

# The ethics of litigation funding.

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## Solicitors' Professional Ethics

1. The purpose of this article is to consider the potential impact on litigation funding arrangements of the ethical obligations imposed upon solicitors at common law and/or by the SRA Handbook 2011 which incorporates the SRA Code of Conduct 2011 - the current version of the code of professional and personal behaviour to be expected of solicitors.
2. Those sections of the SRA Code of Conduct 2011 that are of most significance in the context of third party litigation funding are:
  - *The 10 mandatory principles*
  - *You and your client - client care - O (1.1) to O (1.16) and IB (1.13) to IB (1.21)*
  - *You and your client - conflicts of interests - O (3.2) and O (3.4)*
  - *You and your client - confidentiality and disclosure - O (4.1), O (4.2) and IB (4.1), IB (4.2)*
  - *You and your client - your client and the court - O (5.5), O (5.6) and IB (5.2)*
  - *You and your client - your client and introductions to third parties - O (6.1), O (6.2) and IB (6.1) to IB (6.4)*
3. Similar principles are to be found in the Code of Conduct of the Bar. See, in particular, the fundamental principles 301 to 304 and 307 which apply to barristers. As is to be expected of rules regulating the conduct of lawyers operating within two different branches of the same profession, there are no material differences between the relevant rules applicable to barristers and those applicable to solicitors.

## Fundamentals

4. Before considering the specific ethical principles applicable to litigation funding it is worthwhile taking a step back to consider some fundamental principles of ethics. This is because, although in earlier times attempts were made to codify the rules of professional conduct of solicitors, in more recent times, as will be discussed later in this article, there has been a significant move away from formulating ethical rules applicable in a million and one different circumstances. Instead, the current fashion is to state the overriding ethical principles and to leave individual lawyers to work out for themselves, with minimal guidance, how those principles are to be applied in practice.
5. The concept of "honour" lies at the heart of any attempt to discern the fundamental principles of legal ethics. An act of professional misconduct is committed by a lawyer who does something which is "dishonourable to him as a man and dishonourable in his profession": In re G Mayor Cooke (1889) 5 TLR 407. If this article were being written in the earliest days of the existence of the legal profession in the 13<sup>th</sup> century in England it would probably have seemed to the reader to be completely redundant. Since a lawyer must behave with honour, all that would remain would be for the question to be asked whether any particular course of action that the lawyer proposed to pursue would be honourable or dishonourable. The answer to that fundamental question would supply the answer to the more specific question whether the course of action contemplated was one which would or would not be permissible.
6. A number of attempts have been made to define more precisely the overriding ethical obligations of a litigation lawyer. Lord Macmillan identified five core duties of an advocate: "... a duty to his client, a duty to his opponent, a duty to the court, a duty to the state and a duty to

himself". Sir Malcolm Hilbery regarded the advocate's code of honour as being found in "the traditions of the profession", to be learnt at "the schools of the profession ... the Inns of Court". Du Cann, noting that the proper observance of these duties "may prevent [the advocate] ever rising to his feet at all, whilst a failure to follow them may result in an appearance before a disciplinary committee... and the striking of his name from the list of those qualified to practise in the courts", identified the essential characteristics of an advocate as honesty, judgment, courage, sincerity, humanity and industry.<sup>1</sup>

7. In the later part of the 20<sup>th</sup> century the earlier ethical principles, particularly those governing solicitors, developed into far more detailed and consequently more complicated rules and regulations governing the conduct of lawyers. But towards the end of the century concerted attempts were made to reduce the bulk of the rule book by separating matters of principle, recorded in "practice rules", from matters of detail and interpretation, recorded in "guidance notes". This trend continued with the publication of The Law Society's Code of Conduct in 2007 which set out the core duties of solicitors and the rules of professional conduct, but also contained a substantial volume of guidance notes interpreting and commenting on those rules. The same was true of the Code of Conduct of the Bar.
8. Several years after the regulation of solicitors had been devolved to the Solicitors Regulation Authority ("**SRA**") there was a more determined move in the same direction, a further move away from the burdens of written rules towards a more free-style system of "outcomes focused regulation". This has now become the style of regulation most favoured by the regulators of the legal profession – a "less is more" approach to regulation that concentrates not so much on rules and their contravention but on the purpose behind the rules and how their breach can be prevented.
9. In some ways a return to fundamental notions of ethics such as honesty, judgment, courage, sincerity, humanity and industry would be the supreme achievement for the architects of outcomes focused regulation. But in the complex world in which lawyers practise in the 21<sup>st</sup> century it is probably insufficient guidance, whether for the lawyer or for his client or for third parties affected by the lawyer's actions, simply to require the lawyer to rely upon his innate sense of honour. For example, it has been said that, if it seems right, it probably is right; but if it feels wrong, it is probably unethical.<sup>2</sup> No doubt this is sound advice; but when it comes to legally and technically complex matters such as the intricacies of the contractual relationships between lawyers, clients and litigation funders, it is unlikely that general observations as to right and wrong will be capable of resolving every area of ethical controversy.

## Changing concepts of ethics – litigation funding

10. Historically, English law has refused on public policy grounds to recognise arrangements whereby litigation was funded by third parties ("**maintenance**") or whereby a third party would maintain an action in return for a share of any award ("**champerty**"). A person is guilty of maintenance if he supports litigation in which he has no legitimate concern without just cause or excuse; champerty occurs when the person maintaining another stipulates for a share of the proceeds of the action or suit. In Re Trepca Mines (No 2) [1963] 1 Ch 199 Lord Denning MR said: "The reason why the common law condemns champerty is because of the abuses to which it may give rise. The common law fears that the champertous maintainer might be

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<sup>1</sup> "Legal Ethics – Past and Present", Mark Humphries, The Law Society's Gazette, 19 and 30 November 2009, 7 December 2009.

<sup>2</sup> Vernon -v- Bosley (No 2) [1999] QB 18, 63-4 (CA), per Thorpe LJ.

tempted, for his own personal gain, to inflame the damages, to suppress evidence, or even to suborn witnesses.”

11. But public policy in this area dramatically changed during the 20<sup>th</sup> century. To begin with, the state very often maintained litigation through legal aid funding – a system of public funding created by act of Parliament, although such funding is in more recent times being severely cut back on account of its decreasing affordability in current times of financial austerity. Despite the fact that some lawyers resisted the introduction of legal aid in the post war era on the ground that the independence of lawyers to act in their clients’ best interests would be compromised by their responsibilities to the Legal Aid Fund, the principles behind legal aid, and its desirability as a route to increased access to justice, are now firmly embedded in our legal system. Along with this development a new paralegal sector has grown since the 1970s including citizens’ advice bureaux and law centres which provide further assistance to litigants without sufficient means.
12. Thereafter the opportunity was taken to devise ways of shifting the financial burden of litigation that might otherwise have needed public funding onto the parties themselves, their lawyers and ultimately the unsuccessful defendants and their insurers.
13. Thus the courts will also now uphold certain funding arrangements provided not by the state but by solicitors themselves. For example, section 58 of the Courts and Legal Services Act 1990 (as amended by section 27 of the Administration of Justice Act 1999) has modified the common law rules on maintenance to permit solicitors to work under “no win no fee” arrangements known as conditional fee agreements (“**CFAs**”); and the Legal Aid, Sentencing and Punishment of Offenders Act 2012 (“**LASPO**”), and the Damages-Based Agreements Regulations 2013 made thereunder, have made permissible other such arrangements (“**DBAs**”) more in the nature of the type of contingency fee arrangements commonly operated by litigation lawyers in America. In addition, litigation may be funded by an entirely unconnected third party in certain circumstances, for example where the third party does not seek to exercise “excessive” control over the course of the litigation or where the third party does not make such a profit that the funded party may not benefit from a successful outcome.
14. Such dramatic changes are due to a pragmatic, even (from the perspective of the state), an opportunistic shift in emphasis away from the principles which justified a prohibition on maintenance and champerty towards an emphasis on access to justice for all. If access to justice is to be widened, litigation needs to be funded; and, since the state cannot or chooses not to afford to fund it, others must be encouraged and incentivized to do so.
15. CFAs and DBAs are required to be in writing. Even if they were not required to be in writing, the complexity of the arrangements contained in them and the scope for misunderstanding by the client is such that it would seem obvious that such arrangements must be set out in written form and, indeed, fully explained to the client where the client does not or cannot reasonably be expected to understand them. It may be that in some situations, particularly those involving unsophisticated or vulnerable clients, even the explanation of the written arrangements might need to be in writing. It might even be the case that the client would need to be recommended to seek independent advice on the meaning and effect of the proposed arrangements before entering into them.
16. The law surrounding such funding arrangements is in its infancy and this is a developing area in which ethical considerations are likely to be of huge importance. If the funding of litigation

can be shown to be in the public interest, it will continue to be encouraged; if not, if it is seen to be favourable to lawyers and/or to third party funders but not to clients, it will not survive.

## General principles

17. In order to assess the impact of ethical principles specifically in the area of litigation funding arrangements it is necessary to consider the applicability of such principles to particular aspects of litigation funding. Litigation funding can take a variety of forms. Whilst a basic documented loan from a funder to a client, repayable with interest, would be unlikely to engage any complex ethical principles for a litigation solicitor representing the client, most funding arrangements are more complex than this, involving the solicitor himself (or through his firm) undertaking a range of obligations to the funder and requiring the solicitor (or his firm) to accept a degree of risk.
18. The starting point is, and must always be, the interests of the client. Professional ethics places a good deal of emphasis on the duty of a solicitor to act in the best interests of his client. Indeed the only circumstance in which a derogation from that principle is expressly recognised is where a higher duty intervenes, such as a duty to the court or a duty to the proper administration of justice. See, for example, SRA Handbook Outcome 1.2. Specifically in relation to fee arrangements, a solicitor is required to provide all relevant information to the client and is only permitted to enter into fee arrangements with a client that take account of the client's best interests. See SRA Handbook Outcome 1.6.
19. This focus on the client's best interests which, it is submitted, is an essential ethical requirement (since clients rightly place a very high degree of trust in solicitors) makes it extremely difficult for a solicitor to enter into any form of contractual arrangement with a client that could conceivably result in the solicitor receiving a benefit at the expense of the client.
20. How in these circumstances can it be permissible for a solicitor to enter into a CFA or a DBA with a client? Such agreements permit the solicitor to earn higher fees, or alternatively a percentage of the client's damages, which can translate into a sum potentially far more lucrative than the fees that the solicitor would ordinarily be permitted to charge, i.e. without accepting the risks inherent in the conditional or contingent arrangements. The answer to the question is that CFAs and DBAs have both come to be regarded as ethically permissible: partly because the higher fees are objectively to be regarded as fair and in the client's best interests where the solicitor is prepared to take a corresponding risk of earning no fees, or less fees than he would otherwise have earned, and where the client might find it difficult to find representation without such fee arrangements; and partly out of practical necessity as Parliament in its wisdom has legislated for the permissibility of such fee arrangements as an economically effective means of providing increased access to justice and the SRA has not sought to frustrate that intention by suggesting that CFAs or DBAs contravene the ethical principles enshrined in the SRA Handbook. See SRA Handbook Indicative Behaviour 1.17.
21. This is, of course, unsurprising. In the modern world in which legal fees are too high for most individual clients - and indeed for many small and medium sized businesses - to afford, still less to afford to take the risk of an adverse costs order being made in favour of the opposing party or parties; in a world in which legal aid has all but dried up; and in which before the event ("BTE") insurance (i.e. insurance that can be purchased before the need for it has arisen) is generally inadequate; it would be unsustainable for the SRA to insist on solicitors thwarting

Parliament's will in the interests of attaining goldplated ethical standards, more noble than Parliament has itself considered necessary or desirable. It would also be inconsistent with recent moves to promote the increased use of McKenzie friends in the interests of wider access to justice.

22. SRA Handbook Outcome 1.15 requires a solicitor properly to account to a client for any financial benefit he receives as a result of his instructions. This is not, of course, to be interpreted literally since, were it to be so, solicitors would be unable to act for clients on any commercial terms and all CFAs and DBAs would be outlawed. Accordingly, it is submitted that this outcome is best seen as directed towards incidental, non-core financial benefits rather than those expressly provided for in the retainer.
23. Whether or not a particular firm of solicitors is prepared to enter into a CFA or a DBA with a particular client for a particular matter, the client is entitled to receive advice about the options that may be available to him. Without receiving that information the client may be unaware that he has the option to approach another firm which may be prepared to act under a CFA or a DBA. The obligation to provide this information to the client at the outset of a new instruction is clearly stated in the SRA Handbook in outcomes 1.12 and 1.13: clients must be in a position to make informed decisions about the services they need, how their matter will be handled and the options available to them; and they must receive the best possible information, both at the time of engagement and when appropriate as their matter progresses, about the likely overall cost of their matter.
24. The SRA Handbook does not expressly deal with the information to be provided to clients as to third party funding contracts or after the event ("ATE") insurance policies but it is submitted that a solicitor must provide all relevant information to the client such that the client is able to take an informed decision as to whether or not such arrangements are in the client's own best interests. In practice this will mean that solicitors must err on the side of providing too much information rather than too little information and will certainly be required to give comprehensive advice to the client as to the risks and exposures to which the client is subject. Many solicitors may not feel comfortable giving such advice where they, as is required under most third party funding and ATE arrangements, are themselves party to the arrangements, are subject to contractual obligations to third parties and are the beneficiaries of contractual rights vis-à-vis the client. In these circumstances they may feel that they must recommend the client to obtain independent advice before proceeding further.
25. It is most likely that this situation will spawn a new, niche market for legal practice in which specialised advice will be offered to the clients of other litigation firms contemplating third party funding contracts. Such advice will cover the clients' rights and obligations vis-a-vis their own litigation solicitors. Whilst this may be considered duplicative - or at least overlapping - and therefore wasteful and undesirable, in practice it may be that the giving of such advice will willingly be ceded by most litigation solicitors, recognizing that it is for their own protection and for the further protection of their clients that independent advice should be obtained by their clients. It will be interesting to observe how this new market develops. One possibility is that the fees of the independent lawyers may be built into third party funding contracts or otherwise absorbed by the solicitor of record who will understand, from the client's perspective, that it is difficult to ask a client to pay for a second firm of lawyers to advise on the first firm's proposed funding arrangements.

## Litigation funding – confidentiality and conflicts of interest

26. In situations in which the interests of clients, lawyers and third parties are otherwise than wholly aligned it will always be necessary to consider carefully and to identify whether there may be actual or potential conflicts between the solicitor and the client and/or between the solicitor and the funder or even between all three parties and to give clear advice to clients on how such conflicts can be accommodated, assuming that they can be, always ensuring that the informed consent of the client is obtained - preferably in writing - before such arrangements are concluded.
27. Conflicts of interest will inevitably be the principal area of focus when determining the ethical acceptability of third party litigation funding arrangements. But other professional ethical principles will also be engaged, for example those relating to the confidentiality of a client's affairs, as well as potentially a number of less obvious but nevertheless important principles. The range of areas to be considered from an ethical standpoint clearly emerges from a consideration of a very common litigation funding scenario.
28. Take the example of a client C who approaches a solicitor S wanting S to pursue a civil or commercial claim on his behalf but who either cannot afford to or does not wish to place himself at financial risk in the event that the claim should be unsuccessful. C (or S) therefore approaches a litigation funder F and an after the event insurer ATEI with a view to obtaining non-recourse finance (no recourse to C or S if the claim is unsuccessful) and insurance against the risk of a costs order being made against C in favour of one or more defendants DD.
29. Do circumstances exist in this example in which the interests of C, S, F and/or ATEI are or may be affected by a conflict or interest? Can S, without clear instructions from C, disclose matters which are confidential to C either to F or to ATEI for the purpose of seeking funding or insurance?
30. The example becomes more complicated when adding into the equation the possibility that C asks S to act under a CFA or a DBA.
31. The first consideration is as between C and S. All information received by S from C is confidential and C's informed consent will be required before S may disclose any such information to anyone. See, in particular, SRA Handbook Outcome 4.1 and Indicative Behaviour 4.2.
32. A number of conflicts or potential conflicts also exist. For example, C requires S to spend as little time as possible working on his case (to minimise fees) whereas S earns more if he works more hours. However, this is a conflict that has never been considered to prevent S from acting for C. Indeed, the conflict is inherent in the traditional method of remunerating a solicitor in orthodox civil or commercial litigation retainers, i.e. the chargeable hour. Such a conflict could be eliminated if C asks S to quote a fixed fee for handling the case, as opposed to providing C with an estimate. Yet the provision of a quotation merely replaces one conflict with another. Where S acts on a time charge basis he is incentivised to work more hours; ironically, having provided a quotation, S is incentivised to work less hours which itself gives rise to a conflict where C requires no stone to be left unturned in order to succeed with his claim.
33. In the first scenario S has a financial interest in drawing out the proceedings. It might even be said that S has a financial interest in his own inefficiency. He also has an incentive to avoid settlement. In the second scenario S has a financial interest in quoting high fees and terminating

the proceedings as early as possible. He has a financial interest in early settlement regardless of its terms.

34. These conflicts are insoluble. They cannot sensibly be regarded as so objectionable that C must decline to act because, if they were, the only litigation retainer that would not be objectionable would be one in which S acted for C on a strictly pro bono basis. Even then it could be argued that, as a long case imposes an increasing drain on S's resources and provides him with zero financial incentive, such an arrangement creates its own form of conflict, tempting S towards early settlement on any terms or even loss. These types of conflict are inherent in the relationship between C and S and cannot by any sensible means be taken away.
35. Whilst it could rationally be argued that fixed fee litigation creates a lesser conflict than time charge litigation, such an argument is contentious and in any event way beyond the scope of this article.
36. In recent times the ambit of what might be termed unobjectionable conflicts has been radically extended. Not three decades ago it would have been considered unthinkable that S might be entitled to payment only in the event of success, still less that he might be entitled to an enhanced fee if successful. However, as discussed earlier in this article, the legal rules of maintenance and champerty which prevented such arrangements and were enshrined in the rules of professional ethics for solicitors have now been changed. With the advent of the CFA and, later, the DBA has emerged a new, more pragmatic version of the earlier ethical principles governing the ability of lawyers and third parties to share in clients' litigation fortunes.
37. Under a CFA some, but hardly ever all, of C's costs are recoverable in the event of success. But, following the coming into force of LASPO, the success fee is no longer recoverable from DD with the consequence that the more work S does, the greater the shortfall on the costs recovery. This shortfall will therefore eat into the debt or damages recovered in the claim. It therefore remains the case that C's best interests lie in S doing as little work as possible and S's in doing as much work as possible provided, of course, that the claim is successful. Under a DBA the conflict is somewhat turned on its head but is arguably more acute still. S is incentivised to minimise his working hours but to maximise C's recovery.
38. Given that none of these unobjectionable conflicts apparently gives rise to concerns in the times in which we now practise, or at least not to any concern that is reflected in the current state of the assumed common law or professional ethical principles as currently reflected in the SRA Handbook, presumably the same considerations apply in the second scenario as between C and F?
39. So, for example, F is incentivised to lend as little as possible to C but to charge as much as possible for the funding. Why should this type of conflict be regarded as any more or less objectionable than that which is inherent in the relationship between C and S?
40. It may be argued that the difference between the two conflicts is that S is a solicitor and is therefore subject to a code of behaviour which seeks to prevent him from abusing his position of conflict whereas F is not in general terms a solicitor (although many funders employ solicitors to assess funding prospects) and therefore must be considered to act purely in his own commercial interests and with scant regard to the interests of C. Whilst there is still something to be said for the distinction between a professional person and a business person in the 21<sup>st</sup> century, the distinction has to some extent been eroded by the late 20th century

transformation of the major professional firms into - first and foremost - businesses. As Sir David Clementi pointed out, if a solicitor does not regard himself as in charge of a business, he certainly will not remain in charge of his business for much longer!

41. Provided that F is subject to an appropriate code of conduct, enforceable through robust regulation by an oversight body with power to discipline F in the interests of consumers of litigation funding services, it seems difficult to argue that there should be any distinction. In the absence of such regulation, the conflict between C and F should be considered more objectionable than the conflict between C and S. The law and effective regulation supply the checks and balances for a system of third party litigation funding to be capable of operating in the best interests of consumers. See in this regard the Civil Justice Council's voluntary code for litigation funding produced in November 2011.
42. The third scenario is perhaps even more complex. Assuming that there are conflicts between C and S and between C and F and between S and F, all of which are currently disregarded by both common law and professional ethics with the justification that third party funding is necessary to broaden access to justice, all of C, S and F have an interest (but not necessarily an identical interest) in C obtaining enforceable insurance from ATEI. This is because the provision by ATEI of enforceable insurance serves to eliminate, or substantially reduce, C's costs exposure to DD. This in turn means that the other parties can remove from the recoveries algorithm the possibility that C's recoveries may be less than zero and can effectively ignore the role of DD in their assessment of the desirability of the proposed funding arrangements. In these circumstances care needs to be taken to ensure that ATEI has independent legal advice or at least that ATEI has the availability (normally through in house counsel) of independent legal advice in relation to the risks inherent in the ATE contract.
43. Can S recommend a particular funder or a particular ATE insurer to C? See SRA Handbook Outcomes 6.1 and 6.2 and Indicative Behaviours 6.1 to 6.4. The answer is yes, but there are a number of qualifications. Thus, for example, any interest that S has in recommending a particular provider must be fully disclosed so that C has made an informed decision if he accepts that recommendation.
44. Can S receive a referral fee from F as the price of referring C's case to F? In a personal injury matter the answer is no. See section 56 of LASPO. Even where the claim is not a personal injury matter care should be taken to consider SRA Handbook Outcome 1.6 and ensure that S only enters into arrangements that are suitable for C's needs and take account of C's best interests.

## **A developing area of legal ethics**

45. Many of the above observations are perhaps obvious, or at least they ought to be; but some are not. Now that the regulators of the legal profession have moved to an "*outcomes focused*" system of regulation rather than one based on the enforcement of rules, much is left to the discretion of S in deciding what he can and cannot do. The focus of regulation of the legal profession is now on throwing onto the bonfire as many regulations as can possibly be found to be unnecessary or unwanted, leaving S to do what he thinks is right but to be prepared to justify his decisions.
46. That much is left to the discretion of S in all of the circumstances of each case is particularly true in the context of the complex web of relationships that can exist in third party litigation funding

arrangements. Few statements on ethics are likely to hold good in all given scenarios; but a number of principles which are often engaged in third party litigation funding arrangements are close to being set in stone. The duty of S to safeguard the confidentiality of C's affairs unless C gives his informed consent to a disclosure and the obligation on S to ensure that C is properly advised so as to be capable of giving his informed consent to an arrangement involving a conflict of interests are fundamental principles which must always be observed. The more complex the funding arrangements, the higher becomes S's duty to ensure that C understands them.

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