HFW LITIGATION

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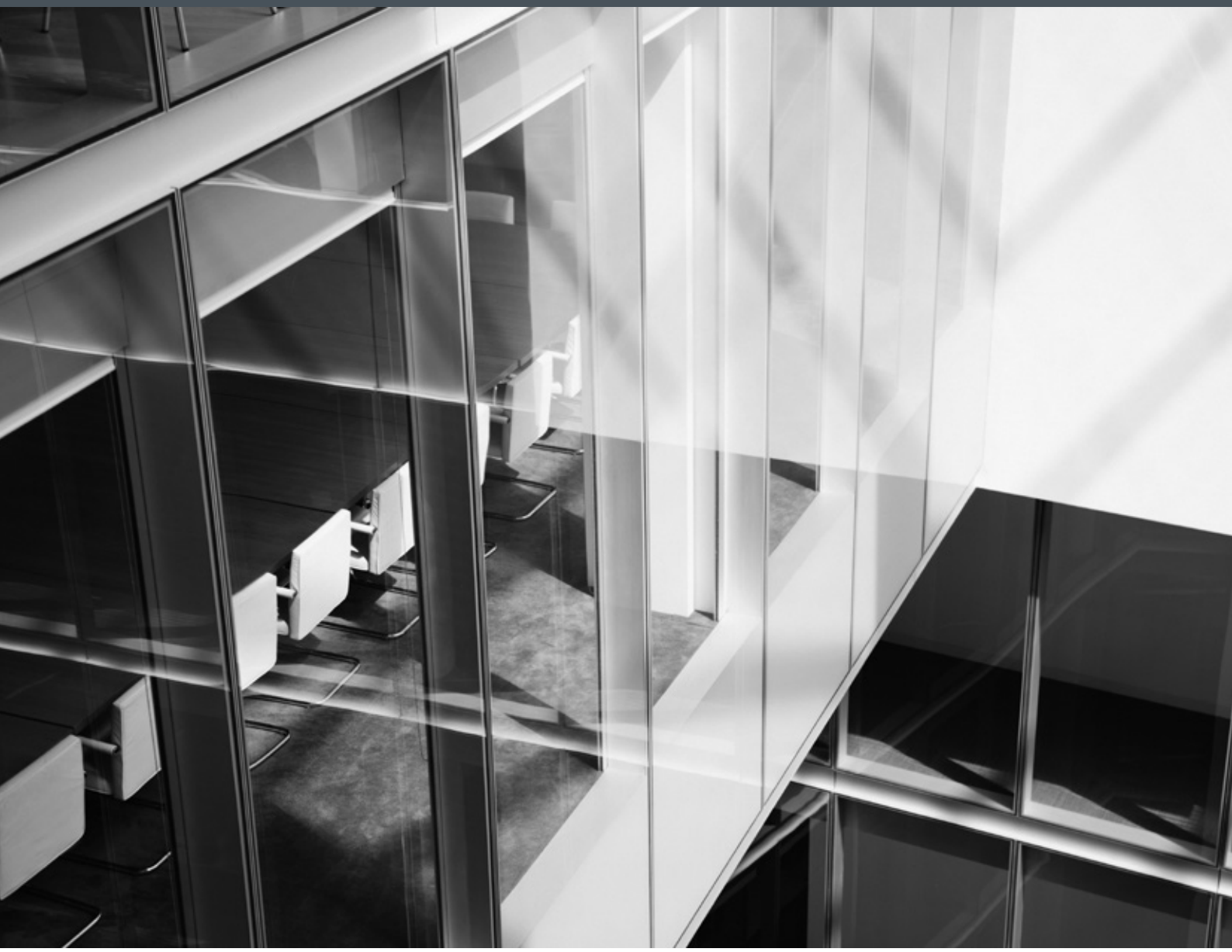

ENGLISH COURT OF APPEAL GIVES GUIDANCE ON WHEN DIRECTORS OF INSOLVENT COMPANIES MIGHT BE LIABLE FOR COSTS OF LITIGATION.

In a recent judgment[1], the English Court of Appeal gives guidance on when a non-party costs order will be made against directors or shareholders of an insolvent company engaged in litigation. The judgment will be of interest to all involved in insolvency based litigation.

1 Goknur Gida Maddeleri Enerji Imalet Ithalat Ihracat Ticaret Ve Sanayi AS v Aytacli [2021] EWCA Civ 1037

"The underlying litigation in this case concerned the quality of orange juice, arguably the case left an even more bitter taste for all concerned."

A snap shot of the courts' jurisdiction to make costs orders against non-parties

The jurisdiction of the English courts to order payment of costs by non-parties dates back to the 1980s and the (then) House of Lords' judgment in *Aiden Shipping v Interbulk Ltd (The Vimeira) (No 2) [1986]*[2], which saw the law head in a new direction, albeit cautiously.

The jurisdiction to award costs against non-parties is found in s.51(1) and (3) of the Senior Courts Act 1981 (s51 SCA81), which confers on the court the *"…..power to determine by whom and to what extent the costs are to be paid"*. This is supplemented by CPR 46.2(1), which references the courts' *"…power … to make a costs order in favour of or against a person who is not a party to proceedings"*.

Both s51 SCA81 and CPR 46.2 operate as part of the courts' overall costs discretion, and there is therefore no need to identify a cause of action to invoke the discretion. This is an important point, the consequence of which is that any argument seeking to resist the application as an alternative means of recovering against a non-party is likely to fail.

We have seen a number of key cases develop the principle. In 1993 the *Court of Appeal in Symphony Group Plc v Hodgson [1994]*[3] identified the types of case where exercising the non-party costs order discretion would be appropriate. The Privy Council in *Dymocks Franchise Systems (NSW) Pty Ltd v Todd anors [2004]*[4] then reviewed and refined the categories, which became a precedent for other English courts when it was adopted by the Court of Appeal in *Arkin v Borchard Lines Ltd anors [2005]*[5]. We then saw the Court of Appeal in *Deutsche Bank AG v Sebastian Holdings Inc anor [2016]*[6] confirm that Symphony offered guidelines, not rules.

Where are we now?

In summary, the cases to which s51 SCA81 or CPR 46.2 might apply are those where:

1. the case is exceptional: *"where parties litigate for their own benefit and at their own expense"*.
2. there is an element of control, for example where the non-party *"is the 'real party' to the litigation"*.
3. there is impropriety or the pursuit of speculative litigation.

In terms of the scope of these orders:

- It is not necessary for the non-party to be made exclusively liable for the costs, nor for all the applicant's costs.
- The amount of costs the non-party can be ordered to pay will no longer be limited to the amount of their funding: the *'Arkin Cap'* is no longer applied in all cases (see our briefing, which discusses this in more detail[7]).

The Court of Appeal judgment

The underlying litigation in this case concerned the quality of orange juice, arguably the case left an even more bitter taste for all concerned.

The applicant sought a s51 SCA81 non-party costs order against the respondent who was a director and shareholder of an insolvent company with whom the applicant was involved in litigation over the quality of the orange juice, and whom it argued controlled and funded the company's litigation. The s51 SCA81 costs order was refused at first instance.

The question before the Court of Appeal was:

"whether it is enough to show that the director controlled and funded the company's conduct of the litigation or whether, in order for a s.51 order to be made, it is also necessary to show either that [they] benefited (or sought to benefit) personally from that litigation, or acted in bad faith or was responsible for impropriety of some kind."

2 AC 965
3 QB 179
4 UKPC 39
5 EWCA Civ 655, see paras 36-37
6 EWCA Civ 23
7 https://www.hfw.com/downloads/001913-HFW-Litigation-Arkin-Cap-is-not-a-binding-rule-in-litigation-funding-March-2020.pdf

The Court of Appeal went on to uphold the first instance decision and dismissed the appeal, setting out the following requirements without which it will be difficult to persuade the courts that a non-party costs order is justified:

1. that the director/shareholder controlled and funded the company's conduct of the unsuccessful litigation; and
2. the director was seeking to benefit personally from the company's pursuit of or stance in the litigation, and/or
3. that they were guilty of impropriety or bad faith, which will be assessed at a high bar. The court will review the underlying litigation to help ascertain the behaviour of the parties and whether there is a causal link between that and the costs incurred.

What are the consequences of this judgment?

It is clear that the threshold for making a non-party costs order is high.

In the absence of either a personal benefit to the non-party, bad faith, or impropriety, which can be linked to an increase in the costs incurred by the parties, s51 SCA81 applications may struggle to succeed. However, where the criteria is met, they will be a powerful tool for successful parties to recover their (recoverable) costs from those financially supporting the case where the corporate involved is insolvent and the likelihood of any recovery from them is remote.

In giving the main judgment Coulson LJ gave a salutary warning, about the impact of costs in litigation, which by extension applies to Disputes generally: *"[f]or those who believe that most civil litigation does not end up being about the costs that were incurred in pursuing that same litigation in the first place, look away now."*

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