EJF Position Paper
on Third Party Litigation Funding

The European Justice Forum (EJF) is supportive of the recently released legislative own-initiative report authored by Member of European Parliament (MEP) Axel Voss, and believes that this constitutes a solid basis for more effective regulation on third party litigation funding (TPLF) in the EU.

EJF would like to contribute to **building fair, balanced and effective Civil Justice Systems in Europe**. The goal is to ensure that consumers who have a legitimate grievance are compensated, while acknowledging that access to justice can also depend on financial resources.

We take note that the Directive on Representative Actions imposes restrictions on litigation funding and over the role litigation funders have in a dispute. But while collective redress mechanisms and TPLF are meant to have a positive impact for consumers in facilitating their access to justice, there is the risk – if no sufficient safeguards are put in place – that private funders' interests (especially in commercial profit) may be disconnected from – or even opposed to – consumers' interests. Concrete examples can be seen in the US and in Australia. Meanwhile in Europe, litigation funding is increasingly becoming part of mainstream litigation culture, and such cases are growing rapidly.

- The EU Directive on Representative Actions has already incited many litigation funders and US law firms to set up shop in the Netherlands which they expect to become the European hub for their business. This means that **commercial interest is driving expansion of EU collective actions** and is likely to lead to **exponential growth of collective actions**.[1]
- The **biggest issue is that intermediaries divert excessive amounts** from claimants'/beneficiaries' compensation into their own pockets. The **underlying problem** is the **disconnect between the profit-making interest** of the **funders**, and the right of **claimants/beneficiaries** to receive full compensation for their grievances which urges the call for an independent oversight function.
- There is a **propensity for conflicts of interests** to arise in the triangle between funders, lawyers and claimants/beneficiaries.
- **Specific problems** occur with regard to the **definition and supervision of funding business**, **transparency of funding agreements** and related **independent control** as well as to the **assessment of settlement** covering issues like distribution of proceeds and finality.
- For society as a whole, **TPLF – if not properly regulated – could also lead to excessive costs ("social inflation")**[2], in particular for consumers, be it in guise of increased prices for future customers of companies successfully targeted, be it in higher premia for e.g. general liability and commercial auto insurance,[3] up to and including opportunistic or "frivolous" claims **affecting innovation as well as the competitiveness of business**.

Therefore, additional effective safeguards against the abuse of TPLF are necessary. An adequate regulatory framework is needed that takes into account procedures, funding alternatives and the different roles of intermediaries. This can greatly improve legal certainty and effectiveness for all stakeholders potentially involved i.e. courts, lawyers, funding providers, qualified entities, ombuds entities/dispute resolution bodies, claimants and defendants.

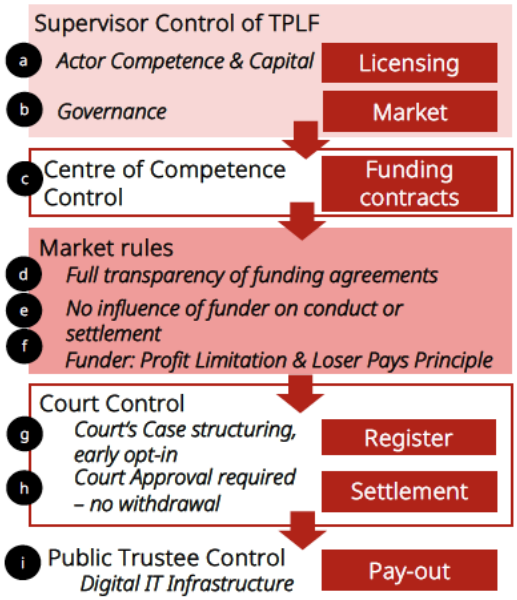
[1] An NGO (iusomnibus) with Pan-European ambition based in Portugal cooperates with Swiss TPL-Funder Nivalion at least on the MasterCard copy-cat case (Link).

[2] Swiss Re Institute, US litigation funding and social inflation – The rising costs of legal liability, December 2021 – (Link).

[3] Ibid., p. 4: seventh consecutive year of underwriting losses for general liability.

The following points are of crucial importance to achieving an effective and coherent legal architecture that safeguards against potential abuses of TPLF. With these points, EJF calls on the European Parliament to support and improve this report in plenary, and on the European Commission to take up the Parliament's proposal by submitting a proposal for a Directive to regulate third party litigation funding.

Core dimensions of TPLF regulation



(a) Financial markets regulation for market participants
(b) Independent public supervision of TPLF activity in representative actions
(c) Scrutiny of funding agreements by a centre of competence
(d) Full transparency of funding agreements
(e) No influence of funder on litigation conduct or settlement
(f) Stricter limitation of profit potential
(g) Full court control of collective settlements
(h) Direct responsibility of funder for adverse costs (including guarantee fund)
(i) Pay-out via public and not private infrastructure – settlements (see also above (g)) need to be channeled through public infrastructure even when no procedure has been undertaken in court or ombuds entities

a) Financial markets regulation for market participants

TPLF market actors should be subject to *institutional* supervision due to the risks their business model poses for the economy, the judicial system and the interests of consumers, just as banking is supervised due to its potential to create money, and insurance due to the importance of insurers' financial capacity towards their customers when the insurance event occurs. That is what Australia has just done with the *Corporations Amendment (Litigation Funding) Regulations 2020*, requiring entities that deal in class action litigation funding to hold an Australian Financial Service License.

b) Independent public supervision of TPLF activity in representative actions

In addition to an institutional supervision, there needs to be supervision of the *market activities* as they unfold. This requires taking a structured approach to the problem, i.e. by ensuring that this is done by experienced reviewers and not by judges or various, different public bodies who may well be seeing such contracts for the first time when they are asked to give an opinion about them.

c) Scrutiny of funding agreements by a centre of competence

In each Member State there needs to be one central unit, and ideally also a single one at Union level to perform this task, either upon request by a party to the proceedings, or at the own initiative of the court or administrative authority approached by the claimant. A very interesting, exemplary and apparently functioning solution can be found in the Canadian province of Québec which has a small, highly qualified and specialized team, supervised by the Québec Ministry of Justice. They have a public fund of their own from which they can initiate collective actions which in their perspective truly are in the public interest. As they fund initial actions without charging interest at all, they are the first body to learn about upcoming intentions to start new collective

actions. By this initial involvement they can screen many impending actions and advise interested parties. Public interest confirmed, they can then assist claimants in obtaining additional commercial TPLF and review the contracts to ensure that their terms are fair, players "fit and proper" and persons involved in funding and the action itself able to handle such case. In Australia, according to the government's 2021 draft legislation on litigation funding, "Litigation funders would not be able to enforce their litigation funding agreements until a Court has made an order to approve or vary the distribution"[4]. See also the generic model in the **annex**.

d) Full transparency of funding agreements

Transparency of funding agreements is of the essence and would be obviously a requirement as far as a court is concerned, but is likewise required for the other stakeholders within the procedure:

i) first, **for the *beneficiaries* opting-in**, because they need to know what share of their potential compensation or of the financial capacity of the defendant is being used to pay intermediaries. Same principle is proposed by the Australian government draft law 2021 on litigation funding as the amendments would *de facto* create an opt-in system for funded class actions by requiring the claimants to agree in writing to be a member of the "scheme" (a class action that is funded) and to be bound by the terms of the "scheme's constitution" (meaning the funding agreement);[5]

ii) second, also **for the *defendant***, because the Directive on Representative Actions requires "a financial overview listing sources of funds used to support the action". The decision-making powers of the funder regarding strategy including case settlement, all to be seen in the context of the profit expectations of the funder, can only be evaluated by reading and knowing the full text of the contracts including any side-letters, contractual framework agreements between lawyers and funder[6] or letters of understanding;

iii) third, **for the sake of full and immediate transparency**, third-party litigation funding agreements should only be permitted to be concluded with the person seeking legal advice (entrepreneur or consumer) and not with an intermediary company that provides legal advice, nor with a lawyer.

e) No influence of funder on litigation conduct or settlement

Any influence on the conduct of litigation and any restriction of instructions must be excluded. In other words, *applicants should have full control over the instructions to the lawyers***.** Moreover, a litigation funder is also prohibited from influencing the conclusion of a settlement or from making it subject to his consent/approval.

f) Stricter limitation of profit potential

Civil Justice systems exist to provide restitution to parties that have suffered a grievance. TPLF puts that fundamental purpose in jeopardy by allowing funders to siphon off large parts of the compensation. While the legislative own-initiative report suggests limiting funders' profit potential to 40% of the total proceeds and the Socialists and Democrats in the EP (S&D group) go further, limiting it to a maximum of 30%, EJF is of the opinion that not less than 75% of the total award – defined as including all granted damages amounts (including interest), all reimbursed costs, fees and other expenses – should be paid out to claimants and beneficiaries, and even then,

[4] Treasury Laws Amendment (Measures For Consultation) Bill 2021: Litigation Funding, Exposure Draft Explanatory Material, Outline of chapter 1.5, (Link) .

[5] Ibid., Outline of chapter 1.6, (Link) .

[6] Swiss Re Institute, US litigation funding and social inflation (fn. 2 above), p. 5: "Funders are dedicating increasing amounts of capital to law firm lending which typically provides a law firm with a full recourse loan for a fixed and/or performance-based return, for general business purposes (operating capital)."

so much *only in the most complex cases*. Typically, much more than 75% should remain for the beneficiaries in cases of medium difficulty and progressively more in straightforward cases.

g) Full court control of collective settlements

Judges should be endowed with strong case management powers to structure the case proceedings from a very early point in time, as they are the only ones truly able to safeguard the interests of the beneficiaries at court. An immensely helpful tool would be proper IT support for case management purposes. Courts must be able to structure the procedure and ensure the collection of relevant facts and details of beneficiaries including injuries/losses, so as to properly give effect to the Court's eventual judgment. Furthermore, once a collective action has been brought in front of the court, it must be resolved within the Court process. No termination and no withdrawal of the action shall be allowed without explicit Court decision. The Court must be able to scrutinize any proposed settlement for its legality and fairness, particularly with respect to the interests of the beneficiaries not actively involved in the procedure with a voice.

h) Direct responsibility of funder for adverse costs ("loser pays principle with teeth")

Under a scenario where the funded claimant is losing, the defendant might face a situation where the funded claimant is financially unable to reimburse the procedural costs. The winning defendant may in such a case have no legal path for recovering the costs from the funder (as the latter is not, from the legal point of view, a party to the proceedings). Accordingly, the EU regulatory framework for TPLF should introduce a "responsibility for adverse costs" rule for funders, giving courts and administrative bodies in EU Member States the power to require litigation funders to cover relevant adverse costs, including damages to be paid arising from counterclaims from the defendant. The Court should be able to require security for costs or proof of insurance backing.

i) Pay-out via public and not private infrastructure

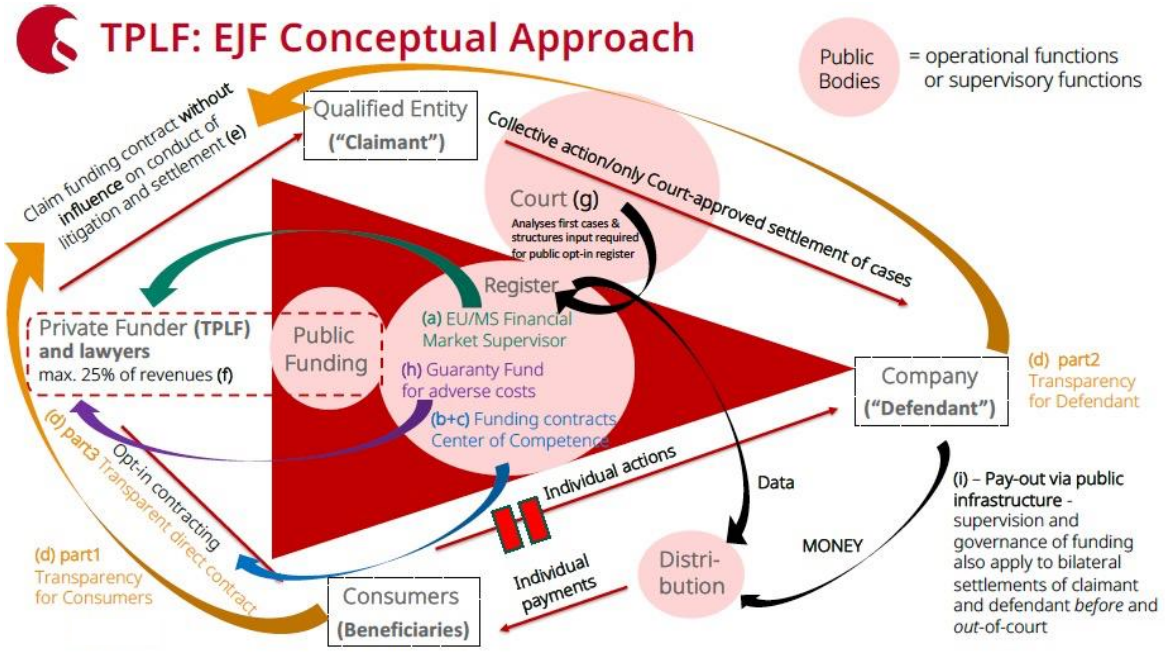
Settlements – see also above g) – need to be channeled through public infrastructure even when no procedure has been undertaken in court or ombuds entities in order to protect consumer interests in proper distribution also in such cases.

In General: Extension and clarification of the scope of application

The general financing of legal disputes should be regulated ("assumption of costs of legal disputes") as opposed to litigation funding in the narrower sense. After all, many cases are already settled out of court, e.g. through settlement agreements, even before court proceedings or dispute resolution proceedings. It should be clarified that the Report also applies to companies which offer litigation financing as an ancillary service or only occasionally, i.e. that the regulation of funding of costs for legal disputes is independent of the actor doing it. This also concerns, for example, legal tech providers, especially debt collection service providers, as well as banks and insurance companies active in this business.

Annex

Graphical presentation of safeguards a) to i)



Private vs. Public Litigation Funding Model