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Litigation & Arbitration Group

UK Supreme Court Rules on the Enforceability of Litigation Funding Agreements: Uncertainty for Existing Funding Arrangements and Obstacles Ahead

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On 26 July 2023, the UK Supreme Court handed down its much-anticipated judgment in *R (on the application of PACCAR Inc and others) (Appellants) v Competition Appeal Tribunal and others (Respondents)*, [2023] UKSC 28 (the "**Judgment**"). The Supreme Court ruled by a majority that litigation funding agreements ("**LFAs**") in which funders are entitled to a payment by reference to a percentage of the damages recovered are Damages-Based Agreements ("**DBAs**"). As a result, these types of LFAs are likely to be unenforceable, unless they are compliant with the relevant regulatory regime for DBAs. This decision therefore will have wide-ranging implications across the litigation funding market, and in particular in the context of opt-out collective proceedings before the Competition Appeal Tribunal ("**CAT**"), where DBAs are unenforceable in any event.[1]

In this article we discuss the background to the Judgment, the reasoning in the Judgment, and its likely implications for the growing number of parties involved in funded litigation.

Background

The Judgment arises out of two applications in the CAT[2] to certify collective proceedings against a group of truck manufacturers (collectively, "**DAF**"). The collective proceedings are 'follow-on' damages actions[3]

1 In "opt-out" proceedings, claimants falling within the class definition are included automatically in the claim whereas, in "opt-in" proceedings, claimants need actively to opt into the claim. Section 47C(8) of the Competition Act 1998 renders unenforceable the use of DBAs in opt-out collective proceedings.

2 1282/7/7/18 *UK Trucks Claim Limited v Stellantis N.V. (formerly Fiat Chrysler Automobiles N.V.) and Others* and 1289/7/7/18 *Road Haulage Association Limited v Man SE and Others*.

3 Claims that rely on a prior infringement finding of a regulator as evidence that anticompetitive behaviour has occurred, meaning that the claimant need only prove that the infringement caused it to suffer loss.

brought in reliance on an EU Commission decision finding that five European truck manufacturers operated a cartel to fix the price of trucks between 1997 and 2011 in breach of Article 101 TFEU.[4]

Before the CAT can certify collective proceedings and make a collective proceedings order ("**CPO**"), it is required to ensure that various criteria[5] have been met. One of those criteria is that the applicants must show that they have adequate funding arrangements in place. At a preliminary issue hearing on 4-6 June 2019, DAF argued that the funding arrangements in place for both of the proposed class representatives ("**PCRs**") were DBAs and were consequently unenforceable because they failed to meet the relevant statutory requirements for DBAs and, in the case of the opt-out proceedings which one of the PCRs (UK Trucks Claims Ltd ("**UKTC**")), sought to bring, were, in any event, an unenforceable form of funding.

The Courts and Legal Services Act 1990 (the "**CLSA**") defines a DBA, at Section 58AA(3[6]) as:

> "*an agreement between a person providing advocacy services, litigation services or claims management services and the recipient of those services which provides that: (i) the recipient is to make a payment to the person providing the services if the recipient obtains a specified financial benefit in connection with the matter in relation to which the services are provided, and (ii) the amount of that payment is to be determined by reference to the amount of the financial benefit obtained*". (Emphasis added)

Therefore, in order for an agreement to be classified as a DBA, it must provide for a payment to be made to a person providing 'advocacy services', 'litigation services' or 'claims management services', the amount of which is determined by reference to the financial benefit obtained from the litigation by the recipient of those services (e.g., the claimant). Additionally, the CLSA states that a DBA will be unenforceable if it does not comply with the requirements set out in Section 58AA(4). This includes the requirement that any DBA complies with the provisions of the DBA Regulations 2013.[7]

In the present case, whether the LFAs were DBAs turned on whether the LFAs involved the provision of "*claims management services*". Section 58AA(7) states that "*claims management services*" has the same meaning as Part 2 of the Compensation Act 2006 at Section 4(2). Section 419A of the Financial Services and Markets Act 2000 ("**FSMA**") replaced the relevant sections of the Compensation Act.[8] Section 419A of FSMA states that "*claims management services"* means "*advice or other services in relation to the making of a claim*" (emphasis added), and "*Other services"* includes providing "*financial services or assistance*".[9]

The CAT ruled against DAF in 2019 and found that the LFAs were not DBAs. This meant that the LFAs were both enforceable and lawful, because they fell outside the regulations governing DBAs. DAF then sought to appeal to the Court of Appeal. DAF also challenged the CAT's ruling by way of judicial review, in case the Court of Appeal did not have jurisdiction. The Court of Appeal decided that it had no jurisdiction to entertain an appeal. However, the same constitution of the Court of Appeal proceeded as a Divisional Court to grant permission for the judicial review claim in relation to the DBA issue and to hear the issue. In its March 2021 judgment, the Divisional Court unanimously dismissed DAF's judicial review claim, upholding the CAT's ruling that the LFAs were not DBAs.

DAF appealed directly to the Supreme Court, under the 'leap-frog' procedure.[10] The Supreme Court also granted permission for the Association of Litigation Funders of England & Wales to intervene and make written submissions in the appeal.

The primary question for the Supreme Court was whether "*claims management services"* included the provision of litigation funding. This was significant because, if the funding arrangements were held to be DBAs, they would be unenforceable because (as was common ground) they did not satisfy the

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4 Treaty on the Functioning of the European Union; *Case AT.39824 – Trucks*.

5 See our client alerts dated 10 November 2021 and 17 June 2022 for details of these criteria.

6 Section 58AA was first introduced in 2009, but subsequently modified by the Legal Aid, Sentencing and Punishment of Offenders Act 2012, the Consumer Rights Act 2015 and The Financial Services and Markets Act 2000 (Claims Management Activity) Order 2018 (S.I. 2018/1253).

7 Damages-Based Agreements Regulations 2013 (SI 2013/609).

8 Section 419A was inserted by the 2018 S.I. 2018/1253 referred to in footnote 6.

9 The relevant sections of the Compensation Act 2006, now repealed, contained similar wording.

10 Administration of Justice Act 1969, Section 13.

requirements of the DBA Regulations 2013.[11] In any event (even if they had complied with those requirements), the DBAs would have been unenforceable in the opt-out collective proceedings before the CAT pursuant to section 47C(8) of the Competition Act 1998 (the "**CA98**"), which provides that "*A damages-based agreement is unenforceable if it relates to opt-out collective proceedings*".

The Judgment

The Supreme Court handed down its Judgment on 26 July 2023. Lord Sales provided the majority decision which overturned the CAT and Divisional Court decisions, determining that the LFAs were DBAs and were unenforceable. Lady Rose provided the dissenting judgment.

Claims Management Services

The majority held that the words "*claims management services*" do include the provision of litigation funding for the following reasons:

1. Where a term is defined in a statute, it is the definition of that term that falls to be construed.[12] In this case, the definition of "*claims management services*" (as defined by reference to the definition in the Compensation Act 2006) included "*Other services*" which were themselves defined as including "*financial services or assistance*". The natural and ordinary meaning of the definition, therefore, included litigation funding.[13] Additionally, *"claims management services*" had no "*established and generally accepted meaning*" which might "*colour*" the natural meaning of the term.[14]

2. The Explanatory Memorandum to the Compensation Act 2006 supported the view that "*claims management services*" confers a wide power to regulate types of activity, including the provision of financial assistance, rather than only particular actors.[15] Therefore, the Divisional Court had no reason to infer that the relevant sections of the definition were only intended to regulate "*claims intermediaries*" (as contended for by the PCRs). Instead, the scheme of the relevant part of the Act was to "*regulate activities, not persons of a particular description*".[16]

3. Whilst the Courts will not interpret a statute "*so as to produce an absurd result, unless clearly constrained to do so by the words Parliament has used*", the inclusion of litigation funding within the definition of "*claims management services*" did not result in absurdity.[17]

4. Where a term has been defined in an earlier statute and then incorporated in a later one without modification, later commentary is not relevant to its interpretation.[18] Therefore, neither the report of Sir Rupert Jackson endorsing third-party funding dated January 2010 nor the Association of Litigation Funders' 2011 Code of Conduct could assist the Court in construing the Compensation Act 2006.[19]

5. Section 58AA of the CLSA and the DBA Regulations 2013 also did not provide assistance to the interpretation of *"claims management services*". It was held that Section 58AA of the CLSA (introduced in 2009 and subsequently amended) could be used as a guide to the interpretation of an earlier act, but this was only relevant "*in order to resolve an ambiguity in that earlier legislation*".[20] However, there was "*no ambiguity of this kind in the present case*".[21] Further, this principle does

[11] Judgment, paragraph 29.
[12] Lord Sales noted that: where parliament has "*taken the trouble to provide a definition, it is the words of the definition which are the primary guide to the meaning of the term defined*" (Judgment, paragraph 49).
[13] Judgment, paragraph 50.
[14] Judgment, paragraph 79.
[15] Judgment, paragraph 76.
[16] Judgment, paragraph 68.
[17] Judgment, paragraphs 43 and 84 - 86.
[18] In this case the later statute is Section 58AA of the CLSA, which was added in 2009 (and subsequently amended). The earlier statute was the Compensation Act 2006, which contained the definition.
[19] Judgment, paragraph 90.
[20] Judgment, paragraph 92.
[21] Judgment, paragraph 93.

not apply where later legislation, the DBA Regulations 2013, is "*subordinate legislation made by the Executive rather than an Act of Parliament*".[22]

6. Although the LFA in the opt-out collective proceedings pursued by UKTC provided that the funders' recovery was subject to: (i) prior payment to members of the class of their full share of damages; and (ii) the CAT's discretion pursuant to section 47C(6) of the CA98,[23] the amount of the payment due to the funder was still "*to be determined by reference to the amount of the financial benefit obtained*", so as to satisfy the condition in section 58AA(3)(a)(ii): "*as a matter of substance, the LFA retains the character of a DBA as defined*".[24] Indeed, the previsions in the LFA merely reflected the means by which the funder would recover under the relevant regime for opt-out collective proceedings in any event.[25]

The minority judgment of Lady Rose disagreed with this interpretation. In summary, she agreed with the CAT and the Divisional Court that the "*the giving of financial assistance is only included in the term claims management services if it is given by someone who is providing claims management services within the ordinary meaning of that term*", which did not include litigation funders.[26] Lady Rose also observed that the alternative interpretation of the majority would mean a radical review of the entire litigation funding sector in the United Kingdom.[27]

Commentary

The significance of Supreme Court decision in terms of its impact on market practice and existing LFAs was noted at the outset of the Judgment:

> "*The assumption has been made that third party funding arrangements such as those in issue in these proceedings, which assign a passive role to the funders in relation to the conduct of the litigation, are not DBAs within the meaning of section 58AA, are not contrary to public policy, and so are enforceable as ordinary binding contractual arrangements. 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*".[28]

However, it is unclear whether the Judgment means that a non-compliant LFA is unenforceable as a whole or merely the part that relates to the funder's recovery of a share of any award of damages. Indeed, in one of the few cases on DBAs, the Court of Appeal took divergent views on this point. In *Zuberi,*[29] which concerned whether a termination payment to a solicitor on the basis of hourly rates made a DBA unenforceable, Lewison LJ and Coulson LJ considered that only the terms of the agreement dealing with the payment as a share of recoveries amounted to a DBA; in other words, the part of the agreement relating to the 'DBA' could be treated separately from the rest of the obligations in the wider agreement.[30] However, Newey LJ took the opposite view (although he considered that the relevant termination provisions were lawful for other reasons).[31]

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22 Judgment, paragraph 94.
23 This section provides that "*the Tribunal may order that all or part of any damages not claimed by the represented persons within a specified period is instead to be paid to the representative in respect of all or part of the costs or expenses incurred by the representative in connection with the proceedings*".
24 Judgment, paragraph 99.
25 Ibid.
26 Judgment, paragraph 254
27 Judgment, paragraphs 242-44
28 Judgment, paragraph 13.
29 *Lexlaw Ltd v Zuberi* [2021] EWCA Civ 16.
30 *Zuberi*, paragraphs 33-34.
31 *Zuberi,* paragraph 66.

A further issue arises in relation to opt-out collective proceedings, where DBAs are expressly prohibited[32] – leaving the funding structure in at least some of the existing opt-out class actions in the CAT in doubt. We expect that this is something that the CAT will need to address in several of these cases over the coming months.

Looking forward, it remains to be seen whether the Judgment prompts a review of the relevant legislative provisions which were considered by the Supreme Court. In the meantime, parties to English litigation (and potentially also English seated arbitration) will have a choice between entering into a DBA that complies with the restrictive terms of the DBA Regulations 2013, which remain largely untested by the courts, or providing a different basis for payment to the funder (and funders may need to re-negotiate existing, non-compliant LFAs in one of these ways). Funders may, for instance, seek to define their entitlement to payment by reference to a multiple of their funding, with that multiple possibly increasing the longer it takes for the funder to achieve a return.

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[32] Competition Act 1998, Section 47(C)(8).