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THIRD PARTY FUNDING: SELF-REGULATION IN THE UK

This article considers the background to the self-regulation of third party funding of civil legal claims in England and Wales. It examines the means by which self-regulation through the Code of Conduct for the Association of Litigation Funders has evolved, along with arguments for reform

The process of seeking redress through the courts, otherwise known as litigation, is expensive. Despite a radical overhaul of the civil litigation rules of practice in England and Wales in 1999, designed with the ‘overriding objective of enabling the court to deal with cases justly and at proportionate cost’ (Rule 1.1(1) Civil Procedure Rules 1998), ‘it remains the case that for very many in society the means to fund litigation remains a substantial barrier to entry to the civil justice system even if the costs are proportionate costs’ (Etherton, 2018). The difficulty in using the courts for legal redress was increased by the passing of the Legal Aid, Sentencing and Punishment of Offenders Act (2012) (‘LASPO’). This legislation removed financial support for most cases previously receiving assistance for matters involving housing, welfare, medical negligence, employment, debt, immigration and most private family law cases. The rationale was not purely financial in seeking to make substantial savings to the legal aid bill and to move the burden of legal costs from the public purse to the private sector; LASPO was also designed to discourage unnecessary and adversarial litigation at public expense.

The effect of LASPO has been a renewed emphasis on alternative means by which Claimants can obtain financial support to pursue litigation. The most common form of charging by legal practitioners is the chargeable hour, whereby legal practitioners charge their clients by the time spent on a matter. This has been replaced in many areas by more sophisticated fee regimes. These include ‘parcelling’

or ‘bundling’ of matters, meaning an agreed charge in advance for a certain amount of work, or up to a specific stage, which is paid privately – utilising legal expenses insurance which may be attached to house or car or business insurance; after the event insurance, a form of insurance obtained to cover the cost of having to pay the winner’s legal costs in the event of a failed claim or counterclaim; conditional fee agreements, which require clients to enter into a formal agreement with their solicitor providing for no or limited legal fees to be payable unless there is a defined successful outcome, and a success fee to be paid out of damages; and/or damages-based agreements which are another form of no-win, no-fee arrangement where the client is charged a straight percentage out of the amount won.

An increasingly important alternative to the litigation funding landscape is third party funding. Without such an alternative, parties might not be able to start or defend a claim thereby limiting access to justice. The global market for third party funding of both commercial litigation and arbitration is in excess of US\$10 billion. It may be of surprise and/or concern to note that there is hardly any formal regulation of this growing sector. This article will explore the nature of third party funding as another means of financing litigation; its acceptance by the judiciary within England and Wales, and the means by which self-regulation of the industry has evolved through the Code of Conduct for members of the Association of Litigation Funders, along with arguments for reform.



What is third party funding: Is it not illegal?

Third party funding is the provision of funds by an outside individual or body with no other pre-existing connection of its own with the parties to the litigation to enable a litigant to pursue or defend a civil claim. It may take the form of unconditional donations by individuals who hope for simple repayment in the event of success or, more often, payments by a commercial funder willing to take a risk on a claim with a view to making a profitable return in the event of success. A funder may provide the full legal costs of proceedings; part fund, or cover disbursements only. Profit may be calculated in a number of ways – such as a percentage of the damages or a return on the multiple of the investment provided. It is mainly used in commercial litigation and commercial and investment treaty arbitrations where the reward justifies the risk of the investment.

The landscape has become ever more complex as the market has expanded. It now includes brokers who specialise in liaising with clients, lawyers and funders and structuring dispute finance arrangements; unregulated financial entities willing to lend direct to clients or lawyers to support litigation; and solicitors who might also source funds and promote this in their marketing material.

Within England and Wales third party funding has yet to be legally regulated and is a *prima facie* breach of the ancient common law rules against champerty and maintenance. The Law Commission (1966) has described maintenance as ‘the procurement, by direct or indirect financial assistance, of another person to institute, or carry on or defend civil proceedings without lawful justification. Champerty is a particular form of maintenance, where the maintainer’s agreement with the litigant gives them a share in the proceeds or subject matter of the action; action referred to as ‘a division of the spoils’.

The concern of the courts goes back to medieval times and the prime issue of the protection of the integrity of public justice. A supporter funding litigation could subvert the legal process; they could, for instance, promote spurious or vexatious legal claims to suppress evidence or even suborn witnesses, or artificially inflate the amount of any damages recoverable. By these means a supporter could try to ensure a victory in the courts as a means of harassing or putting pressure on their opponents.

Attitude of the courts of England and Wales towards champerty and maintenance

The courts in England and Wales have taken a relaxed attitude toward third party funding arrangements in recent years, taking account of the exigencies of funding difficulties, and holding that access to justice for litigants remains paramount. A clear example of this approach is where the former MP Neil Hamilton lost his defamation claim against Mr Al-Fayed and was ordered to pay substantial costs.



A large part of Mr Hamilton’s own costs had been paid by a fighting fund, to which several hundred donors had made contributions. However, they had no control as to how their donations were spent; played no part in the litigation, and their only interest in the outcome was that if the claim was sufficiently successful they expected to be repaid the amount of their donations. In effect, they were classic maintainers. As Mr Hamilton was unable to meet the order for payment of Mr Al-Fayed’s costs, the latter applied for a non-party costs order against nine of the main contributors. Giving the lead judgment of the court, Simon Brown LJ held that the contributors were not liable to contribute any monies as, in his opinion, the legal authorities supported the view that ‘*the unfunded party’s ability to recover his costs must yield to the funded party’s right of access to the courts to litigate the dispute in the first place*’. In other words, access was ultimately more important a principle than legal costs.



Benefits of third party funding

The obvious advantage of third party funding evidenced in the Hamilton case is that it promotes access to justice. Without the benefit of this form of funding a claimant may not be able to embark on litigation at all; the inherent risks of litigation and adverse costs orders are avoided by the prospective claimant and, perhaps controversially, third party funding may promote settlement. The argument here is that a defendant should understand that the claimant has funds to go to trial. Separately, as funders tend to operate on a commercial basis seeking a good return on their investment, defendants should be aware that the claim has been assessed as having good prospects of success by legal professionals. As a consequence a defendant may consider that settlement at a figure higher than justified by the particular case is a more sensible option than fighting a claimant with potentially deep pockets – an aspect that has also been termed ‘the protection racket’ principle. For the claimant, the nature of the commercial agreement with the third party funder means that the latter will not receive the full extent of any settlement or damages awarded if successful. It is a case of ‘something rather than nothing’ and, with third party funders setting claims from £1 million upwards, that can still be a considerable windfall for the successful claimant.

Judicial and academic support for third party funding

In 2009 Lord Justice Jackson was asked by the then Master of the Rolls, ‘to review the rules and principles governing the costs of civil litigation and to make recommendations in order to promote access to justice at proportionate cost’. In his final report in 2009 he endorsed third party funding as providing an additional and sometimes only means of funding litigation, promoting access to justice:

I accept that third party funding is still nascent in England and Wales and that in the first instance what is required is a satisfactory voluntary code, to which all litigation funders subscribe. At the present time, parties who use third party funding are generally commercial or similar enterprises with access to full legal advice. In the future, however, if the use of third party funding expands, then full statutory regulation may well be required, as envisaged by the Law Society (Jackson, 2009)

In 2010 the Civil Justice Council, an advisory non-departmental public body sponsored by the Ministry of Justice, issued a consultation paper entitled, ‘A Self-regulatory Code for Third Party Funding’ (Council, 2010). Legal professionals and third party funders were invited to consider:

1. Continuing with the status quo; or
2. Introducing self-regulation; or
3. Introducing formal regulation

The perceived difficulty with continuing with the *status quo* was that it would potentially leave consumers and third party funders vulnerable. Consumers might face attempted interference or influence from funders in the conduct of litigation, and not be adequately protected on adverse legal costs orders if third party funders had insufficient capital to pay a lost claim. For their part, third party funders would potentially be vulnerable to claimants seeking to use champerty as an excuse not to pay the agreed share of a successful claim, or defendants avoiding paying legal costs for the same reason. Introducing self-regulation was viewed as the least expensive and practical solution and obviated the need for formal regulation. The difficulty with introducing formal regulation was that, to date, no UK regulator has been willing to undertake a formal regulatory role. Formal regulation, however, was the preferred option of the majority of consultees. Yet, recognising both the complexities and practicalities of the means by which full regulation could be achieved, self-regulation was ultimately identified as the preferred route in the report.

Third party funding is accepted in many jurisdictions across the world, without regulation. In Australia, third party funding has been available for over a decade and Australia has gone further than any other jurisdiction in permitting the full assignment of claims to third party funders, in effect permitting the purchase of an action (Jeffery & Katauskas Pty Limited v Rickard Constructions Pty Limited [2009] HCA 43).

Two major studies have investigated third party funding since the CJC report of 2010. Hodges, Peysner and Nurse (2012) reported that regulation would avoid challenges to the validity of any agreements regarding litigation funding; ensure the financial risk of withdrawal and the consequences for all parties was properly understood, and exhort and police good business practice. A key issue for Hodges, Peysner and Nurse was whether regulation should be along financial and investment lines such as that of the Prudential Regulation Authority, or of legal services. A second report (ICCA-Queen Mary, 2015) found that 71% of a cohort of 763 respondents surveyed (including academics, legal professionals, and expert witnesses) desired formal regulation of the industry with only 29% accepting collective self-regulation through a code of conduct by an independent body.

Third party funding is the provision of funds by an outside individual or body with no other pre-existing connection of its own with the parties to the litigation to enable a litigant to pursue or defend a civil claim



Association of Litigation Funders and the Code of Conduct

The response in England and Wales to the Jackson report was to establish the Association of Litigation Funders of England and Wales (ALF) on 23 November 2011. A voluntary Code of Conduct for Litigation Funders was finalised and published the same day. The Code was amended in 2016 – it is short, only five pages long and requires litigants to sign a Litigation Funding Agreement with the funder. Membership is open to third party funders who have previously funded cases or are doing so at the time of their application to the Association (Art 26.1 of the Articles of Association). The third party funder must ensure the funded party has received independent legal advice on the terms of the Litigation Funding Agreement, and must not take any steps which would cause or be likely to cause a claimant's lawyers to act in breach of their professional duties, nor must it seek to influence to cede control or conduct of the dispute to the third party funder.

Clause 9 of the Code requires that a third party funder must be able to maintain adequate financial resources to meet its obligations to fund the disputes it has agreed to fund; to pay all debts when they become due and payable; to cover a minimum period of 36 months aggregate funding liabilities, and to maintain access to a minimum of £5 million in capital. In addition, under Clause 13.2, if there is a dispute between the third party funder and the client, whether it is on the terms of settlement of an action or on termination of the funding, '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'. Additionally, there is a complaints procedure enabling an investigation of a third party funder by the legal counsel of the ALF who reports to its management board. To date no member of the Association of Litigation Funders of England and Wales has faced a formal complaint

Does self-regulation of third party funding in the UK work?

There are only 17 members of the Association of Litigation Funders of England and Wales. There are many more players in the field of third party funding. It is possible that parties are uninterested in becoming members because of the high capital adequacy requirement of £5 million. It is possible, equally, that third party funders are operating outside of the Code as they are maintaining an element of control over the proceedings, permissible in Australia, but not elsewhere. Solicitors for their part might not be overly cautious in seeking funder members of ALF; they may not inquire about insurance or capital adequacy because they are keen to obtain funding immediately for the benefit of the client to commence a claim without the protection offered by the ALF. In any event, legal professionals owe a duty of care to clients; are bound by professional rules, and must be insured to maintain their practice. They are duty bound to consider and investigate with their client the best possible financing of a claim under those rules. Whilst Hong Kong and Singapore have more formally regularised what has been a voluntary state of affairs in England and Wales, Australia is moving forwards. Later this year there is a strong possibility of the introduction of a licensing system of third party funders for class actions where a group with the same or similar injuries caused by the same product sue a Defendant. This reflects the type of claim which has traditionally received support in that jurisdiction with the more liberal approach to third party funders being able to direct and take over the conduct of an action itself (Tallis, 2018).

Within England and Wales, the apparent absence of poor practice; the acceptance by the judiciary, legal professionals and the market of third party funding, and the lack of any obvious regulator, has meant a reluctance to intervene. The fact is that 'the spirit of our age, for good or ill, has been to encourage voluntary regulation and limit state regulation except to egregious cases' (Peysner, 2016). Self-regulation looks likely to remain the only way the sector in England and Wales will be prepared to fund expensive and uncertain litigation and arbitration.



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Keywords

Key words: Third party funding; litigation; arbitration; regulation; justice