Sharing the spoils

Andrew Hogan looks at how lawyers can share in the profits of litigation through funding

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For seven hundred years, the common law courts set their faces against strangers to a case financially supporting its litigation by the doctrines of maintenance and champerty. The historical approach to maintenance and champerty was explained by Lord Mustill in *Giles v Thompson* [1994] 1 AC 142 in these terms: '…the crimes of maintenance and champerty are so old that their origins can no longer be traced, but their importance in medieval times is quite clear.

'The mechanisms of justice lacked the internal strength to resist the oppression of private individuals through suits fomented and sustained by unscrupulous men of power. Champerty was particularly vicious, since the purchase of a share in litigation presented an obvious temptation to the suborning of justices and witnesses and the exploitation of worthless claims which the defendant lacked the resources and influence to withstand.

'The fact that such conduct was treated as both criminal and tortious provided an invaluable external discipline to which, as the records show, recourse was often required.'

Similarly, the common law courts forbade lawyers from acting on a contingency fee basis, wary that giving the lawyers of a stake in the outcome of litigation would lead to the corruption of justice. How times have changed. The failure of the state to fund a legal aid scheme led to the abolition of the common law prohibition on 'no win, no fee' arrangements and the introduction of conditional fee agreements.

Changing fashions have seen the legislature and the courts further take the view that the provision of third-party litigation funding, which would have constituted maintenance and champerty, is neither tortious nor criminal, but rather a useful means of facilitating access to justice in the twenty first century.

LAWYERS FUNDING CLIENTS

An interesting question arises as to how far these developments might become congruent, so that lawyers might not only make the recovery of their remuneration contingent on success, but also charge their client for funding their litigation in a wider sense.

Every lawyer who makes his fees contingent on success or extends credit to his client is 'funding' the litigation to a certain extent. But how far is it open to solicitors to pay for disbursements, to purchase after-the-event insurance, and provide more general funding for litigation; and if so, what sort of return can they properly make, taking a share of the fruits of litigation as their award?

Potentially, this an extremely profitable asset class to invest in. It is also one where there are a limited number of capital rich third-party providers at the moment, who are able to charge litigants an economic rent: third party litigation funding in substantial commercial litigation can be eye wateringly expensive, with a charge of 30% of sums recovered in the claim or three times the litigation funder's outlay, whichever is the higher. Might a solicitor achieve this sort of return, or simply offer a cheaper funding option to a client for their mutual benefit?

The simplest means of a solicitor 'funding' litigation and taking a share of the proceeds is by means of a damages-based agreement (DBA), which provides for a solicitor to be paid a share of the damages, subject to netting off any costs that might be recovered from the other side. This is the Ontario model: it suffers from two flaws in concept and in detail. In concept, it does not grant solicitors what they ideally want, namely an ability to charge costs and a share of the proceeds of recovery. The government took the view that would be too good a deal for the legal profession.

In detail, the statutory scheme set out in the Damages Based Agreements Regulations 2013 is horribly flawed in several ways, making it most uncertain how a DBA should be drafted and what may properly be included within the scope of it. Moreover, while it is a means of funding litigation in respect of a solicitor's own fees, it does

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not create a pot of money to pay for disbursements or ATE insurance, and few solicitors' firms will have deep pockets to pay out the sort of sums that are routinely required in high-value litigation.

A CORPORATE VEHICLE

The other alternative is for a firm of solicitors to establish a linked corporate vehicle, perhaps a subsidiary or sister company, which exists to source capital and to use it to invest in litigation funding. In effect, a move towards vertical integration of the litigation process. In the context of a firm that can readily source valuable litigation and demonstrably has the legal skills to handle it - and which is already utilising third-party litigation funding - this is an intriguing possibility to cut out the middle man.

The obtaining of capital might be relatively straightforward: there would be no need to go down the uncertain routes of crowd funding or crypto-currency issuance, but instead, a reliance on AIM flotation and investment by institutions interested in a 15% plus return on their capital. There is a discernible appetite among institutional investors for an interest in the profits that might flow from litigation: most law firms and other actors, such as credit hire companies, who have taken the plunge have done well from external investment.

POTENTIAL RISKS

More scope might be found to question this model in three respects, which I identify as regulatory concerns, litigation risks including security for costs and non-party costs liabilities.

There are relatively few obligations in the solicitors' Code of Conduct which are directly of application. The most obvious provisions are those that concern introducing a client to another business in which the solicitor has a financial interest. The key here is full disclosure of the extent of the solicitor's interest, and ensuring that the client makes an informed decision: which may require further information, including information about alternative means of funding, or alternative providers of funding.

O(6.1) whenever you recommend that a client uses a particular person or business, your recommendation is in the best interests of the client and does not compromise your independence;

O(6.2) clients are fully informed of any financial or other interest which you have in referring the client to another person or business;

O(6.3) clients are in a position to make informed decisions about how to pursue their matter;

O(6.4) you are not paid a prohibited referral fee.

Once a piece of litigation gets under way funded by a third party, these days the litigation funder will find themselves squarely in the sights of an application for security for costs under rule 25.14 CPR:

(1) The defendant may seek an order against someone other than the claimant, and the court may make an order for security for costs against that person if –

- **(a)** it is satisfied, having regard to all the circumstances of the case, that it is just to make such an order; and
- **(b)** one or more of the conditions in paragraph (2) applies.

(2) The conditions are that the person –

- **(a)** has assigned the right to the claim to the claimant with a view to avoiding the possibility of a costs order being made against him; or
- **(b)** has contributed or agreed to contribute to the claimant's costs in return for a share of any money or property which the claimant may recover in the proceedings; and is a person against whom a costs order may be made.

In the case of *In RBS (Rights Issue Litigation), In the matter of* [2017] EWHC 1217 (Ch) very substantial security for costs was ordered against a third-party funder. It remains to be seen whether a solicitor's firm, as the ultimate owner of a litigation funding company, could be subject to an order for security for costs: one suspects not, noting the limited wording of the rule. Of more concern is to what extent a solicitor's firm with a funding vehicle might itself be liable for non-party costs, rather than just the funding vehicle.

It is well-established law that when a solicitor acts outside the scope of simply being a solicitor running litigation, they run the risk of being made liable for a non party costs order: see *Myatt v National Coal Board* [2007] 1 WLR 1559. Conversely, a solicitor who simply defers and makes contingent their fees, in accordance with the statutory scheme of conditional fee agreements established by the Courts and Legal Services Act 1990, does not do so (see *Germany v Flatman* [2013] 1 WLR 2676). But expressly funding litigation through a dedicated funder limited company would undoubtedly render the funder potentially liable for a non-party costs order if the litigation fails. The question is whether the liability would be contained by a corporate fire wall, or whether the solicitor's own practice with control of the funder – or even the individual solicitors themselves – may be potentially liable.

As noted by Lewison LJ in the case of *Threlfall v ECD Insight Ltd* [2013] EWCA Civ 1444, the existence of a corporate veil is largely irrelevant to the question of the imposition of a liability for non-party costs: '13. If a non-party costs order is made against a company director, it is quite wrong to characterise it as piercing or lifting the corporate veil; or to say that the company and the director are one and the same.

'As Mr Shaw has demonstrated, the separate personality of a corporation, even a single-member corporation, is deeply embedded in our law. But its purpose is to deal with legal rights and obligations.

'By contrast, the exercise of discretion to make a non-party costs order leaves rights and obligations where they are. The very fact that the making of such an order is discretionary demonstrates that the question is not one of rights and obligations of a non-party, for no obligations exist unless and until the court exercises its discretion.

'Moreover, the fact that the discretion, if exercised, is exercised against a non-party underlines the proposition that the non-party has no substantive liability in respect of the cause of action in question.'

GLITTERING PRIZES

There is no doubt that this is a potentially profitable route for a firm to take, as it strives to offer a 'one stop' shop for litigation services; but as can be seen from the considerations noted above, it poses certain risks. It might be thought, though, that as was observed by a former Lord Chancellor from long ago:

'The world continues to offer glittering prizes to those who have stout hearts and sharp swords.'

I look forward with interest to the prospect of stout-hearted solicitors extending the funding options open to their clients, and being paid a portion of the glittering prizes of litigation for their trouble.

Andrew Hogan is a barrister at Ropewalk Chambers in Nottingham specialising in costs and funding; blog: www.costsbarrister.co.uk