The consultation closes on **Friday 31 January 2025 at 23:59**.

Consultees do not need to answer all questions if only some are of interest or relevance.

Answers should be submitted by PDF or word document to **CJCLitigationFundingReview@judiciary.uk**. If you have any questions about the consultation or submission process, please contact **CJC@judiciary.uk**.

Please name your submission as follows: 'name/organisation - CJC Review of Litigation Funding'

You must fill in the following and submit this sheet with your response:

Your response is (public/anonymous/confidential):	Public
First name:	Maura
Last name:	McIntosh
Location:	London
Role:	Solicitor / Knowledge lawyer
Job title:	Knowledge Counsel
Organisation:	Herbert Smith Freehills LLP
Are you responding on behalf of your organisation?	Yes
Your email address:	[redacted]

Information provided to the Civil Justice Council:

We aim to be transparent and to explain the basis on which conclusions have been reached. We may publish or disclose information you provide in response to Civil Justice Council papers, including personal information. For example, we may publish an extract of your response in Civil Justice Council publications or publish the response itself. Additionally, we may be required to disclose the information, such as in accordance with the Freedom of Information Act 2000. We will process your personal data in accordance with the General Data Protection Regulation and the Data Protection Act 2018.

Consultation responses are most effective where we are able to report which consultees responded to us, and what they said. If you consider that it is necessary for all or some of the information that you provide to be treated as confidential and so neither published nor disclosed, please contact us before sending it. Please limit the confidential material to the minimum, clearly identify it and explain why you want it to be confidential. We cannot guarantee that confidentiality can be maintained in all circumstances and an automatic disclaimer generated by your IT system will not be regarded as binding on the Civil Justice Council.

Alternatively, you may want your response to be anonymous. That means that we may refer to what you say in your response but will not reveal that the information came from you. You might want your response to be anonymous because it contains sensitive information about you or your organisation, or because you are worried about other people knowing what you have said to us.

We list who responded to our consultations in our reports. If you provide a confidential response your name will appear in that list. If your response is anonymous, we will not include your name in the list unless you have given us permission to do so. Please let us know if you wish your response to be anonymous or confidential.

Civil Justice Council's Review of Litigation Funding: Interim report and consultation

Response on behalf of Herbert Smith Freehills LLP

This response to the above consultation is submitted on behalf of Herbert Smith Freehills LLP. Please note that have not sought to answer all of the questions.

1. To what extent, if any, does third party funding currently secure effective access to justice?

- Third party funding does secure access to justice to some extent, in that some meritorious cases are brought which otherwise could not be brought or, at least, would be unlikely to be brought due to the costs involved. This is particularly the case for class actions brought by or on behalf of individuals or small businesses.
- In many cases, however, this comes at too great a cost to claimants, who may not receive much benefit from the action once the lawyers and funders have had their share. This problem is recognised in paragraphs 2.18 to 2.20 of the Interim Report.
- Further, in opt-out collective proceedings in the Competition Appeal Tribunal (CAT), even where the fees paid to the funders do not necessarily[1] have a direct impact on the amount of damages the claimants receive (ie in circumstances where the return comes out of undistributed damages)[2], the lawyers and funders will generally benefit from the litigation to a far greater extent than the claimants who have allegedly suffered the damage.
- In both contexts, there is the risk of excessive returns incentivising funders to support unmeritorious or inflated claims, which are time-consuming and costly for defendants. This impact on defendants also needs to be considered when assessing whether funding secures effective access to justice.

4. Does the current regulatory framework surrounding third party funding operate sufficiently to regulate third party funding? If not, what improvements could be made to it?

- The current framework is not sufficient, including because it is purely voluntary. As recognised in the Interim Report, there are many funders operating in England and Wales who are not members of either the Association of Litigation Funders (ALF) or the International Legal Finance Association (ILFA).
- For those who are members of ALF, its Code of Conduct contains some helpful provisions (as referred to below) but ALF's powers to address breaches are very limited (eg private or public warnings, suspension/expulsion from ALF, and fines up to £500). ILFA members commit to abide by certain best practice principles, but ILFA is a representative body rather than a self-regulatory body.
- In collective proceedings in the CAT, the CAT will scrutinise funding arrangements and can require undertakings, for example that funders who are not members of ALF will comply with aspects of the ALF Code of Conduct such as relating to capital adequacy. However: (i) a

[1] There may be circumstances where even in these cases a funder's return can reduce the damages available to the class, for example, where the class is readily identifiable as say clients of the defendant and where distribution can be affected by account credits.

[2] Even then, payment out of undistributed damages does create incentives to favour distribution arrangements which might increase the level of undistributed damages; as a result, distribution arrangements need to carefully reviewed and supervised by the CAT (which is a potential burden on judicial resources).

requirement of formal regulation for funders would reduce the need for CAT scrutiny (and satellite litigation regarding the obligations of funders), thereby increasing efficiency for all parties and streamlining the certification process; and (ii) such scrutiny is not exercised outside the CAT.

5. Please state the major risks or harms that you consider may arise or have arisen with third party funding, and in relation to each state:

a. The nature and seriousness of the risk and harm that occurs or might occur;

b. The extent to which identified risks and harm are addressed or mitigated by the current self-regulatory framework and how such risks or harm might be prevented, controlled, or rectified;

c. For each of the possible mechanisms you have identified at (b) above, what are the advantages and disadvantages compared to other regulatory options/tools that might be applied? In answering this question, please consider how each of the possible mechanisms may affect the third party funding market.

- The key risks or harms listed below are addressed to some extent in the ALF Code, but that is not sufficient particularly given its voluntary status. In our view, they should each be addressed through statutory regulation.
    - Funders not having sufficient funds to meet their funding commitments
    - Funders terminating funding agreements without proper justification
    - Funders seeking to influence or control the conduct of the funded claim, including settlement decisions
- The risk of funders taking excessive returns is not addressed at all in the ALF Code, and in our view it should be addressed through a cap mechanism (see questions 12 and 13 below).
- As a more general point, an imbalance of power typically exists between litigation funders and funded parties, who may in some cases have little awareness or understanding of the terms to which they have signed up (and no awareness at all in the context of opt-out collective proceedings) in circumstances where there is a risk of misalignment of incentives between the funding party and their legal advisers. We consider that there needs to be oversight by an impartial regulator with statutory powers to ensure proper consumer protection – as there would be in most other scenarios in which consumers are entering into complex financial transactions. The decision of the CAT in *Riefa v Apple*[3] highlights that even a sophisticated party will struggle to understand funding arrangements. As a minimum, we consider that independent legal and financial advice should be obtained on the funding arrangements.
- A statutory regulator might also wish to consider the creation of a scheme to compensate funded parties who suffer loss as a result of funders failing to honour their funding commitments (including any commitments in respect of the payment of adverse costs where a claim fails) or otherwise acting contrary to their obligations – particularly bearing in mind that funders' liabilities, including for adverse costs, may emerge many years after a funding agreement is entered into, by which time their financial position may have changed. Such a scheme could be funded by a levy on the industry, similar to the Financial Services Compensation Scheme or the SRA Compensation Fund.

[3] [2025] CAT 5.

6. Should the same regulatory mechanism apply to: (i) all types of litigation; and (ii) English-seated arbitration?

a. If not, why not?

b. If so, which types of dispute and/or form of proceedings should be subject to a different regulatory approaches, and which approach should be applied to which type of dispute and/or form of proceedings?

c. Are different approaches required where cases: (i) involve different types of funding relationship between the third party funder and the funded party, and if so to what extent and why; and (ii) involve different types of funded party, e.g., individual litigants, small and medium-sized businesses; sophisticated commercial litigants, and if so, why?

- The same regulatory mechanism should apply to all types of litigation and English-seated arbitration, and all types of funded party, to avoid an overly complex framework.
- If, however, there is to be some variation, collective proceedings in the CAT should be subject to a higher degree of regulation, as those affected by the funding agreement are parties to neither the agreement nor the proceedings and therefore need additional protection.
- The same is true for proceedings brought on an opt-out basis under the CPR 19.8 representative action regime, as funders are able to influence how such cases are conducted on behalf of the represented class without their involvement. The extent to which a higher degree of regulation is needed in this context may depend, however, on whether and to what extent the courts permit the boundaries of the CPR 19.8 regime to expand, at the behest of claimant law firms and litigation funders, into a broader class action regime – and in particular whether the courts allow damages to be awarded to a representative claimant on behalf of the class and sums to be deducted from those damages to meet the fees of lawyers and funders. We find it difficult to see any justification for such an expansion, in the absence of a legislative regime, but that will ultimately be a matter for the courts.

7. What do you consider to be the best practices or principles that should underpin regulation, including self-regulation?

We consider that the key principles are as follows:

- the need for some statutory underpinning (see question 5 above);
- common rules for all, to avoid undue complexity (see question 6 above);
- a principles-based approach using ILFA principles (see questions 4 and 5 above); and
- appropriate recourse for both funded parties and defendants where there is a breach.

8. What is the relationship, if any, between third party funding and litigation costs? Further in this context:

e. Should the costs of litigation funding be recoverable as a litigation cost in court proceedings? i. If so, why? ii. If not, why not?

- The costs of litigation funding should not be recoverable as a litigation cost in court proceedings, for a number of reasons:
    - First, for the same key reason that the Jackson reforms resulted in CFA success fees and ATE insurance premiums no longer being recoverable – ie because recoverability placed an excessive and often disproportionate costs burden on opposing parties, which could drive them to settle at an early stage despite having good prospects of successfully defending the claim.

  - Second, because it would be anomalous in a litigation landscape in which the additional costs resulting from other forms of funding – eg CFAs, DBAs and ATE insurance – are a matter for the party who chooses to fund their claim in that way.
  - Third, if a claimant chooses to fund their claim through third party funding (or any other form of funding) that is their choice and is not something for which the defendant, who has not chosen to be sued and has no control over how the claimant funds their case, should be responsible. This is especially true for third party funding which (in comparison for example to a CFA success fee) can be significantly more than the costs of either party.
  - Fourth, it would remove the incentive on the funded party to secure the best terms and thereby inhibit the development of an efficient funding market.

- In light of the decisions in *Essar Oilfields Services Ltd v Norscot Rig Management PVT Ltd* [2016] EWHC 2361 (Comm) and *Tenke Fungurume Mining SA v Katanga Contracting Services SAS* [2021] EWHC 3301 (Comm), thought may also need to be given to the recoverability of the costs of litigation funding in English-seated arbitration proceedings. Given the recently enacted Arbitration Act 2025, we recognise that an amendment to s.59 of the Arbitration Act 1996 will not be possible. However, it may be worth considering whether guidance could be issued to clarify that "other costs", which form part of the costs of the arbitration that are potentially recoverable from an opposing party, should not include the costs of litigation funding.

9. What impact, if any, does the recoverability of adverse costs and/or security of costs have on access to justice? What impact if, any, do they have on the availability third party funding and/or other forms of litigation funding.

- The costs shifting rules and the potential for obtaining security for costs are both essential protections against the risk of defendants being exposed to unmeritorious litigation, and therefore are key to ensuring that defendants have access to justice.
- In general, they do not adversely impact access to justice for claimants because of the availability of ATE insurance and/or litigation funding in sufficiently meritorious cases, and (in relation to security for costs) because an order for security is always at the court's discretion and can be refused where it would stifle a genuine claim. Cost capping is available in appropriate cases.
- Claimants may of course also benefit from the recoverability of adverse costs. Moreover, adverse costs and Part 36 offers promote the settlement of cases.

10. Should third party funders remain exposed to paying the costs of proceedings they have funded, and if so to what extent?

- Yes, third party funders should remain exposed to paying the cost of proceedings to the same extent as the parties they fund – ie not solely to the level of the funding they have provided.
- Funders have chosen to take on the risk of funding proceedings, with the potential for a high return. In many cases the funding is instrumental to bringing or continuing the claim. Fairness demands that this potential benefit come with the risk of adverse costs, rather than exposing defendants to funded claims to the risk of not being able to recover their costs from the funded party.
- There is no indication that the exposure of third party funders to potential liability for the full extent of adverse costs, following the Court of Appeal's decision in *Chapelgate Master Fund Opportunity Ltd v Money* [2020] EWCA Civ 246 which made it clear that the Arkin cap is not a

binding rule, has dampened the enthusiasm of litigation funders to support litigation in this jurisdiction.

11. How do the courts and how does the third party funding market currently control the pricing of third party funding arrangements?

- There is some control on the pricing of third party funding arrangements in collective proceedings in the CAT.
    - The CAT can refuse to certify collective proceedings, due to concerns regarding the funding arrangements. To date, certification has not been refused on that basis alone. However, there have been changes made to funding arrangements in the light of concerns expressed by the CAT. (For example, in *Gormsen v Meta* the CAT expressed concerns at the ratchet mechanism applied to the multiple the funder would receive according to the date on which the case settled or judgment was obtained, following which the ratchet was "materially softened".) Further, in *Christine Reifa Class Representative Ltd v Apple,* the CAT expressed concerns about a clause which obliged the proposed class representative to seek an order that the funder's award be paid out of undistributed damages. Whilst a softened form of this clause was agreed following the concerns raised by the CAT, the CAT denied certification on the basis that the proposed class representative was not suitable to be authorised to represent the class, including because she did not demonstrate sufficient understanding of the funding arrangements. The CAT considered that she had not taken adequate steps to satisfy herself that the funding arrangement was appropriate and in the interests of the class she proposed to represent. In light of this, the CAT considered she was not sufficiently independent and robust and had relied too heavily on her legal advisors, without fully considering the potential conflicts of interest in play.
    - The CAT has powers to control the amounts paid to third party funders on judgment or settlement, but these have yet to be tested.
- Outside the context of collective proceedings, the courts do not exercise any control over the pricing of third party funding arrangements.

12. Should a funder's return on any third party funding arrangement be subject to controls, such as a cap? a. If so, why? b. If not, why not?

- Yes, there should be a cap on the funder's return, both to protect claimants against having to give up too large a proportion of their damages to the funder and to protect defendants from unmeritorious cases fuelled by the potential for excessive returns.
- The need for a cap is particularly acute given the lack of transparency in funding arrangements and the difficulty for claimants in comparing what is available in the market (see question 33 below).

13. If a cap should be applied to a funder's return:

a. What level should it be set at and why?

b. Should it be set by legislation? Should the court be given a power to set the cap and, if so, a power to revise the cap during the course of proceedings?

c. At which stage in proceedings should the cap be set? Please explain your answer by reference to a specified regulatory mechanism or mechanisms.

d. Are there factors which should be taken into account in determining the appropriate level of cap; and if so, what should be the effect of the presence of each such factor?

e. Should there be differential caps and, if so, in what context and on what basis?

- In our view, the cap should be set as a maximum percentage of any damages recovered by the funded claimant. We suggest that it would be appropriate for the cap to be set at the same level as the maximum percentage fee that can be charged by a legal representative under a DBA, which for commercial cases is currently 50% (inclusive of VAT). However, any amendments to how the cap operates for DBAs (see our suggestions at question 17 below) should also apply to any cap on a third party funder's return.
- The cap should be set by legislation or regulations, to give clarity and certainty, rather than being set by the court on a case-by-case basis. Funding agreements that fail to comply with the relevant statutory or regulatory restrictions should be unenforceable. Consideration should also be given to a cap on the level of return by reference to the amount funded or committed. This reflects the risk of the claim being funded. There are levels of return which would imply that there is a high risk that the claim will fail. In such circumstances it is hard to justify funding on access to justice grounds given the burden on judicial resources and defendants.

17. Are there any reforms to conditional fee agreements or damages-based agreements that you consider are necessary to promote more certain and effective litigation funding? If so, what reforms might be necessary and why? Should the separate regulatory regimes for CFAs and DBAs be replaced by a single, regulatory regime applicable to all forms of contingent funding agreement?

- The DBA Regulations 2013 are in need of major reform, as has been pointed out in successive reviews since they were introduced. The Regulations as currently drafted are both unclear and overly restrictive. While some degree of clarity on some issues has been provided by the case law, many difficult issues remain.
- In broad terms, we would support the proposals put forward by Professor Rachael Mulheron and Nicholas Bacon KC in their review of the DBA Regulations in 2019 including to:
    - move to a success fee model, rather than the Ontario model, so that recoverable costs would be payable to the lawyer on top of the DBA percentage payment, rather than being subsumed within it;
    - expand the availability of DBAs beyond money claims so that they can be used for money or money's worth; and
    - make it clear that "hybrid" DBAs are permitted, so that the DBA can provide for the lawyer to receive a payment (subject to a maximum, eg 30% of irrecoverable costs) if the claim is lost (though we consider that such a payment should be permissible where the claim results in damages or settlement at a level at which the DBA payment would be lower than that figure, rather than only on a loss). While the reasoning of the majority of the Court of Appeal in *Lexlaw v Zuberi* [2021] EWCA Civ 16 suggests that hybrids are permitted in at least some circumstances, the boundaries of what is permitted are not entirely clear following that decision.
- If the amendments proposed by Prof Mulheron and Mr Bacon were to be adopted, we would have some comments on the drafting, including that the draft Regulations they proposed required irrecoverable costs, counsel's fees and VAT to be netted off from the DBA payment, when they should simply be included within it. We can expand on these if that would be helpful.
- We do not consider that the separate regulatory regimes for CFAs and DBAs should be replaced by a single, regulatory regime. Each of these types of fee agreement may be appropriate in particular circumstances, and seeking to combine the two would unnecessarily reduce flexibility for both law firms and clients.

23. Is there a need to amend the Civil Procedure Rules or Competition Appeal Tribunal rules, including the rules relating to representative and/or collective proceedings, to cater for the role that litigation funding plays in the conduct of litigation? If so in what respects are rule changes required and why?

- The Civil Procedure Rules should be amended to require disclosure of funding arrangements (see question 27 below).
- The CAT rules should be amended to clarify what can and cannot be redacted from litigation funding agreements when they are disclosed to the court and opposing parties. The current position often leads to large amounts of unnecessary correspondence and/or satellite litigation in order to obtain relevant information as the documents are provided with a large number of redactions. We would suggest that the default position should be that funding agreements are disclosed in their entirety, save for the redaction of personal information (eg any home addresses) and the level of any CFA success fees and/or ATE insurance premiums.
- In the case of collective actions the funding arrangements should be publicly accessible. The CAT has expressed concerns in both *Gormsen* and *Riefa* that confidentiality has been asserted over funding arrangements so that information is not available to the class.

25. Is there a need to amend the Civil Procedure Rules in the light of the Rowe case? If so in what respects are rule changes required and why?

- In *Rowe*, the Court of Appeal commented that commercial litigation funders should be properly capitalised, in order to be able to meet an adverse costs order if the claim fails. They should therefore be in a position to defeat any application for an order that security be provided by demonstrating an ability to meet an adverse costs order.
- In light of the principle reflected in those remarks, we consider that funders should be prevented from charging their clients an additional fee where the funder is required to provide security for costs. The question of whether a funder is required to provide security is something that is within its control, and the costs of doing so should not be visited on the funded claimant.

27. To what extent, if any, should the existence of funding arrangements or the terms of such funding be disclosed to the court and/or to the funded party's opponents in proceedings? What effect might disclosure have on parties' approaches to the conduct of litigation?

- The existence and key terms of funding arrangements already have to be disclosed in the context of applications for collective proceedings in the CAT.
- We consider that this approach should be expanded to all legal proceedings, so that there is transparency as to the relevant interests. The CAT's recent decision in *Christine Reifa Class Representative Ltd v Apple* (referred to in our answer to question 11 above) highlights the potential conflicts that can arise between the funded client and the legal representatives, as well as the funders, which need to be properly tested. That can only happen where there is full transparency.
- In our view, there should be a requirement for disclosure to the court in all cases, with a presumption in favour of disclosure also to opposing parties (subject to the court's discretion if there is an objection to disclosure).

28. To what extent, if at all, do third party funders or other providers of litigation funding exercise control over litigation? To what extent should they do so?

- In theory, funders do not exercise control over litigation in England and Wales, following comments by the Court of Appeal in the *Arkin* case that funding which is not objectionable will "leave the claimant as the party primarily interested in the result of the litigation and the party in control of the conduct of the litigation". This principle is enshrined in the ALF Code of Conduct, which provides that the funder shall "not seek to influence the funded party's solicitor or barrister to cede control or conduct of the dispute to the funder".
- Where the boundaries lie, however, is not entirely clear. The Code also provides that the funding agreement shall state whether (and if so how) the funder may provide input to the litigant's decisions in relation to settlements. It is implicit, therefore, that the funder must be able to have some input into that process, and it may be difficult to say where proper consultation ends and improper control begins.
- Even if the funder cannot force the funded party to conduct the claim in a particular way, or make a particular settlement offer, or agree to a settlement offer received, the wish to keep the funder on side and, ultimately, avoid any threat of the funder terminating the funding agreement, may well mean that the funded party has no choice but to comply with the funder's wishes in many cases.
- In our view, funded parties should have a right to seek directions from the court, by an application to an independent judge (ie a judge with no other involvement in the case) without notice to the opponent, where they consider that the funder is exercising an excessive degree of control, including by threatening to withdraw funding in circumstances which are not permitted by the funding agreement and/or any regulatory restrictions that may be introduced.

30. Should the court be required to approve the settlement of proceedings where they are funded by third party funders or other providers of litigation funding? If so, should this be required for all or for specific types of proceedings, and why?

- This requirement already exists for opt-out proceedings in the CAT, and that requirement should continue given that the settlement will be binding on class members who are not parties to the proceedings.
- The same requirement should apply to proceedings brought on an opt-out basis under the CPR 19.8 representative action regime, to the extent that any settlement purports to bind the represented class without their agreement.
- We do not consider that this requirement should be expanded to other cases supported by litigation funders.

33. To what extent does the third party funding market enable claimants to compare funding options different funders provide effectively?

- Based on the report published by The Class Representatives Network in September 2024, which surveyed various class representatives and proposed class representatives as to how they chose their funding and their relationship with their funders, it seems there is currently very limited scope for claimants to compare funding options.
- While that survey was conducted in the context of collective proceedings in the CAT, there is no reason to believe that it is easier for claimants in other contexts to compare funding options.

34. To what extent, if any, do conflicts of interest arise between funded claimants, their legal representatives and/or third party funders where third party funding is provided?

- Conflicts of interest exist or can arise at various stages of the relationship between the funder and the funded party, from the inception of the funding agreement through to consideration of the terms of settlement.
- The potential for such conflicts has been vividly illustrated by the CAT's recent decision in *Christine Reifa Class Representative Ltd v Apple* (referred to above) and by the dispute that has arisen between the class representative and the funder backing the *Merrickx v Mastercard* litigation in relation to the settlement reached in that case where the funder has refused to agree to a settlement on the basis that it was "too low" and would not provide sufficient money for the funder's return provided for under the LFA. The funder has subsequently issued separate proceedings against Mr Merricks for alleged breach of the LFA and also intervened in the settlement hearing in front of the CAT to object to the request for the CAT to approve the settlement. Further, at the *Gutmann v South Western Trains* settlement hearing in April 2024, counsel for the class representative said that they could not agree to an amendment to the distribution arrangement proposed by the CAT as it would not leave sufficient funds for the funder, as too much would likely be distributed to the class. This demonstrates the conflict that can arise in collective proceedings where it is not the class members who are the ones agreeing to the settlement arrangements.

35. Is there a need to reform the current approach to conflicts of interest that may arise where litigation is funded via third party funding? If so, what reforms are necessary and why.

- Yes, we consider that conflicts of interest should be dealt with as part of a system of statutory regulation which would include:
    - A requirement for the funded party to be advised that it should obtain independent legal advice on the funding agreement (ie from a lawyer with no connection to the third party funder or the claim for which the funding is proposed).
    - A requirement for the litigation funder to identify and manage any conflicts of interest which may arise through other business of the funder or the ultimate source of funds, including but not limited to their involvement in other cases or their relationships with, law firms, arbitrators or opposing parties.
    - A mechanism for resolving conflicts arising from the differing interests of the funder and the funded party when it comes to agreeing a settlement or potential termination of the funding agreement, such as a requirement for the matter to be referred to an independent KC for determination at the cost of the funder.

Herbert Smith Freehills LLP

28 February 2025