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Landmark decision awards security for costs against third-party funder in excess of funder's commitment

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The decision in *Sandra Bailey & Others v GlaxoSmithKline UK Limited on 8 December 2017* examines the exposure of third-party funders to security for cost applications and considers whether the so-called *Arkin* cap is of any application in limiting a funder's liability to provide security.

The Arkin cap limits the liability of third-party funders to the amount that they have contributed in funding the claim. The Court's decision on this potentially increases the liability of litigation funders which could push up the cost for funded parties. It also provides an extra pressure point for those defending funded claims.

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Background

An order for security for costs offers protection to a party from the risk of their opponent not being able to pay the party's litigation costs if ordered to do so. Under the English Civil Procedure Rules the Courts may order security for costs to be provided by third parties who fund litigation on a commercial basis.

The "*Arkin* cap" is the principle set out by the Court of Appeal in *Arkin v Borchard Lines (Nos 2 and 3)*, which limits a funder's liability for costs to the amount of their own contribution. The decision in *Arkin* had been followed in other cases prior to this.

Shifting Parameters

In the recent decision of *Sandra Bailey & Others v GlaxoSmithKline UK Limited* the High Court (Foskett J) awarded security for costs against the third-party litigation funder, Managed Legal Solution Limited ("**MLS**"), in excess of the *Arkin* cap. MLS provided £1.2 million of funding towards the litigation in return for a share in the proceeds of any recovery. Notwithstanding that, Foskett J ordered that they provide £1.75 million by way of security for costs which was £550,000 more than the sum MLS would have paid had the *Arkin* cap been upheld. Justice Foskett's decision therefore opens the door to increased orders for security for costs, thereby increasing the potential exposure of litigation funders.

Firstly, the Court found that whether the *Arkin* cap should be applied is properly to be determined at the conclusion of the case. At the security for costs stage, the *Arkin* cap is only one of the factors to be taken into account in the exercise of the Court's broad discretion. Secondly, the Court accepted that the *Arkin* cap may not ultimately be applied at all, and so was willing to exercise its broad discretion to order security in a sum in excess of that figure to do justice in the circumstances.

The Court relied on the following factors in its judgment:

1. The Claimant's After-the Event (ATE) insurance was given limited weight as there was not an adequate assurance that the Claimants' ATE insurance would not be avoided;
2. *Arkin* should not be followed and was not binding upon the Court as it was not a case concerning the quantum of security to be ordered pursuant to CPR 25.14; and
3. Applying *Arkin* would give rise to a substantial injustice in this case.

The specific facts of the case which led the Court to make an order for costs in excess of the *Arkin* cap included that:

- MLS was not a member of the Association of Litigation Funders (ALF);
- MLS was balance sheet insolvent and reliant upon a shareholder for its liquidity. As the judge put it, MLS was "an almost inevitable target for a security for costs application";
- There was no contractual requirement for the shareholder to continue providing MLS with access to funds; and
- MLS had no capital and would need to borrow to provide security.

Therefore, parties who are contemplating accepting third-party funding and consider that there may be a risk of a security for costs application should ensure that they have adequate funding arrangements in place to meet any security ordered. In particular, parties should undertake proper due diligence in relation to potential funders and be wary of engaging funders who are not members of the ALF. (See in this connection, the decision in Excalibur[1] for some of the issues that can arise when dealing with non-mainstream funders here).

After-the-Event insurance

The Court accepted that the availability of ATE insurance was relevant to the exercise of its discretion. Foskett J made particular reference to a recent case *Premier Motorauctions v Pwc LLP & another*[2]. This decision confirms that a Court can take account of a claimant's ATE insurance policy when considering whether to make an order for security for costs. The key issue is whether the policy provides "sufficient protection" in the event the claimant is required to pay costs. This includes consideration of the scope of cover and the risk of it being avoided for misrepresentation or non-disclosure like any other insurance contract. Where a court determines that sufficient protection exists, it should not order security as there would be no "reason to believe" that the claimant would be unable to pay the defendant's costs if ordered to do so.[3]

However, in this case the Court discounted two thirds of the total ATE cover from the sum ordered by way of security.[4] In reaching this decision, it took account of the risk that the policy would be avoided, as inadequate assurances were given that it would not be.

If parties wish to rely on ATE cover in order to resist applications for security for costs they should ensure they carry out due diligence on the ATE insurer they use and that their policy is comprehensive. Parties may wish to consider requesting a policy which will cover orders for costs beyond the sum provided by the funder and/or a policy with the voidance rights removed.

[1] [2016] EWCA Civ 1144

[2] [2017] EWCA Civ 1872

[3] Ibid. [7]

[4] [2017] EWHC 3195 (QB), [79]

Future Outlook

This judgment will be relevant in future cases where there are challenges to security for costs against third party funders. It seems likely that the decision will encourage more security for cost applications in these circumstances going forward. Accordingly, parties may look to a range of other options to address security for cost issues, such as a deed of indemnity or security for costs bonds. These products provide greater reassurance to the courts that any adverse costs order will be paid in full by the funders and/or its insurance. However, such options can be significantly more expensive than standard ATE insurance policies and, as such, will likely increase the cost of funding.

The funding landscape for third-party security for costs is a continually developing area and this case has taken the law a step further. It also signalled that if the *Arkin* cap were to be considered by the appellate courts it might be scrapped altogether. As the judge put it, there is an appetite for change, and "*…a wholesale attack on the reasoning in Arkin might be launched*".[5]

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