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Non-party costs orders in commercial litigation

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Introduction

The Supreme Court recently gave a final determination on whether or not a person can be made liable for the costs of legal proceedings to which he is not a party. The decision in question came in the case of Moorview Development Limited v. First Active Plc [2018] IESC 33, an appeal from the judgment of Clarke J in the High Court. Such appeals would now be heard by the Court of Appeal rather than the Supreme Court, but the Moorview case was appealed prior to the establishment of the Court of Appeal and therefore remained in the Supreme Court list for hearing.

The issues in question are of tremendous importance in commercial litigation. In particular, directors and shareholders of private companies regularly fund their company's litigation where it is insolvent. Banks, often acting through receivers, have been known to provide credit to insolvent companies for issuing or continuing legal proceedings in the name of the company. And then there is the advent of "After the event insurance", a relatively new phenomenon in Ireland whereby an insurance company agrees to fund its customers' legal proceedings in return for a cut of any damages ultimately awarded in favour of their customer. In all of those situations, the person funding the litigation is a non-party and never appears before the court. The question is whether such person, his horse having come second, can be joined to the proceedings for the purpose of being made personally liable for the winning party's legal costs.

Moorview Development - some factual context

The case involved a group of companies suing their bank for fraud and negligence among other things. The litigation was commenced in 2003 and did not come on for hearing until 2008. Before that, there were a number of judgments delivered in the proceedings concerning procedural matters which are of no concern for our purposes. What is important, however, is that the proceedings ultimately resulted in a non-suit, meaning that the case advanced by the companies was held by Clarke J to be so weak that the bank was not required to defend itself any further. Following that decision, the bank issued a motion seeking to have a Mr. Cunningham, the de facto owner of the companies, made personally liable for the substantial costs incurred by the bank in defending the proceedings up to that point. Such an order - an order for costs against a non-party shareholder - had never before been made by a court in Ireland. The commercial world held its breath as Clarke J ultimately found

that the court did have jurisdiction to make the order and that he would exercise his discretion to accede to the bank's application. It was that decision which was under appeal to the Supreme Court.

Does the court have jurisdiction to make non-party costs orders?

The judgment of Clarke J in the High Court was delivered in 2011 which means that it has been the law in Ireland since 2011 that a court can award a non-party costs order against a shareholder for legal costs incurred by his company. Indeed, the concept of such orders became so familiar that they were commonly referred to by lawyers as "Moorview orders". However, some doubt was cast on this by the recent decision of Hogan J in the Court of Appeal. In *WL Construction Limited v. Chawke and Bohan* [2018] I.E.C.A. 113 Hogan J suggested that, in fact, the Irish courts probably had no jurisdiction to make non-party costs orders. The decision of the Supreme Court in Moorview is therefore a welcome clarification of the matter. In any event, a definitive statement on an issue of such importance was both desirable and necessary.

Mr. Cunningham's appeal was certainly spirited if ultimately unsuccessful. In it he made a number of arguments, most of which had already been rejected by the High Court. The first of these was that the court had no jurisdiction to make a non-party costs order. He argued that there was no legal basis - either in statute or the rules of court - on which such orders could be made. McKechnie J, with whom MacMenamin and Dunne JJ concurred, disagreed.

He pointed first to Order 15 rule 13 of the Rules of the Superior Courts, which allows the court to join a person to proceedings if it is "necessary" to do so for the purposes of attributing costs. That rule was applied in *Byrne v. John S. O'Connor & Co.* [2006] I.E.S.C. 30 where the Supreme Court had joined an insurance company to proceedings following the exercise by that company of a right of subrogation to defend legal proceedings which were unsuccessful. Mr Cunningham argued that the court in that case was dealing with a right of subrogation, a well-known legal principle whereby an insurer puts himself in the shoes of the insured and, in so doing, takes on the rights and potential liabilities of the insured. There was no such established principle involving shareholders assuming liability for the debts of a company - indeed, he argued, the doctrine of separate legal identity is meant to prevent just that. That argument had been accepted by Hogan J in the Chawke case, but was rejected by the Supreme Court in Moorview. According to McKechnie J, there was nothing in the rules or the decision in O'Connor to suggest that the court was intending to apply principles which were sui generis. In other words, there was no suggestion in the earlier case that the principles set out there were specific to situations involving subrogation. They could be applied in all situations, including that of a shareholder funding his company's legal proceedings.

As well as the rules of court, McKechnie J also relied on section 53 of the Judicature (Ireland) Act 1877 as supporting the existence of the court's jurisdiction to make a non-party costs order. That section provides that “the costs of and incidental to every proceeding in the High Court … shall be in the discretion of the Court”. A similar provision in the English equivalent of section 53 (section 51(1) of the UK Supreme Court Act 1981) was held by the courts in that jurisdiction to be a legitimate legal basis for making non-party costs orders (*Aiden Shipping v. Interbulk* [1986] A.C. 965). However, as Mr. Cunningham rightly pointed out, the English legislation is worded slightly differently from its Irish counterpart. In addition to stating that the court has a discretion in awarding costs, it further states that "the court shall have full power to determine by whom...the costs are to be paid.” The Irish legislation does not use the words "by whom" or suchlike. That argument was rejected by the Supreme Court, which pointed out that the absence of those words did not intend to limit the court's general discretion. Indeed, those words were also missing in the equivalent New Zealand legislation (section 51G of the Judicature Act 1908 (New Zealand)) where the nevertheless held it had jurisdiction by reason of its general discretion to make non-party costs orders (*Carborundum Abrasives Ltd. v. Bank of New Zealand (No.2)* [1992] 3 N.Z.L.R. 757).

Finally, McKechnie J found support for his broad interpretation of the general discretion in the decision of the Supreme Court of Queensland in *Forest Pty Ltd. (Recs and Mgrs apptd.) v. Keen Bay Pty Ltd. & Ors.* [1991] 4 A.C.S.R. 107. There the court held it had jurisdiction to make a costs order against a non-party receiver of insolvent companies where a bank, acting through the receiver, had funded the unsuccessful litigation. The legislation being applied in that case was the Supreme Court Act (Qld) 1867 which was similarly worded to the Irish and English statutes.

Exercise of the jurisdiction

Having established that the court had a broad discretion to make non-party costs orders, McKechnie J then turned to the question of the circumstances in which that discretion would be exercised. In particular, what factors should the court take into account before making such orders? It is necessary to state at the outset, as Mckechnie J emphasises at numerous points in his judgment, that the discretion will not lightly be exercised - it will be the exception and not the norm. It will only be exercised where failure to do so would lead to injustice between the parties.

McKechnie J set out the following factors which the court will take into account in deciding whether to make such orders:

a. The extent to which it might have been reasonable to think that the company could meet any costs if it failed in the litigation.

b. The degree to which the non-party would benefit from the litigation if successful, including whether it had a direct personal financial interest in the result.

c. The extent to which the non-party was the initiator, funder and/or controller of, and moving party behind, the litigation.

d. Any factors which may touch on whether the proceedings were pursued reasonably and in a reasonable fashion..

e. There is no requirement that there be a finding of bad faith, impropriety or fraud, though of course the same, if present, will support the ordering of costs against the non-party.

f. Whether the non-party was on notice of the intention to apply for a non-party costs order; at what point in the litigation such notice was communicated will also be a relevant consideration, as will the extent of the notice so provided.

g. Whether the successful party applied for security for costs in advance of the trial.

h. The Court's discretion is a wide one, but it must be exercised judicially and, in all the circumstances, must give rise to a just result.

This was not intended to be an exhaustive list, and some factors will be more relevant than others depending on the circumstances of the case. However, the court noted that the factors at (a), (b) and (c) would carry "substantial weight". Indeed, these were the main reasons Mr. Cunningham lost his appeal: the companies were hopelessly insolvent with no prospect of meeting a costs order, Mr. Cunningham would have benefited substantially had the proceedings succeeded (the companies were suing for over €150 million) and it was apparent that Mr. Cunningham was pulling the strings as far as the commencement and conduct of the proceedings was concerned.

Notice to the non-party

One of the factors taken into account by the Supreme Court was that the bank gave notice to Mr. Cunningham of its intention to make him personally liable for any costs awarded against his companies. Mr. Cunningham argued that, even if notice was a valid factor in the assessment, it had been given to him very late in the day. The notice was served on him in 2008, just a few months before the matter went to hearing. In delaying the notice, the bank placed Mr. Cunningham in the difficult position of choosing either to abandon his litigation having already incurred considerable costs or to continue and face the possibility of a costs order against

him. It is worth remembering that non-party costs orders were a novel thing in Ireland in 2008, meaning that Mr Cunningham had no way of knowing if the order would be made even if the bank carried out its threat of applying for it.

The Supreme Court, siding with the bank on this point, held that notice was a relevant, but not decisive, factor. The earlier the notice is given, the more it assists the party seeking the order. However, this does not mean that notice should now be given in all such cases at the earliest opportunity. As Mckechnie J observed, threats of non-party costs orders should not be wielded in a manner intended to suppress legitimate litigation. In any event, it seems that notice ought to be a less relevant factor in 2018 than it was in 2008. Litigants and their funders are expected to know the state of the law and, following the decision of the Supreme Court in *Moorview*, they should automatically be on notice of the possibility of a non-party costs order being made against them.

Security for costs

Under section 52 of the Companies Act 2014 (formerly section 390 of the Companies Act 1963) a person against whom proceedings are issued can apply to the court for security for costs. If granted, such orders restrain the plaintiff from continuing with its litigation until it first pays into court a sum of money which will be used o discharge the defendant's legal costs should it succeed in its defence. The applicant in an application for security for costs is required to show that the plaintiff-company is insolvent and would not be able to pay its costs if called upon to do so.

Mr. Cunningham argued that, if the bank was really so concerned about the inability of the companies to pay its legal costs, then it should have made an application for security for costs at the outset of the litigation. This, he continued, would have been a more appropriate course of action and would have avoided placing him in an impossible situation so late in the day.

Mckechnie J acknowledged that an application under section 52 (section 390 back in 2003 when the proceedings were issued) was open to the bank. However, he could see no reason why the availability of one application ought to prevent a party from making another, especially in the modern age of litigation where there are a myriad of interlocutory applications available to litigants:

> "I cannot accept the argument that the fact that an application may be made seeking security for costs can itself preclude the recognition of what is otherwise a valid discretionary jurisdiction, founded on both statute and the rules of court, to award costs against a non-party. Given the multiplicity of pre-trial, trial and post-trial procedures now available to litigants, all designed with the intention of facilitating the efficient conduct of court proceedings and thereby assisting the administration of justice, it

> will frequently be the case that there are various discrete avenues by which a party may seek to protect its interests or achieve its ends."

Moreover, it will be noted that the requirements for succeeding in an application for security for costs are not identical to those required for a "Moorview order". There is no reason why a litigant should be prevented from pursuing a legal avenue by which he is more likely to succeed.

Separate legal identity

It is trite law that a company is a separate legal entity from its owners. Shareholders doubtless have an interest in their company but they are not the same legal person. Consequently, the shareholders of a limited liability company are not personally liable for the debts of the company, save to the extent of their shareholding. Mr. Cunningham placed great emphasis on this principle in arguing that he ought not to be made personally responsible for costs orders made against his companies. After all, he was not the only shareholder in the companies and, had the group succeeded in its litigation, it would have been the companies who benefited rather than the shareholders personally (though admittedly, their shares would have increased in value).

Once again, the argument did not sway the Supreme Court. McKechnie J, relying on the English decision in *Threlfall v. ECD Insight Ltd* [2013] EWCA Civ 1444, noted that the liability imposed by a third-party costs order is not the liability of the company - it is imposed on the shareholder personally. In other words, it is not correct to say that the shareholder is being made liable for the company's debts. On the contrary, the debt belongs - and always belonged - to the shareholder himself. It is he and not the company who has primary responsibility for the debt. As such, the court is not piercing the corporate veil. Even if it was, there are numerous instances where courts have been willing to impose liability for corporate debts on shareholders where to do so would serve the interests of justice.

Conclusion

The Supreme Court emphatically held that an Irish court had jurisdiction to award costs against parties not before it during the proceedings. It was careful to point out that such orders would be the exception and not the norm. After all, there is nothing unusual or wrong about shareholders funding the legal proceedings of their insolvent companies. That, on its own, will never be enough to make them personally liable for any costs ultimately awarded against the company. The list of factors set out by the court, extensive but not exhaustive, ensures that every case will be decided in accordance with its own facts. The purpose of such orders will not be to punish any

person for failing in its litigation but rather to achieve justice between the parties to that litigation.

All of these factors ultimately boil down to whether or not person funding the litigation acted reasonably. As Mckechnie J pointed out: "The fact that the proceedings were pursued and conducted reasonably may provide a basis not to award costs against the non-party."

While it is clear that non-party costs orders will not be routinely made, the decision of the Supreme Court in Moorview nevertheless gives company shareholders and directors, as well as their legal advisors, much to think about when contemplating commercial litigation.

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Important Note

This article is intended to be an introduction to this area of law and should not be taken as constituting legal advice. If you require more information about this subject or require legal advice or representation, please contact us on 01 6498522.