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Third-Party Funding: Treading on Thin Ice?

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Third-Party Funding ("**TPF**") has emerged as a parallel industrial complex in the modern dispute resolution landscape. Parties routinely enter into Arbitration/ Litigation Funding Agreements ("**LFA**") with third parties, based on both conditional fees and damages-based remuneration models, seeking financial services in relation to advocacy, litigation, or claims management. The increasing popularity of the industry can be accredited not only to its commercial viability especially in contentious commercial arbitrations, as evidenced by a ten-fold increase in funders' assets in the United Kingdom ("**UK**") alone, a whopping £ 2.2 billion over the past decade, but also to its stead-fast socio-legal acceptability as a tool for enabling access to justice as well.

Initially, TPF was met with scepticism, and was excluded on grounds of public policy and to avoid unwarranted interferences with the process of justice. Acceptance came gradually; LFAs which did not entail wanton meddling with the process of justice or did not accord disproportionate control or profits to third parties, were deemed to pass the litmus test of maintenance and champerty rules. International and domestic arbitrations guided by principles of party autonomy and addressing commercial interests of private parties, naturally became the most lucrative and acceptable forums for introducing TPF. A typical look of courts attempting to balance commercial and social values of TPF was seen in the landmark case of *Excalibur Ventures LLC v. Texas Keystone Inc (no. 2)*. While on one hand, TPF was acknowledged as a judicially sanctioned activity in public interest, on the other hand, joint and several liability was enforced upon inexperienced funders for adverse indemnity costs.

However, the UK Supreme Court ("**Supreme Court**") in the most recent development in *R (on the application of PACCAR Inc and Others) v. Competition Appeal Tribunal and Others* has delivered a blow to TPF by holding that LFAs wherein the funder's remuneration was in the form of a share in the damages recovered through the claim, constituted Damages Based Agreements ("**DBA**") within the meaning of Section 58AA of the Courts and Legal Services Act, 1990, and thus, unenforceable. The Supreme Court reversed the findings of the Competition Appeal Tribunal ("**CAT**") and the Court of Appeal (Civil Division) ("**Divisional Court**") which had come to a contrary conclusion. To borrow from the CAT's observations, the resultant implications for litigation funding are stark. Damocles' sword now lingers over the industry, and a review of the LFAs currently in place is critical. This blog post discusses the decision and its implications.

The CAT and Divisional Court Judgment

The controversy emanated from the decision of the European Commission holding that a group of five European truck equipment manufacturers ("**Manufacturers/Respondents**") had engaged in cartel-like anti-competitive activities by, *inter alia*, exchanging information on future gross prices. Two class representatives ("**Applicants**") filed applications for damages before the CAT. The Respondents advanced a two-fold argument against the application:

- The Applicants entered into LFAs and After-the-Event insurances ("**ATE**") with third-party litigation funders for the "provision of financial services or assistance" "in relation to the making of claim." Accordingly, the services of the litigation funders constituted "claims management services" under Section 4 of the Competition Act, 1998. Further, the LFA's payment was determined by reference to the quantum of damages recovered by the Applicants. Therefore, these LFAs constituted DBAs under Section 58AA of the Courts and Legal Services Act, 1990.
- The DBAs were in turn unenforceable since they (i) did not comply with the Damages-Based Agreements Regulations, 2013; and (ii) related to opt-out proceedings which are in any case statutorily deemed unenforceable under Section 47C (8) of the Competition Act, 1998.

The CAT engaged with each of these submissions directly. However, the present analysis concerns the first submission only, relating to the (i) legal position of TPF agreements and (ii) whether LFAs constitute DBAs. At the outset, the CAT observed that the statutory provisions relating to TPF, LFAs, and DBAs were envisaged by the legislature to protect consumers/litigants from the exploitative activities of claims management service providers.

In this context, CAT held that provision of "financial services or assistance" in relation to the "making of claim," could not be equated with a much larger role envisaged for "management of a claim." While financial services such as assisting with the purchase of insurance or loans could be a befitting example of claims management, services such as lending of money to the borrower to fund litigation could not constitute an act of claims management. Any interpretation to the contrary would yield an absurd or impracticable result. In similar vein, since litigation funders were only engaged for the limited objective of funding of a claim and not the management of the claim *per se*, LFAs could not be covered within the ambit of DBAs. Therefore, they were enforceable and compliance with the Damages-Based Agreements Regulations, 2013 was not required.

This decision was also upheld by the Divisional Court in a judicial review proceeding initiated by the Respondents. The CAT and the Divisional Court by applying a strict and restricted meaning to "claims management services" upheld the enforceability of TPF agreements. However, the Manufacturers, dissatisfied with the decision, filed an appeal directly before the Supreme Court.

The Supreme Court Judgment

The Supreme Court overturned the lower courts' decisions and allowed the appeal. Speaking through Lord Sales, the Supreme Court in a 4:1 majority judgment held that LFAs fall within the broad legislative definition of "claims management services" and therefore, are covered under the category of unenforceable DBAs.

The Supreme Court's reasoning was largely founded on a liberal interpretation of the statute. The Supreme Court held that the words "claims management services" appearing in Section 4(2) of the Competition Act, conveyed a natural meaning broad enough to cover LFAs within its ambit. Lord Sales stated: "Where Parliament has taken the trouble to provide a definition, it is the words of the

definition which are the primary guide to the meaning of the term defined."

Section 4(3)(a) which defined the terms of "the provision of services" included a non-exhaustive list of very broad items, which did not link provision of such services to any power of management of a claim. Thus, the Supreme Court held that the explanation to "claims management services" in the statue – "advice or other services in relation to the making of a claim," was fairly broad and could not be restricted to the service of active management of a claim, only. The Competition Act in general does not expressly restrict or limit the provision of claims management services. Thus, the Supreme Court's decision turned on the textual legislative intent which led to the conclusion that "claims management services" was an umbrella term which encompassed an unfettered and broad range of services. As such, the notion of "active case management" would not qualify the wide and express definition set out in Section 4(2) and (3).

In a dissenting judgment Lady Rose while agreeing with the lower court's decision opined that TPF was never intended to fall under the ambit of "claims management services."

Inevitable Implications: Where Are We Headed?

The Supreme Court's decision on enforceability of LFAs has far-reaching consequences. At a first glance, most LFAs in "opt-out" collective proceedings as they stand today may now be deemed unlawful and unenforceable (since most LFAs in the market do not meet the pre-requisite conditions of an enforceable DBA). Practically, all LFAs where the funder's returns are calculated based on the claimant's recoveries are now deemed as unenforceable DBAs in the UK, until they comply with the DBA Regulations. Alternatively, to escape the DBA conundrum, funders may be interested in restructuring existing LFAs on the basis that their returns from the LFA are a multiple of the amount funded rather than a percentage share of damages secured by the litigant. However, such funders would face the risk of litigants refusing to both, making payments under the unenforceable LFAs, as well as signing re-structured LFAs. The funding industry may also lobby with the government to seek changes to the definition of DBAs in the UK or the DBA Regulations itself, expressly exempting LFAs from statutory restrictions.

While LFAs must now comply with the restrictive DBA regime in the UK, several other jurisdictions have increasingly started opening-up to TPF. For example, in 2017, Singapore and Hong Kong introduced it in some court proceedings and arbitrations. In 2023, Ireland brought in reforms allowing the same in international commercial arbitrations. TPF has also received favorable impetus in the 2017 High Level Committee Report for Institutionalisation of Arbitration Mechanism in India. Notably, as discussed in a previous post here, the Delhi High Court very recently in *Tomorrow Sales Agency Private Limited v. SBS Holdings, Inc. and Others* recognized the validity of TPF in arbitrations and called upon the government to formulate rules governing aspects such as transparency and disclosure of TPF. Greater acceptability of TPF in arbitrations can also be evidenced by the express incorporation of TPF in numerous institutional arbitration rules such as the 2021 ICC Arbitration Rules, 2017 SIAC Investment Arbitration Rules, 2018 HKIAC Administered Arbitration Rules etc. Even within the UK, the England and Wales High Court on past occasions, such as in *Essar Oilfields Services Ltd. v. Norscot Rig Management Pvt. Ltd.*, awarded TPF costs in arbitration proceedings under Section 59 read with Section 63 of the Arbitration Act, 1996.

Over time, TPF has encouraged parties, who otherwise may be deterred by the rigorous, dynamic, and cost-intensive nature of dispute resolution, to actively explore arbitration especially for resolving portfolio claims. The inherent commercial nature of arbitration works equally well for third-party funders who decide on funding after carefully considering the likelihood of success and recovery of monies, thus sifting out frivolous claims. The institutional arbitration rules also subject TPF to requirements of disclosure and transparency, capital adequacy, control, and party autonomy etc., ensuring that TPF is regulated with appropriate checks and balances in place, and that in practice it meets the legitimate aims which it seeks to achieve. However, the recent ruling catapults the industry back to the days of suspicion and concerns of maintenance and champerty.

It is evident that TPF of disputes will keep evolving around the globe. However, the contractual uncertainties and bottlenecks will have to be addressed over time both by way of legislative amendments as well as judicial precedents, lest TPF will play only an underwhelming and unpredictable role in the justice-delivery system.

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