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Liability of third party funders in civil claims

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Litigation: The Supreme Court of the United Kingdom has granted permission for a final appeal. In a controversial ruling in February 2015, the Court of Appeal reversed a ruling of HHJ Waksman QC in the Mercantile Court. The Supreme Court will have to determine the nature of an obligation incurred where a solicitor's practice uses funding from a third party funder to enable its personal injury clients to pay for experts' reports and court fees. The Supreme Court will have to decide if this funding is an essential part of a solicitor's practice and thus covered by professional indemnity insurance; or whether it is a financial service and excluded from PII cover as being a trade debt on the insolvency of the solicitor's firm. Alex Bagnall, Associate and Costs Advocate of Just Costs, Solicitors in Manchester comments on the development in this case following the grant of permission to appeal on 20 May 2015.

Original news

Impact Funding Solutions Limited v. Barrington Support Services Limited (formerly Lawyers at Work Limited). AIG Europe Limited – Third Party UKSC 2015/0050
Supreme Court of the United Kingdom (Lords Mance, Clarke and Hodge)

In claims for industrial deafness, Impact provided funding to a solicitor's firms' clients to cover disbursements in their personal injury claims. That solicitor's firm had professional indemnity insurance from AIG. The solicitor's firm went into liquidation. The funder Impact sought to recover its losses from AIG under the insolvency provisions in the Third Parties (Rights against Insurers) Act 1930.

In the Mercantile Court, HHJ Waksman QC ruled [2013] EWHC 4005 (QB) that whilst Impact's claim was within the scope of the PII policy, AIG did not have to pay Impact because a provision in the PII policy excluded trade debts of the firm. This was reversed by the Court of Appeal on 3rd February 2015 [2015] EWCA Civ 31 when it decided that the funding arrangements here were inherently part of the solicitor's practice and were covered by AIG's PII policy. Permission for a final appeal has been granted to the Supreme Court of the United Kingdom on 20 May 2015. It will have to decide whether the Court of Appeal or HHJ Waksman was right on this.

What is background to this case? What are the key issues?

Impact Funding Solutions Limited (Impact) provided funding to a solicitors firm called Lawyers at Work Limited. This law firm changed its name to Barrington Support Services Limited (Barrington) on 7 April 2011. Barrington was operated by a solicitor called Graham Hughes. Barrington specialised in industrial deafness cases. Barrington took on clients on the basis of a "no win, no fee" conditional fee agreement (CFA).

As an incorporated solicitor's practice Barrington had professional indemnity insurance (PII) from AIG Europe Limited (AIG). AIG's former name was Chartis Europe Limited.

Impact provided funding to Barrington for disbursements such as court fees. Impact provided loans to Barrington for these disbursements. Impact had funding by way of a line of credit of £5million from the Manchester Building Society and £750,000 from its shareholders. Impact operated a claims database called Veracity. Data was put on Veracity by various claims management companies (CMCs).

Barrington had entered into two separate Disbursement Funding Master Agreements (DFMA) with Impact. Under condition 6 of the DFMA Barrington agreed it would comply with all applicable laws, regulations and codes of practice and would indemnity Impact against all loss, damages, claims, costs and expenses. Under condition 13 of the DFMA Barrington warranted to Impact that the services to be provided to its clients would be in accordance with the client CFA.

Barrington was meant to verify information on Veracity before taking on a new client. Impact's instructions were that Barrington was not to take on a claim unless it had prospects of success of either 51% or 55%. Barrington's clients signed a loan agreement with Impact for the disbursement funding and a proposal form for the legal expenses insurance. The Barrington claims did not go to plan. 174 cases were abandoned by Barrington. Two cases went to trial, Barrington lost both and adverse costs orders were made.

Impact suffered losses of £581,353.80. Barrington was placed in liquidation on 11 July 2011.

Under section 1 of the Third Parties (Rights against Insurers) Act 1930 (the 1930 Act) where under any contract of insurance a person is insured against liabilities to third parties which he may incur, in the case of a resolution for voluntary winding up being passed, his rights against the insurer shall be transferred to and vest in the third party. Impact accordingly sought to recover its losses from Barrington's PII insurer, AIG.

AIG denied liability to Impact on two bases. Firstly that Barrington's PII did not cover this situation at all. Secondly that, even if it did, AIG's liability was excluded because this was a trade debt of Barrington.

What did HHJ Waksman QC in the Mercantile Court decide?
On 30 May 2013 following a trial between Impact and Barrington, HHJ Waksman QC gave judgment in favour of Impact for £581,353.80. There was then a second trial to determine what, if any liability, AIG had to Impact under the 1930 Act. Impact was able to prove in Barrington's liquidation and it could also pursue individual clients of Barrington for unpaid disbursements under the client loan agreements with Impact.

Under Barrington's PII policy, AIG agreed that it "will pay on behalf of the insured all loss resulting from any claim for any civil liability of the insured which **arises from** the performance or failure to perform legal services". Clause 6 of the PII policy excluded liability for trade debts by providing that AIG would not cover any claim or loss "arising out of, based upon or attributable to any trading or personal debt incurred by an insured".

The trial between Impact and Barrington proceeded on the basis of agreed facts.

On the first issue, HHJ Waksman had to determine if Impact's loss "arises from" Barrington's performance or failure to provide legal services. There is a careful analysis of a number of authorities by HHJ Waksman in his judgment. In *Omega Proteins v Aspen Insurance* [2011] Lloyd's Rep IR 183, Christopher Clark J set out how a court should determine the proximate cause in an insurance dispute. He held that:

- An insured must establish it has suffered a loss,
- The loss must be within the scope of the policy, and
- It is open to an insurer to dispute that an insured was in fact liable.

In *Goddard & Smith v Frew* (1939) 65 LILR 83, rent collected by an estate agent was stolen by its employee. A claim against its PII failed because it was held to be outside the scope of the cover provided. Similarly in *West Wake Pine & Co v. Ching* [1956] 2 Lloyd's Rep 618 a claim against an accountant's PII insurer was dismissed because it depended upon dishonesty and the PII covered only unmixed claims in negligence.

HHJ Waksman found that the proximate cause of the loss was Barrington:

- Failing to scrutinise the claims,
- Wrongly using the disbursements provided by Impact, and

- Failing to obtain valid after the event (ATE) insurance on behalf of its clients.

In *Sutherland Professional Funding Ltd v Bakewells (A Firm)* [2013] Lloyd's Rep IR 93, HHJ Hegarty QC sitting in the Manchester Mercantile Court had to decide a similar claim against a PII insurer to that which Impact was making here. Judge Hegarty ruled on the hearing of a preliminary issue that a firm of solicitors could not claim an indemnity against its PII insurers for a claim made against it by a finance company which provided interim funding for personal injury litigation. This was because the claim did not arise from any neglect, omission or error of a solicitor and so was not within the scope of the PII policy.

Although HHJ Waksman distinguished *Sutherland* on its facts, he did rule that the proximate cause of Impact's losses was Barrington's breach of conditions 6 and 13 of Impact's DFMA with Barrington. Impact accordingly succeeded on the first issue before HHJ Waksman.

However, Impact failed on the second issue. In *Sutherland*, HHJ Hegarty had ruled that the claim against the PII insurer fell squarely within the debts and trading liabilities exclusion in the PII policy. AIG submitted this was correct and that Impact's claim here was also excluded by a trade debts exclusion clause in very similar terms. HHJ Waksman agreed and said that looked at realistically and commercially, Impact was providing a financial service to Barrington. Accordingly HHJ Waksman dismissed Impact's claim against AIG under the 1930 Act.

What did the Court of Appeal decide on the first appeal?
The Court of Appeal over ruled HHJ Waksman in a judgement handed down on 3 February 2015: [2015] EWCA Civ 31; [2015] All ER (D) 31 (Feb). In a short ruling which is disappointingly quite thin on analysis, Lord Justice Longmore said simply that you stand back from all the detail of the scheme and ask what is the essential purpose of clause 6 of AIG's PII policy.

Longmore LJ ruled that obligations arising out of loans made to cover disbursements in intended litigation were essentially part and parcel of the obligations assumed by a solicitor in respect of his professional duties to his client, rather than obligations personal to the solicitor. As an example of an excluded personal debt Longmore LJ said that if a solicitor incurred a liability to the supplier of a photocopier, then PII insurers would not cover that liability.

However Longmore LJ said the Impact loans to Barrington's clients were inherently part of its professional practice and were assumed, as an essential part of its duty to advise the client as to the likelihood of success in the intended litigation. Liabilities incurred by reason of the DFMA were liabilities professionally incurred to which the exception in the insurance policy did not apply. Accordingly, judgment would be entered against AIG insurer for the sum for which Barringtons firm had been found liable together with interest.

There is no consideration in Longmore LJ's ruling as to whether HHJ Hegarty was correct in *Sutherland* or not. It is clear that Longmore LJ was influenced by the fact that legal aid had been withdrawn for personal injury cases and had been replaced by CFAs and ATE insurance.

The only point that did seem to trouble the Court of Appeal was whether any VAT cases were of assistance. One of these was a Supreme Court case (*HMRC v Amai Coalition Loyalty UK* [2013] UKSC 15) and the other is a Court of Appeal one (*Airtours Holidays Transport Ltd v HMRC* [2014] EWCA Civ 1033). Neither Impact's nor AIG's counsel could tell the Court of Appeal whether Barrington paid any VAT on the administration or quarterly monitoring fees it had to pay to Impact. In the end, Longmore LJ said the VAT line of authority was not helpful on the essential issue in this case.

What will be the issue on this final appeal?
The Supreme Court will have to decide whether:
- the Court of Appeal's broad brush approach was correct, or
- if the rulings of HHJ Waksman in this case and HHJ Hegarty in *Sutherland* were correct instead.

Applying the ruling of Longmore LJ he found that the obligation assumed by Barrington was a "professional debt" of the solicitors and so was neither a "trade debt" (excluded by condition 6 of the

PII policy) nor a personal debt. It seems that this other category of "professional debts" are those assumed by a solicitor as an essential part of his duty to his client. On its face this would appear to apply to a wide range of disbursements. There are numerous issues with this. Would a contractual obligation on a solicitor to pay counsel's fees be a "professional debt"? If not, why not? It requires an extremely purposive construction of AIG's exclusion clause to find this 3rd category of debts which is neither trading nor personal, which is not mentioned in the PII policy itself but was not intended by AIG to be excluded.

The Supreme Court will have to decide too if Barrington received a benefit under the Impact agreement. Both Judge Waksman at first instance in this case and Judge Hegarty in Sutherland found that a benefit was received by the solicitors firm each time a loan was drawn down. This point was not dealt with in any satisfactory manner by the Court of Appeal.

As Lady Justice Gloster raised the VAT point during an intervention with counsel in the course of the Court of Appeal hearing, the Supreme Court is likely to have to look at the various supplies that were made, how they were treated for VAT and whether this has any bearing on the liability of AIG.

When will this case come on for hearing?
This case has not been expedited. An appeal is likely to come on for hearing towards the middle of 2016.

What will be the implications for costs recovery in civil litigation?
The wording of funding schemes inevitably differs. Here it was clear that Impact had relied on assurances from Barrington as to what it was doing on individual cases. It did not seem that Impact audited what had been done even when its exposure became high. It is worth noting that no defects were found in any of the scheme documentation. This is reassuring for solicitors who are using similar schemes to fund other cases on a CFA basis. The biggest shock as things stand now will be for PII insurers who effectively stand as guarantors of funding shortfalls where there is an insolvency in the practice of a solicitor or other insured professional.

What should lawyers do next?
This is clearly quite a finely balanced case. From a PII insurer's perspective there is a line to be drawn as to which liabilities are attributable to trade or personal debts of the practice of a solicitor or other insured professional and thus excluded from PII cover.

If Impact succeed in having the Court of Appeal's ruling upheld, this is likely to mean higher PII premiums for solicitors and other insured professionals. We are also likely to see amendments to standard PII policy wording whatever the outcome of the ruling by the Supreme Court.

Finally, an enlarged panel of the Supreme Court of the United Kingdom heard arguments in February 2015 in the case of *David Coventry t/a RDC Promotions v. Lawrence & Shields and others* UKSC 2012/0076. Judgment in that case has been reserved. This case concerned the validity of pre 2013 CFAs and the recoverability of ATE insurance. It remains interesting times for costs lawyers in civil litigation.

Interviewed by David Bowden.

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