Editor's Note

New Rules for Costs Capping Orders: Feeding the Costs Litigation Frenzy?

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The one clear, consistent and persistent trend that has followed the introduction of the Civil Procedure Rules 1998 is the ever increasing volume of litigation over costs. It is generally accepted that the cost of litigation has substantially grown over the last decade. What is equally obvious, though insufficiently acknowledged, is the exponential rise in the opportunities for arguing over the incidence of costs and their amount.

Ten years into the life of the CPR one would have expected the law on costs to have been settled and well bedded. This is not however the case; the law of costs is far from being settled. It is in a constant flux. Indeed, the stream of legislative initiatives on costs has gathered even greater force recently and has resulted in a number of fresh provisions that are now being implemented. Two factors in particular have combined to establish and feed the ever increasing costs-litigation industry: the ever rising amounts of litigation expenditure and court discretion in determining who should pay and how much.

It all started with the idea, not unreasonable in itself, that the indemnity principle (or the "costs follow the event" principle, as it was better known prior to the CPR) should be modified so that costs orders could take into account other factors, such as the parties' conduct before and during the litigation process, and the extent of their success (whether in terms of recovery or success on particular issues) (CPR r.44.3). However, the factors of "conduct" and of the degree of success are open textured and dependent on fact-based value judgement. They therefore opened up new and fertile litigation opportunities.

For example, the effect of a refusal to participate in mediation has had to be considered by the Court of Appeal on several occasions. The Court of Appeal has produced guidelines for determining the reasonableness of such refusal. It held in *Halsey v Milton Keynes General NHS Trust* [2004] EWCA Civ 576; [2004] 4 All E.R. 920, that the reasonableness of a mediation refusal must be judged by reference to all the circumstances, including the following: (i) the nature of the dispute; (ii) the merits of the case (the fact that a party reasonably believes that he has a strong case is relevant to the question whether he has acted reasonably in refusing ADR); (iii) whether other methods of settlement have been attempted; (iv) whether the costs of the ADR would be disproportionately high; (v) delay in suggesting mediation which may have the effect of delaying the trial of the action; (vi) whether the mediation had a reasonable prospect of success. Clearly, a dispute over "reasonableness" may require good preparation and lengthy argument, creating further complexity and adding expense. Each of these guidelines can attract dispute and costly argument.

Other seemingly sensible innovations of the CPR had similar consequences. The requirement of proportionality in determining the amount payable under an order awarding standard costs is on the face of it sensible. The test of proportionality seems eminently desirable, for it is meant to discourage litigation expenditure that is out of proportion to the amount at stake or the importance of the issues. The basic test for assessing the amount of costs was, and still is, whether costs have been reasonably incurred and whether they are reasonable in amount (CPR r.44.4(1)). But where costs are calculated on the standard basis there is a further requirement: the court must "only allow costs which are proportionate to the matters in issue" (CPR r.44.4(2)(a)). In practice the test of proportionality has achieved little by way of rendering litigation expenditure more proportionate. But it has complicated the task of costs judges and has inevitably added to expenditure (see *Lownds v Home Office* [2002] EWCA Civ 365; [2002] 1 W.L.R. 2450).

Another seemingly sensible innovation was the requirement of costs estimates. These must be provided by solicitors to their clients and by parties to their opponents. The idea behind this requirement was laudable: to ensure that clients and parties are aware of the likely costs and the magnitude of the financial risks that they run; so that they may make informed decisions about the desirability of litigation; so that they can make provision for their expenses and, indeed, so that their eventual liability to costs may be predictable. In reality, none of these objectives have been achieved and the requirement of providing costs estimates has only added to expense and created scope for disputes (see *Leigh v Michelin Tyre Plc* [2003] EWCA Civ 1766; [2004] 1 W.L.R. 846; *Mastercigars Direct Ltd v Withers LLP* [2007] EWHC 2733 (Ch); [2008] 3 All E.R. 417).

To give costs estimates more teeth we now have the new CPR PD 6.5A which provides that if there is a difference of 20 per cent or more between the base costs claimed on detailed assessment and the costs shown in an estimate of costs filed by that party, the receiving party must provide a statement of the reasons for the difference with his bill of costs. And CPR PD 6.6 provides that costs estimates may be taken into account as a factor among others, when assessing the reasonableness and proportionality of any costs claimed. Furthermore, where there is a difference of 20 per cent or more between the base costs claimed by a receiving party and the costs shown in an estimate of costs filed by that party; and it appears to the court that the receiving party has not provided a satisfactory explanation for that difference; or the paying party reasonably relied on the estimate of costs; the court may regard the difference between the costs claimed and the costs shown in the estimate as evidence that the costs claimed are unreasonable or disproportionate. While it may be doubted whether these provisions will put a break on excessive costs, it is virtually certain that they would produce more litigation.

The legislation that provided the greatest amount of work for costs lawyers, the largest increase in litigation over costs, and of course the biggest overall expenditure, is the conditional fee agreement legislation. It resulted in many thousands of contested applications, in numerous appeals to the Court of Appeal, and several journeys to the House of Lords. Day by day the CFA system continues to excite debate and periodic legislative intervention. Some legislative initiatives, such as the replacement of the original Conditional Fee Agreement Regulations with a simpler set of rules, were intended to simplify the operation of the CFA system and thereby reduce the scope for litigation over compliance with the relevant rules. But such attempts have had limited success and disputes over CFAs continue to be frequent and expensive. Other legislative initiatives, such as the new CPR rr.44.3A and 44.3B, were designed to put an end to some of the worst excesses. But again, experience shows that practitioners find the temptation of increasing their rewards hard to resist and it is unlikely that this latest attempt will put an end to exploitative practices. The CFA system stands apart as a productive and self-perpetuating litigation industry capable of feeding, and even enriching, many.

English procedure must be unique amongst the major procedural systems in offering litigants a special procedure for litigating over costs where they have settled their substantive dispute without even commencing legal proceedings. The procedure is aptly named costs-only proceedings (CPR r.44.12A). And England must be unique in making provision, in the newly enacted CPR r.44.3C, for costs orders in respect of pro bono representation. Where a pro bono represented party has been successful, the unsuccessful party may be ordered to pay the costs, which the pro bono party would otherwise have been entitled to claim, to a prescribed charity. Again, the idea is sound, for there is no reason to exempt the unsuccessful party from costs liability where he would have had a right to recover his costs had the decision gone the other way. But one can be confident that this provision too will give rise to fresh kinds of disputes and litigation.

CPR Pt 36 was extensively modified. The new CPR Pt 36 regime came into force on April 6, 2007 (Civil Procedure (Amendment No.3) Rules 2006 (SI 2006/3435) r.7). One of the key changes concerns the test of when the protection of a CPR Pt 36 offer runs out. Under the old CPR r.36.20(1) the defendant's protection ran out when the claimant bettered the defendant's CPR Pt 36 payment into court. That is to say, the defendant was protected as long as the claimant did not obtain a judgment award that was higher than the defendant's payment in. This test had the advantage of certainty and put the result beyond argument. If the claimant obtained one penny more than the defendant's payment in, the claimant would have his costs, but not otherwise. The arrangement had of course the disadvantage that the defendant would lose the protection even if the claimant only beat the payment in by a tiny amount so that in reality he did not benefit from refusing the defendant's offer.

To remedy this defect the new CPR r.36.14(1) now provides that the defendant will lose his protection only if the claimant obtains a "more advantageous" judgment. This means that it is no longer the case that a claimant who obtained judgment for a sum higher than the offer would automatically recover his costs. The words "more advantageous" establish an open-textured test that requires the court to engage in a "more wide-ranging review of all the facts and circumstances of the case in deciding whether the judgment, which is the fruit of the litigation, was worth the fight" (*Carver v BAA Plc* [2008] EWCA Civ 412; [2009] 1 W.L.R. 113 at [30]). In addition to making the test more open to value judgement, the new rules also broaden the judicial discretion whether to apply it. CPR r.36.14(2) provides that the court will give effect to the costs consequences of the claimant obtaining a more advantageous judgment "unless it considers it unjust to do so", and CPR r.36.14(4) provides that in determining whether it would be unjust,

> "the court will take into account all the circumstances of the case including—(a) the terms of any Part 36 offer; (b) the stage in the proceedings when any Part 36 offer was made, including in particular how long before the trial started the offer was made; (c) the information available to the parties at the time when the Part 36 offer was made; and (d) the conduct of the parties with regard to the giving or refusing to give information for the purposes of enabling the offer to be made or evaluated".

Whether these changes will increase the rate of reasonable settlements and make the consequences of CPR Pt 36 offers more just remains to be seen. What is certain is that they have greatly complicated the task of determining the consequence of such offers and have created new opportunities for disputes, for further litigation and inevitably for incurring further costs.

The centrepiece of the latest legislative flurry concerns costs capping orders (CCO). The jurisdiction to make such orders has now become well established in public law litigation, where a CCO is known as a protective costs order (PCO) and where a fairly elaborate procedure has now been devised by the Court of Appeal (a matter discussed in the last issue, (2009) 28 C.J.Q. 161). The reason for making such orders available in public law litigation was explained in *R. (on the application of Corner House Research) v Secretary of State for Trade* [2005] EWCA Civ 192; [2005] 1 W.L.R. 2600 at [6], where the Court of Appeal said that the purpose of such orders,

> "is to allow a claimant of limited means access to the court in order to advance his case without the fear of an order for substantial costs being made against him, a fear which would inhibit him from continuing with the case at all".

Yet it is not only claimants in public law litigation whose access to justice is impeded by lack of means. Limited means deter any claimant unable to underwrite an open ended financial commitment for fear of losing the roof over his head or risking his family's welfare. It is therefore not surprising that attempts have been made outside the public law field to obtain CCOs. The jurisdiction to make such orders was acknowledged and asserted in *AB v Leeds Teaching Hospitals NHS Trust* [2004] EWHC 644 (QB); [2004] 2 F.L.R. 365. It was subsequently resorted to in *King v Telegraph Group Ltd* [2004] EWCA Civ 613; [2005] 1 W.L.R. 2282, in order to resolve the awkward tension between the conditional fee agreements legislation and the right to freedom of expression.

Unfortunately, although the court acknowledged the existence of the CCO jurisdiction, it also robbed it of much of its practical use by imposing an almost paralysing limitation on its exercise. It has been held in *Smart v East Cheshire NHS Trust* [2003] EWHC 2806 (QB) at [22], that a CCO will be made only where,

> "there is a real and substantial risk that without such an order costs will be disproportionately or unreasonably incurred; and that this risk may not be managed by conventional case management and a detailed assessment of costs after a trial".

Put simply, the jurisdiction is exercisable only where there is a real risk that the costs incurred by a litigant may get out of hand.

This means that a CCO could be made only in order to place a limit on the recoverability of prospective costs, not of costs already incurred. The trouble is that by the time costs have got out of control or have become wholly disproportionate, it would normally be too late to make a CCO since it could affect only subsequent expenses. It would therefore seem that the jurisdiction can only be invoked once the horse has bolted, by which time there is little point in closing the stable door, as is illustrated by cases such as *Henry v BBC* [2005] EWHC 2503 (QB); [2006] 1 All E.R. 154 and *Willis v Nicolson* [2007] EWCA Civ 199.

The limitation of the costs capping jurisdiction to cases where there is a risk of costs getting out of control is puzzling. It is a fundamental rule that only costs that have been reasonably incurred and that are reasonable in amount can be recovered; and in the case of standard costs they also have to be proportionate. Furthermore, we have a special judicial institution, the costs judges, to apply this rule, and an elaborate detailed assessment procedure is available to enforce compliance. It follows that no matter how much a successful party has spent, the court cannot order the unsuccessful party to pay more than reasonable and proportionate costs. Hence, by definition there is no room for abuse in the sense of being able to recover more than reasonable and proportionate costs (ignoring for the present discussion the effect that the success fee can have where the successful party has been represented on a conditional fee basis).

Conscious of the weakness of the principle that had hitherto governed the CCO jurisdiction, the Court of Appeal in the last mentioned case referred the matter to the Civil Procedure Rules Committee (CPRC) to decide whether to devise a different principle and introduce appropriate rules.

The CPRC, after a consultation process, approved changes to the CPR and Costs Practice Direction, which came into force on April 6, 2009. These are included in the new CPR rr.44.18–44.20. Sadly the new rules are, subject to a possible exception discussed below, largely an elaborate restatement of the present principle.

First, the rule effectively limits the jurisdiction to controlling future costs, leaving costs that have already been incurred outside its ambit:

> "44.18.—(1) A costs capping order is an order limiting the amount of future costs (including disbursements) which a party may recover pursuant to an order for costs subsequently made.
>
> (2) In this rule, 'future costs' means costs incurred in respect of work done after the date of the costs capping order but excluding the amount of any additional liability."

It follows that a CCO cannot in any way affect the recoverability of costs already incurred. Secondly, the rule takes care to exclude from its ambit protective costs orders, which continue to operate in public law litigation under the existing principles (CPR r.44.18(3)).

The key provisions are to be found in CPR r.44.18(4)–(5):

> "(4) A costs capping order may be in respect of—
> (a) the whole litigation; or
> (b) any issues which are ordered to be tried separately.
> (5) The court may at any stage of proceedings make a costs capping order against all or any of the parties, if—
> (a) it is in the interests of justice to do so;
> (b) there is a substantial risk that without such an order costs will be disproportionately incurred; and
> (c) it is not satisfied that the risk in sub-paragraph (b) can be adequately controlled by—
> (i) case management directions or orders made under Part 3; and
> (ii) detailed assessment of costs.
> (6) In considering whether to exercise its discretion under this rule, the court will consider all the circumstances of the case, including—
> (a) whether there is a substantial imbalance between the financial position of the parties;
> (b) whether the costs of determining the amount of the cap are likely to be proportionate to the overall costs of the litigation;
> (c) the stage which the proceedings have reached; and
> (d) the costs which have been incurred to date and the future costs."

The effect of CPR r.44.18(5)(b) and (c) is that in order to obtain a CCO a party will have to demonstrate a risk that costs would be disproportionately incurred and, furthermore, that notwithstanding their disproportionality they may well be recoverable on detailed assessment. This last requirement is bizarre for it requires a party to show that the costs judge responsible for detailed assessment would not be able to do what he normally does, which is to order the payment of only costs that are reasonable in amount, reasonably incurred, and proportionate (where costs are assessed on the standard basis). This alone is a pretty tall obstacle, which added to the need to show a risk of *future* costs getting out of control, would make it very difficult to obtain an order. And as if this were not enough of a deterrence, CPR PD23A.1 states that the "court will make a costs capping order only in exceptional circumstances", which makes one wonder whether the trouble of making new rules was worthwhile.

CPR r.44.18(6)(d) requires the court to consider the costs which have been incurred to date and the future costs in determining the risk of disproportionality. Consequently, a CCO application requires elaborate preparation of estimates of costs and disbursements (CPR r.48.19). The key consideration is, of course, not how much the applicant is spending but how much his opponent is. The applicant can only point to any estimates that the opponent has produced, which may not reveal the full potential of the opponent's spending. The court may therefore order the opponent to file a schedule of costs in the form set out in the Practice Direction supplementing the new rule, which could represent a demanding task. This would require a close examination of both parties' costs bills, which in cases of any complexity is going to be a labour intensive exercise. An application would therefore in effect amount to a detailed assessment of the costs long before the time at which it would be normally due.

Finally, even if the court does grant a CCO, the opponent is at liberty to apply for a variation under CPR r.48.18(7), though he would have to prove that there has been a material and substantial change of circumstances since the date when the order was made, or that there is some other compelling reason why a variation should be made. Both requirements are open ended and present ample opportunity for debate.

Given that the new rules effectively replicate the existing limitations on the jurisdiction there is a risk that the new rule would achieve no improvement in rendering costs more proportionate or predictable but would, on the contrary, feed the seemingly insatiable desire to litigate costs issues.

There is however one aspect of the new rule which represents a new idea and which may give the jurisdiction greater significance in the long run that appears at first sight. It is contained in CPR r.44.18(6)(a), which lists as a relevant consideration, "whether there is a substantial imbalance between the financial positions of the parties". This consideration can be interpreted in a number of ways. The boldest interpretation would be to take it as an indication that one of the purposes of the new rule is to redress substantial resource imbalance.

A substantial imbalance will be present where, for example, the claimant is able to commit large resources to the litigation process and shows an inclination to do so, while the defendant possesses narrow means and is therefore unable to match his opponent's investment. In such a case the claimant's show of financial prowess may deter the defendant from defending his rights, even if he has a strong defence, for fear of total ruin if judgment went the other way. Similarly, a claimant of limited means may be deterred from confronting a rich defendant who will rather exhaust the claimant by outspending him in the pre-trial process than face a trial on the merits.

If the provision were interpreted as intended to enable the court to redress resource imbalances between the parties, a financially weaker party should be able to fulfil the requirements of CPR r.48.18(5) in the following way. He could argue that: (a) a CCO is in the interests of justice because it will offer him access to justice; (b) there is a substantial risk that without such an order costs will be disproportionately incurred because of his opponent's willingness and ability to outspend him; (c) the imbalance is unlikely to be redressed by case management directions or by detailed assessment of costs because the applicant has insufficient resources to fight his determined opponent and would not be able to last the course to get to a detailed assessment.

If this interpretation were accepted then the new CCO rules may improve access to justice by enabling parties of limited means to seek an order that would at least set a limit to their financial exposure, without which they would have no meaningful access to justice. This interpretation effectively opens the possibility for the introduction of fixed cost litigation in at least some situations.

If this interpretation were not accepted, if the CCO jurisdiction remained as limited and as it has hitherto been, if the court limited the availability of such orders to exceptional circumstances, the jurisdiction would do little to protect litigants of meagre means from excessive costs. All it would achieve would be to further feed the costs litigation frenzy because the new rules open new opportunities for satellite litigation. The court has therefore a choice: to adopt a purposeful interpretation of CPR r.44.18(6)(a) and thereby pave the way to fixed costs litigation for those who cannot otherwise afford to litigate, or further feed the costs litigation frenzy which shows no sign of peaking.