Editor's Note

Costs Capping Orders—the Failure of the Third Measure for Controlling Litigation Costs

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The one aspect of civil justice that continually occupies courts, practitioners, and members of the public is the high and unpredictable cost of litigation. The Woolf reforms were meant to provide a solution, but it is by now beyond dispute that the ensuing Civil Procedure Rules 1998 (CPR) have done nothing to improve the situation. On the contrary, litigation costs continue to be disproportionately high, subject to ever greater inflation and wholly unpredictable. Among the measures introduced by the CPR to curb this phenomenon two stand out in particular: the proportionality requirement for standard costs and the obligation for legal representatives to provide costs estimates. Both these measures have failed to make any significant impact.

Proportionality was introduced as a condition for recovering standard costs. CPR r.44.4(2) states that where standard costs (which represent the normal measure of costs) have been ordered, the court will "only allow costs which are proportionate to the matters in issue". At the same time, however, the rules also provide that successful litigants are normally entitled to claim costs that were reasonably incurred and which were reasonable in amount. Costs are considered to be reasonably incurred if the forensic activity for which they are claimed was in accordance with the standards of reasonably prudent and well-informed practitioners. Costs are reasonable in amount if they reflect the hourly fees charged by practitioners operating at the relevant level of expertise or seniority and in the relevant geographical location. Put shortly, the reasonableness of costs is determined by the current professional practice both in terms of assessing the necessity of the forensic input and the size of its reward.

Proportionality represents quite a different concept from that of reasonableness because it does not seek to reflect the current practice. Rather,

it seeks to impose a sensible correlation between the recoverable costs and the value, complexity or importance of the subject matter in dispute. One would therefore have expected that the requirement of proportionality would exert a downward pressure on recoverable costs and thereby redefine the standards of what was reasonable for practitioners to do in prosecuting their clients' case and in charging for their services. All such hope was however dashed when the Court of Appeal held in *Lownds v Home Office* [2002] EWCA Civ 365; [2002] 4 All E.R. 775 that if a particular process was necessary, then a reasonable amount must be allowed in recoverable costs, regardless of its correlation to the subject-matter in matter or its difficulty or importance. The function of the proportionality requirement was thereby reduced to merely requiring the judge who considers that the total amount of costs claimed is disproportionate to examine with greater rigour the necessity for each individual item of costs claimed. As a result, proportionality constitutes a negligible counter-weight to high costs claims.

The second moderating measure inaugurated by the CPR was the requirement to provide costs estimates. CPR Pt 26 requires parties to complete an allocation questionnaire. One of the pieces of information that must be provided in this document, and similarly in the later pre-trial checklist, is the party's estimate of costs incurred to date and of likely future costs to the end of the proceedings (CPR PD 6).

One would have thought that since parties, or more precisely their legal representatives, are required to indicate the level of expected costs these indications would have some bearing on the level of the eventual costs claimed by the solicitors that provided the estimates. But any such expectation was dashed by the Court of Appeal in *Leigh v Michelin Tyre Plc* [2003] EWCA Civ 1766; [2004] 2 All E.R. 175. The court held that the mere fact that a litigant supplied a low costs estimate should not prevent the litigant from claiming much higher costs. Costs estimates are relevant only in so far as a litigant who presents a much higher bill costs than the estimate must justify them. Since, as already noted, a litigant claiming costs must in any event satisfy the court that they were necessary, reasonable and proportionate, a large disparity between the estimated costs and the claimed costs is unlikely to greatly increase the burden of justifying the costs.

Perhaps conscious of these shortcomings, the Court of Appeal added in the last mentioned case that the court would be entitled to take the estimated costs into account if the other party shows that it relied on the estimate in a certain way, or where the court concludes that it would probably have given different case management directions if a realistic estimate had been given. But experience so far suggests that these factors have not been invoked, at least successfully, to hold a party to the original low costs estimate. The fact remains that estimates do not seriously impede a party from recovering much higher costs if they can be justified by the traditional standards of reasonableness.

One of the reasons for which the Court of Appeal in *Leigh v Michelin Tyre Plc* was averse to holding parties to their estimates was the sense of injustice of deciding retrospectively, at the costs assessment stage, that the costs that a

litigant had incurred were not recoverable when at the time the party regarded them as reasonable (see [30]). It is difficult, however, to see why a decision to hold a party to his estimate amounts to a retrospective denial of something to which the party would otherwise be entitled. A rule which says that a party would not be allowed to recover more than the estimated costs would be a prospective rule, which like all rules would inform parties in advance of the consequences of providing an estimate of costs.

Although in *Leigh v Michelin Tyre Plc* the Court of Appeal did not feel that holding parties bound by their own costs estimates was the right way to control costs, it expressed the view that costs capping orders provided a better means of achieving this goal. A costs capping order determines in advance the maximum amount that a party would be allowed to recover by way of costs, should that party be successful. The jurisdiction to make such orders effectively introduces into English law a form of fixed costs litigation similar to the costs recovery systems followed in some European countries. The advantage of such a system is that a litigant knows in advance the maximum amount of costs that he will be able to recover (or to which he may be liable) and has therefore every incentive to ensure that the investment made in litigation does not substantially exceed the expected benefit.

Costs capping forces litigants to take proportionality into account when deciding how much to invest in litigation. By contrast, under the present system a litigant has every incentive to continue investing in litigation, even when the litigation expenses already incurred exceed the value of the subject-matter in dispute. This is because once a litigant has made a substantial investment in litigation he has to continue investing for fear that failure to do so may harm his chances of obtaining a favourable judgment and thereby of recovering the amounts already spent in costs. Indeed, in any litigation of substance the litigant's worst fear is that he would be ordered to pay the opponent's costs as well as having to meet his own. Thus, once a litigant has spent a considerable amount in litigation he is effectively locked into a system which continues to consume his resources without any foreseeable upper limit.

Notwithstanding the plain benefits of costs capping, the jurisdiction of making such orders has been rendered next to useless, except in certain narrowly defined forms of public law litigation and in group litigation, with which aspects this commentary is not concerned. The principal reason for this limitation is rooted in the narrow view that the court has taken of the purpose of this jurisdiction. It has been held that costs capping is not to be used to merely to render costs proportionate and predictable. Instead, the purpose of the costs capping jurisdiction is only to provide a prospective method of assessment of costs. Like post-proceedings assessment, costs capping must still allow litigants sufficient room to incur costs that would be considered reasonable if assessed after the proceedings.

As Gage L.J. put it in *Smart v East Cheshire NHS Trust* [2003] EWHC 2806 (QB) at [22], the function of the jurisdiction is to place a prospective limit on recoverable costs when

> "there is a real and substantial risk that without such an order costs will be disproportionately or unreasonably incurred; and that this risk may not be managed by conventional case management and a detailed assessment of costs after a trial".

Put simply, the jurisdiction is exercisable only where there is a real risk that the costs incurred by a litigant may get out of hand.

The limitation of the costs capping jurisdiction to cases where there is a risk of costs getting out of control is puzzling. For, as already noted, no matter how much a successful party has spent, the court cannot order the unsuccessful party to pay more than reasonable and proportionate costs. Hence by definition there is no room for abuse in the sense of being able to recover more than reasonable and proportionate costs (ignoring for the present discussion the effect that the success fee can have where the successful party has been represented on a conditional fee basis).

The narrow view taken of the justification for costs capping orders has inevitably denuded it of usefulness. *Henry v BBC* [2005] EWHC 2503, QB; [2006] 1 All E.R. 154 illustrated the point. In a claim for defamation backed by a CFA the claimant estimated the costs at the allocation stage to be £360,000. But on the eve of the trial a year later they had arisen to £690,000. At that point the defendants applied for a costs capping. Gray J. refused the application because it should have been made earlier. Costs orders, he explained, are meant to act prospectively not retrospectively. He thought that

> "the imposition of a costs cap so close to trial would in effect penalise the Claimant, or perhaps more accurately her legal advisers, when, as has often been said, the purpose of a capping order is to enable the capped party to plan ahead the appropriate level of expenditure to bring the case to trial at a cost which is in line with the amount of the cap" ([39]).

Yet the reason why the defendants had not applied earlier was that they had not been informed of the escalating costs earlier. Since they had no knowledge of the massive rise in costs they had no reason to apply, nor would they have been able to support such application. The practical effect of this decision is that as long as a party does not reveal disproportionate expenses early in the process, he is virtually immune from a costs capping.

The recent decision in *Willis v Nicolson* [2007] EWCA Civ 199 illustrates the problems and also reveals why the Court of Appeal finds it impossible to tackle the phenomenon of high and unpredictable costs. The claimant commenced proceedings for serious injuries suffered in a road accident in 2005. In his allocation questionnaire dated October 2005 the claimant indicated that the costs already incurred were up to £80,000 and further costs in the proceedings were estimated to be up to £170,000; a total of up to £250,000. However, in June 2006 his solicitors indicated the costs actually incurred by that date were £450,000, almost double the previous total estimate for the entire process. They also stated that the sum of £146,937 was now expected to be incurred to the end of the liability trial only. The new total was now £564,189. A month

later, however, the total expected costs doubled again because on July 31, 2006 an estimate of £459,496 costs referable to future quantum proceedings was submitted, bringing the total for the whole action to £959,342. The damages recoverable on full liability were thought to be in the region of £5 million. But these were likely to be reduced by one third as the claimant was found to have contributed to the accident. That meant that the claimant's lawyers were seeking costs close to £1 million for recovering something in the region of £3.3 million.

When the last estimate was filed, the defendants applied for a costs capping order. The application was heard in October 2006. Field J. expressed some discomfort at the level of costs, describing the costs already incurred as "truly remarkable", but he thought that by the time of the application before him all that was left to be considered was the amount of future costs. In respect of these he concluded (CA, at [11]):

> "Although I am uneasy about the remarkably high level of costs incurred to date I feel unable to reach the conclusion, having regard to all the material before me, including the future estimate, that there is a real risk that the future costs incurred from 31 July will be unreasonable and disproportionate."

However, believing that the defendant "merits a measure of protection", he ordered that costs incurred from that date to the final determination of the claim should not exceed the estimate already provided by the claimant of £459,496. This was hardly a break on the escalating costs, seeing that by that time the total costs of nearly £1 million for the whole action had quadrupled since the initial estimate provided a mere eight months earlier.

On the face of it, the judge's reasoning is puzzling. For if the costs of nearly £500,000 incurred up to July 31 were "truly remarkable", how could a similar amount yet to be incurred be so easily regarded as reasonable and proportionate? The answer which the judge gave and which was approved by the Court of Appeal was that it would take a disproportionate time to refer the matter to a costs judge at this late stage to determine an appropriate cap for the remaining quantum proceedings, especially seeing that some three months of the eight months between the application and the trial had already passed and to that extent the costs were no longer future costs that can be capped. Moreover, the Court of Appeal was of the view that costs capping should not be done if it was likely to require the claimant to adjust his preparations for the trial so close to the trial date.

Notwithstanding the resolute manner in which the Court of Appeal disposed of the appeal, it did express concern about the disproportionately high costs of litigation. Speaking for the court, Buxton L.J. said at [18]:

> "The very high costs of civil litigation in England & Wales is a matter of concern not merely to the parties in a particular case, but for the litigation system as a whole. While disputants should be given every encouragement to settle their differences without going to court, that

> encouragement should not include the making of litigation prohibitively costly so that litigants are deterred irrespective of the merits of their case.''

Such expressions of concern have become commonplace in court decisions. What is novel about this particular one is that the Court of Appeal went on to make some important and telling observations about the factors that contribute to high and unpredictable costs and about reasons why the court can do little to alleviate the plight of litigants. Buxton L.J. explained (at [18]):

> ''One element in the present high cost of litigation is undoubtedly the expectations as to annual income of the professionals who conduct it. The costs system as it at present operates cannot do anything about that, because it assesses the proper charge for work on the basis of the market rates charged by the professions, rather than attempting the no doubt difficult task of placing an objective value on the work.''

Later on in the judgment the court reiterated the last point by saying that ''the amount recoverable on assessment is fixed, as to rates, by the standard amounts allowed'' (at [21]).

These observations are troubling. To begin with, there is a certain inconsistency between the idea that costs are determined by the desire of lawyers to maintain certain standards of income and the idea that the fees charged by lawyers are determined by market forces. If market forces were truly effective in this area, they and not lawyers' expectations would determine fee levels. The fact of the matter is that market forces do not greatly influence fees for several reasons. The hourly fee is screened from market forces by the fact that it is very difficult for clients to relate quality of service to the price charged for it. There is no transparent criterion to determine whether a higher hourly fee would secure better quality in this field of professional activity. More important still, while the client may be able to negotiate the hourly fee, the client has very little influence on the number of billable hours. Finally, the client's resistance to rising costs is undermined by the indemnity principle which both induces him to spend more in order to recover his costs and deters him from desisting for fear of having to pay the other side's costs. It is therefore plausible to assume that both the hourly fee and the number of billable hours are influenced to some notable degree by the expectation of the service providers of an acceptable certain annual income rather than by market forces.

Indeed, in this very case the court ''identified four areas of concern in relation to the time proposed to be spent by fee-earners in the firm of solicitors acting for the claimant'' (at [11]):

> ''182 hours for attending on the client and his immediate carers, at a cost of some £50,000. 80 hours attending on other lay witnesses, at a cost of some £20,000 87 hours working with counsel, at a cost of some £30,000 260 hours working on documents, at a cost of some £51,000.''

The court acknowledged that the present approach to costs

> "led to what appears to be fairly routine work in preparing for trial being charged to the other side at an average, over the range of grades of lawyer involved, of £250 per hour. In such a world, if proportionality is to mean anything, at least the courts should ensure that no more of those expensive hours are spent than the case properly justifies" (at [20])].

For this reason the court thought that (at [21]):

> "The focus of costs limitation thus has to be on the way in which the professionals intend to conduct the case because, as we have seen, the amount recoverable on assessment is fixed, as to rates, by the standard amounts allowed. And, as to the costs of evidence, the number of experts used is controlled by the need to obtain permission to call an expert, and at least in extreme instances by the exercise of the court's power under CPR 35.4(4) to limit the amount of experts' fees: to the extent, and very beneficially, of removing an expensive expert in favour of a more economic alternative . . ."

However, while expressing support for limiting the fees recoverable by experts, it showed no appetite for imposing similar constraints on lawyers' fees. It stated that to "limit the way in which the professionals intend to conduct the case is a delicate matter" (at [22]). So delicate would this matter appear to be that the Court of Appeal left the law unchanged for it concluded (at [22]):

> "The court will be careful before imposing such a restriction, particularly when those restricted are, as in the present case, acting for a claimant who has suffered catastrophic injuries. To conduct the exercise properly the court will need reliable information about, and understanding of, the nature of the particular case and the general demands of that type of litigation. And both for reasons of fairness and for reasons of practicality a cap cannot be imposed retrospectively, so the enquiry must take place at a sufficiently early stage to have a real effect on expenditure: the present case demonstrates the hopelessness of leaving an application until close to the date of trial."

There are different ways of interpreting these views. It is possible that the court thought that proper representation for a person who suffered grave injuries deserves a high reward. Or perhaps the court felt that lawyers representing such a claimant must be given freedom to determine the cost of the litigation and thereby their own profits.

What is, however, clear is that the court did not consider that costs capping orders were suitable for limiting the costs in this case or in any other ordinary civil dispute outside public and group litigation. This is why it left virtually no room for making costs capping applications. As noted earlier, the court considered that the defendants' application made in September 2006 in order to challenge the costs estimates filed on July 31, 2006 was too late. Yet, before that date the defendants had no grounds for applying since the estimates given on June 16 were much lower. There was no right time in this case, just as in the *Henry v BBC* case mentioned earlier, for making an application for a cap on costs.

The upshot is that having failed to control costs by means of court management directions, which the Woolf reforms sought to achieve, having failed to control costs by holding parties to their estimates, the Court of Appeal has now abandoned a third measure for achieving costs control by reducing the practical usefulness of the jurisdiction of making costs capping orders to a vanishing point in ordinary civil litigation.