Sea of adversity

James Whitaker reflects on adverse costs orders

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An adverse costs order is but one of the risks parties to litigation run. That risk, in recent years, has increasingly extended to non-parties, based upon the court's jurisdiction to award costs against non-parties set out in s51(1) and (3) of the Senior Courts Act 1981, albeit such orders are 'exceptional'.

In *Montpelier Business Reorganisation Ltd v Armitage Jones LLP* [2017] the High Court awarded a non-party costs order against a company in the same group as the unsuccessful claimant, finding that such an order can be made against companies that fund, stand to benefit from and control the litigation. Non-parties should take note of their involvement in group company litigation, and the resulting risks of non-party costs exposures.

The law

The court's wide discretion with regard to costs in litigation, derived from s51 of the Senior Courts Act 1981, will be familiar territory. Since 1986, and the House of Lords' decision in *Aiden Shipping Co Ltd v Interbulk Ltd* of that year, the court's power to order costs against non-parties to the litigation has also been recognised. Judicial guidance as to when non-party costs orders should be granted was set down in 2004, when the Privy Council ruled in *Dymocks Franchise Systems (NSW) Pty Ltd v Todd (Costs).*

In essence, the guidance was as follows:

- Although costs orders against non-parties are 'exceptional', exceptional means only that the case is outside the ordinary run of cases which parties pursue or defend for their own benefit and at their own expense. Ultimately, the question will be whether – in all the circumstances – it is just to make the order.

- Generally the discretion will not be exercised against 'pure funders', ie those with no personal interest in, and who do not stand to benefit from (as a matter of business) or seek to control the course of, the litigation. The public interest in the funded party getting access to justice will generally outweigh the recovery of costs by the successful unfunded party.

- If, however, the non-party not only funds, but also controls or stands to benefit from the proceedings, justice will ordinarily require that the non-party pays the successful party's costs if the funded party fails. The non-party, in seeking access to justice for its own purposes, is consequently itself a 'real' party to the litigation.

- Generally, a non-party funding proceedings by an insolvent company solely or substantially for its own financial benefit should be liable for the costs in the event of failure. But non-party costs orders will not invariably be made in such cases, particularly where the funder is a director or liquidator acting in the interests of the company rather than its own.

- A non-party should not ordinarily be liable for costs which would in any event have been incurred without the non-party's involvement in the proceedings, although the position may be different

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where a number of non-parties have acted in concert.

Montpelier

In September 2017, the High Court handed down a significant judgment likely to influence this area, in the case of *Montpelier*. The High Court granted a non-party costs order against a company in the same group as the claimant – specifically, the claimant's corporate shareholder – on the basis that it had funded, stood to benefit from and controlled the claim and was, as such, a 'real party' to the litigation.

Facts

The claimant company (M) issued proceedings for breach of contract against five defendants in relation to alleged breaches of, principally, an asset purchase agreement governing M's purchase of the business and assets of the first two defendant companies. M asserted that, as a result of the defendants' breaches, it should not be liable to make the final payment of £250,000 under the purchase agreement, and that the defendants were liable for damages in excess of £1m. Judgment was entered in favour of three of the defendants, who were awarded damages and costs.

As a result of M's insolvency, however, it was unable to meet the costs order (or, indeed, the damages award). One of the successful defendants therefore applied, pursuant to CPR r46.2, for M's group companies to be joined to the proceedings in order for the court to consider whether to make a non-party costs order against them, on the basis that they had funded the litigation. Those companies were M's 50% shareholder (MP), and MP's parent company (MP Leeds). The court concluded that it was appropriate to make a costs order against MP, but not against MP Leeds.

What was the basis of the non-party costs order?

The bases on which the court granted a non-party costs order against MP were as follows:

- MP had made a loan to M in order to fund the litigation. The fact that this was an interest-free, unsecured, loan to an insolvent company, and was clearly not made on commercial terms, suggested that MP had an interest in the outcome of the litigation.
- MP had much to gain from a successful outcome to the litigation. It had provided a guarantee and indemnity in favour of the defendants for any breach by M of its obligations under the purchase agreement; if M was held to liable to pay the remaining £250,000 of the purchase price, MP would therefore be liable under the guarantee. MP also stood to receive significant additional payments.
- There was clear evidence – which emerged during the cross-examination of one of M's directors – that MP was exercising control of the litigation. The court stressed, however, that while control of the litigation is important, it would not necessarily have been a bar to a non-party costs order if MP had not been exercising control.
- The fact that MP was a major shareholder of M was a relevant factor and weighed in favour of making an order, although

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a shareholding does not give rise to the same rules that apply to directors funding litigation. Rejecting M's argument that, as in the case of directors, there must be some evidence of impropriety in order to make an order against a shareholder, the court said the positions of shareholders and directors were not analogous; shareholders are not officers of the company. The absence of impropriety on the part of MP did not preclude the making of a non-party costs order.

- MP was the 'real party' to the litigation. M was a dormant company, and it could not realistically be said that MP was acting in M's interests, rather than its own interests, by funding the litigation.

- Non-party costs orders are exceptional although, as set out in *Dymocks*, in the context of non-party costs orders, 'exceptional' simply means that they are outside the usual run of orders made.

- That the defendants had failed to apply for security for costs was a factor which would weigh in favour of refusing to make a non-party costs order, but was not fatal. The decision not to apply for security for costs was held to have been reasonably reached. An application for security for costs should not necessarily be a prerequisite to a successful application for a non-party costs order.

- A non-party costs order was not disproportionate, in circumstances where the claim was for over £1m and the costs incurred were substantial.

- MP was the predominant, if not the only, funder, and it was therefore unlikely that the litigation would have proceeded without MP's contribution (although even if that had not been the case, MP was the real party to the litigation and would have benefited from a successful outcome).

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Factors weighing against granting a non-party costs order

By contrast, the court did not consider it to be appropriate to make a non-party costs order against MP Leeds, and it is instructive to consider the reasons why:

- MP Leeds was not a 'real party' to the litigation. While MP Leeds had provided some funding to M, that funding was not so meaningful that the litigation depended on it. Similarly, there was no evidence that MP Leeds had exercised any control over the litigation. While there can be more than one 'real party' to the litigation, there was insufficient evidence that MP Leeds was such a real party.

- MP Leeds only stood to benefit from the outcome of the litigation indirectly. While it had lent money to MP and a successful outcome in the litigation would have put MP in funds to repay MP Leeds, MP Leeds had no control over how MP spent the money; any benefit to MP Leeds from a successful outcome of the litigation was therefore merely a contingent benefit.

- The defendants had argued that in a situation where one group company funded a claim by another group company for the benefit of a third group company, all of those companies should be held liable, in order to avoid the group taking steps to prevent satisfaction of a judgment by ensuring that neither the claimant, nor the company in whose interest the litigation was pursued, were in funds. This was rejected. The court said that in such a situation, the successful party could petition for the company's winding up. If successful, the liquidator could then investigate the circumstances in which the company may have divested itself of its assets, and if such a finding was made, appropriate steps could be taken to set aside those transactions.

- It was not right to make an order against MP Leeds simply because it was a group company. Something more had to be shown.

Key points to note

While non-party costs orders remain at the court's discretion and the appropriateness of such orders will depend largely on the facts of the case, *Montpelier* is significant as an example of a non-party costs order being made against a group company. It is also a useful reminder of the factors that the court will consider in making such orders; namely the extent to which the non-party has funded and stands to benefit from a successful outcome to, and has exerted control over, the litigation. Further, it exemplifies both that a non-party costs order against a corporate shareholder will not require evidence of impropriety in the course of the litigation, and also that a failure to apply for security for costs will not necessarily preclude an application for a non-party costs order. ■

Aiden Shipping Co Ltd v Interbulk Ltd [1986] AC 965

Dymocks Franchise Systems (NSW) Pty Ltd v Todd & ors (Costs) [2004] UKPC 39

Montpelier Business Reorganisation Ltd v Armitage Jones LLP & ors [2017] EWHC 2273 (QB)