Policy brief: Towards regulating Third-Party Litigation Funding (TPLF)

Introduction

Third-party litigation funding (TPLF), an arrangement where external investors finance legal actions for a share of settlements or awards, has rapidly expanded across the EU, contributing to a €40-80 billion global market. Its increasing prevalence in consumer class actions, litigation in many other areas as well as international arbitration and investor-state disputes highlights its growing role within EU civil justice systems.

EU legislation, notably the Representative Actions Directive (RAD) and the revised Product Liability Directive (PLD), along with other measures promoting collective action rights under the 'New Deal for Consumers' package, are expected to increase litigation, highlighting the need for a complementary TPLF regulatory framework. This challenge was recognized in a broadly supported European Parliament resolution on responsible regulation of privately funded litigation.[1]

The problem of unregulated TPLF: economic, judicial, societal and geopolitical impacts

Recent market trends and analysis make clear that unchecked growth of TPLF poses significant economic, judicial, societal as well as geopolitical risks to the EU. Although TPLF can facilitate the filing of lawsuits, more robust regulatory measures are required to prevent unintended negative outcomes, as demonstrated by experiences in jurisdictions such as the US, UK, and Australia.

- ***Economic impact***

Purely financial incentives encourage transactional or even predatory cases driven by objectives of profit rather than justice. The financialization of litigation risks transforming judicial processes into a lottery for speculative investment opportunities without adequate guardrails, which could severely damage the EU's economic competitiveness and its attractiveness as a place to do business.

A recent study by the European Centre for International Political Economy (ECIPE) shows that rising mass litigation in Europe could harm the economy by increasing both business uncertainty and legal compliance costs. Scenario projections estimate additional annual private enforcement costs of €28.3 to €84.8 billion in the EU, affecting companies' competitiveness and impacting their investment in innovation.[2]

- ***Judicial impact***

Unregulated TPLF also puts undue burden on courts. The result is logjammed civil courts with longer and more costly mass cases of dubious merit, increasing backlogs and diversion of judicial resources away from truly meritorious claims.

The inherent opacity of fee arrangements and non-disclosure of TPLF agreements impairs constitutionally required transparency as to the identity of the parties in a case and undermines the rule of law. Without disclosure requirements, courts and defendants remain unaware of third-party influence, allowing covert control over legal outcomes. This opacity can compromise the fairness and independence of the judiciary and erode public trust in democratic institutions.

- ***Societal impact***

Consumer protection is also at risk. While TPLF can finance legitimate claims that might otherwise be unaffordable for individual claimants, it frequently leads to exploitation of vulnerable consumers. Cases such as the UK's Post Office litigation, where claimants received only 20% of the settlement amount, demonstrate how unregulated funding can deliver financial gain to lawyers and funders at the expense of claimants.

- ***Geopolitical impact***

Finally, EU Member States face challenges in safeguarding their judicial systems from external manipulation. As reports suggest, this is already the case in the US, and foreign entities could similarly use TPLF to strategically target European businesses.[3] This consequence of unregulated TPLF underscores the urgent need to protect the EU's courts and businesses from external interference and manipulation by, at the very least, creating transparency as to the identity of the organisations that are funding mass claims.

[1] European Parliament resolution of 13 September 2022 with recommendations to the Commission on responsible private funding of litigation (2020/2130(INL))
[2] ECIPE: The Impact of Increased Mass Litigation in Europe
[3] Bloomberg Law: China Firm Funds US Suits Amid Push to Disclose Foreign Ties

Towards an EU regulatory framework on TPLF

Currently, there is no EU-wide regulatory framework for TPLF and EU Member States' practices are fragmented. This lack of harmonization creates legal uncertainty, invites forum shopping, and weakens the effectiveness of the new civil liability mechanisms introduced by the PLD and the RAD. Establishing a Europe-wide framework for TPLF is essential to safeguard the integrity of judicial systems, provide legal certainty for European businesses, and protect the interests of claimants.

There is growing momentum for regulatory intervention. The European Parliament's 2022 resolution, along with calls from a broad coalition of European industry associations representing key economic sectors[4], underscores this urgency. The case for reform is further strengthened by new evidence of the risks of unregulated TPLF presented by independent research conducted by ECIPE, the European Law Institute (ELI)[5], and the European Justice Forum (EJF)[6].

Building on these insights and drawing from international best practices, a balanced and comprehensive EU regulatory framework should provide:

1. **Transparency**
    - **Mandatory transparency and disclosure:** Require full disclosure to all involved parties of funder identities, ultimate sources of money invested and redacted TPLF agreements, while unredacted disclosure of TPLF agreements to the court is essential to enable full judicial review.
    - **Registration and oversight:** Establish regulatory mechanisms requiring authorization, registration, and supervision of litigation funders, in line with all other business fields in the financial sector that have their own appropriate rules.
2. **Protection of claimants' rights**
    - **Cost liability and capital adequacy:** Impose joint liability for adverse costs and enforce minimum capital adequacy standards to prevent abuses by speculative and financially unstable funders.
    - **Claimant autonomy:** Ensure funders do not control litigation strategies or outcomes in order to preserve claimants' control over the decision-making process.
    - **Claimant-first recovery and caps on fees by ensuring minimum pay-out:** Mandate a recovery structure that prioritises claimant / beneficiary compensation with clear limitations on funders' and other intermediaries' fees to prevent abuse.
3. **Ethical standards**
    - **Conflict-of-interest rules:** Prohibit funding arrangements that have inherent conflicts of interest in order to safeguard judicial impartiality and claimant / beneficiary interests.
    - **Fiduciary and ethical duties:** Set out explicit fiduciary duties obligating funders to act in claimants' best interests.
4. **Harmonized regulatory framework**
    - **Comprehensive applicability:** Apply these regulations consistently across all instruments of mass civil litigation and arbitration in all fields in order to prevent circumvention and ensure regulatory effectiveness in the EU.

A clear EU policy framework for TPLF that incorporates these elements would directly complement broader EU policy objectives by:

(i) Supporting the EU's consumer protection goals through the safeguarding of legitimate redress mechanisms from misuse;
(ii) Aligning with the goal of fostering legal certainty and a fair business environment – critical for boosting the EU's economic security and competitiveness; *and*
(iii) Protecting and reinforcing confidence in the EU's civil courts and litigation processes.

Conclusion

The unchecked expansion of TPLF threatens the EU's economic resilience, legal integrity, and consumer protections. While TPLF can facilitate the filing of more civil cases, a lack of EU regulation leaves the door open to exploitation of claimants and systemic risks. EU regulators now have a window of opportunity to take pre-emptive action and develop a harmonized regulatory framework that mandates transparency, enforces ethical standards, and protects claimants' rights from adverse developments as seen in the US, UK and Australia. Clear, enforceable rules will ensure TPLF serves the public interest - strengthening, not undermining, Europe's justice systems and business environment.

[4] Joint Statement on TPLF
[5] European Law Institute: Principles Governing the Third Party Funding of Litigation
[6] European Justice Forum: Position Paper on Third Party Litigation Funding