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Excalibur Litigation: Court of Appeal Confirms that Funders Will Be Put to the Sword

November 2016

Authors: Robert Wheal, Paul Brumpton, Anna Hart, Thomas Wingfield

Summary

- In the recent decision of Excalibur Ventures v Texas Keystone and others,[1] the Court of Appeal has provided important guidance on the extent to which third party funders may be required to pay the costs of a defendant who has successfully defended a funded claim.
- The Court held that the funders were required to pay the defendants' costs on an indemnity basis even though the funders were not party to the misconduct that led to the award of indemnity costs against the claimant, Excalibur. The Court emphasised that third party funders seek to derive financial benefit from claims just as much as funded claimants and that the "derivative nature of a commercial funder's involvement should ordinarily lead to his being required to contribute to the costs" on the same basis as the funded claimant.
- The Court dismissed the argument that payments by a third party funder to enable a claimant to meet an order for security for costs should be treated differently from other forms of funding. Accordingly, funders who had provided funding solely to meet an order for security for costs were liable to pay costs up to the amount invested (the so-called Arkin cap) in just the same way as funders who had paid for the claimant's lawyers and experts.
- Finally, the decision confirms that a costs order may be made against a party who has in fact provided funding (and stands to benefit from a favourable judgment) despite the absence of a contractual relationship between that party and the claimant. In exercising its discretion to make a third party costs order, the Court looks to the economic realities to determine whether it is just, in all the circumstances, to require a non-party to pay costs "because of the nature of its involvement in the litigation."
- While the judgment clearly represents a financial loss for the funders in question, the clarification of the applicable principles underlines the important role that third party funders play – and will continue to play – in the resolution of high value commercial disputes.

Excalibur's Underlying Claim

Excalibur had brought a claim against the defendant companies, Texas and Gulf for specific performance of a collaboration agreement purportedly granting Excalibur a 30% share in the potentially lucrative Shaikan oil field in Kurdistan. In the alternative, Excalibur claimed damages valued – somewhat optimistically – at US $1.6 billion.

Tomlinson LJ noted that the claim had "failed on every point" at trial, and that it had been described as a "resounding, indeed catastrophic, defeat" for Excalibur. The claims were described as "an elaborate and artificial construct". The Court also found that the claims were opportunistic and based on "false and

[1] [2016] EWCA Civ 1144

misleading statements" from the claimant's principal witnesses. Further examples of the egregious manner in which the litigation was conducted included the pursuit of legally implausible arguments and a "grossly exaggerated" damages claim. In short, the conduct of claim was described by Clarke LJ as being "well outside the norm".

The Funding Arrangements

The underlying litigation was financed by four groups of funders, who had advanced a total of £31.75 million. Of this amount, £14.25 million was required to meet Excalibur's legal and expert fees, and £17.5 million was paid into court pursuant to an order requiring Excalibur to provide security for the defendants' costs. It should be noted that the funding undertaken in this case was not typical of commercial funding in the UK and none of the funders were members of the Association of Litigation Funders. Only one of the funders had any experience of funding litigation and this was its first venture into litigation in the UK.

Background to the Appeal

In view of the serious flaws in the conduct of the litigation, Clarke LJ ordered Excalibur to pay the defendants' costs on the indemnity basis, which amounted to approximately £22.3 million. Security for costs had been posted in the amount of £17.5 million (which would have been sufficient to cover costs on the standard basis) but the award of indemnity costs resulted in a shortfall of approximately £4.8 million. In view of this deficit, Clarke LJ heard arguments as to whether non-party costs orders should be made against the funders pursuant to Section 51(3) of the Senior Courts Act 1981, and concluded that they should all be jointly and severally liable to pay the defendants' costs on the indemnity basis (subject to the "*Arkin* cap" as further discussed below).

The Decision on Appeal

1. Costs Ordered on the Indemnity Basis

On appeal, the funders accepted their liability to pay the defendants' costs, but argued these should be determined on the standard basis because the funders were not themselves culpable of any improper behaviour.

While acknowledging that the funders "did nothing discreditable in the sense of being morally reprehensible or even improper", the Court of Appeal rejected their argument as a result of two "fatal defects": firstly, the Court of Appeal reiterated that a party's conduct was only one of the reasons that needed to be taken into consideration when evaluating the basis of costs, and secondly, the funders could not disassociate themselves from the conduct of those they funded.

2. Limitation of funders' costs liability: the '*Arkin* cap'

In *Arkin v Borchard Lines Ltd,*[2] the Court of Appeal held that a professional funder's liability for the other side's costs should be limited to the amount of funding it had provided in the action itself. This is commonly referred to as the "*Arkin* cap". The Court of Appeal in *Excalibur* was not asked to revisit the *Arkin* cap but noted in passing that it was perceived by some as "unduly generous to funders." However, the Court was asked to consider whether the funding provided in respect of security for costs should be taken into account in calculating the *Arkin* cap.

3. Funding for security for costs – not treated differently

The funders argued that amounts paid into court pursuant to an order for security for costs constituted a potential and then an actual contribution to the costs of the successful defendants, and therefore should not be included in the *Arkin* cap. Tomlinson LJ held that the money advanced by the funders to be paid into court was no different in nature to the monies advanced to fund the claimant's lawyers and experts. The £17.5 million was therefore included in the *Arkin* cap, and served to increase the amount that the funders could be held liable for.

[2] [2005] EWCA Civ 655 [2005] 3 All ER 613

4. Doctrine of corporate personality not relevant

Three of the four groups of funders had not entered into direct funding arrangements with Excalibur, but had provided back-to-back funding from related companies. The Court was dismissive of the argument that a contractual nexus was required in order to justify a third party costs order under Section 51(3) of the Senior Courts Act. As Gloster LJ noted, any such rule would simply lead to funders setting up special purpose vehicles in order to avoid third party costs orders. The exercise of the discretion to make a non-party costs order does not amount to enforcement of legal rights and therefore the doctrine of corporate personality was not relevant. Tomlinson LJ confirmed that it was just and appropriate to make a costs order against a party who has provided funding and who stands to benefit from the spoils of litigation.

Significance for Third Party Funding

The Court of Appeal's decision ensures that litigation funders are incentivised to: (i) conduct thorough due diligence before funding a claim; and (ii) remain involved by performing periodic reviews of the litigation strategy. In particular, the Court suggested that funders can – and in some cases should – engage independent lawyers to review litigation strategy in order to reduce the risk of indemnity costs orders. The ruling is, however, unlikely to send a shockwave through the funding industry, given that typical commercial funders are not in the habit of funding claims that have weak prospects of success.

On the contrary, this decision has been hailed by the funding community as an affirmation of the fact that it now enjoys a place at the "modern" litigation table. Indeed, to echo the words of Tomlinson LJ, litigation funding is a "judicially sanctioned activity perceived to be in the public interest". But the natural corollary of this greater involvement is that the courts are not prepared to allow funders to be automatically shielded from the adverse effects of their funded party's actions.

White & Case LLP
5 Old Broad Street
London EC2N 1DW
United Kingdom

T +44 20 7532 1000