft code stated that:

> Whilst the Funder may assert some measure of control over the litigation funding, your solicitor must not cede control of his or her firm or the conduct of your case to the Funder.

However, the adopted Code at para 7(c) states that a funder will 'not seek to influence the Litigant's solicitor or barrister to cede control or conduct of the dispute to the Funder'. This removes the reference to control of the firm. Some funding arrangements considered during our research explicitly assign ownership of the claim to the funder in a way that falls outside the models employed by the major funders interviewed in our research but which is known to occur in some European countries.[352] While this does not suggest any fault in this model of funding, and its existence is acknowledged in Europe, its development as a method of U.K. funding demonstrates the rapid development of the industry. There is, therefore, already scope to revisit the question of regulating the market based on the evidence evaluated during this research, and in the context of reviewing the specific purpose of regulation within the current market. A preliminary analysis of the reasons for regulation, principles of regulation and the different regulatory proposals considered during this research follows.

## Why Regulate?

The basis of arguments that litigation funding should be regulated lies in concerns about the impact on consumers, and potential fears about the recurrence of something similar to The Accident Group (TAG) saga.[353] TAG and other problems with claims management companies illustrate how a litigation management/funding system can develop beyond its original 'access to justice' intentions which, in the TAG/Claims Direct etc. case resulted in the reactive need to regulate claims management companies.[354] Similar concerns about the development of a system that benefits lawyers and claims managers to the detriment of consumers and the litigation process are explicit in the American literature and the core concerns about litigation funding that drive the debate about regulating the third party litigation industry are:

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[352] See for example para C(d) of the Legal Financing Segregated Portfolio ('the Axiom Fund') (2009) which states that 'The law firm does not own the case, the Axiom fund does; therefore if a law firm is not performing its duties, the Axiom fund can switch the case(s) to another law firm." – online at http://www.theaxiomfund.com/FAQ.pdf accessed 15 July 2010

[353] See p 21 above. For an overview of problems caused by TAG's collapse see 'Playing Tag' in the Law Society Gazette online at http://www.lawgazette.co.uk/features/playing-tag (accessed 10 August 2010)

[354] The *Compensation Act 2006* makes provision for the regulation of claims management companies.

- Conflicts of interest - between funders and clients
- Issues of transparency – does the client fully understand the relationship and their obligations under any funding arrangement?
- Financial risk – what happens to the client should the funder withdraw or lack the funds to continue a claim?
- Disclosure – should the existence of a funder be revealed
- Independence – is the lawyer's independence jeopardised by the funding agreement or any arrangements with a third party?

These issues are repeatedly discussed in the literature and policy debates about regulating litigation funding.[355] From our discussions with funders during this research the following should also be added as concerns that potentially require regulatory control:

- Challenges to funding agreements - abuse of process challenges made by defendants alleging that litigation funding is an abuse of process may be a tactic through which defendants seek to destabilise litigation funding agreements. Regulation of litigation funding agreements whether by legislation or Civil Procedure Rules could prevent such proceedings from being brought and further frustrating access to justice.

- 'Rogue Traders' – regulation should address concerns about new entrants to the market developing business practices which bring the industry into disrepute or increase the potential for harm or loss to be caused to claimants.

Regulating the third party litigation funding market, is thus a means through which unethical business practices can be prevented and the industry can be adequately regulated rather than becoming the subject of reactive regulation.[356] However there are questions concerning who should regulate and whether this would best be achieved through self-regulation, financial services regulation, legal services regulation or consumer protection legislation?

One difficulty in determining how litigation funding should best be regulated is that of defining the litigation funding 'product' within its market context. Part of the reason for differences in regulation (and regulators) is that there are frequently different social goals that determine the regulation of an industry, and the perception of different products requiring different controls drives the regulatory regime. Howell Jackson (Harvard Law School) questions whether there should be a 'functional approach to regulation where legal regimes are determined by the nature of the

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[355] See, for example J Beisner, Miller & Rubin (2009) *Selling Lawsuits*, Washington, US Chamber Institute for Legal Reform, Standing Committee of Attorney Generals (2006) *Litigation Funding in Australia: Discussion Paper*, and Rubin (2009) *Third Party Financing of Litigation*, paper presented at Searle Center, NorthWestern University Law School, Third Party Financing of Litigation, September 24 – 25, 2009; D Dana and M Schazenbach, 'How Would Third Party Financing Change the Face of American Tort Litigation? The Role of Agency Costs in the Attorney-Client Relationship' (unpublished, 2009).

[356] See, for example Michael Napier's comments at The Civil Justice Council's (2008) Regulation of Third Party Agreements meeting at Down Hall Country House Hotel at http://www.civiljusticecouncil.gov.uk/files/Down_Hall_minutes_(Chatham_House).doc accessed 10 July 2010

transaction in question rather than the identity of the intermediary that initiates the transaction.'[357] Arguably, the functional process of the litigation product (to facilitate the cost-effective provision of legal services) may be more appropriate than its purpose (to gain profit from investment in litigation) when determining the regulatory requirements.

An appropriate 'functional' regulatory system for litigation funding thus needs to:

1. Promote good practice within the litigation funding industry, ensuring an appropriate litigation product for the specific type of litigation and client's needs.
2. Provide for an effective (independent) complaint handling, investigation and dispute resolution system.
3. Set and maintain (minimum) standards for information to be provided to claimants about funding arrangements so that they can make informed decisions.
4. Provide for effective scrutiny of funding arrangements and an effective consumer (claimant) protection regime.
5. Ensure the provision of effective legal services and maintain the integrity of the lawyer-client relationship.

These basic principles encapsulate the main regulatory requirements for addressing complaints about potential risks in the market. But as regulators approach their task in different ways and self-regulation also takes many different forms the regulatory approach should be tailored to the specific needs of the market.

## The Principles of Regulation

Regulatory regimes frequently consist of a 'cocktail of different regulatory approaches.'[358] Regulating an industry as diverse as third party funding, which this research concludes contains a range of different funding models and business practices, thus requires an approach that reflects this diversity and provides dual protection; for funders and clients, while also preserving the integrity of the client-lawyer relationship. Arguably self-regulation is inadequate to achieving these objectives.

While voluntary (self-funding) regulation may be desirable for a nascent industry, formal regulation will, undoubtedly be necessary as the industry grows.[359] A number of interviewees expressed concern about rogue funders entering into the market and having a negative impact on the funding pool and the reputation of the industry; this is a legitimate concern. While the current players in the funding market are primarily lawyer-based companies and/or companies who have established their business model

[357] H Jackson, (1999) *Regulation in a Multi-Sectored Financial Services Industry: An Exploratory Essay,* Harvard Law School John M. Olin Center for Law, Economics and Business Discussion Paper Series available online at: http://lsr.nellco.org/ accessed on 12 July 2010
[358] T Prosser, 'Self-Regulation, Co-regulation and the Audio-Visual Media Services Directive,' *Journal of Consumer Policy*, Volume 31, Number 1 (2008).
[359] See for example Lord Justice Jackson's (2009) analysis and proposals on regulating litigation funding.

in foreign jurisdictions (e.g. Germany, Australia, Canada or the US), new entrants into the market are likely as it becomes established and gains attractiveness as a business model. The lack of regulatory control (champerty and maintenance issues notwithstanding) makes it likely that new funders will enter the market with the attendant risks that new business models will be developed that further push the boundaries of 'management' or 'supervision' of cases, unfair contractual terms and influence over the lawyer-client relationship and/or choice of lawyer.[360]

Ogus (1995) suggests that the public interest justification for self-regulation is primarily based on fulfilment of three conditions; that the activity (e.g. provision of litigation funding) is afflicted by market failure, that private law instruments are inadequate or too costly to correct the failure, and that self-regulation is a better (and cheaper) method of solving the problem than conventional regulation.[361] Arguments that self-regulation is better than formal public regulation commonly include the claim that industries and specialist industry associations are better able to regulate an industry than public regulators. This argument is frequently predicated on the greater degree of expertise and technical knowledge of the industry and its practices that industry experts can command.[362] But while self-regulation may be effective in the case of those reputable companies who operate responsibly and see preservation of the industry as within their best interests, it is less effective in the case of rogue companies and others who see litigation funding purely in terms of the profits it generates and who may consider high volume low-to-medium returns as a means through which to secure profits. It may also be inadequate in the case of those companies whose business models fail or who experience difficulty as a result of adverse circumstances. The objectivity of the (professional) public regulator with a willingness and authority to scrutinise industry practices that industry participants themselves may accept as normal business practice thus provides for effective independent oversight. Statutory regulation could, therefore, protect the industry from inadequate business models that could do it irrevocable harm, protect the integrity of the funding arrangements so that 'authorised' providers can produce and maintain contracts without concern that there will be unnecessary interference or challenge to the content or use of funding contracts, and provide for a formal complaint handling and dispute resolution mechanism and redress for consumers as well as protection for funders.

The function of the nascent litigation-funding industry also raises a question about its regulatory requirements. Delegates to the International Litigation Funding Conference held at the University of Oxford in May 2010 overwhelmingly saw litigation funding as the provision of financial services, although a small number consider it to be the provision of legal services.[363] This dual nature of the industry requires assessment of

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[360] While no criticism is implied of products like the Axiom Fund, the main litigation funders all confirmed that a core feature of their product is that they have no direct control over choice of legal team and generally require a legal team and strategy to be in place before they will fund a claim. Alternate products like the Axiom Fund, thus represent a shift from the industry 'norm' in ways that the main funders appear to consider unacceptable within their business models.
[361] AI Ogus (1995) 'Rethinking Self-Regulation', *Oxford Journal of Legal Studies*.1995; 15: 97-108
[362] Ibid.
[363] Notes from the conference can be found online at - http://www.csls.ox.ac.uk/documents/1005NOTEOFCONFERENCEON19MAY2010.doc (accessed 12 August 2010

both the specific principles of financial regulation and principles of legal services regulation, and how they might apply to third party litigation funding.

Benson[364] suggests the following as the main goals of financial regulation:

(1) to maintain consumer confidence in the financial system
(2) to assure that a supplier on whom consumers rely does not fail
(3) to assure that consumers receive sufficient information to make "good" decisions and are dealt with fairly
(4) to assure fair pricing of financial services
(5) to protect consumers from fraud and misrepresentation, and
(6) to prevent invidious discrimination against individuals.

These principles directly address the financial services aspects of third party funding and the protection/regulation of the financial and money management arrangements involved. They are reflected in the Financial Services Authority's (FSA) approach to regulation of financial services. The FSA's statutory objectives are to: (1) maintain market confidence, (2) promote public awareness of financial services, (3) protect consumers, and (4) reduce financial crime.[365] The FSA has been empowered with comprehensive regulatory authority to achieve these objectives (notwithstanding current debates about its break-up). FSA principles of good regulation include:

- **Role of management -** designed to secure an adequate but proportionate level of regulatory intervention by holding senior management responsible for risk management and controls within firms. Accordingly, firms must take reasonable care to make it clear who has what responsibility and to ensure that the affairs of the firm can be adequately monitored and controlled.
- **Proportionality –** any restrictions imposed on the industry must be proportionate to the benefits that are expected to result from those restrictions:
- **Innovation -** The desirability of facilitating innovation in connection with regulated activities. This provides scope for different methods of compliance.
- **International character –** takes into account the international character of financial services and markets and the desirability of maintaining the competitive position of the UK:
- **Competition -** The need to minimise the adverse effects on competition that may arise from regulation and the desirability of facilitating competition between regulated firms.

A new prudential financial regulation authority (PRA) will come into being in the UK by the end of 2012. The PRA will be responsible for supervision of around 2,000 firms which includes developing and applying policies and rules on firms' resilience (including such areas as capital, liquidity and leverage); supervisory assessments and interventions; and policies and mechanisms to support resolution. The PRA will have an obligation to monitor the capital adequacy, liquidity and large exposures of the firms it regulates which will include; 157 UK banks, 48 UK building societies, 652

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[364] G Benson, 'Consumer Protection as Justification for Regulating Financial-Services Firms and Products', *Journal of Financial Services Research*, (2000) Volume 17, Number 3, 277-301.
[365] A Komatsubara, *New Financial Product Regulations in the U.K. — The Insurance Industry's Stance on the Expansion of CAT Standards* 'NLI RESEARCH', NLI Research Institute, 2002) No 160.

UK credit unions (1) and 162 branches of overseas banks. However, other firms could be designated for PRA supervision if the PRA determines that the firm 'could present significant risks either to the stability of the financial system or to one or more PRA-supervised entities within the firm's group.'[366] At present it seems unlikely that litigation funding operations will be caught by the PRA's supervisory regime, except where funding is provided by a subsidiary company of a larger financial business. However, as the supervisory functions of the PRA are clarified and developed, they may well influence the manner in which the PRA carries out its regulatory functions and this could impact on the financial investment side of litigation funding and the applicable regulatory regime.

Law firms have not generally been regulated by the FSA where financial activities are an incidental part of their business although alternative business structures brought in by the Legal Services Act 2007 could impact on this situation. In April 2011 the SRA wrote to all FSA regulated professional firms to alert them to client protection issues should they decide to convert to an ABS. The regulation of legal services is intended to ensure consistent standards of good conduct, impartiality of advice and minimum levels of professional standards that lay down the requirements for practice as a member of the legal profession.[367] In particular, for those members of the legal profession offering legal services to the public, ethical, disciplinary and complaints handling rules and procedures provide mechanisms through which the lawyer-client relationship is regulated and the primacy of the clients' objectives is maintained. While it is not the focus of this report to discuss the regulation of the legal profession in detail, the purpose of regulation as it relates to the cost of providing legal services is relevant to third party litigation funding. Critics of third party litigation funding suggest that in determining the appropriate funding mechanism for a case there is scope for a conflict of interest between lawyer and client or between funder, lawyer and client. Concerns have also been raised that clients rely on the advice of their lawyers who may have an interest in entering into funding agreements that ensure payment of their fees but which may not be in the best interests of their client or the most cost-effective way of funding a particular claim. But there are specific principles (rules) of good conduct in the provision of legal services that are relevant to the provision of third party litigation funding and the interaction between funder and the legal profession, as follows:

- Legal professionals should act with integrity and should not allow their independence to be compromised
- Legal professionals should act in the best interests of the client and should avoid any conflicts of interest
- The provision of legal services should be subject to appropriate disciplinary and (independent) complaint resolution procedures with a power to obtain redress for aggrieved clients
- Legal professionals owe a duty of confidentiality to their client
- Independence must be maintained when receiving or making any referrals to third parties

[366] The Bank of England, Prudential Regulation Authority: Our approach to banking supervision, Bank of England/FSA (2011).
[367] See, for example, the 8th edition of the Bar Standards Board's *Code of Conduct of the Bar of England* and Wales, *the Solicitor's Code of Conduct 2007*, enforced by the Solicitor's Regulation Authority, and their Scottish equivalents.

- Legal professionals should give their client the best information possible about the costs involved in any legal action
- Legal professionals should explain any limitations or conditions arising from a relationship with a third party (including funders) that could impact on the service they provide or the steps they can pursue on the client's behalf.

The principles of both financial services and legal services regulation thus, in theory at least, provide for protection of the client, a secure dispute resolution and complaint handling system, for the client to receive impartial advice and information about their options and for the advisor/lawyer-client relationship to be one where the client's needs are paramount and are protected. Regulatory bodies should ensure that the industry (whether financial or legal services) is effectively monitored so that it maintains appropriate levels of good practice in the client's best interests. With these broad principles in mind, there are three broad options for regulating the third party litigation market; self-regulation (private), statutory regulation (public), ethical (professional) regulation. Each of these options is briefly discussed below.

## Self-Regulation

The current voluntary Code of Practice for third party litigation funding covers core elements of the funder-client-lawyer relationship but also needs to include some provision governing what happens in the event of disputes. One option is to have disputes concerning agreements open to ADR such as a form of Ombudsman review, either via a private/industry Ombudsman scheme funded by the Association or via a statutory Ombudsman such as the new Legal Ombudsman (LeO). However, the Code as adopted does not explicitly provide for a dispute resolution mechanism except in respect of disputes about settlement or termination of the agreements, which will be referred to appropriately nominated Queen's Counsel. In any review of the Code or move to formal regulation, the need for an effective dispute resolution option should be reconsidered. There is also scope for a voluntary code to include increased emphasis on education for all using funding and to ensure that claimants have access to independent or impartial advice on funding arrangements and contract terms. The voluntary scheme also has the advantage of being promoted and endorsed by the larger players in the litigation funding industry, who (currently at least) have a vested interest in promoting good standards within the industry.

However, for the reasons outlined above, a voluntary scheme does not fully address the requirements of the developing market and any potential harm caused by the emergence of new funders who may develop new litigation funding products and alternative business models that fall outside the scope of the code. A voluntary code is also inadequate to deal with rogue funders and lacks sufficient penalties for bad practice, thus doubts remain over the adequacy of a voluntary code. Responses to the Civil Justice Council's consultation on the draft code showed that the majority of respondents recognised the need for regulation of third party funding and that a code of conduct was an important step forward. There was general acceptance that as TPF was still in its infancy, self-regulation was the most practical solution in the first instance, but that statutory regulation may be required if the market expanded significantly. However as we observe above, market developments suggest that this may already be the case. In its response the Law Society said that TPF should be dealt with by statutory regulation and that the Civil Justice Council should continue to press the Government to legislate on this issue.

## Statutory (Public) Regulation

Formal regulation of third party funding either by the FSA, a Legal Services Ombudsman or the MoJ remains a possibility. The 'investment' side of litigation funding is already broadly covered by the FSA and some companies (e.g. Harbour Litigation Funding Ltd) are already FSA registered. This issue has been considered in other jurisdictions, for example in Australia where litigation funding agreements may be subject to regulation (as a derivative) under the *Corporations Act 2001*, requiring the funder to hold a Financial Services Licence issued by the Australian Securities and Investments Commission. The licence and the associated statutory provisions impose capital adequacy, conflicts management, mandatory disclosure and dispute resolution requirements on funders.[368]

Regulation by the MoJ would bring litigation funders into line with claims management companies in requiring them to be appropriately registered with the MoJ, subject to de-registration in the event of any breach of the requirements of registration, and subject to formal regulatory investigation and sanction by the MoJ. While there are significant differences between the claims management and litigation funding industries, not least because some claims management companies will actually take on the claim themselves while litigation funders do not do so, regulating litigating funders alongside claims management companies would provide consistency in the claims market and provide for statutory scrutiny.

## Professional Regulation

Professional regulation of litigation funding is a possibility even if the industry continues to operate under a voluntary Code agreed by members of the Association. Given the emphasis on maintaining the integrity of the client-lawyer relationship and, in some cases, the use of contractual terms that enforce this by requiring the client to act within the parameters of legal advice, there is scope for a legal services industry regulatory body (e.g. Law Society, Solicitors Regulatory Authority, Bar Council) to consider litigation funding issues as part of the respective Ethics Code making some third party arrangements subject to disciplinary oversight. This is already the case in other jurisdictions (mainly the U.S.) as discussed below.

The American Bar Association (ABA) has broadly considered that there is no inherent conflict in a lawyer either referring a client to a litigation funding company or entering into an agreement with a litigation funding company on the client's behalf, as long as the terms of these agreements do not give rise to any conflicts in the lawyer's ability to represent his client's interests. However analysis of the ABA's position and some State Bar decisions indicate that there are circumstances where specific third

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[368] W Attril, at http://www.claimsfunding.eu/fileadmin/Documents/Ethical_Issues_Paper.pdf accessed 12 July 2010

party litigation funding models (including those considered in this research) could give rise to conflicts which the ABA has concerns about.

The main ethics rules at issue in the U.S. are:

Rule 5.4 – Professional Independence of a Lawyer
Rule 1.7 - Conflict of Interest: Current Clients
Rule 1.8(e) – Conflicts of Interest: Current Clients: Specific Rules (a lawyer cannot provide financial assistance to a client in connection with pending or contemplated litigation except under certain enumerated circumstances)
Model Rule 2.1 (Rule on Advisers) – The involvement of a third party company poses risks that lawyers may not exercise the independent professional judgement and 'candid advice' required by this rule.

Currently there have been approximately 50 state bar opinions since 1986 that concern issues relating to litigation financing as well as court judgements that have scrutinised the legality of such agreements.[369] Generally state bar authorities have considered that there is no inherent conflict between a lawyer's duty to their client and their entering into an arrangement with a third party funder on the client's behalf. Provided that the arrangements do not interfere with the lawyer's independent professional judgment and that client's confidences are not disclosed without the client's consent, the general view of the state bar associations is that litigation financing is an acceptable tool for attorneys in seeking to ensure effective litigation for client's. However, the detail of specific funding arrangements has been subject to scrutiny and there have been some adverse opinions as well as opinions which suggest that the lawyer should warn the client of the possible loss of attorney-client privilege when making disclosures to litigation financing companies.[370] Some specific examples include:

- In 2000, the Michigan State Bar Association issued an opinion stating that an agreement between a venture capital company and plaintiff was so onerous that it created irreconcilable conflicts of interest between the lawyer and his client. The Michigan Committee said that provisions that required (among other things) that the client waive any defences in the event of a dispute between the client and the company and restricted the right of the plaintiff to discharge his lawyer were unreasonable and that such agreements represented an impermissible conflict of interest.[371]

- In *Echevierra v. Lindner*, 801 N.Y.S. 2d 233 (2005) the court held that while under New York law an agreement between a litigation finance company and the plaintiff was not champertous, it did violate New York State usury laws.

[369] See PH Geragthy, *Litigation Financing* (2006) at – www.abanet.org accessed 4 October 2010
[370] See, for example, New Jersey Advisory Committee on Professional Ethics Opinion 691 (2001), Missouri Office of Chief Disciplinary Counsel Informal Opinion 2000-0229 (11/00) Committee on Ethics of the Maryland State Bar Association Opinion 92-25 (1992), Committee on Professional Ethics of the Connecticut Bar Association Opinion 99-2 (1999) and Committee on Legal Ethics and Professional Responsibility of the Pennsylvania State Bar Opinion 99-8.
[371] Michigan State Bar Opinion R1-321 available at: http://www.michbar.org/opinions/ethics/numbered_opinions/ri-321.html

- In *Lawsuit Financial v. Curry*, 683 N.W. 2d 233 (2004), the Michigan Court of Appeals held that non recourse capital advances made by a litigation funding company constituted loans which were usurious as the litigation funding company had loaned the client $177,500 but demanded payment of $887,500 shortly after.

Such cases illustrate that while the industry as a whole, and the nascent U.K. industry in particular, may adopt business practices that do not raise significant concerns, individual business practices and agreements may cause concern and be of a type that requires formal regulation, intervention or legal action to resolve. The *Legal Services Act 2007* provides that individual complaints[372] about legal services can be made to the LeO and there is, potentially, scope to include complaints about third party litigation funding within the LeO's remit. In particular, where the claimant has concerns about the funding arrangements and has either not clearly understood the consequences of entering into a funding arrangement (i.e. impact on quantum, likely costs of a case, distribution of proceeds) or has potentially been mislead into using litigation funding where other forms of funding (such as a CFA) might be available but third party litigation funding is the lawyer's preference. Such complaints could potentially be heard by the LeO and provide for scrutiny of funding arrangements.

## Conclusion

Litigation funding is a new source of funding, and a new market: an analogy is with leasing a car, not owning it. It is not difficult to anticipate that some funders of litigation might combine in new consortia, so as to provide services that offer enhanced expertise, cohesion or competitive advantage for users. Indeed, we have found evidence that all these situations currently exist.

Regulating the third party litigation funding market presents particular challenges. It is unlikely that the industry can remain 'unregulated'.[373] Regulation needs to be comprehensive to cover not just the relationship between the lawyer–funder–client, but also the integrity of funding agreements and protection from external challenges.

Self-regulation is effective only when the players in an industry voluntarily adopt, maintain and enforce uniform standards that protect the industry and its consumers. Yet while the established practitioners and existing business models are largely those that have been tested in other jurisdictions and are employed by companies with the requisite professional services and product backgrounds to provide for effective self-regulation, any system also needs to safeguard against new entrants and rogue traders with lower standards and less robust business models and it is here that self-regulation fails. The experience of the claims management company industry indicates that there is scope for abuse in a litigation system that might otherwise appear robust but which develops and mutates as it grows. As identified in chapter 10 above, concern over the potential for abuse rises if funders expand from supporting litigation involving larger

[372] The Act's definition includes companies with fewer than 10 staff and an annual turnover not exceeding 2 million Euros, thus some small companies who are provided with litigation funding in their claims against larger companies could be caught by this definition.
[373] Accepting that case law, the court's discretion and professional ethical rules already provide for an informal regulatory regime.

corporations to claims involving the less sophisticated smaller companies and consumers.

As interview respondents and our analysis of the funding models suggest, third party litigation funding occupies a position which, dependent on the model employed, is either a financial services product or a hybrid financial and legal services product. While some funders are providing pure investment (financial) services, others seek to engage with the legal services aspects of litigation funding, planning and management in a manner that directly benefits clients and which (maintenance and champerty issues not withstanding) provides for more active engagement with case assessment and handling. While Lord Justice Jackson has indicated that his concerns about capital adequacy, termination of funding and funder influence on litigation have been met, the nature of the third party litigation funding market and its various models suggest that a single form of regulation would be inadequate to the task and while there is scope for the investment side of litigation funding to, *in some cases*, be covered by financial services regulation and FSA oversight, this would only address certain aspects of the funder-client relationship.

We consider therefore that the question of formal statutory regulation of litigation funding is an issue that should be explored further with a view to providing for a regulatory system that addresses the legal services aspects of the litigation funding industry.

## 12. Conclusions and Recommendations

The main conclusions from the research summarised here, together with our recommendations for litigation funding in England and Wales,[374] are as follows:

**A revolution in national policy.** The rules on funding and costs of litigation are being transformed in England and Wales with implementation of most of the Jackson Recommendations. The policy favours a 'mixed economy' of methods of funding, with adoption of the principle that fees can be deducted from recoveries, considerable expansion in funding methods (extension of BTE insurance and of lawyer-funding with DBAs added to CFAs, the acceptance of third parties, but restriction of legal aid) but also a transfer of dispute resolution to alternative methods (ADR). But there has been no analysis of which methods may be preferable for which types of case, or of what problems may occur. The situation calls for careful ongoing research.

**The established state of Litigation Funding – limited to commercial cases.** Litigation funding by third party investors who are not involved as parties has been established in England and Wales as an identifiable phenomenon in the past decade. Demand for funding currently far exceeds supply, and the market is expanding. We expect that it will grow further and innovations will be introduced. The business model of all litigation funders is entirely commercial, and not philanthropic. To date, most funders support claimants, who are almost entirely commercial clients and frequently SMEs. The threshold of viability for a claim value is currently not less than £100,000, and for many funders £1 million. The threshold is lower in Germany, where costs are lower (and more predictable).

Such funding provides a useful function and has filled an access to justice gap. The commercial imperative to select good (and the best) investments, and to obtain best returns for the investment, currently acts as pressure to support cases with merits, to advance them strongly, and to settle them without delay. It will also act on the efficiency of the legal system for commercial cases.

There are various different models for litigation funding in different jurisdictions. The traditional prohibitions on third party funding have fallen in many common law countries, and never existed in many civil law jurisdictions. However, different policies exist on the extent to which funders may control the litigation, replacing clients. There are policy and architectural reasons who such control may be approved in Australia and the United States, although such issues are hotly debated, but such control has not been exercised in England and Wales.

**We recommend that funders should not control tactical decisions in litigation, and that the demarcation of roles between client, lawyer and funder should remain and should be set out clearly in professional ethical requirements. If that position is to change, there is an urgent need for full empirical evidence on the consequences and on what level of regulation should be introduced.**

[374] For the reasons stated above, different conclusions might be reached in relation to other jurisdictions, about which we expressly do not comment.

**We also see conflicts of interest and risks where lawyers are the sole funder of litigation and have large stake in the outcome: the current increase in DBAs gives cause for concern and should be carefully reviewed.**

**We recommend that the following four principles should be adopted as policy rules:**

1. **the client retains control over the litigation;**
2. **the integrity of the lawyer-client relationship should remain intact;**
3. **core factors in any litigation should be the maintenance of the integrity of the court process and cases should be pursued on legal merits; and**
4. **the client should understand the terms of any agreement entered into with a third party so as to make an informed decision on whether to accept funding from a third party, lawyer or any other source.**

**Confidentiality, privilege and transparency.** Litigation funding requires full disclosure between client, lawyer and funder, and confidentiality of all information outside that circle. Funders favour transparency of the existence of a funding agreement. **We recommend that these principles of full disclosure and information, confidentiality, and transparency of notification be adopted**.

**The need for regulation**. Regulation will be necessary to control commercial activities, financial prudence and the reliability of the funding source, and to maintain the integrity of the legal system. In the last case, the central issue is the potential for conflicts of interest to arise.

## Appendix 1 – List of interviewees

Dr Eversberg, Allianz ProzessFinanz GmbH
Dr Ulrich Classen and Dr Till Schreiber, Cartel Damage Claim Services SPRL
Timothy Meyer, Allianz Litigation Funding Limited
Susan Dunn, Harbour Litigation Funding Limited
Brian Raincock, Commercial Litigation Protection Limited
Selvyn Seidel, (then of) Burford Partners
Rocco Pirozzolo, QBE Insurance (Europe) Ltd
Steve Fineman, Lief Cabraser
Paul Huck, Colson Hicks Eidson, formerly of Florida State Attorney General's Office
John Walker and Wayne Attrill, IMF(Australia) Ltd
Peter Koutsoukis, Claims Funding International
Christian Steurwald, Calunius Capital Limited
Neil Purslow, Therium Capital Management Limited
James Blick, The Judge
Deborah Prince, Which?
Lola Bello and Joanne Milligan , Consumer Focus
Kevin Roussell and Natasha Zitcer, Ministry of Justice
Linda Jackson, Confederation of British Industry
Malcolm Carlisle, European Justice Forum

We are grateful to Greg Cox and Robert Ridgewell for helpful comments in relation to privilege issues.

# The Association of Litigation Funders of England and Wales

## Code of Conduct for Litigation Funders

November
2011

# The code

1. This code (the Code) sets out standards of practice and behaviour to be observed by Funders who are Members of The Association of Litigation Funders of England & Wales.

2. A Funder has access to funds immediately within its control or acts as the exclusive investment advisor to an investment fund which has access to funds immediately within its control, such funds being invested pursuant to a Litigation Funding Agreement (LFA) to enable a Litigant to meet the costs of resolving disputes by litigation or arbitration (including pre-action costs) in return for the Funder:

   (a) receiving a share of the proceeds if the claim is successful (as defined in the LFA); and

   (b) not seeking any payment from the Litigant in excess of the amount of the proceeds of the dispute that is being funded, unless the Litigant is in material breach of the provisions of the LFA.

3. A Funder shall be deemed to have adopted the Code in respect of funding the resolution of disputes within England and Wales.

4. The promotional literature of a Funder must be clear and not misleading.

5. A Funder will observe the confidentiality of all information and documentation relating to the dispute to the extent that the law permits, and subject to the terms of any Confidentiality or Non-Disclosure Agreement agreed between the Funder and the Litigant.

6. A Litigation Funding Agreement is a contractually binding agreement entered into between a Funder and a Litigant relating to the resolution of disputes within England and Wales.

7. A Funder will:

   (a) take reasonable steps to ensure that the Litigant shall have received independent advice on the terms of the LFA, which obligation shall be satisfied if the Litigant confirms in writing to the Funder that the Litigant has taken advice from the solicitor instructed in the dispute;

   (b) not take any steps that cause or are likely to cause the Litigant's solicitor or barrister to act in breach of their professional duties;

   (c) not seek to influence the Litigant's solicitor or barrister to cede control or conduct of the dispute to the Funder;

   (d) maintain at all times adequate financial resources to meet its obligations to fund all of the disputes that it has agreed to fund, and in particular will maintain the capacity:

      (i) to pay all debts when they become due and payable; and

      (ii) to cover aggregate funding liabilities under all of its LFAs for a minimum period of 36 months.

8. The LFA shall state whether (and if so to what extent) the Funder is liable to the Litigant to:

   (a) meet any liability for adverse costs;

   (b) pay any premium (including insurance premium tax) to obtain costs insurance;

(c) provide security for costs;

(d) meet any other financial liability.

9. The LFA shall state whether (and if so how) the Funder may:

(a) provide input to the Litigant's decisions in relation to settlements;

(b) terminate the LFA in the event that the Funder:

(i) reasonably ceases to be satisfied about the merits of the dispute;

(ii) reasonably believes that the dispute is no longer commercially viable; or

(iii) reasonably believes that there has been a material breach of the LFA by the Litigant.

10. The LFA shall not establish a discretionary right for a Funder to terminate a LFA in the absence of the circumstances described in clause 9(b).

11. If the LFA does give the Funder any of the rights described in clause 9 the LFA shall provide that:

(a) if the Funder terminates the LFA, the Funder shall remain liable for all funding obligations accrued to the date of termination unless the termination is due to a material breach under clause 9(b)(iii);

(b) if there is a dispute between the Funder and the Litigant about settlement or about termination of the LFA, a binding opinion shall be obtained from a Queen's Counsel who shall be instructed jointly or nominated by the Chairman of the Bar Council.

This code is to be read in conjunction with the Articles and Rules of the Association of Litigation Funders of England & Wales, which are available for inspection at:
**http://www.judiciary.gov.uk/about-the-judiciary/advisory-bodies/cjc**