Non-party costs order against insurers

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Dispute Resolution analysis: In what circumstances can a court make a non-party costs order against an insurer under section 51 of the Senior Courts Act 1981 (SCA 1981)? David Bowden, freelance independent consultant, notes the submissions made to the Court of Appeal on 10 December 2015 in Legg & others v Sterte Garage Ltd & Aviva UK Ltd and talks to Alex Bagnall, associate and costs advocate of Just Costs Solicitors in Manchester about the implications for lawyers.

Original news

Legg, Taylor, Lee, Porter & Dorey v Sterte Garage Ltd & Aviva UK Ltd A2/2014/1884

The Court of Appeal has heard submissions and reserved judgment in this case. Claims were made against Sterte Garage alleging environmental damage caused by oil leaks from its premises. Initially Aviva provided cover to the garage. The claims were amended. Aviva declined to provide further cover and the garage went into liquidation. A Deputy District Judge made a non-party costs order in favour of the claimants against Aviva. Aviva appealed against this ruling to the Court of Appeal.

What is the significance of this case?

David Bowden (DB): SCA 1981, s 51(1) provides that 'subject to the provisions of this or any other enactment and to rules of court, the costs of and incidental to all proceedings in…shall be in the discretion of the court'. Further, SCA 1981, s 51(3) provides that '[t]he court shall have full power to determine by whom and to what extent the costs are to be paid'.

It is the SCA 1981, s 51(3) provision that gives a court power to make a costs order against a person who was not a party to the proceedings (a non-party costs order). In the County Court, the judge, in the exercise of his discretion under SCA 1981, s 51, made a non-party costs order against an insurer who had initially provided cover and had then withdrawn it.

The insurer submitted that the judge fell into error as the effect of his ruling is to make the insurer a guarantor of the insolvent car dealer's costs. If the Court of Appeal endorses the ruling below then this may have the effect that non-party costs orders may be easier to obtain against insurers. If this happens then this will affect the costs of premiums for a large range of insurance policies.

What are the facts?

DB: Substantial quantities of diesel leaked from Sterte Garage's premises in 2003. This diesel leaked into a number of houses in Sterte Road, Poole. This caused contamination and the residents noticed smells coming from their gardens. Poole Borough Council investigated and:

- concluded there was serious danger to the residents' health
- evacuated the residents
- replaced the floors in the residents' houses, and

- installed special membranes to prevent the entry of diesel particulates

The residents claimed a 21% diminution in value to their homes.

Poole Borough Council told the residents that the source of the pollution was an above-ground storage tank at Sterte Garage that had failed suddenly in 1997 or 1998, leaking hundreds of litres of diesel into the soil. This was confirmed by the fire brigade, Atkins (who were instructed by the council to prepare a report) and by employees of Sterte Garage.

The residents instructed solicitors who sent an initial letter before claim in November 2004. The ownership of the garage subsequently changed hands. The garage said its insurers were Norwich Union (as Aviva was formerly known). In February 2005, the residents' solicitors sent a letter before claim to Aviva. In March 2005, Sterte Garage's then solicitors claimed in correspondence that it was possible that the spillage had occurred as a result of a leakage during a delivery of diesel.

In May 2005, Questgate wrote to the residents' solicitors saying it had been appointed by Aviva to act as loss adjusters. It asked for evidence of a causal link. This evidence was produced by the residents. In November 2005, Aviva stalled saying it was 'unable to comment on the legal liability of Sterte Garage at the present time'. It also said its enquiries were limited to ascertaining if Sterte Garage was entitled to indemnity under its insurance policy terms.

In February 2006, the residents' solicitors wrote to Aviva asking them to nominate an address for service of proceedings. In response, Aviva said it was still considering the issue of liability. Aviva then hardened its position and in September 2006 wrote back claiming that 'on balance, the incident in August 1997 is not the source of damage'. Aviva said damage was not covered by the policy and that it would not be providing an indemnity. Aviva wrote to the residents' solicitors in July 2008 informing them that it had instructed Berrymans Lace Mawer LLP (Berrymans) to accept service of proceedings on Aviva's behalf.

Proceedings were issued in Bournemouth & Poole County Court in November 2008 and Aviva filed a defence in January 2009 alleging for the first time that the spillage was a result of vandalism. A request for further information about this allegation did not cast any clarity on it. The case was allocated to the multi-track. In July 2009, Sterte Garage issued an application to strike out the residents' claims and for summary judgment in the alternative. The residents instructed their own environmental consultant (Mr Firth) who produced an expert's report for them. Mr Firth's report revealed that the scale of pollution was larger than originally thought involving 20,000 litres of diesel. He also said that there had been a second source of contamination from defective underground pipes at Sterte Garage's premises.

In July 2010, Deputy District Judge Baehr dismissed Sterte Garage's application and ordered it to pay the residents' costs. The residents were granted permission to amend the claim to include this second source of contamination. In September 2010, Berrymans sent a £7,500 cheque to the residents' solicitors as a payment on account of these costs. Sterte Garage then took no further steps in the action. Judgment was obtained against Sterte Garage in October 2010 in default of filing an amended defence. In December 2010, Berrymans came off the court record as acting. On 7 January 2011, a resolution was passed to wind up Sterte Garage and a liquidator was also appointed.

In April 2011, District Judge Hurley gave judgment for the residents, assessed damages and ordered Sterte Garage to pay the costs of the action. In December 2011, the court issued a default costs certificate in the residents' favour for £85,450.19.

What ruling did Deputy District Judge Coppen give?

DB: In July 2013, the residents applied to join Aviva as a party to the action and for a non-party costs order against Aviva. In November 2013, Aviva applied for its costs against the residents from December 2008 onwards. These applications were heard at a one-day hearing on 13 February 2014. DDJ Coppen handed down a written reserved judgment on 23 May 2014 (unreported—claim number: 8PH04003).

Deputy District Judge Coppen ruled that Sterte Garage had the benefit of a public liability policy with Aviva which specifically provided indemnity for non-gradual pollution (and expressly excluded an indemnity for nuisance caused by gradual pollution). Under clause 11 of the policy, Sterte Garage agreed to let Aviva do whatever it needed to do in Sterte Garage's name in order to safeguard Aviva's interest. Section E of the policy provided for payment of claimant's legal costs for which Sterte Garage is legally liable.

Deputy District Judge Coppen found that Aviva had been engaged with the claims since February 2005. Sterte Garage had been in a precarious position financially from the start of the matter. Aviva had appointed loss adjusters and Berrymans to act for it. Deputy District Judge Coppen found that Aviva effectively withdrew on 7 September 2010 when Berrymans wrote advising that Aviva had decided the claim was not covered by the policy. Deputy District Judge Coppen ruled that the fee (£5,200) for the residents' expert's report was incurred in defending Sterte Garage's unsuccessful application and was recoverable.

Deputy District Judge Coppen rejected Aviva's submission that the residents had never proved that the nuisance was caused by non-gradual pollution. He ruled that judgment was entered on the residents' pleaded case which included non-gradual pollution. The judge said that if Aviva had wanted to take the points now raised it could have done so by amending its defence but it chose not to do so. The judge said that in September 2010 the residents added a further allegation of pollution and Aviva still faced the original pleaded allegation of non-gradual pollution. The judge said Aviva:

- had taken a view on the case before a trial on the issues
- had unilaterally withdrawn their support when the pollution issue was still live
- was now asking the court to conclude the residents had failed to establish their non-gradual pollution claim

However, the judge said it was not appropriate to go behind the judgment made.

The judge ruled that he was satisfied that judgment was entered for the residents on the basis of their pleaded claim which did establish the pollution was caused by the failure of Sterte Garage's above ground tank.

Section 1 of the Third Parties (Rights Against Insurers) Act 1930 (TP(RAI)A 1930) provides:

> '1(1) Where under any contract of insurance a person…is insured against liabilities to third parties which he may incur, then—
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> [...]
>
> (b) in the case of the insured being a company, in the event of a winding-up order being made, or a resolution for a voluntary winding-up being passed, with respect to the company […] if, either before or after that event, any such liability as aforesaid is incurred by the insured, his rights against the insurer under the contract in respect of the liability shall, notwithstanding anything in any Act or rule of law to the contrary, be transferred to and vest in the third party to whom the liability was so incurred.'

Deputy District Judge Coppen ruled that the requirements of TP(RAI)A 1930 were met. He also ruled that he was persuaded that the application for a non-party costs order succeeded because Aviva:

- took over the defence of the action
- determined the claim would be contested
- funded the defence of the claim up to September 2010
- had effective conduct of the litigation for Sterte Garage and conducted the litigation for its own benefit

Accordingly, Deputy District Judge Coppen:

- dismissed Aviva's application
- granted the residents' application
- ordered Aviva to pay the costs of the application, and
- refused permission to appeal

What were the issues the Court of Appeal was asked to address?

DB: On 25 July 2014, Aviva was granted permission to appeal on the papers. Broadly, the Court of Appeal was invited to overturn the judgment below on the basis that the requirements for a non-party costs order in SCA 1981, s 51 were not met. Alternatively, that the judge below was wrong to exercise his discretion to make a non-party costs order. There were competing versions of chronologies of events in the litigation provided to the Court of Appeal. The residents were at pains to point out that there was an information vacuum and they did not know the terms of the Aviva insurance.

What does the appellant insurer say?

DB: Aviva changed counsel for the appeal and instructed Mr Michael Kent QC of Crown Office Chambers to lead.

Aviva submitted that it never intended to defend the long term pollution claim but only intended to defend the 'sudden incident' defence. Aviva submitted that the approach of the judge below represented a new departure or novel extension for the non-party costs order regime in SCA 1981, s 51. It said the residents had assumed that Sterte Garage would cave in without a fight. Mr Kent submitted that just to look at the pleadings in the case did not grapple with the SCA 1981, s 51 issue and that Aviva could only start to be liable for costs under SCA 1981, s 51 if its conduct had been causative of any costs. Mr Kent was keen to stress in his reply that there had not been a contested trial on liability as such and that an application for a non-party costs order simply glosses over this distinction.

Aviva repeated its submissions made below that there was no basis to make a non-party costs order because:

- the allegation of nuisance arising from the 1997 incident has never been proved and it would be unjust to award costs against Aviva
- Aviva made it clear throughout they had concerns on causation and were reserving their position as to whether there was liability to indemnify
- the residents would have incurred costs whether or not Aviva was involved
- the residents could have joined Aviva into the proceedings to determine the issue of whether there was liability under the policy
- the residents gave no notice to Aviva they may seek a non-party costs order, and
- there had been some unexplained delay

Do any prior authorities on non-party costs orders have any bearing on this case?

DB: The leading case on non-party costs orders is one from the Privy Council (*Dymocks Franchise Systems (NSW) Pty Ltd v Todd* [2004] UKPC 39, [2005] 4 All ER 195). Lord Brown ruled that where a non-party promotes and funds proceedings by an insolvent company solely or substantially for his own financial benefit, he should be liable for the costs if his claim or defence or appeal fails. Lord Brown stressed these three criteria:

- although costs orders against non-parties are to be regarded as 'exceptional', the ultimate question is whether in all the circumstances it is just to make the order
- the discretion will not be exercised against 'pure funders' being those with no personal interest in the litigation, who do not stand to benefit from it, are not funding it as a matter of business, and in no way seek to control its course, and
- where a non-party not merely funds the proceedings but substantially also controls (or at any rate is to benefit from them) justice will ordinarily require that, if the proceedings fail, he will pay the successful party's costs—the non-party in these cases is the 'real party' to the litigation

What do the claimant residents say?

DB: The residents instructed Mr John Ross QC of 1 Chancery Lane chambers to lead the junior who appeared below for them. Broadly, the residents submitted that the approach of the judge below was unimpeachable—that SCA 1981, s 51 gives the court an unfettered discretion and that the judge below properly exercised that discretion on the facts.

Mr Ross in his submissions referred to prior case law on SCA 1981, s 51 including *Dymocks* which the Court of Appeal will have to follow. His submission was that Aviva had substantially controlled the litigation and thus fell squarely within Lord Brown's tests in *Dymocks*. Mr Ross submitted that Aviva was the real party in this case.

Mr Ross referred to *Chapman (TGA) Ltd v Christopher* [1998] 2 All ER 873 where Philipps LJ considered a submission that public policy requires that insurers should not be rendered liable to costs. The insurers said a claimant must take his defendant as they find them. Where a defendant is impecunious, they are nonetheless entitled to defend the claim. Where they do so, a claimant will not recover their costs. A defendant with only limited funds is entitled to use all those funds in conducting their defence, even though this will deprive a claimant of the fruits of success in the litigation. The insurers submitted that a claimant should not be in a better position because the defendant is insured, but this submission was rejected as the Court of Appeal said this argument begs the question and the basis upon which the claimants sought a costs order against the insurers is that, in reality, it is the insurers rather than Mr Christopher who was the defendant.

Mr Ross also referred to *Excalibur Ventures LLC v Texas Keystone Inc* [2014] EWHC 3436 (Comm), [2014] All ER (D) 300 (Oct) where the Commercial Court found that a Mr Lemos stood to gain a very large sum if Excalibur won. Excalibur valued its interest in an oil field at $1.481bn. Mr Lemos stood to gain about £308m–£320m—a return of around 1,450% on his investment. Not only was a non-party costs order made, but this was made on the indemnity basis because 'the pursuit of objectively hopeless claims which required much time, labour and expense to refute is itself a ground for indemnity costs both against the litigant and his funder'.

What interventions did the judges make? What points seem to be troubling them?

DB: In one pithy exchange, Gloster LJ challenged Mr Kent that Aviva were not seeing off this claim. Gloster LJ also remarked that Aviva's solicitors had filed the defence in the name of Sterte Garage. Gloster LJ was also clear that there was no assertion that the pollution damage to the residents' houses had not been caused in any other way to that alleged in the pleadings. Sales LJ intervened to say that the damage had been caused by the same event. Gloster LJ said points in relation to the Latent Damage Act 1986 were bad points.

Gloster LJ challenged Mr Ross that she could not see why the residents should get their costs after December 2010, but Sales LJ thought the amount of those costs was minimal.

Gloster LJ said that absent an intervention by the insurers, Sterte Garage would not have required the residents to go to a hearing because it had no protection and was insolvent. Gloster LJ said Sterte Garage would have read Mr Firth's expert's report. Sales LJ in one exchange said that the appeal could only succeed if the judge below was wrong in the evaluative judgment he made. Sales LJ also remarked in construing section E of the Aviva policy that a policyholder has to go on litigating the claim unless the insurer gives consent in writing to settling the claim.

In an exchange with Mr Kent during his reply, Gloster LJ intervened to say that the point they had to decide was whether the case would have been dealt with any differently but for Aviva's involvement. Gloster LJ said that the case could have evolved in all sorts of ways. Sales LJ interjected that Aviva knew that if this claim was outwith the policy that Sterte Garage would go into liquidation.

What lessons can dispute resolution practitioners learn from this case?

DB: While SCA 1981, s 51 confers an unfettered and broad discretion on a court in relation to costs, the difficulties in obtaining a non-party costs order under SCA 1981, s 51(3) should not be underestimated.

In *Adris v Royal Bank of Scotland (Cartel Client Review Ltd, additional parties)* [2010] EWHC 941 (QB), [2010] All ER (D) 156 (May), HHJ Waksman QC determined a non-party costs order application. Cartel Client Review Limited was insolvent and a non-party costs order against it would have been pointless. The banks tried to get a non-party costs order against its director, Carl Wright, on the basis he was the real party behind the claims. Under intensive cross-examination, Mr Wright came up with an answer to all questions. In the end, HHJ Waksman QC refused to make a non-party costs order against Mr Wright because he accepted that his company had passed over the conduct of cases to its solicitors. HHJ Waksman QC ruled that he did not accept that Mr Wright's attendance at meetings 'meant that he was making decisions about the litigation in any real way or otherwise controlling or influencing it'.

In *Flatman v Germany; Weddall v Barchester Healthcare Ltd* [2013] EWCA Civ 278, [2013] 4 All ER 349, Leveson LJ declined to make a non-party costs order against a solicitor who had funded some disbursements while acting for clients

on a ‘no win, no fee’ basis. He said that ‘payment of disbursements, without more, does not incur any potential liability to an adverse costs order’.

What should lawyers do next?

DB: Five of the seven residents were in court for the hearing. At the end of the hearing, Gloster LJ said the court would reserve its judgment. A draft judgment will be circulated in due course for any typographical errors to be corrected but this was not to be treated as an opportunity to re-argue the case. Gloster LJ gave no indication as to when judgment will appear but it is likely to appear this side of Easter 2016. Gloster LJ was clearly sympathetic to the plight of the residents who are of ordinary means. If the appeal is allowed, then not only will those residents not get some of their costs incurred reimbursed but they could be held liable for the Aviva’s costs in both courts.

Alex Bagnall: At the present moment in time, this is a difficult one to comment on because we don’t know which way the Court of Appeal is going to rule on this. The panel interventions are interesting. I would be very surprised if the Court of Appeal comes out with a decision in terms that insurers will be exposed to non-party costs orders in all circumstances which are similar to the facts in this case. If the Court of Appeal dismisses the appeal, it is likely to want to frame its reasons in clearly defined terms to prevent insurers becoming a guarantor of an insolvent party’s costs.

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