SECURITY FOR COSTS, CFAS AND INSOLVENCY LITIGATION FUNDING – THE QUEST FOR THE HOLY GRAIL

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May 2018

INTRODUCTION

1. It is one thing to identify a potentially meritorious claim. It is another to have the resources to fund it, and have a sufficiently robust structure in place to be able to fend off the canny defendant. Funding and ATE insurance play a central role in modern insolvency litigation and it is the purpose of this talk to explore the latest case law developments in those areas, as well as to consider the current state of the market, and predictions as to where we might be heading in the years to come.

2. So far as litigation funding is concerned the Courts tend to view it as falling into two categories (as demonstrated in the recent Court of Appeal decision in *Excalibur Ventures llc v Texas Keystone Inc (No 2)* [2016] EWCA Civ 1144; [2017] 1 WLR 2221, referred to further below):

3. The first is so-called "pure funding" – the case of *Hamilton v Al Fayed (No 2)* [2003] QB 1175, when Neil Hamilton sued Al Fayed for libel, is a classic example. Pure funders will not ordinarily be made the subject of a non-party costs order under section 51(3) of the Senior Courts Act 1981 ("the SCA 1981"), to pay the costs of the successful unfunded party, because their main motivation was to enable the funded party to litigate what the funder considered to be a genuine and meritorious case. Section 51(3) of the SCA 1981 is, as is well-known, the provision which gives to the court a discretion to determine by whom and to what extent the costs of proceedings are to be paid, and is reflected in CPR r. 46.2, which enables the funder to be joined to proceedings for the purposes of costs.

4. The second category is so-called commercial or professional funding. The commercial funder is an investor who hopes to make a return on its investment. Most insolvency litigation will fall into this category and whilst commercial funding facilitates access to justice, the courts tend to view that as not being the essential motivation of the commercial funder. For that reason, if the claim is unsuccessful and the funded proceedings fail, the court will be inclined to see that any commercial funder or funders must pay the successful party's costs, subject to certain limitations which we consider further below. Moreover the presence of a commercial funder means that the claimant is likely to be treated in the position of a solvent company with access to further resources of the funder, if so required.

5. So it is as important for the funder as it is for the office-holder that there is effective security for costs in place, and a funding package which works for all the parties involved.

6. These notes seek to consider the principles and practical points which arise for insolvency litigation funding in relation to both security for costs and funding more generally, and are divided into two parts:

7. Part 1: considers security for costs applications, the decision of *Premier Motorauctions* at first instance and in the Court of Appeal, and significant case law since then.

8. Part 2: considers the use of "recovery only" CFAs and the position following *Stevensdrake* in the Court of Appeal.

9. We propose to address (more fully) the question of security for costs and insolvency litigation funding from a market, and funders', perspective, including consideration of where the funding market is now, and is likely to be in the future, in our slides and oral presentation ("Part 3" of our talk). Accordingly these notes tend to focus more on the attitude and approach of the courts, though we hope in the course of them to address some of the key practical issues which arise.

PART 1: SECURITY FOR COSTS APPLICATIONS

The context

10. The main context for security for costs applications are proceedings brought by an office-holder in the name of the insolvent company. The assumption is that either the misfeasance gateway under section 212 of the Insolvency Act 1986 ("IA 86") is not open to the office-holder, which would enable the office-holder to avoid a security for costs application, or the litigation team have chosen not to use it as a procedural route. In these circumstances the question of, and protection against, a security for costs application against the claimant company must be considered.

11. There is also now the ability to seek a security for costs order against a litigation funder. Some of the case law in this context will be considered below, but the main focus is on applications for security against the claimant company itself.

Applications for security against claimant company– the jurisdictional and discretionary tests

12. Whilst an application for security for costs is made under CPR r. 25.12, the jurisdiction to order security for costs is governed by CPR r. 25.13:

> *"(1) The court may make an order for security for costs under rule 25.12 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) (i) one or more of the conditions in paragraph (2) applies…*
>
> *(2) The conditions are - …*
>
> *(c) the claimant is a company … and there is reason to believe that it will be unable to pay the defendant's costs if ordered to do so."*

13. Condition (c), sometimes referred to as the impecunious or insolvent company condition for short[1], was previously duplicated by section 726 of the Companies Act 1985, but as from 1 October 2009 section 726(1) was repealed and not replaced[2]. Prior to its repeal, section 726(1) provided as follows:

> *"Where in England and Wales a limited company is plaintiff in an action or other legal proceeding, the court having jurisdiction in the matter may, if it appears by credible testimony that there is reason to believe that the company will be unable to pay the defendant's costs if successful in his defence, require sufficient security to be given for those costs, and may stay all proceedings until the security is given."*

14. Given the historic overlap, some of the case law considered below considers section 726, rather than CPR 25.12(2)(c).

15. It should also be noted, however, that whilst there is a jurisdictional threshold, there is also, if that jurisdictional threshold is crossed, a discretionary stage, at which the Court may consider other

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[1] See Vol 1 of The White Book, 2018 Edition, at 25.13.12

[2] Companies Act 2006 (Commencement No.8 Transitional Provisions and Savings) Order 2008 (SI 2008/2860)

factors or facts which may be of relevance to the question of whether security, or further security, should be ordered, and if so on what terms and in what amount. We will return to consideration of that second stage further below.

The decision in *Premier*, at first instance and then in the Court of Appeal

16. In *Premier Motorauctions Ltd v PwC & Lloyds Bank Plc* [2016] EWHC 2610 (Ch) the claimants, companies in liquidation, issued proceedings against PwC and Lloyds Bank Plc. The claimant companies were, prior to entry into administration in December 2008, in the business of car auctions and the auction of cherished DVLA registration plates, with the main trading premises being in Leeds. The allegation was that an employee of PwC was introduced in late July 2008 on false pretences as someone who was willing to take on the role of non-executive director, where as in fact the employee of PwC was reporting back to the Bank. The claimant claimed that PwC wrongly identified a substantial further funding need, preceding, and during, an IBR, in August 2008, and that a condition of support by the Bank to assist with that urgent funding need was that an accelerated merger and acquisition ("AMA") sale be carried out under the supervision of PwC. When the companies, acting by its managing director, Mr Keith Elliott, refused to agree to sign up to that, and after failed attempts at an injection of further capital to take the funding position back to its pre-IBR levels, the companies were eventually sold in a pre-packaged administration, with only nominal sums being received for the enterprise value of the business. In short, the claim was that the companies had wrongly and unlawfully been pushed into the Bank's Business Support Unit ("BSU"), with the objective of maximisation of profit making opportunities for PwC, by way of fees, and for the Bank, by acquiring an equity stake in the business, off the back of an AMA or distressed sale. The allegations may be described as falling within the same pattern of misconduct as were described and referred to in the Tomlinson report. As well as denying the claims in their defences, and contending that the claimant companies would in any event have failed so that no loss had been suffered by any wrongful acts, the defendants issued security for costs applications against the claimant companies.

17. At first instance, the companies, acting by their liquidators, successfully resisted a security for costs application on the grounds that the jurisdictional threshold had not been crossed by reason of the existence of ATE insurance, in respect of which there was no reason to believe it would not respond. On the facts in *Premier* there were four different insurers providing cover for different sums and at different layers, but for the purposes of these notes they are treated as one.

18. The first instance judgment of Snowden J, is reported at [2017] 2 All ER (Comm) 681. He concluded that the approach taken by Stuart-Smith J in *Geophysical Service Centre v Dowell Schlumberger (ME) Inc* [2013] EWHC 147 (TCC), 147 Con LR 146 was the right one and, having conducted a careful review of the authorities before and since then, concluded that (at [41]):

> *"Accordingly, I think that in a case in which a claimant has obtained an ATE policy specifically to cover the bringing of a claim, and relies upon it to resist an application for security for costs, the approach taken by Stuart-Smith J in paragraph 20 of Geophysical is correct. The question is not whether the ATE policy provides the same security as cash or a bank guarantee, or indeed whether the ATE policy provides the same security as might a deed of indemnity from the same or another insurer. It is whether, having regard to the terms of the ATE policy in question, the nature of the allegations in the case and all the other circumstances, there is reason to believe that the ATE policy will not respond so as to enable the defendant's costs to be paid."*

19. The judge then considered the terms of the ATE insurance, the nature of the allegations in the case (which relied on the former managing director, Mr Elliott) and all the other circumstances, including in particular the fact that the claims were brought by office-holders of insolvent companies whose knowledge was not material to the issues in the case, and concluded that the jurisdictional threshold

test, under CPR 25.13(2)(c) was not met, in that he was not satisfied there was reason to believe that the Companies would be unable to pay the defendants' costs if ordered to do so (see at [74]).

20. The judge was also asked to consider, and rejected (see at paragraphs [39] and [66]), the contention that because any insurance monies would be paid to the office-holder they would be swallowed up in the insolvency estate, and this rendered the ATE policies of little use to the defendant. The judge referred to *Norglen v Reeds Rains Prudential* [1998] BCC 44 at 56, as supporting the proposition that the claim has priority over other creditors. However if one looks at the official report, reported at [1999] 2 AC 1 and in particular at the bottom of p20 and top of p21, the observations of Lord Hoffmann make clear that this also includes priority over the liquidator's own costs (by reference to the decisions in *see In re Pacific Coast Syndicate Ltd.* [1913] 2 Ch. 26 *and In re Movitex Ltd.* [1990] B.C.L.C. 785.)

21. In *Premier* the Companies not only had ATE insurance but also had a professional funder, and in those circumstances they could not mount any convincing stifling defence – which would have been relevant at the discretionary stage. The judge made clear that if he had concluded the jurisdictional threshold had been crossed he would not have been willing to find that the claims would be stifled, notwithstanding the substantial additional financial burden caused by the need to purchase deeds of indemnity or additional endorsements on the policy.

22. The Court of Appeal, in a judgment handed down on 23 November 2017, and with neutral citation [2017] EWCA Civ 1872, disagreed with the judge's analysis, and allowed the appeal, and ordered that security be provided either by a payment into court, or by way of a deed of indemnity from its UK lead insurer or by way of a bank guarantee.

23. There were three main issues before the Court of Appeal.

24. The first issue was whether or not ATE insurance could be taken into account at the jurisdictional stage. The Court of Appeal (with apparent reluctance; see at [19]-[20]) rejected the submission that ATE insurance could not be considered at all at the jurisdiction stage and was only material to the question of the exercise of discretion (see at [22]-[24]).

25. The second issue was whether the ATE insurance provided what Longmore LJ described as "*sufficient protection*" such that there would not be "*reason to believe*" that the company would be unable to pay the defendants' costs if ordered to do so (see at [22] & [25] et seq). The Court of Appeal concluded that the defendants did not have sufficient assurance that the insurance was not liable to be avoided for misrepresentation or non-disclosure (see at [29]).

26. The third issue was whether, assuming the jurisdictional threshold was crossed, it would be just, as a matter of discretion, to order that security be provided beyond that provided by the ATE insurance, and if so in what form. The Court found it should (see at [37]) and ordered security be provided in the form of either a deed of indemnity, or payment into court or a bank guarantee.

27. Longmore LJ, who gave the lead judgment, framed the issue before the Court as follows (at [5]):

> "*So the question of principle arises: does ATE insurance which has no anti-avoidance provisions (and other exceptions or conditions precedent to liability) constitute adequate security for costs in a case requiring such security to be given*?"

28. It is apparent from the framing of the issue in this way that Longmore LJ was treating the case as one where "security" was required, whereas, the Companies submitted, properly understood, the question was whether the presence of the ATE insurance meant that security was not required.

29. Having (wrongly, the Companies submitted) framed the issue before the Court in that way, and having cited the jurisdictional test in CPR 25.13(2)(c) (at [6]), Longmore LJ noted (at [7]) that the requirement of showing, in relation to the claimant, that "*there is reason to believe that it will be*

unable to pay the defendant's costs if ordered to do so", was not a requirement that the court must be satisfied "*on the balance of probabilities that the claimant would be unable to pay the defendant's costs. It only needed reason to believe that it would not be able to do so*", citing the judgment of Arden LJ in the Court of Appeal in *Jirehouse Capital v Beller* [2009] 1 WLR 751. In particular he noted (at [7]).

> *"Arden LJ indicated at paragraphs 33-34 that, since such non-payment of an order for costs is a future event, what the court has to do is to consider all of the circumstances and evaluate the risk of that occurring. She also indicated that it would be preferable for the court not to paraphrase the relevant words of CPR 25.13(2)(c). That observation was endorsed by Moore-Bick LJ in his judgment in the case and was subsequently repeated in SARPD Oil v Addax Energy [2016] BLR 301, where Sales LJ commented, at paragraphs 13-14:-*
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> *"13. It follows that it is not sufficient for the court or the defendant to be left in doubt about a claimant's ability to pay the defendant's costs if the claimant loses. Nor is it sufficient as the first instance judge in Jirehouse had done to paraphrase the wording of the rule by saying that there was a significant danger that the claimants would not be able to pay such costs. The court must simply have reason to believe that the claimant will not be able to pay them.*
>
> *14. That is, as Arden LJ said, a matter of evaluation…"*

30. Longmore LJ was bound to follow the earlier Court of Appeal decision in *Jirehouse*, and it was not suggested otherwise in the Court of Appeal.

31. Having reminded himself that the requirement in CPR 25.13(2)(c) is a jurisdictional requirement (at [8]), Longmore LJ then went on to consider the terms of the ATE insurance (at [9]) and noted (at [10]) that they reflected the ordinary common law principle by which the insurer is entitled to avoid liability if the insured makes any material non-disclosure or representation.

32. Having reviewed the judgment below (at [12] & [13]) and the competing submissions (at [14]-[18]), Longmore LJ indicated that it was "*unfortunate that the court's jurisdiction to order security for costs should depend on a detailed analysis of a claimant's ATE insurance policies…*" (at [19]), but concluded that such analysis was inevitable (at [20]) because the authorities did support the proposition that ATE policies might provide an answer to an application for security for costs at the jurisdictional stage (see at [22-23]) and, in any event, given that they would have to be considered at the discretionary stage, perhaps this was not too troubling (see at [23]).

33. When rejecting the submission that ATE insurance could not be considered at all at the jurisdiction stage, the judge framed the answer to the jurisdiction question by posing, first, the question, did the ATE insurance give the defendant "sufficient protection", and, if so, the Court should then conclude there will not be "reason to believe" that the company will be unable to pay (see at [22]).

34. This approach was then followed through by the judge when considering the second issue, namely whether the ATE insurance meant that the jurisdictional threshold test was not crossed, in particular at [25]-[29].

35. The question posed, in the heading above this section of the judgment, was whether the ATE provides "*Sufficient Protection?*". Longmore LJ noted the absence of anti-avoidance provisions and considered Mr Elliott's evidence to be of central importance in the determination of the action (see at [25]) and, if he was disbelieved, then, unlike Snowden J, he was not satisfied it remained "*something of a leap*" to conclude that would provide grounds for avoidance (see at [26]-[27]).

36. He concluded that innocent non-disclosure could not be ruled out (at [28]), even with professionals involved in conducting the litigation, and there was not sufficient "*assurance*" (at [29]). As a result, he concluded:

    "*It follows therefore that there is reason to believe that the Companies will be unable to pay the defendants' costs if ordered to do so and that the jurisdictional requirement of CPR 25.13 is satisfied.*"

37. Whilst recognising that he was displacing the first instance judge's evaluation with his own, he justified this on the basis that "*the present case raises important questions of principle which have not been previously considered at an appellate level"* and he detected a tendency for judges at first instance to be too ready to accept that an ATE policy can stand as security for costs (see at [30]).

38. He nevertheless purported to have no quarrel with the observations of Stuart-Smith J in *Geophysical*, as cited by Snowden J, and cited at [30], to the effect that the ATE market was now more mature, and, in the absence of evidence to the contrary: "*the court's starting position should be that a properly drafted ATE policy provided by a substantial and reputable insurer is a reliable source of litigation funding*" and that "*depending upon the terms of the policy in question, an ATE policy may suffice so that the court is not satisfied that there is reason to believe that the claimant will be unable to pay the defendant's costs.*"

39. But he wished to emphasise the words "*properly drafted*" and "*depending on the terms of the policy in question*" and noted that, unlike in *Geophysical*, there was no anti-avoidance provision (see at [31]).

40. He considered that whilst the Court may not find it difficult to assess the likelihood of avoidance where the right to avoid is confined to fraud, the same could not be said where there is no anti-avoidance clause (see at [31]).

41. He appeared to endorse an anti-avoidance clause (used in *Geophysical*) in the following terms (quoted at para 31):

    "8. The insurer shall not be entitled to avoid this policy for non-disclosure or misrepresentation at the time of placement except where such non-disclosure was fraudulent on your part."

42. Ostensibly, therefore, the decision of Longmore LJ was not to challenge the correctness of the first instance decisions before Snowden J but to distinguish them on the basis that they had anti-avoidance provisions, and to treat *Premier* as fact sensitive given the risk of avoidance based on the risk of Mr Elliott's testimony being disbelieved (though he then muddied the waters somewhat by noting that in another case, where security for costs was not the issue, an ATE policy with such a clause might not be sufficient for fortification purposes).

43. Finally, on the question of discretion, whilst Longmore LJ had seemingly accepted that the discretionary stage would require the sufficiency of the ATE policies to be evaluated, when it came to it, he concluded that the fact that there was reason to believe they would not respond, taken with the fact that the Companies had no other assets and were not advancing an argument as to stifling, meant that it was just to order security in the form ordered (see at [37]).

44. The claimants identified various issues of general public importance arising from the Court of Appeal's decision, calling for the Supreme Court's consideration and determination. In summary, those included:

45. Whether it is permissible to treat the jurisdictional threshold as already having been crossed when an impecunious company relies on ATE insurance, so as to effectively reverse the burden of proof (the burden of proof issue)? The criticism of the Court of Appeal's judgment is that to pose the

question as to whether there was "sufficient protection" was to wrongly reverse the burden, and instead the proper question was that posed by statute and the rules of "*reason to believe*".

46. How the words "*there is reason to believe that it will be unable to pay the defendant's costs*", in CPR 25.13(2)(c), should be interpreted and applied - in the context of ATE and more generally (the meaning and application issue)? This would have permitted the Supreme Court to clarify the approach taken in *Jirehouse*, clarify what "*reason to believe*" really means when interpreted with "*will be unable to pay*", and consider whether a "balance of probabilities" test, as seemingly articulated by Sir Donald Nicholls V-C in *In re Unisoft Group Ltd (No 2)* [1993] BCLC 532, or something akin to it, should be adopted.

47. Whether ATE insurance, without anti-avoidance clauses can enable office holders, seeking to make recoveries for the benefit of the estates of insolvent companies, to resist security for costs applications in circumstances where they are strangers to the events in question (the insolvency attribution issue)? This appeared to be a straightforward application of two principles: The fact that a director's agency ceases (at the latest) when the company enters liquidation (*Measures Brothers v Measures* [1910] 2 Ch 248 at 256); secondly, the principle that the obligation to disclose facts material to the risk is restricted to facts known to "the insured" in the sense of being either a directing mind or someone sufficiently concerned with insurance transactions (see *The Eurysthenes* [1976] 2 Lloyd's Rep. 171 at 179 col.2), and would not extend to facts known to a former director. The reasoning of the Court of Appeal as to why the former director's state of mind might be relevant to risk avoidance on the policy is not spelt out.

48. Whether the approach taken in the first instance line of authorities on the ability to use ATE insurance policies to resist security for costs applications, dating back over 4 years to Stuart-Smith J in *Geophysical*, should be preferred to that of the Court of Appeal in the instant case (the evaluative issue)? This encouraged a higher consideration of public policy and access to justice considerations.

49. Whether the approach to the discretionary stage, where ATE insurance is in place from reputable providers for the benefit of office holder claims, requires a different approach to that adopted by the Court of Appeal (the discretion issue)? This would have allowed the Supreme Court to consider were the line should be drawn in terms of discretion.

50. The Supreme Court refused to give permission to appeal on any of these points. So the insolvency industry has not had the benefit of scrutiny of those issues at the highest level, and in the circumstances litigants must do the best they can to identify solutions based on the law as now stated by the Court of Appeal in *Premier* and having regard to subsequent High Court decisions since then.

Summary of the position following *Premier*

51. It can be seen that *Premier* is somewhat unsatisfactory in that it purports to endorse the approach in principle taken in earlier High Court decisions, but also suggests they may reflect an overly tender approach by first instance judges to claimants faced with security for costs applications who rely on ATE policies. Overall, however, it must be recognised that the prospects for claimants of showing the jurisdictional threshold is not crossed by reason of the existence of an ATE policy are reduced, particularly where there are no anti-avoidance clauses, but not limited to such a situation – as paragraph 5 of the judgment of Longmore LJ makes plain, conditions precedent or exclusions may also provide grounds for concluding that the jurisdictional threshold has been crossed.

52. The position may be summarised as follows, following the decision of the Court of Appeal in *Premier*:

53. First, whilst it is now accepted that the starting point is that a properly drafted ATE policy provided by a substantial and reputable insurer is a reliable source of litigation funding, defendants are positively being encouraged to test out whether the drafting leaves them open to risks of avoidance on a case by case basis, and having regard to the circumstances of each case. ATE insurance is

simply the start of the enquiry and does not answer the question, and the process requires a greater degree of scrutiny on the part of lawyers, ATE providers and funders.

54. Secondly, without any clear reasoning as to why they should not be able to rely on non-attribution of knowledge of former directors when submitting proposals for ATE insurance, and depending on the nature of the claims being brought, office-holders remain vulnerable to the contention that without sight of the proposal documentation, which will ordinarily contain privileged and sensitive information as to merits analysis, the Court cannot entirely discount the risk of avoidance. Moreover, policies will typically contain wording along the following lines (aside from the common law duty of disclosure), namely the insured shall "*Ensure that the information You give to Your Legal Representative is a complete, accurate and truthful account of the facts, to include the provision of all relevant and necessary documentation, information and evidence in Your Possession*". In order to counter the contention that such a condition might be innocently breached the claimant will now have to give serious consideration to the inclusion of a general anti-avoidance clause (save perhaps in the case of fraud).

55. Thirdly, even if the avoidance issue can be overcome by a suitable anti-avoidance clause, there could still be a risk of cancellation or cover being withdrawn in the event that the litigation is not conducted properly or efficiently by the legal team, depending on how the policy conditions are framed. This area of enquiry remains untested above High Court level, and the High Court decisions are more favourable to the claimant than the defendant on this issue, but it must be expected there will be a greater degree of scrutiny on the policy wording following the decision in *Premier*. In order to try and counter this potential complaint some litigants may offer an endorsement or a deed of indemnity to cover off these issues too.

56. Fourthly, the fact that insurance proceeds responding to an adverse costs order will be paid to an office-holder conducting the affairs of the insolvent company should not be of concern to the defendant for three reasons: (i) the adverse cost order has "super" priority, including over the liquidator's own costs; (ii) the monies are probably the subject of a purpose trust; and (iii) in any event an office-holder can readily give an undertaking should there be any doubt about the above propositions on the facts of the particular case.

57. Finally, while the point has yet to be tested, there appears to be a reasonable basis to contend that the increased cost of offering either an anti-avoidance endorsement or a deed of indemnity, in response to or in fulfilment of an order for security, should be recoverable as costs of the security (cf. the position in relation to ATE policies generally, which are not recoverable in post-LASPO exemption cases, after 6 April 2016 – see further in Part 2 below).

Subsequent case law – the door ajar following *Bailey*?

58. Subsequent first instance decisions since *Premier* appear to show the market shift following the decision, and most litigants will now either include in the policy at the date of inception, or offer to a defendant who threatens a security for costs application, an anti-avoidance endorsement.

59. The Court of Appeal's approach in Premier was applied this year by the High Court in *Recovery Partners GB Ltd and another v Rukhadze and others* [2018] EWHC 95 (Comm). Whilst it is right to say the Court considered the application of *Premier* in fact the case was somewhat different. The claimants' solicitors had given undertakings to hold sums of money as security for costs and by the claimants' application sought an order permitting the undertakings to be released in exchange for the provision of security for those same costs by way of a deed of indemnity from an insurance company which had provided the claimants with ATE insurance. Thus, the focus of the argument was on whether the deed was sufficient, which the Court found it was, but the Court was not persuaded the undertaking should be released given there was no change in circumstances which justified it being released. This case does not take the jurisprudence any further than the decision in *Premier* therefore.

60. There is another High Court case, however, which is of potential relevance and significance, namely the decision of Foskett J in *Bailey and others v GlaxoSmithKline UK Ltd* [2017] EWHC 3195 (QB);

[2018] 4 WLR 7. This concerned a security for costs application against a funder under CPR r 25.14.This provides as follows:

"(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."

61. The background to this were helpfully set out recently by Hildyard J in *In re RBS Rights Issue Litigation* [2017] EWHC 1217 (Ch); [2017] 1 WLR 4635, at para 19:

"The potential exposure of litigation funders to orders for costs against them at the end of the day does not, of course, of itself mean that an order for security for costs should be granted. At such an interlocutory stage the court must assess not only whether it is sufficiently clear that the criteria for the potential imposition of liability are fulfilled, but also whether there is a sufficient basis for interlocutory intervention. Of particular relevance in assessing whether an interlocutory order against a non-party under CPR r 25.14(2)(b) to secure a contingent liability pursuant to section 51 is appropriate and just will be: (1) whether it is sufficiently clear that the non-party is to be treated as having in effect become in all but name a real party motivated to participate by its commercial interest in the litigation; (2) whether there is a real risk of non-payment such that security against the contingent liability should be granted; (3) whether there is a sufficient link between the funding and the costs for which recovery is sought to make it just for an order to be made; (4) whether a risk of liability for costs has sufficiently been brought home to the non-party, either by express warning, or by reference to what a person in its position should be taken to appreciate as to the inherent risks; (5) whether there are factors, including for example, delay in the making of an application for security or likely adverse effects such as to tip the overall balance against making an order."

62. Hildyard J also referred to the position of multiple claimants pursuing a claim under a GLO (which is the case here) in the following way, at paras 16-17:

"16. It has been held in a number of cases that orders for costs against non-parties are 'exceptional'; but ... this is less of a restriction than might at first be thought. To quote again from Lord Brown of Eaton-under-Heywood in [Dymocks Franchise Systems (NSW) Pty Ltd v Todd (Associated Industrial Finance Pty Ltd, Third Party) [2004] 1 WLR 2807], at para 25: 'Although costs orders against non-parties are to be regarded as "exceptional", exceptional in this context means no more than outside the ordinary run of cases where parties pursue or defend claims for their own benefit and at their own expense. The ultimate question in any such "exceptional" case is whether in all the circumstances it is just to make the order. It must be recognised that this is inevitably to some extent a fact-specific jurisdiction and that there will often be a number of different considerations in play, some militating in favour of an order, some against.'

"17. Thus it is a truism, but an important one, that every case must be considered on its facts; but in my view, a case with multiple claimants seeking to vindicate their rights under a [group litigation order] and who have been accorded by court order the considerable benefit of several and not joint liability for costs will be likely to be considered 'exceptional'. In such a case, the defendant(s) will almost inevitably be put to exceptional difficulty in enforcing any costs order in their favour if they obtain one at the end of the day."

63. The essential battleground in *Bailey* was as to the quantum of the security to be granted, although it was contended by the respondent funder, MLS, that the ATE cover, combined with what it contended to be a realistic appraisal of the recoverable costs of the defendant if successful, was sufficient security and, accordingly, no order should be made. Further, MLS submitted that the amount ordered, if any at all, should be limited by the approach referred to in *Arkin v Borchard Lines Ltd (Zim Israel Navigation Co Ltd, Part 20 defendants) (Nos 2 and 3)* [2005] EWCA Civ 655; [2005] 1 WLR 3055 (otherwise known as "the *Arkin* cap") to the current level of the funding facility (£1,200,000) and that there should be a cross-undertaking in damages. The basis for that latter requirement was that MLS would have to borrow the funds to provide the security and thereby incur borrowing costs and/or would not be able to use those funds to pursue other funding opportunities. It was contended that it should be compensated for those losses if the security proved to have been unnecessary or excessive. Finally, if, contrary to those arguments, security was to be ordered and the *Arkin* cap does not apply, MLS contended that the security should be very much less than that sought by the defendant and should certainly only relate to future costs.

64. The defendant, and applicant, submitted (i) that *Arkin* was not a case concerning the quantum of security to be ordered pursuant to CPR r 25.14, and was not binding upon the court for the purposes of that issue in this case, nor should it be followed in present circumstances, and (ii) applying the *Arkin* cap would give rise to a substantial injustice in this case.

65. The Court agreed with the defendant on these points, concluded that the security for costs figure should not be capped by reference to the amount of funding, and left open for debate whether or not the *Arkin* cap should be applied in future cases,noting the criticisms by Sir Rupert Jackson in his *Review of Civil Litigation Funding: Final Report* (December 2009) ("the Jackson Report") and discussion of the same in *Excalibur Ventures llc v Texas Keystone Inc (No 2)* [2016] EWCA Civ 1144; [2017] 1 WLR 2221.

66. In the latter case the judge at first instance had joined the funders to unsuccessful proceedings for the purposes of making a non-party costs order against them, and concluded that the £17.5m of monies paid into court by way of security for costs, which the funders had funded, should be included within the *Arkin* cap. Given the impact on litigation funders the Association of Litigation Funders of England and Wales intervened, and made submissions on the appeal. The Court of Appeal upheld the first instance decision, and held that: in view of the derivative nature of a commercial funder's involvement, it would ordinarily be just and equitable to require it to contribute to the costs on the basis on which they had been assessed against those whom it chose to fund; that both the provision of security for costs ordered by the court and the payment of the litigant's own lawyers and experts were costs of pursuing the litigation which, if not met, would have resulted in the litigation being unable to proceed and had been used in pursuit of the common enterprise and for the benefit of all of the funders; that a funder who advanced money to enable security for costs to be provided by a litigant should not be treated any differently from one who advanced money to enable that litigant to meet the fees of its own lawyers or expert witnesses.

67. It can therefore be seen that funders will ordinarily wish to ensure that it is the ATE provider who provides the necessary instrument or payments in relation to security for costs.

68. A secondary part of the decision in *Bailey*, but no less interesting for the purposes of this talk, concerned the argument as to whether or not the terms of an ATE policy were sufficient to show that the jurisdictional threshold had not been crossed and also, importantly, considered how it might be taken into account at the discretionary stage. At paragraphs 65 to 71 Foskett J made the following material observations, which are worth citing in full here:

> ***65*** *The focus of the Premier Motorauctions case was to determine whether the ATE policy in place for the claimant in that litigation provided "sufficient protection" to the defendant in relation to costs in the event of the claimant's case failing. The Court of Appeal recognised (at para 20) "that an appropriately framed ATE insurance policy can in theory be an answer to an application for security", but equally confirmed (as Mance LJ had said in Nasser v United Bank of Kuwait*

[2001] EWCA Civ 556; [2002] 1 WLR 1868, para 60) that a defendant would be "entitled to some assurance as to the scope of the [ATE] cover [and] that it was not liable to be avoided for misrepresentation or non-disclosure": para 29.

66 *In Nasser the grounds upon which the insurer could avoid the policy for non-disclosure or misrepresentation were restricted to a situation where the "non-disclosure was fraudulent". As Longmore LJ said in relation to that provision in Premier Motorauctions, at para 31:*

"Insurers could therefore avoid for fraud but not otherwise. It may not be a particularly difficult exercise for a judge to assess the likelihood of avoidance if the right to avoid is confined to fraud but, where there is no anti-avoidance clause of any kind, the exercise is very much more difficult and the defendants' need for the assurance to which Mance LJ referred is all the greater."

67 *In Premier Motorauctions the Court of Appeal held that, on the facts, the defendants could not receive the required reassurance and that the prospect of avoidance was not "illusory": para 29.*

68 *In the present case there is no anti-avoidance clause in the insurance contract. Whilst that of itself does not preclude the efficacy of the ATE policy in this case, it does bring into play Longmore LJ's observation referred to at para 66 above. Furthermore, the defendant draws attention to certain provisions in the contract (a redacted version of which has been disclosed), including the following: (a) clause 3.1.1 is a condition precedent to the insurer's liability under the policy, namely, that the proposal "was made following reasonable and diligent investigation of the facts, information and evidence relevant to [the claimants'] solicitors' assessment of success in the litigation" and that the claimants "have included in [their] proposal all matters relevant to the provision of cover under this policy"; (b) clause 3.1.2 is also a condition precedent under the policy which requires "[the claimants'] solicitors [to] have prepared (and ... disclosed in the proposal) a reasoned estimate of the costs of [the claimants] and [the defendant]; (c) clause 5.2 permits cancellation if the insured failed to meet the obligations in clause 4 concerning the conduct of the litigation including clause 4.1.6 which requires the claimants' solicitors to inform the insurer "as soon as reasonably practicable of any change in [the solicitors'] appraisal of [the] prospects of success in the litigation".*

69 *A copy of the proposal has not been disclosed (doubtless for good reason) and it is not, therefore, possible to evaluate the statements made to the insurers on behalf of the claimants by their solicitors about the prospects of success and/or in respect of the costs assessments and thus to determine whether they were accurate or complete. I have previously expressed concern that the claimants' legal team appear to have had an unrealistic appreciation of the likely level of damages, assuming liability is established (see [2016] EWHC 1975 (QB) at [7]-[20]), and that an unrealistic attempt was made to expand the scope of the forthcoming trial (see [2017] EWHC 377 (QB) at [20]-[24]). The apparently less than wholly accurate way in which certain things about the funding of the litigation (see paras 23-43 above) have been expressed leads to a sense of unease about how watertight everything is within the claimants' camp even though I accept Mr Carpenter's point that no one within FL or within the group of claimants would have any interest in obtaining a worthless ATE policy. Equally, there has been no hint that the ATE insurers have as yet felt that there are grounds for avoiding the cover and it is to be observed that a fair amount of the "loose" talk to which I have referred was some while ago.*

70 *However, for the reasons foreshadowed in the preceding paragraph, I do not think it is possible to discount as illusory the prospect of the avoidance of the ATE insurance cover at some stage. Since it is not an issue that arises at the jurisdiction stage (as it did in Premier Motorauctions), the issue is to what extent can or should it be reflected in the discretionary, balancing exercise. The defendant argues that I should "disregard (alternatively ... give limited weight to), the existence of the ... ATE policy when exercising [my] discretion as to the appropriate quantum of security to be*

ordered." MLS (supported by the claimants) contends that I "should conclude that the ATE policy gives [the defendant] sufficient protection in relation to £750,000 of its costs" or, alternatively, that I

"should ascribe some value to the policy as part of the exercise of discretion [and if] ... there is some risk [of avoidance], then [I should] reduce the amount of security which [I] might otherwise order by an amount below £750,000 to reflect those contingencies."

***71** It appears to be recognised by all sides in the case that this is another area where a broad discretionary exercise is called for. For my part, I can see no other alternative. I will return to that exercise when I have reviewed briefly the costs structure around which the defendant submits that I should carry out this exercise.*

69. Having concluded (at paragraph [74]) that a suitable starting point for costs should be to take 66% of the estimated sum (£6.8m) as reasonably recoverable on an assessment (so taking the figure in issue to £4.5m), Foskett J then turned back to the issue of ATE when considering what sum should be ordered for security in the following terms at paragraphs [78] to [80]:

    ***78** Doing the best I can to reflect all the competing considerations as they exist at present, I consider that ordering security in a sum reflecting 50% of the reasonable working figure I have adopted above will do broad justice to the present application. On that basis, and subject to any adjustment in light of the ATE policy, the sum required would be £2·25m.*

    ***79** MLS argues that the whole of the £750,000 under the ATE policy should be deducted; the defendant says that none of it should be deducted. Given the considerations to which I referred above (see paras 68-69) I consider that the risk of the ATE policy being avoided at some stage can be reflected by deducting two-thirds of the sum of £750,000 (namely, £500,000) from the amount of security otherwise to be provided. This reflects my assessment that it is more likely that the policy will remain intact and remain available for the payment of part of the defendant's costs if the defendant is successful, but that there is a more than minimal risk that it will not remain intact.*

    ***80** The net effect of all this is that I propose ordering MLS to provide £1·75m by way of security for costs. This is £550,000 more than the sum it was prepared to offer, namely, the amount currently committed to the litigation. That balance will be protected if the end result of the proceedings is that the Arkin cap is applied. If the cap is not applied, the defendant will (subject to any other avenues it may pursue) be secure in the knowledge that it will recover at least £1·75m.*

70. In short, the decision in *Bailey* suggests that (1) the Courts will be more inclined to find the jurisdictional threshold has been crossed if there is no anti-avoidance provisions, but (2) the Courts will also be astute to consider carefully any concerns raised about cancellation or withdrawal by reason of acts during the course of the policy and (3) even where the Court is satisfied that the jurisdictional threshold is crossed, it may reflect its assessment of the likelihood or otherwise of the policy responding by making a deduction for that event when exercising its discretion as to the amount of security to be ordered.

71. Depending on the facts of the case, the amount of costs to be secured and the amount of ATE cover this decision could be very useful to future claimants, assuming it is followed in other cases.

72. The third feature of the decision worth noting is that the Court required the defendant, who was to obtain the benefit of the security, to give a cross-undertaking in damages, following the approach taken in *In re RBS Rights Issue Litigation* [2017] 1 WLR 4635, para 150, and having regard to paragraph 5 of Appendix 10 to the Admiralty and Commercial Courts Guide which is in the following terms:

"In appropriate cases an order for security for costs may only be made on terms that the applicant gives an undertaking to comply with any order that the court may make if the court later finds that the order for security for costs has caused loss to the claimant and that the claimant should be compensated for such loss. Such undertakings are intended to compensate claimants in cases where no order for costs is ultimately made in favour of the applicant."

Other discretionary factors – a reminder

73. It should also be remembered that there are other discretionary factors which may be prayed in aid by the respondent to a security for costs application. Some of these were usefully summarised by Warby J in *Startwell Ltd v Energie Global Brand Management Ltd and another* [2015] EWHC 421 (QB), who noted, by reference to the decision of Lord Denning MR in *Sir Lindsay Parkinson & Co v Triplan Ltd* [1973] QB 609, [1973] 2 All ER 273, [1973] 2 WLR 632, that the factors to be taken into account in determining whether and if so how to exercise the discretion include the following:

   "(1) Whether the Claimant's claim is bona fide and not a sham;

   (2) Whether the Claimant has reasonably good prospect of success;

   (3) Whether there is an admission by the defendants in their defence or elsewhere that money is due;

   (4) Whether there is a substantial payment into court of an "open offer" of a substantial amount;

   (5) Whether the application for security was being used oppressively, e.g. so as to stifle a genuine claim;

   (6) Whether the Claimant's want of means has been brought about by any conduct by the Defendant, such as delay in payment or in doing their part of any work . . ."

74. As to factors (1) and (2), and as noted by Warby J in *Startwell,* at [89]: *"*it is settled law that the court should not attempt to go into the merits of the case unless it can clearly be demonstrated one way or another that there is a high degree of probability of success or failure: *Porzelack Kg v Porzelack (UK) Ltd* [1987] 1 All ER 1074, [1987] 1 WLR 420, [1987] NLJ Rep 219."

75. This reduces the number of cases where the courts will be willing to have regard to the merits on a security for costs application, which is a potential barrier to insolvency claims where such a high threshold cannot be overcome.

76. As to factors (3) & (4), these give rise to the question as to what offers may be referred to in evidence. Commentary in The White Book, Vol 1, states (2018 – p. 836 [25.13.1]):

   "In considering an application for security for costs against a claimant, the court must take into account the claimant's prospects of success, admissions by the defendant, open offers and payments into court; but a defendant should not be adversely affected in seeking security merely because they have attempted to reach a settlement. Evidence of negotiations conducted without prejudice should not be admitted without their consent."

77. Authorities cited in support of the proposition are: *Simman General Contracting Co v Pilkington Glass Ltd* (No. 2) - [1988] 2 WLR 761; and *Kristjansson v R Verney & Co Ltd and anor* 1998 unrep CA.

78. There remains the potential argument, not apparently the subject of any authoritative decision, as to whether an offer made "*without prejudice save as to costs*" may be referred to on an application for security for costs.

79. It is also worth considering factor (5) here, and the question of stifling. Ostensibly it may be thought this would be a promising line of defence by an insolvent company to a security for costs application, but the onus of establishing it is on the respondent, and they must adduce evidence that (i) they have no means (ii) they cannot obtain assistance from a third party, who might reasonably be expected to provide assistance if they could; (iii) that the claim would be stifled and (iv) that it would be unfairly stifled in all the circumstances. As noted in Startwell at [91]:

> "*Before the court refuses to order security on the ground that it would unfairly stifle a valid claim the court must be satisfied that, in all the circumstances, it is probable that a claim would be stifled: Keary Developments v Tarmac Construction [1995] 1 All ER 534, 540 (Peter Gibson LJ). If the court is so satisfied it will undertake a balancing exercise, weighing the injustice to the Claimant if prevented from pursuing a proper claim by an order for security against the injustice to the Defendant if no security is ordered. The court will be concerned not to allow an impecunious company to use its inability to pay costs as a means of putting unfair pressure on the more prosperous company: Pearson v Naydler [1977] 3 All ER 531, [1977] 1 WLR 899, 906."*

80. Where a claimant company has a third party litigation funder this is likely to require evidence as to why such a funder is not willing and able to put up security. In most substantial pieces of commercial litigation the court is likely to be sceptical as to any alleged lack of funds where a professional funder is supporting the claim: even if a funded Claimant could get over the evidential hurdle that no further funds would be forthcoming – it seems likely the court, as part of its discretionary exercise and independent of the factors laid out by Denning MR in Lindsay Parkinson, would find the prospect that a funder would reap the benefits of the litigation whilst refusing to provide security/fund an indemnity/pay for anti-avoidance provision a reason to require security.

81. If there is no litigation funder the position is somewhat different. Whilst it is the case that the company's creditors could (in theory) put up the necessary funds, the jurisdiction is not against the creditors – rather it is against the company (*Aquila Design (GRP Products) Ltd v Cornhill Insurance plc* [1988] BCLC 134 at 137g-h). However it is questionable as to whether a benevolent approach will be taken in this respect to creditors following *Keary* especially if the question has not been considered or explored with creditors. The court may, however, be sympathetic that it is not always easy to prove a negative and suitable inferences may be drawn (see: *Spy Academy Ltd v Sakar International Inc.* [2009] EWCA Civ 985 (Sir Simon Tuckey) [19]).

82. As to factor (6), it should be noted (as Warby J did in this case) that the issue as to want of means cannot be approached on a basis that would involve pre-judging a substantive issue in the case: *Automotive Latch Systems Ltd v Honeywell International Inc* [2006] EWHC 2340 (Comm). Accordingly, unless the case may be said to be one where there is a high probability of success then the Court may be reluctant to accept this point as being determinative in favour of the claimant.

83. Finally, the question of amount and the possibility of providing for security in stages should not be forgotten, as noted by Warby J in *Startwell* at [92]:

> *In considering the amount of security that might be ordered the court should bear in mind that it can order any amount up to the full amount claimed by way of security, provided it is more than a merely nominal amount: Keary Developments Ltd v Tarmac Construction Ltd [1995] 3 ALL ER 534, 540, [1995] 2 BCLC 395. It is also, in my judgment, a matter to be borne in mind that security may be ordered in stages so that the Claimant is not required to post a large capital sum at one go but only to secure its opponents costs as those costs are incurred. This may be an important power, given the need to maintain a level playing field and to control costs.*

84. The courts will often look at providing security at a sum considerably smaller than that claimed by the defendant, though the prospect of the court taking a different approach where there is an approved cost budget is also worth bearing in mind (given that, after the case is concluded, the courts are willing to make interim payment orders for much higher sums than they were previously).

Non-party costs orders – a postscript

85. It is useful, before departing from the topic of security costs, to consider two contrasting decisions as to the relevance and availability of a non-party costs order when considering whether a security for costs order should be made.

86. In *Aidiniantz v The Sherlock Holmes International Society Ltd* [2015] EWHC 2882 (Ch); [2015] BPIR 1329, Henderson J (as he then was) declined to order the appellant to provide security for costs on the basis that the respondent had the ability to seek a non-party costs order.

87. The case concerned appeal proceedings brought by a company against a winding-up order. The court refused to order the company to make payments into court as a condition of its permission to appeal where to do so would have the practical effect of requiring a third party to pay the company's unquantified costs of the appeal. The court also refused to order security for costs against the company where the person seeking that order was said to be responsible for the company's impecuniosity. In addition, the court, in the exercise of its discretion, noted the availability of a non-party costs order as a reason to reject the application for security for costs. So in that case the court was willing to effectively treat the non-party as already party to the proceedings, albeit the facts were unusual, essentially concerned a family dispute in a corporate context, and there had already been a non-party costs order against the non-parties in question at first instance.

88. Contrast that decision with the consideration of the same issues, in the context of an appeal against an arbitration award, in *Progas Energy Ltd and others v Islamic Republic of Pakistan* [2018] EWHC 209 (Comm), where Picken J rejected the argument that the non-binding offer by a third party professional funder to pay an adverse costs order militated against making a security for costs order. At paragraph [34] Picken J noted the submissions as follows:

> "*since the Court is able to make an adverse costs order directly against a non-party (such as Burford) by virtue of section 51 of the Senior Courts Act 1981, the Court should approach the present case on the basis that there are assets which are "available" to the Claimants which mean that an order for security for costs would not be appropriate*."

89. He rejected this at paragraph [37] noting that "*the purpose of the security for costs jurisdiction is clear: it is to enable a defendant to recover costs subsequently awarded to it without delay or other difficulty*."

90. These divergent decisions may be an illustration of the tougher approach taken by the courts were a commercial funder is in place.

91. They may also be an illustration of old adage that the only rule where costs are concerned is that there are no (hard and fast) rules.

PART 2: FUNDING AND CFAs

Introduction

92. As well as having a mechanism to address and fund adverse costs any case requires own costs to be funded. The majority of the following notes concern the historical evolution of the CFA rules and consideration of the decision at first instance in *Stevensdrake* concerning the practice of recovery only CFAs in the insolvency market. They in part replicate notes produced for the Guildhall Chambers seminar in 2016, but they are reproduced here in order to assist those unfamiliar with the *Stevensdrake* decision and understand the second decision in the Court of Appeal, which took place in 2017. Any reader familiar with this topic may skip to the heading which addresses the second decision of the Court of Appeal.

Funding of Insolvency Proceedings: Conditional Fee Agreements

93. As noted in the Jackson Report:

> *"Until 1995, it was widely accepted that, at common law, barristers and solicitors could not agree to conduct litigation on the basis that they would only be paid if the action was successful. The common law position in respect of solicitors was reinforced by the Solicitors' Practice Rules 1990, the effect of which was that a solicitor was not permitted to agree to receive remuneration which was related to the outcome of an action. This rule became increasingly detached from the general perception of what was ethically acceptable. A number of solicitors have told me that they turned a blind eye to this rule and engaged in "speccing". In other words, they conducted cases for clients on the explicit or implicit understanding that if the case was won, they would charge their normal fee (or at least what was recovered from the other side); if the case was lost, they would charge nothing. There were two situations in which solicitors commonly engaged in "speccing". First, the solicitor might regard a case as so strong that there was no real risk of losing; thus a "speccing" arrangement made good sense, in order to ensure that the solicitor got the business. Secondly, a solicitor might desire to help an impecunious client, whose case was meritorious but not certain of success. In the first situation, the solicitor was essentially making a commercial decision. In the second situation the solicitor, although making a commercial decision, was also taking a deliberate risk in order to promote access to justice."*

94. This practice of "speccing" was frequently adopted by insolvency practitioners and solicitors in cases where there were no or few realisable assets in the insolvent estate as a commercial means of enabling the office holder to pursue litigation that may result in further recoveries. However, the practice was not without its limitations. In particular: (i) the solicitor was not entitled to any increased financial reward to reflect the risk of not being paid; and (ii) there was no protection for the office holder against an adverse costs order if the litigation was unsuccessful.

95. On 5 July 1995, it became permissible for solicitors to enter into conditional fee agreements (see further below) in relation to three types of proceedings: (i) personal injury; (ii) litigation before the European Commission or Court of Human Rights; and (iii) insolvency [3]. The effect of this reform was to legalise the former practice of speccing and to entitle the solicitor to charge a success fee of not more than 100% to reflect the risk of losing. At this stage, it was not possible to recover the success fee from the unsuccessful opponent and this would effectively be funded from the damages awarded.

96. At or around this time, the insurance market began to develop 'after the event' (ATE) insurance policies to enable office holders to protect against the risk of adverse costs orders. An early example of this type of product was considered by the High Court in *Newsforce Marketing Ltd v Chander Hingorani*[4]. However, at this stage, it was not possible to recover the cost of funding the ATE premium from the unsuccessful opponent.

97. On 1 April 2000[5]: (i) the scope of CFAs was extended to all civil proceedings (excluding family); and (ii) the principle of "recoverability" was introduced (i.e. the successful party became entitled to recover the success fee and ATE insurance premiums from the unsuccessful opponent).

98. The Jackson Report recommended the abolition of recoverability, leading to the enactment of ss.44 and 46 of the Legal Aid, Sentencing and Punishment of Offenders Act 2012 ("**LASPO**"), which brought an end to the recovery of success fees and ATE insurance premiums in relation to most

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[3] s.58 Courts and Legal Services Act 1990, as implemented by the Conditional Fee Agreements Order 1995 (S.I.
1995/1674) and the Conditional Fee Agreement Regulations 1995 (S.I. 1995/1675).

[4] Unreported, 28 June 1996. Referred to in Walton: The Likely Effect of the Jackson Reforms on Insolvency Litigation – an Empirical Investigation (April 2014).

[5] By s.27 of the Access to Justice Act 1999

civil litigation with effect from 1 April 2013. Insolvency proceedings were temporarily exempted from the operation of those provisions[6]. However, that exemption was removed with effect from 6 April 2016[7].

Conditional Fee Agreements: Requirements

99. Section 58 of the Courts and Legal Services Act 1990 (as amended by LASPO) provides that a conditional fee agreement is unenforceable unless: (i) it is in writing; (ii) it relates to proceedings which can be the subject of an enforceable CFA (which includes insolvency proceedings); and (iii) it states the percentage by which the amount of the fees which would be payable if it were not a conditional fee agreement is to be increased, which must not exceed 100%.

100. A solicitor acting under a conditional fee agreement must give the client all relevant information relating to the arrangement (SRA Code of Conduct 2011 IB(1.17)).

The Indemnity Principle

101. Costs between parties are awarded as an indemnity to the party incurring them and a successful party cannot therefore recover a sum in excess of their liability to their own solicitor; *Gundry v Sainsbury* [1910] 1 KB 645. So a "speccing" arrangement might be good for getting business in, but it ran the risk of it being said it was tantamount to an agreement the client would never have to pay the solicitor which then imperilled recovery from the other side under the indemnity principle.

102. The indemnity principle was recognised in statute by section 60(3) of the Solicitors' Act 1974, which provides:

> *"A client shall not be entitled to recover from any other person under an order for payment of any costs to which a contentious business agreement relates more than the amount payable by him to his solicitor in respect of those costs under the agreement."*

103. Section 51(2) of the Senior Courts Act 1981 states that rules of the court may regulate "matters relating to the costs of proceedings". By section 31 of the Access to Justice Act 1999 that sub-section was amended to state that such rules may provide for securing cost orders not limited to what would have been payable if the party had not been awarded costs. This paved the way for a rule which departed from the indemnity principle.

104. By 1998 the Courts recognised that it was not contrary to public policy for a solicitor to agree to charge a client unless a particular result was achieved (see *Thai Trading (a firm) v Taylor & Another* Court of Appeal, unreported 27 February 1998). In other words that a solicitor could agree to waive their fee if the client lost, though not claim an uplift (unless a compliant CFA was entered into).

105. On 2 June 2003 CPR 43.2(3) was introduced, which has now become CPR 44.1(3). CPR 44.1(3) provides:

> *"Where advocacy or litigation services are provided to a client under a conditional fee agreement costs are recoverable under Parts 44 to 47 notwithstanding that the client is liable to pay the legal representative's fees and expenses only to the extent that sums are recovered in respect of the proceedings, whether by way of costs or otherwise."*

106. This rule was not that well known in the insolvency market: insolvency solicitors and practitioners have not, until recently, had to pay much attention to the CPR.

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[6] By art.4 of the Legal Aid, Sentencing and Punishment of Offenders Act 2012 (Commencement No. 5 and Saving Provision) Order 2013

[7] By art.2, Legal Aid, Sentencing and Punishment of Offenders Act 2012 (Commencement No. 12) Order 2016/345

107. How far this has eroded the indemnity principle, and the effect on "speccing" in the insolvency market, is considered further below.

Stevensdrake v Hunt **- introduction**

108. The thorny issue of the enforcement of CFAs in ‘nil asset’ insolvency cases was the subject of litigation between stevensdrake (“**the Solicitors**”) and Stephen Hunt (“**the IP**”) which has resulted in two reported High Court decisions, and two appeal decisions (one from the Court of Appeal).

109. The principal dispute arose following the Solicitors’ instruction to act in relation to the liquidation of Sunbow Limited (“**Sunbow**”). Sunbow was the corporate vehicle which traded Monsieur Max, a Michelin-starred French restaurant in Hampton Hill, London. In March 2000, Sunbow entered administration and Theodolous Papanicola (“**TP**”) and Alan Simon (“**AS**”) (together, “**the Former Administrators**”) were appointed as administrators. In June 2000, Sunbow entered into a CVA and TP was appointed as supervisor. In May 20005, Sunbow entered insolvent liquidation and the IP was appointed as liquidator.

110. Following his appointment, the IP considered making the following applications: (i) an application to rescind the Former Administrators’ release in order to enable a potential future claim to be made under their bond; (ii) an application for the private examination of the directors and Former Administrators; (iii) an application against the former directors pursuant to s.238 IA; and (iv) a misfeasance claim against the Former Administrators pursuant to s.212 IA (“**the Misfeasance Claim**”), which was considered to be the main claim.

111. Shortly after his appointment, the IP engaged the Solicitors under a general retainer. The retainer letter provided that the Solicitors would wait for payment of their charges (other than out-of-pocket expenses) until recovery of any assets in the estate, regardless of source. In April 2006, the IP wrote to the Solicitors stating (“**the No Liability Letter**”):

> *“I currently hold a negative balance of £2,601.54 in the estate of Sunbow Limited. In the light of this, your fees in this matter can only be paid out of realisations. In the event that there are no realisations I, as Liquidator, will not be in a position to pay your fees, nor will I accept personal liability for those fees. Notwithstanding anything which may be stated in your terms of business, which may have been, or will be, signed by me, your instructions are given on the basis stated here. If you are not willing to act in this matter on this basis, please return to me all papers currently held by you.”*

112. The Solicitors responded confirming their agreement to await recoveries in relation to their own costs but indicating that they would require disbursements (in particular counsel’s fees) to be paid.

113. In August 2007, the IP issued the Misfeasance Claim against the Former Administrators. At that time, it was agreed that the Solicitors and counsel would enter into CFAs in relation to that claim.

114. On 29 January 2008, the Solicitors sent to the IP a proposed CFA which provided for the payment of a success fee of 100% if the IP “won” the Misfeasance Application. The schedule to the CFA contained a clause (“**the Personal Responsibility Clause**”) which had not been previously flagged up in correspondence, and which provided:

> *“You are personally responsible for any payments that you may have to make under this Agreement; those payments are not limited by reference to the funds available in the liquidation”*

115. On 19 February 2008, the IP signed and returned the CFA to the Solicitors, who countersigned on 16 April 2008.

116. In November 2009, the claim against AS was settled for £125,000. The parties agreed to divide those monies (“**the AS Monies**”) proportionately between counsel, the Solicitors and the IP. At the

same time, TP entered into negotiations to settle the claim against him. In July 2011, the claim against TP was settled for £1.9m. However, in January 2012, TP was adjudged bankrupt without having made any payment.

117. In October 2013, the Solicitors notified the IP that counsel had referred his outstanding fees to arbitration and threatened to present a bill for immediate payment of counsel's and its fees in full, which it did in February 2014. In April 2014, the Solicitors settled the arbitration proceedings commenced by counsel and issued a claim against the IP for payment of the sum of £938,838.71.

Summary Judgment

118. In his original defence, the IP admitted that the Solicitors had provided legal services to him personally under the CFA. However, it was asserted that there was an agreement to the effect that (save for disbursements) the Solicitors were only entitled to payment from recoveries. In the alternative, the IP raised a defence of estoppel by representation or convention. In addition, the IP raised a counterclaim of negligence, breach of fiduciary duty and undue influence on the basis of the Solicitor's alleged failure properly to advise as to the consequence of the CFA.

119. The Solicitors applied to strike out the defence and counterclaim and/or for summary judgment pursuant to CPR 24.2. Chief Master Marsh granted summary judgment to the Solicitors in respect of counsel's fees and ordered the IP to make an interim payment of £75,000, stating:

> "So far as disbursements are concerned, in my judgment paragraph 4 of the defence is clear. The Defendants have expressly accepted that even under the terms of the agreement they rely upon, disbursements were payable regardless of recoveries. I can see no reason to conclude that disbursements were intended to exclude counsel's fees."

120. He also struck out the IP's estoppel plea and counterclaims for breach of fiduciary duty and undue influence on pleading grounds. This left the IP's counterclaim for negligence. He ordered the IP to pay £100,000 into court as a condition of pursuing those claims.

First Appeal [2015] EWHC 1527 (Ch)

121. The IP appealed against the Chief Master's decision. He argued that as he entered into the agreement as liquidator of Sunbow, he was not personally liable for the costs of the Misfeasance Claim (including disbursements); the costs were payable by Sunbow as an expense of the liquidation. There is a respectable line of authority to support that contention. The general rule is that a liquidator contracts as the agent of the company and does not incur personal liability unless the terms of the contract showed that he was undertaking a personal liability: see *Stewart v Engel* [2000] 2 BCLC 528 at 532 referring to and following the earlier decisions of *Re Anglo-Moravian Hungarian Rlwy Co* (1875) 1 Ch D 130 and *Stead Hazel & Co v Cooper* [1933] 1 KB 840, [1933] All ER Rep 770.

122. The *Anglo-Moravian* case concerned the right of a solicitor appointed by a liquidator to recover his fees. It was held that he had to look to the assets of the company and that the liquidator was not personally liable. The matter was dealt with by the Court of Appeal in general terms. James LJ stated (at 133):

'. . . credit in these cases is given to the assets of the company; that is to say a liquidator is only the agent of the company.'

123. Mellish LJ stated (at 134):

'The liquidator is in a different position from a trustee in bankruptcy. He has not the assets of the company vested in him. In the case of a voluntary winding-up he is the officer of the company who acts instead of the directors. He is no more personally liable for contracts which he makes on behalf of the company than the directors would be for the contracts they make on behalf of the company.' Brett J (at 136) stated that he supposed a liquidator might make himself personally

liable 'but it would require very strong words to lead me to believe that he intended to make himself personally liable when according to law, he was not liable'.

124. The *Anglo-Moravian* case was followed in *Stead Hazel & Co v Cooper* [1933] 1 KB 840, [1933] All ER Rep 770. We can take the headnote as stating what the case decided:

'When a liquidator appointed by the Court performs a contract of the company without disclaimer or purports to make a new contract on its behalf, there is no presumption that he does so in his personal capacity even though he does not describe himself as liquidator . . .'

125. So the general position is that a liquidator contracts as the agent of the company and does not incur personal liability. He may, however, contract on terms which show that he *is* undertaking a personal liability. The contract in question must be examined.

126. In the Stevensdrake appeal the argument was rejected by HHJ Purle QC on the basis of his construction of the contract, and having regard in particular to the Personal Responsibility Clause. Accordingly, he dismissed the appeal against the grant of summary judgment in respect of counsel's fees.

127. HHJ Purle QC noted that the Chief Master was perfectly entitled to strike out parts of the IP's defence and counterclaim (as originally pleaded) and that the IP's remedy was to apply to amend his pleading. Following that decision, the IP successfully applied to amend his defence and counterclaim to include a reformulated plea, including pleas of estoppel by convention and counterclaims for breach of fiduciary duty and undue influence.

Trial [2016] EWHC 342 (Ch)

128. The trial of the Solicitors' claim was heard by HHJ Simon Barker QC. He summarised the IP's case as including the following contentions:

"At the core of [the] denial of liability for any part of [the Solicitors] bill ... are contentions that (1) there is a recognised and established practice in the field of insolvency litigation against estates where there are few or no assets of value that (a) to secure instructions solicitors and counsel offer to provide their legal services on terms that they will become entitled to payment only out of recoveries made in the litigation, (b) to the extent that there are insufficient recoveries, the entitlement to payment would abate pro rata, (c) nevertheless, and so as not to breach the indemnity principle, the strict legal rights created by the conditional fee arrangements stipulate that success in the litigation triggers a liability to pay the fees, and (d) it is known and understood that the parties will not enforce their strict legal rights but operate Recoveries Only Liability ("the Practice"); and, (2) the Practice was (a) an established method of working between [the IP] and [the Solicitors] and (b) expressly adopted in relation to the Sunbow liquidation and the s.212 claims against TP and AS."

129. The judge did not consider the evidence supported the contention of such a universal "Practice". In particular, whilst he recognised that the evidence was generally to the effect that in nil or low value asset cases the expectation was that solicitors would be looking to recovery from assets recovered, and not from an IP, the ways solicitors used to achieve that objective were not the same, and in particular there were different approaches to the issue of pro rata abatement. That said, having regard to "the volume, quality and sheer weight of the contemporaneous evidence", he concluded that the full terms of the agreement operating between the IP and the Solicitors in relation to the Misfeasance Claim could not be ascertained from the CFA alone and incorporated a term that the Solicitors' fees would only be paid out of realisations and that the IP had no personal liability for those fees. This was because the Solicitors' acceptance of the No Liability Letter had the effect of importing recoveries only liability into any agreement for the Solicitors to undertake work in relation to the Sunbow liquidation; every retainer of the Solicitors by the IP in relation to any and all aspects of the Sunbow liquidation was to be on the recoveries basis (see para [100]).

130. Accordingly, the IP was not liable to pay the Solicitors' fees. He was only liable to pay disbursements (including counsel's fees).

131. Although not necessary to do so, on the basis of his reading, the Judge went on to consider the estoppel plea and the counterclaim and found as follows:

(i) if the CFA imposed personal liability on the IP to pay the Solicitors' fees, the Solicitors would be estopped by convention from enforcing the terms of that agreement because there was a shared common understanding from which it would be unconscionable to permit the Solicitors to withdraw or resile (i.e. that the Solicitors' fees would be paid from recoveries and the IP would not be personally liable for any shortfall);
(ii) there is an irrebutable presumption that the Solicitors had influence over the IP in relation to his agreement to the CFA. If the Solicitors intended to introduce personal liability into its retainer for work on the Sunbow liquidation it was incumbent on them to draw that expressly to the IP's attention because it would obviously introduce a materially disadvantageous financial change in his position and it ran counter to the agreed basis upon which they had been working and had expressed themselves willing to work together on the Sunbow liquidation;
(iii) if the Solicitors intended to introduce personal liability into its retainer, their failure to advise the IP of this would amount to negligence and breach of their fiduciary duties.

132. At the end of his judgment, HHJ Simon Barker QC included the following postscript:

> *"This has been a trial in which an elephant has been lurking in, or at least peering through the glass panelled doors into, the courtroom. The issues as presented and decided have not called for consideration of or a decision upon whether the arrangements that SH insists upon in few or nil asset estate cases offend the indemnity principle, the essence of which is that if a solicitor expressly or impliedly agrees that the firm will not in any circumstances charge the client no costs are recoverable from the other party (Cook on Costs 2015 [12.3]). There is a public interest in there being a practical means by which insolvency practitioners are able to obtain the assistance of lawyers to advise and represent them in the pursuit of misfeasant and dishonest officers and former office holders in nil asset estate cases where no creditor is willing to provide an indemnity, and it is the case that litigation funding is evolving, but at present the indemnity principle remains the law."*

Second appeal: decision of the Court of Appeal: [2017] EWCA Civ 1173

133. Stevensdrake appealed the decision, and were granted permission to appeal against all the findings of the judge at first instance. The Court of Appeal handed down judgment in July 2017, dismissing the appeal against the decision of HHJ Barker QC.

134. The Court of Appeal (Briggs and Hamblin LJJ) overturned his finding that a 'recoveries only' term was incorporated into the CFA as "a matter of construction or implication" (such term being directly contrary to the express terms of the CFA). This was always a difficult proposition to defend given that the term which was to be implied was, on the face of it, contrary to the express wording in the CFA. In order to meet this problem it was submitted on behalf of Mr Hunt that an earlier agreement was an "umbrella" contract which governed all subsequent agreements in relation to the Sunbow liquidation and prevailed in the event of inconsistency, as borne out by the accepted condition in the earlier agreement that: "Notwithstanding anything which may be stated in your terms of business, which may have been, or will be, signed by me, your instructions are given on the basis stated here."

135. The Court of Appeal were unwilling to adopt this approach however, having regard to the fact that they considered the judge had not adopted it, and so far as they were concerned the CFA was a standard form document drafted with the assistance of solicitors and which was intended to be self-contained statement of the relevant risks and liabilities of the parties in question.

136. However the Court of Appeal upheld his alternative finding that the solicitors were estopped by convention from seeking to enforce the CFA against the liquidator personally.

137. As summarised in *Chitty on Contracts* (32nd edition) at 4-108:

"Estoppel by convention may arise where both parties to a transaction "act on assumed state of facts or law, the assumption being either shared by both or made by one and acquiesced in by the other." The parties are then precluded from denying the truth of that assumption, if it would be unjust or unconscionable (typically because the party claiming the benefit has been "materially influenced" by the common assumption) to allow them (or one of them) to go back on it."

138. Briggs LJ (as he then was), was, however, notably lukewarm as to whether an estoppel by convention would have been established if the trial had been before him, noting as follows at para 100:

"*I have found the question whether SH has the benefit of a convention estoppel more difficult than my Lord, so much so that, if it had been necessary to resolve it purely upon the documents before this court, I would have found it to be a very finely balanced question indeed. But where the trial judge has, as in this case, made no error of law in his approach and made clear, well reasoned findings of fact after hearing extensive cross-examination of the witnesses, an appellate court both can and should give real weight to the judge's conclusion on a mixed question of fact and law such as this.*"

139. He also observed, at para [102]:

"As for the alternative grounds relied upon successfully at trial by SH, namely undue influence, negligence and breach of fiduciary duty, I have considerable reservations about them but, like my Lord, do not consider that any useful purpose would be served by an analysis of what were in the end obiter dicta, the outcome of which on appeal can make no difference to the result."

140. Accordingly, the evidence at first instance as to the special relationship, and longstanding mutual understanding between the parties that the solicitors' right to payment under the CFA was conditional or contingent upon there being funds available from realisations or recoveries, was ultimately critical to the successful defeat of the claim on the appeal.

Discussion

141. The *Stevensdrake v Hunt* litigation provides a colourful insight into the working practices which operate between IPs and solicitors specialising in recovery work for insolvency practitioners. Beyond that, however, it raises some interesting technical points for IPs and solicitors, both of a legal nature and of a practical nature. In particular:

Contracting parties

142. Probably the first question the IP and solicitors will want to think about is who should be the contracting party?

143. As noted above, in the absence of an express agreement by an IP to be liable the presumption is they are contracting as agent. But as an agent for who? As noted above, the starting point is that the IP is acting as agent for the company. But after a company has entered liquidation the notion of "acting for the company" in substance means acting for the benefit of those interested in the statutory trusts created by the Insolvency Act 1986 and The Insolvency Rules. So, if a solicitor is engaged to assist in relation to matters arising in a liquidation, who is their client if not the IP?

144. In one case concerning an assessment of solicitors' costs, *In re Nation* [1978] 1 WLR 45, the Court went so far as to suggest that the solicitor has no client (at p. 50). However, read in context

what the Court appeared to be saying was that the solicitor was only entitled to look to payment out of the assets of the company: in effect that the company, in liquidation and subject to the special statutory trusts, was the client. In other words payable as an expense of the administration.

145. Under the rules in force at the time of the case law considered below (IR 7.34), where the costs of any person are payable as an expense out of the insolvent estate, the amount payable "must be decided by detailed assessment unless agreed between the office-holder and the person entitled to payment.". The office holder may serve notice requiring the person to commence detailed assessment proceedings. The default basis for assessment is the standard basis.

146. This has the possibility of providing for some tension between solicitors and IPs: the IP may prefer not to contract personally, but if they do so the solicitors could find themselves in the position of having their costs assessed on a standard basis as if it were a standard inter-partes assessment.

147. This rule has been the subject of separate consideration in *Hosking v Slaughter and May (a firm)* (before Registrar Jones, November 12, 2013, and then subsequently before HHJ Cooke [2014] EWHC 1390 (Ch) and then subsequently by the Court of Appeal [2016] EWCA Civ 474, where a subsequent IP (liquidator) sought to challenge the former administrators' decision to agree the solicitors fees without there being an assessment. The lower courts concluded that the administrator could do so (albeit on different grounds). The Court of Appeal held (Arden LJ giving the lead judgment) that if the liquidators do not agree with the fees that have been paid, they can bring misfeasance proceedings against the administrators. The IA 86 and IR thus provide ways in which liquidators can challenge the decision of an administrator to pay legal fees, but they do not provide a means by which liquidators can require the assessment of costs paid in an earlier administration.

148. But the short point here is that if the office-holder does not agree the fees the solicitor may be subject to an assessment exercise carried out in a way which departs from the ordinary approach to be expected from a client-solicitor assessment. That said there presumably is nothing to prevent a solicitor requiring the IP to agree that the basis is to be a different one.

The indemnity principle & personal liability clauses

149. As noted above, the judge observed that the proverbial "elephant" in the courtroom, or as he put it peering through the glass panelled doors, was the indemnity principle, though he noted this had not been taken as a point by the IP. This is linked, to some degree, to the client conundrum.

150. If the solicitor really had no client in a liquidation then it is difficult to see how they could recover any fees from the other side under the indemnity principle. But as noted above, properly understood the client, for the purposes of any litigation, would either have to be the company (subject to the statutory trusts) or the IP.

151. If the client is expressed to be the company then the IP need not be concerned about personal liability. Nor should an agreement that the company is only liable to pay to the extent that sums are recovered in the proceedings. As noted above, CPR 44.1(3) now provides:

"Where advocacy or litigation services are provided to a client under a conditional fee agreement costs are recoverable under Parts 44 to 47 notwithstanding that the client is liable to pay the legal representative's fees and expenses only to the extent that sums are recovered in respect of the proceedings, whether by way of costs or otherwise
Success fees"

152. As regards the situation where an IP is a contracting party a potential difficulty might arise, in relation to recovery of fees from the other side, if the agreement is not one which complies with the CFA regulations. The IP might stipulate for no personal liability and the indemnity principle could become a problem.

153. But where the CFA complies with the regulations then in most cases CPR 44.1(3) should provide the solution to the problem.

154. In the *Stevensdrake v Hunt* the problem may have been more one of perception. The solicitors involved had previously suffered a problem with an earlier CFA, which had been attacked on the basis of an indemnity principle argument. The rules had moved on in the meantime but they had not. Once bitten twice shy: the introduction of a clause (the Personal Responsibility Clause) which sought to emphasise to the counter-party there was no potential breach of the indemnity, whilst also maintaining the general position that the IP would not be pursued if there were no assets (the no Liability Letter) represented the outcome. An outcome which created a drafting tension. The conduct of the parties showed very clearly what they intended, but the indemnity principle played its part as an elephant in the drafting, if not in the courtroom. The fear of the pyrrhic victory needed to be guarded against.

Sharing & waterfalls

155. The judge at first instance in *Stevensdrake* rejected the idea there was any standard practice as to pro-rating. The question of how recoveries should be shared - the waterfall agreement as it is sometimes referred to - presents some practical challenges and potential legal complications.

156. How is the pro-rata to work? Is pro-rating on the basis of an hourly rate fair to all concerned? Might it be said the parties are partners, or party to a common design and potentially liable as joint tortfeasors (see *Sea Shepherd UK v Fish & Fish Ltd* [2015] UKSC 10; [2015] WLR 694), and so liable for each other's acts if they adopt a sharing approach on a 1/3, 1/3 and 1/3 basis?

Lessons from the Court of Appeal decision

157. The lessons from the Court of Appeal decision that in cases of a longstanding relationship the court may be willing to accept that there was an estoppel which prevents the solicitor from enforcing the precise wording of the CFA, but the IP would be wise not to rely on that relief valve, since the court will take some persuading of that. The IP will also probably not have a good chance of persuading the court that there are other causes of action they can rely on against the solicitor. Ultimately whilst the IP may rely on the commercial relationship involved, relationships can change and the IP should be prepared for the commercial consequences if the formal documentation does not in fact match their expectations so far as funding and fees are concerned.

158. Less “speccing” and instead more putting your “specs on” before signing on the dotted line.

END