In search of security

John McElroy and **David Lawne** ask if ATE is still adequate as security for costs

A striking recent trend in commercial litigation has been the growing number of security for costs applications in which claimants' funding arrangements, and especially their after-the-event insurance, have been put to the test. This has resulted in some important decisions over the last six months, raising questions about whether ATE insurance is a sufficient answer to security for costs and the extent of funders' exposure to such applications. This article assesses these developments and comments on where this leaves insured parties.

BACKGROUND

Security for costs is based on the principle that a successful defendant should be able to recover its costs in defending the litigation without delay or other difficulty. It is enshrined in the CPR, and the critical wording is at CPR 25.13(2)(c), which provides that security can be ordered against a claimant if 'there is reason to believe that it will be unable to pay the defendant's costs if ordered to do so'. Once the court is satisfied that this is met (the jurisdictional threshold), it has discretion to make an order, having regard to all the circumstances of the case (the discretionary stage). Orders for security may also be made against third parties, including commercial funders: CPR 25.14(2)(b).

However, while defendants should not suffer the injustice of being unable to recover their costs, that should not tip the balance towards stifling bona fide claimants with limited resources. This is especially so when the claim vests in insolvent companies, which usually do not have sufficient funds to pay defendants' costs. ATE insurance was seen to be the answer to this difficulty: provided the level of insurance matched a defendant's estimated recoverable costs, the defendant would have the desired protection because it would be paid under the policies. This approach was endorsed by the courts, most notably in *Geophysical Service Centre v Dowell Schlumberger (ME)* [2013] EWHC 147, in which Stuart-Smith J recognised the funding of litigation by ATE policies as 'a central feature of the ability of parties to gain access to justice'. In that case, the defendant had challenged the adequacy of the claimants' insurance, focusing on the risk of avoidance. The judge dismissed these arguments, finding that there was no more than a theoretical chance that the insurers might seek to avoid the policy.

PREMIER MOTORAUCTIONS

It was against this backdrop that, in 2016, a security for costs application was brought in the case of *Premier Motorauctions v Pricewaterhousecoopers LLP & Anor*. The claimants were the liquidators of Premier, an insolvent car motor auction business, who pursued claims on its behalf against Lloyds Bank and PwC, alleging that they caused its insolvency.

Anticipating that the defendants could incur several millions in costs, the liquidators took out ATE insurance cover up to £5 million. The defendants challenged the adequacy of this insurance, pointing to exclusion clauses allowing the insurers to avoid payment and the absence of any connected deeds of indemnity.

The liquidators argued that the defendants had not been able to point to any specific risks of non-payment and that, as in *Geophysical*, there was no more than a theoretical risk of avoidance. These arguments came before Snowden J who, following a two-day hearing, dismissed the application ([2016] EWHC 2610). Referring to the 'public interest in permitting ATE insurance on appropriate terms to provide access to justice for insolvent companies under the control of responsible insolvency office-holders', he did not consider there was any reason to believe that the ATE policies would fail to respond, meaning that the defendants did not meet the jurisdictional threshold.

The defendants appealed and in November 2017 the Court of Appeal overturned Snowden J's decision ([2017] EWCA Civ 1872). Giving the sole judgment, Longmore LJ agreed that 'properly drafted' ATE insurance could be considered sufficient security, but found that on the facts the policies did not give sufficient protection.

Remarking that it was 'unfortunate that the court's jurisdiction to order security… should depend on a detailed analysis of a claimant's ATE insurance' he nevertheless decided that 'such analysis is inevitable'. Referring to the risk that the policies could be avoided for misrepresentation or non-disclosure, he expressed concern that neither the court nor the defendants knew what information had been given to the insurers to procure the policies. He was especially troubled by the claimants' reliance on the evidence of Premier's managing director, finding that, if he was not believed at trial, the claims would fail. While acknowledging that this might not give grounds for the insurers to avoid the policies, he concluded that in the absence of information it was 'unsatisfactory to have to speculate.'

While its decision may come across as fact specific, the Court of Appeal clearly wanted to send a message. Noting that the case raised 'important questions of principle which have not been previously considered at an appellate level', Longmore LJ commented that 'there may be a tendency… for judges at first instance to accept that an ATE policy can stand as security for costs'. That is no longer the case, and unsurprisingly defendants have started to challenge ATE insurance arrangements in other disputes. Indeed, it may prove difficult to rely on ATE insurance without any anti-avoidance provisions or deeds of indemnity in the light of Longmore LJ's remark that it was 'enough to say that the existence of [avoidance] rights give sufficient reason to believe that the [claimants] will not pay the defendants' costs.'

FORTIFYING ATE INSURANCE

Unfortunately, the Court of Appeal did not decide whether anti-avoidance provisions would have been adequate protection in *Premier* and indeed referred to an earlier decision where an ATE insurance policy which provided for avoidance only in cases of fraud was deemed inadequate security (*Holyoake v Candy* [2017] 3 WLR 1131).

However, in another recent decision, the court considered the adequacy of a deed of indemnity in the context of an application to replace security in the form of a solicitor's undertaking by a deed (*Recovery Partners GB Ltd & Anor v Rukhadze & Ors* [2018] EWHC 95). Although the judge declined to vary the security arrangements he considered that, if he were giving security afresh, the deed of indemnity offered by the claimants would provide adequate protection, on the facts of the case. These contrasting decisions underline that assessing the adequacy of ATE insurance arrangements is highly fact sensitive and will depend on the circumstances in each case.

The principal difficulty for claimants seeking to bolster their insurance is the cost. The need for such additional expenditure can place strain on claimants' funding arrangements and might even render claims economically unviable. However, while in the post-Jackson world insurance premiums are not recoverable, there may nevertheless be a means for claimants to recover their costs of meeting orders to give security.

STING IN THE TAIL – CROSS UNDERTAKINGS

It is now established practice that the court may order defendants to give cross undertakings in damages to protect those giving security if it were later found that the order should not have been made and that compensation would be fair and appropriate. A notable recent example was the *RBS Rights Issue litigation*, in which RBS sought security from the claimants' litigation funders ([2017] EWHC 1217 (Ch). In awarding security, Hildyard J required RBS to give an undertaking, commenting 'I do not think it should be considered particularly exceptional as the price of an order for security by a non-party funder.' Defendants considering whether to seek security should therefore be mindful that the price for having security may be accruing a contingent liability of their own.

SECURITY APPLICATIONS AGAINST LITIGATION FUNDERS

As noted earlier in this article, funders may be liable to give security. This principle was extended in the *Wall v RBS* case, in which RBS sought disclosure of the identity of the claimant's funder. In 2016, Andrew Baker QC (as he then was) decided that funders cannot expect anonymity where there is reason to believe that the case is funded by a commercial entity in return for profit, and accordingly may be liable for costs of the case or by way of security ([2016] EWHC 2460). Notably, RBS subsequently sought security from the funder and its application was dismissed after the claimant offered to put in place further insurance.

Another recent security application against a litigation funder was determined shortly after the Court of Appeal's judgment in Premier: *Sandra Bailey & Ors v Glaxosmithkline UK Ltd* [2017] EWHC 3195 (QB). After GSK applied for security against the claimants' funder, the key issues for the judge, Foskett J, to address were whether the Arkin cap (by which, following a 2005 Court of Appeal decision, commercial funders' liability for adverse costs is capped at the level of their investment in the litigation) applies to security for costs; and the weight to give ATE insurance in exercising discretion.

Noting that the litigation funding market had developed considerably since Arkin, and referring to Jackson LJ's criticisms of the cap in his 2009 report on litigation funding, Foskett J decided that the cap did not apply to security and ordered that the funder give security exceeding its investment. Taking account of claimants' ATE insurance (which, like Premier, contained exclusion clauses), he reduced the security by an amount equivalent to two thirds of their ATE cover. In the authors' view, this was a sensible and pragmatic means of balancing the expected benefit of the ATE insurance against the risk that it might be avoided.

CONCLUSION

The adequacy of ATE insurance as security will continue to be put to the test as the courts flesh out the Court of Appeal's decision in *Premier*. Insured claimants (especially insolvency practitioners) and their funders would be well advised to consider whether any steps should be taken to bolster their insurance arrangements to meet legitimate concerns. There is also an opportunity for insurers to offer updated products to litigants that respond to the Court of Appeal's concerns but are more cost effective than standalone deeds of indemnity.

More generally, the courts have underlined that claimants cannot expect to be able to keep their funding arrangements confidential in the face of such challenges. While this can cause difficulties, it also gives claimants an opportunity to demonstrate that they are backed by third-party funders who have independently assessed the case and believe it to be legitimate and likely to succeed.

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