Online Case 11
Threlfall

v

ECD Insight Ltd and Another

[2014] 2 Costs LO 129

Neutral Citation Number: [2013] EWCA Civ 1444
Court of Appeal (Civil Division)
29 October 2013

Before:
Richards, Tomlinson and Lewison LJJ

Headnote

Appeal by the claimant against an order for costs following a successful claim for breach of contract. Below, the judge had refused the claimant's application that the principal shareholder and managing director of the defendant firm be made jointly and severally liable with the defendant company for the claimant's costs. Held. It would be wrong to characterise a non-party costs order made against a company director as "piercing or lifting the corporate veil". The judge had given no consideration to the principles on which non-party costs orders are made. The making of a non-party costs order is discretionary and the court is entitled to look at the economic realities. Here, the director was the sole shareholder of the company and in that capacity, had been entitled to all its economic benefit: he had had absolute control of the company, yet had sought to resile from the contract because it was so damaging to his

own financial interests, as well as to those of the company. Appeal allowed.

Cases Cited

Goodwood Recoveries Ltd v *Breen*; *Breen* v *Slater* [2005] EWCA Civ 414; [2006] 1 WLR 2723; [2007] 2 Costs LR 147

Systemcare (UK) Ltd v *Services Design Technology Ltd and Sharif* [2011] 4 Costs LR 666; [2011] EWCA Civ 546; [2012] 1 BCLC 14

Judgment

1. **Lewison LJ:** Between February 2003 and September 2008 Mr Threlfall was employed by ECD. He brought an action for breach of contract against ECD and its sole director and shareholder, Mr Whitney. In his action Mr Threlfall alleged that ECD was in breach of contract. The contract in question was his contract of employment, which he said had been varied by agreement by him and Mr Whitney. Mr Threlfall said he was entitled to a 20% share in the equity of ECD, share dividends, a termination payment and a bonus payment. ECD denied the claim and counter-claimed, alleging breaches by Mr Threlfall of his obligations of fidelity and also of restrictive covenants in his contract of employment. Mr Whitney was joined as a party to the action, because any order in Mr Threlfall's favour for specific performance of his entitlement to the 20% equity would have either required a transfer of shares by Mr Whitney himself or would have had to have taken the form of requiring ECD to issue and allot shares to him, thus diluting Mr Whitney's sole shareholding.

2. The trial took place before Lang J, who handed down judgment on 17 December 2012. Her judgment is at [2012] EWHC 3543 (QB) and is reported at [2013] IRLR 185. Her main conclusions can be summarised as follows: (1) the contract of employment was varied, as Mr Threlfall alleged. (2) Under the varied contract Mr Threlfall was entitled to the claimed share in the equity of ECD or, at his option, payment in lieu. (3) Mr Threlfall was also entitled to dividends but not

to the claimed termination payment or bonus. (4) ECD was in breach of contract in not having given effect to these entitlements. (5) Mr Threlfall was in breach of his obligation of fidelity but ECD had suffered no loss. (6) Mr Threlfall was not in breach of the restrictive covenants contained in his contract of employment.

3. There is no appeal against any of the judge's conclusions on these substantive issues. In order to give effect to her decision, the judge made an order by which judgment for Mr Threlfall was entered against ECD for the sums of money specified in the order, Mr Threlfall having elected to take payment rather than shares *in specie*. Judgment for ECD was entered against Mr Threlfall for nominal damages for breach of the obligation of fidelity, but apart from that both the claim and the counter-claim were dismissed.

4. Mr Threlfall's victory was a Pyrrhic one, because less than a month later ECD went into insolvent liquidation. The issue arising on this appeal relates only to the judge's order for costs. Before coming to that, I will set out some of the judge's factual finding about ECD and Mr Whitney.

5. Mr Whitney was the founder of ECD, which was incorporated in May 2001. The company's share capital consisted of 100 shares of £1, all of which were held by Mr Whitney. Regular and substantial dividend payments were made to Mr Whitney, totalling about £489,000-odd between April 2003 and June 2011. Mr Whitney was ECD's only director and he actively controlled it. There was no formal management structure below Mr Whitney; and although he discussed management issues, clients, strategy and finance and other business issues with others, decisions were always made by Mr Whitney. Mr Whitney also controlled ECD's foreign subsidiaries.

6. The judge's overall conclusion was that, first, "Mr Whitney ran ECD as a private company of which he was the sole director and shareholder and therefore not accountable to anyone else" and, second, that Mr Whitney exercised "absolute control over ECD". Mr Whitney gave evidence at the trial. The judge rejected his evidence on a number of issues, including the nature of ECD's business and his future plans for it. In particular, on the question whether Mr Threlfall's entitlement to an equity stake had been varied by agreement, the judge did not find Mr Whitney's evidence credible, conflicting as it did with all the contemporaneous documents. She also rejected his evidence on a number of other issues. A judge's conclusion that a witness's evidence

is not credible, rather than simply preferring one recollection to another, is a strong finding. Mr Freedman QC is quite correct in submitting that, seen in context, it is tantamount to a finding of dishonesty.

7. The judge concluded that there was a binding agreement between Mr Threlfall and "Mr Whitney as principal shareholder and managing director" for an increase in Mr Threlfall's equity stake. She also found that "Mr Whitney was seeking to resile from the agreement he made … because the financial implications of doing so were damaging both to ECD and to himself personally". As Mr Freedman again rightly submitted, this provides the context in which the incredible evidence was given. It was given by Mr Whitney in order to further, amongst other things, his own personal financial interests.

8. It was in this context that Mr Neaman, then acting for Mr Threlfall, applied to the judge that Mr Whitney should be jointly and severally liable with ECD for the costs of the action. Among the submissions that Mr Neaman made to the judge was that if Mr Whitney had not been a party to the action, this was the kind of case in which a non-party costs order would have been made under s 51 of the Senior Courts Act 1981. It would be wrong for him to be in any better position by having been joined as a party to the action. This submission does not appear to have been seriously contested before the judge. Mr Oram, then appearing for ECD and Mr Whitney, submitted in his written argument that any application against Mr Whitney "ought to be considered by analogy to a non-party costs order". It was not of course in fact an application for a non-party costs order because Mr Whitney was a party to the action. Therefore the consideration of his liability on the basis of s 51 would have been by way of analogy only. Indeed the only legal material that was shown to the judge was a passage in the commentary in the White Book on CPR Part 48 which deals with the making of non-party costs order. Mr Shaw, appearing on behalf of Mr Whitney on this appeal with Mr MacEvilly, submitted that the non-party costs order point was not really raised before the judge. It may not have been in the forefront of Mr Neaman's submissions, but I am satisfied that it was raised both in writing and orally, judging by the passages in the transcript to which we have been referred.

9. The judge first considered whether there was any basis for making Mr Whitney personally liable for ECD's breach of contract.

She said that ECD was a solvent company which ran a legitimate defence at trial even if ultimately it was unsuccessful on the main issues. She could see no other basis of claim against Mr Whitney and concluded it was not necessary for any order to be made against him. She then continued:

> "Turning then to the question of costs, the first defendant [ECD] has accepted that it should pay the claimant's [Mr Threlfall's] costs of the action, both claim and counterclaim. I do not accept the claimant's submission that the second defendant [Mr Whitney] should also be made liable for the costs, for the reasons which I have already given above. Judgment was properly entered against the first defendant only."

10. The reasons which the judge had "already given above" appear to me to have been confined to the question whether there was a cause of action against Mr Whitney or whether there was some other basis for making him personally liable for ECD's breach of contact. In other words, the judge's reasons all related to a question of substantive liability. However, although it appears to me to have been common ground that the application for costs against Mr Whitney should be considered by analogy with a claim for costs against a non-party, the judge gave no consideration to the principles on which such orders are made. The important point about such orders is that they are *ex hypothesi* made against persons against whom there is no substantive cause of action and who therefore have not been joined to the substantive action. So the judge's reasons for refusing to order Mr Whitney to pay Mr Threlfall's costs did not engage with these principles. In my judgment, the judge's omission to deal with this basis on which the application for costs was put vitiates her exercise of discretion. I therefore consider that it is open to this court to exercise that discretion afresh.

11. The courts have repeatedly [warned] against overburdening cases of this kind with reference to decided cases and I will attempt to heed that warning. The ultimate question is whether it is just to make what is an exceptional order. I would, however, refer to two passages. The first is a paragraph from the judgment of Rix LJ in *Goodwood Recoveries Ltd* v *Breen* [2005] EWCA Civ 414, [2006] 1 WLR 2723. Rix LJ said this at para 59:

> "Where a non-party director can be described as the 'real party', seeking

> his own benefit, controlling and/or funding the litigation, then even where he has acted in good faith or without any impropriety, justice may well demand that he be liable in costs on a fact-sensitive and objective assessment of the circumstances."

12. Commenting on that extract in *Systemcare UK Ltd* v *Services Design Technology Ltd* [2011] EWCA Civ 546; [2012] 1 BCLC 14, I said:

> "It is to be noted that controlling on the one hand and funding on the other are separated by 'and/or'. Thus it is not the case that both elements need to be present."

Ward LJ and Lloyd LJ agreed with my judgment.

13. If a non-party costs order is made against a company director, it is quite wrong to characterise it as piercing or lifting the corporate veil; or to say that the company and the director are one and the same. As Mr Shaw has demonstrated, the separate personality of a corporation, even a single-member corporation, is deeply embedded in our law. But its purpose is to deal with legal rights and obligations. By contrast, the exercise of discretion to make a non-party costs order leaves rights and obligations where they are. The very fact that the making of such an order is discretionary demonstrates that the question is not one of rights and obligations of a non-party, for no obligations exist unless and until the court exercises its discretion. Moreover the fact that the discretion, if exercised, is exercised against a non-party underlines the proposition that the non-party has no substantive liability in respect of the cause of action in question. Of course, it is not enough merely to say that Mr Whitney was a director of ECD, but in deciding whether or not to make such an order, the court is not fettered by the legal realities. It is entitled to look to the economic realities. It is in this sense that many of the cases pose the question whether the non-party is "the real party" in the case. In the present case, (1) Mr Whitney is the sole shareholder in ECD and is therefore entitled to all its economic benefits; (2) Mr Whitney is the sole director of ECD and makes all decisions on its behalf; (3) ECD was under Mr Whitney's absolute control and he ran it without regarding himself as accountable to anyone else; (4) the variation of the contract under which Mr Threlfall's entitlement arises was, on the judge's finding, made by Mr Whitney not only in his capacity as managing director, but also in his

capacity as sole shareholder; (5) Mr Whitney sought to resile from that contract because it was so damaging to his own financial interests as well as the company's. The judge's phrase "sought to resile" suggests knowing resiling from that contract; (6) the failed counterclaim would also have been to Mr Whitney's financial benefit had it succeeded, because it would have paved the way for the argument that Mr Threlfall had forfeited his entitlement to the claimed share of equity; (7) the result of Mr Threlfall's success was that Mr Whitney would either be deprived of part of the value of his own shareholding or his entitlement by way of dividend to the payment in lieu, and thus Mr Whitney can be seen to have defended his own position in resisting the dilution of his own shareholding; (8) it is usually a matter of indifference to a corporation who its shareholders are, and consequently a battle over shareholdings is in reality a battle between shareholders; (9) Mr Whitney gave evidence in support of ECD's defence, and his evidence was in part rejected and in part found not to be credible. It is quite clear, as Mr Freedman demonstrated, that on analysis this section of Mr Whitney's evidence was given in bad faith; (10) Unlike most cases of non-party costs order Mr Whitney was in fact a party and as such entitled to participate in the trial to the fullest extent possible; and (11) Mr Whitney caused the company to advance a false defence which he must have known was false.

14. In my judgment these factors, taken cumulatively, make it just to order Mr Whitney to pay Mr Threlfall's costs. I would allow the appeal.

15. **Tomlinson LJ**: I agree. In my judgment this was a very clear and plain case in which the appropriate order was as indicated by my Lord.

16. **Richards LJ**: I agree with both judgments.

Order: Appeal allowed.

Clive Freedman QC and *Sam Neaman* (instructed by Pennington Manches LLP) appeared on behalf of the appellant.

Peter Shaw and *Conn MacEvilly* (instructed by Glenn Whitney, by Direct Access) appeared on behalf of the respondents.