Editor's Note

The Costs Indemnity Principle—From Restoration to Blame

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LT Costs between the parties; Costs orders; Disciplinary procedures; Equality of arms; Public authorities

The indemnity principle has been fundamental to the administration of civil justice in England. This principle requires the court to order the unsuccessful party to pay the successful party's reasonable litigation costs. The court may, however, deviate from this principle but only for good cause. The prospect of recovering legal expenses is all the more important in a system, such as the English system, where litigation costs are high and unpredictable and could well exceed the value of the subject matter in dispute. In the absence of a possibility of recovering one's litigation costs, disputants would be deterred from asserting or defending their rights for fear that even a favourable judgment may prove a pyrrhic victory which results in greater loss than the wrong suffered in the first place.

The traditional justification for this principle, which is by no means universal amongst legal systems, rests on the belief that a person should not be out of pocket as a result of having to seek court adjudication to vindicate his rights. In *Harold v Smith* [1850] 5 H. & N. 381, 385 Bramwell B. said:

> "Costs as between party and party are given by the law as an indemnity to the person entitled to them; they are not imposed as a punishment on the party who pays them, nor given as a bonus to the party who receives them."

Dyson J. spelt out the reason in *R. v Lord Chancellor Ex p. Child Poverty Action Group* [1999] 1 W.L.R. 347; [1998] 2 All E.R. 755, 764:

> "The basic rule that costs follow the event ensures that the assets of the successful party are not depleted by reason of having to go to court to meet a claim by an unsuccessful party."

By stressing the aim of ensuring that the successful party is not worse off as a result of engaging in litigation, the common law gave the indemnity principle a purely restorative function; it has enabled the court to see to it that the successful party is in no worse financial position for being obliged to assert or defend his rights in court proceedings. In recent years, however, there has been a subtle but significant shift in the understanding of the purpose of the indemnity principle. For example, in *Arkin v Borchard Lines Ltd* [2005] EWCA Civ 655; [2005] 1 W.L.R. 3055; [2005] 3 All E.R. 613 at [23], Lord Phillips M.R. stated:

> "The main principle that underlies the rule is that if one party causes another unreasonably to incur legal costs he ought as a matter of justice to indemnify that party for the costs incurred. A defendant who has wrongfully injured a claimant and who has refused to pay the compensation due should pay the costs that he has caused the claimant to incur, so that the claimant receives a full indemnity. A claimant who brings an unjustified claim against a defendant so that the defendant is forced to incur legal costs in resisting that claim should indemnify the defendant in respect of the costs he has caused the defendant to incur. Causation is usually a vital factor when considering whether to make an award of costs against a party."

On this view, the unsuccessful party is ordered to pay costs because he is to blame for the successful party's litigation expenses, just as a tortfeasor is blamed for inflicting loss on another. Clearly this represents a shift from a restorative principle, which is morally neutral and blame-free, to a principle of compensation for inflicting unjustifiable loss, which is blame-based. A restorative principle does not require an assessment of the unsuccessful party's motives for engaging in the proceedings whereas the blame-base principle does, as we shall shortly see.

While the immediate purpose is merely to discuss the consequences of this transformation of the indemnity principle, it should be noted in passing that the new justification is questionable. In particular, the analogy drawn between an unsuccessful party and a tortfeasor is weak. A tortfeasor has committed an unlawful act whereas a litigant has merely chosen to assert or defend his perceived entitlements by exercising his fundamental civic right of access to court. Although litigation, like any other activity, can be conducted in an improper manner (e.g. malicious prosecution or abuse of process), there is nothing inherently wrong in seeking court adjudication. It may of course happen that a litigant advances a weak or unsustainable case. But existing procedures allow for such cases to be disposed of summarily either by striking out under CPR r.3.4(2), or by summary judgment under CPR Pt 24. Disposing of such cases does not normally involve serious costs. Litigation expenses tend to be high and burdensome in disputes that give rise to difficult or complex issues of fact or of law and which need full court adjudication. It cannot, therefore, be said that a party who insists on court determination of a serious dispute is comparable to a wrongdoer. There is plainly nothing unlawful, improper, or even undesirable in seeking court adjudication. Indeed, the opposite is true. As

Lord Diplock observed in *Bremer Vulkan Schiffbau and Maschinenfabrik v South India Shipping Corp* [1981] A.C. 909, HL; [1981] 1 All E.R. 289, 295:

> "Every civilised system of government requires that the state should make available to all its citizens a means for the just and peaceful settlement of disputes between them as to their respective legal rights."

Yet blame-based understanding of the indemnity principle tends to be increasingly reflected in practice, as may be seen in *Baxendale-Walker v Law Society* [2007] EWCA Civ 233; [2007] 3 All E.R. 330. B, a solicitor, had advised clients in relation to investments which went badly wrong and which ended up in High Court proceedings. B appeared as a witness in these proceedings but the judge found his evidence unsatisfactory and was very critical of his conduct. As a result, the Law Society brought disciplinary proceedings against B for conduct unbefitting a solicitor. The accusation was founded on two grounds: first, that B had given false evidence in High Court proceedings, and secondly, that he had provided a reference to a bank in circumstances that he knew were improper and unprofessional. The tribunal dismissed the first allegation but upheld the second, finding that B gave a false reference to the bank. The tribunal suspended B from practice for three years but held that, since he had been successful in his defence of the first and more serious allegation, it would not be right that B should pay the Law Society's costs but that, on the contrary, the Law Society should pay a proportion of his costs. It accordingly ordered the Law Society to pay 30 per cent of B's costs.

On appeal, the Divisional Court upheld the tribunal's ruling on the merits but allowed the Law Society's appeal against the costs order and ordered B to pay 60 per cent of the Law Society's costs. The Divisional Court held that a different costs principle applied where a disciplinary body or regulator was taking proceedings in the public interest in the exercise of its public function. It was of the view that, absent dishonesty or bad faith, a costs order should not be made against such a regulator unless there is good reason to do so. Such reason must be more than that the other party had succeeded.

Upholding this decision the Court of Appeal drew attention to *R. v Merthyr Tydfil Crown Court Ex p. Chief Constable Dyfed Powys* (1998) 95(46) L.S.G. 35; *R. v Totnes Licensing Justices Ex p. Chief Constable of Devon and Cornwall* (1992) 156 J.P. 587; *Chief Constable of Derbyshire v Goodman*, unreported, April 2, 1998, DC; and, in particular, to *Gorlov v Institute of Chartered Accountants in England and Wales* [2001] EWHC Admin 220. The Court of Appeal endorsed Jackson J.'s view in the last last-mentioned case that, when it brings disciplinary proceedings, the Law Society is discharging its public interest responsibilities as a regulator of the profession to ensure the maintenance of proper professional standards. For the Law Society to be exposed to the risk of an adverse costs order simply because properly-brought proceedings were unsuccessful might have a chilling effect on the exercise of its regulatory obligations, which would be to the public's disadvantage. Therefore, the Court of Appeal concluded, an order for costs should not ordinarily be made against it on the basis that costs follow the event. The "event" is simply one factor for consideration.

There is no assumption that an order for costs in favour of a solicitor who has successfully defeated an allegation of professional misconduct will automatically follow.

The Court of Appeal observed that, in this particular case, serious professional misconduct was established and a sanction imposed, which meant that the proceedings served to uphold the integrity of the profession. It therefore concluded that the Tribunal misdirected itself as to the applicable costs consequence. The Divisional Court, which had to make a fresh order, took the view that overall fairness required that B should pay 60 per cent of the Law Society's costs and the Court of Appeal agreed.

It has to be stressed that the Court of Appeal did not hold that, when they have acted properly in instituting disciplinary proceedings, public bodies such the Law Society are not liable to costs. It only held that the normal indemnity principle does not automatically apply in such proceedings. It endorsed Lord Bingham's view in *Bradford MDC v Booth* (2000) 164 J.P. 485 that, when a private litigant has been successful in such cases, the court should consider, in addition to any other relevant circumstances: (1) the financial prejudice to the private litigant if not awarded costs; and (2) the need to encourage public authorities to make and stand by honest and reasonable administrative decisions without fear of being subject to undue financial prejudice if these decisions are successfully challenged.

If the starting point is not that the unsuccessful public body must pay costs, then it must be its opposite, i.e. that the public body will not be ordered to pay costs even if it fails to establish its case. Indeed, the Court of Appeal stated at [39] that:

> ''Unless the complaint is improperly brought, or, for example, proceeds as it did in *Gorlov*, as a 'shambles from start to finish', when the Law Society is discharging its responsibilities as a regulator of the profession, an order for costs should not ordinarily be made against it on the basis that costs follow the event.''

This departure from the indemnity principle raises questions that are yet to be faced. First and foremost is the question of equality before the law, or equality of arms under ECHR Art.6. The exemption, albeit qualified, given to public bodies from the obligation of paying costs puts the individual at a serious disadvantage when challenging a public body in court. The Court of Appeal noted (at [39]) that for:

> ''[T]he Law Society to be exposed to the risk of an adverse costs order simply because properly brought proceedings were unsuccessful might have a chilling effect on the exercise of its regulatory obligations, to the public disadvantage.''

Yet the same can be said about the individual. Similarly, if there is a ''need to encourage public authorities to make and stand by honest and reasonable administrative decisions without fear of being subject to undue financial prejudice if these decisions were successfully challenged'', (in the words of

Lord Bingham above), there must be a similar need to encourage individuals to defend their civic rights; what's sauce for the goose is sauce for the gander.

One of the reasons that the Court of Appeal in *Baxendale-Walker* (at [34]) gave for its departure from the indemnity principle was that:

> ''[W]hen the Law Society is addressing the question whether to investigate possible professional misconduct, or whether there is sufficient evidence to justify a formal complaint to the Tribunal, the ambit of its responsibility is far greater than it would be for a litigant deciding whether to bring civil proceedings.''

Presumably, the Court had in mind the responsibility to ensure that the case against the individual solicitor is well-founded and is sufficiently serious to justify proceedings.

This last consideration is relevant only if one accepts that the indemnity principle is blame-based. But if blame is the key to costs orders in cases such as the present one, the court should consider not just the public body's responsibility but also that of the private opponent. Of course a private litigant does not owe a comparable legal responsibility to ensure that his case is well-founded and justified (though such responsibility may well be carried by office holders, such as company directors). However, even in the absence of a legal obligation to avoid advancing unfounded claims or defences, few rational litigants would choose to maintain an unfounded case, not least on account of the costs consequences of failed proceedings. But all this is somewhat beside the point because the exemption from the indemnity rule inflicts the greatest pain not on frivolous litigants who have behaved irresponsibly but, on the contrary, on private litigants with strong claims of right who have moreover vindicated their rights by successfully resisting a challenge from a public body.

Citizens who are accused of wrong-doing by a public body are now put on notice that, even if they succeed in defending their conduct, they may well end up worse off by virtue of being unable to recover their own litigation costs. Suppose that a solicitor is charged with a disciplinary offence that carries only a sanction of reprimand or of suspension for a short period. Such solicitor will be advised that it may well make better financial sense to admit the offence and take the consequences than to fight the accusation because, even if the solicitor were exonerated, her own legal expenses would be greater than the financial loss caused by the sanction. It must therefore be recognised that the present ruling puts obstacles in the way of the very people who should be supported in their attempts to seek court protection.

It is not suggested that costs orders may not be influenced by the litigation conduct of the parties. Conduct has become an important consideration in making costs orders. What is under consideration here is a rule which says that, all else being equal, a public authority will be treated more favourably than the individual who has successfully challenged its decision. If costs orders are now blame-based, then the court making the order should consider the relative blame of the parties. It should consider why the successful private litigant has greater blame for the proceedings than the unsuccessful public body. In this particular case the Court of Appeal was of the view that B, ''brought the

proceedings in relation to both allegations on himself'' (at [40]). This may have been the situation in this instance, but the Court of Appeal was declaring a general rule for all similar cases. On the face of it, however, this principle is at odds with the right to equality of arms under ECHR Art.6, which forbids placing one litigant at a substantial procedural disadvantage compared with the opponent.

The exemption given to public authorities from the indemnity rule might conceivably be justified if it were symmetric; that is, if the indemnity principle were similarly suspended where the public body is successful and the private litigant is unsuccessful. But there is no indication that this is the case. Since the Court of Appeal was worried about the chilling effect of requiring the public body to pay costs when unsuccessful, it would be even more concerned about the chilling effect that public bodies would feel if they had to bear their own costs when successful. It is clear therefore that the qualified exemption is given only to public bodies, not to private individuals.

It is remarkable that, while the benefit that the exemption from the indemnity principle confers on public bodies was sympathetically articulated in this case, little mention was made of the effect that this exemption may have on private litigants, nor was a justification provided for this discrimination. Yet, in the past the court did acknowledge the need for comparable treatment even in public law litigation. In *R. v Lord Chancellor Ex p. Child Poverty Action Group* [1999] 1 W.L.R. 347; [1998] 2 All E.R. 755, 764, for example, Dyson J. said:

> ''The basic rule that costs follow the event ensures that the assets of the successful party are not depleted by reason of having to go to court to meet a claim by an unsuccessful party. This is as desirable in public law cases as it is in private law cases . . . where an unsuccessful claim is brought against a public body, it imposes costs on that body which have to be met out of public funds diverted from the funds available to fulfil its primary public functions . . . It is plainly right that in the normal run of the mill public law case, the unsuccessful party should pay the other side's costs . . . in considering whether, and in what circumstances, there should be a departure from the basic rule that costs follow the event in public interest challenge cases, in my view it is important to have in mind the rationale for that basic rule, and that it is for the applicants to show why, exceptionally, there should be a departure from it.''

Quite apart from the objections in principle to the partial exemption from the indemnity principle, this departure from the normal costs consequences is likely to have undesirable effects in practice. As already noted, the exemption is not absolute. It only represents a presumption, which the successful private litigant can overturn by showing that he would suffer financial prejudice. Successful private litigants are bound to try to recover their costs by showing prejudice. This is bound to lead to more litigation and more expenditure since the notion of prejudice is flexible, not to say unclear. Does prejudice require a showing that the private litigant is of limited means, or is it enough to show that the legal expenses were large? If ''prejudice'' requires a showing of poverty, how poor must the private litigant be? And what if the private litigant is represented

on a CFA basis? Even if these questions had a clear answer, it would still not be the end of the matter since the court has to balance the prejudice to the private litigant with the chilling effect that ordering a public body to pay costs would have on its willingness to fulfil its public duties. There is no escaping the potential that the qualified exemption has for stoking up further litigation and even greater expense on all sides.

But there is perhaps one positive aspect emerging from this ruling: the increasing recognition on the part of the Court of Appeal that costs have a chilling effect on access to court; so much so that even well resourced public bodies can be affected. If such bodies are likely to be deterred from fulfilling their public duties for fear of costs, what hope is there for litigants of lesser means? Unfortunately, it must be assumed that the courts have found this question too troublesome to be directly addressed, for otherwise they would surely have done so before now.