

Litigation funding: does the cap fit?

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In this article, Maura McIntosh of Herbert Smith Freehills Kramer discusses the growing significance of litigation funding and whether the “Arkin cap” (which limits funders’ liability for adverse costs to the amount of funding contributed) is still fit for purpose.

In recent years, third party funding has gradually entered the mainstream in English litigation. Arrangements that would once have been struck down as offending against public policy, in the form of the historic rules against trafficking in litigation known as champerty and maintenance, are now accepted and indeed endorsed by lawyers and judges.

The Court of Appeal’s 2005 decision in *Arkin v Borchard* was an important stepping stone in that process. That decision recognised litigation funding as a desirable activity, in particular for its potential to provide access to justice which would otherwise be lacking. The decision also established what has become known as the “Arkin cap” – the principle that a funder’s potential liability for adverse costs will be limited to the amount of the funding provided.

But is the cap still appropriate, now that litigation funding has become big business? And, in any event, does it apply as broadly as is generally assumed?

Arkin v Borchard

Mr Arkin was a “man without means” who brought proceedings with the benefit of a conditional fee agreement with both solicitors and counsel. Other expenses to the tune of £1.3 million (expert reports and the cost of organising documents) were funded by a third party in return for a share of damages if the case was successful. It wasn’t. Mr Arkin’s claim failed and the defendants sought to recover their costs (nearly £6 million) from the funder.

The High Court declined to order the funder to pay costs. The judge described it as “highly desirable”

that third parties should be encouraged to provide access to the courts to those who could not otherwise afford it. He considered that this aim would not be met if professional funders were by definition to be subject to non-party costs orders.

The Court of Appeal reversed that decision, saying it would be unjust that a funder who purchased a stake in an action for a commercial motive should be protected from all liability for adverse costs if the action failed. On the other hand, the court was keen to ensure that funders would not be deterred from supporting litigation by the fear of disproportionate costs consequences if the case failed.

The Arkin cap

The Court of Appeal arrived at the *Arkin* cap as a compromise solution. The court made it clear, however, that the cap would only apply to funding arrangements which would support, and not undermine, public policy:

“Our approach is designed to cater for the commercial funder who is financing part of the costs of the litigation in a manner which facilitates access to justice and which is not otherwise objectionable. Such funding will leave the claimant as the party primarily interested in the result of the litigation and the party in control of the conduct of the litigation.”

The court said it could see no reason in principle why the same approach should not apply where a funder has financed all or most of the claimants’ costs but did not express a concluded view on the point.

There are few reported decisions in which the *Arkin* cap has been applied, though it is widely assumed to be of general application.

One example is *Excalibur v Texas Keystone*, where a number of different funders provided funding in various tranches and on various terms, with each funder due to receive a share of any proceeds of the litigation (said to be worth some US \$1.6 billion). The litigation failed spectacularly and the defendants argued that the funders should be held jointly and severally liable for costs. The High Court disagreed; it ruled that it was appropriate to apply the *Arkin* cap.

That aspect of the decision was not appealed – though there was an appeal on other issues, including the High Court’s decision to include within the cap sums provided by the funders in payment of security for costs as well as the claimant’s own costs. That appeal was dismissed.

The Court of Appeal noted that it was not being asked to revisit the *Arkin* cap. It recognised that some had criticised the cap as “over-generous to commercial funders”, but did not express a view on that debate.

The Jackson report

One notable source of such criticism was the [Final Report in Jackson LJ’s Civil Litigation Costs Review in 2009](#). Jackson LJ said there was no evidence that full liability for adverse costs would stifle third party funding or inhibit access to justice. In his view, it was wrong in principle that funders should escape part of the liability for costs in the event of defeat.

He recommended that the cap should be removed, either by rule change or by legislation, so that funders would be potentially liable for the full amount of adverse costs, subject to the judge’s discretion in the ordinary way. However, as yet, there has been no sign of any move to implement this recommendation.

Funders in the front line

Since the decision in *Arkin*, the market for litigation funding has undergone significant change, with both the number of professional funders and the amount of funding available having increased substantially. Funders have also become heavily involved in funding group litigation, where they may often stand to gain as much as (or more than) individual claimants in terms of any recoveries. That has had implications for how funders are seen by the courts when it comes to decisions on costs.

In the [RBS Rights Issue Litigation](#), the High Court ordered a group of claimants to reveal the identity of those funding the claims so that the defendants

could consider whether to apply for security for costs against them. The court dismissed the contention that the funders’ liability to pay adverse costs was secondary, in the sense that they would not be ordered to pay costs unless the claimants did not pay or were unlikely to pay. In group litigation, he said, there was good reason to assume enforcement might be directed first against the funders – as he put it, the funders “stand in the front-line”.

Against this background and given the importance to defendants of ensuring they have full costs protection in defending what are often complex and high value actions, it seems likely that the *Arkin* cap will be challenged before too long.

Indeed, the possibility of a “wholesale attack” on the reasoning in *Arkin* was recognised in *Bailey v GlaxoSmithkline*, a decision in the *Seroxat Group Litigation* handed down shortly before Christmas. In that case, the High Court ordered a funder to provide security for costs in an amount higher than its liability for adverse costs would ultimately be if the court applied the *Arkin* cap at the end of the litigation. The judge said that it would be wrong to ignore the possibility that the cap might not be applied, including because of a potential challenge to the reasoning in *Arkin*, though he recognised that such a challenge might have to go to the Court of Appeal to be resolved definitively.

Whole v part funding?

In *Bailey*, another reason the judge said the cap might not ultimately be applied was the potential argument that, in *Arkin*, the Court of Appeal was addressing only the situation where (unlike in *Bailey*) a funder had contributed a part of the costs and not the whole of the costs.

Although, as noted above, the Court of Appeal in *Arkin* said it could see no reason in principle why the same approach should not apply where a funder has financed the whole claim, it did not decide the point. The issue therefore remains open.

And indeed, the Court of Appeal’s willingness in *Arkin* to equate the two situations seems capable of challenge. There is arguably a world of difference between a situation where a claim is funded in its entirety and one where funding is provided for a discrete element of the claim. In the latter situation, it is easy to see that it may be unjust to make the funder liable for the whole of the adverse costs, particularly where that liability is wholly disproportionate to its own investment. In the former, it is not immediately apparent why the

funder should not simply be treated as standing in the shoes of the claimant for costs purposes.

Access to justice

In addition, given the Court of Appeal's comments in *Arkin*, there may be some doubt as to whether the cap applies (or should apply) where there are no access to justice issues. In *Arkin*, the Court of Appeal's concern was to avoid deterring funders who "provide help to those seeking access to justice which they could not otherwise afford".

In recent years, there has been an expansion of funding, beyond the impecunious claimant, to those who could afford to litigate but have chosen to seek funding essentially as a risk mitigation tool. In such circumstances, of course, a successful defendant

may not need to enforce a costs order against the funder, given the claimant's own means. However, it may be said that the same public policy arguments in favour of the *Arkin* cap do not apply, or not as strongly, in this situation.

Where does that leave us?

What is clear is that a commercial litigation funder is likely to be held liable for adverse costs where a claim fails. The extent of that liability, and whether it will be subject to the *Arkin* cap, is less clear - particularly where the funder has funded the claim in its entirety and the funding was not required to provide access to justice. Sooner or later - most likely sooner - it's going to be put to the test.

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