Insurers liable for uninsured costs under non-party costs order

There are no special rules limiting the circumstances in which the court can, by means of a non-party costs order, make an insurer liable for costs that would otherwise fall outside the scope of the insurance policy, the Court of Appeal emphasised in *Travelers Insurance Company v XYZ* [2018] EWCA Civ 1099 (judgment handed down on 17 May 2018). The only immutable principle is that the discretion to make such an order has to be exercised justly.

Although the facts of the case, set out below, were described by the Court of Appeal as "highly unusual (if not unique)", the judgment will make uncomfortable reading for insurers: it suggests that a non-party costs order may potentially be available against an insurer in any case in which the insured's liability for damages and costs exceeds the limit of the policy and the insured cannot pay. Certainly, the judgment suggests that insurers should think carefully about how they act in any case that involves both insured and uninsured elements.

Facts

This was an appeal against a non-party costs order made pursuant to section 51 of the Senior Courts Act 1981 at the conclusion of litigation concerning the supply of defective implants for use in breast surgery. Some 1,000 claims were made under a Group Litigation Order ("GLO"), and included 623 claims against Transform Medical Group ("Transform"), which was insured by Travelers. Of those claims, only 197 were insured by Travelers: the others either related to a period which fell outside that covered by the insurance, or were brought by the "worried well": claimants who had been fitted with the defective implants, but whose implants had not yet failed.

Transform repeatedly sought guidance as to whether it should disclose to the claimants that many of the claims were uninsured, and was willing to make that disclosure. Travelers (albeit on advice which was given, ill-advisedly, on a joint retainer basis) took the position that the lack of insurance should not be disclosed; so the uninsured claimants were not aware that there would be no means of recovery in the event of Transform's insolvency.

The litigation was subject to case management and four sample cases were selected to go forward to a trial of certain preliminary issues. Transform was the defendant in all four cases, but two – unbeknownst to the claimants – were uninsured claims. Shortly before the trial of the preliminary issues, medical evidence was exchanged which made it seem likely that the implants would be found to be not of satisfactory quality. A settlement meeting took place in June 2015 but Transform went into administration shortly afterwards. The insured claims were settled in August 2015 and in March 2016, the uninsured claimants entered judgment in default against Transform.

Travelers paid the insured claimants damages and costs representing about 20% of the costs of the claimants under the GLO (on the basis that 197/1000 claims were insured by Travelers). Transform was, in principle, liable for approximately 42% of the common costs, but since it was insolvent, the uninsured claimants recovered nothing. Hence the application under section 51, which was granted by the judge. In her view, the facts that i) Travelers had taken the lead in the conduct of all the defences, including the uninsured claims which were "nothing to do with Travelers", and that but for Travelers' involvement, Transform would have disclosed to the claimants at an early stage that the majority of claims were

uninsured, were "powerful factors" in favour of the exercise of the discretion. Furthermore, had the applicants lost, they would have been liable to pay all the insurer's costs of defending the claims against the defendant. It was held that the insurer could not take this benefit without bearing some risk too.

The appeal

On appeal, Travelers sought to argue that there were clear principles regulating the circumstances in which costs could be awarded against an insurer under s.51. These were said to be that the insurer controlled the litigation in its own interest, and without paying appropriate regard to any inconsistent or contrary interest of its insured. In, and only in, such a case, Travelers argued, the insurer could be regarded as the "real party" to the litigation so that such an order was appropriate.

Not so, said the Court of Appeal. Giving the leading judgment, Lewison LJ observed (at [11]-[12]):

> *"The costs of defending the preliminary issues, for both claimants and defendants, were the same whether there had been 197 claims or 623. Had there only been 197 claims (all insured) Travelers would have been liable to indemnify Transform against all the claimants' costs of the preliminary issues. But because 426 uninsured claimants joined the register, if Travelers are right they have fortuitously escaped liability for approximately 68 per cent of those costs, even though the addition of those uninsured claimants had no effect on the costs at all.*
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> *My instinctive reaction is that this result accords neither with reason nor justice given the probably unique circumstances of this case."*

Viewed in that light, the result is unsurprising. However, Lewison LJ went on to review the five cases concerning applications for s.51 orders against insurers relied upon by Travelers. He stressed that the power is discretionary and that as such, no case set a precedent, and insofar as any case (particularly the case of *Citibank NA v Excess Insurance Co Ltd*[1] in which Thomas J referred to "clear principles" within which a case should fall in order for an order to be granted) purported to do so, it was wrong.

That review served to highlight the fact that a costs order is potentially available not only in the perhaps unusual scenario where there are a number of discrete claims, some of which are uninsured; but also in the more run of the mill situation where costs and damages exceed the limit of cover, if the insured is unable to meet its own liability.

In any event, the court went on to find that many of the features relied upon in previous cases were features of the present case. For example:

- Travelers' interest in defending the preliminary issues was to avoid a claim falling within the cover provided by the policy. The same could be said of every indemnity insurer conducting the defence of a claim in the name of its insured. This is sufficient, however, to render a case "exceptional" for the purposes of s.51, for it puts it "outside the ordinary run of cases where parties pursue or defend claims for their own benefit and at their own expense". Whether this is really an apt description of the general pattern in "the whole run of litigation that comes before the court" may be open to question in the light of the prevalence of both BTE and ATE insurance may be

[1] [2002] Lloyd's Rep IR 398

open to question, but given that the observation has been made several times in the Court of Appeal, may have reached the status of a presumption that will need to be displaced by evidence to the contrary.

- Travellers stood to benefit from a successful outcome to the preliminary issue. Again, so it will be in every case where the paying party is funded by an insurer who is indemnifying that party against an adverse costs order.
- The Court of Appeal was unmoved by the prospect of insurance premiums rising to meet the risk that insurers might be exposed to costs orders beyond their contractual liabilities.

The Court of Appeal disagreed with the judge that the uninsured claims were nothing to do with Travelers: both Transform and Travelers had a common interest in the outcome of the preliminary issues, and it was unavoidable that Travelers' defence of the insured claims gave Transform a collateral benefit in relation to the uninsured claims. The Court of Appeal, therefore, seems not to have regarded the order as justified on the basis of "intermeddling" in that sense; however, like the judge, it was troubled by the fact that Travelers' involvement had led to the claimants not being told that many of the claims were uninsured. Had that fact been known, none of the uninsured claimants would have pursued the litigation.

Arguably somewhat inconsistently with the passage set out above, the Court of Appeal therefore concluded that the order was also justified by the fact that Travelers' conduct in failing to make this disclosure had caused additional costs to be incurred.

Points to note

As the Court of Appeal emphasised, applications for orders under s.51 are always fact-sensitive, and the facts of this case were extreme. However, I suggest there are some lessons to be learnt, both for those conducting litigation in circumstances where it is unclear whether insurance is sufficient to meet the full extent of any liability in costs and damages, and, subsequently, for those facing (or contemplating making) such an application:

- Insurers dealing with claims that have insured and uninsured elements should carefully consider the extent to which there is really inevitable overlap between the two, and try to avoid their involvement straying into uninsured territory;
- There would seem to be no benefit in failing to disclose gaps in insurance: if the claimant does not drop the claim, the insurer should be in a better position to defend a s.51 application if it can show that the claimant knowingly took the risk of non-recovery;
- Claimants should press for confirmation of the insurance position if there is doubt (though the insurer is not obliged to reveal the limit of indemnity);
- Insurers faced with a s.51 application may wish to consider obtaining evidence as to whether the use of insurance to fund litigation is "exceptional";
- As ever, all parties should be wary of appealing a decision which is based on what the Court of Appeal has now confirmed is an extremely broad discretion.

Case note by Alice Nash

Hailsham Chambers, Friday 18th May 2018