AmCham EU
SPEAKING FOR AMERICAN BUSINESS IN EUROPE

Our position

Regulating Third Party Litigation Funding

AmCham EU speaks for American companies committed to Europe on trade, investment and competitiveness issues. It aims to ensure a growth-orientated business and investment climate in Europe. AmCham EU facilitates the resolution of transatlantic issues that impact business and plays a role in creating better understanding of EU and US positions on business matters. Aggregate US investment in Europe totalled more than €3 trillion in 2020, directly supports more than 4.8 million jobs in Europe, and generates billions of euros annually in income, trade and research and development.

American Chamber of Commerce to the European Union
Speaking for American business in Europe

Avenue des Arts/Kunstlaan 53, 1000 Brussels, Belgium • **T** +32 2 513 68 92
info@amchameu.eu • amchameu.eu • European Transparency Register: 5265780509-97

Key concepts

The practice of third party litigation funding **(TPLF)** can be defined as: 'professional practice of an entity, which is not a party to the dispute, in funding all or part of the costs of domestic or cross-border proceedings; the funding is provided in exchange for a reimbursement of the investment and for remuneration that is dependent on the outcome of the dispute.'[1] It constitutes a rapidly growing market that can generate very high returns for investors (sometimes up to 500% of the invested capital)[2], ensures high levels of liquidity (robust secondary market for trading in legal claims) and enables portfolio diversification as litigation funding does not correlate with other classes of assets.

Why regulate?

While it is often argued that TPLF can increase access to justice by providing claimants with financial resources, there are several reasons why the EU should learn from other countries and regions that have allowed the TPLF sector to grow while properly regulating it as these kinds of financial services are starting to take hold in the EU. As the experience of other countries shows,[3] without proper regulations in place, there is a risk that TPLF could undermine the civil and commercial justice systems by failing to ensure adequate compensation for claimants (while providing funders with remuneration disproportional to the risk incurred) resulting in procedural decisions that are not in the claimant's best interest or leading to litigation abuse.

1) Litigation funding agreements as *sui generis* contracts

Litigation funding is based on the so-called Litigation Funding Agreement **(LFA)** between the claimant and the litigation funder. The consensus view among legal experts indicates that LFAs are sui generis contracts not covered by any specific pieces of legislation. Unless explicitly prohibited/regulated (as in the case of Slovenia or Greece), LFAs can be shaped by parties in line with the general principles of contractual freedom. Under such circumstances, the claimant, as the weaker party acquiring a TPLF service from the funder, may not receive sufficient protection. Furthermore, given that claimants in litigation cases are generally not natural persons but rather legal persons, in most cases they would not be afforded protection under the existing EU legislation on consumer protection (applicable to natural persons). Thus, there is a strong rationale for EU-wide regulation of LFAs.

2) Status of litigation funders

Litigation funders themselves constitute a relatively new class of financial institutions. As such, they are not covered by existing regulations pertaining to providers of financial services. Given the increasing role the funders play in the provision of justice, they should be considered as 'systemically important' for the justice system and certain aspects of their corporate governance should be regulated.

[1] Responsible private funding of litigation. European added value assessment; European Parliamentary Research Service, March 2021; p. 43.

[2] M. Roe, "Third Party Funding: An introduction", 2020.

[3] Selling More Lawsuits, Buying More Trouble; US Chamber Institute for Legal Reform, January 2020.

3) Fragmentation of Single Market due to divergent regulatory measures and policy approaches

In the absence of EU-wide harmonisation of rules, the risk of Single Market fragmentation will significantly increase.[4] For example, Greece and Ireland generally prohibit this kind of external funding of litigation. On the other hand, Slovenia has introduced safeguard measures to regulate the TPLF market. While Member States should retain the right to apply a full ban on TPLF, those that decide to allow funders to operate should apply a harmonised regulatory framework developed at EU level. Otherwise, as TPLF continues to proliferate across the EU, unilateral regulatory measures by Member States might prove ineffective as litigation funders set up operations in countries with the least restrictive regulations ('forum shopping' and 'race to the lowest standard'). This would lead to the fragmentation of the EU Single Market and would result in de facto undermining of Member States' regulatory autonomy.

Hitherto experience with self-regulatory measures indicates limited effectiveness of such an approach. In the United Kingdom, only 12 out of 50 funders are members of the Association of Litigation Funders which operates a self-regulatory code.[5] The code foresees relatively mild sanctions for its breaches (eg, a 500 GBP fine or expulsion from the association), and thus fails to disincentivise abusive activities.

Building blocks for effective TPLF regulation

Given the above, AmCham EU calls on the European Union to introduce a robust, harmonised regulatory regime for TPLF. Such a regulatory framework should incorporate the following building blocks:

Corporate governance of funders	
Licensing/authorisation of funders	It is customary for financial service providers to only be allowed to operate based on authorisations granted by regulatory/supervisory authorities, requiring such providers to satisfy certain regulatory requirements to obtain and maintain their operating license. Given the importance of litigation funders for the civil and commercial justice system, a licensing system should be applicable to such entities. Supervisory authorities at the Member State level should be established to receive applications for assessing, granting, rejecting or even revoking authorisations for funders to operate.
Capital requirements	In the absence of capital requirements for funders, a risk arises that a litigation funder - in case of undercapitalisation - may be unable to meet its obligations vis-à-vis the claimant under the LFA, as well as vis-à-vis the defendant (ie, costs arising in the case of claimant losing the proceedings under the 'loser pays principle'). This may lead to a situation whereby the funder discontinues involvement in an otherwise viable proceeding. Further risk arises when a claimant, in case of losing the initial proceedings, is facing a counterclaim from the defendant seeking redress for damages suffered due to the initial claim. Without adequate capitalisation, the funder may be unable to

[4] Uncharted Waters. An Analysis of Third-Party Litigation Funding in European Collective Redress; US Chamber Institute for Legal Reform, October 2019.

[5] Uncharted Waters. An Analysis of Third-Party Litigation Funding…, p. 39.

	support the claimant with resources necessary to participate in such secondary proceedings. Thus, supervisory authorities at the Member State level should, as part of their mandate for authorisation of funders, require funders to demonstrate sufficient capital to satisfy all their financial obligations (initial and secondary proceedings).
LFAs	
Transparency	Unless required by specific regulatory measures, claimants may be under no obligation to disclose during the proceedings that they are being funded by a third party. Thus, EU-wide regulation of TPLF should require the claimant to disclose the LFA to the court or administrative authority (depending on the nature of the proceeding) as well as to the defendant.
Review	LFAs should be subject to review by a competent authority in terms of their compliance with regulatory requirements discussed in this paper. To ensure uniform case-law, this review should be conducted by one specialised court or public authority per Member State. Such specialisation and concentration are justified by the complexity of third-party litigation funding agreements. Any court or administrative authority in charge of a case where a third-party funder is involved would have the opportunity to request this specialised jurisdiction to assess the compliance of the related third-party litigation funding agreement with the proposed rules. Such assessment may be demanded by the court or administrative authority at the request of one party or on its own initiative, even if doubts regarding this compliance have not been expressed by any party.
Conflicts of interest	Conflicts of interest might arise between the claimant and funder as well as between the funder and the lawyer representing the claimant. EU regulation should put in place rules to prevent such conflicts from occurring. Additionally, the regulation should protect the claimant's freedom in terms of selecting the procedural strategy, especially regarding potentially settling the issue. EU regulatory framework for TPLF should prevent the funder's control and/or influence over the claimant's procedural strategy and legal counsel's guidance.
Banning funder control	
Fiduciary duty	Providers of financial services are customarily required to operate under the 'fiduciary duty', ie they are expected to act in the best interest of their clients. LFAs are no different from other contracts covering the provision of financial services and thus should follow the same principle.
Cap on funders' share of reward	When assessing the funder awards' legality, its fairness, reasonability and proportionality should be ensured. To guarantee that these principles are properly applied, the EU regulatory framework should set a 'floor' of 75% as the share of the total awards to be secured for the claimant and the intended beneficiaries. This percentage is in line with the recommendations of the Australian Parliamentary report of December 2020.[6] In application of the principles of fairness,

[6] 'In addition, the committee notes the proposal by some class action law firms and litigation funders to guarantee a minimum return of at least 70 per cent of the gross proceeds to class action members, and recommends the Australian Government investigate the best way to implement this floor.' Australian Parliamentary Joint Committee on Corporations and Financial Services, Litigation funding and the regulation of the class action industry, 22 December 2020, Executive Summary, p. xviii.

	proportionality and reasonability, this 'floor' share shall only be reached for the most complex litigation; as a rule, funders should make do with less than a 25% share. Furthermore, rules should be put in place to prevent undermining of this 'floor' by defining that the award on which this share is calculated shall include all granted damages amounts and reimbursed costs, as well as fees and other expenses. It must also be prevented that this share could be diminished by charges, fees or any other kind of reduction to be paid by the claimant – directly or indirectly - to the funder.
Recovery of funds/responsibility for adverse costs	Under the 'loser pays' principle, the losing party is ordered to cover the costs of the winning party. 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 has in such a case 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 proceeding). Accordingly, the EU regulatory framework for TPLF should introduce a 'responsibility for adverse costs' rule for the funders, giving the courts and administrative bodies in EU Member States power to require the litigation funder to cover relevant adverse costs, including damages arising from counterclaims by the defendant.
Other aspects	
Scope	a) While TPLF is frequently used in collective redress litigation, the EU rules should apply whenever TPLF is employed, ie civil and commercial cases, alternative dispute resolutions (ADRs), mediations, insolvency proceedings, etc. b) Regulations should apply to both domestic and cross-border cases. c) Finally, given the variety of private litigation funding instruments that exist, the regulation should at least cover the following instruments: third party litigation funding agreements; assignment of claims (for collection purposes); and sale of claims.

The way forward

AmCham EU calls on the Commission, Parliament and Council to recognise the need to regulate TPLF in the EU and to take relevant steps to this end. The recently released legislative own-initiative report authored by Member of European Parliament, Axel Voss, constitutes a good starting point for regulating TPLF in the EU. To this end, AmCham EU believes the report should be adopted (albeit with modifications to incorporate all the safeguards listed above) by the European Parliament. Furthermore, the European Commission should take up the Parliament's proposal and initiate legislative procedure leading to the adoption of a relevant directive.