## A British Roadmap to Protect Consumers, SMEs and Other Parties in Funded Legal Actions

JUNE 2024

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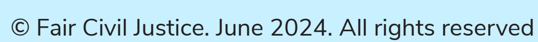
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This paper is a thorough update of a paper initially published in 2016 by the U.S. Chamber of Commerce Institute for Legal Reform.

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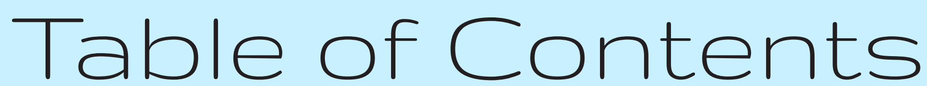



Introduction ........ 2

Part I - Development of TPLF and Current Regulatory Landscape ........ 6

Part II - Ethical and Practical Issues of TPLF ........ 11

Part III - Potential Safeguards ........ 25

Conclusion ........ 29

# Introduction

**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 a fee payable from the proceeds recovered by the funded party.**

The UK now plays host to more TPLF providers than any other country, and the industry has grown at an astonishing rate in recent years, with assets under management in the billions of pounds.

Advocates for TPLF routinely tout it as a means to facilitate "access to justice". However, such terminology masks the reality that TPLF can itself lead to highly unjust outcomes. Victims of wrongdoing can end up with little or nothing when funders capture most or all of settlements or awards. Litigation, and the pursuit of justice, can be distorted when the dominant interest becomes the funder's financial returns.

Regrettably, the UK Government appears to have an instinct towards the ever-greater facilitation of TPLF. The government's recent announcement of technical legislation to reverse the outcome of the Supreme Court's PACCAR ruling in Summer 2023 (which declared certain features of some funding agreements illegal) was accompanied by a press release stating that the legislation was "to make justice more accessible for innocent people wronged by powerful companies" and to "make it easier for members of the public to secure the financial backing of third parties when launching complex claims against moneyed corporations…".[1]

Specifically, the Government's press release cited the case taken by the former sub-postmaster Alan Bates in *Alan Bates & Others v Post Office Limited* ("Bates"),[2] which was financed through litigation funding, as the inspiration for moves to facilitate TPLF, saying that "the post-masters' claim was only possible due to the backing of a litigation funder". In fact, the *Bates* case is itself an example of the dangers TPLF can pose to funded parties.

In that case, 555 sub-postmasters led by Mr. Bates initiated litigation (through a Group Litigation Order or "GLO") backed by TPLF. During the case, the post-masters said they "had no other option but to accept" a settlement, due to the funders' actions, despite their desire to fight on for the justice they claimed.[3] These settlements, which the post-masters said were agreed under duress,[4] were described as "full and final", and excluded those in the GLO from any further possibility of claim or compensation. From the GLO settlement, the funder and advisors took £46 million from a circa £58 million total payment (almost 80 percent), leaving the funded claimants with on average £20,000 each, far less than their losses and what they expected.[5]

**Litigation, and the pursuit of justice, can be distorted when the dominant interest becomes the funder's financial returns."**

The Post Office paid the settlement, but upon learning of the funder's share, even they argued it was unfair and "urged the Government to address this unfairness".[6] The funder's fee was nearly £24 million, equating to nearly £45,000 per sub-postmaster. The funders point to this case to illustrate how they facilitate access to justice, but given the funders received more than double the sum the claimants received, access to justice will feel hollow for the sub-postmasters.

Separate from the GLO, a compensation scheme was created for victims of the same post office scandal. Victims who had not participated in the GLO, and who had never become involved with funders in the first place, were able to access this scheme and receive compensation. However, those that had participated in the GLO were excluded, because their settlements had extinguished their claims. In other words, those that had signed up for TPLF and participated in the GLO (a) had been forced to settle, (b) had 80 percent of their settlement taken by funders and advisors, and (c) ended up, years later, worse off than if they had never litigated at all.

Consequently, the Government was required to announce plans for a further redress scheme from taxpayers' money, specifically to offer supplemental

payments to the victims of the Post Office scandal that had participated in the GLO using TPLF. The Government webpage describes the purpose of the scheme as follows: "Much of the agreed GLO settlement monies went to the firm which funded the litigation, leaving those postmasters worse off than their peers who qualified for the HSS [the scheme for those who had not been funded]. The Government has long considered unfair the unequal treatment received by members of the GLO, which is why on 22 March 2022, the Chancellor announced that the Government would make funding available to ensure that they received similar compensation to that given to their non-GLO peers in similar circumstances."[7]

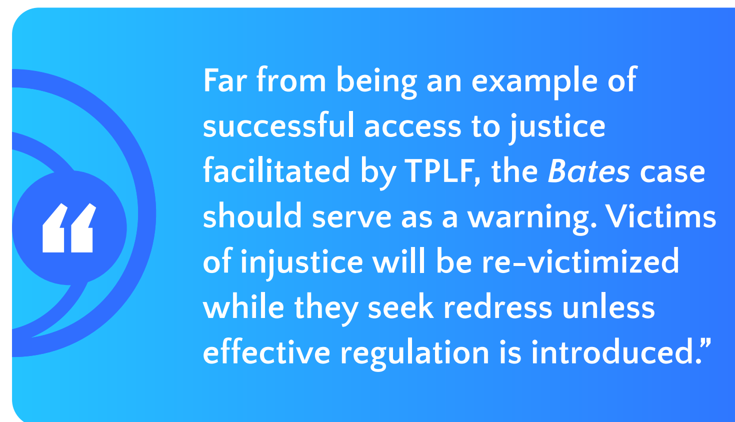
The Government's webpage, explaining how to access this supplemental compensation, offers this advice to claimants from the scheme: "You should not engage any firm which asks you for money now or later, or which offers a 'no-win, no-fee', conditional fee or litigation funding agreement".[8]

The outcome above arose from the so-called post office scandal, but the efforts to adjudicate the victims' claims was a scandal in its own right. The Government and Post Office acknowledge this injustice, and the taxpayers have had to foot the bill to deliver compensation, while the funders shared in £46 million at the expense of victims.

Despite this, the funder in question promotes the case in its marketing materials, calling it "a notable example of litigation funding providing access to justice"[9] and the Government's press release of 4 March 2024 makes the same access to justice point saying that funding allows members of the public to "hold corporates to account" (while also noting how facilitating funding will "further bolster UK's thriving £34 billion legal services sector").

Far from being an example of successful access to justice facilitated by TPLF, the Bates case should serve as a warning. Victims of injustice will be re-victimized while they seek redress unless effective regulation is introduced.

The Civil Justice Council—an advisory public body backed by the UK Ministry of Justice—has now released its "Terms of Reference" for a review of litigation funding. As drafted, the Terms of Reference mention all of the issues and potential safeguards discussed in this paper, including: whether, how and by whom TPLF should be regulated; whether and to what extent there should be a cap on a funder's return; the court's role in controlling the conduct of litigation supported by TPLF, including the protection of claimants funded by TPLF; funders' duties concerning the provision of TPLF, including potential conflicts of interest between funders and claimants; and whether TPLF encourages specific litigation such as collective actions. The breadth of the review reflects the fact that a comprehensive inspection of TPLF and funders' business practices is long overdue.




The challenges the TPLF industry presents have already been acknowledged by several funders who have formed an industry association, called the Association of Litigation Funders (ALF), 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.

Meantime, the industry is rapidly expanding. It is estimated that the top 15 TPLF providers in the UK now have approximately £2.2 billion in assets under management. In 2016, this figure was half the size at £1.1 billion.

The focus of the TPLF industry has also changed in recent years. While funders initially invested in the largest commercial cases, funding is now increasingly used in mass-action and consumer cases. The rapid growth and increasing maturity of the sector, paired with evidence of consumer interests being directly impacted, suggests that it is imperative to consider the creation of an appropriate governing framework now.

While the problems posed by the TPLF industry are challenging, so too is developing a solution. An extensive suite of safeguards will be needed to protect against the negative effects of TPLF including licencing and oversight, fiduciary duties, and transparency.

Some of the issues that a future regulatory framework should address 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. Should all funders be required to guarantee that they can meet their commitments?

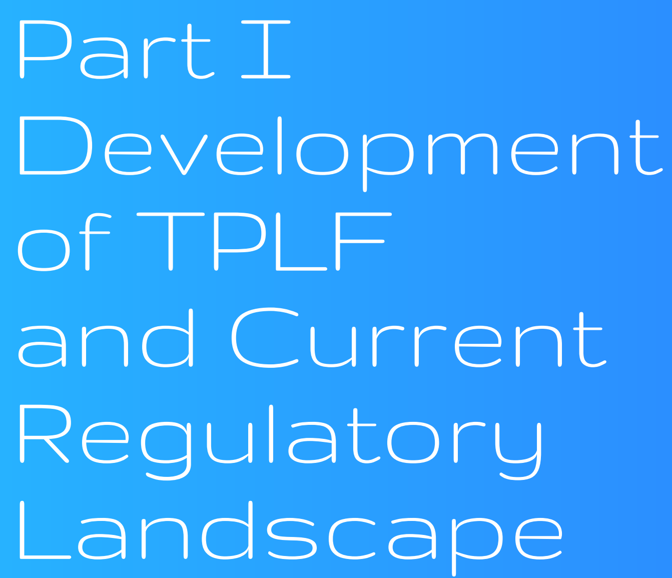
- **Ethical Issues - Fiduciary Duties, Control, Conflicts of Interest and Withdrawal:** There is a very real risk that funders have the means and incentive to control the litigation they fund, and that they may do so in a manner beneficial to their own interests, but not those of the funded party. Should 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, administrative bodies, defendants, and sometimes even claimants have no means to know the degree of control exercised by the funder, the source of funds, 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?

Part I of this paper explores the development of TPLF and why meaningful oversight is desirable and could be achieved. Part II considers some specific ethical and practical issues. Finally, Part III considers possible safeguards to anticipate and prevent the negative effects of TPLF.



# Part I Development of TPLF and Current Regulatory Landscape

## Early Consideration of Legal Costs Reform 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 Lord Justice Jackson. The final report[10], the "Jackson Report", was published in early 2010 and recognised the complex issues that can arise regarding TPLF and the potential need for an oversight framework. At the time, the Jackson Report considered TPLF as a nascent industry, noting that a voluntary code would provide sufficient oversight if all funders subscribed to that code.[11] Crucially, the Jackson Report recognised that "if the use of third party funding expands, then full statutory regulation may well be required".[12]

The Association of Litigation Funders ("ALF") was subsequently created, and it adopted a voluntary Code of Conduct for Litigation Funders ("ALF Code").[13] 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").

## The Development of TPLF in England and Wales

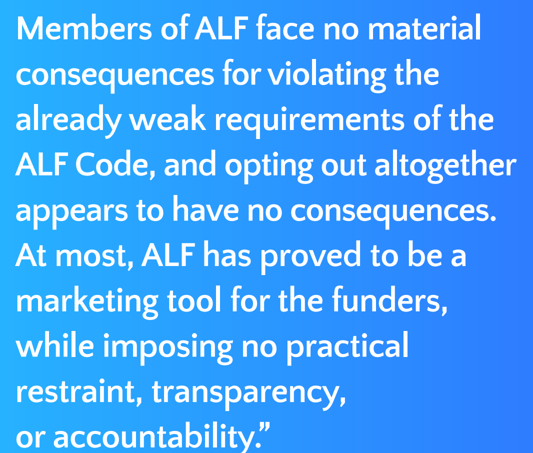
Since the Jackson Report, the use of TPLF has expanded globally, particularly in England and Wales where TPLF is now a multi-billion-pound industry.

Publicly available information indicates that in England and Wales, the number of active funders has quadrupled since 2015, from 16 to 71 active funders today. It is estimated that the top 15 funders in the UK have assets under management of over £2.2 billion, meaning that the industry far exceeds this figure. The growth of TPLF in England and Wales demands a more robust regulatory landscape that goes beyond a voluntary code of conduct.

## Issues with the Voluntary Mechanism

ALF is a voluntary association and currently only 16 of the 71 funders known to be operating in England and Wales are members.[14] 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, fewer than a quarter of the funders operating in England and Wales have subscribed to the ALF Code, and thus more than three quarters 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.

Unfortunately, this self-regulation mechanism has no "teeth", even for those that chose to join. ALF is an independent body owned and directed by the member funders.[15] Adherence to the ALF Code is policed by ALF. The maximum penalty 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 ALF, this would have no bearing at all on the funder's ability to continue funding cases.



> Members of ALF face no material consequences for violating the already weak requirements of the ALF Code, and opting out altogether appears to have no consequences. At most, ALF has proved to be a marketing tool for the funders, while imposing no practical restraint, transparency, or accountability."

Considering 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 more than £2.2 billion.

Members of ALF face no material consequences for violating the already weak requirements of the ALF Code, and opting out altogether appears to have no consequences. At most, ALF has proved to be a marketing tool for the funders, while imposing no practical restraint, transparency, or accountability.

Furthermore, whatever oversight is provided by 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.[16] 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. For example, ALF did not raise any concerns about the excessive fee relative to the claimants the funder took in the *Bates* case.

> "... the current regulatory landscape leaves the door open to abusive practices, such as excessive profit-taking by funders, funders exerting inappropriate control over the conduct of litigation, and funders being used as a conduit for foreign states to bring vexatious claims.

The Law Society's "Access to Justice" report considered this deficit as early as 2010 and found: "As Lord Justice Jackson recognised, third party funding has become an increasingly important method of funding large cases. It may be of particular importance to collective 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."[17]

As recognised by the Law Society above, the current regulatory landscape leaves the door open to abusive practices, such as excessive profit-taking by funders, funders exerting inappropriate control over the conduct of litigation, and funders being used as a conduit for foreign states to bring vexatious claims.

Since then, the relevance of the ALF Code has been questioned in court. For example, in *Re Ingenious Litigation*[18] the court found that a funder's ALF membership, particularly in relation to capital adequacy requirements, did not provide sufficient comfort to remove associated risks of adverse costs to defendants.

## A Flood of Consumer Cases

As noted by Lord Justice Jackson, 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 the litigation funding industry as these cases have been the most obvious source of returns. However, recent years have shown significant growth and diversification within the TPLF market in England and Wales, leading to a surge of consumer cases.

First, central to litigation funding business models are maximising financial returns. Therefore, the funders continue to expand the array of cases they fund to include collective actions and other mass disputes. Whilst claims relating to employment, product liability, and personal injury continue to be popular, TPLF cases in recent years have seen a significant growth in both data-related and ESG-related collective actions. For example, in *Weaver and Others v British Airways Plc (No.2)*[19], a group action was brought against British Airways by 16,000 claimants alleging unlawful access to personal data belonging to over 420,000 customers and employees.

Second, funders and law firms in the UK have formed partnerships to offer TPLF products and services. For example, in October 2023, law firm Pogust Goodhead and emerging markets investment manager Gramercy, announced a £454 million investment partnership, the largest litigation funding deal at the time.[20]

Third, the range of funding structures available has continued to expand. Funders are now offering a range of mixed structures from single case arrangements to portfolio funding of multiple cases, as well as purchasing claims and law firm financing.

Fourth, there has been significant growth in "opt-out" claims, including collective proceedings regime in breaches of competition law and representative collective actions. In 2015, the UK introduced the collective proceedings regime ("CPR"), an opt-out collective action specifically for competition cases. The first CPR was certified in *Mastercard Incorporated and others v Walter Hugh Merricks*[21] in 2021, where the Supreme Court implemented a low threshold for certification. Since then, the use of the CPR regime has been popular, with 15 CPR applications filed in 2022.

While this dramatic increase in collective action claims may lead observers to conclude that there is an equal increase in access to justice, the reality may end up being disappointing, and litigation funding may be a contributor to this problem. The substantial fees claimed by TPLF and lack of claimant involvement or even knowledge of the claim in opt-out cases can result in claimants receiving or taking up only a very small percentage of awards. As an example, according to an analysis of 149 consumer collective action settlements conducted by the United States Federal Trade Commission, the median claims rate, i.e. the percentage of eligible people who filed claims in class action settlements, between 2013 and 2015 was just 9 percent.[22] Thus, the empirical evidence demonstrates that collective actions are in fact incredibly ineffective at delivering access to justice.

Overall, in recent years, there is a momentous rise of funded 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, and in particular consumers in collective redress.

As Lord Justice Jackson 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 ...".[23]

## Need for Safeguards

The risks and the dangers that unchecked TPLF brings need to be recognised and addressed by introducing effective regulation and safeguards for the industry. In all cases it is essential to remain focussed on the litigation funding industry's central purpose: providers of TPLF do not seek "access to justice" per se, they seek financial return and profit by design. Litigation funders seek out and promote cases in which a grievance can be turned into a financial opportunity for the funder. Their principal occupation is not to provide legal aid or any pro bono social or public services to society. It is a for-profit solution to an otherwise legitimate civil justice necessity.

Reasonable and proportionate regulation is a necessary solution to fully protect funded parties, in particular consumers and SMEs, from exploitation, and to preserve the integrity of the civil justice system in England and Wales.

The risk to funded parties and the wider civil justice system is particularly great where consumers are joining funded collective actions. In these cases, consumers are especially vulnerable because they lack the specialised knowledge of TPLF or claimant lawyers. In many other areas, consumers are given specific protections. In general commerce, consumers are protected by the Consumer Rights Act 2015. Consumers can return goods bought online within 14 days even if there are no faults with the goods. Consumers also have specific protections when buying financial services. For example, consumers must be supplied with a clear "fact

sheet" setting out key information before taking out a mortgage and for most types of insurance. To also assist with transparency and ensure customers understand the product, levels of interest must be expressed in a standardised format as annual percentage rate.

Since 31 July 2023, suppliers of certain financial services for consumers have been subject to a new "consumer duty".[24] The consumer duty is principles-based rather than prescriptive. A core requirement is that the financial services provider must "act to deliver good outcomes for retail customers". Litigation funding and litigation is inherently complex, and it is incongruous that consumers have no protections, unlike in other areas of commerce which are far less complex and where consumers face fewer risks. As discussed in more detail in Part III, necessary safeguards for consumers should include an independent regulator for TPLF; funders owing fiduciary duties to funded parties; and restricting the circumstances in which funders can terminate funding arrangements. Each of these proposals is avowedly pro-consumers and would introduce safeguards to better protect those who choose to use TPLF in litigation.

More broadly, this paper considers some of the issues related to the use of TPLF in litigation and identifies safeguards that should be adopted to achieve appropriate oversight and promote consumer protection. For present purposes, the issues and accompanying safeguards 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.

Part II
Ethical and
Practical
Issues
of TPLF

## Capital Adequacy

It is essential that an oversight system requires 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[25] following allegations that it was financed by a "Ponzi scheme".[26] There have been several other examples of litigation funds collapsing, leaving claimants and law firms without adequate funding part-way through a case.[27] 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 £5m of capital".[28] However, at the same time, the separate "Rules" of ALF require funders to accept that when assessing whether they have adequate financial resources, funders should be "pessimistic about the timing and level of any expected returns under existing Litigation Funding Agreements" and accept "the uncertain nature of litigation—in particular with respect to the merits, realistic claim value, budgeted costs (including overruns), enforcement and collection risks, and timing of a case, and the professional experience of the litigation team and the [funder]".

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Thus, the absence of a formal requirement to maintain adequate capital and the recognition of the inherent uncertainty in litigation leaves funded parties significantly exposed. Lord Justice Jackson 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.[29] Capital adequacy requirements should therefore now be imposed upon funders through a formal structure.

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

The interest that a funder may have in safeguarding its investment is understandable and a normal business practice. However, this interest should not permit the funder's investment to become the primary driver of the litigation and its fair outcome. Therefore, it is essential that an oversight regime addresses the following:

- duties that funders owe to funded parties;
- degree to which funders may control decisions regarding a case;
- how any conflicts of interest may be resolved; and
- how and when any funder can withdraw from litigation once they have committed to fund a case.

## Fiduciary Duties: Funders Should be Required to Act in the Funded Party's Best Interests

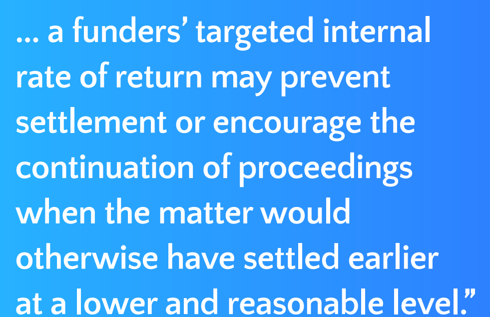
A key issue related to TPLF is that the interests of the funder are only partly aligned with those of the funded party and the degree of alignment may change during the lifetime of a case. The funder and funded party will often both want to achieve the highest possible financial award; however, a funders' 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.

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.[30]

Ensuring that the funded party's interests predominate at every level of the relationship could be challenging 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 able to take 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.



> "... 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."

Such a duty would also be an invaluable consumer protection foundation as the TPLF industry has shifted towards lower value and mass consumer claims, particularly claims pursuing breaches of competition law in the Competition Appeal Tribunal. The dangers are particularly acute in collective consumer cases because groups of consumers with a smaller stake in the dispute are typically not the real authors of the action but rather join an action conceived, designed, and promoted by a funder. Consumers in such situations often have little information about the action, or individual leverage or the knowledge to negotiate terms with a funder. The larger combined awards potentially available in collective action scenarios, coupled with a dispersed class of individuals with limited ability to negotiate or defend their interests, can be especially attractive to funders, as it allows them to appear as though they are defending consumer interests while in fact, they are pursuing terms which advantage the funder far more than the class of consumers.

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### Control: A Clear Prohibition Should Exist Preventing Funders from Influencing or Exercising Control Over Cases, Including Any Settlement Terms

In addition to the need for a clear fiduciary duty owed to litigants, it is imperative to impose clear limitations upon the degree to which a funder should be allowed to influence or control litigation which, in effect, prioritises the funder's interests over the funded party's interests.

Although there is little public knowledge about the degree to which funders in practice take control of cases in England and Wales, it appears that they are highly effective in pursuing claims that align with their own interests. Aristata Capital established an Impact Litigation Fund in 2022, aiming to make ESG litigation into a profitable investment. A backer of Aristata, the Open Society Foundation, referred to these being a "huge untapped pipeline of viable cases", the obvious inference being that this was an investment aimed at achieving an internal rate of return, not acting in the best interests of the environmental causes it purported to support through funding.[31]

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".[32]

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, 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

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make an 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, where the lawyer has a broader financial interest in keeping the funder satisfied. Litigation funders should therefore be prohibited from exercising any control or influence (formally or informally).

### Conflicts of Interests: 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. 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 litigation funder, those client-related duties can come under severe pressure.

Such pressure can arise, for example, where funders are making direct investments in law firms. In October 2023, U.S. hedge fund Gramercy Fund Management announced a £454 million financing deal with group-action firm Pogust Goodhead, which was observed to be intentionally structured to avoid any concerns around it being construed as a DBA. Similarly, in August 2023, litigation funder Harbour agreed to a £33 million financing deal with law firm Slater & Gordon to fund investments in the consumer legal services team and a book of clinical negligence and personal injury claims. The obvious concern in these cases is that the law firm will be seeking to provide the funder with a return on investment at the same time as owing a fiduciary duty to its client. The interests of the litigation funder and the client will not always be aligned.

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]

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The UK's Legal Services Board has also recognised the importance of solicitors' independence and has observed: "A client should be confident that their provider will advise and act in their interests, subject only to their overriding duty to the court. This relates to the importance of providers being independent from government and other influence, such as financial incentives, which could undermine their independence".[34]

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 litigation funder) is already well recognised.

The damage caused by lawyers receiving outsized financial incentives for the outcome of cases was shown in *Federal Republic of Nigeria v Process & Industrial Developments Limited*. In this case, the law firm and barrister acting for P&ID were offered sums of up to £3 billion and £850 million respectively, contingent upon success for their client. Their rewards were subsequently linked to corrupt and unprofessional conduct in the judgment in that case, handed down in October 2023.[35]

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

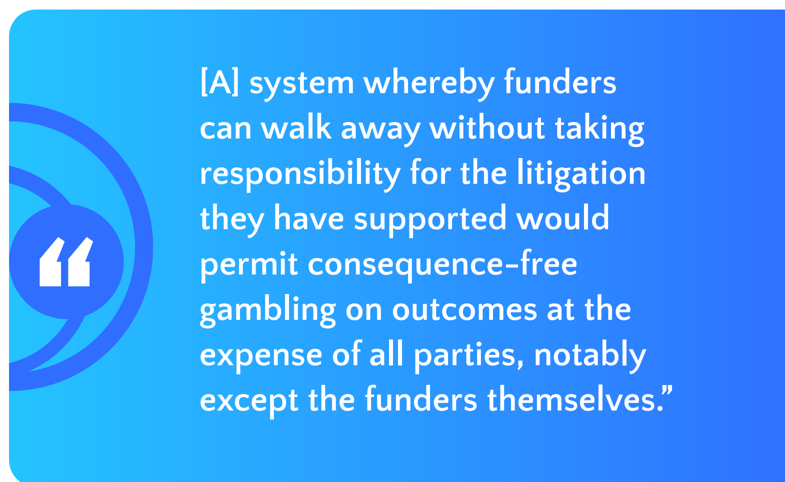
One way to address the threats presented is to require that all funding relationships involve a direct contractual link between the funder and the funded party in the LFA, setting out in detail:

- the funded party's rights and obligations with regard to each specific case; and
- 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.

Litigation 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.[36] 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 withdrawal, 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. Lord Justice Jackson recognised this as a fraught issue, and considered that the "precise definition of proper grounds for withdrawal [under an LFA] will require some careful drafting".[37] Lord Justice Jackson 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 clients' interests or unreasonable".[38]

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 percent. It was found by the court that the "reasonableness of an estimate that the prospects do not exceed 60 [percent] 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

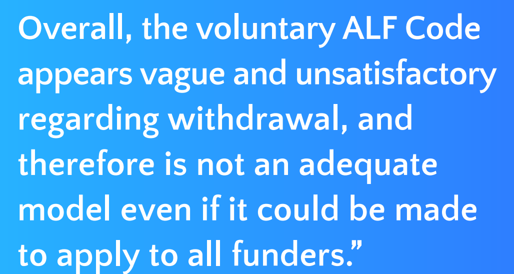
reached: the result is all."[39] Significantly, the case demonstrates that there is bound to be controversy over the grounds upon which a funder is entitled to terminate an LFA, and highlights the difficulties in providing protective measures to litigants from the unreasonable withdrawal of funds by 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. Limb (ii) is particularly egregious. It allows a funder to terminate wholly for its own commercial purposes, which may include reasons beyond worsening merits in the case. This is an example of a clear conflict between the funder and the funded class, which the ALF Code facilitates.

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 grounds for termination 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 King's Counsel in the event of a dispute about termination of the LFA,[40] but the practical application of this mechanism is unclear. It does not specify, for example, whether King'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 King'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 the grounds for withdrawal, defined with reference to objective standards.

Overall, the voluntary ALF Code appears vague and unsatisfactory regarding 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 meet objective criteria and give notice based on reasonable grounds that are not solely based on the discretion of the funder.



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## 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.

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### 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."[41]

Funders will likely decline to invest in some cases because the chance of a case generating a sufficient return appears to be low. However, it should 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 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".[42]

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 after-the-event (ATE) insurance (the premia for which may or may not be paid for by the funder), which limits funders' costs exposure even if the case should never have proceeded. Litigation funders therefore often 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 Ventures v Texas Keystone and others* ("Excalibur") involved a claim for $1.65 billion in damages, which was summarised by Lord Justice Clark 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".[43]

In a separate ruling awarding costs, Lord Justice Clark 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.[44]

In 2020, the Solicitors Regulation Authority opened an investigation into Clifford Chance, the law firm representing Excalibur, after it emerged there were ties between the Clifford Chance legal team and litigation funder Psari Holdings which had invested £13.75 million in the case.[45] Lord Justice Tomlinson described Clifford Chance as having an "acute conflict of interest", the extent of which worsened over time.[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 $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". 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 2021 the American lawyer in question was jailed for wilfully and deliberately disobeying court orders. He was described by the judge as having "spent the last seven-plus years thumbing his nose at the U.S. judicial system".[48]

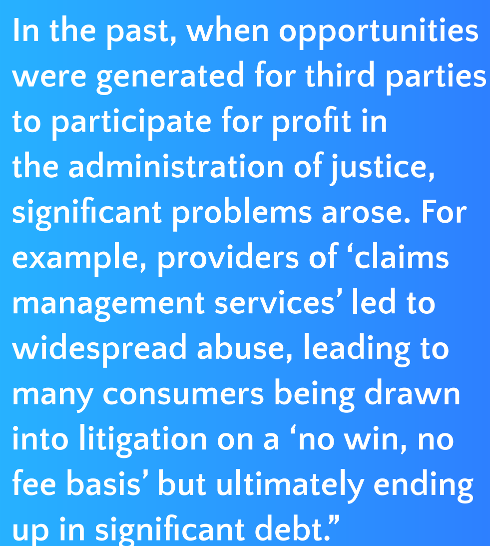
In the past, when opportunities were generated for third parties to participate for profit in the administration of justice, significant problems arose. For example, providers of "claims management services" led to widespread abuse, leading to many consumers being drawn into litigation on a "no win, no fee basis" but ultimately ending up in significant debt. [49]

Consequently, 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."[50]

Thus, it would be a significant mistake to accept the fallacy that the sole profit motivation of funders, and their preference to be involved in large "sure thing" cases, 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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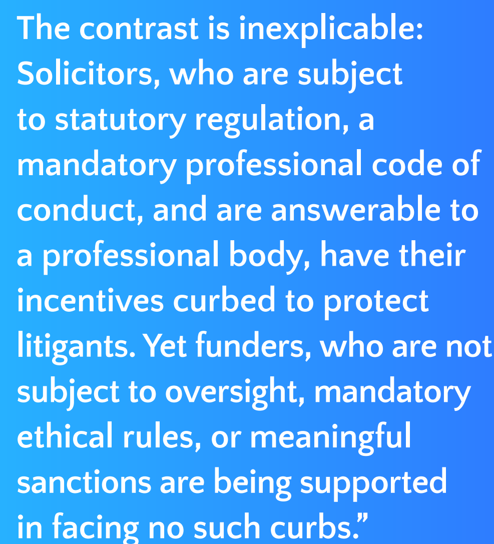
This sort of limitation already exists within the relationship between lawyers and their clients. Within the lawyer-client relationship the possibility of a lawyer's financial interests creating conflicting interests and interfering with the sound administration of justice to the detriment of clients 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 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").[51] 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 [percent] of the sums ultimately recovered by the client".[52]

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 percent.[53]

The practical effect of the UK's Supreme Court in *R (on the application of PACCAR Inc and others) (Appellants) v Competition Appeal Tribunal and others (Respondents)* ("PACCAR") [54], is that many LFAs are classified as DBAs. DBAs are specifically regulated, and funders are not permitted to receive more than 50 percent of the sums ultimately recovered by the client. This affords the funded class a degree of protection. However, even post PACCAR, it is easy to structure an LFA such that it is not a DBA and thereby avoid the 50 percent cap on the funder's return. For example, an LFA may provide that the funder is paid a multiple of its investment rather than a percentage of any sums recovered. In any event, the government has proposed legislation to reverse the effects of this ruling and therefore permit funders to continue to make uncapped returns to the detriment of the funded party.[55]


"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 are being supported in facing no such curbs."

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There appears, therefore, a significant case for maintaining and strengthening the 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 v Borchard Lines Ltd and others* 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 judicial attention, and its effect has been greatly reduced. Following the ruling in *Chapelgate*[57], it is apparent that the Arkin Cap does not apply automatically in cases involving professional funders. Instead, the court retains a broad discretion to make such order as is just in all the circumstances. Following *Chapelgate*, Litigation funders rarely rely on the Arkin Cap and instead are likely to insist that the funded party obtain sufficient ATE insurance to cover the adverse costs risk.

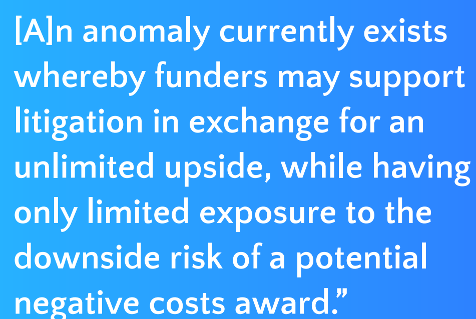
However, the ALF Code contains no requirement that funders cover the premia associated with obtaining the ATE insurance. Clauses 10.1 and 10.2 of the ALF Code are limited in stating that the LFA shall state whether the funder is liable to meet any liability for adverse costs that result from a settlement accepted by the funded party or from an order of the Court, and whether the funder is liable to pay any premium (including insurance premium tax) to obtain adverse costs insurance”. Therefore, the fact remains that the funder may hold no liability for an adverse costs order or the costs of ATE insurance to protect against the downside risk of litigation.

## 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 ALF. For example, the ALF Code provides that the promotional literature of a funder must be clear and not misleading.[58] 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.[59] 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 if 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.[60]




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 legislation on unfair terms in consumer contracts[61] and the UK's Unfair Terms in Consumer Contracts Regulations.[62] 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".[63]

"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.

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 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.[64]

In most 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.

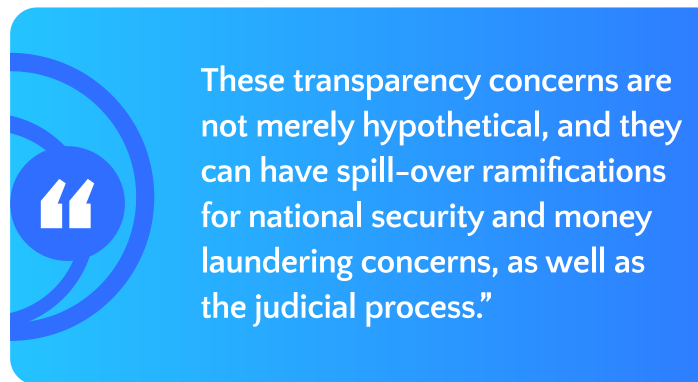
There appears to be a strong case for the introduction of disclosure provisions that will enable the court to understand who will really benefit from any awards and to ensure that awards have the effect intended by the court: to compensate an injured party, rather than to compensate an undisclosed third 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 transparency concerns are not merely hypothetical, and they can have spill-over ramifications for national security and money laundering concerns, as well as the judicial process. In November 2023, it was reported that a company based in China was funding patent lawsuits brought by a Florida-based technology company called Staton Techiya.[65] The cases were brought against subsidiaries of Samsung alleging patent infringements. The cases are understood to be an attempt to put American technology companies of strategic importance to the nation's electronic hardware and software capabilities under pressure as well as to seek disclosure of confidential intellectual property. The case has prompted the Speaker of the U.S. House of Representatives and a member of the U.S. Senate Judiciary Committee to introduce legislation aimed at preventing the manipulation of the American legal system by hostile foreign actors.[66]

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.

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. Disclosure of funding terms is currently only required automatically in collective actions in the Competition Appeal Tribunal.[67]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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 even exists.

Compared to the benefits, there appear to be no obvious downsides to requiring parties to disclose the existence and terms of an 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, taking into account objections and allowing for appropriate redaction. For the reasons

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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.

Furthermore, anti-money laundering ("AML") concerns are growing in the TPLF industry. Users of funding, as with most recipients of money, should be aware of the potential risk of organised crime using litigation funding as a means of laundering proceeds of crime. High risk factors that may point to AML concerns include less established funders, complex offshore structures and unremarkable claims with limited issues and evidence.

In one of the few cases where there has been disclosure in this area, a March 2024 *Bloomberg* article exposed an investment group established by Russian investors with close ties to Vladimir Putin had funded lawsuits globally, including in the UK. The group, A1- a subsidiary of the Russian conglomerate Alfa Group, funded lawsuits in London while simultaneously evading international sanctions.[68]

To allay these concerns, funders should be subject to AML laws in the same way as solicitors or other regulated professions. This would force funders to identify their source of funds and make disclosure of any suspicious activity.

Part III
Potential
Safeguards

## Means of Effective Safeguarding

Continuing with the present system whereby funders can "opt-in" to partial self-regulation is no longer tenable considering the significant growth in the industry, its importance to the administration of civil justice in England and Wales, and by virtue of the fact that the majority of funders do not participate in ALF and are not bound by the ALF Code. Indeed, each of these factors points towards the need for legislative action to achieve a satisfactory oversight regime.

The UK has one of the most mature and sophisticated TPLF industries in the world. Therefore, the UK should seek to take up the role of a global leader in the measures it implements to protect the interests of funded parties from the risks of TPLF. To achieve this goal, an extensive suite of safeguards are needed, which should cover (i) licensing and oversight; (ii) fiduciary duties; and (iii) transparency and disclosure.

## Global Legislative Efforts

Around the world, efforts to implement regimes to protect consumers and/or funded parties, and to prevent the use of TPLF in pursuit of vexatious litigation are under way.

In the European Union (EU), consideration of measures to regulate TPLF began in 2013, when the European Commission made recommendations for the disclosure of TPLF in legal actions and to avoid conflicts of interest either between the funder and funded party or between the funder and the defendant.[69] These measures were reiterated in a Commission report published in 2018.[70] In 2022, the European Parliament voted to approve a resolution proposing a directive on the regulation of TPLF titled "Recommendations to the Commission on responsible private funding of litigation" (the "Voss Report").[71] The Voss Report supported the establishment of common minimum standards for TPLF in an attempt to harmonise safeguarding efforts across EU Member States. The European Commission agreed in December 2022 to fully consider the issues raised by the Voss Report and determine if and what type of regulation of TPLF is needed. This process is already underway, with the European Commission launching a stakeholder consultation and study of TPLF in early 2024.

"Around the world, efforts to implement regimes to protect consumers and/or funded parties, and to prevent the use of TPLF in pursuit of vexatious litigation are under way.

In June 2023, the EU's Representative Actions Directive ("RAD") for collective actions on consumer protection entered into force.[72] This includes various safeguards relating to funding, though they are limited to consumer representative actions and to mitigating conflicts of interest by preventing funders from diverting the representative action away from the protection of the collective interests of consumers. In several Member States, additional safeguards have been added or contemplated. For example, in Germany in certain contexts there are provisions for mandatory disclosure of LFAs and limiting any funder success fee to 10 percent of the enforced claims. Another example is the Netherlands, where there is a prohibition in some contexts on collective actions against defendants that are a competitor of the funder or against defendants on which the funder is dependent. Additionally, in the Czech Republic, national authorities proposed expanding the RAD language to require disclosure of the details of the beneficial owner of the legal entity providing the funding, in particular if it is foreign owned.[73]

Efforts in the EU and its Member States to protect against the dangers of TPLF represent small inroads dealing only with issues of disclosure and conflicts of interest. This piecemeal approach is due in part to the way in which EU directives can be implemented differently in separate Member States. Consequently, the UK has been presented with an opportunity

to seize the initiative and forge a path towards a comprehensive safeguarding regime, which its international partners may be inspired to follow.

## Proposed Safeguards

### Licence and Oversight

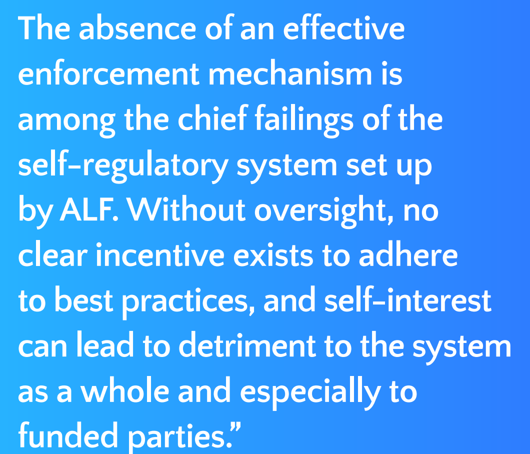
The absence of an effective enforcement mechanism is among the chief failings of the self-regulatory system set up by ALF. Without oversight, no clear incentive exists to adhere to best practices, and self-interest can lead to detriment to the system as a whole and especially to funded parties.

Funders should be subject to a system of authorisation that permits operation only if certain minimum standards are upheld. This will provide comfort to consumers that any funder they engage is complying with these minimum standards.

It is recommended that an independent supervisory body should oversee funders activities to ensure compliance with such minimum standards. This supervisory body should be empowered to determine applications for authorisation by funders. Further, if a funder is not adhering to the minimum standards, the supervisory body should be able to make necessary orders and withdraw authorisations.

A licence and oversight mechanism that is mandatory for all funders with appropriate sanctions for non-compliance is essential. 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 a mechanism to prevent funders from operating in the UK.

A supervisory body should be constituted of persons able to provide case-by-case analysis to ensure that minimum standards are maintained within an appropriate overall framework. This is because a one-size-fits-all approach is unlikely to be effective for TPLF cases. For example, the issue of limits on funders' recovery is a complicated question which may differ depending on the unique circumstances of each case. Such a mechanism would also ensure that all funders can be overseen by the supervisory body, and that their activities could be monitored impartially.



The absence of an effective enforcement mechanism is among the chief failings of the self-regulatory system set up by 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 especially to funded parties."

Additionally, by taking responsibility for oversight of TPLF, the supervisory body diverts this burden away from already over-stretched courts and funded parties, who can progress funded cases with confidence that funders are not undermining the funded party or the civil justice system.

Another important advantage of the licence and oversight system is consumer transparency. Such a system would publicly 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 ALF has a distinct shortcoming in this regard as no information is available about complaints, fines, expulsion decisions, or how any disputes between funders and funded parties are

resolved. This lack of transparency prevents funded parties from taking informed decisions when entering into funding relationships.

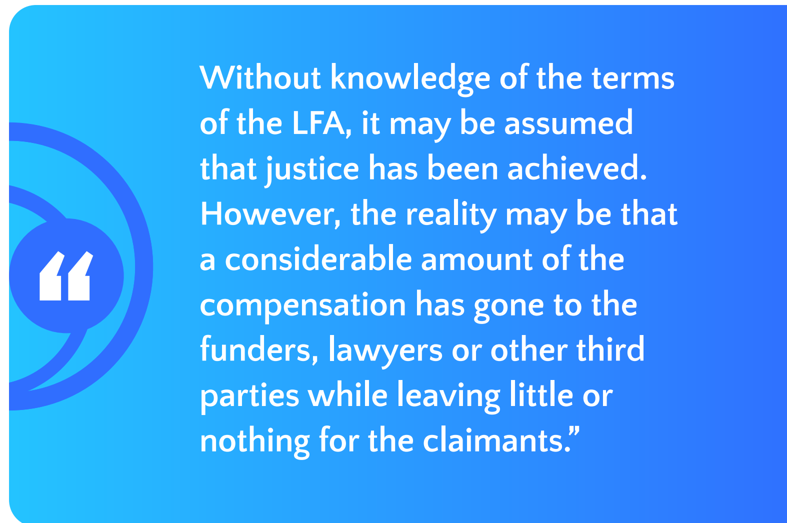
Minimum standards should aim to tackle the issues presented by TPLF outlined in Part II above. Namely, confidentiality, transparency, independence, governance, capital adequacy, liability for adverse costs, and limits on recovery. For example, the supervisory body should be empowered to verify whether funders have at their disposal adequate capital to fulfil liabilities under LFAs, including being able to (i) fund all stages of the proceedings, and (ii) pay adverse cost premia. Funders should also be able to prove sufficient capital adequacy in proportion to the case they propose to fund.

Ensuring LFAs comply with clear minimum standards will be crucial to tackling issues presented by TPLF. Therefore the supervisory body must ensure that LFAs are drafted in clear and intelligible terms, with appropriate provisions describing (i) actions the funder must take to prevent a conflict of interest arising and what actions to take when one does arise, (ii) the limits on a funder's recovery, (iii) how adverse costs will be provided for and the funder's liability to pay for adverse costs or ATE insurance, and (iv) disclosure of the LFA in appropriate circumstances.

## Fiduciary Duties

Many of the ethical issues that arise from the imbalance of power between funders and funded parties can be resolved through the establishment of fiduciary duties owed by funders to funded parties.

Funders should be obliged to respect a fiduciary duty requiring them to act in the best interests of the funded party. This will prevent, among other things, funders taking undue control over the legal proceedings they fund. Powers contained in LFAs allowing funders to take or influence decisions in connection with specific claims pursued, settlement, management of expenses or provision of capital should have no legal effect. Making funders subject to fiduciary duties will also ensure undue control is not exercised through informal pressure such as




threats to withdraw funding to coerce the funded party to agree to a certain approach.

Once a framework of broad fiduciary duties has been established, they can be overseen and appropriately applied by a supervisory board on a case-by-case basis. This approach would align to that already taken by the Solicitors Regulation Authority and the Bar Standards Board.

## Transparency and Disclosure

As it stands, courts, administrative authorities and defendants are often not aware whether a claim is funded by a third party. As discussed in Part II, this can lead to damaging effects to the civil justice system and funded parties.

Jurisdictions around the world including Singapore, Hong Kong, and Australia, have laws in place requiring disclosure of the existence of an LFA and the identity of the funder.

The Voss Report takes this safeguard one step further and proposes that the court, administrative body, or defendant could compel claimants to provide a complete and unredacted copy of the LFA to the court at an early stage of proceedings. This recommendation would be beneficial in providing all parties and the court with the chance to assess the impact of funding arrangements on the integrity of proceedings from the start and throughout.

Without appropriate disclosure and transparency, the administration of civil justice can be greatly undermined. For example, the courts may issue a compensation order with no intelligence on how the money is truly distributed to the claimants. Without knowledge of the terms of the LFA, it may be assumed that justice has been achieved. However, the reality may be that a considerable amount of the compensation has gone to the funders, lawyers or other third parties while leaving little or nothing for the claimants.

For several valid reasons, the identity of the funder is essential information that the courts and other parties should be given access to, if requested. First, it allows for courts to consider requiring funders to provide security for costs without a defendant having to make a non-party costs application. In this way, funded parties can be assured that the funder will contribute to any adverse costs order. Second, courts and other parties will be able to locate, contact and take action against funders who withdraw from proceedings in the event that it no longer serves their financial interests. Third, the identity of the funder will allow courts and parties to verify that the funder is authorised to operate in England and Wales.

# Conclusion

Now that TPLF is a sizeable and growing industry that has given rise to several serious issues and questions, it requires prompt attention. The proliferation of TPLF into consumer cases and collective proceedings means these issues are not limited to business-to-business cases but presents a threat to groups of vulnerable individuals and entities, and more generally to the safe administration of civil justice in England and Wales.

The oversight of the TPLF industry requires a multi-faceted response to tackle issues of capital adequacy, ethics, incentives and limits on recovery, adverse costs, and disclosure and transparency. As outlined above, this can be done through a suite of safeguards to ensure funded parties and the civil justice system are shielded from these issues.

It is also clear from the breadth of the Civil Justice Council's Terms of Reference for the review of litigation funding, that the staggering growth of the TPLF industry necessitates a wide-ranging review into the industry's practices and the potential need for regulatory intervention.

The legislative proposals on TPLF that have emerged, ostensibly in response to the *Bates* case, have been rash and misguided. While the Postmasters' overdue day in court to clear their names was a triumph for justice, most of the compensation going to funders and lawyers was a miscarriage. The result of the case exemplified the dangers posed by TPLF. Any proposed legislation should focus not only on the potential benefits of TPLF but also on these hazards. Accordingly, it is encouraging to see the Terms of Reference propose consideration of, among other things, a TPLF regulator, the court's role in controlling TPLF, and the funder's potential conflicts of interest.

While some advocates of unrestricted litigation funding argue that the safeguards proposed in this paper could somehow lead to TPLF being banned, that could not be further from the truth. These commonsense consumer protections would allow the funding industry to continue in its unprecedented growth and give it further legitimacy. Critically, however, they would also ensure that the aggrieved party is placed first and justice carried out as intended.

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