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In this journal in 2015, I wrote on the subject 'Funding insolvency litigation: a new dawn', outlining various streams of funding available to insolvency practitioners (IPs) (see (2015) 5 CRI 183). Since then, the sun has set on one era and risen again. This article considers key developments in litigation funding in recent years, as well as upcoming reforms which may further change the landscape.

Key Points

- The Jackson reforms have now bitten on insolvency proceedings, meaning insolvency practitioners cannot recover the costs of conditional fee agreements and after the event insurance entered into after 6 April 2016.
- Unfortunately, the alternative funding models introduced by the same reforms have not been well used.
- However, there remains a range of options for funding insolvency litigation other than from the insolvent estate, with legal representatives, insurers, commercial funders and insolvency practitioners themselves coming up with innovative packages of funding.
Conditional fee arrangements (CFA)

One of the key means of funding insolvency litigation has historically been the CFA, which is a funding arrangement under which all or part of the legal fees and expenses incurred on a matter will be payable only if the claim succeeds. A full CFA is thus colloquially known as a 'no win, no fee' arrangement. The payoff is that, to offset the risk of not recovering their fees on an unsuccessful claim, lawyers will charge an uplift of up to 100% of their basic fees in the event of success (as defined in the CFA), known as the success fee.

CFAs are often used in conjunction with an after the event insurance (ATE) policy. In the case of a full CFA, if a claim is unsuccessful, the IP pays none of its own legal costs, and their successful opponent's legal costs and disbursements are covered by the ATE policy. If the claim succeeds, the IP pays its lawyers' basic fees plus the success fee and the ATE premium (which is often deferred until the outcome of the case). What historically made this funding combination even more popular was that a successful litigant could in principle recover both CFA success fees and ATE insurance premiums from their unsuccessful opponent, in addition to basic fees. CFAs backed by ATE therefore allowed IPs to commence proceedings without up-front costs, and eliminate the risk of an unsuccessful claim having to be funded out of the assets of the insolvent estate.

The landscape changed somewhat when the Legal Aid, Sentencing and Punishment of Offenders Act 2012 (LASPO) came into force, implementing many of the costs reforms proposed in Lord Justice Jackson's 2009 Review of Civil Litigation Costs. One of the effects was that in most civil proceedings, success fees and ATE premiums would no longer be recoverable from the losing party for CFAs and ATE policies entered into after 1 April 2013. Litigants could still obtain the costs protection of CFAs and ATE, and use them to defray (in the case of success) or defer (in case of loss) the payment of legal costs, but the costs of that funding could no longer be visited on their opponent.

There was, however, a carve out for certain types of proceedings, including insolvency proceedings, which were given a longer grace period where these funding costs would continue to be recoverable on an inter partes basis.

On 6 April 2016, the carve out for insolvency proceedings came to an end. For CFAs and ATE entered into on or after that date, the success fee and premium are no longer recoverable from an opponent. The costs of CFAs and ATE taken out before 6 April 2016 remain recoverable in principle, but this regime change does need careful consideration where changes in the litigation necessitate changes to a pre-April 2016 funding arrangement. While it is possible to amend the terms of a pre-April 2016 CFA, such changes may ultimately be closely scrutinised by a court to
ensure that they do not offend the principles introduced by the Jackson reforms. For example, while it is in theory possible to increase the level of a success fee payable under a pre-April 2016 CFA, a court may look critically upon a substantial increase, and may decline to allow recovery of the increased amount from an opponent.

While CFAs therefore remain available and are still a very popular means of funding insolvency proceedings, the new regime means that the costs of funding will now be for the insolvent estate's account, and thus ultimately reduce the recovery available to clients, creditors and victims.

After the event insurance (ATE)

Although the cost of obtaining ATE insurance is no longer recoverable from an unsuccessful opponent, ATE remains a valuable funding product for keeping litigation off the balance sheet. Further, other recent developments mean that, if anything, ATE is increasing in popularity.

In my previous article, I highlighted that IPs should pay close attention to the ATE policy exclusions and the circumstances in which the insurer could avoid cover. In 2017, the Court of Appeal considered the risk of avoidance in Premier Motorauctions Ltd & Anor v Pricewaterhousecoopers LLP & Anor [2017] EWCA Civ 1872. The court held that an ATE insurance policy in favour of the joint liquidators of insolvent companies was not adequate security for their opponent's costs, because there was a prospect that the insurers could avoid the policy in case of non-disclosure or misrepresentation by the insured. Around the same time, although not in an insolvency context, my colleagues successfully argued in Holyoake v Candy [2017] EWCA Civ 92 that an ATE policy which allowed for avoidance in the case of fraud by the insured could not provide adequate fortification of a cross-undertaking in damages.

In the last couple of years in particular, though, the market appears to have responded to those concerns, and ATE insurers are now addressing this by fortifying their policies with anti-avoidance language which makes clear they will be liable even in the event of non-disclosure, misrepresentation or fraud by their insureds, or by providing separate deeds of indemnity in favour of the insured's opponent in litigation. As such, properly drafted ATE policies can now be an answer to security for costs and similar applications.

Commercial funding

The professional litigation funding market has continued to develop in recent years and is now a
well-established source of funding with numerous market players looking to commit sizeable sums to suitable cases.

The abolition of recoverability of CFA success fees and ATE premiums has also gone some way to increasing the appeal of commercial funding, since a successful litigant will now have to pay its own cost of funding whichever method it chooses - whether that’s a CFA success fee, or a funder’s fee.

In broad terms litigation funding is now cheaper than five years ago. However, it is still a challenge in the medium value cases to make the economics work and, other considerations aside, insurance will usually still be the cheaper source of funding.

Funders tend to favour funding either a small number of high value cases where the returns can be high, or a large portfolio of lower value claims. The funder’s fee is also a much more flexible and variable than it used to be, with many models available.

Where the fee used often to be a multiple (usually three or four times) of the amount of funding provided, there are now many possible permutations, including multiples of amount actually funded; multiples of the amount the funder commits to fund (whether or not actually spent); a percentage of recoveries; or a combination of the above.

As the market has matured and become a more prevalent source of funding though, so too the court’s approach to professional funders has developed. In 2005, the nascent funding market was bolstered by the decision in *Arkin v Borchard Lines Ltd & Ors* [2005] EWCA Civ 655, in which the Court of Appeal held that a professional funder’s liability for adverse costs was capped at the amount of funding it provided (the so-called ‘Arkin cap’). This limit on funders' exposure helped to drive growth in the market. In recent years, though, the courts have been willing to expand the extent to which funders stand alongside their funded clients. For example, in *Excalibur Ventures LLC v Texas Keystone Inc & Ors* [2016] EWCA Civ 1144, funders were found jointly and severally liable with their insured for costs on the indemnity basis in litigation which the court found was unmeritorious and which had been waged 'as if it was an act of war'. While the funder sought to dissociate themselves from the client and their conduct of the litigation, the court found that funders are substantially invested in the outcome of litigation, and that they should follow the fortunes of those they fund - including where indemnity costs are ordered. In this case the funders' exposure was, however, still limited by the Arkin cap.

More recently in *Davey v Money & Anor* [2019] EWHC 997 (Ch) though, the court considered on the facts of the case it was not just to apply the Arkin cap to limit the funder's exposure, and that the funder should pay the defendant's costs on the indemnity basis, to be assessed if not agreed. The decision is understood to be under appeal.
Whilst there is a sizeable UK funding market, decisions such as these will no doubt mean that funders will be increasingly circumspect about the cases they fund, the funding they commit to them, and the control they exercise over the litigation.

**Damages based agreements (DBAS)**

In theory, LASPO took away with one hand but gave with the other. As a counterpoint to the abolition on recoverability of CFA success fees and ATE premiums, the implementation of the Jackson reforms also saw the legalisation of contingency fees (previously outlawed) in the form of DBAs.

Where a CFA provides that all or part of a lawyer's fees are payable only in specified circumstances, a DBA goes a step further by calculating the lawyer's fees as a percentage of the compensation actually received by the client (subject to a statutory cap of 50% of the sums ultimately recovered). This recoveries-based remuneration might be thought to be particularly well suited to insolvency proceedings.

For a variety of reasons, though, the uptake of DBAs by lawyers since 2013 has been low. First, there are very prescriptive statutory rules around what constitutes a compliant (and thus legal) DBA. A non-compliant DBA is unenforceable, and it is thought unlikely that a lawyer acting under a defective DBA would have a quantum meruit claim against its client, giving rise to a significant risk that a lawyer under a non-compliant DBA would get no recompense at all. This 'all or nothing' risk has left lawyers reluctant to use DBAs in preference to better established models like CFAs.

DBAs are 'all or nothing' in a second way too. With CFAs, it is possible to have either a full CFA ('no win, no fee') or a partial CFA ('no win, low fee') where only part of the lawyer's remuneration is conditional on the outcome of the case, while a proportion of fees are paid in any event or 'pay as you go'. Unlike with CFAs, it is not currently possible to have a partial or hybrid DBA, where only part of the lawyers' fees are subject to the DBA, with the remainder subject to some other payment arrangement.

Finally, the contingent payment is calculated net of costs which are recoverable from another party to the proceedings. This means that under a DBA the lawyer, rather than the client, bears the risk of non-payment of costs by other parties. These and other uncertainties about the operation of DBAs have meant low take-up to date.

Insurers have attempted to plug the gap and facilitate the take-up of DBAs by offering DBA insurance policies. Broadly speaking, these provide lawyers with cover for a proportion of their fees in the event of an unsuccessful case where no payment is due from the client under the
DBA. This innovation was anticipated to breathe new life into the DBA regulations, but it is still a work in progress and it will be interesting to see if it encourages DBAs to take off on a large scale.

Other options

Other options for funding include funding by the IP’s firms in return for a share of recoveries, funding from creditors (as opposed to unrelated third party commercial funding) and, ultimately, funding from the assets of the insolvent estate.

In practice, often two or more of the funding options outlined above are combined - some costs may be self-funded for instance, with others subject to a full or partial CFA, all backed by ATE insurance. Likewise where commercial funders are injecting funds into the litigation, they will commonly require the lawyers to act on a partial CFA to help align interests, and again ATE will typically be involved. In the current market therefore, funding can involve a complex portfolio of arrangements which may alter as the stages of litigation progress.

What does the future hold?

If the last few years have seen a shift in litigation funding, we can be sure that the next few will see further evolution in some areas, and perhaps more radical reform in others.

In the ATE insurance market, we are likely to see continued consolidation in the number of providers, following Fortress’s recent acquisition of Vannin Capital, and the merger between IMF Bentham and Omni Bridgeway.

After an apparently abortive attempt in 2015, there also appears to be renewed interest in making DBAs work. The DBA Reform Project 2019 is an independent review of the 2013 DBA Regulations by leading costs counsel Nicholas Bacon QC and Professor Rachael Mulheron of Queen Mary University of London. The project has recently published re-drafted regulations for consultation. The key reform proposals are as follows:

- Hybrid DBAs will be expressly allowed. In the event of an unsuccessful case, the lawyer will be able to recover a maximum of 30% of its incurred costs.
- The client under a DBA will pay recoverable costs in addition to the contingent DBA payment (rather than net of the recoverable costs).
- The maximum contingent payment for success will be reduced from 50% to 40%.
- The regulations contain default provisions re: the termination of DBAs, to resolve uncertainty in the 2013 regulations.
If those reforms are carried through, then it may well answer current criticisms from legal practitioners and mean that DBAs become a more mainstream funding alternative for insolvency litigation in future.

Conclusion

Although the sun has set on some aspects of an era of largely cost free litigation funding under CFAs and ATE, there are still numerous options for IPs looking to fund litigation other than out of the assets of the insolvent estate. Legal services providers, insurers, commercial funders and the IPs themselves are often working together to put in place a package of funding which uses the options outlined above to best advantage. It is to be hoped that reforms in this area open up further opportunities to assist IPs in obtaining maximum recoveries at minimal cost to creditors.