

# Is It All That Fishy? A Critical Review of the Concerns Surrounding Third Party Litigation Funding in Europe

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## Abstract

Virtually all major jurisdictions worldwide, including those in Europe, have been facing constrained budgets in civil justice and increasing litigation volume, delays, complexity and costs in the last few decades. This makes it difficult, or impossible, for certain individuals and entities to pursue meritorious claims, be it individually or collectively, posing a significant challenge to access to justice. With third-party funding (TPF) of litigation frequently touted as a promising private funding solution to this problem, this article explores the question of how and why the proliferation of TPF has been viewed with a considerable degree of caution in Europe, and questions to what extent this caution is warranted. The scale of the civil justice crisis in Europe, the shift from public to private funding and the purported benefits of TPF are first briefly investigated. The article then proceeds to critically examine, including from a law-and-economics perspective, the main sources of concern leading to the scepticism shown towards TPF in Europe, which is still largely unregulated. These sources are the commodification of justice, conflicts of interest and funder capital inadequacy. Particular reference is made to the regulatory frameworks of the jurisdictions of England and Wales, the Netherlands and Germany in Europe, and at the European Union level, to the Representative Actions Directive. It concludes by restating the potential benefits and complexity of this industry and the importance of distinguishing and analysing the arguments most commonly raised against it in the literature, policy and jurisprudence.

**Keywords:** access to justice, third-party litigation fund, collective redress, Europe, conflicts of interest.

## 1 Introduction

Virtually all major jurisdictions worldwide, including those in Europe, have been facing cuts to public expenditure in civil justice and increasing litigation volume, delays, complexity and costs in the last few decades.<sup>1</sup> This makes it difficult, or impossible, for certain individ-

uals and entities to pursue meritorious and socially desirable claims, be it individually or collectively, posing a significant challenge to access to justice. Third-party funding (TPF) of litigation is frequently touted as a promising private funding solution to this problem.<sup>2</sup> TPF can be broadly defined as an arrangement whereby a third party, which has no other link to a dispute, provides the funding for some or all of a party's litigation costs in return for a share of the proceeds in case of success.<sup>3</sup> TPF is only one form of private or market-based funding of dispute resolution; other forms are contingency fees arrangements and legal expenses insurance.<sup>4</sup> TPF can be used for both individual claims and for collective redress, and the industry has been expanding at a rapid pace in the last few years in a number of jurisdictions around the world.<sup>5</sup> This is especially true in common law jurisdictions, including, for instance, Australia, the United States and England and Wales.<sup>6</sup> So far, the use of TPF has been limited in the European Union (EU). However, it is expected to be of growing importance in the provision of dispute resolution services in the coming years, with climate change and the recent COVID-19 pandemic potentially giving rise to a significant number of claims.<sup>7</sup>

X.E. Kramer and S. Kakiuchi, 'Austerity in Civil Procedure and the Role of Simplified Procedures', 8 *Erasmus Law Review* 139, at 139 (2015).

2 See, for example, for consumer collective redress, L.T. Visscher and M.G. Faure, 'A Law and Economics Perspective on the EU Directive on Representative Actions', 1 *Journal of Consumer Policy* 1-28, at 8 (2021). Collective redress refers generally to the obtaining of redress in cases of mass harm situations.

3 J. Saulnier, K. Müller & I. Koronthalyova, 'Responsible Private Funding of Litigation. European Added Value Assessment', *European Parliament Research Service* (March 2021), at 1.

4 *Ibid.*, at 45. Contingency fees refer to a payment agreement prior to the end of a judicial procedure, wherein the lawyer receives a share of the proceeds of the dispute if the client is successful and nothing if the client is unsuccessful. Legal expenses insurance, on the other hand, is insurance taken out in the form of the payment of a premium, either before a dispute starts to cover the insured's litigation costs (BTE) or, alternatively, after the dispute starts, to cover the insured's future litigation costs (ATE).

5 *Ibid.*, at 1.

6 England and Wales was the most popular European jurisdiction for collective redress actions in 2020, followed by the Netherlands. [www.litigationfutures.com/news/uk-leads-the-way-as-class-actions-surge-across-europe](http://www.litigationfutures.com/news/uk-leads-the-way-as-class-actions-surge-across-europe). England and Wales is also home to the largest TPF market, followed by the Netherlands and Germany. See Saulnier, Müller & Koronthalyova, above n. 3, at 8.

7 Saulnier, Müller & Koronthalyova, above n. 3.

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1 See generally amongst others; C. Hodges, S. Vogenauer & M. Tulibacka, *The Costs and Funding of Civil Litigation: A Comparative Perspective* (2010).

In practice, while private funding of litigation has been in place for a long time for a variety of reasons in specific circumstances, including, for instance, through donations, trade unions or consumer organisations, professional commercial TPF is today almost exclusively dedicated to high-value claims in Europe. These claims are where funders can higher returns from their investments. TPF is, therefore, commonly used in the collective redress frameworks by small and medium enterprises (SMEs) litigating against larger opposition and in international arbitration proceedings. Professional funders have nowadays started to diversify their investment portfolios to include smaller lawsuits,<sup>8</sup> and some have provided pro bono funding<sup>9</sup> while new funders are also crowdfunding litigation.<sup>10</sup> In Europe, unlike in the United States, consumer TPF, that is, funding to individual non-sophisticated litigants, most of whom have not engaged in litigation before, is not widespread.<sup>11</sup> Despite its potential to provide access to justice where otherwise not available, one can often discern a somewhat negative attitude towards TPF: that there is something ‘fishy, even distasteful’ about the practice.<sup>12</sup> It has indeed been heavily resisted in several jurisdictions throughout the years.<sup>13</sup> This article identifies the main objections that are commonly raised in relation to TPF in the literature, jurisprudence and policymaking, and generally analyses how they are currently dealt with in the European jurisdictions explored. TPF, especially in individual claims, is still largely unregulated if one excludes self-regulation, jurisprudence, the court’s discretion and professional ethical rules.<sup>14</sup> This article focuses on several European jurisdictions, but in particular on the ones where the TPF industry is most developed: England and Wales, the Netherlands and Germany. Out of these three, TPF seems to be most developed<sup>15</sup> and viewed most positively in England and Wales jurisdiction,<sup>16</sup> and while it is also well developed in the Netherlands and Germany, one can identify a sometimes suspi-

cious attitude towards it in Germany.<sup>17</sup> This attitude is also evident at the EU level<sup>18</sup> in the recent EU Representative Actions Directive for consumers (RAD),<sup>19</sup> where TPF is allowed, under strict conditions, in collective redress actions.<sup>20</sup> By severely restricting TPF, this attitude is implicit in the RAD.<sup>21</sup> It is also undisguised in the recent European Parliament Draft Report with recommendations to the Commission on Responsible Private Funding of Litigation (Draft Report).<sup>22</sup>

Following the Introduction, Section 2 briefly reviews the growth and benefits of TPF. The subsequent sections then illustrate, categorise and critically examine the main objections to the industry, which are the commodification of justice (Section 3.1), conflicts of interests (Section 3.2) and funder capital inadequacy (Section 3.3). These concerns are the ones most often encountered in the existing literature, jurisprudence and policy. This article critically examines this non-exhaustive list of objections, including from a law-and-economics perspective, which provides useful insights. It also briefly sketches how these have been dealt with so far in the selected jurisdictions, while focusing on both individual and collective litigation in Europe. The article then concludes with a few thoughts on the future development of this industry in Europe. It highlights anew the complexity of this industry and the importance of understanding it by distinguishing and putting the main concerns most commonly raised against it under a critical lens.

- 8 I.N. Tzankova and X.E. Kramer, ‘From Injunction and Settlement to Action: Collective Redress and Funding in the Netherlands’ in A. Uzelac and S. Voet (eds.), *Class Actions in Europe: Holy Grail or a Wrong Trail?* (2021) 97.
- 9 For instance, England and Wales funder Therium has set up a pro bono scheme to tackle legal aid gaps. [www.ft.com/content/72a099a2-41b1-11e9-9bee-efab61506f44](http://www.ft.com/content/72a099a2-41b1-11e9-9bee-efab61506f44).
- 10 Saulnier, Müller & Koronthalyova, above n. 3, at 8.
- 11 R. Avraham and A. Sebok, ‘An Empirical Investigation of Third Party Consumer Litigant Funding’, 104 *Cornell Law Review* 1133, at 1135 (2019).
- 12 W.B. Wendel, ‘Alternative Litigation Finance and Anti-commodification Norms’, 63(2) *DePaul Law Review* 655, at 656 (2014).
- 13 W. Van Boom, ‘Litigation Costs and Third-party Funding’, in W. Van Boom (ed.), *Litigation, Costs, Funding and Behaviour: Implications for the Law* (2017) 5.
- 14 C. Hodges, J. Peysner & A. Nurse, ‘Litigation Funding: Status and Issues’, 55 *Oxford Legal Studies Research Paper*, at 151 (2012).
- 15 B. Zhang, ‘Third Party Funding for Dispute Resolution: A Comparative Study of England, Hong Kong, Singapore, the Netherlands and Mainland China’ (Doctoral theses on file at University of Groningen) (2019). <https://doi.org/10.33612/diss.102275228>, at 2.
- 16 Sir Rupert Jackson’s comprehensive Review of Civil Litigation Costs: Final Report 2009 recommended that there should be as many funding methods as possible available to litigants, which would promote access to justice, provided that they are suitably regulated. Available at [www.judiciary.uk/wp-content/uploads/JCO/Documents/Reports/jackson-final-report-140110.pdf](http://www.judiciary.uk/wp-content/uploads/JCO/Documents/Reports/jackson-final-report-140110.pdf).

- 17 A. Stadler, ‘Third Party Funding of Mass Litigation in Germany: Entrepreneurial Parties – Curse or Blessing?’ in L. Cadiet, B. Hess & M.R. Isidro (eds.), *Privatizing Dispute Resolution* (2019) 209, at 209-231. See also A. Bruns, ‘Third-party Financing in the Perspective of German Law: Useful Instrument for the Improvement of the Civil Justice System or Speculative Immoral Investment?’ 8(3) *Journal of Law, Economics and Policy* (2012), 525 and I. Tillema, *Entrepreneurial Mass Litigation: Balancing the Building Blocks* (2019), at 53. The German government in 2013, in response to a Commission Recommendation on collective redress, expressed that no incentives should exist to profit from litigation.
- 18 Visscher and Faure, above n. 2, at 20.
- 19 Directive 2020/1828/EU of 25 November 2020 on representative actions for the protection of the collective interests of consumers and repealing Directive 2009/22/EC, OJ L 409/1.
- 20 A. Biard and X.E. Kramer, ‘The EU Directive on Representative Actions for Consumers: A Milestone or Another Missed Opportunity?’ 27 *Zeitschrift Für Europäisches Privatrecht* 249, at 251-2 (2019).
- 21 Visscher and Faure, above n. 2, at 20-1. The RAD rejects American-style class (group) actions with market-based solutions for funding. See also C.I. Nagy, *Collective actions in Europe. A Comparative, Economic and Trans-systemic Analysis* (2019), at 59-60. Contemporary developments in Australia are very interesting to compare with those in Europe given the presence of the loser-pays rule and general prohibition of contingency fees in both. Recent federal government reviews of TPF in class actions in Australia have also very recently proposed increasingly stringent and aggressive regulation of TPF. See J. Geisker and D. Luff, ‘Australia’, in L. Latham (ed.), *The Law Reviews - The Third Party Litigation Funding Law Review, Fifth Edition* (2021) available at <https://thelawreviews.co.uk/title/the-third-party-litigation-funding-law-review/australia#>>
- 22 European Parliament Draft Report with recommendations to the Commission on Responsible Private Funding of Litigation. See also <https://conflictoflaws.net/2021/the-time-is-ripe-proposed-regulation-of-third-party-litigation-funding-in-the-european-union/>> and <https://www.theparliamentmagazine.eu/news/article/protecting-eu-consumers>>

## 2 The Rise and Benefits of TPF

### 2.1 The Rise of the TPF Industry in Europe

The growing TPF industry marks a trend in litigation funding in the decades following World War II. The focus of litigation funding was primarily on public legal aid, but in more recent decades it has been shifting to private means. Amongst the reasons for this shift are the increasing cost of legal aid schemes and cuts in public expenditure in civil justice, and the increasing number, complexity and duration of cases, including mass claims and cross-border cases.<sup>23</sup> In the 1990s, it was widely accepted that civil justice systems across Europe were in crisis, with one of the main reasons being the high cost of litigation.<sup>24</sup>

Given the cuts in public legal aid, private funding becomes essential for certain individuals, large corporations and SMEs who choose not to incur or cannot afford the risks and costs of litigation. Without private funding, they would either increasingly resort to go to court unrepresented or lack access to justice altogether.<sup>25</sup> It was in recent years, especially after the 2009 financial crisis, that private professional third-party funders came to the fore.<sup>26</sup> This happened first in Australia, where TPF has been available since 1995. Here litigation funders emerged after insolvency practitioners started to be able to contract for the funding of lawsuits, if these are deemed as company property,<sup>27</sup> and a combination of the loser-pays rule and prohibition of contingency fees led to a fertile ground for the industry to develop.<sup>28</sup> This was followed by the rest of the common law world and continental Europe.<sup>29</sup> The industry in Europe, which has been growing at a steady rate, is estimated at around one billion Euro and is projected to keep growing rapidly.<sup>30</sup> The largest funders operating in the European Union are Burford Capital, Omni Bridgeway and Therium Capital Management.<sup>31</sup>

### 2.2 The Need for and Benefits of TPF

The lack of access to justice that results from a lack of funding can be viewed from a law-and-economics perspective. This perspective can provide useful additional insights explaining the need for a funding solution to the access to justice problem.

Firstly, TPF<sup>32</sup> enables access to justice (or compensation) and has a deterrent function. In engaging in activities, parties can create negative externalities, that is, the uncompensated indirect impact on the well-being of individuals other than those involved in the harmful activity in question.<sup>33</sup> They spill over on bystanders without them being internalised by the actors engaging in the harmful activities. Externalities constitute a market failure. In other words, the harmful actors do not incur the social cost of their activity. Externalities can be private if they affect one individual or public if they affect multiple individuals.<sup>34</sup> Lack of internalisation causes social costs if there is 'a too high activity level and a too low investment in care'<sup>35</sup> and the market failure will persist. In order for internalisation to occur, legal rights may be enforced publicly, which is common for criminal and tax offences, or privately, as happens in tort, contract and property disputes.<sup>36</sup> Unless externalities are internalised through private bargaining, government intervention or public enforcement, the victims have the option of starting legal proceedings and pursuing their claims through private enforcement.

The law-and-economics perspective is primarily concerned with incentivising desirable behaviour. From this perspective, the primary goal of obtaining damages is not to compensate the victims but to incentivise potential wrongdoers to engage in socially desirable behaviour in the future.<sup>37</sup> This model of deterrence entails that the expected costs of wrongdoing need to exceed, or at least equal, the benefits. The expected costs include the size of the penalty and the chances of detection and enforcement. By increasing the penalties and/or the probability of enforcement, the appeal of wrongdoing can be reduced. Bigger penalties can counterbalance under-enforcement by increasing the expected cost of wrongdoing. Private enforcement depends on individuals' incentives to detect and litigate harms at their own expense. When claims are not pursued because the costs of enforcing them outweigh the expected recovery, the civil justice system fails 'either to deter socially wasteful activity or to compensate for violations of rights'.<sup>38</sup>

This can happen because individuals might simply lack the funds to initiate proceedings. If they have the funds,

23 See generally R.D. Kelemen, *Eurolegalism – The Transformation of Law and Regulation in the European Union* (2011), at 63-71; Van Boom, above n. 13.

24 A. Zuckerman, *Civil Justice in Crisis* (1999).

25 A. Higgins, 'The Costs of Civil Justice and Who Pays?' 37 *Oxford Journal of Legal Studies* 687, at 687-8 (2017).

26 G. Solas, *Third Party Funding: Law, Economics and Policy* (2019), at 28-37.

27 M. Legg, L. Travers, E. Park & N. Turner, 'Litigation Funding in Australia', *UNSW Law Research Paper No. 2010-12*.

28 This combination is also present in Europe, which could lead to similar results. I. Samuel, 'Litigation Funding and the Problem of Agency Cost in Representative Actions' 63(2) *Depaul Law Review* 561 (2014) at 567-570.

29 Solas, above n. 26, at 38-122. See also generally Zhang, above n. 15.

30 The European Parliament Research Service finds that it is growing at an average of 8.8% per year in the next 5 years, and that globally, it provides higher return rates than other financial investment markets. See Saulnier, Müller & Koronthaloyova, above n. 3, at 3-7.

31 *Ibid.*, at 8.

32 And other forms of litigation funding in which the costs and risks of litigation are not borne by the claimant. For the purposes of this article only the claimant will be considered, and not defendants. Claimants are much more common recipients of TPF. See Saulnier, Müller & Koronthaloyova, above n. 3.

33 L.T. Visscher, 'Tort Damages', in M. Faure (ed.), *Tort Law and Economics, Encyclopaedia of Law and Economics*, Second Edition (2009) 153, at 153.

34 R.D. Cooter and T.S. Ulen, *Law and Economics*, Sixth Edition (2012), at 39.

35 M. Faure and L.T. Visscher, 'Mass Damages in the Netherlands: To Collect or Not to Collect, that Is the Question', in M. Faure, W. Schreuders & L.T. Visscher (eds.), *Don't Take It Seriously. Essays in Law and Economics in Honour of Roger Van den Bergh* (2018) 389, at 390.

36 W.M. Landes and R.A. Posner, 'The Private Enforcement of Law', 4(1) *The Journal of Legal Studies* 1, at 1 (1975).

37 Visscher and Faure, above n. 3, at 2.

38 I. Ramsay, 'Framework for Regulation of the Consumer Marketplace', 8(4) *Journal of Consumer Policy: Consumer Issues in Law, Economics and Behavioural Sciences* 353, at 356 (1985).

they could rationally decide not to start legal action as litigation is costly and risky. Lawyer costs, court fees, information costs and the time and hassle dedicated to the case need to be taken into consideration. There is also the chance that a claim can be unsuccessful and that the costs of the opposing party would need to be paid. The expected benefits of pursuing a claim could therefore be less than the expected costs.<sup>39</sup>

This very often happens in public externalities or mass harm situations, such as pollution. In such collective redress scenarios, one has dispersed losses and individuals often rationally decide not to sue due to rational apathy because of the usually limited amount of compensation involved in proportion to the costs and risks of litigation.<sup>40</sup> In these cases of dispersed losses, victims would also wait and check if other individuals start a legal procedure in order to freeride from the benefits of the result if the procedure is actually started. This fear of freeriding by others could inhibit any of them from starting private enforcement in the first place. Information asymmetry could also curtail the initiation of legal procedures. The victim, or the judge in a private individual lawsuit, might not be able to meet the high thresholds of information and evidence required to successfully pursue the claim. There is also the chance that victims are not even aware of the fact that they were victims and that they can pursue a claim. Collective actions, which blur the distinction between private and public enforcement, are seen as a solution to the problem of individual litigation failing to be started. However, even more than in individual litigation, given the widespread social cost involved, the question of funding of the collective action is crucial.<sup>41</sup> With collective actions, the ‘collective matter is dealt with in one proceeding and individuals are relieved of (most of) the litigation costs.’<sup>42</sup>

TPF is generally viewed positively in the law-and-economics literature, as it is a market-based solution that remedies the above-mentioned market failure and enables access to justice by shifting the litigation costs and risks away from the victims onto the funder, in return for a share of the damages.<sup>43</sup>

If more disputes are resolved or adjudicated upon due to TPF, this internalises the negative externalities and produces deterrence on the behaviour of potential defendants generally.<sup>44</sup> These potential defendants would con-

sider the expected cost of harmful activities they engage in as they would expect a higher probability of a claim being successfully pursued against them. In other words, TPF can affect parties’ behaviour *even before* a claim arises<sup>45</sup>; it increases the chance that if a party is harmed it will successfully litigate against the wrongdoer. This makes the amount of damages that the wrongdoer would expect to pay more closely aligned with the losses that would actually be incurred by the victim. TPF allows litigation to better operate as a private enforcement mechanism and causes parties to more fully consider the costs of their activities, be they in breaching contracts, in taking care against possible accidents and so on.<sup>46</sup>

In other words, the possibility of resorting to TPF makes the human right of access to justice available to those individuals and entities with meritorious claims not entitled to public legal aid, by providing them with access when they would otherwise not litigate due to the costs and risks involved. TPF is seen in economic theory as private actors bargaining over property rights in litigation in response to a market failure in access to justice. This market failure arose from the increasing cost and risk aversion corporations faced due to the interplay of increasing litigation volume, delays, complexity and costs.<sup>47</sup>

Secondly, funders are usually in a significantly more advantaged position than claimants who only pursue claims on isolated occasions, that is, one-shotter parties. Funders are repeat players in litigation; they have extensive experience and expertise in the field. Having a large investment portfolio in legal claims also means that they can diversify risk better. The chance of having some unsuccessful claims is offset by many more successful claims. Furthermore, having substantial financial resources means that they are less liquidity constrained than one-shotter parties.<sup>48</sup> TPF therefore equalises the litigation playing field. By providing the claimant with a reduction of the risk constraint, higher quality legal assistance and financial resources, it strengthens the bargaining power of the claimant who would otherwise usually be in a weaker bargaining position relative to the defendant. This can occur both in settlement negotiations and in adjudication, with the claimant being both more likely to settle closer to,<sup>49</sup> and to secure judgements for, the full value of the claims.<sup>50</sup>

39 These can be referred to as ‘negative-expected value claims.’ See T. Ulen, ‘An Introduction to the Law and Economics of Class Action Litigation’, 32 *European Journal of Law & Economics* 185-203 (2011).

40 This is the rational apathy problem. See J.D. Mot, M. Faure & L.T. Visscher, ‘TPF and Its Alternatives an Economic Appraisal’, in W. Van Boom (ed.), *Litigation, Costs, Funding and Behaviour: Implications for the Law* (2017) 31, at 32.

41 Visscher and Faure, above n. 2, at 4.

42 M.G. Faure and F. Weber, ‘Dispersed Losses in Tort Law – An Economic Analysis’, 6(2) *Journal of European Tort Law* 163, at 163 (2015).

43 Contingency fees are also viewed positively in the law-and-economics literature and serve similar goals to TPF. Both of these forms of funding are better able to tackle agency problems than hourly fees. Contingency fees are generally not allowed in continental Europe. See Visscher and Faure, above n. 2, at 8-9.

44 S. Shavell, ‘The Social Versus the Private Incentive to Bring Suit in a Costly Legal System’, 11 *Journal of Legal Studies* 333 (1982), see also W.B.

Rubenstein, ‘Why Enable Litigation? A Positive Externalities Theory of the Small Claims Class Action’, 74 *UMKC Law Review* 709 (2006).

45 S. Bedi and W.C. Marra, ‘The Shadows of Litigation Finance’, 74 *Vanderbilt Law Review* 588-613, at 591-605 (2021).

46 *Ibid.*, at 591-605.

47 Solas, above n. 26, at 130-2. A market failure arises when goods and services are not efficiently allocated to their highest valued use, due to, inter alia, negative externalities and regulatory barriers. See also M. Steinitz, ‘Whose Claim is This Anyway – Third-Party Litigation Funding’, 95 *Minnesota Law Review* 1268, at 1311, 1338 (2011).

48 See generally M. Galanter, ‘Why the “Haves” Come out Ahead: Speculations on the Limits of Legal Change’, 9 *Law & Society Review* 95 (1974).

49 J.T. Molot, ‘Litigation Finance: A Market Solution to a Procedural Problem’, 99 *Georgetown Law Journal* 65 (2011).

50 Bedi and Marra, above n. 45, at 588-613.

Thirdly, by enabling access to justice, TPF can increase adjudication, court decisions, precedent and the resolution of disputes generally, which can be characterised as a public good.<sup>51</sup> Public goods are non-rivalrous and non-excludable, in the sense that the use by one person does not diminish the opportunities for use by others and no one can be excluded from their use, without contributing to the costs. Public goods are another source of market failure, as they are underprovided by the private market,<sup>52</sup> and TPF can serve to mitigate this. One can therefore argue, at least theoretically, that TPF has great potential in alleviating the civil justice crisis Europe has been facing and to increase social welfare from an economic perspective. However, despite all the mentioned benefits, the TPF phenomenon has been met with opposition throughout history. The article now turns to outline and scrutinise the concerns raised against it. The three objections to be examined are the commodification of justice, conflicts of interest and funder capital inadequacy.

### 3 The Concerns Surrounding TPF in Europe

#### 3.1 The 'Commodification of Justice'

The first objection to be examined has been coined the 'commodification of justice'<sup>53</sup> and cannot be analysed without first briefly describing the history of the legal restrictions against TPF, and secondly, exploring the merits of using economic analysis of law with respect to the TPF phenomenon.

##### 3.1.1 A Brief History of the Legal Restrictions Against TPF

The argument against unduly commodifying justice emanates from the historical prohibitions or limitations of property rights in litigation. At national levels, the common law doctrines of maintenance and champerty, the prohibition to enter into *pacta de quota litis* and *redemptio litis* in civil law<sup>54</sup> and more recent doctrines preventing frivolous and fraudulent claims<sup>55</sup> and strict confidentiality obligations<sup>56</sup> have been used to constrain TPF,

but their relevance has been decreasing significantly. These doctrines refer broadly to the general prohibition of interference in others' litigation claims, for profit or otherwise, originating in the Greek and Roman legal systems.<sup>57</sup> Christianity was a major influence in the continuation of these prohibitions as it viewed litigation itself and anything that promoted it as an 'evil', which was only to be pursued as a last resort.<sup>58</sup> With the advent of the independence of the judiciary and rule of law principles, these prohibitions started to be seen instead as a barrier to the fulfilment of the right of access to justice. The idea of enhancing access to justice by providing public funding for litigation was only realised with the rise of the welfare state and when legal aid became a fundamental component of Western democracies,<sup>59</sup> and the restrictions to private funding also started to be done away with.

##### 3.1.2 The Anti-Commodification Argument and Economic Analysis of TPF

The anti-commodification of justice argument relies on a non-consequentialist<sup>60</sup> argument where the 'commodification' and meddling in others' claims for profit by private actors is still in itself often seen as undesirable.<sup>61</sup> This moral objection is familiar because it has also been raised against US-style class actions, contingency fees and legal expenses insurance.<sup>62</sup> It entails opposition to the transformation of a non-market good, civil justice, into a tradable commodity, as its value is reduced to the amount of money it sells for. In order for this argument to be successful, one must, however, show that the civil justice system has higher *value* than other practices in human life, in order for it to escape the process of commodification. One must also show that investments by third parties in suits will degrade the civil justice system. A further problem for this line of argumentation is that legal systems already value personal relationships, harms and damages in monetary terms.<sup>63</sup>

To examine this objection to TPF, some differing conceptions of *value* itself need to be outlined. Some approaches to *value* rely on the reasons and justifications for actions. For instance, human dignity and the uniqueness of each individual are important reasons and justi-

51 W.M. Landes and R.A. Posner, 'Adjudication as a Private Good', 8 *The Journal of Legal Studies* 235, at 248 (1979). See also S. Harnay and A. Marciano, 'Collective Litigation versus Legislation: a Rent-seeking Approach to Class Actions' in J.G. Backhaus, A. Cassone, and G.B. Ramello (eds.), *The Law and Economics of Class Actions in Europe* (2012) 219, at 222.

52 Cooter and Ulen, above n. 34, at 40-1.

53 Wendel, above n. 12, at 657. Commodification is a common fear with regard to the broader market order and liberal individualism that drive 'out other and better ways of perceiving or evaluating objects and activities'. It has been also referred to as the 'domino theory'. See E. Mack, 'Dominoes and the Fear of Commodification', in J. Chapman and J. Pennock (eds.), *Markets and Justice: Nomos XXXI* (1989) 198, at 198-99.

54 The prohibitions for legal counsels to receive a share of the damages and of the transfer of claims by assignment or purchase. Solas, above n. 26, at 18-26.

55 V. Shannon, 'Harmonizing Third-Party Litigation Funding Regulation', 36(3) *Cardozo Law Review* 861, at 874 (2015).

56 A. Grec and O. Marquais, 'Investment Management and Corporate Structuring Considerations for Third-Party Litigation Funders in Luxembourg',

38 *ASA Bulletin* 296, at 296 (2020).

57 Shannon, above n. 55, at 874.

58 M. Radin, 'Maintenance by Champerty', 24 *California Law Review* 48, at 68 (1935). See generally also A.J. Sebok, 'The Inauthentic Claim', 64 *Vanderbilt Law Review* 61 (2011).

59 Solas, above n. 26, at 38-122.

60 In other words, a deontological argument. For a more comprehensive analysis of the anti-commodification argument see Wendel, above n. 12.

61 Wendel, above n. 12, at 656.

62 *Ibid.*, at 655. See also Tillema, above n. 17, at 53 and Bruns, above n. 17. The European Commission expressly provided that contingency fees should not be permitted out of fear of creating incentives for 'abusive litigation', a fear that is reflected in the RAD. See European Commission (2013) 'Commission Recommendation of 11 June 2013 on Common Principles for Injunctive and Compensatory Collective Redress Mechanisms in the Member States Concerning Violations of Rights Granted under Union Law', at para. 30. <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32013H0396>.

63 *Ibid.*, at 667.

fications for acting in particular ways. These approaches adopt an internal perspective. One of these approaches, the expressive theory of value, focuses on the attitudes expressed. However, the emotions guiding attitudes can be said to not always be reliable. Life insurance, for example, which seemed suspicious at first as it involved speculation over the death of other people, is now an accepted practice.<sup>64</sup> The same reasoning could in a way be applied to TPF.

The economic approach to *value* avoids taking moral stances in contested issues and relies on externally observable behaviour. By default, in the absence of market failures, the government does not get involved, and the people have no obligation to engage in controversial practices – such as bargaining over lawsuits – if they find them objectionable. In expressivist terms, the anti-commodification argument against TPF is that the goal of profiting from a lawsuit is not a good or moral reason to participate in the civil litigation process. Nevertheless, it is widely agreed that litigation should be resolved as fairly, quickly and cheaply as possible. This is achieved in economic theory by private actors bargaining over lawsuits to reach optimal dispute resolution, absent transaction costs and market failures. It constitutes a belief in individualism and a mistrust towards government. Such a faith in individualism is already present in various areas of substantive law, including in property law, where ownership is given over property and individuals can decide on its use, and in contract law, which allows people to bargain and reach their own agreements.<sup>65</sup>

A problem with the economic approach to value where individuals maximise their own welfare or utility, that is, the net balance of total benefits over costs, is that this can result in the reduction of welfare of others, and winners only in principle compensate the losers.<sup>66</sup> On the one hand, another approach, the rights-based or corrective justice theory, is appealing; it emphasises the victim-wrongdoer relationship. On the other hand, welfare economists emphasise rules that apply to everyone, such as the minimisation of social costs. The corrective justice theorist would say that this is a characteristic of public law – not private law. The participation of strangers in the civil litigation process would somehow express an inappropriate attitude with respect to corrective justice. Justice should be perceived as ‘relational’. Claims can only be brought by harm sufferers against those responsible, in line with the direct relationship that arises.<sup>67</sup>

The corrective justice theory, however, is sometimes at odds with the principle of party autonomy – autonomous claimants do agree to sell part of the damages be-

forehand in TPF. Furthermore, when it comes to other practices in the legal system, such as the examples of insurance and settlement, the law already undermines the importance of safeguarding this corrective justice relationship. This raises the question of why it is so essential that justice should be relational. The law permits the transfer of the obligation to directly correct harm, in the case of the party causing the harm being insured. With settlements, there is no institutional expression that the defendant has committed a wrong. If damages paid by insurance is a partial commodification, then a settlement paid by insurance is nearly complete commodification of civil justice. Critics of TPF, therefore, should also condemn these practices, or show that there is some distinction between insurance, settlement and TPF.<sup>68</sup>

From a law-and-economics perspective, if TPF increases overall social welfare in the future, the objection of profiting from other people’s litigation being morally deplorable would be dismissed as mere ‘superstition’.<sup>69</sup> One could, however, successfully criticise TPF by distinguishing it from other forms of private funding of litigation like insurance – for instance, by showing a greater extent of conflicting interests. This can be done through touching on economic themes such as agency costs and externalities rather than through commodification arguments.<sup>70</sup> The next section will examine the agency problems or risks of conflicts of interest TPF brings about but will mostly refrain from attempting to compare TPF’s magnitude of conflicting interests with those of other forms of funding such as insurance, contingency fees and hourly fees. It will rather adopt a perspective internal to a TPF situation.

### 3.2 Conflicts of Interest

The second argument against TPF relates to the risk of conflicts of interest. Given the assumption of self-interest, TPF arrangements inevitably give rise to the possibility of conflicting interests between the funder, the claimant and the lawyer. The conflicts examined in this article are grouped into Pre-existing Relationships and the Economic Interest of the Funder (Section 3.2.1), Excessive Shares of the Damages (Section 3.2.2), Control on Procedural Decisions (Section 3.2.3) and Opportunistic Entrepreneurial Parties Stirring up Litigation (Section 3.2.4).

#### 3.2.1 Pre-existing Relationships and the Economic Interest of the Funder

There could be conflicts of interest that emerge due to pre-existing relationships *inter alia* between the funder and any of the lawyers in the dispute and/or when the defendant is a competitor of the funder of the case. The *Gawker Media* case in the United States is an illustrative controversial case of a possible conflict of interest, where it was discovered after the case that the funder

64 *Ibid.*, at 681-2.

65 *Ibid.*, at 682-8.

66 This is Kaldor Hicks efficiency. A legal system achieves Pareto efficiency when no one can be made better off without making at least one individual worse off. With Kaldor Hicks efficiency, changes that bring about an increase in utility for some individuals which exceeds the decrease in utility suffered by others are favoured.

67 Wendel, above n. 12, at 689-92.

68 *Ibid.*

69 *Ibid.*, at 693.

70 *Ibid.*, at 693-4.

funded the case out of personal revenge motives.<sup>71</sup> In TPF involvements, a frequent concern is the question of disclosure of funding to the court, which would uncover, amongst others, conflicts of interest and funder profile and motivations.<sup>72</sup> Furthermore, disclosure of funding could send a signal on the merits of the case to the opposing party.<sup>73</sup>

In the *Fortis* shareholder collective redress case in the Netherlands,<sup>74</sup> the Amsterdam Court of Appeal stated that in the future it may require transparency on the disclosure of the identity of the funders and of the contents of funding agreements. This was in order to establish funder capital adequacy, standing and business models of those funders and to determine the absence of conflicts of interest.<sup>75</sup>

In the EU collective redress scenario, the RAD requires that representative actions are not brought against a defendant who is a competitor of the funder or against a defendant on which the funder is dependent. It also requires disclosure on the source of funding to the court or administrative authority by the entity representing the class members.<sup>76</sup> However, as of the time of writing, there is no such requirement for disclosure in individual claims in Europe. The RAD also requires that the qualified entities, namely, consumer organisations or public bodies representing the consumers, be independent and have established procedures preventing conflicts of interest between it, its funders and the consumers.<sup>77</sup> Their decisions, including those on settlement, are not to be 'unduly influenced by a third party in a manner that would be detrimental to the collective interests of the consumers'.<sup>78</sup>

The reason funders fund claims is the potential economic reward they only receive if the case is successful. Only claims with the prospects of high financial awards are funded. Actions for specific performance, injunctive relief or actions that offer a low-value return are not considered by funders as there is no or little financial outcome that can be shared with the claimants. This economic interest itself is sometimes cited as the reason for restricting TPF. In the RAD, it is provided for that this interest must be aligned with the consumer interests. In Germany, a court found that a collective profit disgorgement claim against a major telecommunica-

tions company was primarily in the financial interest of the funder, and the use of TPF was considered against the legislature's intention and an abuse of the consumer association's legal standing.<sup>79</sup> This exemplifies the bad reputation TPF has in Germany. Despite being aware of the financial difficulties consumer associations face, especially when it comes to risky litigation, it effectively prohibited the entity from making use of TPF, and made it very difficult for similar actions to be brought in the future.<sup>80</sup>

A few important considerations in this regard must at this point be listed. The first consideration is that litigation is risky, that is, there is never a 100% chance that even a good claim will succeed. In such a case the funder will be liable to an adverse cost order to compensate for litigation costs incurred by the defendant. This entitles the funder to a risk premium. Secondly, depending on the rules of the specific jurisdiction or the judicial discretion, the losing defendant might also have to pay parts of, or the full TPF fee on top of the litigation costs and the damages to the winning claimant, ensuring that the claimant ends up with bigger shares of the damages. Thirdly, without TPF, some claims would not be started in the first place and no damages or compensation are ever recovered. Finally, funders always have an economic interest in the outcome, which is usually well, but not perfectly, aligned with the claimant's interests or the consumer interests represented by the consumer organisation. Both parties are interested in obtaining good settlements or judicial decisions.<sup>81</sup>

### 3.2.2 Excessive Shares of the Damages

The second conflict arises when, during pre-agreement negotiations, the better-informed funder with a stronger bargaining position attempts to obtain excessive shares of the damages in case of success at the expense of claimants, thus undermining the effectiveness of access to justice. This is obviously relative to other forms of funding of litigation, including hourly fees and insurance. With hourly fees there is a two-player relationship instead of three, which reduces transaction costs.<sup>82</sup> If claimants win, they receive the full damages. However, if they lose, they might have to pay the litigation costs – so claimants might be willing to bear the TPF risk premium. With insurance, from an ex-post perspective, the insured might be paying the premiums for nothing if they never get into legal disputes. It may result in the situation that, in the aggregate, plaintiffs may be left better off with TPF than with the two other forms of private funding.

71 *Bollea v. Gawker Media, LLC*, No. 8:12-cv-02348-T-27TBM, 2012 WL 5509624, at \*2 (M.D. Fla. 14 November 2012).

72 On the *Gawker Media* case and the question of disclosure generally see M. Steinitz, 'Follow the Money? A Proposed Approach for Disclosure of Litigation Finance Agreements', 53 *University of California Davis Law Review* 1073 (2019).

73 R. Avraham and A.L. Wickelgren, 'Third-party Litigation Funding with Informative Signals: Equilibrium Characterization and the Effects of Admissibility', 61 *The Journal of Law and Economics* 637 (2018).

74 On collective redress actions and their funding in the Netherlands, see more extensively Tzankova and Kramer, above n. 8 and also X.E. Kramer and I. Tillema, 'The Funding of Collective Redress by Entrepreneurial Parties: The EU and Dutch Context', 2 *Revista Ítalo-Española de Derecho Procesal* 165 (2021).

75 Amsterdam Court of Appeal 2018 ECLI: NL: GHAMS: 2018: 368.

76 RAD Art. 10.

77 *Ibid.* Art. 4(3)(e).

78 *Ibid.* Art. 10(2)(a).

79 BGH, 13.9.2018, I ZR 26/17, BeckRS 2018, 24788.

80 Stadler, above n. 17, at 221.

81 Visscher and Faure, above n. 2, at 20.

82 While TPF 'overcomes the budget constraint of the plaintiff ... [it] leads to another "profitability" constraint: claims have to be profitable enough to be financed so as to support the additional organizational costs.' These costs include the cost of the additional contract, bargaining, risk assessment and conflicts of interest in decision making. See B. Deffains and C. Desrieux, 'To Litigate or Not to Litigate? The Impacts of Third-party Financing on Litigation', 43 *International Review of Law & Economics* 178, at 179-80 (2015).

In practice, litigation funders in Europe typically take twenty to fifty percent of the amount awarded in the case.<sup>83</sup> In England and Wales, the landmark *Arkin* case<sup>84</sup> provided strong judicial approval to TPF and established the well-known 'Arkin Cap'.<sup>85</sup> It was deemed that by virtue of the fact that a professional funder could be liable for the costs of the opposing party 'to the extent of the funding provided' if the case loses, 'the funding is provided on a contingency basis of recovery'.<sup>86</sup> The funder would therefore be entitled, as 'the price of the funding', to a portion of the proceeds if the claim succeeds.<sup>87</sup> The damages recovered by the successful claimant would be decreased. While the court called this 'unfortunate', it saw this as a 'cost that the impecunious claimant can reasonably be expected to bear'.<sup>88</sup> This was considered more just than situations where successful defendants cannot recover their litigation costs from funders, whose intervention is the reason why claims, which eventually prove to be evidently without merit, are maintained to an advanced stage.<sup>89</sup> Despite the cap being subsequently criticised by many,<sup>90</sup> the court here provided justification for the acquisition of shares of the damages by the funder when the funded case wins.

This, however, does not satisfactorily attenuate the concern that the shares recovered by the funder could be excessive or unfair. In the *Fortis* collective redress case in the Netherlands, it was decided that, given the considerable procedural risks and funding costs that the claimant organisations and their litigation funders undertook for lengthy periods of time, the compensation to be paid by Ageas was not unreasonable and had not been provided at the expense of the damages paid to the shareholders.<sup>91</sup> This suggests that in the case of commercial parties, the chance of excessive return rates for funders would be reduced by market forces, which would lead to the normalisation of rates.

In the US consumer TPF sector, concerns about predatory practices by funders have been raised. It has been considered as comparable to payday lending, which is another form of high-cost, short-term credit.<sup>92</sup> In the first comprehensive empirical study on the situation of

consumer TPF in the United States, it was found that consumer TPF agreements are unnecessarily 'complex and opaque', possibly leading the less sophisticated consumers to routinely underestimate the future costs of the agreement. The payment actually returned to the funders at the conclusion of the disputes was, however, lower than what was contractually agreed and what is sometimes speculated in the media. The authors suggest that renegotiations happen because consumers are surprised that they have to pay more than what they expected.<sup>93</sup>

Caps on the return rates have indeed been suggested to reign in the concern of excess return rates.<sup>94</sup> This concern seems, however, to be only relevant when it comes to less well-informed and well-resourced, and more risk-averse, consumers in retail TPF markets and does not concern more sophisticated commercial parties. The necessity for specific regulation for the protection of vulnerable claimants could arise in the occasion that TPF becomes more widely accessible to consumers in Europe.<sup>95</sup>

### 3.2.3 Control on Procedural Decisions

The funder's interests are never fully aligned with those of the claimant and a third conflict arises if it attempts to exert control on procedural decisions, such as during settlement negotiations. Though it has frequently been stated in the economic literature that TPF should bring about better settlements for claimants, it could also be the case that funders push for speedier and lower settlements than would be the case without TPF, due to short-termism ('early harvesting problem').<sup>96</sup> In the EU collective redress scenario, the RAD addresses this problem by expressly prohibiting any form of control on procedural decisions diverting away from the collective interest of the consumers.<sup>97</sup>

This strict prohibition may, however, reveal a certain kind of suspicion towards funders that might not be justified. Having undertaken the due diligence on the case and the litigation costs and risks, funders would be interested in having some form of influence on the direction of the dispute. The case has already been made that this should be allowed unless they push lawyers to violate ethical duties.<sup>98</sup>

In England and Wales, a recent judgement did not apply the Arkin Cap and made a third-party costs order against a funder who had 'massive' control over the case in question.<sup>99</sup> The Association of Litigation Funders Code of Conduct for Litigation Funders (ALF Code) in England and Wales<sup>100</sup> requires funders to ensure that the funded

83 Saulnier, Müller & Koronthalyova, above n. 3, at 22.

84 *Arkin v. Borchard Lines Ltd & Ors* [2005] EWCA Civ 655 26 May 2005. [www.bailii.org/ew/cases/EWCA/Civ/2005/655.html](http://www.bailii.org/ew/cases/EWCA/Civ/2005/655.html).

85 The cap or limitation of a professional funder's liability for the costs of the opposing party if the case loses, to the amount of the funding provided for the litigation. To illustrate, if the funder funds £50,000, if the case loses, the funder will also pay a maximum of £50,000 to the winning party.

86 *Arkin*, above n. 84, para. 41.

87 *Ibid.*

88 *Ibid.*

89 *Ibid.*

90 Including by Sir Rupert Jackson in 'In my view, it is wrong in principle that a litigation funder, which stands to recover a share of damages in the event of success, should be able to escape part of the liability for costs in the event of defeat. This is unjust not only to the opposing party (who may be left with unrecovered costs) but also to the client (who may be exposed to costs liabilities which it cannot meet)'. Jackson, above n. 16, at 123, para. 4.6.

91 Amsterdam Court of Appeal 2018 ECLI: NL: GHAMS: 2018: 368.

92 P.M. Skiba and J. Xiao, 'Consumer Litigation Funding: Just Another Form of Payday Lending? (Consumer Credit in America: Past, Present, and Future)', 80 *Law and Contemporary Problems* 117, at 117 (2017).

93 Avraham and Sebok, above n. 11, at 1172-1176.

94 Saulnier, Müller & Koronthalyova, above n. 3, at 17.

95 Van Boom, above n. 13, at 26.

96 M. Steinitz and A.C. Field, 'A Model Litigation Finance Contract', 99 *Iowa Law Review* 711, at 738 (2014).

97 RAD, above n. 19, Art. 10(1).

98 Van Boom, above n. 13, at 24, see also Stadler, above n. 17, at 227.

99 *Laser Trust v. CFL Finance Ltd* [2021] EWHC 1404 (Ch) 21 May 2021. [www.bailii.org/ew/cases/EWHC/Ch/2021/1404.html](http://www.bailii.org/ew/cases/EWHC/Ch/2021/1404.html).

100 Association of Litigation Funders Code of Conduct for Litigation Funders Arts. 9, 11.



party receives independent advice prior to the funding agreement, allows some degree of input to the funded party's decisions on settlements and provides for the possibility of termination of the agreement if certain conditions are satisfied. In Germany, funding agreements are not considered to be contracts for legal advice and only lawyers can give legal advice. However, standard funding agreements also often stipulate termination rights.<sup>101</sup> In the Dutch collective redress scenario, as per the WAMCA<sup>102</sup> and the Dutch Claim Code 2019, the entity representing the parties must have a professional board whose members do not have a direct or indirect financial interest in the outcome of the lawsuit. The court can review the organisation's funding in order to protect the interests of the claimants.<sup>103</sup> This minimises funder control over the lawsuit.

The presence of a conflict of interest between the claimant and the funder puts the lawyer in a delicate position, as the lawyer is engaged by the claimant but getting paid by the funder.<sup>104</sup> Professional rules of ethics require lawyers to act in the client's best interests<sup>105</sup>; therefore, the lawyer should only allow the level of control by the funder, which is most beneficial for the claimant in the funding. However, if there is a mistrust in funders, it could also be argued from the above that there also seems to be a trust in lawyers that might not be justified. In the archetypal hourly fee type of funding of litigation, where the claimant pays the lawyer in accordance with the time spent on the case, there are also conflicting interests. As per rational choice theory, the claimants, who in reality are never fully informed, will not be able to monitor the lawyers on whether they are acting in their best interest, irrespective of the existence of lawyer codes of ethics.<sup>106</sup> Reputational sanctions could control the lawyer, but these apply more in the case of repeat players than with 'one-shotters'.<sup>107</sup> This information asymmetry might therefore lead the lawyer to spend more time on the case in order to bill more hours than would be necessary. Being less exposed to risk, lawyers therefore change their behaviour.<sup>108</sup> Furthermore, the claimants cannot properly distinguish between good- and bad-quality lawyers. With hourly fees, the lawyer does not consider whether the number of hours spent on the case produces more benefits than costs to the claimant.<sup>109</sup>

This goes to show that, in reality, lawyers do not always act in the best interest of the claimant, and that with the presence of some form of control and monitoring by the funders, who are usually interested in obtaining good outcomes for both themselves and the claimant, the lawyer's interests could also become more closely aligned with those of the claimant.

This principal-agent problem is further aggravated in mass claims. When the lawyer or other representative represents a whole group, the members of this group will, as a result, face even larger coordination and monitoring costs with regard to the agents, who further their own interests.<sup>110</sup> Pursuant to the RAD, representative actions are allowed, as opposed to group actions (class actions), which are common in the United States, where the group or class is directly represented by the lawyer, who funds the action and, if the action is successful, recovers a reasonable and judicially overseen fee out of the outcome.<sup>111</sup> With representative actions, there is a double agency relationship, one between the parties represented and the qualified entity and the other between the qualified entity and the lawyer. Being better informed and financially resourced, the qualified entity might be better suited to monitor the lawyer than the individual claimants. However, problems arise if the funded qualified entity, which proclaims to work for the consumers interests, is a self-interested monopoly, and prioritises 'reputation, an increase in membership, and more public attention' over consumer interests.<sup>112</sup> Nevertheless, with representative actions, the risk of collusive settlements mainly benefitting the attorneys are reduced.<sup>113</sup>

### 3.2.4 *Opportunistic Entrepreneurial Parties Stirring Up Litigation*

Another common concern is that, by looking to make a profit from lawsuits, opportunistic entrepreneurial parties may stir up litigation and fuel a compensation culture that may cause negative externalities on society in the form of unmeritorious litigation<sup>114</sup> and an overall increase in the volume of litigation,<sup>115</sup> thereby further overburdening the already overburdened civil justice systems. Claimants could also overstate the value of their lawsuits during its negotiations with funders. On further examination, it is not immediately straightforward that a bigger volume of litigation is necessarily a negative effect of TPF, as increased litigation itself can reduce litigation undersupply (the access to justice problem) and the deterrent benefits of increased litiga-

101 D. Sharma, 'Germany', in L. Perrin (ed.), *The Law Reviews - The Third Party Litigation Funding Law Review*, 3rd ed. (2019), at 63-80.

102 Wet Afwikkeling Massaschade in Collectieve Acties (Act on Collective Damages Claims) 2020.

103 Kramer and Tillema, above n. 74, at 179. In individual claims, general rules of contract apply subject to public policy principles. See R. Philips, 'Netherlands', in L. Perrin (ed.), *The Law Reviews - The Third Party Litigation Funding Law Review*, Third Edition (2019), at 114-120.

104 Saulnier, Müller & Koronthalyova, above n. 3, at 72.

105 CCBE Code of Conduct for European Lawyers Art. 2.7.

106 As per agency theory, the contract between principal (claimant) and agent (lawyer) may be designed to better align the interests of both parties. See Mot, Faure & Visscher, above n. 38, at 45.

107 M. G. Faure and F. Weber (2015), above n. 42, at 179.

108 This is the moral hazard phenomenon.

109 Mot, Faure & Visscher, above n. 40, at 45.

110 Visscher and Faure, above n. 2, at 7.

111 Tillema, above n. 17, at 49.

112 *Ibid.*

113 Faure and Weber, above n. 42, at 179-80.

114 Funded claimants have less risk in starting litigation and this could incentivise unmeritorious suits. This is primarily a problem of adverse selection.

115 On this objection with specific reference to collective redress in the Netherlands, see more extensively I. Tillema, 'Entrepreneurial Motives in Dutch Collective Redress: Adding fuel to a "compensation culture"?' in W. Van Boom (ed.), *Litigation, Costs, Funding and Behaviour: Implications for the Law* (2017) 221.

tion could outweigh its costs.<sup>116</sup> In Australia, an empirical study did find some evidence that third-party funding corresponds to an increase in litigation and court caseloads.<sup>117</sup> With regard to unmeritorious litigation, for instance by competing businesses, the loser pays principle<sup>118</sup> in Europe makes this unlikely. Furthermore, it is in the interest of funders themselves who have the gatekeeper role and the legal expertise to conduct thorough due diligence on the claims' merits throughout the litigation process. Despite being able to fund risky high-value claims as the risk of loss is spread among many other less risky high-value claims, funders ultimately only receive their fee if they win and will have to pay the litigation costs if they lose. In the US empirical study on consumer TPF carried out by Avraham and Sebok, the funder refused to follow through with half of the 200,000 funding requests in the dataset.<sup>119</sup>

In the collective redress scenario, unmeritorious suits could also be brought with the intent of inducing early settlement by pressuring defendants to settle in order to avoid litigation costs and reputational losses. As per the RAD, there are information requirements on the qualified entities and on the cases they bring,<sup>120</sup> and the judge can dismiss 'manifestly unfounded' cases at the earliest possible stage of the proceedings,<sup>121</sup> thereby diminishing the risk that qualified entities would extract such blackmail settlements.<sup>122</sup> Following the introduction of entrepreneurial parties in Dutch collective redress, no increase in unmeritorious collective redress claims occurred.<sup>123</sup> The arguments of overburdening the civil justice system and increasing frivolous litigation seem to be the most easily dismissed ones with respect to TPF.<sup>124</sup>

### 3.3 Funder Capital Inadequacy

Lastly, funders with insufficient capital to fund in full their portfolio of investments in disputes may leave the claimant without funding, or may be unable to meet adverse cost orders. In England and Wales, pursuant to another landmark case, *Excalibur*,<sup>125</sup> funders who persist in funding 'hopeless cases'<sup>126</sup> are required to pay costs on an indemnity basis, that is, all the litigation costs incurred by the defendant, going beyond the Arkin Cap. This makes it important for funders to have adequate

financial reserves. In the ALF Code, minimum capital requirements of five million pounds with continuous disclosure obligations are prescribed for funders within the association.<sup>127</sup> However, this is a self-regulation instrument, and membership within the association is voluntary, which means that there are funders operating in the market who are not under the auspices of the ALF Code.<sup>128</sup>

In Germany, funder capital inadequacy at the time of the assignment of claims could prove to be a legal obstacle for litigation funding by special purpose vehicles. In the *cement cartel* case, Cartel Damage Claims (CDC) filed an action against the participants of the cement cartel, after purchasing the claims from direct purchasers. The case was dismissed ten years after the filing because, despite having adequate financial means at the time of the dismissal, at the time of the assignments CDC did not have enough to meet a possible adverse cost order. This was considered by the courts to be a violation of public policy and the standards of good faith and good dealing. Now, there is an obligation to provide security for costs.<sup>129</sup> In the Netherlands, the Claim Code 2019 stipulates that the entity representing the claimants must ascertain of sufficient financial resources to bring the claim and of the potential track record and reputation of the funder.<sup>130</sup>

While lack of funder capital adequacy is a legitimate concern giving rise to the need of minimum capital requirements, the above-mentioned German case illustrates how consideration should also be given to all the circumstances of the case, as meritorious claims can fail to be pursued despite adequate financial resources being available. Furthermore, capital requirements might create barriers to entry for newcomers into the market.

## 4 Conclusion

This article has highlighted the importance of understanding the TPF industry by distinguishing and critically examining the main objections most commonly raised against it. It provides the background of the emergence of the TPF industry as a partial solution to the access to justice problem in Europe. It focuses on analysing the main concerns TPF has raised, them being the commodification of justice, conflicts of interest and funder capital inadequacy, including from a law-and-economics perspective. It finds after examination that these concerns have been overemphasised and inflated and that TPF is not all that fishy. The future development and growth of the TPF industry in Europe seems to be guaranteed, and it could even be the case that it finds

116 Shavell, above n. 44.

117 D.S. Abrams and D.L. Chen, 'A Market for Justice: A First Empirical Look at Third Party Litigation Funding', 15(4) *Faculty Scholarship at Penn Law* 1075, at 1075 (2013). This however does not at all mean that 'the sky is falling' due to TPF's introduction as Deborah R. Hensler puts it. See D. R. Hensler, 'Third-party Financing of Class Action Litigation in the United States: Will the Sky Fall?' 63(2) *DePaul Law Review*, 499 (2014)

118 Hodges, Vogenauer & Tulibacka, above n. 1, at 28. In almost all jurisdictions the general rule is that the losing party pays the litigation costs. Some exceptions are possible.

119 Avraham and Sebok, above n. 11, at 1141.

120 RAD, Art. 13.

121 *Ibid.* Recital 39 and Art. 7.7.

122 Visscher and Faure, above n. 2, at 15.

123 Tillema, above n. 17, at 235.

124 A few studies did find that TPF may cause an increase in the number of frivolous claims. See, for example, Deffains and Desrieux, above n. 82.

125 *Excalibur Ventures LLC v. Texas Keystone Inc & Ors* [2016] EWCA Civ 1144 18 November 2016. [www.bailii.org/ew/cases/EWCA/Civ/2016/1144.html](http://www.bailii.org/ew/cases/EWCA/Civ/2016/1144.html).

126 *Ibid.*, para. 27.

127 ALF Code Art. 9.4.2.

128 R. Mulheron, 'England's Unique Approach to the Self-regulation of Third Party Funding: A Critical Analysis of Recent Developments', 73 *The Cambridge Law Journal* 570, at 577 (2014).

129 OLG Dusseldorf, 18 February 2015, IVU Kart 3/14, *Juristenzeitung* (JZ) 2015.

130 Tzankova and Kramer, above n. 9, at 114. See also Philips, above n. 101.

itself gradually entering individual consumer litigation rather than only commercial litigation. Some form of European-wide regulation could address the risks of TPF in a more holistic manner; however, the evolving nature and substantial complexity of this industry and its important benefits of access to justice and deterrence need to be taken into consideration. There is the further issue that this industry is empirically under-researched and that, if left on its own, TPF will fail to provide access to justice, where otherwise not available, to strong claims, which are of low value or are for specific performance or of an injunctive nature.

The Draft Report constitutes one such response to the concerns. It proposes very stringent additional regulation of TPF, including requirements on setting up a licensing system of funders in each Member State, disclosure of funding agreements (as opposed to the disclosure of only the 'source' of funding as required in the RAD), on funding agreements being worded transparently, on capping the return rate to funders at 40%, and on, subject to limited exceptions, preventing litigation funders from withdrawing funding halfway through proceedings. It is up to the European regulator to strike a balance between taking advantage of the benefits TPF provides while minimising its costs. TPF has the potential of deterring undesirable behaviour and facilitating access to justice, despite these not being self-interested funders' primary goals. The task of regulation is to minimise the social costs which could arise from TPF in a way that does not disincentivise funders from funding meritorious and socially desirable cases, which would otherwise not be pursued due to a lack of funding options available to claimants.