CFAs AND PYRRHIC VICTORIES - *STEVENSDRAKE v HUNT* [2016] EWHC 342 (Ch)

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Funding of Insolvency Proceedings: Conditional Fee Agreements

1. As noted by Sir Rupert Jackson in his Review of Civil Litigation Costs: Final Report ("**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."*

2. 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.

3. 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 [1]. 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.

4. 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*[2]. However, at this stage, it was not possible to recover the cost of funding the ATE premium from the unsuccessful opponent.

5. On 1 April 2000[3]: (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).

6. 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

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[1] 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).

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

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

brought an end to the recovery of success fees and ATE insurance premiums in relation to most civil litigation with effect from 1 April 2013. Insolvency proceedings were temporarily exempted from the operation of those provisions[4]. However, that exemption was removed with effect from 6 April 2016[5].

Conditional Fee Agreements: Requirements

7. 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%.

8. 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

9. 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.

10. The indemnity principle wa 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."*

11. 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.

12. 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).

13. 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."*

14. 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.

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

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

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

Stevensdrake v Hunt

16. The thorny issue of the enforcement of CFAs in 'nil asset' insolvency cases was recently the subject of high profile litigation between stevensdrake ("**the Solicitors**") and Stephen Hunt ("**the IP**") which has resulted in two reported High Court decisions.

17. 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.

18. 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.

19. 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."*

20. 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.

21. 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.

22. 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"*

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

24. 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.

25. 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

26. 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.

27. 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."

28. 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.

Appeal [2015] EWHC 1527 (Ch)

29. 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.

30. 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.'*

31. 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'.*

32. 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 . . .'

33. 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.

34. 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.

35. 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)

36. 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."

37. 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]).

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

39. Although not necessary to do so, 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.

40. 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."*

Discussion

41. 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. It is intended to use the seminar presentation as an opportunity to explore these points in more detail, but to give a flavour of some of the key discussion points here:

Contracting parties

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

43. 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?

44. 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 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 under IR 4.218(3).

45. Under 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.

46. 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.

47. 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)). Permission to appeal to the Court of Appeal has been granted in that case as regards the exercise of discretion - the Court retains an inherent jurisdiction to order an assessment. The appeal principally concerns the narrow question of whether, on the facts, the Registrar exercised such a discretion.

48. 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

49. 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.

50. 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.

51. 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"

52. 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.

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

54. 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

55. The judge 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.

56. 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?

The Golden Rule

57. There is one golden rule which emerges from the litigation. Can you guess what it is?