Excalibur judgment changes playing field in litigation funding market

23 OCTOBER 2014

CATEGORY:
ARTICLE

Background to the underlying claim

The claim against the non-party funders is the tail end of an epic $1.6bn claim by Excalibur Ventures LLC against the US oil company, Texas Keystone Inc. Excalibur contended that it had been unlawfully cut out of a deal with Texas which would have given it a 30% interest in four petroleum blocks in Kurdistan. After a 57 day trial the longest heard in the history of the Commercial Court, the judge handed down judgment in October 2013 in which he dismissed all of Excalibur's claims and ordered it to pay the defendants' costs on the indemnity basis. One of the reasons why Excalibur was ordered to pay costs on the indemnity, rather than standard, basis was the way in which Excalibur and its solicitors, Clifford Chance LLP, had conducted the case.

The funders

Excalibur funded the huge legal costs of its claim through third party funding and the funders also provided the £17.5m security for costs ordered by the Court.

Psari Holdings Limited – and its sole shareholder and director Mr Lemos – was represented by Withers LLP in the costs' hearing, was one of the professional funders. Psari provided c. £13.5m of funding, the majority of which went towards paying legal fees. The funding which came from the other professional funders, referred to in the judgment as Hamilton, Platinum (or PPCO), Blackrobe and Blackrobe Capital, Huron and PPVA and JH, was provided for and applied mainly towards security for the defendants' costs.

As Excalibur was a shell with no money or assets, the successful defendants applied for non-party costs order against not only the three professional funders who had directly provided funds to Excalibur (namely, Psari, Hamilton and Blackrobe) but also against those funders' holding companies and/or ultimate beneficial owners – in other words, the people who provided the funds to the funders who funded the claim.

The Defendants' Application

The defendants' application was made pursuant to Section 51 of the Supreme Courts Act which provides that the Court shall have "full power to determine by whom and to what extent the costs [of a party] are to be paid". As a result of this statutory provision, there have been a number of cases in which a funder of an unsuccessful claim has been ordered to pay the winning party's costs, notwithstanding the fact that the funder was not a party to the proceedings.

Save where a funder has been champertous (i.e. exercised an element of control over the conduct of the litigation) the Courts have imposed a cap on a funders' potential liability under Section 51 – the so-called Arkin Cap, Arkin v Borchard Lines Limited being the seminal case in which this cap was first introduced. The main principle established by the Court of Appeal in Arkin is that a professional funder can be liable for the winning party's costs but only to the extent of the funding provided. The purpose of the Arkin cap was to provide a satisfactory medium between two competing principles: that costs should follow the event and ensuring access to justice.

In the light of the above well-established principle, Psari and Mr Lemos accepted from the outset ("to its credit" as the judge said) that it should and would pay the defendants' costs on a standard basis. However, Psari did not accept that it should have to pay costs on the indemnity basis.

By contrast, the other funders disputed any liability at all. They contended that a distinction should be made between funds provided for Excalibur's costs and expenses of prosecuting the action on the one hand, and further provided to enable Excalibur to provide security on the other hand. . They also claimed that that no order should be made against PPCO and PPVA which provided their subsidiaries with the funds to support Excalibur, but did not themselves agree with Excalibur to do so.

Issues raised

The defendants' claim raised four important and novel points of law:

1. **Standard vs indemnity debate**
Where a losing party is ordered to pay costs on the indemnity basis as a result of its and its solicitors conduct, and this conduct was not known by or attributable to the funders – indeed, the Judge found that the funders had behaved entirely properly throughout the claim, stating specifically that "I do not regard Mr Lemos as having behaved in a morally reprehensible manner or with any impropriety" – should the funders be

automatically fixed with the Claimant's liability to pay costs on the indemnity, rather than standard basis? In other words, should the funder have to pay more than it would have had to pay had the Claimant and its solicitors behaved properly, by virtue only of the fact that the Claimant did not in fact behave properly in circumstances where a properly acting funder cannot interfere in the conduct of the claim?

2. **The corporate veil**
*In circumstances where there has been no misconduct by the funder or its directors, shareholders or associated companies, does Section 51 give the Court power to exercise its discretion to make a costs order not only against the losing party's funder, but also against that funder's funder, shareholder or director (or anyone else who may have funds with which to pay the losing party's liability)?

3. Security vs costs
Where a funder has only paid security for costs, or paid more by way of security for costs than it has paid towards the losing party's legal fees, and that security is then paid to the winning party, has that funder's liability to pay any additional shortfall in the defendants' costs been discharged?

4. Timing
Should the Court differentiate between funders who invest at different stages of the litigation?
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How the court determined the issues
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In relation to the standard vs indemnity debate, the Judge decided that, in a case of this kind, justice requires that the funder should, subject to the *Arkin* cap, bear the costs ordered to be paid by the person whom or which he has unsuccessfully supported. In short, absent special circumstances, he should follow the fortunes of those from whom he himself hoped to derive a return. To do otherwise would, in the Court's view, be unfair to the defendants. Whilst the funders had the choice of which claims to back and whom to instruct, the defendants could not choose by whom to be sued or in what manner. The judge made it clear that his intention was not, therefore, to penalise the funders who, in the case of Psari and its owners *'were not personally responsible for the matters which caused me to order indemnity costs'* and were not *'consciously aware of the legal sink hole which underlay Excalibur's case.'* The decision was also driven by the unique characteristics of this case, in particular, its size (in terms of value), its merits and the way in which it had been run by the Claimant and its legal advisers.

In relation to the corporate veil issue, the Judge did not agree with the Platinum funders' claim that to treat PPVA as the funder would be to pierce the corporate veil in circumstances where there was no justification for doing so. The economic reality was that the investments in the litigation were made by PPVA and PPCO and it was they who would have been the ultimate beneficiaries of success. Indeed, the funding vehicles did not appear to have any independent interest from that of their owners, nor would they have any assets of their own from which to satisfy any order made against them. The Judge recognised the wide discretion afforded to him by Section 51 and held that, in determining what was 'just' in this case, he should not disregard the role of the parent companies; on this occasion, parent and subsidiary should stand together (*see footnote 1*).

In relation to the third issue (regarding the provision of security), the judge determined that the function of the *Arkin* cap is to limit the costs which the funder has to pay *'by reference to the money that he has put up to finance the action.'* The Judge held that the provision of money to the Claimant in order that it may provide security for costs was not the equivalent of a payment of costs ordered at the end of the case; it is a form of funding of the claim in exchange for a return attributable to the monies provided for that purpose – in effect, an investment. Again, the decision as to this element of the claim was driven mainly by the circumstances of this particular case and the specific arrangements that the funders had in place with regards to the provision of security. Nonetheless, the general rule now appears to be that the Court will not allow any one funder a *'free ride'* on the back of those financing the costs by virtue of the fact that its funding was provided through a particular or different mechanism. This *'would not be just and could not be right.'*

Finally, as to the timing of the funding, the Judge favoured the approach of Morrit LJ in *Globe Equities* and later adopted in the case of *Goodwood*, namely that, in order to succeed in a claim for costs against a non-party, those costs must *'to some extent'* have been caused by the non-party (*see footnote 2*). Accordingly, in circumstances where a funder provides funding later in the litigation than other funders, that later funder should not be liable to pay for any of the costs that the receiving party had incurred prior to the date of that party's funding. This is notwithstanding the fact that the later funder stands to inherit all the work (and benefit) that had been done prior to the provision of its funding. This decision will therefore leave the receiving party in the unenviable position of having to divide its costs into periods of investment and then, within those periods, apportion the costs incurred as between each funder.

The potential impact on the professional funding market

The effect that the judgment may have on the professional market is potentially significant and may require professional funders to reconsider how they fund claims and, once they have provided the funding, how they monitor their investment to ensure that they too are not unwittingly exposed to the consequences of improper behaviour of the funded party and/or its legal representatives.

The Judge has recognised that there are competing public policies of ensuring a fair deal for the winning party without curtailing access to justice. He acknowledged that, if professional funders are exposed to the risk not only of standard but also of indemnity costs, they may decline to fund or only be prepared to do so at a higher cost or, perhaps more likely against some form of indemnity or an increased reward for success even in relatively standard cases. Alternatively, they may seek to intervene in the proceedings and run the risk of champerty. However, in this particular case where the sums at stake were so high and the deficiencies in the case were egregious, he decided that it would be unfair to leave the receiving party out of pocket because of the impact it may have on possible future funders in different cases.

In concluding, the judge doesn't think that his decision will send an unacceptable chill through the litigation funding industry, but stated that, if it causes those funders and their advisors to take rigorous steps short of champerty, to reduce the occurrence of the sort of circumstances that caused him to order indemnity cost in this case, that is, in his view, an advantage and in the public interest. Clearly, this judgment was heavily influenced by the relatively (and thankfully) rare peculiarities of this particular case, its faults and its failings.

Footnotes

1. _ It was also relevant to the judge's decision on this point that the Platinum funders had the benefit of ATE insurance policies
2. *Although he did not apply the same 'causation' reasoning when determining the funders' liability for indemnity costs having acknowledged that the funders did not know of the Claimant's and its advisors' faults and failings which led him to order the Claimant to pay indemnity costs in the first place.*

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