

Kluwer Competition Law Blog

The UK Supreme Court Rams Down Damages-Based Funding Agreements, Heavily Reshaping the Standards in the Litigation Finance Industry

Josep Galvez (Del Canto Chambers, Litigo Partners) · Tuesday, August 8th, 2023

With a much-unanticipated outcome, on 26 July 2023, the Supreme Court of the United Kingdom (UKSC) finally handed down its long-expected judgement in [R \(on the application of PACCAR Inc and others\) v Competition Appeal Tribunal and others \[2023\] UKSC 28](#), a decision that is considered to have a significant hit on the litigation funding industry in the UK and even abroad.

In the context of collective proceedings for breaches of competition law, the majority of the UKSC justices held that litigation funding agreements (LFAs) which involve the funder being entitled to a proportion of any damages recovered are damages-based agreements (DBAs) within the meaning of [Section 58AA\(7\) of the Courts and Legal Services Act 1990 \(CLSA\)](#).

According to the UKSC judgement, the regulation governing DBAs also applies to LFAs, making most existing litigation funding contracts signed likely non-compliant with regulations and, therefore, unenforceable. This circumstance is particularly dramatic in the context of collective proceedings orders (CPOs) in private enforcement of competition law infringements, where valid funding arrangements are a pre-requisite for claims to be certified as collective proceedings in the Competition Appeal Tribunal (CAT).

It is pretty clear that the UKSC judgement will significantly impact litigation funding firms in the UK and possibly abroad. Until now, funders have operated assuming that their agreements were not DBAs and, therefore, not subject to regulatory compliance. However, this will likely change with the profound restructuring in the litigation funding industry sector to follow the UKSC judgement, unless a legislative reform prevents it.

Background to the dispute

On 19 July 2016, the European Commission (EC) decision in [Case AT.39824 -Trucks](#) imposed a fine of nearly three billion euros on five major truck manufacturing groups that had infringed Article 101 TFEU by colluding on pricing and gross price increases for medium and heavy trucks as well as the timing and the passing on of costs for the introduction of emission technologies according to EU standards.

Following the EC's decision, European customers who had purchased trucks from the companies implicated in the cartel took legal action seeking compensation from the manufacturers in various countries, such as Spain, Germany, and the Netherlands.

Similarly, in the English jurisdiction, UK Trucks Claim Ltd (**UKTC**) and the Road Haulage Association (**RHA**), among others, commenced applications before the CAT for a collective proceedings order on behalf of customers against DAF and other truck manufacturers (**DAF**) combining follow-on actions for damages arising from the Decision also based on the breach of Chapter I of the Competition Act 1998.

While the RHA's application was for opt-in collective proceedings, i.e., customers wishing to participate in any award would have to opt into the class represented by the RHA, UKTC's application was for opt-out proceedings, whereby an order would be made for it to represent a specified class of persons who would have the ability to opt-out if they did not wish to be represented, although UKTC also applied for opt-in proceedings in the alternative.

As both UKTC and the RHA had to demonstrate that they had sufficient funding to cover their expenses and any potential adverse costs to receive a CPO from the CAT, both claimants secured financing from third-party litigation funders Therium and Yarcombe Ltd, respectively. As usual, the collective proceedings applications for UKTC and RHA were funded through LFAs, in which the funders were entitled to receive a fixed portion of the damages recovered in the event of a successful outcome, i.e., LFAs were structured so that in exchange for the investment, in the event of a successful result, Therium and Yarcombe would receive a return based on a percentage of the total compensation for damages recovered.

The proceedings before the CAT

DAF and the rest of the defendants in the proceedings before the CAT raised a preliminary issue alleging that the LFAs were unenforceable because they should be considered DBAs and did not meet the requirements of the [Damages Based Agreements Regulations 2013 \(DBA 2013\)](#). Furthermore, DAF claimed that LFAs qualify as DBAs under Section 58AA of the CLSA because they provide claims management services. Additionally, DAF argued that LFAs could be considered claims management services under Section 4(2) of the Compensation Act 2006 (**CA 2006**), as the definition also covers financial services or assistance.

Essentially, DAF stated that the CAT could not make a CPO in favour of UKTC or RHA because the arrangements for supporting the CPO did not include provisions for paying any costs order favourable to the defendants in the proposed proceedings.

In other words, without enforceable funding arrangements, claimants had no valid agreement to provide the necessary financing to bring forward the claims.

In determining that preliminary issue, the CAT composed by Roth J, Dr William Bishop and Professor Stephen Wilks considered in [\[2019\] CAT 26](#) that the LFAs did not involve the provision of claims management services, which was the relevant part of the definition of DBAs in Section 58AA, as defined by reference to the CA 2006 until 1 April 2019 and the Financial Services and Markets Act 2000 (**FSMA 2000**) after that. Consequently, the CAT found that the LFAs were lawful and enforceable funding arrangements that could justify the making of CPOs in favour of

UKTC and RHA.

The proceedings in the Court of Appeal

DAF attempted to appeal to the Court of Appeal and contested the ruling of the Tribunal via a judicial review, just in case the Court of Appeal did not have the authority to hear an appeal. Accordingly, a Court of Appeal panel consisting of Henderson, Singh, and Carr LJ was formed, also functioning as a Divisional Court to oversee the judicial review claim if required. The panel ruled that it had no jurisdiction to entertain an appeal and that this matter was irrelevant to the current appeal before the court.

Following this decision and acting as a Divisional Court, the panel allowed the appellants' request for a judicial review concerning the DBA preliminary matter. However, the appeal justices eventually dismissed the claim in [\[2021\] EWCA Civ 299](#); [\[2021\] 1 WLR 3648](#), rejecting the claim and siding with the CAT's interpretation that the LFAs did not fall under the definition of DBAs as stated in Section 58AA of the CLSA. Therefore, the Court of Appeal concluded that the LFAs were lawful and could be enforced.

It is worth noting that DAF directly appealed to the UKSC regarding its judicial review claim using the leap-frog procedure outlined in Section 13 of the Administration of Justice Act 1969. Additionally, the Association of Litigation Funders of England & Wales was also allowed to intervene in the proceedings and provide written submissions with permission from the UKSC.

The Judgement of the Supreme Court

In a 98-page judgement, the UKSC overruled the CAT and the Court of Appeal's previous decisions and allowed the appeal by DAF by finding that the LFAs entered by UKTC and RHA were DBAs under Section 58AA(7) of the CLSA and section 419A of the FSMA 2000.

Lord Sales, delivering the court's majority opinion (as agreed by Lord Reed, Lord Leggatt and Lord Stephens), stated that the term claims management services in the Competition Act 1998 could encompass the LFAs when interpreted according to its ordinary meaning. The UKSC's position was based on the circumstance that Parliament intentionally used those broad terms in the CA 2006 due to the unclear nature of claims management services, required to "*new and developing service provision to encourage or facilitate litigation, where the business structures were opaque and poorly understood at the time of enactment*".

Therefore, the term claims management services was broadly defined without specifying any active management of claims, an expansive definition backed by the [Compensation \(Regulated Claims Management Services\) Order 2006](#) and the accompanying Explanatory Memorandum, both of which were part of the CA 2006's legislative framework.

In addition, even though the legal or common definition of a term may help determine the meaning of a term mentioned in a statutory definition, claims management services did not have a universally acknowledged sense that would modify or influence the precise language of the definition provided in the statute. Interpreting its meaning in this manner would go against the

design and intention of the CA 2006.

Thus, the UKSC concludes that DAF's interpretation of the term did not result in any absurdity, nor was it the responsibility of the court to restrict the power's scope or modify the broad language used in the definition under the CA 2006 by considering scenarios in which the power's use may be unreasonable.

The UKSC concluded that events occurring after 2006 were not significant in interpreting Section 58AA because they did not offer guidance on the policy context of the CA 2006 or its intended purpose, although the court noted that *"Even if it might be said that it is desirable in public policy terms that third party funding arrangements of the kind in issue in this case*

should be available to support claimants to have access to justice [...], this is not a reason why there should be any departure from the conventional approach to statutory interpretation".

In the end, the UKSC resolved that the LFA involved in the dispute were, in fact, DBAs, and as they did not comply with the strict regulations governing DBAs, the agreements could not be enforced.

Interestingly, in her lengthy dissenting judgment, Lady Rose expressed her agreement with the Divisional Court and the CAT, considering that *"the giving of financial assistance is only included in the term claims management services if it is given by someone who is providing claims management services within the ordinary meaning of that term"*, concluding that the appeal should be dismissed.

The Aftermath in the Litigation Funding Industry

The UKSC's recent determination that some LFAs fall under DBAs and are unenforceable unless they meet certain conditions has raised grave concerns in the third-party litigation industry under English law. Particularly since these conditions were not thought to apply to LFAs, they were unlikely to be drafted with compliance in mind. According to the UKSC judgement, many current third-party litigation funding agreements are at risk of being challenged as unenforceable due to their non-compliance with the DBA regulations.

Additionally, in her dissenting opinion, Lady Rose also quoted the Chairman of Calunius, Leslie Perrin, mentioning that *"no [collective proceedings order] could ever be pursued, given the reliance that has been placed on litigation funding in the development of this aspect of the work of the CAT. At the least, it would require a radical review not only of these LFAs but of the entire litigation funding sector as it has developed in the United Kingdom"*.

Indeed, the recent UKSC ruling in PACCAR has significant implications for the funding arrangements in this dispute and many other cases involving similar LFAs. These agreements offer a return based on a percentage of the damages obtained, but due to the ruling, they will now be classified as DBAs and, therefore, unenforceable. It is important to note that LFAs, where returns are structured based on a multiple of the initial investment, not in sharing a percentage of damages awarded, should not be considered DBAs and, therefore, not be affected by the UKSC decision.

On the other hand, although many third-party litigation firms have already taken proactive steps to

address the potential impact, disagreements may arise, particularly when successful claimants would be forced to pay substantial sums to their funders based on LFAs that are no longer enforceable, according to this ruling.

However, the vast majority of the dispute funding industry in the UK will probably be reviewing their current portfolios and deciding whether existing LFAs can be replaced with compliant ones according to the UKSC as well as assessing the risk that any funded party on past cases may seek to challenge amounts previously paid to the funder based on arrangements now declared unenforceable.

The Aftermath in Competition Disputes

Yet, the lawsuits currently filed with the CAT are expected to be significantly affected, particularly the more than 20 class action-style cases brought by consumer groups supported by litigation funding to the extent that they allow funders to take a share of any damages. Therefore, existing LFAs for opt-out competition collective damages proceedings are rendered unenforceable under the UKSC decision because DBAs are expressly prohibited for such claims under Section 47C(8) of the Competition Act.

Actually, most of the current competition law collective proceedings in the CAT are opt-out, including all stand-alone claims, where the claimant must prove the competition law infringement that caused the damages rather than relying or following on an existing infringement decision from a competition authority. The recent UKSC ruling will significantly impact stand-alone and opt-out claims, which are becoming more prevalent in the UK and quite often used to raise new competition law cases, as it could dramatically restrict these claims unless a solution is found. However, it is unclear at this stage if the government will intervene and modify the Competition Act 1998 concerning LFAs and opt-out claims.

Undoubtedly, the recent UKSC decision has provided painful clarity on the matter, and any future LFAs will need to adhere to the DBA Regulations, or they may be structured based on a multiple of the investment amount to avoid being categorised as a DBA.

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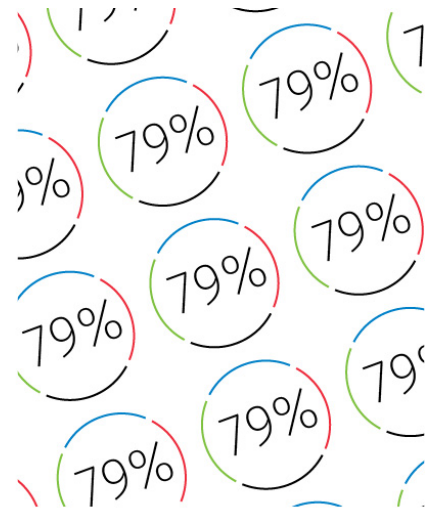
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