LITIGATION FUNDING AGREEMENTS "RETAIN THE CHARACTER OF A DBA AS DEFINED"

THE LEGAL LANDSCAPE FOLLOWING THE SUPREME COURT'S DECISION IN PACCAR

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P J Kirby KC and Charlotte Wilk consider the impact of the Supreme Court's decision in R (on the application of PACCAR Inc and others) v Competition Appeal Tribunal and others [2023] UKSC 28

The Supreme Court's decision

Last month, the Supreme Court handed down its decision in the PACCAR Trucks appeal ("the Appeal"). The court allowed the Appeal, and decided by a majority (Lords Sales, Reed, Leggatt and Stephens) that a litigation funding agreement ("LFA") under which the funder is to receive a percentage of any damages recovered by the funded party is a damages-based agreement ("DBA") within the meaning of s58AA Courts and Legal Services Act 1990 ("CLSA"). Lady Rose delivered a strong lengthy dissenting judgment.

Whilst some funders have prepared for an adverse outcome, the impact of the decision should not be underestimated. The majority's favouring of a wide definition of claims management services will have a significant impact on the litigation funding industry at large, and much commercial litigation, in particular claims in the Competition Appeal Tribunal ("CAT") and other large group actions.

Historically, the law of champerty and maintenance rendered the funding by third parties in return for a share of the proceeds unlawful.

However, over the last 25 years public policy considerations including increasing access to justice led to the acceptance of third party funding. The Appeal turned not on the development of the common law in relation to third party funding but rather the proper interpretation of the relevant legislation and its complex history. The deceptively simple issue of statutory construction was how to interpret the meaning of the words "claims management services".

Whilst the definition of a DBA was found in section 58AA CLSA the definition of claims management services was borrowed from the Compensation Act 2006.

The Justices grappled with a range of issues, including but not limited to the relevance, if any, of uncommenced legislation, the significance of secondary legislation as an aid to construction, and the presumption against absurdity. Sir Rupert Jackson's endorsement of third party funding, in his preliminary Review

of Civil Litigation Costs (May 2009) and his final report (January 2010), as a means of improving access to justice carried little weight. In the CAT and the Divisional Court, accepting the Respondents' purposive approach to statutory construction, it was held that for a service to be caught by the definition of claims management services, that service had to be provided within the context of the management of the claim, and that funders did not ordinarily manage claims. Lady Rose agreed with this approach in her dissenting judgment.

However, the majority considered that Parliament's drafting of a wide definition was deliberate. As per [para 67] "the textual and contextual indicators from the 2006 Act itself clearly lead to the conclusion that the definition of 'claims management services' is meant to be wide and is not intended to be coloured by the notion of 'claims management'". This drafting decision meant that the Secretary of State could decide which claims management services should be regulated as and when the need to do so arose and provided for regulation of the same through a Scope Order. Litigation funding is not a form of regulated claims management under the current scope orders; however, the definition of a DBA covers all those providing claims management services and is not confined solely to regulated claims management services.

Troubled Waters?

Litigation funders now face a central problem: any funding agreement providing for a return based on a proportion of damages will be caught by the definition of a DBA. Therefore, such agreements are unenforceable unless they comply with s58AA CLSA and the Damages Based Agreements Regulations 2013 ("the Regulations"). In all likelihood, the majority (if not all) of funding arrangements since the birth of litigation funding would not have complied with the Regulations. This has wide-reaching consequences.

Third party funders are therefore urgently seeking advice as to whether it is possible to draft a compliant LFA. It is worth noting that in Lady Rose's dissent [para 227], she opined that LFAs cannot "realistically" comply because the Regulations were not, in her view, drafted with any intention to be applied to the litigation funding industry. This probably overstates the difficulty.

Challenges in the CAT

The Appeal involved both opt in and opt out proceedings in the CAT. A DBA is unenforceable if it relates to opt-out collective proceedings (s47C(8) Competition Act 1998). LFAs providing for a percentage-based return will therefore not be permissible for funding opt-out proceedings. The Collective Proceedings Orders in those cases will need to be re-evaluated, and funders continuing to fund such cases will have to limit their return to a multiple of their investment. At present, it is believed that all opt-out proceedings in the CAT are backed by LFAs, and those claims are worth billions of pounds, hence the colossal impact of this Appeal.

What issues should funders be considering?

Since the hearing of the Appeal in February, some funders are one step ahead of the game and have already been advised as to the appropriate steps to take. Funders will need to act swiftly to consider what action to take in relation to existing but unresolved cases within their portfolios as well as future LFAs, with a view to ensuring compliance. Funders may also have to carry out a risk assessment in relation to resolved cases and the possibility that a funded party may try to recoup amounts previously paid to the funder.

LFAs where the return is a multiple of the amount invested will not be caught by the definition of a DBA. Some LFAs are drafted with a return based on a multiple or a percentage of the recovery, whichever is higher.

In LFAs with a severance clause, caution must be exercised as to whether the same can be relied upon in removing the provision pertaining to a percentage return.

What should funded parties consider?

It is likely that funded parties will find themselves unable to secure further funds unless an amended or new LFA is drafted and agreed; it is therefore prudent for funded parties to agree the same to avoid hampering the progress of the litigation.

What next?

New primary legislation may be required temper the uncertainty ahead. It is therefore essential that the Association of Litigation Funders and funders themselves spearhead lobbying to secure these vital legislative reforms. If solutions are not forthcoming, the UK's reputation on the commercial litigation stage will be in jeopardy.

PJ Kirby KC, David Went, and Charlotte Wilk appeared for the Road Haulage Association in the Supreme Court instructed by Backhouse Jones and Addleshaw Goddard