Dispute Resolution
Case Law Update
Rosling King LLP

## Background

The Joint Administrators of Angel House Developments Limited ("**the Applicants'**") had successfully defended a claim made against them by Ms Davey ("**the Claimant**"). The Applicants thereafter applied for a non-party costs order, pursuant to Section 51 of Senior Courts Act 1981, against ChapelGate Credit Opportunity Master Fund Ltd ("**the ChapelGate**"), who were the Claimant's commercial funder in the underlying litigation.

The Court had characterised the conduct in the underlying litigation as significantly outside the norm and so warranted costs on an indemnity basis. The Claimant had been ordered to contribute £3.9 million towards the Applicants' costs. Whilst the ChapelGate did not resist a non-party costs order, it contended that its total liability should be limited to the overall maximum of the funding that it had provided to the Claimant (some £1.2 million), in reliance on the Arkin Cap.

## The High Court Decision

The High Court ordered ChapelGate to pay costs without any cap, incurred after the date of the funding agreement (23 December 2015), thus deciding not to cap ChapelGate's liability at the extent of its funding to Ms Davey. Snowden J concluded that the Arkin Cap is *"best understood as an approach which the Court of Appeal in Arkin intended should be considered for application in cases involving a commercial funder as a means of achieving a just result in all the circumstances of a particular case" and that it was "not a rule to be applied automatically in all cases involving commercial funders, whatever the facts, and however unjust the result of doing so might be".*

The High Court considered that "*the balance between the principle that the successful party should have its costs, and enabling commercial funders to provide finance to facilitate access to justice should be struck differently than it was in Arkin*". The High Court held that it would be unjust to apply the Arkin Cap in ChapelGate's favour, in reference to the following factors:

1. ChapelGate had approached its involvement throughout as a commercial investment;
2. Whilst ChapelGate did not itself direct the conduct of the case, it had every opportunity to investigate and assess the nature of the claim and the type of allegations it was funding. Therefore, if the Arkin Cap were to be applied, ChapelGate would be "*insulated*" from indemnity costs arising from the manner in which the claim was pursued;
3. It must have been apparent to ChapelGate (i) that the Claimant was unlikely to be able to pay any substantial costs awarded against her, and (ii) that the Applicants' costs were likely to be very substantial and well in excess of the amount which ChapelGate itself proposed to invest in the litigation;
4. ChapelGate's decision to enter into a funding agreement highlighted that it was closely focused on its own self-interest in finding the litigation as a commercial venture; and there was no correlation between the amount of its investment and the costs to which the Applicants were exposed;
5. The use of the Waterfall structure in the funding agreement, and the level of ChapelGate's profit share, meant that ChapelGate stood to receive a substantial commercial profit, which would have taken priority over any compensation payable to the Claimant. This

showed that Ms Davey's access to justice came a clear second to ChapelGate receiving a significant return on its commercial investment, and that ChapelGate was the party with primary interest in the claim; and

6. The Judge rejected ChapelGate's policy argument that if the Arkin Cap were not to apply, it would discourage commercial litigation funders from providing finance in the future, and signal an open-ended exposure to adverse costs.

ChapelGate thereafter appealed to the Court of Appeal against the High Court's decision not to cap its liability at the extent of its funding to Ms Davey.

## The Court of Appeal Decision

The Court of Appeal unanimously dismissed ChapelGate's appeal and held that Snowden J was entitled to make the order he did.

### Arkin in context

The Court of Appeal considered that the Arkin approach does not represent a binding rule, and therefore judges do not necessarily have to adopt it when determining the extent of a commercial funder's liability for costs. The decision as to what, if any, costs order to make against a commercial funder is ultimately discretionary. Lord Justice Newey concluded that "*Judges retain a discretion and, depending on the facts, may consider it appropriate to take into account matters other than the extent of the funder's funding and not to limit the funder's liability to the amount of that funding... In the case of a funder who funded only a distinct part of a claimant's costs, a judge may well decide that it should pay no larger sum towards the defendant's costs… The more a funder stood to gain, the closer he might be thought to be the 'real party' ordinarily ordered to pay the successful party's costs.*"

The Court of Appeal considered that Arkin was decided at a time when third party funding of litigation, CFA and ATE Insurance were still 'nascent' and relatively new. The Court in Arkin focused exclusively on 'the extent of the funding provided' to highlight the importance of ensuring commercial funders were not deterred by the fear of disproportionate costs consequences, if the litigation they funded does not succeed. Nowadays, third party funding of litigation is much more established, and a funder should be able to protect their position by ensuring that either or the claimant has ATE cover.

The Court of Appeal also referred to Sir Rupert Jackson's Civil Review of Civil Litigation Costs Report, to highlight there is 'no evidence that full liability for adverse costs would stifle third party funding or inhibit access to justice', and to show 'it is wrong in principle that a litigation funder, which stands to recover a share of damages in the event of success, should be able to escape liability for costs in the event of defeat'.

The Court of Appeal did, however, emphasise that there will continue to be cases where it is right to follow the approach in Arkin. Lord Justice Newey decided that "*the Arkin solution is particularly likely to be relevant on facts closely comparable to those in Arkin, were the funder had merely covered the costs incurred by the claimant in instructing expert witnesses*".

Significance of Arkin and the Court's discretion

The Court of Appeal held that the exercise of Snowden J's discretion cannot be impugned. The order Snowden J made was plainly one that was reasonably open to him, and his decision cannot be said to have been founded on irrelevant considerations. Lord Justice Newey considered that this was a case in which it was legitimate for Snowden J to attach importance to ChapelGate's prospective gains as well as its outlay, and to have regard to the extent to which the Arkin Cap would leave the Applicants out of pocket. The Court of Appeal concluded the following:

1. This was not a case, as Arkin was, of a funder funding only a distinct part of the claimant's costs. In the instant case, all payments in respect of Ms Davey's costs were made with funds provided by ChapelGate from the date of the funding agreement;
2. ChapelGate stood to receive in return a profit amounting to a multiple of what it had spent, if the underlying litigation had been successful. ChapelGate would have derived far more than Ms Davey would from an award of £10 million (the value of the claim);
3. The litigation which ChapelGate chose to fund involved very serious allegations against more than one party, and the parties could not be expected to share legal representations. As a result, it was inevitable that the Applicants would incur costs greatly in excess of the funding which ChapelGate provided to Ms Davey; and
4. ChapelGate were not to have the protection of any ATE cover, and therefore its waiver of the requirement for ATE insurance very much increased the exposure of the Applicants.

## Commentary

Snowden J and Lord Justice Newey's respective judgments make clear the Arkin Cap is not a binding rule but only guidance; and the Arkin approach may still be appropriate to apply in cases where funders fund a distinct part of a claimant's costs. In any event, the extent of a commercial funder's liability for costs is in the end a discretionary decision, and commercial funders of litigation seeking to limit their liability to the winning side's costs should be very weary. The Court of Appeal's decision highlights to commercial funders the need to consider not only the level of funding provided, but also the broader factors involved, including the manner in which the claim proceeds, the extent of its prospective gains, the stages of litigation it funds and the importance of having effective ATE insurance in place to protect their costs exposure.

For further information, please contact Georgina Squire or the Partner with whom you usually deal.