U.S. CHAMBER
Institute for Legal Reform

Before the Flood

An Outline of Oversight Options for Third Party Litigation Funding in England & Wales

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Institute for Legal Reform

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Executive Summary

Third Party Litigation Funding ("TPLF") is the arrangement through which litigation costs are paid for by a party unconnected to a dispute, in exchange for an agreed percentage of any recovery.

Whilst proponents of TPLF tout advantages for claimants, such as providing an alternative method of financing potentially costly disputes, the industry also gives rise to complex ethical and legal issues. Naturally, those investing money in litigation ("Funders") have an interest in the protection of their capital. But allowing this to become a dominant interest in the litigation can lead to the process being distorted, and to unjust and undesirable outcomes.

As the TPLF industry continues to expand, potential issues and questions have arisen. Some of the most challenging include the following:

- **Capital Adequacy:** The potential for a Funder to have insufficient capital is a serious risk to the funded party, as they could become fully liable for a case they might not have pursued absent the Funder's commitment. Nothing currently requires Funders to maintain adequate capital. How should Funders be required to guarantee that they can meet their commitments?

- **Ethical Issues – Fiduciary Duties, Control, Conflicts of Interest and Withdrawal:** There is a very real risk that Funders have the means and incentive to control the litigation they fund, and that they may do so in a manner beneficial to their own interests, but not those of the funded party. Do Funders owe fiduciary duties? To whom? When does control of funding lead to control of the strategy in a case, including settlement decisions? How should conflicts of interest between a Funder and funded party be resolved? Under what circumstances should a Funder be permitted to abandon a lawsuit?

- **Incentives and Limits on Recovery:** A systemic risk arises if the potential rewards for Funders are so great (compared to the downsides) that incentives are created to pursue meritless litigation. This scenario arises, in particular, if claims of varying quality are bundled together, as an incentive may be created to "roll the dice" on some low quality claims that would otherwise never be taken. Limits are routinely placed upon the degree to which lawyers may benefit from their clients' cases, so that lawyers' incentives are not distorted. What limits should be placed upon Funders' recoveries?

- **Responsibility for Adverse Costs:** An anomaly currently exists whereby Funders may support litigation in exchange for a nearly unlimited upside, while having only limited exposure to the downside risk of a potential negative costs award. What liability should a Funder have for adverse costs?

- **Disclosure and Transparency:** The existence of a funding arrangement is typically not disclosed, and so courts

have no means to know the degree of control exercised by the Funder, the degree to which any champerty exists, the degree to which the Funder's interests are prioritized, or who the real parties in interest are. Should courts be notified if the case involves a Funder?

TPLF in England and Wales currently lacks a governing framework, and there is uncertainty, disparity and a lack of coherence in terms of the appropriate practical and policy responses to the questions above. However, it is clear that an appropriate structure is needed so that the Funders' investments can be balanced against a number of other interests, such as the need for a just outcome, fairness to both parties, transparency and respect for the court's role.

The challenges the TPLF industry presents have already been acknowledged by a number of Funders who have formed an industry association, which created a voluntary code of conduct. But as the description suggests, the code is only suggested guidance, and is incomplete, lacks any real enforcement mechanism, and does not apply to the great many Funders that have chosen not to join the association.

To make matters worse, the industry is rapidly expanding. The top sixteen TPLF providers in the United Kingdom now have approximately £1.5 billion in assets under management globally.[1] This represents a 743% growth in the industry between 2009 and 2015.[2] The focus of the TPLF industry is also changing rapidly. While Funders initially focused on the largest commercial cases, funding is now increasingly available in smaller cases, as well as in mass-action and consumer cases, and this trend shows no sign of slowing down. The rapid growth and increasing maturity of the sector, as well as the increasing likelihood of consumer interests being directly impacted, suggests that the time is right to consider the creation of an appropriate governing framework.

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While the problems posed by the TPLF industry are challenging, so too is developing a solution. A number of different acts, regulations and rules already touch upon areas relevant to TPLF. It may be possible to amend some or all of these in a piece-meal fashion to close the gaps. However, the issues raised by TPLF are diverse and complex, and such a solution would be unlikely to offer a coherent outcome.

A second, comprehensive option would be a single centralized oversight solution, based upon a licensing regime for Funders. This would allow market participation to be based on adherence to common rules, with easy-to-follow limitations and an easy-to-apply supervisory and enforcement mechanism.

To implement this option, certain pre-existing structures for the oversight of financial services could be adapted to create a suitable structure for TPLF. Equally, a number of structures already exist for the regulation of legal services which could be readily adapted to include TPLF.

Part I of this paper explores some of the overarching themes and issues regarding TPLF and why meaningful oversight is desirable and could be achieved. Part II considers some specific ethical and practical issues. Finally, Part III considers what solutions are available and identifies just some of the options for an oversight structure.

Part I — Introduction

Early Consideration of Legal Costs Reform Issues and a Governing Framework for TPLF

In November 2008, the Master of the Rolls commissioned a report to review the costs of civil litigation in England and Wales, led by Jackson LJ. The final report, the "Jackson Report", was published in early 2010.[3] It provides a valuable insight into the need for reform in various aspects of the civil litigation process. In particular, the Jackson Report recognised the complex issues that can arise with regard to TPLF and the potential need for an oversight framework.

Jackson LJ stated in his report that: "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."[4]

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Note that Jackson LJ only believes a voluntary regulatory code would be sufficient if "all funders subscribe to that code" (emphasis added).[5]

The Association of Litigation Funders ("ALF") was subsequently created, and it adopted a voluntary Code of Conduct For Litigation Funders ("ALF Code").[6] The ALF Code sets out various terms that its members should include in an agreement between a Funder and a funded party (Litigation Funding Agreement or "LFA").

Issues with the Voluntary Mechanism

ALF is a voluntary association and currently, only seven of the 16 Funders known to be operating in England and Wales are members.[7] The exact number of Funders that have entered into LFAs concerning litigation in England and Wales is unknown, as the existence of funding arrangements and the identity of Funders in cases is typically not disclosed. However, it is clear that fewer than half of the Funders operating in England and Wales have subscribed to the ALF Code, and thus more than half of those in the industry operate outside any governing framework whatsoever. Those that have subscribed to the ALF Code have agreed with each other to operate subject to its terms, which attempt to address at least some of the problems that can arise in relation to TPLF.

Apart from Funders' lack of participation, this self-regulation mechanism has no "teeth" even for those that chose to join. The ALF is an independent body owned and directed by the member Funders.[8] Adherence to the ALF Code is policed by the ALF. The maximum penalty the ALF

has empowered itself to impose is a £500 fine, alongside possible exclusion from the association at the discretion of the organisation's board. However, even if a Funder were to violate every one of the principles of the ALF Code and eventually be excluded from the ALF, this would have no bearing at all on the Funder's ability to continue funding cases.

In light of the above, it cannot be said that the ALF Code has led to any meaningful oversight of, or even monitoring of, the activities of an industry with assets under management of in excess of £1.5 billion.

Furthermore, whatever oversight is provided by the ALF over its members is hidden from the public, as no information is available about penalty actions taken or how any disputes with funded parties were resolved.[9] This means that those considering entering into funding relationships are deprived of an ability to make fully informed choices about which Funder to do business with, based on their record of interactions with a body overseeing Funders' activities.

The Law Society's "Access to Justice" report considered this deficit in 2010 and found: "As Jackson LJ recognised, third party funding has become an increasingly important method of funding large cases. It may be of particular importance to class actions. First, the funders are presently unregulated and there are no rules or guidance as to the appropriate level of percentage that they can take from damages, their liability for costs or what happens if they become insolvent or wish to withdraw from the action. Proposals for voluntary regulation do not address these problems. We therefore recommend [that] work should be done on providing a statutory code to regulate third party funding."[10]

EU Recognition of Concerns with TPLF

In addition to the Law Society and Jackson LJ's comments on the issues presented by TPLF, it is noteworthy that the European Commission has also raised concerns. In its 2013 Recommendation on Common Principles for Collective Redress

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Mechanisms,[11] it identifies a broad range of safeguards that should apply in national systems in order to ensure that funding does not have an inappropriate influence over the course of proceedings and that the interests of the funded party are protected. While this Recommendation addressed collective redress cases, the concerns giving rise to it exist in all kinds of litigation.

Part 14-15 of the Recommendation provides, for example, that EU Member States' litigation systems should ensure that a claimant declares to the court at the outset of a claim the origin of the funding, and that the court should be allowed to stay proceedings if there is a conflict of interest between the Funder and the claimant, or where the Funder has insufficient resources to meet any adverse costs order.

Part 16 of the Recommendation requires that each Member State ensure that in cases where an action for collective redress is funded by a private third party, it is prohibited for the private third party:

(a) To seek to influence procedural decisions of the claimant party, including on settlements;

(b) To provide financing for a collective action against a defendant who is a competitor of the fund provider or against a defendant on whom the fund provider is dependent; and

(c) To charge excessive interest on the funds provided.

Thus, there is a broader recognition at the EU Commission level of the issues surrounding TPLF.

A Changing Environment – Consumer Cases on the Horizon

As noted by Jackson LJ, at the time of his report the TPLF industry in England and Wales funded predominantly larger-value commercial cases. This continues to be an important focus for Funders as these cases have been the most obvious source of returns. However, this is changing rapidly.

First, central to Funders' business models is the expansion of the array of cases they fund to include class actions and other mass disputes. In other jurisdictions, Funders concentrate heavily on class actions.[12]

Second, Funders and law firms in the UK already offer participation in mass claims in the UK against UK based-companies. For example, a funded mass claim on behalf of shareholders is already underway against Tesco PLC alleging overstatement of profits.[13]

Third, Funders—including those operating in the UK—are increasingly playing a role in funding mass claims outside the UK where relevant aggregate litigation mechanisms exist. For example, Funder IMF Bentham is involved in a class action case in Germany against Volkswagen regarding so-called emissions "defeat devices".[14] A mass action in Austria against Facebook regarding allegations of privacy violations is being financed entirely by a Funder.[15]

Fourth, as the market has become more saturated, lower-value claims are now being actively pursued by Funders. According to press reports, at least three Funders now offer finance for lower-value claims:

- Augusta is said to be looking to provide at least £50,000 of finance;
- Burford has launched a specialist 'Sprint' product for lower-value claims, providing finance from £25,000 to £500,000; and
- Acasta has launched a product offering a minimum investment of just £10,000.

Fifth, Funders are now actively seeking portfolios of cases, including lower-value cases.[16] This could involve the provision of funding to a finite group of similar cases. However, the trend is far more expansive than that. For example, Burford Capital's annual report states, "[I]n our inaugural

year, 100% of our business was single case litigation funding. In 2015, only 13% of our new investments related to single litigation cases, and the remaining 87% was for a variety of other forms of capital provision to the legal market".[17] Just two of the investments cited in the same report are (a) a $45 million portfolio financing arrangement with a FTSE 20 company, and (b) $100 million in financing to a major global law firm against a broad and widely diversified portfolio of matters.

Sixth, it seems inevitable that the TPLF industry will shift towards other types of mass consumer claims in the UK as soon as these cases are available. Section 81 and Schedule 8 of the Consumer Rights Act 2015 created an opt-out class action procedure for the first time, limited to competition cases. The first such action was reportedly launched in March 2016.[18] Interested law firms are already indicating that such cases are fundable and will be explored.[19]

Overall, there is already a significant shift towards funding cases involving significantly less resourced and less sophisticated claimants. This immediately changes the dynamic, and creates a need for far more protection for funded parties.

As Jackson LJ noted, "If funders are supporting group actions brought by consumers on any scale, then this would be a ground for seriously re-considering the question of statutory regulation of third party funders …".[20]

Need for Oversight

This paper considers some of the issues related to the use of TPLF in litigation, and identifies just some of the legal mechanisms that could be adapted to achieve appropriate oversight, whether by bringing TPLF within existing structures or creating new structures under the auspices of existing systems and agencies.

For present purposes, the issues raised by TPLF have been grouped into five categories, discussed in more detail below:

- Capital adequacy;
- Ethical issues: fiduciary duties, control, conflicts of interest and withdrawal;
- Incentives and limits on recovery;
- Responsibility for adverse costs; and
- Disclosure and transparency.

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Part II — Specific Issues Regarding TPLF

Capital Adequacy

It is essential that an oversight system should require Funders to be bound to the terms of the financial commitments they make, and to have sufficient capital adequacy to remain in a position to discharge the entirety of their liabilities during the course of the litigation.

There is currently no obligation on Funders to establish and maintain sufficient funds to cover any unmet liabilities. The capital adequacy of the Funder is a serious risk to the funded party as they could become fully liable for a case they might not have pursued absent the Funder's commitment. There has been at least one example of a litigation fund being de-listed[21] following allegations that it was financed by a "Ponzi scheme".[22] This potential liability includes not only the funded party's own legal fees, but also their opponents', in the event of an adverse costs order.

The ALF Code acknowledges the need in principle for capital adequacy controls. It provides, for example, that ALF members must have capacity to "cover aggregate funding liabilities under all of their LFAs for a minimum period of 36 months" and "maintain access to a minimum of £2m of capital".[23] However, in circumstances where costs are unpredictable even in one case, but Funders are committing tens of millions to diverse portfolios of cases, a voluntary commitment to have enough money available seems wholly insufficient, even if it could be made applicable to all Funders.

Thus, the absence of a formal requirement to maintain adequate capital leaves funded parties significantly exposed. Jackson LJ initially identified capital adequacy as "a matter of such pre-eminent importance that it should be the subject of statutory regulation", before conceding that a self-regulatory mechanism would be appropriate instead while the industry was nascent and if all Funders subscribed.[24] Capital adequacy requirements should therefore now be imposed upon Funders through a formal structure.

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Ethical Issues: Fiduciary Duties, Control, Conflicts of Interest and Withdrawal

The interest that a Funder may have in safeguarding its investment is understandable. However, this interest should not permit the Funder's investment to become a primary driver of the litigation. Instead, it is essential that an oversight system addresses the following:

(a) the duties that Funders owe to funded parties;

(b) the degree to which Funders may control decisions regarding a case;

(c) how any conflicts of interest may be resolved; and

(d) how and when any Funder can withdraw from litigation once they have committed to fund a case.

FIDUCIARY DUTIES: A FIDUCIARY RELATIONSHIP SHOULD EXIST REQUIRING THE FUNDER TO ACT IN THE FUNDED PARTY'S BEST INTERESTS

A key issue related to TPLF is that while the interests of the Funder are often aligned with those of the funded party, they are not always aligned (and the degree of alignment may also change during the lifetime of a case). The Funder and funded party will often both want to achieve the highest possible financial award; however, it is clear that a Funders' targeted internal rate of return may prevent settlement or encourage the continuation of proceedings when the matter would otherwise have settled earlier at a lower and reasonable level.

Alternatively, a Funder may wish to "cash out" rather than pursue a case as a matter of principle or establish a point of law or public policy that would be helpful to the funded party. Also, the participation of a Funder may prevent settlement involving terms other than cash, such as agreeing to discounted terms for future business between the parties to the dispute.

It is clear that the Funder's interests should not predominate in circumstances where the Funder and the funded party discover that they have differing views on an issue, such as strategy or the best outcome, or where the funded party's legal advice indicates that a different course should be pursued to the one preferred by the Funder. The interests of justice plainly require that the litigant's interests must predominate, as any other outcome would encourage the subordination of justice to the financial interests of an investor.[25]

Ensuring that the funded party's interests predominate at every level of the relationship could be difficult to legislate and oversee in the abstract. However, by requiring an up-front recognition that a Funder owes a fiduciary duty to act in the best interests of the funded party, the relationship is clarified and both parties can proceed on the basis that, by default, any doubts can be resolved in favour of the interests of the funded party.

Since the introduction of Damages Based Agreements ("DBAs"), lawyers have been capable of taking cases on a contingency fee basis. Lawyers already owe exactly the sort of fiduciary duty envisaged to their clients, even when the lawyers are acting under a DBA and so have their own financial interest in the outcome. Imposing a fiduciary duty upon Funders would, therefore, protect the funded party and resolve the anomaly that lawyers with an interest in the outcome are under a duty to protect litigants' interests, but Funders have no such duty despite having a comparable interest in the outcome.

Such a duty would also be an invaluable consumer protection foundation as the TPLF industry shifts towards lower value and mass consumer claims.

CONTROL: A CLEAR PROHIBITION SHOULD EXIST PREVENTING FUNDERS FROM INFLUENCING OR EXERCISING CONTROL OVER CASES, INCLUDING IN RELATION TO THE TERMS OF ANY SETTLEMENT

In addition to the need for a clear fiduciary duty owed to litigants, it is essential to impose clear limitations upon the degree to which a Funder should be permitted

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to influence or control litigation which, in effect, to prioritizes the Funder's interests over the funded party's interests.

Although little is known about the degree to which Funders in practice take control of cases in England and Wales, it is apparent that in other jurisdictions Funders make no secret of their interest in protecting their investments by influencing cases. A principal of the now-defunct BlackRobe Capital Partners, LLC, was quoted as saying his firm would take a "'pro-active' role in lawsuits".[26] Bentham IMF (a U.S. funder which also operates in the UK) has a set of "best practices" applicable to its U.S. operations which notes the importance of setting forth specific terms in funding agreements that address the extent to which the Funder is permitted to "manage the Claimant's litigation expenses"; "receive notice of and provide input on any settlement and/or offer, and any response"; and "participate in the claimant's settlement decisions".[27]

In one case in Australia, the birthplace of TPLF, the court approved a funding arrangement which resulted in the Funder "having broad powers to control the litigation" and in which the Funder "actively searched for and propositioned potential plaintiffs in the case." The agreement authorized the Funder to "conduct representative proceedings, choose the attorney (who regarded the funder as its client), and settle with the defendant for seventy-five percent of the amount claimed".[28]

The ALF already recognises this as an issue requiring intervention and clarification in England and Wales. The voluntary ALF Code states (at Clause 9.3) that the Funder should "not seek to influence the Funded Party's solicitor or barrister to cede control or conduct of the dispute to the Funder".

However, the weakness of the ALF Code is illustrated by Clause 11.1 which provides that the LFA should state whether the Funder "may provide input to the Funded Party's decisions in relation to settlements". Thus, it is clear that some Funders may wish to "provide input" while simultaneously saying that they do not "seek to influence" the conduct of the case.

In circumstances where Funders pay the bills, the risk of their interests being prioritised are significant and the distinction between "providing input" and "exercising control" will be extremely difficult to establish in practice. For example, it may be possible for a Funder to influence strategy simply by decisions about which litigation costs it will pay, for which services, and when. It may also insist that its "input" be adhered to by hinting that funding could be withdrawn, without needing to make an

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explicit threat. The effect of such implicit threats might be even more difficult to establish if made not to the funded party, but to a lawyer representing a funded party but where the lawyer has a broader financial interest in keeping the Funder satisfied.

Funders should therefore be prohibited from exercising any control or influence (formally or informally).

CONFLICTS OF INTERESTS: AN LFA SHOULD EXIST BETWEEN THE FUNDER AND THE CLIENT AND OTHER RELEVANT RELATIONSHIPS SHOULD BE DISCLOSED

The above issues regarding the relationship between the Funder and the funded party become more acute when one considers that the market trend is towards ever closer alignment between Funders and law firms (as opposed to relationships between Funders and funded parties). While lawyers have clear duties to remain independent and to serve their clients' interests in individual cases, in circumstances where their future business and financial success depends on satisfying the demands of a Funder, those client-related duties can come under severe pressure.

Such pressure can arise, for example, where a referral fee arrangement exists between lawyers and Funders for new cases, or where Funders have agreed to fund portfolios of cases taken by lawyers. The risk also arises when Funders have direct investment interests in law firms, either through a commercial investment relationship, or through ownership of the firm (such as through an Alternative Business Structure ("ABS")) introduced by the Legal Services Act 2007 ("LSA").[29]

Indeed, there is at least one example of a Funder taking up an ABS licence.[30] Furthermore, there is at least one example of a Funder arranging to pay for the opening of a new office of a law firm, in exchange for an agreement of Funder involvement in future claims[31] and an example of a Funder offering $100 million to a law firm to participate in the outcome of a diverse portfolio of cases.[32]

The code of conduct applicable to solicitors already acknowledges the significant risks that can arise in such situations and requires that any fee sharing or referral arrangements should not compromise solicitors' independence or professional judgement. The same code requires that clients are informed by their solicitors of any fee sharing arrangements relevant to their matter.[33]

The UK's Legal Services Board has also recognised these risks and has observed: "An independent profession serves to promote the principle that legal service providers should be free from inappropriate influence (financial or institutional) to act as an agent of the client, in their best interests. Regardless of the structure within which legal services are delivered, we expect lawyers to be mindful of the source of payment for their services (be it legal aid, after the event insurance, before the event insurance, third party funding or any other source) so that they can identify and manage the potential threat to their independence".[34]

Similarly, the Bar Standards Board, the body responsible for regulating barristers, has published a "Risk Outlook" which finds that "commercial forces can be powerful and if not carefully managed, those pressures can have an adverse impact on the quality of services, availability of services and longer term sustainability. They may – in certain circumstances – even threaten professional independence and integrity."[35] The same report describes the potential threats to independence that can arise with the use of referral fees and retainer fees[36], as well as relationships between barristers and intermediaries, stating that "Our fear is that by trying to win and retain influential clients or intermediaries, some members of the Bar could resort to financial tactics that harm the wider public interest and threaten the Bar's independence."[37]

Thus, the risk of clients' interests becoming subordinated when there is a broader commercial interest shared by the lawyer and a third party (such as a Funder) is already well recognised.

The focus has—to date—exclusively been on curbing the activities of lawyers. In light of market developments, it appears logical and necessary to address and oversee the source of the threat, and also impose duties directly upon Funders.

One way to address the threats presented is to require that all funding relationships should involve a direct contractual link between the Funder and the funded party in the LFA, setting out in detail:

(a) The funded party's rights and obligations with regard to each specific case; and

(b) Disclosure of the full details of any broader relationship between the Funder and the funded party's lawyer, so that the funded party is aware of any potentially conflicting interests, including whether his or her individual case is part of a broader portfolio arrangement, and how that might affect his or her individual interests.

WITHDRAWAL FROM PROCEEDINGS: SAFEGUARDS SHOULD BE IN PLACE TO PREVENT UNREASONABLE WITHDRAWAL BY THE FUNDERS

Consistent with the above theme of protecting the interests of funded parties, and not having those interests subordinated to the interests of Funders, it is crucial that Funders are not permitted to abandon funded parties during litigation absent narrow and well defined circumstances.

Funders should not be permitted to support the commencement of litigation, and then walk away without consequences if they later change their mind, develop a different appetite for risk, or discover information that changes their risk appreciation where that information would have been available to them before providing funding if they had conducted appropriate due diligence. Withdrawing support for litigation can leave all parties without a resolution despite significant costs having been incurred. It can also leave funded parties significantly exposed to adverse costs and their own costs.[38] Also, a system whereby Funders can walk away without taking responsibility for the litigation they have supported would permit consequence-free gambling on outcomes at the expense of all parties, notably except the Funders themselves. Despite this, at present there is nothing constraining Funders from withdrawing.

Although this may be addressed in the LFA, nothing requires an LFA to address it, which may be a particular concern in, for example, consumer cases where one would not expect consumers to be in a position to negotiate the terms of the LFA in detail. Jackson LJ recognises this as a fraught issue, and considered that the "precise definition of proper grounds for

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withdrawal [under a LFA] will require some careful drafting".[39] Jackson LJ also noted that one of the Law Society's key arguments in favour of the oversight of TPLF was that an LFA "is likely to allow the funder to withdraw funding in circumstances which would be contrary to the client's interests or unreasonable".[40]

In *Harcus Sinclair (a firm) v Buttonwood Legal Capital Ltd*, the LFA entitled the Funder to terminate the LFA if the prospects of success were less than 60%. It was found by the court that the "reasonableness of an estimate that the prospects do not exceed 60% is a purely substantive question, to be answered by an objective assessment of the available evidence against the background of the relevant legal rules and principles applicable to the claim. If the estimated figure is by that test within the ambit of reasonableness, it matters not by what route or process it was reached: the result is all."[41] Significantly, the case demonstrates that there is bound to be controversy over the grounds upon which a Funder is entitled to terminate an LFA, and highlights the difficulties in providing protective measures to litigants from the unreasonable withdrawal of funds by Funders.

Provisions of the voluntary ALF Code seek to address this issue in terms that favour the discretion of the Funder. Clause 11.2 of the ALF Code provides that a Funder may terminate the LFA on any of the following grounds: (i) it reasonably ceases to be satisfied about the merits of the dispute; (ii) it reasonably believes that the dispute is no longer commercially viable; or (iii) it reasonably believes that there has been a material breach of the LFA by the funded party. Whilst Clause 12 of the ALF Code provides that the LFA shall not establish a discretionary right to terminate, it would seem apparent that the aforementioned are, in practice, discretionary in nature in that they are based on the "reasonable belief" of the Funder, rather than any objective standard.

Clause 13.2 of the ALF Code provides for a binding opinion to be obtained from a Queen's Counsel in the event of a dispute about termination of the LFA,[39] but the practical application of this mechanism is unclear. It does not specify, for example, whether Queen's Counsel will be required to evaluate the case and provide an opinion of the likely outcome should it go to trial. The ALF Code is also silent on which party will pay the fees of the Queen's Counsel opinion. A better solution would arise through an oversight mechanism, ensuring certain contractual safeguards are in place for both parties, such as a notice period for an intention to withdraw and more details as to what grounds for withdrawal, defined with reference to objective standards, would be acceptable within an LFA.

Overall, the voluntary ALF Code appears vague and unsatisfactory with regard to withdrawal, and therefore is not an adequate model even if it could be made to apply to all Funders. An appropriate policy would encourage Funders to evaluate carefully the litigation being funded *before* making a commitment with the knowledge that they will have to honour that commitment, rather than allowing them to make an arrangement to fund high-stake but riskier litigation, knowing it can be abandoned once underway. Appropriate oversight could ensure that if Funders are permitted to withdraw funding from proceedings, they should be required to give notice based on reasonable grounds that are not solely based on the discretion of the Funder.

Incentives and Limits on Recovery

As above, the possibility arises of a Funder having interests which diverge from the interests of the funded party. In addition, a systemic risk arises if the potential rewards are so great (compared to the downsides) that incentives are created for

Funders to seek out and pursue meritless litigation in the hope of extracting a settlement, or if incentives are created to run litigation in a manner designed to maximise the Funder's interests, at the expense of the funded party.

One of the keys to ensuring that interests are balanced is to weigh the Funders' interest in receiving a fair return in light of the risks they undertake, so that returns are not disproportionate and do not create inappropriate incentives.

POSSIBILITY OF ABUSIVE LITIGATION

As a starting point it must be recognised that, as a third party investor, a Funder's interest in a case is based solely on the financial return achievable, rather than on whether the outcome is "just", satisfactory for the parties, or consistent with public policy. In the words of one Funder: "A litigation claim is an asset. It may seem strange to think of litigation in that way, but if one strips away the drama and the collateral dynamics associated with the litigation process, a litigation claim is nothing more than an effort to get money to change hands. In other words, a litigation claim is just like any other receivable."[43]

Funders will likely decline to invest in some cases because the chance of a case generating a sufficient return appears to be low. In this scenario, Funders will likely not knowingly support a weak or meritless case. However, it should also be recognised that where a calculation can be made that a weak or meritless case will—despite its weakness—generate a return, then it would be perfectly consistent with a Funders' incentives to pursue such a case. This scenario arises where it seems likely that a defendant will want to settle even a meritless case in order to avoid long, costly or public exposure in the courts. Pursuing cases on such a basis—a common phenomenon in the United States and elsewhere—is often referred to as pursuing a "blackmail settlement".[44]

Whilst claimants can and sometimes do pursue meritless cases (without the involvement of a Funder), such claimants are named parties with duties to the court and would be fully exposed to adverse costs orders. Funders, however, are insulated from risks due to the fact an LFA is not typically disclosed. Therefore, the possibility arises of proceedings being influenced in ways that the court cannot be aware of. Funders are also insulated through the "Arkin Cap" (discussed below) which limits Funders' costs exposure even if the case should never have proceeded. Funders therefore have a lower "downside" risk than parties, and there is no ceiling on their potential "upside" returns.

It is sometimes argued that abusive litigation backed by Funders is unlikely because the due diligence they conduct to protect their investment will mean that bad claims are unlikely to receive support. However, this does not take account of the fact that Funders may have incentives to support bad claims if a return is available.

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For example, *Excalibur* involved a claim for US$1.65 billion in damages which was summarised by Clarke LJ as follows: "The claim was essentially speculative

and opportunistic. It has been advanced at great length and by the assertion of a plethora of causes of action, all of which have been maintained to the last possible moment, no doubt upon instructions. [The defendants] have been put to enormous expense in terms of legal costs … The claims put forward were an elaborate and artificial construct which … were reverse engineered from the position in which the [funded parties] found themselves on the facts. They were replete with defects, illogicalities and inherent improbabilities".[45]

In a separate ruling awarding costs, Clarke LJ found that [Excalibur] "could not have brought this action unless it had been financed by a number of different persons who at different times and in different amounts produced the monies necessary to start and, later, to continue the action". The ruling identified no less than nine separate funding entities, organised into four groups, each of which satisfied itself that supporting the claim presented a worthwhile financial opportunity.[46]

Other jurisdictions have already been exposed to the pursuit of large-scale claims backed by Funders despite strong indications that the claims lacked merit. An oil pollution claim, backed by Funders, was pursued against Chevron Corporation in Ecuador, and the American lawyer acting for the Ecuadorian claimants succeeded in obtaining a US$9.5 billion judgment from a local court against Chevron. As reported in *Bloomberg Businessweek*, the case "had evolved into an extortion plot featuring bribery, coercion and fabricated evidence" which the lawyer in question "sustained a two-decade legal campaign, in part, by accepting investments totalling close to $30 million from hedge funds and individuals".[47]

In March 2014, a U.S. federal judge ruled that the lawyer in question (and the Ecuadorian lawyers he led) "corrupted the Lago Agrio case". They submitted fraudulent evidence. They coerced one judge, first to use a court-appointed, supposedly impartial, "global expert" to make an overall damages assessment and, then, to appoint to that important role a man whom [the lawyer] hand-picked and paid to "totally play ball" with the [plaintiffs]. They then paid a Colorado consulting firm secretly to write all or most of the global expert's report, falsely presented the report as the work of the court-appointed and supposedly impartial expert, and told half-truths or worse to U.S. courts in attempts to prevent exposure of that and other wrongdoing. Ultimately, [they] wrote the Lago Agrio court's judgment themselves and promised $500,000 to the Ecuadorian judge to rule in their favor and sign their judgment. If ever there were a case warranting equitable relief with respect to a judgment procured by fraud, this is it".[48]

The American lawyer in question is appealing this verdict; meanwhile, efforts to enforce the Ecuadorian judgment in Canada, Argentina, and Brazil continue. One of the Funders involved was ALF member Burford Capital, which settled with Chevron and withdrew from the case, claiming it was deceived by the claimants' lawyers.[49]

In the past, when opportunities were generated for third parties to participate for profit in the administration of justice, significant problems arose. For example, providers of "claims management services" led to widespread abuse, leading to many consumers being drawn into litigation on a "no win no fee basis" but ultimately ending up in significant debt.[50] As a consequence, the UK government was forced to introduce the Compensation Act 2006 to control the activities of claims management companies. In justifying this legislation, the Government stated 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]

Thus, it would be a significant mistake to accept the fallacy that the profit motivation of Funders, and their preference to be involved in large "sure thing" cases if possible, is in itself an adequate brake on the potential incentives to fuel meritless or abusive litigation.

NEED TO CURB INCENTIVES THROUGH LIMITATION ON RECOVERY

One way to dampen the risk of abusive litigation and to limit systemic risks is to ensure that Funders are not permitted to claim an unfair or disproportionate share of the damages.

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This sort of limitation already exists within the relationship between lawyers and their clients. Within the lawyer-client relationship the possibility of a lawyer's financial interests creating conflicting interests and interfering with the sound administration of justice to the detriment of clients is expressly recognised. For this reason, both contingency fees and success fees are regulated and capped by statute to ensure that incentives remain balanced.

The availability of Damages-Based Agreements, or DBAs—otherwise known as contingency fees—is described in regulations that were adopted following the introduction of the Legal Aid, Sentencing and Punishment of Offenders Act 2012 ("LASPO").[52] These regulations cap the amount that solicitors are able to recover under a DBA, providing that "damages-based agreements must not provide for a payment above an amount which, including VAT, is equal to 50% of the sums ultimately recovered by the client".[53]

LASPO also introduces a maximum cap on a success fee that lawyers may recover under a Conditional Fee Arrangement ("CFA"). Article 3 of the Conditional Fee Agreements Order 2013 provides that the maximum success fee is capped at 100%.[54]

An equivalent provision for TPLF would place a reasonable limit on any award that a Funder is entitled to claim; for example, to a 100% uplift on the amount of financing provided. Currently, Funders typically appear to recover 200% to 400% of their investment. Despite this, and as a result of the "Arkin Cap" (discussed below), the Funder is only responsible for adverse costs to the opposing party to the extent of the funding provided. In light of the constraints on lawyers, it does not seem appropriate that a Funder should be entitled to the possibility of awards of many times their investment, coupled with a capped downside risk, as this may incentivize speculative litigation.

Solicitors are prohibited outright from using DBAs in opt-out collective proceedings.[55] It does not appear that Funders are covered by this prohibition. The prohibition was motivated by the Government's concern that permitting DBAs would encourage vexatious proceedings to be brought by lawyers.

The contrast is inexplicable: Solicitors, who are subject to statutory regulation, a mandatory professional code of conduct, and are answerable to a professional body, have their incentives curbed to protect litigants. Yet Funders, who are not subject to oversight, mandatory ethical rules, or meaningful sanctions, and keep their funding relationships secret, face no such curbs.

There appears, therefore, a strong case for introducing limits on the recovery that Funders can demand.

Responsibility for Adverse Costs

Consistent with the theme of balancing incentives in litigation, an anomaly currently exists whereby Funders may support litigation in exchange for an unlimited upside, while having only limited exposure to the downside risk of a potential negative costs award.

Funders are not currently required by law to cover an adverse costs order made against the funded party. Pursuant to Section 51(1) and (3) of the Senior Courts Act 1981 (formerly the Supreme Court Act 1981), the court may make an award against a non-party, i.e., a Funder. However, the principle established in *Arkin* provides that a Funder's liability for adverse costs is typically capped at the amount that the Funder has contributed to the litigation.[56] In essence, this creates a ceiling on any liability the Funder may incur for adverse costs, hence the so called "Arkin Cap".

The result of the Arkin Cap is that the "loser pays" principle applies in full to the funded party, but not to the Funder that may have inspired, supported and steered the litigation in the hope of a significant reward.

Unsurprisingly, the Arkin Cap has received substantial criticism. Most notably, Jackson LJ stated that "it is wrong in principle that a litigation funder, which stands to recover a share of damages in the event of success, should be able to escape part of the liability for costs in the event of defeat. This is unjust not only to the opposing party (who may be left with unrecovered costs) but also to the client (who may be exposed to costs liabilities which it cannot meet)".[57]

Jackson LJ's recommendation was that "either by rule change or by legislation third party funders should be exposed to liability for adverse costs in respect of litigation which they fund ... The funder's potential liability should be not be limited by the extent of its investment in the case".[58]

To date, Parliament has not adopted this suggestion; accordingly, Funders are usually protected by the Arkin Cap. The Australian experience suggests that the potential for full liability for adverse costs does not reduce the Funders' appetite to fund litigation proceedings. Thus it appears that there is no clear public policy reason to maintain the Arkin Cap.[59]

As a matter of fairness and also to ensure that only appropriate incentives exist, it would seem apparent that legislation should be introduced to address the current ceiling on a Funders' liability for adverse costs and provide certainty, subject to the discretion of the judge in each individual case, that full adverse costs may be recovered from a Funder. As Clarke LJ eloquently expressed, the Funder should "follow the fortunes of those from whom he himself hoped to derive a small fortune".[60]

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The voluntary ALF Code does not adequately address this issue, even for those choosing to adhere to the ALF Code: It simply provides at Clauses 10.1 to 10.4 that the extent of any liability for costs should be stated in the LFA.

Transparency and Disclosure

With the accelerating growth in the use of funding, and the increasing trend of consumer-facing funding arrangements, it would be appropriate to require all funding arrangements to be both transparent as between Funder and funded parties, and disclosed to the court, and as necessary to opposing parties.

A transparency requirement would ensure that an LFA with a funded party could be valid only if it is in writing and it contains a clear statement of all terms and conditions, including a detailed explanation of the expenses that the funded party could be obligated to pay.

The principle of appropriate transparency between Funders and funded parties should not be controversial and is already accepted by those participating in the ALF. For example, the ALF Code provides that the promotional literature of a Funder must be clear and not misleading.[61] It provides that the LFA should state whether (and if so to what extent) the Funder is liable to the funded party to meet any liability for adverse costs; pay any premium (including insurance premium tax) to obtain costs insurance; provide security for costs; and meet any other financial liability.[62] It also provides that the LFA shall state whether (and if so how) the Funder may: provide input to the funded party's decisions in relation to settlements; terminate the LFA in the event that the Funder reasonably ceases to be satisfied about the merits of the dispute; reasonably believes that the dispute is no longer commercially viable; or reasonably believes that there has been a material breach of the LFA by the funded party.[63]

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While, as discussed above, the latter two points—input into decision-making about the case and withdrawal from the arrangement—should be defined and limited, subject to those limitations, these terms are an appropriate starting place for the protection of funded parties, and should be moved to a mandatory footing.

In addition, before any LFA is offered to consumers, adjustments to LFAs should be made to ensure compliance with EU legislation on unfair terms in consumer contracts[64] and the UK's Unfair Terms in Consumer Contracts Regulations.[65] In particular, Section 7(1) of those Regulations provides that "a seller or supplier shall ensure that any written term of a contract is expressed in plain, intelligible language". Section 5(1) of those Regulations provides that "a contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer".

A disclosure requirement would ensure that the existence and terms of a funding arrangement affecting proceeds from the lawsuit are disclosed to the court, and at the discretion of the court, to the opposing party.

In most litigation, the named participants are the real parties in interest. Issues of importance to them will be addressed by the litigation. Both sides know who

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they are litigating against, both sides bear certain risks (notably costs) and the court weighs and addresses the dispute between them. The lawyers acting in a matter go "on record" and openly engage their professional responsibility and liability, and each side's lawyers are known to the court, and to the other parties.

Funders also participate in and have a direct financial interest in a case. Despite this, and the fact that no ethical constraints exist regarding conflicts of interests, the maximum recovery, or their real possibility to influence cases in unseen ways, Funders are subject to no duty to disclose their role or the extent of their involvement to the court.

A funding relationship could be regarded as "champerty" or "maintenance" if it were found to be contrary to public policy, for example, if the Funder were to exercise "excessive control". However, as things currently stand, only the funded party itself would be in a position to raise such an argument. The court can require the disclosure of the identity of a Funder in a case if, for example, security for costs is an issue, but even in such cases the terms of the LFA are not typically required to be disclosed.[66] In the large majority of cases the court will have no indicators that a funding arrangement even exists. Thus, the existence and terms of funding relationships are typically a secret to everyone except the funded party. The degree of control exercised by the Funder, the degree to which any champerty exists, and the degree to which the Funder's interests are prioritized are invisible to opposing parties and the court. Neither the court nor opposing parties have any opportunity to know who the real parties in interest are, nor do they have any opportunity to comment upon, or even know about, the possibility of a case having been maintained in pursuit of an interest other than the one stated.

There appears to be a strong case for the introduction of disclosure provisions that will enable the court to understand who will really benefit from any awards and to ensure that awards have the effect intended by the court: to compensate an injured party, rather than to compensate an undisclosed third party. There appears also to be a strong case for the courts to know whether a contract exists which allows a third party effectively to veto a settlement or which secretly impedes a claimant's ability to comply with any order to try to reach settlement. Furthermore the court should automatically know about funding so that it may properly consider costs issues, for example in determining whether costs security is desirable, or whether compliance with a burdensome disclosure order would be excessive in light of the claimant's actual—as opposed to apparent—resources.

These concerns are not merely hypothetical. In the Chevron case, it was estimated that if Chevron were to settle, only a tiny fraction of any settlement would go to the claimants because of the way the funding arrangements were set up. It was estimated, for example, that if Chevron paid $100 million, the Funders would receive $69 million; lawyers and other advisers would share $22 million; and administrative expenses would take $8 million. That would leave only $1.5 million for the claimants.[67]

Furthermore, the terms of the funding arrangements in that case demonstrate how the existence of funding could prolong litigation. The agreement in that case reputedly sets a higher percentage of recovery for the investors if the case were to settle for less than $1 billion than if it were settled for over $1 billion; thus, the claimants and their lawyers have significant incentive to prolong the case in the hopes of driving up its value.[68]

In addition to ensuring that the court is aware of an LFA and its terms, there should be a presumption in favour of allowing opposing parties to be notified of the existence of a funding arrangement so they know who is on the other side of an action and can, if necessary, make observations to the court. For example, the case for disclosure is particularly compelling in circumstances where opposing parties have observations to make regarding costs, or have reason to suspect that a Funder has interfered with a settlement, or has otherwise exercised inappropriate influence. The party receiving funding should be permitted to argue that the disclosure presumption should be overridden, by demonstrating to the court's satisfaction that disclosure would compromise its litigation strategy, or that there is some other legitimate reason to displace the presumption.

In particular, any disclosure rules should state that the court's discretion should be liberally exercised in favour of disclosure in collective and group action cases, as in these cases the Funder is typically the largest single potential beneficiary of any award, and is far more likely to be the real driving force behind this type of litigation.

While the problematic issues that the court may wish to address might not always be evident from the terms of the LFA itself (e.g. champertous interference could exist through more subtle means), disclosure of the existence and terms of the funding arrangement represents a logical minimum threshold. Without such disclosure, courts have no place to begin to understand the arrangements as they truly are, no opportunity to exercise their supervisory functions over the conduct of litigation, and no means of knowing whether an issue requiring supervision exists.

Compared to the benefits, there appear to be no obvious downsides to requiring parties to disclose the existence and terms of a LFA to the court. Instead, disclosure would allow all parties and the court to deal openly with the different interests in the dispute as they really are, rather than as they appear to be.

Disclosure to the court would give the judge the opportunity to consider and order disclosure to opposing parties, having taken into account objections. For the reasons above, the court should exercise a presumption in favour of disclosure, and this presumption is particularly necessary in group or collective action cases. The ability to raise objections to the exercise of this presumption will allow the court to protect any legitimate interests that Funders or funded parties may have.

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Part III — Possible Types of Oversight

Means of Effective Oversight

It seems evident that inviting Funders to "opt-in" to partial self-regulation is now inadequate in light of the significant growth in the industry, its changing character, its importance to the administration of civil justice in England and Wales, and the reluctance of the majority of Funders to participate in the ALF and be bound by the ALF Code.

This suggests that government and/or legislative action will be required in order to achieve a satisfactory oversight regime.

The two main ways to achieve appropriate oversight include: (a) adopting or amending issue-specific legislation addressing each of the issues raised above; or (b) moving towards a blanket licensing regime.

Issue-Specific Legislation

The possibility exists to address each of the issues above through the adjustment of different existing legal instruments. However, one drawback is that TPLF is an evolving phenomenon which spans the realms of finance, dispute resolution and consumer protection, and so the issues raised do not appear to fall neatly within any single particular item of legislation.

CAPITAL ADEQUACY

The issues surrounding capital adequacy might be addressed within an amendment to LASPO which, *inter alia*, already addresses legal costs issues in relation to DBAs. The difficulty with introducing a legislative capital adequacy requirement is that it may lack the necessary adaptability. Instead, it seems clear that a more flexible decision-maker would be needed to determine and advise on capital adequacy issues on a case-by-case basis.

ETHICS

There does not appear to be any pre-existing legislative framework that could easily be adapted to incorporate oversight of all of the elements addressed above in a comprehensive ethical code. One possibility might be to adapt LASPO to introduce the creation of rules for Funders (just as LASPO authorised the adoption of the DBA Regulations), and for those rules to include minimum terms and conditions that should exist in an LFA. However, even if this were done, one would still need a body to supervise and apply these rules, as ethical issues are not easily supervised in a static way and require case-by-case analysis.

INCENTIVES AND LIMITS ON AWARDS

The options for limiting Funders' potential returns in order to maintain balanced incentives include adjusting LASPO and the DBA Regulations. These already limit the fees that lawyers may charge in litigation, and may therefore provide a logical starting point for equivalent rules for Funders. Lawyers acting under a DBA are limited by the DBA Regulations to 50% of the damages awarded (in most circumstances), and as such, a corresponding limit could be imposed upon Funders.[69] Lawyers acting under a CFA are limited by Article 3 of the Conditional Fee Agreements Order 2013 to a 100% uplift on their fees, and as such, a corresponding limit could be imposed on Funders (i.e. a maximum recovery of 100% of the investment amount, in addition to recovering their investment).[70]

The Consumer Rights Act introduced a collective action regime for breaches of competition law. This regime includes as

an "opt-out" system, meaning that those meeting the definition of claimants in the class can automatically be included in the lawsuit unless they indicate affirmatively that they wish to be excluded. Lawyers are prevented from entering into DBAs (in which they would receive a portion of any recovery) in opt-out collective proceedings.[71] However, this prohibition does not appear to prevent a Funder from entering into an agreement to fund litigation in exchange for a percentage of the outcome in collective actions. There is no obvious logic behind this distinction. Accordingly, an equivalent limitation could easily be inserted into the amended Competition Act 1998, Section 47C to create at the very least parity between solicitors and Funders.

ADVERSE COSTS

Following the suggestions of Jackson LJ, Funders should be exposed to full responsibility for adverse costs. This change could be introduced by legislation, or in the alternative, by rule change. The Senior Courts Act 1981[72] already provides that courts may make an award of costs against a non-party. This may be the appropriate place for a legislative amendment to specify that costs may also be awarded against Funders. Alternatively, Part 44 of the Civil Procedure Rules, which already provides for how and when costs should be awarded in civil litigation, could be changed to clarify that where a costs award is made against a funded party, there shall be no limitation in principle on the ability of the Court to require the Funder to be jointly and severally liable for those costs.

DISCLOSURE & TRANSPARENCY

An adjustment of LASPO could be an appropriate place to consider the imposition of disclosure and transparency obligations in that it already addresses some aspects of litigation funding arrangements. Alternatively, Part 48 of the CPR addresses some aspects of Civil Litigation Funding and Costs and could be amended to incorporate a chapter requiring transparency/disclosure of funding arrangements.

Comprehensive Oversight Solution with Real Enforcement Mechanism

While each of the above piece-meal legislative possibilities could undoubtedly work to address issues with TPLF in important and needed ways, achieving oversight through such means could lead to a disjointed network of rules, and would not create a unified and comprehensive framework. This could lead to significant confusion for Funders, funded parties and courts.

More importantly, a disjointed approach would not lead to any single enforcement mechanism, but would instead rely on the enforcement mechanisms applicable to each of the different acts, regulations and rules. The absence of an effective enforcement mechanism is among the chief failings of the self-regulatory system set up by the ALF. Without oversight, no clear incentive exists to adhere to best practices, and self-interest can lead to detriment to the system as a whole, and funded parties in particular.

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For this reason, a mechanism which is mandatory for all Funders, and requires compliance under pain of sanctions could be preferable. These sanctions could include penalties which are more than symbolic (as is the case with the £500 that can be imposed by ALF), and which could therefore act as a real deterrent to improper behaviour. Ultimately the sanctions available would have to include an ability, subject to due process, to exclude Funders from the ability to provide funding in England and Wales in appropriate cases.

The logical way to achieve these outcomes would be through the introduction of a mandatory licencing regime for Funders, administered and enforced by a single body. This would be superior to a purely rules-based mechanism as having an authorisation body that understands the industry would allow decisions to be dynamic and which can take account of different circumstances. Such a mechanism would also ensure that all relevant Funders are within the supervisory net, and that the activities of Funders could be monitored impartially.

As there is currently no pre-existing statutory regulation of TPLF in the UK, a change in the law would likely be required to create a satisfactory oversight system for TPLF.

Having a single centralised oversight system could have another important advantage: consumer transparency. Such a system would publically identify the Funders that are authorised to operate, thus allowing parties seeking funding to know whether they are dealing with an entity that has complied with the applicable rules. Equally, publishing complaints and decisions imposing any restrictions or penalties upon Funders, or withdrawing their authorisation to act would have clear advantages for consumers and other parties considering whether to enter into an LFA with a Funder. The current voluntary system operated by the ALF has distinct shortcomings in this regard: information is not available about complaints, fines or expulsion decisions, or how any disputes between Funders and funded parties were resolved. This secrecy shields important information from the public and does not allow for fully informed choices about funding relationships.

In terms of which body or agency could take on responsibility, there are at least two options: (a) oversight through existing financial services structures; and (b) oversight through existing structures to supervise legal services.

OVERSIGHT THROUGH FINANCIAL SERVICES STRUCTURES

As TPLF is, at least in part, a form of financial service, oversight through existing financial services structures has some appeal. However, among the issues identified above, some are more obviously within the purview of a financial services regulator than others. So, for example, it might be quite natural for a financial services regulator to supervise capital adequacy requirements, though somewhat less natural to supervise issues such as responsibility for litigation costs, or concern itself with some of the possible policy consequences of unsupervised funding, such as a rise in unmeritorious litigation.

As mentioned above, Jackson LJ considered in 2010 that a voluntary code subscribed to by all Funders would be sufficient as the industry was still nascent. In reaching that conclusion, he considered the regulatory alternatives, and the fact that some issues (such as capital adequacy) were clearly financial services issues, but others were not. He stated "My initial view was that capital adequacy was matter of such pre-eminent importance that it should be the subject of statutory regulation. The natural body to undertake such regulation is the Financial Services Authority (the "FSA"). … I have made contact with the FSA to ascertain whether that body is the appropriate body to monitor the capital adequacy of third party funders. I

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understand that the FSA would not be able to deal with capital adequacy alone. If the FSA takes on a regulatory role, it would undertake full regulation of third party funders, the costs of which would need to be outweighed by the benefits. Hitherto the FSA, as a risk based regulator, has been holding a general watching brief in relation to this area and, on the basis of liaison with the Ministry of Justice, is not aware of any significant risk to consumers".[73]

As TPLF has now reached a sufficient level of maturity to merit oversight, the Financial Conduct Authority ("FCA", which is the successor to the FSA mentioned by Jackson LJ) seems like an obvious candidate to take this on, even if some of the subjects requiring oversight would be outside the usual range of issues considered by the FCA.[74]

In general, the FCA's stated aim is to "make financial markets work well so that consumers get a fair deal. [They] supervise firms to make sure they act in the best interests of consumers and the market."[75]

The infrastructure that would be required for TPLF oversight is already in place. The FCA already supervises various types of institution (credit, investment firms, insurance) and activities (accepting deposits, issuing electronic money, insurance-related activities, mortgage-related activities, and consumer credit regulated activities). For example, the FCA holds a Consumer Credit Register where businesses that lend money to consumers or provide debt solutions and advice to consumers need a licence.[76] Further, there is a similar regime for UK Alternative Investment Fund Managers who manage funds above a certain threshold.[77]

The fact that TPLF raises relatively broad issues and some of these may sit somewhat outside the usual range of activities undertaken by the FCA should not be overlooked. While the structures are adequate, the relevant industry knowledge might not be.

One way to address this is to consider the establishment of a new subsidiary body or unit beneath the FCA with particularised knowledge of the legal services sector and on dispute resolution and Court proceedings.

An example of a similar approach is the Payment Systems Regulator ("PSR") which was introduced as a subsidiary regulator of the FCA on 1 April 2015. This was achieved through an amendment to the Financial Services (Banking Reform) Act 2013 ("FSBRA").[78] The PSR has its own statutory objectives, Board of Directors and Managing Director. FSBRA gives the PSR certain powers such as requiring the payment system to establish or change its rules, and investigate the behaviour of payment systems which is not consistent with the PSR directions. In this way, the PSR has a clear remit to oversee certain payment systems companies, under the guidance of the FCA, but as a separate body.

There seems no reason in principle why a similar arrangement could not be made for the oversight of TPLF.

OVERSIGHT THROUGH THE LEGAL SECTOR

While the issues raised by TPLF might be somewhat unfamiliar to financial services regulators, they are well-known to the legal sector and its regulators.

One alternative may therefore be to treat TPLF as a form of legal service and achieve oversight though the expansion of the mechanisms currently governing the provision of legal services.

There are growing arguments for treating TPLF as a legal service. In particular, there is growing evidence of cooperation and convergence between TPLF providers and law firms. Capital Law, a Cardiff-based law firm, recently launched its own litigation fund as a solution to a more cost-effective means to fighting claims. Capital Law claims that this move was aimed at cutting out third party "litigation middlemen".[79] There is at least one example of a Funder taking up an ABS licence, in effect becoming a law firm.[80] Furthermore, there is another example of a Funder arranging to pay for the opening of a new office of a law firm, in exchange for an agreement of Funder involvement in future claims.[81] More broadly, there is growing evidence of Funders seeking deeper relationships with law firms by indicating their desire to fund case portfolios, rather than individual cases.[82]

The Legal Services Act 2007 is designed to "make provision for the establishment of the Legal Services Board and in respect of its functions; to make provision for, and in connection with, the regulation of persons who carry on certain legal activities...".[83] It thus establishes the Legal Services Board ("LSB") as an oversight body to monitor those who carry out reserved legal services.

The LSB is the general oversight body for the legal profession and sector in England and Wales and has overall supervision of The Law Society and Bar Council, among others. It has an overarching mandate to "ensure that regulation in the legal services sector is carried out in the public interest; and that the interests of consumers are placed at the heart of the system".[84]

Section 1 of the Legal Services Act of 2007 outlines the objectives pursued by the LSB, all of which are entirely consistent with the need to oversee TPLF. These include: "protecting and promoting the public interest; supporting the constitutional principle of the rule of law; improving access to justice; protecting and promoting the interests of consumers; promoting and maintaining adherence to the professional principles". These professional principles are "that authorised persons should act with independence and integrity, that authorised persons should maintain proper standards of work, that authorised persons should act in the best interests of their clients, that persons who exercise before any court a right of audience, or conduct

> *"More broadly, there is growing evidence of Funders seeking deeper relationships with law firms by indicating their desire to fund case portfolios, rather than individual cases."*

litigation in relation to proceedings in any court, by virtue of being authorised persons should comply with their duty to the court to act with independence in the interests of justice, and that the affairs of clients should be kept confidential".

Here "authorised persons" means authorised persons "in relation to activities which are reserved legal activities." This includes "the conduct of litigation" which in turn includes "the issuing of proceedings before any court in England and Wales; the commencement, prosecution and defence of such proceedings, and the performance of any ancillary functions in relation to such proceedings (such as entering appearances to actions)." Although the meaning of "ancillary functions" is ambiguous, the current view of the LSB appears to be that TPLF would not fall within a reserved legal activity definition under the Legal Services Act. However, it would not appear difficult to adjust this definition to bring TPLF within the purview of the LSB.

This would enable TPLF to become a reserved legal activity. In order to be entitled to carry on the reserved legal activity, Funders would therefore need to be authorised by an "approved regulator", subject to compliance with conditions. The Legal Services Act permits the LSB to designate bodies as approved regulators for certain reserved legal activities. It approves, for example, the Law Society, the Bar Council, the Chartered Institute of Legal Executives, the Council for Licensed Conveyancers, the Institute for Trade Mark Attorneys, the Association of Costs Lawyers and the Institute of Chartered Accountants, all of which have functions in authorising or licencing the provision of certain legal services. The LSB could therefore approve a new or existing entity or an industry-created association capable of performing independent functions. It is not impossible therefore that the ALF could evolve into a suitable governing body and seek approval from the LSB, though in its current form it appears to serve more as a representative body for just a small number of Funders, so approval is perhaps unlikely.

Just as has been done with solicitors, barristers and other service providers within the legal services industry, an LSB-approved body would be capable of establishing (subject to LSB guidance) its own mandatory oversight regime, its own conditions, its own code of conduct, and its own disciplinary powers and mechanisms.

The LSB would also be well placed to act as an oversight body in relation to consumer issues as TPLF inevitably expands. The LSB has a Consumer Panel which offers independent insight to the LSB in the interests of those users of legal services.[85] The LSB's strong focus on consumers would guide and aid the TPLF industry in maintaining a balance between profit seeking and protecting consumer claimants.

Notably, the LSB already monitors DBAs[86] as part of its general sectoral oversight functions. It is also noteworthy that the Legal Services Act already governs claims management services, and treats the Claims Management Regulator as an approved regulator for some purposes.[87]

The LSB is therefore well placed to consider TPLF, which shares some features—at least in terms of the risks presented—with claims management services and DBAs.

> *"The LSB's strong focus on consumers would guide and aid the TPLF industry in maintaining a balance between profit seeking and protecting consumer claimants."*

Conclusion

"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".[88]

It is evident that TPLF has a number of shortcomings which derive mainly from the absence of any formal oversight. Whilst TPLF may previously have been exclusively a business-to-business or commercial phenomenon in England and Wales, this is changing, and increasing numbers of smaller and more consumer-focused claims can now be expected. A proactive response to TPLF would avoid the need to introduce reactive legislation, as was the case with the Compensation Act 2006 in response to the claims management abuses.[89]

It is clear that the oversight of the TPLF industry requires a multi-faceted response to tackle its very specific issues: capital adequacy; ethical issues; incentives and limits on recovery; adverse costs; and disclosure and transparency. As outlined above, these issues could be targeted in a number of ways. One option would be piecemeal statutory reform and the introduction of issue-specific legislation.

Another would be to introduce a comprehensive oversight structure with adequate enforcement capabilities by means of an authorisation/licencing structure for TPLF, through which Funders would be required to meet conditions before being authorised to provide funding to litigation in England and Wales. This could be achieved in a number of ways, including through adaptations to existing financial services or legal services oversight mechanisms, as well as by other means.

Endnotes

1 http://www.justicenotprofit.co.uk/wp-content/uploads/2015/09/Final-TPLF-Paper.pdf.

2 *Ibid.*

3 "*Review of Civil Litigation Costs: Final Report*", Lord Justice Jackson, December 2009, https://www.judiciary.gov.uk/wp-content/uploads/JCO/Documents/Reports/jackson-final-report-140110.pdf.

4 Jackson Report, paragraph 2.4, Page 119.

5 Jackson Report, paragraph 2.12, Page 121.

6 See ALF Code at: http://associationoflitigationfunders.com/wp-content/uploads/2014/02/Code-of-conduct-Jan-2014-Final-PDFv2-2.pdf. http://associationoflitigationfunders.com/wp-content/uploads/2014/02/Code-of-conduct-Jan-2014-Final-PDFv2-2.pdf

7 The Association of Litigation Funders, Membership directory, available at: http://associationoflitigationfunders.com/membership/membership-directory/.

8 The Association of Litigation Funders, "about us", available at: http://associationoflitigationfunders.com/about-us/.

9 There is only one public example of the ALF having investigated a Funder and in this case the Funder resigned its membership: http://associationoflitigationfunders.com/2014/04/notice-regarding-argentum-capital-limited/.

10 The Law Society, Access to Justice Review Final Report, November 2010, Page 26.

11 Commission Recommendation of 11 June 2013 on common principles for injunctive and compensatory collective redress mechanisms in the Member States concerning violations of rights granted under Union Law.

12 See, for example, the array of class action cases promoted by just one Funder, IMF Bentham, on its Australian website: http://www.imf.com.au/cases.

13 See: https://www.benthameurope.com/docs/default-source/default-document-library/faqs---tesco-plc.pdf.

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17 See 2015 Annual Report of Burford Capital, available at: http://www.burfordcapital.com/wp-content/uploads/2016/03/25029_Burford_RA_2015_WEB_3.pdf.

18 See: https://www.leighday.co.uk/News/News-2016/March-2016/Leigh-Day-launch-first-UK-class-action-on-behalf-o.

19 For example, Hausfeld & Co. LLP comments: http://www.lawgazette.co.uk/law/new-rules-herald-us-style-class-actions/5048871.fullarticle.

20 Jackson Report, Paragraph 3.4, Page 121.

21 See: http://www.thelawyer.com/funding-fail-argentum-exits-association-of-litigation-funders/.

22 See "Argentum Capital litigation fund financed by £90 m Ponzi scheme": http://www.offshorealert.com/brendan-terrill-argentum-litigation-fund-buttonwood-legal-capital-suspected-ponzi-scheme.aspx.

23 See clauses 9.4.1.2 and 9.4.2: http://associationoflitigationfunders.com/wp-content/uploads/2014/02/Code-of-conduct-Jan-2014-Final-PDFv2-2.pdf.

24 Jackson Report, Paragraph 3.1 and 3.2, Page 119.

25 A corollary can be drawn with the priority given to clients' interests by the Solicitors Regulatory Authority Handbook governing relations between solicitors and clients (see: http://www.sra.org.uk/solicitors/handbook/intro/content.page). For example, this Handbook requires that solicitors ensure that they "treat clients fairly", "provide services ... in a manner which protects their interests in their matter, subject to the proper administration of justice" and that solicitors "only enter into fee agreements … that are legal, and which ... are suitable for the client's needs and take account of the client's best interests". As no mandatory framework applies to TPLF, no such obligations apply to Funders.

26 Nate Raymond, Sean Coffey Launches New Litigation Finance Firm with Juridica Co-Founder, Vows to Move Beyond "Litigation Funding 1.0," The American Lawyer (June 17, 2011).

27 Bentham IMF, Code of Best Practices (Jan. 2014) http://www.benthamimf.com/docs/default-source/default-document-library/code-of-best-practices-final-10-01-14.pdf.

28 See Maya Steinitz, *Whose Claim Is This Anyway? Third-Party Litigation Funding*, 95 Minn. L. Rev. 1268, 1309 (2011).

29 The Legal Services Act 2007 permits non-law firms to provide legal services.

30 See, for example, see: http://www.lawgazette.co.uk/practice/litigation-funder-burford-granted-abs-licence/5053067.fullarticle.

31 See: http://www.legalbusiness.co.uk/index.php/lb-blog-view/4850-hausfeld-to-open-berlin-office-with-30m-investment-from-litigation-funder-burford.

32 See the 2015 Annual Report of Burford Capital, available at http://www.burfordcapital.com/wp-content/uploads/2016/03/25029_Burford_RA_2015_WEB_3.pdf.

33 See: http://www.sra.org.uk/solicitors/handbook/code/part3/rule9/content.page.

34 See the Legal Services Board regulatory Objectives, Paragraph 39: http://www.legalservicesboard.org.uk/news_publications/publications/pdf/regulatory_objectives.pdf.

35 See the Bar Standards Board "Risk Outlook", Page 58: https://www.barstandardsboard.org.uk/media/1751659/bsb_risk_outlook.pdf.

36 *Ibid*. Pages 64 and 65.

37 *Ibid*. Page 62.

38 For just one example, see the Bloomberg.com article "Wild West of lawsuits Funders Supports Divorcees to Soldiers", describing how a Funder (Buttonwood Legal Capital) pulled out of a case after two years leaving the claimant to represent herself at a 2011 trial. Unable to cope, she quit in the middle of the hearing, and was left with legal bills she couldn't pay. See: http://www.bloomberg.com/news/articles/2013-04-08/-wild-west-of-lawsuit-funders-supports-divorcees-to-soldiers.

39 Jackson Report, Paragraph 2.8, Page 119.

40 Jackson Report, Paragraph 2.2(i), Page 118.

41 *Harcus Sinclair (a firm) v Buttonwood Legal Capital Ltd* [2013] EWHC 1193, Ch., see Paragraph 43 and footnote 6.

42 Queen's Counsels will in most cases be independent rather than employed by a law firm and are required by their own professional rules to avoid conflicts of interest.

43 See the 2015 Annual Report of Burford Capital, Page 4, available at: http://www.burfordcapital.com/wp-content/uploads/2016/03/25029_Burford_RA_2015_WEB_3.pdf.

44 In re Rhone-Poulenc Rorer Inc., 51 F.3d 1293, 1298 (7th Cir. 1995) (quoting Judge Henry Friendly).

45 *Excalibur Ventures v Texas Keystone and others* [2013] EWHC 4278 (Comm), at Paragraphs 8 and 14.

46 *Excalibur Ventures v Texas Keystone and others* [2014] EWHC 3436 (Comm), at Paragraph 5.

47 See "Crowdsourcing Comes to the Booming World of Litigation Finance" Bloomberg Business Week, 20 November 2014: http://www.bloomberg.com/news/articles/2014-11-20/lexshares-crowdsourcing-comes-to-the-litigation-finance-world.

48 See Case 1:11-cv-00691-LAK-JCF Document 1874 filed 03/04/14 available at: http://www.nysd.uscourts.gov/cases/show.php?db=special&id=379.

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50 See, for example, Fran Abrams, "No win no fee" catch leaves poor in debt, BBC News Online (22 June 2004): http://news.bbc.co.uk/1/hi/uk/3827419.stm.

51 Page 3 of the Ministry of Justice, Claims Management Regulation: Annual Report 2009/2010, (July 2010): https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/315439/claims-management-regulation-annual-report-2009-10.pdf.

52 See Damages-Based Agreements Regulations 2013: http://www.legislation.gov.uk/ukdsi/2013/9780111533444.

53 A cap of 25% is applicable to personal injury claims and 35% to employment claims.

54 See: http://www.legislation.gov.uk/uksi/2013/689/contents/made.

55 See: Section 47C(8) of the Competition Act 1998, as amended by Schedule 8 of the Consumer Rights Act 2015.

56 *Arkin v Borchard Lines Ltd and others* [2005] EWCA Civ 655, at Paragraph 45.

57 Jackson Report, Paragraph 4.6, Page 123.

58 Jackson Report, Paragraph 4.7, Page 123.

59 See Jackson Report, Paragraph 4.5 of Chapter II, Page 123.

60 *Excalibur Ventures LLC v Texas Keystone Inc* [2014] EWHC 3436 (Comm) at Paragraph 110.

61 ALF Code, Paragraph 6.

62 ALF Code, Paragraph 10.

63 ALF Code, Paragraph 11.

64 Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts.

65 Unfair Terms in Consumer Contracts Regulations 1999, available at: http://www.legislation.gov.uk/uksi/1999/2083/contents/made.

66 The Court has the power to order the disclosure of the identity of the Funder for the purpose of security of costs, but not disclosure of a LFA (Reeves v Sprecher [2007] EWHC 3226 (Ch)).

67 See "Crowdsourcing Comes to the Booming World of Litigation Finance" Bloomberg Business Week, 20 November 2014: http://www.bloomberg.com/news/articles/2014-11-20/lexshares-crowdsourcing-comes-to-the-litigation-finance-world.

68 See Fortune "Have you got a piece of this lawsuit", 28 June 2011: http://fortune.com/2011/06/28/have-you-got-a-piece-of-this-lawsuit-2/.

69 http://www.legislation.gov.uk/uksi/2013/609/pdfs/uksi_20130609_en.pdf.

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71 Pursuant to Section 47C(8) of the amended Competition Act 1998, a "damages-based agreement is unenforceable if it relates to opt-out collective proceedings".

72 Section 51(1) and (3), formerly the Supreme Court Act 1981.

73 Jackson Report, Paragraph 3.1 to 3.2, Page 119.

74 Funders which are registered and based in the UK are already regulated to some extent by the FCA as investment firms (meaning the way that they attract investment into their own fund is regulated). However, the litigation funding as a product itself is not currently subject to oversight.

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78 The Payments Systems Regulator, "Who we regulate" available at: https://www.psr.org.uk/payment-systems/who-we-regulate.

79 http://www.walesonline.co.uk/business/business-news/capital-law-launches-50m-litigation-10813816.

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82 See the 2015 Annual Report of Burford Capital, cited above.

83 The Legal Services Act 2007, available at: http://www.legislation.gov.uk/ukpga/2007/29/contents.

84 http://www.legalservicesboard.org.uk/about_us/.

85 http://www.legalservicesconsumerpanel.org.uk/.

86 See, for example, the LSB's consideration of DBA's here: http://www.legalservicesboard.org.uk/about_us/board_meetings/pdf/13_33_damage_based_agreements.pdf.

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88 Hodges, Peysner and Nurse, *Litigation Funding: Status and Issues Litigation,* Page 120.

89 See, for example, Michael Napier's comments at The Civil Justice Council's (2008) Regulation of Third Party Agreements: https://www.judiciary.gov.uk/wp-content/uploads/JCO/Documents/CJC/Publications/Minutes/CJC+Minutes+of+the+Third+Party+Funding+Conference+on+8th+February+2008.doc.

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