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THE 2015 MUSTILL LECTURE

DELIVERED BY LORD JUSTICE JACKSON

THE CIVIL JUSTICE REFORMS AND WHETHER INSOLVENCY LITIGATION SHOULD BE EXEMPT

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1. INTRODUCTION

1.1 The Mustill Lectures. The Mustill Lecture is a biennial event held in Leeds, which was established in honour of Lord Mustill. Lord Dyson MR delivered the previous lecture in this series. That was in October 2013. Sadly Lord Mustill died on the 24th April 2015. The lecture series now continues in his memory.

1.2 Lord Mustill. Others are paying tribute to Lord Mustill today, immediately before the start of this lecture. Therefore my own remarks must be brief. Lord Mustill was an outstanding judge. He was also a courteous tribunal. When at the Bar, I had the good fortune to appear before him from time to time.[1] Lord Mustill was also a loyal Yorkshireman, who never forgot his roots in this part of the country. For many years he was the patron of the North East Branch of the Chartered Institute of Arbitrators. It is fitting that that body has established the present lecture series.

1.3 This lecture. This lecture will briefly outline the civil justice reforms of 2013. It will then focus upon the exemption which has been carved out for insolvency litigation and address the question whether that exemption should continue.

[1] E.g. *Clarke Boyce v Mouat* [1994] 1 AC 428

1.4 Abbreviations. In this lecture I will use the following abbreviations:
"ATE" means after-the-event insurance.
"C" means claimant.
"CFA" means conditional fee agreement.
"D" means defendant.
"DBA" means damages-based agreement.
"ECHR" means the European Convention on Human Rights.
"FR" means Review of Civil Litigation Costs Final Report.
"HMRC" means Her Majesty's Revenue and Customs.
"IP" means insolvency practitioner.
"IS" means the Insolvency Service, which is an executive agency sponsored by the Department for Business, Innovation and Skills.
"LASPO" means the Legal Aid, Sentencing and Punishment of Offenders Act 2012.
"Misconduct" is used as shorthand to include breach of duty, fraudulent trading, wrongful trading and participation in transactions which can be impugned.
"QOCS" means qualified one-way costs shifting.
"Recoverability" is used as shorthand for the ability of a party to recover a CFA success fee and ATE premium from its opponent under a costs order.
"R3" is the short name by which the Association of Business Recovery Professionals Ltd is generally known.
"The 1986 Act" means the Insolvency Act 1986.

1.5 Caveat. The issues addressed below have not been the subject of consideration by the Insolvency and Company Court Users Committee. This lecture simply sets out my own opinions on the issues.

2. CFAs, ATE AND THE 2013 CIVIL JUSTICE REFORMS

2.1 Conditional fee agreements. CFAs provide that if the case is lost the lawyer receives either no fee or a "low fee", but if the case is won the lawyer receives a success fee in addition to his ordinary costs. With effect from 1995 CFAs were permitted for personal injury proceedings, insolvency litigation and ECHR applications. With effect from April 2000 CFAs were permitted in all types of civil litigation. Until April 2000 the client was liable to pay the success fee if the case was won. He could not recover that from the opposing party.

2.2 After-the-event insurance. This is a peculiar form of litigation insurance, which developed during the 1990s. ATE insurers receive a premium if the case is won. If the case is lost, they receive no premium. Instead (a) they pay the adverse costs which are awarded against their insured and (b) depending upon the terms of the insurance, they may also pay the insured's disbursements. Until April 2000 the insured was liable to pay the ATE premium if the case was won. He could not recover that from the opposing party.

2.3 Recoverability introduced in April 2000. As a result of legislative changes, in April 2000 successful parties became entitled to recover (in addition to their ordinary costs) both the success fee and the ATE premium. The success fee could be up to 100% of the ordinary costs. The ATE premium could on occasion amount to similar sum. It is usually claimants, rather than defendants who have CFAs and ATE. Thus in such a case:

(i) C may be litigating at no risk as to costs. He will pay no costs, whether he wins or loses.
(ii) D may be litigating at massive costs risk. He may be liable for up to four times the costs of the action (own costs + C's ordinary costs + C's success fee + C's ATE premium).

2.4 Disastrous consequences of recoverability. During the first decade of the twenty first century recoverability emerged as one of the main drivers of excessive litigation costs. It distorted incentives and added a new layer of costs to the litigation process. Recoverability also became an instrument of oppression. One party could crush the other party into submission (regardless of the merits of the case) simply by dint of its superior position on costs.

2.5 Recoverability abolished in April 2013. In those circumstances I recommended the abolition of recoverability in FR chapters 9 and 10. Parliament implemented that recommendation in April 2013 by enacting sections 44 and 46 of LASPO.[2] I shall refer to these provisions as "ss 44/46".

2.6 The 2013 civil justice reforms. The abolition of recoverability formed part of a wider package of reforms introduced in April 2013. The policy objective was (a) to control and reduce the costs of civil litigation and (b) to promote access to justice. These reforms spanned the domains of case management, costs management, litigation funding and the assessment of costs.

3. THE EXEMPTION FOR INSOLVENCY LITIGATION

3.1 Temporary exemption announced on 24th May 2012. By written ministerial statement on 24th May 2012 the Parliamentary Under-Secretary of State for Justice announced that the implementation of ss 44/46 in relation to insolvency litigation would be delayed until April 2015. The stated purpose was to allow time for practitioners to adjust to the changes and to make alternative arrangements for litigation funding.

3.2 The statutory instrument. Article 3 (a) and (c) of the Legal Aid, Sentencing and Punishment of Offenders Act 2012 (Commencement No. 5 and Saving Provision) Order 2013 (S.I. No. 77 of 2013) brought ss 44/46 into force on 1st April 2013. Article 4 provided:

> "Article 2(1) (a) and (c) and article 3 (a) and (c) do not apply to—
> …
> (c) proceedings in England and Wales brought by a person acting in the capacity of—
> (i) a liquidator of a company which is being wound up in England and Wales or Scotland under Parts IV or V of the 1986 Act; or
> (ii) a trustee of a bankrupt's estate under Part IX of the 1986 Act;
> (d) proceedings brought by a person acting in the capacity of an administrator appointed pursuant to the provisions of Part II of the 1986 Act;

[2] Measures were introduced at the same time to assist claimants who had formerly benefited from the recoverability regime: QOCS, 10% increase in general damages, enhanced reward for effective claimant offers under CPR Part 36, limit upon personal injury success fees, etc.

(e) proceedings in England and Wales brought by a company which is being wound up in England and Wales or Scotland under Parts IV or V of the 1986 Act; or
(f) proceedings brought by a company which has entered administration under Part II of the 1986 Act."

3.3 The campaign to extend the exemption. Thereafter R3 campaigned – as they were fully entitled to do – for a permanent extension of that exemption. A "Jackson Research Committee" was set up, including representatives of the Insolvency Practitioners Association and others involved with insolvency proceedings. R3 also commissioned Professor Peter Walton to prepare a report on the likely effect of ss 44/46 on insolvency litigation.

3.4 The Walton Report. Professor Walton has produced a detailed report in support of the proposition that the temporary exemption for insolvency proceedings should be made permanent. I would summarise Professor Walton's arguments as follows:
(i) Insolvency litigation is typically brought against former directors, whose misconduct has squandered the assets of the now insolvent company.
(ii) Such litigation is usually brought for the benefit of creditors. HMRC is usually a major creditor and receives approximately 24% of all monies recovered. Therefore insolvency litigation is in the public interest and is of a different character to other litigation.
(iii) Because of the special character of insolvency litigation a special exemption from ss 44/46 is justified.
(iv) Very often defaulting directors leave the company with little or no assets to fund litigation. CFAs and ATE coupled with recoverability enable (a) the liquidator or administrator to bring proceedings at no cost, alternatively low cost, and (b) the creditors to receive the fruits of the litigation without any deduction of the success fee or ATE premium.
(v) If insolvency litigation is backed by a CFA and ATE, this frequently pressurises the defendant into settling.
(vi) Many insolvency actions are brought to recover modest sums (e.g. £50,000) or against individuals of modest means. Without the benefit of recoverability it may not be practicable to pursue such claims.

3.5 The Government extends the exemption. On 26th February 2015 the Minister of State for Civil Justice and Legal Policy issued a written ministerial statement. He said that the Government accepted that insolvency practitioners and other interested parties needed more time to prepare for the changes. The Government would therefore delay commencing ss 44/46 for insolvency litigation "for the time being". He concluded: "We will consider the appropriate way forward for insolvency proceedings and will set out further details later in the year."

4. IS THE CONTINUATION OF THE EXEMPTION JUSTIFIED?

4.1 A matter of policy for Government. I accept, of course, that the question whether the exemption should continue is a matter of policy for Government. Nevertheless, as a lawyer with special interest in this area who originally proposed the reforms under consideration, I am entitled to hold an opinion on the question. It may be helpful for me to set out that opinion together with the supporting reasons, so that those who disagree can explain why I am wrong.

4.2 My opinion. The exemption should not continue. It should come to an end exactly as the Government proposed in May 2012. Furthermore by now the profession has had more than enough time to prepare for the changes.

4.3 Four reasons. I reach that opinion for the following reasons.
(i) The recoverability regime was principally designed to assist individual claimants of modest means, in particular those who ceased to qualify for legal aid in April 2000. The advantages gained for insolvency litigation were a windfall.
(ii) Recoverability is an instrument of oppression, which is liable to crush defendants who have a good defence.
(iii) Recoverability drives up the overall costs of litigation.
(iv) It is perfectly possible to bring insolvency litigation without the benefit of recoverability.

4.4 Relevance of Walton Report. Those who support a continuation of the insolvency exemption rely heavily upon the Walton Report. R3 make extensive reference to that report in their literature. R3's counsel summarised and relied upon the Walton Report in their written submissions to the Supreme Court in *Lawrence v Fen Tigers Ltd* (No. 3) [2015] UKSC 50; [2015] 1 WLR 3485. The Bar Council has also pressed for an extension of the insolvency exemption, again citing the research of Professor Walton as support for its case. In those circumstances, I shall pay close attention to the Walton Report in explaining the four reasons why – with the utmost respect – I disagree with R3, the Bar Council and many other campaigners on this issue.

5. FIRST REASON WHY THE EXEMPTION IS NOT JUSTIFIED

5.1 The introduction of recoverability and the underlying policy. Sections 27 and 29 of the Access to Justice Act 1999 introduced the recoverability regime. The policy underlying this reform was summarised in the Government's 1998 consultation paper *Access to Justice with Conditional Fees* as follows:

> "1.2 A huge swathe of ordinary people on modest incomes are deterred from starting a legal action by the potential costs of litigation – their own costs and the risk of ending up paying the costs of the other side.
> …
> 1.4 At the same time the cost of the Legal Aid Fund goes up and up…on civil alone the costs had almost tripled.
> …
> 1.6 The Government intends to promote access to justice for the majority of the population in England and Wales through the wider availability of conditional fee agreements. This will make access to the courts a reality for the majority of the population of England and Wales. Conditional fees ensure that risks of litigation are shared between the lawyer and the client: clients do not pay their lawyer fees unless they win, and lawyers, when they win, receive a level of fees that recognises the risk they have taken."

I would comment that the "risk" to lawyers is more than offset by success fees on winning cases, provided that the lawyers choose carefully, as they usually do.

5.2 Retraction of legal aid. The Government greatly reduced the availability of legal aid in April 2000. In particular, personal injury litigation (other than clinical negligence) dropped out of the scope of legal aid. The intention was that the extension of CFAs (see para 2.1 above) coupled with recoverability would take the place of legal aid. In particular, the liability insurers who paid out on personal injury and similar claims would step into the shoes of the legal aid fund. Through the mechanism of recoverability the liability insurers would pay all of the claimants' costs in every case (including the costs of those cases which the claimants lost).

5.3 <u>A windfall.</u> The problem with the reforms in April 2000 was that all sorts of people (whom the reforms were never intended to benefit) gained huge windfalls. For example, household insurers started using CFAs and ATE when they were suing local authorities in tree root cases. Wealthy companies litigating against SMEs sometimes used CFAs and ATE. Sometimes even businesses litigating against consumers used these devices. International finance companies suing the Civil Aviation Authority used CFAs and ATE. So did large contractors suing public authorities in procurement disputes.

5.4 <u>Did it matter that all these lucky people gained windfalls?</u> Yes, I am afraid that it did. To illustrate this proposition, assume that a cohort of 100 claimants bring cases with CFAs and ATE.
(i) Cs win, say, 80 cases and lose 20 cases. **The theory** is that Cs' lawyers recover their costs on the 20 lost cases from the success fees on the 80 successful cases. Likewise the ATE insurers recover what they pay out on the 20 lost cases from the premiums which they receive on the 80 successful cases. Therefore at the end of the day Ds end up paying the total amount of both sides in all 100 cases, regardless of whether they won or lost any individual case.
(ii) So much for the theory. **In practice** Ds end up paying significantly more than all the costs of all 100 cases. This is for two reasons. First, the ATE insurers have to cover their own costs (salaries, overheads etc) and also make a profit. So that is all added onto the ATE premiums. Secondly, the lawyers are human and business people. They will in practice cherry pick winning cases, so that they recover more from success fees in successful cases than they lose from the failed cases.

5.5 <u>Consequences.</u> The consequence of all this is twofold. First, it massively drives up the overall costs of litigation. Secondly, it creates a hopelessly unequal playing field. One side is at no risk as to costs whatever the outcome of the case. The other party is at risk of paying up to four times the costs of the action if it loses. Some (not including myself) may regard that as acceptable in the context of personal injury litigation, where liability insurers are footing the bill. It is certainly not acceptable, however, in the 'windfall' situations. Outside personal injury, consumer claims and similar claims, it is quite wrong that when the contestants enter the ring one party has a huge advantage and the other party has a lead weight chained to its ankles.

5.6 <u>What about insolvency litigation?</u> The claimants in insolvency litigation are an example of a group of litigants who gained a windfall. Undoubtedly they were a group who sometimes used CFAs – hence the 1995 extension of the CFA regime. But they were not a group who had previously been operating on legal aid and were now losing it. Nor were they one of the groups of people at whom the recoverability regime was targeted.[3]

5.7 <u>The picture revealed by Professor Walton.</u> Professor Walton (page 37) tells us:

[3] There is no suggestion that this was intended in the 1998 consultation paper.

> "The use of CFAs has become increasingly common across all types of IP firm from the smallest sole practitioner practice to three of the "Big Four". The claims being enforced by CFA-backed litigation appear likely to total approximately £300 million per annum. Of this figure, between £50m and £70m will relate to monies owed to HMRC. Over half of this figure appears eventually to be brought into insolvent estates."

5.8 Comment. When Parliament scaled back legal aid and introduced recoverability in its place, it was not endeavouring to assist the "Big Four" in pursuing insolvency claims. IPs were managing perfectly satisfactorily throughout the twentieth century. In strong cases IPs were willing to carry the costs of litigation as work in progress on their balance sheets. Then they got a pay-out at the end, if the action was successful. That encouraged responsible litigation. IPs gained a windfall from the 2000 reforms.

6. SECOND REASON WHY THE EXEMPTION IS NOT JUSTIFIED

6.1 *Lawrence v Fen Tigers.* In *Lawrence v Fen Tigers Ltd* (No. 3) [2015] UKSC 50; [2015] 1 WLR 3485 the Supreme Court regarded the following as the most objectionable of the four flaws in the recoverability regime:
"The 'blackmail' or 'chilling effect' of the regime which drove parties to settle early despite good prospects of a defence".
Lord Neuberger added at [53]: "Another way of describing it is as imposing a costs burden on opposing parties which is excessive and in some cases amounts to a denial of justice." Indeed two members of the court, Lord Clarke and Baroness Hale, considered that the regime constituted a breach of the defendant's article 6 rights. They favoured striking down the regime as incompatible with ECHR.

6.2 The 'blackmail' or 'chilling effect' in insolvency proceedings. Professor Walton graphically explains how the 'blackmail' or 'chilling effect' to which the Supreme Court referred operates in insolvency proceedings. On page 15 he states:

> "Even though the four largest City IP firms have a reputation for only taking appointments where there are assets to cover their fees (and the fees of their legal teams), the evidence suggests that three of the Big Four are increasingly using CFAs to conduct litigation where there is lack of funds in the insolvent estate. These actions are typically for large sums (e.g. £1.3m and £650,000). Even though the remaining Big Four firm does not use CFAs itself, it is very supportive of their current and continued use generally.
>
> There is also significant anecdotal evidence that claims worth "many millions of pounds" are settled every year on confidential terms where the existence of ATE insurance has encouraged a settlement sooner rather than later on terms beneficial to creditors. In such cases, there are commonly some funds in the insolvent company and so a CFA is not needed. The settlement of the claim is often reached just before the next increment on the ATE insurance premium is due. The fact that the defendant will be liable to satisfy the cost of the ATE insurance premium, in the event the matter goes to trial and the defendant loses, is often a critical inducement to settle the claim. Due to the confidential nature of such settlements, it has not been possible to identify any data supportive of this phenomenon but it is clear that recoverability of the ATE insurance premium is a useful tool for IPs pursuing such claims."

6.3 On page 32 Professor Walton states:

> "This suggests that in relation to all (or virtually all) of the cases which do settle, they would not have settled (at least at the point they did settle) without the potential consequences of recoverability of CFA uplift and provision for adverse costs. This supports the views of all stakeholders who were interviewed to the effect that although CFA uplifts and ATE insurance premiums are infrequently recovered in full, the threat of such a recovery does concentrate the minds of defendants and is often decisive in reaching a settlement."

6.4 The position of defendants. Many defendants in insolvency litigation backed by CFAs/ATE are individuals and often they are of modest means. This is true both in personal insolvency (where the bankrupt's spouse may be the first target) and in corporate insolvency (where ex-directors may be the first target). Professor Walton tells us on page 11: "Most insolvency litigation is aimed at individuals who often have only limited funds." Exactly so. These are just the sort of litigants who are most likely to be overwhelmed by the 'blackmail' or 'chilling effect' to which the Supreme Court referred.

6.5 Don't pre-judge the outcome. Unless and until insolvency litigation is concluded by a trial or a fair settlement, it is not known whether the defendant has been guilty of misconduct. Some defendants have been. Some have not. It is wrong in principle to force all defendants in insolvency cases backed by CFA/ATE to litigate at massive disadvantage.

6.6 Obviously those ex-directors who **have been** guilty of misconduct should pay up. But not every defendant is liable, as Professor Walton acknowledges by his frequent reference to the risk of adverse costs which claimants run in insolvency proceedings. It is quite wrong that those ex-directors who **have not been** guilty of misconduct should be crushed into paying up. In addition to their financial loss they also suffer the stigma of conceding liability for that which they did not do.

7. THIRD REASON WHY THE EXEMPTION IS NOT JUSTIFIED

7.1 The effect of recoverability. The effect of recoverability is to drive up the overall costs of litigation substantially. See FR chapter 2 and the tables in appendix 1. This is essentially for two reasons, which operate in combination. First, the success fee and ATE premium add a new layer of costs. Secondly, the recoverability regime distorts incentives. The party with a CFA and ATE has insufficient incentive to control costs, since win-or-lose he will not be paying them.

7.2 The Walton Report shows how recoverability drives up costs. Once again the professor illustrates my point perfectly. He states on page 24:

> "The function of the IS in agreeing sanctions requests is to act in place of a committee of creditors. The data held by the IS suggests that the IS is keen to ensure that the base legal cost of CFA-backed litigation is reasonable. Indeed many applications to the IS involve asking sanction for a small increase in such base costs. There appears to be little, if any, querying of the level of CFA uplift. Two observations may be made about this practice. First, under the current regime, it is difficult to see why the IS, in acting in the role of creditors' committee, would be at all worried about either the level of the base fee or the level of uplift. Under the

> current regime, both are recoverable from a losing defendant in addition to any damages. The benefit to the estate is in theory untouched by either the base legal costs or the level of uplift. If the IS, in agreeing sanctions requests, is taking account of the complex nature of some global settlement agreements, it ought to be just as concerned with percentage uplifts as with base legal costs. Secondly, if and when the insolvency carve-out from Jackson comes to an end, the IS will need to consider changing its approach to sanctions requests. It will need to consider both the base legal costs and the percentage uplift as both will be payable out of any ultimate recovery."

7.3 Conclusion. It is only when the present exemption from ss 44/46 comes to an end that the Insolvency Service will take proper steps to control litigation costs. Furthermore, in cases which do not require the sanction of the IS, precisely the same considerations apply. Neither IPs nor the lawyers acting for claimants in insolvency litigation have sufficient incentive to control costs in circumstances where the claimants have no liability to pay those costs.

7.4 The public interest. I accept that there is a public interest in the effective conduct of insolvency litigation. It is in the public interest that the assets of insolvent companies and individuals be recovered by office-holders (who are strangers to the insolvent estate) for distribution to creditors, so far as this is lawful and possible. There is also, however, a public interest in controlling litigation costs generally. Excessive litigation costs are wasteful of the nation's resources. In addition there is a public interest in litigation being conducted fairly. The means that there should be a level playing field, rather than one sloping at 90 degrees. The civil justice regime must balance all the public interests which are in play.

8. FOURTH REASON WHY THE EXEMPTION IS NOT JUSTIFIED

8.1 How on earth will insolvency practitioners manage if the exemption ends? It might be a good start for practitioners to ask their more senior colleagues how they managed before April 2000. As indicated in section 5 above, IPs operated perfectly satisfactorily throughout the whole of the twentieth century without the benefit of the recoverability regime. In 1995 CFAs became available as an additional funding option for insolvency litigation. But this was on the basis that Cs paid their own success fees. That was perfectly fair to all parties.

8.2 Fair litigation. It is the essence of fair litigation that each party takes a risk in costs. The loser, absent special circumstances, normally pays the costs of both sides. If the director of an insolvent company has been guilty of misconduct, the creditors can put up the necessary funds for suing him/her in conventional litigation and they will recover the costs of doing so at the end of the case. What is the problem with that?

8.3 The Revenue is now unwilling to fund its own litigation. HMRC is a key player in this area, as Professor Walton explains:

> "Although the HMRC keeps no record of how much money it is owed from insolvent estates, the Office of Fair Trading estimates that 24% of all unsecured debt in liquidations is owed to HMRC. From the estimate it is reasonable to

> suggest that 24% of the money being claimed by IPs in liquidations by CFA-backed litigation is likely to be owed to HMRC."[4]

On page 15 Professor Walton states:

> "HMRC is often the largest unsecured creditor in an insolvent estate. It often encourages action to be taken by an IP and will support the IP with appropriate evidence of wrongdoing (the effectiveness and efficiency of this has been questioned by some practitioners but it is clearly of assistance in many cases). Until fairly recent times, HMRC was able to provide significant financial support for actions by IPs in appropriate cases, but such funding appears now to be significantly restricted."

8.4 But why? The above passages in the professor's report prompt the obvious question. Why is HMRC so reluctant to pay the costs of its own litigation? If it wins, it will recover its costs. If it loses (e.g. because the defendant was not guilty of misconduct), then it should pay the defendant's costs. There is nothing unfair or problematic about that. HMRC is funded by, and acts for the benefit of, the public purse. HMRC is not a cash-strapped party which can only afford to litigate if the other side pays all of its costs in every case.

8.5 Illustration. The absurdity of the present position may be illustrated by my earlier example of a cohort of 100 cases. Suppose that HMRC supports 100 cases against ex-directors for misconduct. It does so with the benefit of ATE, no win-no fee CFAs and recoverability. HMRC (being shrewd) wins – say – 85 of those cases and loses the other 15 cases. HMRC pays out no costs on any of those 100 cases. Collectively the defendants end up paying more than all of the costs of both sides in every case. Is that how a public body should be conducting litigation against individual citizens?

8.6 The other creditors. What is true for HMRC is true for other creditors as well. If they wish to support claims for misfeasance against ex-directors or others, they should fund the litigation in the conventional way. If they win, they will get their costs back. If they lose, they should pay the defendants' costs. Insolvency litigation proceeded on this basis throughout the twentieth century without giving rise to serious concern.

8.7 But if the creditors are unable or unwilling to fund the litigation, what then? Now the position is much better than it was in the past. New funding options have opened up, which were unavailable in the past:
(i) IPs will still be able to use CFAs and/or ATE, albeit without recoverability, if the present exemption ends.
(ii) In larger cases IPs will be able to take advantage of third party funding, which is a new arrival on the litigation scene. A glance at the Internet reveals at least one major funder which specialises in insolvency litigation.
(iii) IPs will also be able to use DBAs, which first became lawful in April 2013.
It was an important element of the 2013 civil justice reforms that as many different funding options as possible should be made available to litigants. Unlike their forefathers, IPs will now be able to take advantage of these options.
(iv) Since 1st October 2015 liquidators and administrators have been able to assign rights of action for fraudulent trading, wrongful trading etc pursuant to the provisions of the Small Business, Enterprise and Employment Act 2015. In some cases this enables them to raise money for the benefit of creditors without taking on the risks of litigation.

[4] Walton Report page 22

8.8 After I had drafted the preceding paragraph, the funder referred to in that paragraph – unsolicited – wrote to me stating (a) that it strongly opposed the present exemption for insolvency litigation and (b) that the market had been geared up for ending the exemption in April 2015. "Insurers were ready with new products and funders (new and existing) were readying new financing solutions."

8.9 Note concerning DBAs. There are problems with the current regulations DBAs governing DBAs. These should soon be resolved following the excellent report of the Civil Justice Council working group chaired by Professor Rachel Mulheron.[5] The only additional comment which I would make is that if IPs are going to make full use of DBAs, it will be vital to permit the use of hybrid DBAs, as discussed in my Law Society lecture on 20th October 2014.[6] The Mulheron Report states at chapter 21, paragraph 5:

> "The Working Group noted that the issue has assumed huge importance in the legal marketplace, in that without concurrent hybrid DBAs, lawyers may not see DBAs as being attractive enough to encourage them to take C's cases. This reluctance is heightened by the innate conservatism of the legal profession. In particular, the uncertainty as to whether or not concurrent hybrid DBAs are permissible has had an incredibly chilling effect on the take-up of DBAs."

8.10 Low value cases. I accept that low value multi-track cases (e.g. claims for £50,000) pose a particular problem for all areas of civil litigation. The Master of the Rolls has for some time been pressing for a fixed costs regime in respect of such cases. I strongly support that proposal.[7] Nevertheless the one solution which is not acceptable is to load all of the costs of both sides onto defendants so that claimants have a free ride.

8.11 An additional note of comfort for IPs. Even now, despite the availability of recoverable success fees and recoverable ATE premiums, IPs still choose to bring a huge number of cases without either CFAs or ATE. This is apparent from all of the sets of data set out in chapter 5 of the Walton Report. For example, in the middle paragraph on page 17 the professor refers to 1,157 sanctions requests which he has examined. Only 234 of those cases (i.e. 20%) were brought on CFAs. The proof of the pudding is in the eating.

8.12 Recent material received from R3. Having noted the title of this forthcoming lecture, on 8th September 2015, R3 kindly sent to my clerk a bundle of material in support of continuing the current exemption. The bundle included recent open letters to politicians as well as reports of Parliamentary proceedings. A recurrent theme in these documents is that ending the present exemption for insolvency litigation "will leave creditors, including HMRC and small businesses, more than £160 million a year out of pocket." The only supporting evidence cited for this proposition is Professor Walton's report. With the greatest respect to the professor, his report simply does not support that proposition.

9. IS THE CONTINUATION OF THE EXEMPTION LAWFUL?

[5] "The damages-based agreements reform project, drafting and policy issues", August 2015
[6] Accessible on the Judiciary Website – https://www.judiciary.gov.uk/wp-content/uploads/2014/10/litigation-post-jackson-world.pdf.
[7] See e,g, "Fixing and funding the costs of civil litigation" (2015) 34 CJQ 260-266.

9.1 The undecided question. So far I have focused on why, as a matter of principle, the insolvency exemption should be brought to an end. There is, however, a separate question of law which may arise at a future date. That is whether the continuation of the present exemption is contrary to ECHR.

9.2 The effect of the *Lawrence* decision. *Lawrence*[8] was concerned with the "old" recoverability regime (which existed between April 2000 and March 2013), not the current regime. In *Lawrence* the Supreme Court held by a majority of 5:2 that the old recoverability regime, although flawed in four respects, was not inconsistent with ECHR. The two dissenters took the opposite view and would have declined to give effect to that regime.

9.3 The present recoverability regime. The present regime is very different from the old regime which was under consideration in *Lawrence*. Recoverability has now been abolished in the general run of cases. But there remains an "insolvency carve-out", as Professor Walton aptly calls it. In other words, Parliament and the Rule Committee have created a special sub-set of rules for insolvency litigation, which (i) gives claimants a massive advantage over 'normal' claimants in CFA/ATE cases and (ii) puts defendants at a massive disadvantage when compared with 'normal' defendants in CFA/ATE cases. In insolvency cases (but not in the general run of cases brought with CFAs and ATE) defendants are being subjected to a form of blackmail which drives them to settle early, even if they have good prospects of a defence.[9]

9.4 An additional worrying feature. An additional worrying feature of the new regime is that the sub-set of CFA + ATE claims which Parliament has selected (by statutory instrument) for this specially favourable treatment is a group of cases in which the Government stands to benefit substantially. On Professor Walton's figures 24% of the proceeds from these cases go to HMRC.

9.5 So, what is the answer to the undecided question? It is not for me, as a serving judge, to predict how a court in the future will resolve a hitherto undecided question of law. I merely point out that the issue is there and some time it may have to be decided.

10. CONCLUSION

10.1 A wise decision by the minister. There was much wisdom in the minister's announcement on 24th May 2012 that the Government would end the exemption for insolvency litigation in 2015. Perhaps the Government should do what it said it would do.

Rupert Jackson 16 October 2015

[8] *Lawrence v Fen Tigers Ltd* (No.3) [2015] UKSC 50; [2015] 1 WLR 3485
[9] See Lord Neuberger PSC and Lord Dyson MR at [43] and [53]; Lord Clarke and Baroness Hale at [130].