SLAUGHTER AND MAY/

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SUPREME COURT DEALS BLOW TO LITIGATION FUNDERS IN THE CAT

R (PACCAR, INC) V CAT & OTHERS [2023] UKSC 28

The Supreme Court has held that litigation funding agreements that allow funders to recover a percentage of damages are, in fact, damages-based agreements ("DBAs") and enforceable only if they comply with the detailed legal regime for DBAs.

The decision, which overturned the lower courts and has taken many market participants by surprise, will have significant implications for current and planned collective proceedings in the Competition Appeal Tribunal ("CAT"). Funders and those they work with will need to consider whether and how they can amend existing and future funding agreements to ensure they are enforceable.

There may also be impacts for funders in group litigation outside the competition sphere, and defendants may be expected to probe the robustness of funding arrangements, in particular as they relate to liability for adverse costs.

Background to the judgment

The Road Haulage Association ("RHA") and UKTC each commenced collective proceedings in the Competition Appeal Tribunal against truck manufacturers named in a European Commission cartel decision.

In order to continue those claims, both the RHA and UKTC, as proposed class representatives ("PCRs"), needed certification from the CAT. The adequacy of a PCR's funding arrangements, both as regards their own costs and their ability to meet the defendants' costs, were relevant to that assessment and both PCRs disclosed details of litigation funding agreements ("LFAs") each had entered into with funders.

Certain defendants argued that: (a) the LFAs were properly characterised as DBAs, (b) the LFAs did not satisfy the requirements for DBAs set out in the statutory scheme and were accordingly unenforceable; and (c) the CAT should therefore decline to grant either of the PCR's applications for certification.

The CAT held that the LFAs were not DBAs and were, accordingly, lawful and enforceable funding arrangements. The Court of Appeal agreed and the relevant truck manufacturers appealed to the Supreme Court.

The funding context: what is a DBA?

A damages-based agreement is a "no win, no fee" arrangement. Generally entered into by a claimant with their solicitor, the solicitor's entitlement to payment for their work arises only in the event the claimant wins their case and recovers damages from their opponent. The solicitor's payment is calculated as a percentage of the damages actually recovered, capped at 50% of those recoveries (net of any costs recovered from the losing opponent). If the claimant's case fails, the solicitor gets nothing.

English law has historically outlawed arrangements which allowed people other than claimants to share in the proceeds of litigation in exchange for supporting it. It was only in 2013 that the law was changed to permit the use of DBAs in most disputes, and only then where their form and terms satisfied the strict requirements set out in law.

Along with conditional fee agreements - under which a lawyer may, in the event of success, claim a success fee calculated by reference to their base costs - DBAs are "islands of legality in a sea of illegality".

Until now, DBAs had generally been seen as agreements that only lawyers or other advisers - and not funders - would (or even could) enter into with claimants.

The Supreme Court's decision

In a judgment handed down on 26 July 2023, the Supreme Court held (by a 4 to 1 majority) that the relevant litigation funding agreements fell within the definition of DBAs as set out in s.58AA of the Courts and Legal Services Act 1990 (the "Act").

In his leading judgment, Lord Sales said that the provision of litigation finance constituted a "claims management service", one of the elements of the statutory definition. Because it was common ground that the LFAs did not satisfy the other conditions in s.58AA, they were not valid DBAs and as such were unlawful and unenforceable.

In a lengthy dissenting judgment, Lady Rose agreed with the lower courts that the mere provision of finance by a professional funder did not constitute a claims management service for the purposes of the Act, taking them outside the statutory definition of a DBA. Lady Rose considered that, even if it were right to construe the LFAs as DBAs, they could never be perfected because the statutory scheme was so ill-suited to litigation funders.

What are the implications for collective proceedings in the CAT?

To the extent that funders have litigation funding agreements in place that mirror the terms of those used by the RHA and UKTC, they will be unenforceable DBAs. Lord Sales recognised the far-reaching significance of this outcome:

"The court was told that if LFAs of this kind, whereby the third party funders play no active part in the conduct of the litigation but are remunerated by receiving a share of any compensation recovered by their client, are DBAs within the meaning of section 58AA, the likely consequence in practice would be that most third party litigation funding agreements would by virtue of that provision be unenforceable as the law currently stands."

The precise effects of this for competition claims vary depending on whether the collective proceedings in question are opt-in or opt-out.

Opt-in collective proceedings

A DBA will be enforceable if it can be amended so as to satisfy the rules in s.58AA(4) of the Act and the Damages-Based Agreements Regulations 2013. The rules are relatively prescriptive: notably, they circumscribe the payment which a service provider can receive (including by capping it at 50% of the damages actually recovered from an opponent, net of recovered costs); require an explanation of the reason for setting the payment at the agreed level; and define the circumstances in which it will be payable.

It is not clear how easily funders will be able to amend existing agreements so as to satisfy the relevant rules. As Lady Rose noted in her dissenting judgment in the Supreme Court, "damages-based agreements entered into by litigation funders cannot realistically comply with [the] DBA Regulations because those Regulations are not drafted in a way which applies to their business."

Opt-out collective proceedings

DBAs are effectively prohibited in opt-out collective proceedings by s.47C(8), Competition Act 1998. So merely seeking to rectify deficiencies in an existing DBA will not be enough: the core payment mechanic of the funding arrangement will need to be renegotiated on a new basis.

What are the implications for other funded group litigation?

Litigation funders stand behind much (if not most) of the large group litigation in the English courts. In contrast to collective proceedings in the CAT, claimants are not generally required to disclose the existence or nature of any funding arrangements they may have entered into with funders.

Traditionally, the only way in which defendants have gained some insight into the financial position of their opponents has been where they have been able to persuade the court that there is a question mark over the claimants' ability to satisfy any order for costs that might be made against them. In a string of cases, claimants were required to disclose the existence and terms of specialist insurance policies designed to cover liability for an adverse costs order. In practice, the arrangement of this so-called after-the-event ("ATE") insurance will often be closely connected to any broader financing package offered by a litigation funder. It remains to be seen whether any issue with that underlying funding arrangement as a result of the Supreme Court's decision impacts ATE insurance cover.

Conversely, funders will, understandably, be keen to ensure that their funding agreements are enforceable against claimants in the event an award is made, even if it is not necessary to demonstrate this to the courts in order for the claims to proceed. This may therefore require parties to renegotiate funding arrangements and develop a new model going forward.

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