



LIQUIDATOR'S FIRM ORDERED TO PAY COSTS OF INSOLVENT COMPANY'S UNSUCCESSFUL LITIGATION

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Legal Briefings - By **Natasha Johnson and Andrew Cooke**

The High Court has ordered a liquidator's firm to pay a proportion of the costs incurred by successful defendants following judgment in proceedings commenced by a claimant company in liquidation. The court held that the liquidator's firm should not be made liable for all of the defendants' costs, but instead a sum equal to the amount of the claimant's costs which the liquidator's firm had funded, applying the so-called *Arkin* cap: [*Burnden Holdings \(UK\) Limited \(in Liquidation\) v Gary John Fielding* \[2019\] EWHC 2995](#).

As the liquidator explained to the court in this case, it is not uncommon for an officeholder's firm to provide funding to an insolvent company to which the officeholder has been appointed. This decision highlights the potential risks of doing so.

More generally, the judge's approach to determining the extent of the firm's liability for adverse costs provides useful guidance both to those funding a claim on commercial terms and to those defending a commercially funded claim. The factors considered by the judge in determining whether to apply the *Arkin* cap included whether the funder's prospective rate of return fairly reflected the risks that it took, which may be a matter of some concern to funders, though they may take comfort that the court considered the return in this case to be fair. Ultimately, the application of the cap will turn on the particular facts.

BACKGROUND

The claimant ("Burnden"), while in liquidation, brought proceedings against its former directors seeking recovery of an allegedly unlawful distribution made before Burnden became insolvent. Burnden's claim failed after a 12-day trial in the High Court. The judgment of Zacaroli J, summarised [here](#), considered in detail whether directors' liability for payment of an unlawful dividend is strict or fault-based. The judge held that liability is fault-based and that Burnden's directors were not at fault, having relied on appropriately skilled professional advisers when making the relevant distribution. The claimant has sought permission to appeal from the Court of Appeal.

When judgment was handed down, Zacaroli J ordered Burnden to pay the directors' costs of the proceedings but adjourned to a separate hearing the question of whether certain third parties were liable for costs. The parties subsequently agreed that the liquidator would be liable for 15% of the directors' costs. A commercial third party funder, Project Appledene PC ("Appledene"), which had funded the majority of the claimant's costs of the proceedings, also agreed to pay a significant proportion of the defendant directors' costs.

However, the parties were unable to agree whether the liquidator's firm, Griffins, should also be liable for the directors' costs.

The liquidator had been appointed in December 2012, at which point Burnden's potential claim against the defendants was the only material asset remaining in the liquidation. The judge found that the liquidator had sought out his appointment in order to manage the potential claim.

The liquidator caused Burnden to commence litigation against the directors in October 2013. The litigation was initially funded by Burnden's creditors, who also agreed to indemnify Burnden against adverse costs. Burnden's claim was struck out in November 2014. Burnden was ordered to bear the defendants' costs in the amount of £50,000. The creditors did not pay these costs and the liquidator chose not to pursue them under the indemnity.

Instead, the liquidator obtained funding from Griffins in order to pay the adverse costs and provide security for costs in relation to Burnden's appeal. The liquidator explained that he sought funding from Griffins because he was concerned that he had received negligent legal advice and did not wish the claim to fail as a result of that advice. While the claim was struck out, he was unable to obtain commercial third party funding. Griffins advanced funding on the basis that, if the proceedings were successful, it would be repaid its capital plus a return equal to the amount of its funding.

The appeal progressed. Griffins advanced further funding for Burnden's costs of the appeal. The creditors resolved that the liquidator would be entitled to additional remuneration in order to meet the liability to Griffins. The liquidator himself was entitled to remuneration equal to 50% of net recoveries in the litigation.

Burnden's appeal was successful, the strike out was reversed and its claim was restored in June 2016. The liquidator secured commercial litigation funding from Appledene, though Griffins advanced more funding in order to meet certain adverse costs orders made against Burnden. The total amount of Griffins' funding was approximately £500,000. Appledene funded approximately £1.35 million.

The trial was heard in March 2019. Burnden's claim failed. In the usual way, the defendant directors were entitled to their costs as the successful party. The directors argued that Griffins should be jointly liable for their costs, alongside Burnden, the liquidator and Appledene.

DECISION

The High Court (Zacaroli J) held that Griffins should be liable for the directors' costs in a sum equal to the amount of the funding it had provided to Burnden.

Under section 51 of the Senior Courts Act 1981, the court has the power to order a third party to litigation to pay a party's costs. The power will not generally be exercised against pure funders, being funders with no interest in the litigation, who will not benefit from it, are not funding it as a commercial enterprise and who do not seek to control the litigation's course. However, where the funder substantially controls the litigation or is to benefit from the litigation, it is more likely that the power will be exercised.

The judge held that Griffins was a commercial funder of the litigation. The liquidator had sought his appointment knowing that the potential claim against the directors was the only asset of the estate and that succeeding in the claim was therefore his only prospect of recovering his remuneration. Though the liquidator and Griffins were technically to be treated separately, Griffins stood to gain from the liquidator's remuneration (50% of net proceeds of the litigation) and its return on the funding advanced to Burnden.

The court then considered what proportion of the directors' costs Griffins should meet. The directors argued that Griffins should be liable for the entirety of their costs on the basis that, but for Griffins' funding, Burnden's claim would have remained struck out after November 2014 and the directors would not have incurred any costs defending the claim. The judge disagreed. From August 2017, the predominant cause of the proceedings being continued was the access to Appledene's funding. Even though Griffins retained its potential upside after August 2017, it should not be liable for costs incurred by the defendants in that period. The defendants had to look to Appledene for the costs they incurred while Appledene funded the claimants.

Griffins argued for a further reduction in its liability for costs based on the principle in *Arkin v Borchard Lines Ltd (Nos 2 & 3)* [2005] 1 WLR 3055, where it was held that a non-party to litigation who provides funding in a commercial capacity should be liable for the other side's costs only to the same extent as it had funded the costs of the unsuccessful party – a principle which has become known as the *Arkin* cap. It was accepted that the *Arkin* cap is not mandatory and can be disapplied in an appropriate case.

The directors argued that the *Arkin* cap should not be applied in this case because: (a) Griffins was entitled to a high rate of return; (b) Griffins' substantial commercial profit would have taken priority over the interests of the creditors; and (c) Griffins knew that Burnden could not pay any substantial adverse cost award without this funding.

Zacaroli J rejected the directors' submission, holding that Griffins' liability should be capped at an amount equal to the amount Griffins had funded (including amounts provided to pay adverse costs and security for costs) because:

- The rate of return on the funding contribution was a fair reflection of the credit risk taken by Griffins in providing interest free financing. The arrangements between Burnden and Griffins were not solely devised as a means of maximising financial gain. Though the liquidator was entitled to remuneration equal to 50% of the net proceeds of the litigation, this could not be taken into account when assessing the return which Griffins itself stood to make on its funding contribution.
- Griffins' funding was for the limited purpose of restoring the struck out claim so that funding could be obtained from another professional funder.
- Griffins had funded a successful appeal.
- The funding benefitted the creditors as well as the liquidator.
- The directors' total costs claim was over ten times higher than the total amount of the funding advanced by Griffins.
- The court was required to balance the entitlement of the defendant directors against the risk of discouraging funding which facilitates access to justice.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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