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Does Santa Claus exist? Litigation funding revisited.

By Ryan Deane

Introduction

In the recent case of *R (on the application of PACCAR Inc & Ors)* v *Competition Appeal Tribunal & Ors* [2023] UKSC 28, the Supreme Court ruled that a litigation funding agreement (**"LFA"**) under which the funder is to receive a percentage of any damages recovered by the funded party is a damages-based agreement (**"DBA"**) within the meaning of s58AA Courts and Legal Services Act 1990 (**"CLSA"**). As a result, the majority of existing LFAs governed by English law became instantly unenforceable, prompting a likely reshaping of the litigation funding sector in this country**.**

Background

The origin of these proceedings follows from a finding by the European Commission in 2016 that five European truck manufacturers infringed competition law. Following on from the European Commission's finding, the Road Haulage Association Ltd (**"RHA"**) and UK Trucks Claim Ltd (**"UKTC"**) sought an order from the Competition Appeal Tribunal that would authorise them to bring collective claims for damages on behalf of purchasers of trucks from these manufacturers.

RHA and UKTC obtained litigation funding, in which the funders' compensation was calculated by reference to a share of the damages recovered in the litigation.

The truck manufacturers argued that these agreements were DBAs and were hence unlawful and unenforceable because they did not comply with the statute that regulates DBAs, namely the Damages Based-Agreements Regulations 2013. That argument turned on the wording of section 58AA of the CLSA, following a complex history of legislative amendments. Sections 58AA(1) and (2) provide:

> "*(1) A damages-based agreement which satisfies the conditions in subsection (4) is not unenforceable by reason only of its being a damages-based agreement.*
>
> *(2) But … a damages-based agreement which does not satisfy those conditions is unenforceable.*"

The CLSA therefore provides in clear terms that if a DBA does not satisfy certain conditions, it will be rendered unenforceable. How exactly is a DBA defined? Section 58AA(3) provides the answer:

> "*(3) an agreement between a person providing advocacy services, litigation services or claims management services and the recipient of those services which provides that—*

> *(i) 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*".

This is an important provision because it was generally accepted in the litigation funding industry that funders could not be party to a DBA because they neither provided advocacy, litigation or claims management services. With regard to the latter, section 58AA(7) states:

> *(1) In this Act "claims management services" means advice or other services in relation to the making of a claim.*
>
> *(2) In subsection (1) "other services" includes—*
>
> *(a) financial services or assistance, …*

Taking the relevant parts of the provisions together, the result is that a DBA includes:

> "*an agreement between a person providing financial services or assistance, in relation to the making of a claim, and the recipient of those services which provides that—*
>
> *(i) 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*".

The truck manufacturers argued that what has become a common form of litigation funding agreement is a DBA because it involves the provision of financial assistance "*in relation to the making of a claim*" with the funder receiving a share of any damages.

The Competition Appeal Tribunal and the Divisional Court each dismissed that argument, finding that to be within the definition, "*claims management services*" must be provided in the context of the management of a claim. Although litigation funders undeniably provide financial assistance, they did not do so within the context of claim management. Giving judgment in the Divisional Court, Henderson LJ concluded that it is:

> "*… entirely natural to read the words of the definition as both coloured and conditioned by the reference to 'claims management' in the phrase which is being defined, so that the 'advice or other services in relation to the making of a claim' must be understood as referring to advice or other services of a claims management nature, or having to do with the management of a claim, and the reference in subsection (3)(a)(i) to the*

> *provision of financial services or assistance should likewise be read as referring to the provision of such services or assistance in the context of claims management.*"

The result was that conventional LFAs were held not to be "*damages-based agreements*" for the purposes of the CLSA and so were not rendered unenforceable by it, with the result that the objection to the continuance of the collective proceedings against the truck manufacturers failed. Following that decision, the truck manufacturers appealed to the Supreme Court.

Supreme Court's decision

The Supreme Court allowed the appeal by a 4-1 majority. Lord Sales gave the leading judgment, in which he comprehensively dismissed the analysis of the Divisional Court and concluded that the litigation funding arrangements in issue in *PACCAR* fell within the definition of a DBA in section 58AA. Lord Sales' reasoning can be reduced to four core points.

First, the words of the statute "*read according to their natural meaning*" cover funding arrangements such as those in issue in *PACCAR*.

Second, when the legislative scheme of the CLSA is understood, what Parliament intended to do was "*to create a broadly framed power for the Secretary of State to regulate in this area*" with the Secretary of State able "*to decide what targeted regulatory response might be required from time to time as information emerged about what was then a new and developing field of service provision to encourage or facilitate litigation, where the business structures were opaque and poorly understood at the time of enactment*".

There was therefore no basis to read-down the words of the statute in the way the Divisional Court had done. Lord Sales concluded:

> "*The textual and contextual indicators from the* [CLSA] *itself clearly lead to the conclusion that the definition of 'claims management services' is meant to be wide and is not intended to be coloured by the notion of 'claims management', which is simply inapt to qualify the various aspects of the express definition of the phrase which Parliament has used. I do not regard this as a case where there is any ambiguity about this.*"

Third, while there might be nothing objectionable in principle about litigation funding on what has become the conventional model, it does not follow that Parliament must have intended to leave such arrangements outside the scope of the definition because:

> "*… evidence might emerge of third party funders extracting more than a reasonable share of the recovery, in which case regulation would plainly be fairly and squarely within the purpose of the power in* [the CLSA]*, to protect consumers of such services. Moreover, there might be an element of bundling financial services together with other services as part of an overall package offered to a potential litigant, or the funding*

> *provided might be used to pay the fees of other service providers, or the person providing the financial assistance might pay a referral fee to a person promoting the litigation, any of which might require the regulatory power under section 4 to be exercised.*"

Fourth, none of the above was affected by the fact that many LFAs have been concluded on the basis that they did not fall within the statutory definition of a DBA. As Lord Sales put it:

> "*Participants in the third party funding market may have made the assumption that such arrangements are not DBAs and hence are not made unenforceable by section 58AA(2). But this would not justify the court in changing or distorting the meaning of "claims management services" as it is defined in the statute.*"

In the context of the *PACCAR* case, this meant that the funding arrangements entered into by RHA and UKTC were DBAs. It was undisputed that the agreements did not satisfy the conditions for enforceability set out in the Damages Based-Agreements Regulations 2013, meaning that the funding arrangements were unenforceable. This in turn meant that proceedings against the truck manufacturers in the Competition Appeal Tribunal, which requires applicants to have adequate funding arrangements in place, could not continue.

Comment

The Supreme Court noted that the majority of LFAs currently in force provide for funders to receive payment based on the amount of damages recovered. Most of these are now likely to be unenforceable, as they were not drafted with the conditions of the Damages Based-Agreements Regulations 2013 in mind. That is so even in cases where the LFA stipulates that the funder's entitlement to payment is conditional on other requirements being met. As long as the funder's remuneration is determined by reference to damages recovered, it will constitute a DBA.

As the Supreme Court observed in *PACCAR*, the common law was historically hostile to arrangements for third parties to finance litigation between others. While there has been a substantial shift over the last 30 years in England and Wales, not least because the effectiveness of group litigation may depend on the use of third-party funding, DBAs at least on one view remain "*islands of legality on a sea of illegality*" (*per* Lewison LJ in another case involving DBAs, *Zuberi* v *Lexlaw Ltd* [2021] EWCA Civ 16).

On any view this decision is a serious blow for litigation funders. Susan Dunn, Chair of the Association of Litigation Funders submitted the following by way of intervention in the PACCAR case:

> "*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 to hundreds of funded claims with potentially catastrophic financial consequences for all involved in the case …*"

Whether the consequences will be as catastrophic as predicted remains to be seen. However, in future, litigation funders are likely to structure their LFAs in a manner that avoids linking their entitlement to payment to the amount of any damages recovered. For example, payment could be structured as multiples of the amount invested. However, such arrangements traditionally provide for a lower return to funders rather than LFAs based on a percentage of damages.

In cases where funding arrangements are already in place but proceedings are at an early stage, funders will likely move to replace existing agreements with alternative arrangements. In cases where proceedings have been ongoing for an extended period of time, even if it is possible to replace existing arrangements on a forward-looking basis, historical legal spend may prove difficult to recover, and returns on that spend even harder. This could leave some funders sitting on significant losses.

In the short term, the Supreme Court's ruling is likely to prompt a period of reflection among funders and claimant law firms alike. While it is unlikely to spell the end of funded litigation before the English courts, it has certainly sent shockwaves through a sector which, at least prior to the ruling, offered investors opportunities to generate very substantial returns if they were willing to take the appropriate risk.

Government action?

This decision of the Supreme Court was only possible as a result of the government deciding not to introduce the draft Damages Based Agreements Regulations 2019 drafted by Professor Rachael Mulheron and Nicholas Bacon QC following a request by the Ministry of Justice for them to review the existing regulations. Their draft regulations had expressly provided that an LFA is not a DBA.

In light of the Supreme Court's decision, it is likely that any change would now require primary legislation. There are some signs that the government may do just that and revert to the status quo, no doubt wanting to protect the UK's position as a centre of international commercial litigation.

After the *PACCAR* decision the government hinted at possible legislative intervention to blunt its effects, stating that it would be looking at all available options to bring clarity to interested parties. On 15 November 2023, the Secretary of State for the Department of Business and Trade tabled an amendment to the Digital Markets, Competition and Consumers Bill 2022-23 that was said to "respond to" the PACCAR decision.

Litigation funders and their clients will be anxiously waiting on the results of any such government intervention.