HFW LITIGATION

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BEYOND PACCAR
HOW SHOULD THE ENGLISH LITIGATION FUNDING INDUSTRY NOW PROCEED?

Introduction

The majority UK Supreme Court judgment in R *(on the application of PACCAR Inc and others) (Appellants) v Competition Appeal Tribunal and others (Respondents)* [2023] UKSC 28, 26 July 2023, (Paccar) has come as a surprise to many.

Until now, the litigation funding industry had assumed that Litigation Funding Agreements (**LFAs**) were not Damages Based Agreements (**DBAs**), and, therefore, were not impacted by legislation applicable to DBAs.

However, the Paccar judgment has reversed this common understanding, by concluding that LFAs entitling funders to payment based on the level of damages recovered are unenforceable: (i) if they are used to fund opt-out collective proceedings before the Competition Appeal Tribunal (**CAT**) (as to which see Section 47C(8) of the Competition Act 1998, which states that damages-based agreements are "unenforceable" to the extent they relate to "opt-out collective proceedings" before the CAT); or (ii) "***unless they comply with the DBA regulatory regime***" [**Emphasis added**].

What are Damages Based Agreements?

Section 58AA(4) of the Courts and Legal Services Act 1990 (**CLSA**) states that a DBA will be unenforceable unless it complies with the requirements of the Damages Based Agreements Regulations 2013 (**DBA Regs**).

Section 58AA(3) of the CLSA states that:

> "*(a) a damages-based agreement is an agreement between a person providing advocacy services, litigation services or claims management services and the recipient of those services which provides that—*
>
> *(ii)* *the recipient is to make a payment to the person providing the services if the recipient obtains a specified financial benefit in connection with the matter in relation to which the services are provided, and*
>
> *(ii)* ***the amount of that payment is to be determined by reference to the amount of the financial benefit obtained…***" [**Emphasis added**].

The CLSA refers to Section 419A of the Financial Services and Markets Act 2000 (FSMA) (which replaced Sections 4(2) and 4(3) of the Compensation Act 2006 (CA)) for the definition of a "*Claims Management Service*". This states that:

> "*Claims Management Services*" include "*advice or other services in relation to the making of a claim*"; and
>
> "*other services*" includes the provision of "*financial services or assistance*".

The Judgment

For a case that has already received significant 'airtime' it is notable how simple the conclusions reached in the judgment of Lord Sales are (affirmed by Lord Reed, Lord Leggatt and Lord Stephens, dissenting Lady Rose). There is a logic that suggests that Paccar should not be considered an error.

What was the question before the Supreme Court?

Paragraph 3 of the *Paccar* judgment states:

> *"The specific issue for determination is whether litigation funding agreements ("LFAs") pursuant to which the funder is entitled to recover a percentage of any damages recovered constitute "damages-based agreements" ("DBAs") within the meaning of the relevant statutory scheme of regulation ("the DBA issue"). This depends on whether litigation funding falls within an express definition of "claims management services" in the applicable legislation, which includes "the provision of financial services or assistance". If the*

LFAs at issue in these proceedings are DBAs within the meaning of the relevant legislation, they are unenforceable and unlawful since they did not comply with the formal requirements for such agreements."

Q: *Is litigation funding a Claims Management Service?*

A: *Yes.*

The judgment is primarily concerned with deciding whether litigation finance amounts to a "*claims management service*" within the meaning of Section 58AA(3) of the CLSA. Contrary to prior thinking in the industry, the Supreme Court found that litigation funders are offering financial services, and this is sufficient to make litigation funding a claims management service. Various reasons were given: (i) the language in the CLSA and Explanatory Memorandum to the CA are wide; and (ii) the phrase "*claims management service*" has no established meaning through which this issue must be interpreted, hence giving the Supreme Court a wide discretion.

Q: *What is the meaning of Sections 4(2) and 4(3) of the CA and could interpretation of this superseded legislation nonetheless inform the current question?*

A: *Yes.*

Section 4(1) provides that a person cannot provide *regulated* claims management services unless certain conditions are fulfilled.

Contrary to the findings of the Divisional Court, there was no reason to infer that Sections 4(2) and (3) of the CA were only intended to regulate "*claims intermediaries*". The scheme of the relevant Part of the CA was to regulate "*activities*", not persons of a particular description.

Therefore, in the eyes of the Supreme Court: (i) litigation funding is an activity regulated by the relevant legislation; and (ii) litigation funders are "*claims intermediaries*".

To the extent that any divergence of meaning exists between the CA and 58B of the CLSA, it was determined that the two items of legislation are to be interpreted together. This is because, at the time of enactment of the CA, Section 58B of the CLSA had ceased to be a "*comprehensive scheme of regulation*" for litigation funders.

Q: *Are Sections 4(2) and 4(3) of the CA superior to the CLSA and DBA Regulations?*

A: *Yes.*

The Supreme Court found that the CLSA and DBA Regs are subordinate to the CA because the latter is an Act of Parliament.

Q: *Does the Jackson Review or Association of Litigation Funders' Code of Conduct 2011 effect this interpretation?*

A: *No.*

The Jackson Review endorsed the use of third-party funding in England & Wales. However, in Paccar, the conclusion was that the Jackson Review did not assist with interpreting the relevant provisions of the CA. The majority opinion of the Supreme Court was that the Association of Litigation Funders' Code of Conduct 2011 was irrelevant as it was issued in line with the Jackson Review. In addition, the Supreme Court concluded that the prior assumption by the industry that LFAs could not be DBAs under the legislation was erroneous and irrelevant.

Q: *Are all Litigation Funding Agreements also Damages Based Agreements?*

A: *Probably not. Our opinion is that whether an LFA is a DBA will depend on its terms.*

If a LFA determines the payment to the funder "*by reference to the amount of the financial benefit obtained*" then that LFA is a DBA. By extension, that LFA / DBA must comply with all the procedural steps that are required for a DBA to be enforceable.

In our view, any LFA where the return is calculated based on a percentage of the damages or settlement is caught. Any LFA where the return is on a 'ratchet' calculated by reference to the quantum of damages is also likely to be considered a DBA.

The questions arise as to whether LFAs where the investors fees are calculated based on a multiple of the investment made but capped by reference to a percentage of the overall damages may also be caught by *Paccar*.

Paccar's Breadth of Impact

For litigation funders operating in the UK perhaps the most immediate thoughts will turn to: (i) whether Paccar applies to their business and disputes they have funded or might fund; and (ii) consider how their LFAs can comply with the DBA Regs in the future.

What is Paccar's jurisdictional scope of effect?

If the LFA is governed by the law of England & Wales and the dispute is before an English Court (or English seated arbitration) then we consider it clear and logical that Paccar will apply.

However, what if the governing law of the LFA is English law, but the dispute is before a court of another jurisdiction? What if the LFA is governed by non-English law but the dispute is before an English Court?

In a case before the English Courts, where the underlying contract is governed by a non-English governing law, the English Courts usually hear that case based on expert evidence of the foreign law. This may lead to a situation where the foreign law position on litigation funding is applied by the English Court. However, if the foreign law is silent on the matter, it may be that the English Court is left with no choice but to fall back on English law to determine the dispute.

How a non-English court would hear a case where the underlying contract is governed by English law would be a matter for the procedural rules of that court. However, it is possible that where a non-English court determines a case according to English law, it would apply Paccar.

Thus, the effects of *Paccar* may be felt more widely than one might first imagine.

Does Paccar impact funding of arbitral disputes?

It is unclear under English law the extent to which the laws regarding third-party funding of cases before an English court are applicable to arbitration. Without judicial guidance on this point, most arbitration practitioners have adopted a conservative interpretation, and have applied the English law regarding third-party funding to English-seated arbitration. This approach was broadly validated in *Diag Human SE and Mr Josef Stava v Volterra Fietta* [2022] EWHC 2054 (QB).

Given that there are already questions as to whether the third-party funding regime in England & Wales applies to arbitral disputes, it is possible that some funders may take the view that *Paccar* does not apply to English seated arbitration. However, we anticipate that many funders will adopt a cautious approach to the matter, and proceed on the basis that *Paccar* does apply to English seated arbitration.

Past LFAs, Current LFAs, and funding of future disputes

Legal analysis aside, the crux of the matter for litigants and funders will be the commercial realities that exist in a post-*Paccar* world. We consider that *Paccar*'s impact falls into three categories: (i) funded disputes that have concluded, where the LFA is considered to be a DBA and was in breach of the DBA Regs; (ii) funded disputes that are ongoing, where the LFA is considered to be a DBA and is in breach of the DBA Regs; and (iii) future funded disputes that will go before the English courts or are English-seated arbitration.

Conceivably, the most complex situation to untangle will be those cases where the dispute has ended, an award or settlement distributed, and now, following *Paccar*, the applicable LFA is considered to be a DBA and where funds have already been distributed and basis on which funds were distributed were in breach of the DBA Regs.

We are anecdotally aware of several parties that availed themselves of litigation funding, received a profitable return, and the litigation funder took a share of those profits under an LFA which would now be considered invalid, who are already reviewing their legal positions.

Indeed, it may be the case that there is a fiduciary responsibility on parties (e.g. Boards of Directors or Liquidators) to consider whether they should seek recourse against their third-party funder. Of course, considering it is not the same as deciding to pursue it, but legal obligations may make claims following Paccar more likely. We anticipate that there will also be at least some opportunistic parties that envisage an opportunity to 'claw back' amounts paid to their funder.

However, there may be one or two practical reasons which may limit the number of cases brought by potential claimants. Parties that needed litigation funding in the first place may not be in a strong enough financial position to launch a further claim. They may also be suffering sufficient litigation fatigue, or simply not regard further hardship as being worth it, if they have already obtained an award that they are happy with.

One must also question whether litigation funders will be keen to finance claims against other litigation funders. Litigation funders co-fund cases with each other regularly and we suspect that some funds would hesitate before funding a case against their colleagues.

Litigation funders are also well capitalised and sophisticated entities. At face value this might make them an attractive target. However, potential claimants may also be wary of a defendant that is more than capable of putting up stiff opposition. In addition, cases may have been funded out of sub-entities that have subsequently been liquidated and funds distributed, further complicating the issue.

This may mean that claimants will find it very difficult to pursue claims against their funder. In these circumstances, claimants may instead file claims against law firms who advised them on the meaning and content of their LFA. Law firms should be considering their possible exposure to this type of claim and preparing themselves to manage issues arising, including notifying their insurer.

In cases that are ongoing, parties are going to have to review the LFAs that govern their funding relationships. It may be the case that funding provisions are now partly or entirely in breach of the DBA Regs and they are partly or

entirely unenforceable. Many LFAs will contain provisions on severability, so to the extent that any LFA is now partly unenforceable, those terms will be struck out and the remaining terms of that LFA will remain.

Where an existing LFA does need to be re-negotiated one would hope that the funder and funded party are sufficiently aligned in their aims that they can agree to amendments that make it legally compliant. In addition, parties may not want to be distracted from their ongoing dispute, by side-issues around the terms of their LFA. Of course, reaching agreement may prove challenging for some, as the matter strikes at the heart of what both parties care about most – their financial return.

Looking forward, the question becomes; how hard is it to comply with the DB Regs? If very challenging or uncommercial then funders may be deterred from entering the English funding market for fear their LFAs will be in breach of Paccar. If relatively easy, then *Paccar*'s impact may be limited to past and ongoing LFAs that are in breach of the DB Regs.

In simple terms, the DBA Regs provides that:

> "*The terms and conditions of a damages-based agreement must specify—*
>
> *(a) the claim or proceedings or parts of them to which the agreement relates;*
>
> *(b) the circumstances in which the representative's payment, expenses and costs, or part of them, are payable; and*
>
> *(c) the reason for setting the amount of the payment at the level agreed, which, in an employment matter, shall include having regard to, where appropriate, whether the claim or proceedings is one of several similar claims or proceedings*."

The DBA Regs also contains a cap on the percentage of damages that can be taken by a litigation funder (in some cases 50% net of costs) and a methodology as to how that cap is to be calculated.

In reality, then, the DBA Regs are not overly onerous. They are, in fact, conditions that in our opinion broadly make good sense.

However, we should reflect on one thing. A cap on damages may at first glance look to be totally beneficial to the claimant. But the reality of any cap is that some cases will not be capable of funding as a result of such a cap. A case with the same quantum of costs but a lower expected quantum of damages will at some stage breach the cap, thereby making some cases non-fundable thereby blocking their access to justice. An unintended consequence or a necessary claimant protection?

How does Paccar impact the litigation funding industry more widely?

As we have already noted, Paccar certainly applies to cases before the English courts, and probably to English seated arbitration. There may be disputes where the substantive law of the dispute is English law but that dispute is heard before the court of another jurisdiction or before an arbitral tribunal seated outside of England & Wales.

Some words in the dissenting judgment of Lady Rose in Paccar should be referred to on this topic. Quoting Ms Dunn, chair of the Association of Litigation Funders:

> "*These consequences will extend to all or most litigation funding agreements that have been agreed since litigation funding began in England and Wales. This would be massively damaging both for the administration of justice in relation to the existing cases which involve funding by litigation funders, and the future access to justice of parties who would otherwise have employed litigation funding agreements to fund their cases. It would bring to an abrupt end hundreds of funded claims with potentially catastrophic financial consequences for all involved in the case. It would have a major impact on the development of group litigations before the English Courts…*"

Time will tell whether these concerns are well founded.

Conclusion

Paccar itself is a relatively simple case, with clear outcomes:

- it has not created new law. It is a clarification and restatement of the existing law;
- litigation funders are offering financial services, and this is sufficient to make litigation funding a claims management service;
- crucially:
  - if a LFA determines the payment to the funder "by reference to the amount of the financial benefit obtained" then that LFA is a DBA;

    that LFA / DBA must comply with all the procedural steps that are required for a DBA to be enforceable; and.

- in our view, any LFA where the return is calculated based on a percentage of the damages or settlement is caught. Any LFA where the return is on a 'ratchet' calculated by reference to the quantum of damages is also likely to be considered a DBA

The complexity of *Paccar* perhaps really lies in its effect. It will, no doubt, cause funders and their clients to review past, present, and future funding agreements.. We anticipate that it will lead to a spate of disputes the majority of which will be brought by parties who were formerly clients of litigation funds against those funds.

We are already aware of the matter of *Therium litigation Funding v Bugsby Property* [2023] EWHC 2627 (Comm), where the English High Court has granted Therium (a litigation funder) a freezing order against its client (Bugsby), where Bugsby refused to pay Therium following an award of damages on grounds that the LFA between Therium and Bugsby was no longer valid pursuant to the judgment in Paccar.

The LFA in issue provided for three types of payment to be made by the funded party to the funder: (i) return of the investment sum; (ii) a return calculated as a multiple of that funding; and (iii) a return calculated as a percentage of the damages / settlement sums above a certain threshold. Therium argued, relying on *Zuberi v Lexlaw* [2021] EWCA Civ 16, that a DBA is not the entire retainer but only those provisions that deal with payment of recoveries.

Whilst the Court found that the third type of payment was unenforceable (in line with Paccar) it also concluded that there was a "*serious issue to be tried*" (*per American Cyanamid*) as to whether the entire LFA was unenforceable or whether the provisions were several. No doubt this case will be watched by the litigation funding industry with much interest.

In addition, hidden in the Digital Markets, Competition and Consumers Bill currently going through Parliament, is an amendment that will effectively permit LFAs provided by litigation funders in the Competition Appeal Tribunal. However, it is recognised that even this amendment does nothing to address the uncertainty in relation to funded cases outside the CAT. Even with this proposed amendment there are still question marks over the timing of its implementation and even greater uncertainty as to when or if the Government will turn its attention to the wider issue. It is a rather unhelpful case of “watch this space”.

We do not believe that *Paccar* will end litigation funding in England & Wales. Far from it. Litigation funders have often demonstrated adaptability and we believe this will continue. But adapt they must.

The industry may well see *Paccar* as an inflexion point. A moment where it recognises that some parts of this industry need to improve. We may all like to see new legislation to clarify the current legal position, however with a crowded legislative agenda and with a general election due to take place in the next 14 months or so, we shouldn’t be holding our breath.

Now may be the time for a new regulatory body, truly independent from the litigation funders, properly empowered to manage the industry. However, if this required legislative input then, as stated above, that may not be happening any time soon. The industry may also be assisted by a development of a standard form LFA (or set of, for different circumstances) that is compliant with Paccar.

The Paccar case is a moment for the litigation finance industry to reflect. To be better than it is today, better for litigants, better for all stakeholders. It is an opportunity that should be grasped.

This note is not legal advice. It is the view only of the writer. Readers of this note should be taking their own independent legal advice to review the case findings and conclusions.

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