

CCBE first comments on the European Parliament's recommendations to the Commission on Responsible private funding of litigation

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The Council of Bars and Law Societies of Europe (CCBE) represents the bars and law societies of 45 countries, and through them more than 1 million European lawyers.

Executive Summary

- The CCBE welcomes the initiative of the European Parliament on a legal framework on responsible private funding of litigation.
- While the CCBE recognises the benefits that third party litigation funding (hereafter “TPLF”) have on access to justice, it recalls the dangers of TPLF to the administration of justice.
- A framework on TPLF should also apply to relations between the third-party funder and the defendant. The draft directive only mentions and defines the claimant, without justifying the exclusion of the “defendant”. The term defendant should also be included in the definitions of Article 3.
- The CCBE considers that the European Parliament should reviewed the role of the legal profession and make a clear distinction between the concept of conflict of interests and the independence of the legal profession.
- Any clause from a funding agreement which may influence the task of the lawyer and prevent him to act in his or her client’s best interests should be prohibited. Article 11.b. of the draft directive should be modified in accordance by deletion of the *point i.* to exclude any clause in third-party agreements restricting the party’s autonomy.
- Third party funding agreements should ensure the principle of professional secrecy. Any clause in a third party funding agreement according to which the litigation funder may contact directly the party’s lawyer should have no legal effects under Article 13.2. The CCBE considers that it is important to clearly separate the relationship between the Private funder and the client on one side, and the relationship between the client and the lawyer, on the other side.
- Concerning invalid clauses, the draft directive should avoid situations where the invalidity of a clause affects the procedural actions undertaken and the rights of the parties themselves. Article 13.2 should include a clause which prohibits the litigation funder to influence a court settlement in any way, independent of the stage in which the settlement is closed and independent of its conditions. A clause which prohibits the influence of the litigation funder on the application for cost-triggering evidence and court remedies should also be added.
- The draft should clarify, at least in its Recitals, that it covers not only providers offering litigation funding as a main activity but also those carrying out such activities as an ancillary service.
- Article 7 makes a broad reference to the notions of fiduciary duties and fiduciary relationships, without making clear why such relationship is required in every case and what is the purpose of

this relationship. Article 7 should be developed, including by presenting the concrete obligations of litigation funders towards parties.

- The CCBE considers that the draft directive should motivate and justify the threshold of the litigation funder's reward.
- The CCBE considers that the draft should clarify the role of intermediary service providers and better take into account the specificity of their relationships with the funder and the party. The draft should clarify the respective obligations and rights of the funder, the intermediary and the party.

A. Introduction

The CCBE notes that the Legal Affairs Committee of the European Parliament is drafting a report with recommendations to the Commission on Responsible private funding of litigation. The draft report¹ contains an annex to the resolution presenting the content of a proposal for a directive on the regulation of third-party litigation funding.

As recognised in the draft report, the practice of third party litigation funding (hereafter "TPLF") is increasing while it can have impacts on the administration of justice, for example by influencing litigation², and access to justice. Furthermore, it can have significant consequences on the ethical rules of the legal profession, in particular its core principles, such as the independence of the lawyer, the right and duty of the lawyer to keep clients' matters confidential and to respect professional secrecy, and the avoidance of conflicts of interests³.

In this regard, the CCBE considers that it is of paramount importance for the legal profession to be involved and consulted in the development of a possible European legislative initiative on TPLF. Therefore, the CCBE is presenting its first comments on the draft directive proposed by the European Parliament.

B. General comments

1. Benefits of TPLF

The practice of TPLF might be of great interest to litigants and lawyers. It is a means of access to justice for parties who do not have the necessary funds to assert their rights. TPLF can offer a remedy to the imbalance between parties. The growing practice of TPLF is also an opportunity that should not be neglected by legal practitioners and especially lawyers.

2. The risks

However, the intervention of a third-party funder may result in a breach of the ethical obligations of lawyers. In this regard, the CCBE welcomes the fact that the European Parliament recognises the dangers to the administration of justice posed by TPLF and is considering the adoption of a regulatory regime to ensure that justice systems in Europe do not prioritise the interests of investors. Indeed, as commercial entities, litigation funders have their own economic interests and are expecting profit from the outcome of a litigation. In a way or another, they may try to influence the litigation to reach the

¹ Draft report with recommendations to the Commission on Responsible private funding of litigation (2020/2130(INL)).

² BRAK Opinion 51/2021, August 2021.

³ CCBE Charter of Core principles of the European Legal Profession.

most profitable results, creating conflicts of interests with funded litigants who are seeking recognition and enforcement of their rights.

3. Scope and inclusion of the defendant

The CCBE considers that a framework on TPLF should also apply to relations between a third-party funder and the defendant. Although a third-party financing agreement also covers an agreement in which the investor bears, in whole or in part, the costs of the proceedings in exchange for obtaining a share of the success fee, i.e. including the success of the defendant (Article 3(h)); according to Article 2, the draft directive applies only to relations between entities engaged in litigation financing activities and claimants. The CCBE notes that there are 104 mentions of the claimant in the proposed directive and no explanation or justification of the exclusion of defendants from TPLF. In this regard, there might be situations where the funder is interested in the judgment for their future business and could therefore provide funding for the defendant to win or to be passive during the proceedings which could be determinative for the decision-making.

Therefore, the CCBE considers that the scope of the draft directive should include not only the claimant, but also the defendant as possible funded parties in the litigation, and that the term “defendant” should be included in the definitions of Article 3.

4. The Role of the legal profession

Regarding the role of the legal profession in TPLF, the CCBE notes that in the resolution prepared by the European parliament must be critically reviewed in point 6 of page 5. The mandating of a lawyer is equated with direct financing and is described as constituting a potential conflict of interest. There should be a careful distinction between a conflict of interest and the independence of the legal profession. The question of whether a lawyer's freedom to act in a given case is impaired by ongoing and recurring cooperation with another client or an institution that can influence the awarding of a mandate is dealt with in the law on the legal profession under the concept of independence. The legal profession in the past has proven its ability to safeguard independence and understands how to ward off unreasonable restrictions of independence.

From the perspective of the legal profession, it is further surprising that the draft does not mention the legal profession under D. on page 4, but instead mentions “mediation, ADR/ODR, the Ombudsman or [...] grievance systems managed by companies [which] could result in faster and more adequate compensation for claimants”. This implies that the current administration of justice as a whole is not capable of achieving this aim which is not the case.

C. Content of third party funding agreements

The CCBE notes that the proposed provisions of Article 11 regulates the content of third party funding agreements as they should be drafted in “*clear and easily understood terms*”, in particular with regard to specific elements such as the risks that the parties are assuming, including “*any restrictions on the claimants’ autonomy in issuing instructions to the claimant law firm or otherwise controlling the conduct of the litigation*” (Article 11.b.i.).

The CCBE considers that this provisions opens the possibility for funders to influence the conduct of the litigation or to restrict instructions made by the party to his or her lawyer. However, the party should remain free to give instructions to his or her lawyer without being influenced, and the lawyer should be free to act in the best interests of his or her client, without being bound by a funding agreement.

Such provision jeopardised lawyer's independence, as recognised by the Court of justice of the European Union ("CJEU"). The latter recognised that the objective of the task of the lawyer, representing his or her client, is above all, *"to protect and defend the principal's interests to the greatest possible extent, acting in full independence and in line with the law and professional rules and codes of conduct"*. According to the CJEU, *"the concept of the independence of lawyers, is determined not only negatively, that is to say, by the absence of an employment relationship, but also positively, that is by reference to professional ethical obligations"*.

The Court concludes that the lawyer's duty of independence is to be understood as *"the lack of connections which have a manifestly detrimental effect on his or her capacity to carry out the task of defending his or her client while acting in that client's interests to the greatest possible extent"*⁴. Therefore, any clause from a funding agreement which may influence the task of the lawyer and prevent him to act in his or her client's best interests should be prohibited.

The CCBE considers that Article 11.b. should be modified in accordance by deletion of the point *i.* to exclude any clause in third-party agreements restricting the party's autonomy.

Furthermore, the CCBE considers that Articles 11.b.i. contradicts the provisions of Article 13.2 on "Invalid agreements and clauses" which provides that *"third-party funders are not permitted to influence the decisions of a claimant in the course of proceedings"* and *"any clause in third-party funding agreements granting a litigation funder the power to take or influence decisions in relation to proceedings should have no legal effect"*.

D. Protection of professional secrecy

The CCBE considers that any legislative initiative on TPLF should ensure respect for professional secrecy and the protection of confidentiality of the communications between a funded client and his or her lawyer. A third party funder may try to obtain information about the nature and development of the funded proceedings. In this regard, they may wish to obtain such information directly from the funded party's lawyer. The third party funding agreement might provide for this.

However, lawyers are subject to professional secrecy and cannot reveal to a third-party funder any documents, information or even confidences of the funded client covered by professional secrecy. **Third party funding agreements should ensure the principle of professional secrecy. In this regard, any clause in a third party funding agreement according to which the litigation funder may contact directly the party's lawyer should have no legal effects under article 13.2.**

The CCBE considers that it is important to clearly separate the relationship between the Private funder and the client on one side, and the relationship between the client and the lawyer, on the other side. The latter cannot be subject to any intrusion from the private funder in order to preserve professional secrecy.

⁴ CJEU, Grand Chamber, 4 February 2020, Uniwersytet Wrocławski, Cases C-515/17 P and C-561/17 P, §§62-64.

E. Consequences of invalid contracts

The CCBE considers that provisions of Article 13 might be inadequate and detrimental to the party, who must be, according to paragraph 6 of Article 13, compensated for all losses if a funding agreement is declared invalid due to a breach of the principles contained in the Directive.

A finding of invalidity results in the contractual claims (specific performance) lapsing and the party being referred to a claim for compensation. **The CCBE believes that a party might be in a better position if the funding agreement were not considered invalid in their entirety due to an invalid clause, but if the agreement were to remain valid to the extent permitted by the directive, by discarding only the invalid clause.**

Depending on the contractual relations, the invalidity of the funding agreement does not protect the party as they have not concluded an agreement with the litigation funder. For example, if a non-profit organisation bundles claims, only the organisation would be compensated under Art.13(6), as contractual relations only exist between the organisation and the funder.

The CCBE considers that the provisions of the draft directive should avoid situations where the invalidity of a clause affects the procedural actions undertaken and the rights of the parties themselves.

Furthermore, the CCBE considers that Article 13 (2) should include a clause which prohibits the litigation funder to influence a court settlement in any way, independent of the stage in which the settlement is closed and independent of its conditions. A clause which prohibits the influence of the litigation funder on the application for cost-triggering evidence and court remedies should also be added.

F. Unclear terminology and scope of the draft directive

The CCBE considers that, due to the unclear wording of the draft, it is difficult to know whether the scope of the proposed directive only includes the funding of a “litigation” or whether it also covers prelitigation phases, such as the negotiation of a settlement. The CCBE notes that the Article 2 only refers to “litigation”, while Article 3 refers to dispute “before a court or an administrative authority”. **In this regard, the CCBE considers that the scope of draft directive should explicitly include the extrajudicial settlement of disputes.**

Moreover, the CCBE notes that the parliamentary draft refers to litigation funders as “undertakings” without differentiating between undertakings practicing litigation funding as a main activities and undertakings offering such services as an ancillary service. **In this regard, the CCBE considers that the draft should clarify, at least in its Recitals, that it covers not only providers offering litigation funding as a main activity but also those carrying out such activities as an ancillary service.**

G. Further remarks

- **Fiduciary duties and relationship**

In its Article 7, the draft makes a broad reference to the notions of fiduciary duties and fiduciary relationships, without making clear why such relationship is required in every case and what is the purpose of this relationship. Such broad wording may lead to doubts as to the true legal nature of the relationships falling within the scope of the Directive between a party and a litigation funder, as well as the related obligations. **The CCBE considers that the Article 7 of the draft directive should be**

developed, including by presenting the concrete obligations of litigation funders towards parties. It would be correct to speak either of a referral to fiduciary duties or of the creation of fiduciary duties.

The only constellation in which the concept of a fiduciary relationship applies, is when the assignment of the claim is made to a third party who, as plaintiff, at the same time brings about the enforcement of the claim and thus the assumption of the litigation risk. Conversely, if the third party finances the litigation, it is merely a matter of financing not a fiduciary relationship. In any case, the negative consequences of an invalidity of the litigation funding agreement for the beneficiaries must be considered.

- **Threshold for the litigation funder's reward**

The CCBE notes that there is no justification and explanation for the choice of 40% as the maximum percentage considered permissible as a reward claimed by the litigation funder, as provided by Article 13(4). A maximum percentage of 25 to 30% should suffice as a reward for the litigation funder. **The CCBE considers that the draft directive should motivate and justify the threshold of the litigation funder's reward.**

- **Intermediary legal service provider**

The CCBE notes that the conditions under which the draft directive applies to intermediary service providers are unclear, for example when litigation funding agreements are not directly concluded with the beneficial owner but with such intermediaries. This is the case when the funding agreement is not concluded with the beneficial owner of the claim but with a legal service provider, such as a debt collection company, a lawyer or a qualified entity representing consumers. This kind of situation could lead to conflicts of interest to the detriment of the beneficial owner of the claim. **The CCBE considers that the specificities of these relationships should be better taken into account in the proposal. Its provisions should clarified the respective obligations and rights of the funder, the intermediary and the party.**