

litigation lawflash

11 November 2014

English High Court Holds Litigation Funders Liable for Indemnity Costs

The court's decision will have wider significance for litigation funders, parties seeking funding, and their opponents.

On 23 October, the English High Court handed down its judgment in *Excalibur Ventures LLC v Texas Keystone Inc and others*.¹ The court ordered a number of funders—and in some cases, those funders' parent entities—to pay the defendants' costs on the indemnity basis. This will be a welcome development for opponents of funded parties. It will be less welcome for funders, for whom the decision highlights the need to conduct thorough due diligence before funds begin to flow.

Background

In 2010, the claimant (Excalibur) commenced proceedings against the defendants, claiming entitlement to interests in a number of oil fields in Kurdistan. Excalibur said that the value of those interests was roughly \$1.6 billion.

A number of entities (the Funders) provided funding for Excalibur to pursue the litigation. The Funders would receive significant financial gains if Excalibur was successful. The Funders contributed more than £30 million to Excalibur's legal costs and into court as security for costs over the lifetime of the proceedings.

In late 2013, the English High Court dismissed Excalibur's claim on all points. The court awarded costs on the indemnity basis,² to be assessed. Excalibur was ordered to make a \$17.5 million payment on account of costs to the defendants, which was paid immediately from funds already paid into court as security.

Excalibur was also ordered to pay a further £5.6 million into court as security for the defendants' costs, pending assessment. Excalibur did not make that payment, and the defendants applied to join the Funders to the proceedings.

Decision

The court held that the Funders, along with certain of their parent entities, were liable to pay the defendants' costs on the indemnity basis, subject to the following limits:

- No paying entity would be liable in costs for an amount greater than its total funding contribution (which included payments toward Excalibur's legal costs and payments toward security for costs).
- No paying entity would be liable for any costs incurred prior to making its contribution.

1. [2014] EWHC 3436 (Comm).

2. An order for indemnity costs in English proceedings typically allows a winning party to recover a greater proportion of its costs than it would otherwise recover under the "standard" basis for costs awards. In this way, orders for indemnity costs are used by the English court to penalise poor conduct.

The court left any issues of apportionment between the paying entities to be determined at a later date.

Wider Implications

The court's judgment provides valuable guidance as to cost consequences in funded cases. The key aspects of that guidance are summarised below.

Liability

The court applied principles summarised by Lord Brown in *Dymocks Franchise System (NSW) Pty Ltd v. Todd*³ that, where a “non-party not merely funds the proceedings but substantially also controls or at any rate is to benefit from them, justice will ordinarily require that, if the proceedings fail, he will pay the successful party's costs”. This is likely to be particularly true where a funded claimant is insolvent or financially insecure.

The court in *Excalibur* stressed the need to identify the “real party” to litigation. In many cases, this may be a funder who stands to gain significantly from a successful outcome. A funder will not be able to avoid costs liability on the grounds that it did not control the litigation or that it made funding contributions based on positive legal advice.

The Arkin Cap and Timing

The court drew on the Court of Appeal's decision in *Arkin v. Borchard Lines Ltd*,⁴ which held a professional funder liable in costs only to the extent of the funding it provided.

This “Arkin cap” seeks to balance the competing principles of (i) facilitating access to justice through litigation funding and (ii) ensuring that a funder who causes a defendant to incur costs is made liable for those costs.

Excalibur confirms that, absent dishonesty or impropriety on the funder's part, the Arkin cap will apply. This means that, as set out above, a funder's costs liability will be limited by reference to the total amount of its contribution.

In addition, the court (drawing on *Arkin* and other authority) held that a funder should not be liable for costs incurred prior to the time its contribution was made. This is because the funder's contribution must, to some extent, have caused an opponent to incur costs, and such causation will not normally arise before a funding contribution has been made.

Indemnity Costs

The court held that a funder “should, absent special circumstances, follow the fortunes of those from whom he himself hoped to derive a small fortune”. Accordingly, where a funded party is held liable for costs on the indemnity basis, any costs order made against a funder will generally also be made on that basis. The rationale behind this approach is to ensure that a party is adequately compensated in costs, irrespective of whether its opponent is professionally funded.

Funder Parent Entity Liability

It is not uncommon for funds to pass from a parent master fund to a subsidiary for onward transfer to a funded party. That subsidiary may have no or few assets and, thus, provide little prospect of recovery under a costs order. Aware of this potential injustice, the court stressed that it is entitled “to look to the economic realities” when

3. [2004] 1 WLR.

4. (Nos 2 and 3) [2005] 1 WLR 3055.

making nonparty costs orders. In circumstances where certain Funders' parent entities would have been the "ultimate beneficiaries of success", the court considered it appropriate to also make costs orders against those parent entities.

Comment

For funders, the case highlights the need to complete thorough due diligence prior to providing funding and the importance of building potential costs exposure into contingency planning and case risk models. For funders' clients, this may mean longer funding lead times and reduced access to funding (particularly in more speculative cases).

For opponents of funded parties, however, the case is good news. The case confirms that nonparty costs orders will normally be available against funders (and, in some cases, their parents) on the same basis as costs ordered against a funded opponent, albeit subject to the *Arkin* cap and timing limitations discussed above.

Contacts

If you have any questions or would like more information on the issues discussed in this LawFlash, please contact any of the following Morgan Lewis lawyers:

London

Nicholas "Nick" Greenwood	+44.20.3201.5570	ngreenwood@morganlewis.com
Peter Sharp	+44.20.3201.5580	psharp@morganlewis.com
David Waldron	+44.20.3201.5590	dwaldron@morganlewis.com

About Morgan, Lewis & Bockius

Founded in 1873, Morgan Lewis offers more than 1,600 legal professionals—including lawyers, patent agents, benefits advisers, regulatory scientists, and other specialists—in 26 offices across the United States, Europe, Asia, and the Middle East. The firm provides comprehensive litigation, corporate, transactional, regulatory, intellectual property, and labour and employment legal services to clients of all sizes—from globally established industry leaders to just-conceived start-ups. For more information about Morgan Lewis or its practices, please visit us online at www.morganlewis.com.

This LawFlash is provided as a general informational service to clients and friends of Morgan, Lewis & Bockius. It should not be construed as, and does not constitute, legal advice on any specific matter, nor does this message create an attorney-client relationship. These materials may be considered **Attorney Advertising** in some jurisdictions. Please note that the prior results discussed in the material do not guarantee similar outcomes. Links provided from outside sources are subject to expiration or change. © 2014 Morgan, Lewis & Bockius. All Rights Reserved.