**Funding (in more detail)**

This element explores CFAs, DBAs, ATE insurance and third party funding in more detail.

**Read alongside:** This element assumes you understand the material in the element ‘Funding’. If you are unsure whether you have this understanding, study that element before or alongside this element. In particular, you must be familiar with what is set out in the Funding element in relation to CFAs, DBAs, ATE insurance and third party funding, as the basic explanation of those funding arrangements in the Funding element is not repeated in this element.

**The solicitor’s and the client’s interests**

It is a fundamental principle of professional conduct that a firm of solicitors must act in its client’s best interests. For the most part, there is no tension between a firm’s interests and those of its client – both want the client to achieve its objectives in the litigation.

However, there are some areas where these interests can conflict, and the funding of litigation can often be one of those. For example, whilst a client and its solicitor will clearly work together to agree a funding arrangement that works for them both and helps to build a trusted-advisor relationship, it must also be acknowledged that on matters such as amount of charges and even time for payment, the solicitor’s and client’s interests are not totally aligned, given that the solicitor is receiving the payment and the client is paying it.

The solicitor and client may have different views in relation to risk: the extent to which (and terms on which) they are willing to risk money to obtain money.

As we explore funding in this element, we will examine how different funding arrangements expose or help resolve some of these conflicts. However, given these potential conflicts, particular care needs to be taken to comply with the rules of professional conduct and to ensure the relationship between solicitor and client remains a harmonious one.

**Types of costs**

In litigation there are four main types of costs which a client may need to pay:

- Own solicitor’s fees

- Own counsel’s fees

- Own disbursements/expenses (e.g. expert fees, court fees etc.)

- The opponent’s costs \*

\*The opponent’s costs are generally formed of their own solicitor’s fees, counsel’s fees and disbursements/expenses.

Ensure you have these types of costs clear in your mind before progressing through this element, otherwise it will be difficult to understand how the various funding arrangements operate.

**Conditional fee agreements**

A CFA is a way for a client to fund its own solicitor’s fees. Additional funding arrangements will be required to fund the other potential types of costs, such as the risk of an adverse costs order to pay the opponent’s costs.

From the client’s perspective, a CFA has the major advantage that, under a full contingency, its solicitor’s fees only become payable when the case is successful (however ‘success’ is defined in the fee agreement – typically it is linked to an award (eg judgment) in a client’s favour or to actual recovery of a sum of money by the client). The client may also prefer its solicitor to share in the risk of the claim succeeding. The disadvantage is that some of the damages recovered by a successful client will need to be paid to the solicitor to satisfy the ‘uplift’ on their fees. Note that in some areas of work ‘partial’ CFAs are more common – so part of the fees are paid by the client during the litigation, and part of the fees operate on a CFA basis.

**Task:** What do you think are the advantages and disadvantages of a CFA from the solicitor’s perspective?

**Conditional fee agreements – solicitor’s perspective**

**Advantages:**

By offering a CFA, the solicitor will hope to attract clients / work that they might not otherwise attract. In fact, not only might it help a solicitor in the competition for clients, but the availability of a CFA can make litigation possible where it would otherwise be unaffordable, and in this way, expand the market-place for legal services.

In the event of a successful outcome (as defined in the fee agreement), the solicitor can expect to be paid more than they would normally be paid for the work because they receive an uplift of up to 100% of their normal fee.

**Disadvantages**

If the client is unsuccessful, the solicitor will be paid nothing (or, in the case of a partial CFA, will be paid less than it would normally be paid for the work done).

Even if the client is successful, the solicitor will have received no payment prior to that point (in the case of a full CFA). The case may have lasted for some time, and this can cause difficulties for the solicitor in terms of cashflow.

The solicitor’s entitlement to payment is subject to the risk of litigation, and particularly if the case goes to trial, the solicitor has only limited control over the outcome of the dispute.

**Potentially problematic areas**

What happens if the client receives an offer for less than the sum claimed, and the solicitor and client cannot agree on whether it should be accepted?

The solicitor’s interests and client’s interests are not totally aligned: the client may want to decline the offer, whereas the solicitor might consider it should be accepted because it reflects a good outcome given the risks. Whilst the decision whether to settle should remain with the client, the solicitor might not be comfortable continuing with a CFA if the client is not taking a reasonable approach to settlement. A well drafted CFA can help clarify what should happen, but it cannot totally avoid this tension.

**Damages based agreements**

A DBA is an alternative means for a client to fund its own solicitor’s fees. Additional funding arrangements will be required to fund the other potential types of costs.

Again, from the client’s perspective, it has the major advantage that the client does not need to pay the solicitor’s fees unless and until it recovers damages. As with a CFA, the client may also prefer that their solicitor shares in the risk of the litigation. The main disadvantage is that in the event of success, the damages need to be shared (to the agreed extent) with the solicitor.

**Task:** What do you think are the advantages and disadvantages of a DBA from the solicitor’s perspective?

**Damages based agreements – solicitor’s perspective**

**Advantages**

By offering a DBA, the solicitor will hope to attract clients / work that they might not otherwise attract.

Depending on the sum recovered, the solicitor may be paid more than it would normally be paid for the work, because payment will be based on damages recovered rather than time spent by the solicitor. DBAs also provide an incentive to solicitors in that the more that is recovered, the more the solicitor will be paid.

**Disadvantages**

The disadvantages are the same as with CFAs.

**Potentially problematic areas**

The difficulty mentioned in the context of CFAs when there can be conflicting interests concerning settlement applies equally to DBAs.

In addition, there are challenges that arise from the regulations that govern DBAs - the Damages-Based Agreements Regulations 2013. These state (s 4) that the sum to be paid under the agreement (eg 50% of damages ultimately recovered) must be paid by the client to their solicitor ‘net of’ any costs (meaning solicitors’ fees) payable by the opponent (whether or not those have actually been paid). The risk of the opponent not paying a costs order made against it is shifted to the solicitor.

Similarly, the sum to be paid under the agreement (eg 50% of damages) must be paid by the client to the solicitor ‘net of’ any sum in respect of counsel’s fees – so that 50% needs to provide for counsel’s fees too. It appears that if the client is unsuccessful, the client is not liable for counsel’s fees – if the solicitor does not wish to shoulder this potential liability, then it would be desirable for counsel to enter into a separate DBA with the client.

Finally, the sum to be paid under the agreement must cover the VAT on the solicitor’s fees too.

An agreement which does not comply with these rules is unenforceable against the client. In such a case, the client has no liability to pay anything to its solicitor, which in turn means that the client cannot recover anything in relation to those costs from the opponent.

**Prior to entering into a CFA or DBA**

Given the risks that a solicitor is taking when entering into a CFA or DBA, some crucial questions must first be considered:

**Concerns relating to the matter specifically**

- How should success be defined in a CFA / DBA for this matter?

- What are the prospects of success?

- How long will the matter take to conclude?

- Will the opponent pay any judgment? What are the enforcement prospects?

- What is an appropriate uplift for a CFA, or percentage of damages for a DBA?

**Broader concerns**

- How important is it to the law firm to provide a viable / attractive funding arrangement for a particular client?

- How does the cashflow prediction arising from a particular funding arrangement fit in the context of the cashflow position / other commercial concerns of the law firm?

Some of these questions, particularly those which are matter-specific, will require significant investigation, and thought must be given to how that investigation will be funded.

**ATE Insurance**

ATE insurance is typically purchased to fund those types of costs that are not covered by a CFA / DBA, namely disbursements/expenses, possibly own counsel’s fees and the other party’s costs. It is possible, but much less common, to purchase ATE insurance to cover own solicitor’s fees. A client may be able to fund the ongoing litigation, but want to provide protection against any adverse costs orders made against it.

The ATE insurance contract is between the client and the insurer. From the client’s perspective, ATE insurance gives a client a good deal of costs protection. In addition, if the client chooses to make their opponent aware of the insurance, it shows them that the client has ‘invested’ in the litigation and is in a good position to pursue it to a conclusion. The disadvantage to this method of funding is that as the ATE premium is not recoverable from the opponent, the client will need to pay for the premium out of any damages recovered. Often the premium for ATE insurance is contingent on success (as defined in the insurance agreement), so if the client is unsuccessful in their claim, then they do not need to pay the premium. Other options include paying an upfront premium, or a staged premium (an initial fee and then additional fees at certain stages of the litigation). Given the insurer’s potential exposure, the premiums are often high, particularly where premiums are contingent on success.

**Potentially problematic areas**

An insurer is unlikely to offer ATE insurance unless the prospects of success are sufficiently high. The insurer is likely to want the solicitor, or counsel, to provide an opinion on the prospects of success. In some cases, the insurer will only offer insurance if the solicitor is also acting on a CFA / DBA – perhaps because they need the reassurance provided by the solicitor willing to make their fees contingent on success too.

The insurance policy is likely to require the solicitor to report material developments in the litigation to the insurer. If the prospects of success drop too low, the insurer may terminate the insurance.

**Third party funding**

Third party funding is potentially available to cover any of the types of costs discussed above. However, it is most commonly used to cover the client’s own fees and expenses. It is much less common for a funder to agree to cover the other party’s costs since funders are looking for a return on their investment.

Alternative options such as ATE insurance are often required alongside a third party funding agreement to cover, for example, the risk of an adverse costs order being made against the client. Third party funding was, for a long time, illegal. Broadly, it was considered unlawful for an unconnected third party to support or take a financial interest in litigation (the rules against ‘maintenance’ and ‘champerty’). Third party funding is now permitted and there seemed to be a great deal of flexibility in the form that the client and funder might agree, prior to the PACCAR case explained below. Not only could they agree which areas of expense the funder would fund, but also the basis on which the funder would be paid. For example, it could be a percentage of the amount recovered in the litigation, a multiple of the amount the funder has paid or a combination of these.

These arrangements were attractive to a client because the client only paid the funder in the event of success (as defined in the funding agreement), and so reduced its risk in relation to legal costs. The client was able to pursue a claim that it would not otherwise have had the financial means to pursue.

**Problematic areas**

The third party funder is at risk of being ordered to pay the opponent’s costs – even beyond the level of funding that the third party has contributed to the litigation (Chapelgate v Money [2020] EWCA Civ 246). To avoid this risk, third party funders often insist on ATE insurance being in place to cover that potential liability instead, and often take out ATE insurance themselves to cover adverse costs. ATE insurance premiums can be very high. Sometimes this can make it uneconomic to pursue a claim that a third party funder would be willing to fund.

Even though third party funding became generally permitted, the client and funder need to ensure that the funding arrangement does not allow excessive control over, or profit from, the litigation on the part of the funder. This could constitute champerty / maintenance and make the agreement unenforceable as well as significantly increasing the likelihood of the court ordering the third party funder to meet any adverse costs order.

Funding agreements addressed these issues, for example, by including provisions that the client retained control of the litigation etc. Giving too great an involvement to a third party funder can also put the solicitor in a difficult position when trying to act in the client’s best interests if the client and third party funder do not agree.

Third party funding was completely shaken up in July 2023 when the Supreme Court decided in the case of *R (on the application of PACCAR Inc and others) (Appellants) v Competition Appeal Tribunal and others (Respondents)* [2023] UKSC 28 that the third party funding arrangements in place in that claim were actually DBAs and, as such, were required to comply with the DBA regulations, as summarised above. Existing third party agreements would not comply with these rules and so were unenforceable, meaning the client had no liability to pay anything to its solicitor, and could not recover anything in relation to those costs from the opponent. The impact of this in practice is still unfolding and has prompted a Civil Justice Committee consultation on litigation funding which should conclude with a final report and recommendations in 2025. In the meantime, the PACCAR decision remains in force and the availability of third party funding as an option must be considered in this context.

Negotiating and finalising a third party funding agreement can take a considerable amount of time. Most funders claim to be able to finalise such agreement within a 2-3 month period, however this can be much longer if the legal facts are particularly complex or if a quantum expert is required to provide additional comfort that the cost to quantum ratio is at an appropriate level to ensure it is economically feasible. This can often steer clients away from this option as they need to start proceedings quicky.

**Considering funding in the round**

Each of the funding arrangements described here are complex enough when considered alone. But they must be considered together, which increases the complexity further. Three particular complexities are considered below.

**Comprehensive coverage**

You need to understand whether, considering all the funding arrangements which are being proposed, everything the client wants to be covered is covered, and to the desired extent.

**Priority of recovery**

In what order should the interested parties recover if the sums recovered from the opponent will not satisfy them all? If a client has a CFA, ATE and third party funding in place, then that is four parties (including the client) who will want a share of the sum recovered. The payment priority will usually be set out in any third party funding agreement, and it typically would provide for the funder to recover first, followed by the ATE insurer. It is important that the client is made aware of this waterfall of payments and the proportion of the damages recovered that will be paid over to the interested parties.

**Relative merits**

You must advise your client, with external input if necessary, as to the relative merits of different funding options. For example, if a third party funder and ATE insurance are both options, what are the relative merits and relative costs of each?

**The commercial reasons for entering into these funding arrangements**

The funding arrangements set out in this element can allow a party to litigate when it would not otherwise be able to do so. For example, without CFAs and ATE insurance, many claimants in personal injury claims would be unable to meet the costs or take the financial risks involved in litigation, and the same may be true of some commercial claims.

However, particularly in relation to commercial claims, to see funding arrangements only from this ‘access to justice’ perspective is too limited. For example, even for a client well able to fund litigation on the usual basis, these funding arrangements may be attractive because they can (depending on the arrangements in place):

- Engage lawyers in the litigation by giving them a stake in its success or failure;

- Improve a client’s cashflow position;

- Allow a client to alter the risk profile of litigation, from higher risk and with higher potential reward to lower risk with lower potential reward; and

- Alter the way the litigation needs to be reflected in the company’s accounts.

**Summary**

- Funding options need to be considered for all clients, not only those clients who may not be able to fund the litigation in the traditional manner.

- Funding needs to be approached carefully: it can lead to, or exacerbate, areas where the solicitor’s and client’s interests are not totally aligned.

- Consider funding of a client’s own solicitor’s fees, own counsel’s fees, disbursements/expenses and the other party’s costs.

- CFAs and DBAs join the client and the solicitor together in sharing in the risk of the litigation failing: but they can cause tensions if the solicitor and client disagree about how to proceed, in particular in the context of settlement. A solicitor will need to investigate a claim thoroughly before agreeing to a CFA or DBA.

- ATE insurance can provide cover for costs other than own solicitors’ fees, but at a price, and subject to the claim having sufficient prospects of success.

- Third party funding was always potentially problematic due to conflicts of interests and the risk of unlawful maintenance / champerty. It would often only be feasible alongside one or more other funding mechanisms eg ATE. Since *PACCAR*, it is less likely to be an available option, as it could be indistinguishable from a DBA.