Client Alert | Commercial Litigation

The High Court heralds the end of the Arkin cap

May 2019

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Davey v Money and others [2019] EWHC 997 confirms that litigation funders can no longer rely on the 'Arkin cap', to limit their adverse costs exposure to the amount of funding they contributed. The decision continues the trend of recent cases and reflects both a more robust judicial attitude to the liability of funders for adverse costs and a further judicial acknowledgment that the funding market has matured greatly over the last 14 years.

Summary

On 17 April 2019, Mr Justice Snowden refused to apply the Arkin cap principle ruling that a commercial funder was liable for all of the Defendants' indemnity costs incurred post the funding agreement in a successfully defended claim. This decision departs from the approach of the Court of Appeal in *Arkin*[1] in 2005, where a funder's liability for adverse costs was limited to the amount of funding provided to the Claimant (the "Arkin cap"). In *Davey*, Mr Justice Snowden moved away from a mechanical application of the Arkin cap, determining instead that the Court should consider it only as part of its overall discretion when considering how to achieve a just result.

Background

In 2014, Ms Davey (the Claimant) had made serious allegations of breach of duty and dishonest conduct against Mr Money and Mr Stewart-Kosher in their role as administrators of her company, and also against Dunbar Assets plc, who had appointed the administrators (together, the Defendants). In April 2018, the Defendants succeeded in defending the claims made against them, and Mr Justice Snowden ordered Ms Davey to pay each of the Defendants' costs on an indemnity basis. The Defendants' costs collectively were in the region of £7.5 million, and Ms Davey was ordered to make a payment on account of £3.9 million. Ms Davey had not taken out any ATE (After-the-Event) insurance cover; no doubt to the funder's later chagrin.

As Ms Davey failed to make any payment, the Defendants requested that the Court exercise its discretion under section 51 of the Senior Costs Act 1981, and sought a non-party costs order against her commercial funder, ChapelGate Credit Opportunity Master Fund (ChapelGate). While ChapelGate accepted the non-party costs order (on an indemnity basis) should be made against it, ChapelGate argued that its total liability to the Defendants should be limited by the Arkin cap. Rather than be responsible for the full amount of costs, ChapelGate claimed that its maximum exposure was £1.3 million (being the amount of funding it had provided). This would have left the Defendants facing a large shortfall when it came to costs recovery.

[1] Arkin v Borchard Lines (Nos 2 and 3) [2005] 1 WLR 3055

In considering the non-party costs order, there were two key issues the Court had to address:

i. whether the liability of ChapelGate to the Defendants should be for all of the costs, or only those incurred by the Defendants after the date the funding agreement had been entered into; and

ii. whether the order for costs against ChapelGate should be limited to the amount of funding it provided to the Claimant, in line with the principle of the Arkin cap.

Period of Liability

By the time Ms Davey had entered into the funding agreement with ChapelGate on 23 December 2015, the Defendants had already incurred over £3 million in costs defending her claim. Nevertheless, the Defendants argued that ChapelGate's liability ought not to be limited to the period after the funding was put in place, as under the terms of the funding ChapelGate was effectively the sole beneficiary of Ms Davey's claims. This was because under the funding arrangement it would have been highly unlikely for Ms Davey to receive any residue once the funding costs and other fees had been paid. As such, the Defendants claimed that ChapelGate stood to benefit from the entirety of the claim (if successful), and so it should also be liable for the entirety of the adverse costs without limiting the period of liability.

Mr Justice Snowden rejected the Defendants' argument on the basis that there needed to be a causal connection between the involvement of a non-party and the incurring of the costs in question for ChapelGate to be found liable on this basis. In doing so, the Court followed a long line of judicial authority. On the facts, the Defendants' costs incurred prior to 23 December 2015 would always have been incurred regardless of the participation of ChapelGate. As a result, the Judge refused to find ChapelGate responsible for the costs incurred in the period before the funding arrangement was in place.

The Arkin Cap

In order to determine whether ChapelGate's liability should be capped in line with the decision in *Arkin*, Mr Justice Snowden referred to the timing of *Arkin*. In establishing the Arkin cap, the Court of Appeal was mindful of the fact that at the time of that decision (in 2005) the litigation funding industry was in its infancy and the provision of funding was seen as aiding access to justice.

Over the ensuing years, the Arkin cap has been the subject of significant criticism as the funding industry has become increasingly well established and more sophisticated. Indeed, in December 2009 the Final Report of the review of Civil Litigation Funding (also referred to by Mr Justice Snowden in his judgment) highlighted the inequity that a funder "*which stands to recover a share of damages in the event of success, should be able to escape part of the liability for costs in the event of defeat*"[2] and referred to the Arkin cap as creating "*an uneven playing field*".[3]

Mr Justice Snowden therefore concluded that the Arkin cap should be "*best understood as an approach which the Court of Appeal... 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 the particular case*".[4] As such, the Arkin cap should not be applied automatically and the Court ultimately retains its broad discretion under section 51 of the Senior Costs Act 1981 to determine the appropriate liability for parties and their funders based on what is just. By adopting this interpretation of the Court of Appeal decision, Mr Justice Snowden found he was not bound by *Arkin* but could weigh up the merits of the case to achieve a just result.

In reaching his decision, Mr Justice Snowden took into account various factors present in the claim before him, including the nature of the claim itself, the "*lack of discrimination in the allegations*" made by Ms Davey, and the "*elements of speculation and exaggeration*" that had significantly increased the burden of the case against the Defendants, thus driving up costs.[5] As ChapelGate had been given every opportunity to investigate the nature of the claim and the supporting evidence, the Judge considered that it must have been

2 Review of Civil Litigation Costs: Final Report, December 2009, p. 123, paragraph 4.6

3 Review of Civil Litigation Costs: Final Report, December 2009, p. 123, paragraph 4.4

4 [2019] EWHC 997 (Ch) [89]

5 [2019] EWHC 997 (Ch) [92]

apparent to it that the adverse costs were likely to be substantially more than its investment and that Ms Davey would most likely not be in a position to pay them.

Mr Justice Snowden also noted that ChapelGate had renegotiated the funding arrangement during its term, so that it maintained the same level of profit on success, while halving its overall investment. In his view, the manner in which ChapelGate had negotiated the funding arrangement plainly demonstrated that the funder was "*closely focussed on its own self-interest*" and that "*it [was] not easy to see why the choice of the funder as to the amount of its funding should dictate the amount of costs it should pay to the litigant's opponent if the litigation fails… the amounts provided by a funder to a claimant may have no correlation whatever to the costs which a defendant or defendants are thereby caused to incur in defending themselves*"[6]. Interestingly, there was evidence that when calculating its costs exposure, ChapelGate had done so on the basis of facing only an Arkin cap risk.

Notably, Mr Justice Snowden was also not persuaded by ChapelGate's policy argument that a refusal to apply the Arkin cap would discourage commercial funders from providing funding in the future due to the potential open-ended exposure to costs, stating that he had been provided with no evidence that "*14 years after Arkin and ten years on from Sir Rupert Jackson's Report, the commercial litigation industry would be unable to factor into its operations the possibility that, in an appropriate case – especially one involving an award of indemnity costs - the Arkin cap might not be applied.*"[7]

Future Outlook

Davey marks a shift in judicial attitude even if it is one that has been coming for some time. As Mr Justice Foskett indicated in *Bailey & Others v GlaxoSmithKline U.K. Ltd* (considered here), there was an appetite for change and "*a wholesale attack on the reasoning in Arkin may be launched*". [8]

Under *Davey*, the Arkin cap is not an invariable rule or principle to be applied automatically but instead is an approach that should be considered by the Court in cases involving a commercial funder as a way of achieving a just result, if necessary. In other words, the Court has a wide discretion to reach a just result and may well decide not to apply the Arkin cap.

If widely followed, funders will be potentially exposed to the full amount of adverse costs should they find themselves funding an unsuccessful claim. It seems unlikely that the Courts will have much sympathy for policy arguments that such open exposure to costs will discourage the availability of funding. As Sir Rupert Jackson noted when conducting his Review of Civil Litigation Costs,[9] funders have a range of business models available to them capable of encompassing liability for adverse costs. As such, the decision in *Davey* will probably in practice encourage greater due diligence by funders and a greater uptake of ATE insurance as part of the funding package. However, for many commercial funders such steps are routine and the decision is unlikely to do more than reinforce their existing practices.

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6 [2019] EWHC 997 (Ch) [97]

7 [2019] EWHC 997 (Ch) [108]

8 [2017] EWHC 3195 (QB) [59]

9 Review of Civil Litigation Costs: Final Report, December 2009, p. 123, paragraph 4.5