Unlimited risk

Ben Smiley on how funders have now lost the protection of the Arkin cap

The Court of Appeal recently handed down judgment in *ChapelGate Credit Opportunity Master Fund Limited v Money and others* [2020] EWCA Civ 246, a case concerning the so-called 'Arkin cap'. Professional litigation funders can no longer assume (if they ever did) that their liability for a successful party's costs will be limited to the amount they invested. That remains a possible outcome, but is likely to be rare. However, the impact on the litigation funding market ought to be limited, since the court's finding was consistent with judicial treatment of the Arkin cap for several years.

THE ESTABLISHMENT OF THE ARKIN CAP

Arkin v Borchard Lines Ltd (Nos 2 and 3) [2005] EWCA Civ 655 was decided when the litigation funding market was nascent, and the courts were still grappling with the principle and extent of litigation funders' costs liability.

The funder in that case had only contributed to limited parts of the claimant's costs – in particular the expert evidence and associated work. The claim having failed, Colman J at first instance held that the funder should have no liability to the successful defendants.

In that context, the Court of Appeal in *Arkin* sought to balance what the judges saw at that time as a tension between the need to balance the need for a successful party to recover its costs, and the possible deterrent effect of imposing a 'disproportionate' costs liability on commercial funders.

The solution that they devised was the Arkin cap: the principle that 'a professional funder, who finances part of a claimant's costs of litigation, should be potentially liable for the costs of the opposing party to the *extent of the funding provided*' (emphasis in the original).

The result was that the funder was only liable in costs to the defendants in an amount equal to the sums it had invested to pay for the claimant's expert and the associated work.

DOUBTS CAST ON THE ARKIN CAP

Sir Rupert Jackson considered the Arkin cap in 2009, when he conducted his Review of Civil Litigation Costs. The City of London Law Society's Litigation Committee and the Commercial Litigation Association each criticised the impact of the Arkin cap in the course of that review. Sir Rupert concluded that the criticisms of *Arkin* were 'sound' and that it was '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 part of the liability for costs in the event of defeat. This is unjust not only to the opposing party (who may be left with unrecovered costs) but also to the client (who may be exposed to costs liabilities which it cannot meet).'

The criticisms of the Arkin cap have been acknowledged in later cases. In *Bailey v GlaxoSmithKline UK Ltd* [2017] EWHC 3195 (QB), the court ordered security for costs against a funder in an amount that was not limited by the Arkin cap. Foskett J recognised various ways in which it might be suggested that the cap should or did not apply to a particular case. In *Excalibur Ventures llc v Texas Keystone Inc (No 2)* [2016] EWCA Civ 1144, Tomlinson LJ noted that some considered the Arkin cap 'to be over-generous to commercial funders but that is a debate for another day'.

AT FIRST INSTANCE

That day came in 2018. The context was a claim - brought against administrators and a bank – which had catastrophically failed. Costs orders were made against the claimant on the indemnity basis, with substantial interim payments due. The administrators and the bank then pursued the claimant's funder, ChapelGate, for the unpaid costs.

ChapelGate accepted that it was liable in principle, but relied on the Arkin cap to assert that its liability was limited to a total of c.£1.3m. (There was also a dispute as to whether ChapelGate could be liable for costs incurred before ChapelGate had agreed to fund. That issue was determined in ChapelGate's favour and did not arise on appeal.) ChapelGate's position would have left the administrators and the bank substantially out of pocket. In the period following ChapelGate's agreement to fund the claimant's claims, they had incurred sums totalling more than £4.3m.

Snowden J rejected ChapelGate's position. He held 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 the 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 judge accepted the submissions made by the administrators and the bank that there were various factors which meant that it would be unjust to apply the Arkin cap in that case. These included the waterfall structure of the payment of proceeds, and the level of ChapelGate's profit share.

> The *Arkin* approach is now likely to be limited to rare cases, where only a discrete portion of the claimant's costs have been funded

Snowden J rejected ChapelGate's submission that commercial litigation funders would be discouraged from providing funding in the future because they might have an 'open-ended' exposure to adverse costs. He found that 'if the possibility that they might not be able to take advantage of the Arkin cap causes funders to keep a closer watch on the costs being incurred, both by the funded party and the opposing side, and if careful consideration is given to employing the mechanisms in the CPR to limit exposure to adverse costs in an appropriate case, I do not see that as contrary to access to justice or any other public policy.'

IN THE COURT OF APPEAL

ChapelGate appealed Snowden J's decision on the basis that he had misunderstood Arkin, which was said to be binding authority establishing the correct 'solution' to be applied in respect of commercial funders where the stated criteria were met. The Court of Appeal dismissed the appeal, and went further than Snowden J had done in undermining reliance on the Arkin cap.

The court emphasised that, when determining a non-party costs order under s.51 of the Senior Courts Act 'the only immutable principle is that the discretion must be exercised justly' (per Moore-Bick LJ in *Deutsche Bank AG v Sebastian Holdings Inc* [2016] EWCA Civ 23).

The court noted that it is possible to envisage circumstances in which applying the Arkin cap would not be felt just, even when the funder had only contributed to part of the unsuccessful party's costs. The court might wish to examine justice by reference to what the funder stood to gain, whereas the *Arkin* approach focuses exclusively on the extent of funding provided.

The development of the litigation funding market since *Arkin* was an important factor. Commercial funding, conditional fee agreements and after-the-event insurance are more established now, such that the risk of funders being deterred by disproportionate costs consequences is diminished.

The court did not consider that the *Arkin* approach has become redundant. It noted the recent decision of *Burnden Holdings (UK) Ltd v Fielding* [2019] EWHC 2995 (Ch), an unusual case in which Zacaroli J had applied the Arkin cap even having regard to the guidance of Snowden J. The cap was 'particularly likely to be relevant on facts closely comparable to those in *Arkin*', where the funder had covered the cost of, for example, expert witness evidence alone.

Crucially, the court rejected ChapelGate's submission that the *Arkin* approach is a binding rule. Judges 'retain a discretion'. It might be appropriate to take into account factors other than the extent of the funding, such as the funder's potential return: 'The more a funder had stood to gain, the closer he might be thought to be to the "real party" ordinarily ordered to pay the successful party's costs… In the case of a funder who had funded the lion's share of a claimant's costs in return for the lion's share of the potential fruits of litigation against multiple parties, it would not be surprising if the judge ordered the funder to bear at least the lion's share of the winners' costs, regardless of whether the funder's outlay on the claimant's costs had been a lesser figure.'

Finally, the court considered the factors relied on by Snowden J in determining that the Arkin cap should not apply to the current case, and held that the exercise of his discretion 'cannot be impugned'.

IMPACT ON THE MARKET

The Court of Appeal's decision ought not to have a substantial impact on the market. Funders should have been aware of the risk that the Arkin cap might not be applied to a particular case for many years. That risk was apparent from the decision in *Arkin* itself, and the potential injustice of the Arkin cap has been documented since Sir Rupert's Review over a decade ago.

However, the Court of Appeal has gone further than Snowden J had at first instance. The *Arkin* approach is now likely to be limited to rare cases, where only a discrete portion of the claimant's costs have been funded (such as in *Arkin*) and/or where there are unusual facts (such as in *Burnden*). In the more usual case, where the funder pays the bulk of the claimant's costs, in return for a hefty profit, it is likely that the costs order will not be limited by the Arkin cap.

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