Berlin, October 26, 2021

Statement of the Legal Tech Association Germany

on the 17 June 2021 draft report of the European Parliament Committee on Legal Affairs regarding litigation funding [2020/2130(INL)]. [As of October 26, 2021]

The report of the European Parliament's Committee on Legal Affairs (JURI Committee) paints a distorted picture of third party litigation funding in Europe. It says providers "act in their own economic interest, rather than in the legal interest of claimants", "pocketing" the proceeds of litigation and leaving claimants "almost empty-handed" (pages 3 and 29). Simply by citing a 2019 speech in the Australian Parliament - and without consulting stakeholders in Europe themselves – JURI claims that litigation funding needs urgent and strict regulation within the European Union.

The Legal Tech Verband Deutschland (German Legal Tech Association) rejects this initiative as it violates the principles of subsidiarity and the sovereignty of the Member States in the field of justice. Its implementation would result in far-reaching cuts into national legal systems, both in substantive and procedural law.

The JURI Committee's approach would make access to justice more difficult for a large number of consumers and businesses, because litigation financiers often create an equality of arms in legal disputes. This is particularly the case where the damaging party is financially superior to the injured party and where legal disputes are very expensive and time-consuming. Two examples of this are antitrust damages and the handling of the diesel engine manipulations under civil law. The proposal ignores these advantages of litigation funding. It opposes it as an undesirable phenomenon, and to this end formulates drastic encroachments on the freedom of disposition protected by property law and on the professional and entrepreneurial freedom of litigation financiers. Furthermore, the proposed directives undermines the European Directive on Representative Actions and the Directive on Antitrust Damages.

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The proposals also undermine the German government's commitment to litigation funding as a means of promoting equity in the distribution of social resources in the judicial system. This is because German consumer services such as flightright.de, wenigermiete.de or hartz4widerspruch.de also promote access to justice through the use of litigation funding. With "no win no fee" offers, they enforce the rights of injured parties who cannot afford a legal dispute or who fear their costs.

The directives now under consideration would massively restrict the enforcement of the rights of damaged parties under national and Community law - contrary to the European law requirements of practical effectiveness, effective legal protection and equality of arms.

Overview of the draft of the JURI Committee

These are the key proposals of the JURI Committee:
Litigation funding providers of whatever form would require authorisation by a regulatory authority in the country of domicile to enter the EU market in the first place (Article 4(2)); individual funding agreements would have to be submitted to the competent court at the outset of each individual civil dispute, but also to the defendant on request (Article 15(1) and (3)); 'a court or administrative authority' would be required to monitor the fiduciary duties, transparency and 'fairness' of a litigation funding agreement at all times (Article 16, points (a) to (d)); the litigation funder's economic share would be capped in the event of judicial success and without regard to the circumstances of the case (Article 13(4)); and the litigation funder would be required to place the interests of the litigant "above its own interests" (Article 7(2)), to refrain from exerting any influence on the course of the litigation despite assuming full risk (Article 13(2)), as well as being required to fully bear costs in the event of a procedural defeat (Articles 13(3) and 17).

The position of the Legal Tech Association Germany

Litigation financing is what makes legal enforcement possible in the first place

Litigation funding often makes it possible to enforce individual rights ("access to justice"). It thus also serves to create a level playing field ("no competitive advantages for infringers") and to deter future infringements. Litigation funding creates equality of arms between parties of unequal strength, especially in the case of expensive legal disputes.

Litigation funding is even required under EU law in order to enable legal enforcement in many cases (principle of effectiveness). This is recognised, for example, in the area of antitrust damages. It serves not only the private compensatory interests of those affected, but also the public interest in protecting the competitive market order in the EU (ECJ, Judgment of 5 June 2014 - C-557/12 - "Kone", paras. 23, 25; cf. Federal Court of Justice, Judgment of 10 February 2021 - KZR 63/18, BGHZ 229, 1, para. 36). Antitrust damages claims would often not be asserted at all if the enforcement of the claim is not supported by litigation financiers (CEPS/EUR/LUISS, Making antitrust damages actions more effective in the EU: welfare impact

and potential scenarios, Report for the European Commission, 2007, p. 617 et seq.). This is because the costs of the economic expert report for the proof of damages and the representation in the very complicated and lengthy court proceedings represent an enormous hurdle for the injured companies in enforcing their rights.

Another example of the establishment of equality of arms is the civil law processing of customers claims against European motor vehicle manufacturers regarding diesel manipulations.

Litigation funding as an instrument for balancing interests

The "Act to Promote Consumer-friendly Offers in the Legal Services Market", also known as the "Legal Tech Act", which came into force in Germany on 1 October 2021, contains a clear commitment to litigation funding as an a means of promoting equity in the distribution of social resources in the justice system:

"In certain cases, it may be commercially necessary or appropriate for debt collectors or consumers to have the process funded by a third party (for example, commercial litigation funders, banks, or others).“
(Federal Government bill of 17 March 2021, Bundestag printed paper 19/27673, p. 46)

It creates legal certainty for services that relieve clients of the financial risks of defeat in court ("no win, no fee"), either acting as litigation financiers themselves or cooperating with them. In this way, the legislator aims to overcome the "rational disinterest" that has been shown to prevent holders of civil claims from taking legal action against overpowering opponents, even if their claims are obvious, for example if they have limited financial resources or if the cost risk of a lawsuit is out of proportion to the amount of the claim. The German legislator put it this way:
"As a consequence, [claimants] might prefer to forego enforcing a claim altogether rather than run the risk of a current loss of assets. Moreover, it might also seem hardly promising for them to pursue a case from start to finish against large and economically powerful companies as individuals, even if a large number of consumers are affected in the same way. “
(Federal Government bill of 17 March 2021, Bundestag printed paper 19/27673, p. 14)

In 2019 to 2021, some German courts of instance had denied the right to represent damaged parties in damages proceedings relating to the truck cartel, diesel lawsuits and other disputes - meaning, in particular, the bundling and financing of such disputes by third parties. The Legal Tech Act is a response to this case law. It clarifies that claims may be bundled and funded within the current statutory framework.

In recent years, the Federal Supreme Court has also emphasised the contribution that litigation funding makes to "access to justice". It has stated in several landmark decisions that litigation funding - contrary to the opinion of the JURI Committee - does not create a clash of interests but generally leads to a concurrence of interests with the claimant (Judgment of 27 November 2019 - VIII ZR 285/18, BGHZ 224, 89 - "Lexfox I", para. 208 and Judgment of 27 May 2020 - VIII ZR 45/19, BGHZ 225, 352 - "Lexfox IV", para. 71 - *"principled alignment of interests"* [of litigation funder and claimant]; Judgment of 13 July 2021 - II ZR 84/20 - "Airdeal", paras. 29, 33 and 42).

The situation is similar in other Member States. For many years, the so-called "class action under Austrian law" has proven its worth in mass damage cases. Here, several consumers assign their claims to a plaintiff for collection, who then jointly asserts them in court (similar to the German "Airdeal" case). Financing is usually provided by external litigation financiers in return for a contingency fee. The Austrian Supreme Court recognizes in this model a *"better position"* for the consumer. At the same time, it sees no reason why the defendant should interfere in the litigation financing of the plaintiff (decision of 27 February 2013 - 6 Ob 224/12b; cf. decision of 12 July 2005 - 4 Ob 116/05w). In the Netherlands and Finland cartel damages claims were also enforced in such a way and this idea has already been taken up by the EU legislator (Article 2 No. 4 [at the end] of the Cartel Damages Directive (EU) 2014/104/EU).

Competition law is at the same time a good example of the fact that there is an urgent interest in the business community not to make litigation financed "debt collection class actions" more difficult. In this area of law commercial enterprises, as victims of cartels, often request such offers, as they consider them more sensible, after consciously weighing up all the advantages and disadvantages, than taking action "alone" against their cartelised business partners (cf. the Opinion of the ECJ Advocate General of 11 December 2014 - C-352/13 - "CDC Hydrogen Peroxide", para. 29; see also German Federal Government, Bundestag Printed Paper 19/27673 of 17 March 2021, p. 63: *"the most commercially reasonable offer"*). This access to justice is

therefore by no means appreciated solely by private consumers, whose protection is the concern of the JURI Committee here, but also by enterprises of all sizes and in all sectors.

No need for this directive

The proposal is also methodologically incomprehensible, because there has not yet been any stocktaking of the need for such regulation for European providers of litigation funding, as is now being called for by the JURI Committee. Where are the European cases of abuse that now justify such regulation? And are there any gaps in the system of European and national rules that already limit the risks of litigation financing, especially vis-à-vis consumers, for example through the usury offence, immorality, the law on general terms and conditions, transparency provisions in consumer protection law and in the new German Legal Services Act? The JURI Committee does not present any review of the current legal system. Its proposal is unrelated to the current legal framework, and thus disproportionate.

The JURI Committee does not even attempt to explain the transfer of experience from Australia, which is subject to a very different legal system from the codified law of continental European countries (or even to present what has led to difficulties in litigation funding in other regions of the world). The Australian study it cites refers to opt-out "class actions" for consumers - and thus to a type of litigation hardly relevant in the EU. No need for regulation is apparent. It is also unclear how the proposed directive would promote the functioning of the internal market. However, this is a prerequisite for the adoption of an EU directive (Article 114(1) TFEU).

The subsidiarity principle is also not taken into account in the JURI Committee's regulatory concern. It is true that the effective enforcement of consumer and business rights guaranteed under EU law serves the objectives of a single internal market. However, the EU is far from having a single legal market. The national regulations for lawyers, notaries and other professionals differ considerably from one another. The same applies to procedural rules, the organisation of justice and the costs of proceedings. The proposal for a uniform, EU-wide regulation for the area of litigation funding misses the reality at this point in time. Litigation funding is currently carried out in the light of the national legal order, and must be consistent with it.

Current system of litigation funding in the European Union

Litigation financing is not a new phenomenon. The market offers a wide range of options (e.g. financing by professional litigation financiers and by means of insurance, sometimes with special arrangements (litigation cost funds, cost contributions, etc.)). No undesirable development has been observed in the EU over a period of several decades. The applicable law, in particular the general limits of private autonomy, which also applies to the conclusion and conditions of a litigation financing agreement, seems to be offering enough protection to the individual case. The German courts have dealt with specific participation quotas of various litigation financiers, mostly without objection (for example, Munich Higher Regional Court, judgment of 4 December 2017 - 19 U 1807/17; judgment of 31 March 2015 - 15 U 2227/14). The JURI Committee does not provide any proof for its core thesis that litigation funders would "often demand a disproportionately high share of the proceeds" (page 4). A need for EU-wide regulation has not been not established.

The German Legal-Tech Act, for example, introduced a procedure as per 1 October 2021 whereby a judicial supervisory authority examines the business models of providers acting as debt collection service providers in advance. In the interests of legal certainty, this examination can have a so-called factual effect in subsequent civil proceedings for the enforcement of claims. This system would be undermined if - as the JURI Committee proposes - the litigation financiers were now to be subjected to separate licensing and monitoring at any time, and if they were to be obliged to disclose their entire business model in the course of civil enforcement and to have their economic structuring options subject to regulatory restriction.

Of course, all this does not only apply to litigation financiers operating in the status of debt collection service providers, but to all market players as a whole. Such far-reaching interference in their freedom to exercise their profession and their entrepreneurial freedom (Articles 15, 16 of the EU Charter of Fundamental Rights; cf. for example Article 12 of the German Basic Law), as envisaged by the JURI Committee, lacks objective justification.

Inappropriate regulatory proposals

In addition, the JURI Committee makes a number of regulatory proposals, some of which are inappropriate and some of which are manifestly disproportionate. These are a few examples:

- Despite the broadly formulated scope of application (Article 2: "Funding of litigation"), the proposed directive is primarily concerned with damages proceedings, especially in the case of mass damages (refer to section A. of the draft resolution) - although litigation funding is also significant in other areas of private and civil procedural law. In any case, the proposal for a directive thwarts the current efforts at national and EU level to facilitate access to justice for mass damages, indeed to make it possible in the first place. It also undermines Directive (EU) 2020/1828 on Representative Actions for the Protection of the Collective Interests of Consumers, which already contains detailed funding requirements for this particular area.
- Capping the litigation funder's economic share without regard to the circumstances of the case (Article 13(4)) makes no sense, as litigation financing is a complex system of ex ante consideration of all risks. It must take into account the possibility of total loss and defies a rigid threshold approach. Even "very high contingency payments can [...] be justified in individual cases if the cost risk is exceptionally high" (Munich Higher Regional Court, judgment of 4 December 2017 - 19 U 1807/17).
- Out of touch with the world are the ideas on the rights of the debtor, who, as suggested by JURI, should be able to demand disclosure and review of litigation funding (Article 12(2) in conjunction with Article 3(d)). This makes the debtor the trustee of his own creditor (the claimant), a role which the debtor might gratefully assume, but only in speculation of a ground for dismissal of the claim even with the best prospects of success of the right claimed. This manifestly violates the protection of the funded claimants (contrary to recital 6).
- But also with a view to the debtor's own (potential) claims for reimbursement of costs, it is not clear why protections should apply to litigation financed actions that deviate from the everyman principle of "no right to a solvent plaintiff" (Article 17(1) of the draft Directive). After all, the "loser pays" rule, which is recognised throughout Europe, leads to plaintiffs and litigation funders thoroughly examining relevant cases in advance (due diligence). As a rule, therefore, only well-founded claims are pursued.

- The requirement for litigation funders to hold and demonstrate equity for 24 months for all cases (Article 6) is impracticable. In many cases, the specific funding liabilities cannot be predicted because they are determined by the actual course of the litigation (e.g. need for, consideration of and filing of appeals; court requirement of an advance on expenses for expert reports). This would also erect high entry thresholds for the litigation finance market and massively privilege incumbent players. However, it is also unnecessary because litigation funding can be secured through compulsory insurance and reasonable equity arrangements.
- The statutory "priority of interests" of the claimant over the litigation funder (Article 7(2)) assumes a conflict of interests which the case-law precisely does not confirm. A litigation funding agreement cannot be concluded in the first place if the parties cannot reach a consensus on their interests. Should the litigation funder disregard this and pursue its own interests to the detriment of the claimant, then he would be liable for damages, not to mention its own damage to its reputation with potential further clients.
- The prohibition of limiting the litigation funder's obligation to pay costs to the defendant (Article 13(5)) disregards private autonomy in litigation funding agreements and restricts it without any apparent reason. The court ordered reimbursement of the defendant's costs is, of course, not at the disposition of the claimant and the litigation funder. However, the claimant may be satisfied with internal or partial funding (e.g. mere contribution towards costs) on suitably more favourable terms. This outcome would also be unreasonably advantageous for the defendant, given it may mean no litigation funding occurs at all.
- The comprehensive obligation to disclose funding arrangements to the court or supervisory authority at the outset of proceedings (Article 15(1)) is a unilateral interference with the legal position of applicants. This means if they avail themselves of litigation funding, then they must justify it from the outset. They are thus in a worse position than other claimants as well as defendants who do not have to disclose their sources of funding (bank loan, etc.). Simply disclosing the fact of having to use litigation funding can put a claimant at a significant disadvantage in court.

About the German Legal Tech Association:

Legal Tech Verband Deutschland e.V. comprises all players in the German legal market who want to advocate in politics and society for a liberalization of the restrictive legal framework for the provision of modern legal services. The goal of Legal Tech Verband Deutschland e.V. is to bridge the supposed gap between the legal profession and legal tech companies inside and outside of law firms. Here, the Legal Tech Verband Deutschland advocates an innovation-friendly legal framework, legal certainty, and the promotion and facilitation of investments.

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