Costs Budgeting: A practical approach in an uncertain regime

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Although costs budgeting has now been in place for over 20 months, the detailed implementation of the scheme is still relatively untested" per Warby J in Yeo v Times Newspapers Ltd [2015] EWHC 209 (QB).

The costs budgeting regime has been operating in some form for almost three years. Its scope was extended in April 2014 and now covers cases up to £10 million in value. There are a number of issues which should be considered by clients and their practitioners in the cost budgeting process, and, while Yeo gave some much needed guidance on the issues, the position remains unclear in many respects. This article provides an overview of the recent developments in case law and practical advice for completion of the cost budget.

The overriding factor to remember when preparing a cost budget is that if, at the conclusion of a case, more costs are claimed than are budgeted for, they will (probably) not be recoverable. It is, therefore, imperative to ensure that careful thought goes into preparing the budget in order that the risk of exceeding it in the future is minimised.

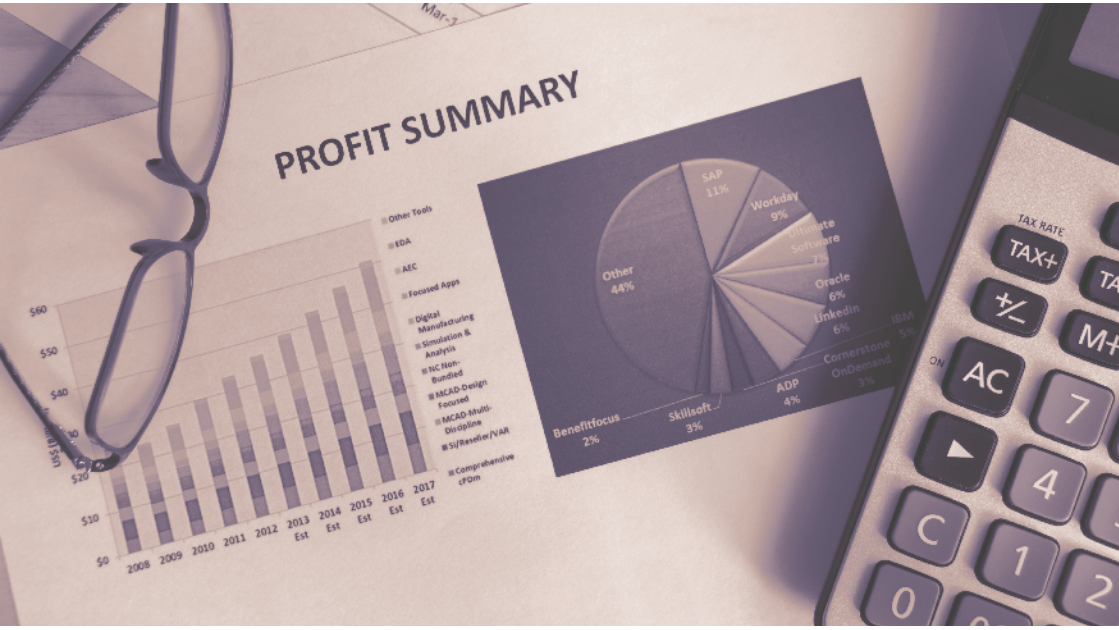
Application of the new regime

The costs budgeting regime is governed by Section II of Part 3 of the Civil Procedure Rules ('**CPR**') and supporting Practice Direction 3E. CPR 3.12 requires parties to proceedings to file and exchange costs budgets in a specific format ('**Precedent H**') in all Part 7 multi-track cases **unless:**

- the claim is commenced after 22 April 2014 and the value of claim is more than £10 million; or
- the matter is subject to fixed or scaled costs (prescribed by CPR 45, e.g. uncontested cases, small claims and enforcement proceedings); or
- where the Court, in its discretion, otherwise orders.

The emerging position, however, is that the first two limitations should not be enforced too strictly and should always be subject to the Court's discretion. See, for example, Coulson J's comments in *CIP Properties v Galliford* Try [2014] EWHC 3546 where he stated that, even where exceptions might apply, the use of costs management should be considered and cost budgets are "*generally regarded as a good idea and a useful case management tool*". In this case, the Claimant had served a number of unexpected expert reports, and the Defendant therefore made an application for the costs budgeting regime to apply so as to preclude the Claimant from conducting proceedings in the same costly manner going forward.

In emphasising the importance of the Court's discretion, Coulson J gave an example of a



party "*framing*" their claims for simply £1 more than £10 million in order to avoid any consideration by the Court of the proposed costs (no matter how disproportionate or inflated they may be). Accordingly, in circumstances where the value of the claim itself is disputed, parties can, and, in appropriate cases, *should* apply for an order that costs budgeting apply. This is particularly so where there is a risk that the costs of the proceedings could become disproportionate to the actual value of the claim[1]. As a matter of good practice, it is suggested that clients and their practitioners consider proportionality of the costs to the dispute from the outset. As we understand from Harbour, they have seen an increasing number of their £10 million plus cases being submitted to the costs budgeting process.

Precedent H

Where the regime applies, the entire case must be budgeted unless the Court orders otherwise. Clients and practitioners should also bear in mind that, save in exceptional circumstances: (i) the recoverable costs of initially completing Precedent H shall not exceed the higher of £1,000 **or** 1% of the approved budget; and (ii) all other recoverable costs of the budgeting and costs management process shall not exceed 2% of the approved budget.

Precedent H is broken down into eleven distinct phases, each of which must include the parties' incurred costs (i.e. costs actually incurred including WIP) and estimated future costs.

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Making the right assumptions and planning for contingencies

Compiling the estimated costs sections of Precedent H is more challenging. It is not always clear what costs fall within each of the distinct phases of Precedent H. The Guidance Notes are instructive, but the individual practitioner's drafting approach will, of course, vary. Under 'Disclosure', for instance, the Guidance Notes provide that *"reviewing documents"* and *"correspondence...* about the scope of disclosure and queries arising" should be included in the figures for that phase; however, sums in relation to any application for specific disclosure are specifically excluded from the estimated costs.

It appears then that parties have three options: (i) to include an application for specific disclosure as a **'contingency'**; (ii) to include an **'assumption'** in relation to the scope of the opposition's disclosure; or (iii) revise the budget later down the line.

The distinction between each of these options (whatever procedural aspect is being dealt with) is important, and care should be taken when drafting and deciding which particular option to pursue. Clients and practitioners should pay close attention to the provisions of Practice Direction 3E and the relevant case law which strongly suggests that parties should not over-caveat with extensive assumptions[2]. Any contingent costs which are included must be anticipated and foreseen as more likely than not to be required. Striking the right balance between the different options is therefore fundamental to successful budgeting.

> **"Assumptions are imperative in allowing the Court and other parties to understand how the budget has been created."**

Assumptions

- Assumptions are imperative in allowing the Court and other parties to understand how the budget has been created and provides a benchmark upon assessing the budget's reasonableness.
- Making good use of this feature appears to give parties some scope to revise budgeted figures later[3].
- Examples include: "there will be no (further) amended pleadings", "trial will be 5 days", "it is intended that witness evidence be taken from X, Y and Z; if any potential witness is unavailable when called upon the additional expense involved in locating a new witness can be reflected in a revised budget".

1 This was the case in *CIP Properties v Galliford* Try [2014] EWHC 3546.

2 See, for example, Coulson J's comments in *CIP Properties* where he noted that the excessive use of assumptions is a *"wholly illegitimate exercise in avoiding the certainty and clarity that comes from case management orders; it is designed to undermine the whole basis of such orders".*

Contingencies

- A contingent cost is marked in Precedent H as an additional phase and, according to the Guidance Notes, must reflect "*anticipated costs*" which do not naturally fall within one of the pre-set phases.
- In *Yeo*, Warby J stated that work should be included as a contingency "*only if it is foreseen as more likely than not to be required". He added that, "if work that falls outside one of the main categories is not thought probable, it can reasonably be and should be excluded from the budget"*. Contingencies should therefore be drafted clearly and realistically.

The importance of regularly reviewing the budget

Clients and practitioners must conduct a regular review of all costs of the proceedings as they develop against the approved budget. Revisions to budgets should be considered as soon as a cost which is not budgeted for becomes reasonably likely to be incurred. Crucially, budgets should not be revised *after* that cost is actually incurred as the risk is that the Court will not allow it[4].

3 Clearly any application to vary the budget will be considerably assisted if parties are able to demonstrate that the reasonable assumptions on which the budget is based have been departed from.

4 See *Venus Asset Management Limited v Matthews & Goodman LLP* [2015] EWHC 2896 (Ch) which provides useful summary of the degree of diligence required in this regard.

In *Venus Asset Management Limited*, both parties applied for retrospective revisions to their approved budgets on the basis that the costs actually incurred were greater than the budgeted figures. In refusing the application, Chief Master Marsh held that the language used in the CPR clearly pointed to "the court's costs management powers being limited to future costs". Paragraph 7.3 of Practice Direction 3E provides that the Court *"will not undertake a detailed assessment in advance"*. Similarly, in the Commercial Court Users' Group Committee update dated 16 October 2015, on analysing recent developments in case law (and, in particular, *Yeo*), HHJ Waksman QC (Mercantile Court) noted that, where parties have a costs budget and see an *"overshoot looming"*, an application to revise the budget should be made promptly and before the budgeted figure is exceeded.

Pursuant to paragraph 7.4 of Practice Direction 3E, if, by the time the costs management process takes place, substantial costs have been incurred, the Court may "record its comments on those costs" and the Court will *"take those costs into account when considering the reasonableness and proportionality of all subsequent costs"*.

Revising budgets for unforeseen interim applications

The provisions of paragraph 7.9 of Practice Direction 3E state that, if interim applications are made which, reasonably, were not included in a budget, then the costs of such interim applications shall be treated as additional to the approved budgets. Warby J in Yeo also noted that, should the *"improbable"* occur, parties should utilise this provision and, should a *"significant development"* in the proceedings occur, a revised budget should be prepared in line with paragraph 7.4 of Practice Direction 3E (which is then agreed or approved).

> **"Cost budgeting is becoming a core part of the litigation process and accurate forecasting is therefore imperative."**

Whether there is good reason to depart from the approved budget in any given case is likely to depend, among other things, on how the proceedings have been managed, whether they have developed in a way that was not foreseen when the relevant case management orders were made, and whether the costs incurred are proportionate to what is in issue[5].

In preparing a budget, parties should assume that their opposition will comply with the CPR and conduct proceedings in accordance with the order for directions (making adverse assumptions about the opposition's possible future behaviour are unlikely to be viewed as justified). Equally, parties should not include a contingency (for example, for an interim application) unless it is reasonably foreseeable. It is therefore suggested, in any event, that parties use the provisions of paragraph 7.9 of Practice Direction 3E in relation to interim applications.

Proportionality and approval of budgets

The cases to date do not provide a coherent approach to the questions of reasonableness and proportionality in budgeting terms. In *Yeo*, it was suggested that, whilst the Court's primary consideration when approving budgets is whether the total costs proposed for each phase of the proceedings are reasonable and proportionate, it may also be appropriate to consider the hourly rates and number of hours claimed or forecast. In the authors' experience, the usual judicial approach is to focus more on the total costs claimed than the detailed build up of that number (the balance of cases support this). However, in all cases, an objective approach should be taken to consider whether the estimated costs can be justified as reasonable and proportionate in the circumstances.

83rd update to the CPR, April 2016

The 83rd Update to the CPR Rules[6] includes important changes to the costs budgeting regime. Notably, for all claims (irrespective of value), where parties file and exchange budgets they must also file an agreed budget discussion report no later than seven days before the case management conference. The budget discussion report must set out the figures which are agreed and those which are not agreed for each phase and a brief summary of the grounds of dispute.

Conclusions

Producing a proper budget can take considerable time (and can, therefore, cost more than the amount recoverable for it under the CPR). Costs budgets can, however, greatly assist parties in managing costs to resolution. Cost budgeting is becoming a core part of the litigation process and accurate forecasting is therefore imperative for the reasons set out above. The importance of proper costs budgeting for parties in all forms of litigation should not be underestimated.

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5 See *Henry v News Group Newspapers Ltd* [2013] EWCA Civ 3 and *Murray & Anor v Neil Downlman Architecture Ltd* [2013] EWHC 872 (TCC).

6 See: https://www.justice.gov.uk/courts/procedure-rules/civil