COSTS MANAGEMENT AND THE IMPLIED APPROVAL OF INCURRED COSTS

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One of the major defining features of Lord Justice Jackson’s reforms to civil litigation costs was the introduction of costs budgeting and judicial costs management.¹ Inspired by developments in Australia where costs management had been introduced in the Federal Court,² Jackson LJ strongly recommended that a similar approach be taken to controlling costs in the English civil justice process. Consequently, those recommendations came into force in April 2013 and were implemented through Part II of CPR 3. Applicable to certain multi-track cases,³ costs management is an integral part of the case management process.

On the second anniversary of the costs regime taking effect, Jackson LJ delivered a lecture entitled ‘Confronting Costs Management’⁴ in which he reported on how costs management had been working and suggested ways in which the rules could be developed. Although acknowledging that costs management was tiresome for judges and the parties, Jackson LJ was adamant that, when done properly,

Costs management works. When an experienced judge or master costs manages litigation with competent practitioners on both sides, the costs of litigation are controlled at an early stage. Although some practitioners and judges regard the process as tiresome, it brings substantial benefits to court users.⁵

His Lordship’s strong conviction that costs management works was repeated in his 2016 IPA Lecture in which he stated that costs management had done much to control the level of costs.⁶ He did,

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² The Access to Justice Taskforce appointed by the Attorney-General’s Department of the Australian Government published its report entitled A Strategic framework for Access to Justice in the Federal Civil Justice System in which the authors proposed that, in the Federal Court, lawyers should be required to provide their clients with a litigation budget and to provide copies of that budget both to the court and to opposing parties. These recommendations were implemented through the enactment of the Access to Justice (Civil Litigation Reforms) Amendment Act 2009 (Cth) Section 37N (3) (b) which allow the court to direct lawyers to submit estimates of costs, including “(i) the costs that the lawyer will charge to the party; and (ii) any other costs that the party will have to pay in the event that the party is unsuccessful in the proceeding or part of the proceeding.”

³ Costs management applies to multi-track cases with a value of up to £10 million (CPR 3.12(1)(a)).


⁵ ibid 2.1.

however, recognise that some of his reforms were proving problematic.\(^7\) One such area is the status of ‘incurred’ costs (i.e. those costs incurred before the first cost and case management conference (CCMC)) in the judicial costs management exercise. At present, the courts may not formally approve costs\(^8\) that have been incurred before the date of any budgets; the courts may only approve the parties’ future costs. The judge conducting the CCMC may, nevertheless, record his comments on whether the incurred costs element appearing on the parties’ costs budget is reasonable and proportionate and those comments may be taken into account when the court considers the reasonableness and proportionality of all subsequent costs.\(^9\)

A small but significant body of case law is beginning to emerge on judicial approaches to the issue of incurred costs when approving costs budgets. This is, for the first time, a critical review of that emerging jurisprudence. It reveals that, despite the formal prohibition on the courts in approving incurred costs, an analysis of judicial approaches when approving costs budgets shows that the courts have gone beyond simply recording comments on the reasonableness and proportionality of incurred costs; rather they have impliedly approved incurred costs when officially approving the parties’ future costs. It is argued that, given the existence of this paradoxical situation in a crucial part of the litigation process, there is an urgent need for clarity. It also calls for incurred costs to be made an official part of the costs management process by removing the prohibition on the approval of incurred costs and by amending Precedent H (the costs budgeting form used by the parties). This will promote and reinforce a stronger culture of ‘costs consciousness’ among litigating parties which will see costs management apply to the whole of the litigation process and not simply in respect of future costs.

**Background and rules**

The objective behind costs management is to control the litigation in a way in which the costs of each party are proportionate to, amongst other things, the amount at stake and to ensure that the parties are on an equal footing. It is concerned with, as Jackson LJ elaborated in his Interim Report, ensuring that costs are actively controlled by the court as the case moves from inception to its conclusion. This should have the effect of removing or reducing the need for an ex post facto examination of whether the costs incurred should have been incurred or were reasonably incurred.\(^10\)

The costs management regime is contained in CPR 3.12 to 3.18 and applies to most Part 7 multi-track claims with a value of less than £10 million to file and exchange costs budgets.\(^11\) Part 3.12(2) provides that the purpose of costs management “…that the court should manage both the steps to be taken and the costs to be incurred by the parties to any proceedings so as to further the

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\(^7\) Lord Justice Jackson ‘Confronting Costs Management’ (n 4).
\(^8\) Para. 7.4 of Practice Direction 3E.
\(^9\) Para 7.4 of Practice Direction 3E.
\(^10\) Lord Justice Jackson Interim Report vol. 2 Ch. 48 para 1.6 (n 1). Jackson LJ also stated that effective costs management was in the interest of the client and it was the client who seemed most keen on costs management being undertaken by the courts. Zuckerman has strongly argued that this was the “nub of the matter: clients need protection form their own lawyers...The aim of costs management is therefore to protect clients from their own lawyers.” Adrian Zuckerman ‘The Jackson Final Report on Costs – Plastering the Cracks to Shore Up a Dysfunctional System’ (2010) 29(3) CJQ 263, 274. See also Adrian Zuckerman ‘Lord Justice Jackson’s Review of Civil Litigation Costs – Preliminary Report (2009)’ (2009) 28(4) CJQ 435.
\(^11\) Practice Direction 3A (1) (a) (n 3). CPR 3.15 (1) goes on to state that the court may manage the costs to be incurred by any party in any proceedings (CPR 3.15 1A).
overriding objective.” The costs budgets are required to be set out in the format of the Precedent H template. Precedent H includes columns of figures for costs already incurred as at the date of the costs budget and columns of figures for the sums which it is estimated will have to be incurred in the future through to the end of trial. Paragraph 7.4 of Practice Direction 3E elaborates on the relevance of incurred costs to the costs management exercise and provides

As part of the costs management process the court may not approve costs incurred before the date of any budget. The court may, however, record its comments on those costs and will take those costs into account when considering the reasonableness and proportionality of all subsequent costs.

Thus, it can be seen that although Precedent H provides for details of incurred costs to be included in a costs budget, the court does not formally approve the incurred costs element: only the estimated future costs element is formally approved. Nevertheless, the court retains the discretion to record its comments on the incurred costs element as well as take them into account when considering the reasonableness and proportionality of items in the estimated costs element in the budget. These comments can be taken into account when the court is required to exercise its general discretion as to costs under CPR 44 at the end of trial.

The jurisprudence

Although not significant in quantity, the emerging jurisprudence surrounding the issue of incurred costs is significant. It is significant because it reveals a paradoxical situation between the prohibition on the courts to officially approve incurred costs on the one hand and the desire and efforts of the judiciary to control litigation costs on the other. Clearly, this unsatisfactory situation has the undesired effect of undermining the policy underpinning the costs management regime. It introduces uncertainty and confusion for the parties and the courts themselves. This is not to suggest that judicial approaches have been incorrect. Indeed, judicial efforts in trying to grapple with the issue of incurred costs are to be commended. It is submitted that the fault lies with the rules on the prohibition on judges to approve incurred costs at the CCMC and it is that prohibition which is undermining the essential propose of the costs management regime in controlling litigation costs.

Redfern v Corby Borough Council was one of, if not the first, cases to consider the new cost management rules. The claimant had submitted a costs budget of £744,000 for approval at the first CCMC of which £130,000 had already been incurred. At the CCMC Deputy Master Eyre expressed surprise at the overall amount of the claimant’s budget and, in particular, the amount that had already been incurred at such an early stage in the litigation process. He found the incurred costs element to be excessive and disproportionate and, fixing a figure that he found to be proportionate, he eventually approved a lower figure of £266,796. On appeal the claimant argued that the focus of a costs management order should be on the future costs and not to consider whether those which had already been incurred were proportionate. Further, the claimant submitted that the Deputy Master had been wrong in fixing a provisional figure which he considered would be reasonable and proportionate for the whole costs of the action. In dismissing the appeal, HHJ Seymour QC noted

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12 Para. 6 of PD 3E.
13 Emphasis added.
that it was clear, from the wording of the relevant provisions of the CPR, that the focus of attention in relation to costs management was on costs which are to be incurred and not those which have been incurred. However, the judge found that the Deputy Master had taken the correct approach in determining and approving the costs budget because he was not approving costs that has been incurred but was simply recording his comments in respect of those costs. As the judge explained,

As it seems to me, it is quite plain that Deputy Master Eyre was not seeking to approve, or indeed to disapprove, costs which had been incurred before the hearing before him at which the issue of the costs management order arose. Rather, what the Deputy Master was doing, as it seems to me plainly, was recording his comments on the costs which had been incurred set out in his order, which I have read, and taking those costs into account, as he was bidden to do by para 7.4, when considering the reasonableness and proportionality of all subsequent costs.15

It is difficult to understand how the Deputy Master’s approach to approving the claimant’s costs did not also involve approval of the incurred costs element of the budget. On the facts the Deputy Master fixed a provisional costs figure he felt was proportionate for the whole of the case. He then worked backwards through the various elements of the claimant’s budget, including the incurred costs element, to make it conform to the provisional figure. It is difficult to see how this exercise did not amount to the ‘budgeting’ or ‘approval’ of incurred costs, albeit impliedly. To fix a figure and then to budget for future costs taking into account those costs that have been incurred does, effectively, amount to the budgeting of incurred costs because the overall figure, the approved budget, will incorporate the adjusted incurred costs figure which will have a direct impact on the calculation or adjustment of future costs.

The practice of recording the judge’s comments on the incurred costs was briefly mentioned in Yeo v Times Newspaper (2).16 Warby J observed that costs incurred before the approval of a budget would normally need detailed assessment after trial. However, in the course of the costs management process, the court could comment on those costs and reduce a budget for reasons which applied equally to incurred costs.17

A similar approach of adjusting and ‘budgeting’ and thus approving incurred costs was taken in CIP Properties (AIPT) Ltd v Galliford Try Infrastructure Ltd.18 In that case the court considered how to approach costs management in circumstances where the claimant’s costs budget, put forward at over £9.2 million, was ‘entirely unreliable’ and where the costs already incurred and estimated future costs were disproportionate and unreasonable. Coulson J found, inter alia, the claimant’s costs budget was a wholly unreliable document. Those findings of unreliability meant that the claimant was in a particularly difficult position in respect of the incurred costs to date and fixture of budget figures, but only had itself to blame. The judge then reviewed and adjusted the claimant’s cost budget which included work that had already been done at the pre-action stage during which the claimant had incurred £1.3 million. That figure was adjusted to £680,000 as were other future estimated costs to reach an overall approved cost figure of £4.28 million. Thus, by adjusting the pre-

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15 Ibid [29].
16 Yeo v Times Newspaper (2) [2015] EWHC 209 (QB).
17 Ibid [60-61].
18 CIP Properties (AIPT) Ltd v Galliford Try Infrastructure Ltd [2015] EWHC 481 (TCC).
action costs the court was adjusting and approving incurred costs. It was, in the interest of justice, considering both incurred and estimated costs and arriving at a costs budget that was reasonable and proportionate. Coulson J’s approach is to be commended because it demonstrates the difficulties that courts may face in trying to manage costs which are obviously disproportionate and unreasonable and which may be principally due to the incurred costs element. Coulson J adopted a pragmatic and proactive approach in approving the claimant’s costs budget by effectively adjusting and approving the incurred costs element.

The case of Various Claimants v Sir Robert McAlpine and Others\(^\text{19}\) should be briefly noted. In that case the court found the incurred and estimated costs to be disproportionate to the monetary value of the claims and the important non-monetary remedies. The court accordingly made a costs management order in accordance with CPR r.3.15(2) and set out the approved amounts for the phases of the proceedings. However, as noted by an editorial note on the case, save for commenting that they were “disproportionately high”, the court did not follow the approach in respect of incurred costs adopted by Coulson J in CIP Properties or HHJ Seymour in Redfern, but appeared to have left them in their entirety for detailed assessment. This is surprising, especially given that one of the members of the court was the senior costs judge and the previous authorities on this very issue illustrated pragmatic judicial approaches in actively trying to control the escalation of litigation costs.

The issue of incurred costs was considered in some detail by the Court of Appeal in Sarpd Oil International Limited v Addax Energy SA.\(^\text{20}\) At first instance,\(^\text{21}\) Andrew Smith J had refused to grant the defendant an order for security for costs on the ground that the conditions under CPR 25 had not been met. He held that the mere fact that the claimant refused to provide the defendant with information on its financial viability to meet the costs of the litigation was not enough to justify the granting of a security for costs order. The judge also indicated if he had decided to order provision of security for the defendant’s costs he would have done so by assessing the amount by reference to the defendant’s costs budgets which had been approved on an earlier occasion on the papers by Blair J. Andrew Smith J noted that the ‘Costs & Funding’ guidance made clear that at the costs management stage the rationale is that the past conduct of the parties is not relevant because the court can only budget the costs to be incurred. However, Andrew Smith J went on to state that the costs budgets approved by Blair J applied to both costs that had already been incurred and estimated future costs. In reaching this conclusion, Andrew Smith J explained:

> However, a costs budget in the form of precedent H includes both past and anticipated costs and the legal representatives who verifies it is required to certify that “This budget is a fair and accurate statement of incurred and estimated costs which it would be reasonable and proportionate for my client to incur in this litigation”. When a costs management order is made, CPR 3.15 contemplates that it will refer to the whole budget, and CPR 3.18 does not distinguish between costs that were already incurred and those which were anticipated. As I see it, this means that Mr Lewis’ argument applies with equal force to costs that had already

\(^{19}\) Various Claimants v Sir Robert McAlpine and Others [2015] EWHC 3543 (QB).

\(^{20}\) Sarpd Oil International Limited v Addax Energy SA [2016] EWCA Civ 120.

been incurred by the time of Blair J’s order and the costs budget of Addax that he approved, and the costs that it anticipated.\textsuperscript{22}

Delivering the only judgement of the Court, Sales LJ overturned the decision denying an order for security for costs. A deliberate failure to provide evidence of ability to pay costs provided “every reason to believe that, if and when it is required to pay a defendant’s costs, it will be unable to do so”\textsuperscript{23} but that should be evaluated in light of all the evidence before the court. On the issue of the costs budgets, Sales LJ agreed with Andrew Smith J. The proper starting point to assess the amount of costs for which security was to be given was the approved costs budget. This was the case because any issues concerning the appropriate level of costs ought to have been raised and dealt with at the first case management conference and, to allow the parties to re-open the issue, absent a change in circumstances since the first case management conference, and go behind the costs budget would be contrary to the Overriding Objective. Sales LJ went further in his analysis of incurred costs. His Lordship noted that, although Precedent H sets out incurred costs element and estimated costs element, the court does not formally approve the incurred costs element as a result of para. 7.4 of Practice Direction 3E and it is only in relation to the approved estimated costs element that the specific rule of assessment apply. He also noted that the court may still record its comments on incurred costs as well as take them into account when considering the reasonableness and proportionality of items in the estimated costs element in the budget. Those comments would, Sales LJ emphasised, “carry significant weight when the court comes to exercise its general discretion as to costs under CPR Part 44 at the end of trial.”\textsuperscript{24}

This is the first occasion on which the court has provided guidance on the impact and level of importance judicial comments have on the incurred costs element of a budget. The wording of paragraph 7.4 is not helpful as it simply states that the court may record its comments and will take incurred costs into account when dealing with subsequent costs. It does not explain what weight, if any, should be given to those comments and to what extent they will impact on the estimated future costs when the courts assesses the reasonableness and proportionality. Sales LJ’s comments provide valuable judicial guidance on that point. However, a shortcoming in his Lordship’s analysis is his reference to the court placing significant weight to its comments on incurred costs “at the end of trial” and when exercising powers under CPR 44. As was clear from Redfern and CIP, the practice of the courts has been to consider the incurred costs element of a budget, to comments on those incurred costs and then to impliedly ‘approve’ those costs at the CCMC. Sales LJ seems to be suggesting that judicial comments will carry significant weight only at the stage of final assessment of costs even though in practice the courts have made comments and actively adjusted and approved budgets before that stage in the litigation process.

Sales LJ went onto explain how the court’s comments on incurred costs would “carry significant weight” and the impact those comments would have when he said,

For example, if a court has commented that incurred costs in a costs budget appear to be reasonable and proportionate, it would usually require good reason to be shown why such costs should not be included in an award of costs on the standard basis at the end of the trial. In such

\textsuperscript{22} ibid [30].
\textsuperscript{23} Sarpd Oil (n 16).
\textsuperscript{24} Sarpd Oil [42] (n 16).
a case, the party who had put forward the costs budget would have been encouraged by the
court to litigate on the understanding and with the legitimate expectation that such costs would
be likely to be recovered if he were successful, and good reason would need to exist to justify
defeating that expectation. Therefore, depending on what is said by the court by way of
comment, the practical effect of a comment on already incurred costs made by a court pursuant
to para.7.4 of PD3E may be similar to the effect under Pt 3.18(b) of formal approval of the
estimated costs element in a cost budget.25

Sales LJ comments are of particular interest for two principal reasons. The first relates to Sales LJ’s
reference to the parties “legitimate expectation” to recover incurred costs that have been found to
be reasonable and proportionate. The practical effect of any judicial comments on incurred costs
would, quite rightly, lead the parties to believe that those costs will be reflected in the final
assessment of costs. This is consistent with and reinforces one of Jackson LJ’s expectations of the
costs management regime that it would help promote settlement.26 It would help promote
settlement because the parties, who have a clear idea of the court’s assessment of incurred and
future costs, will know with certainty what the totality of potential cost recoverability is likely to be,
thus enabling them to decide the cost-benefit analysis of whether to continue to litigate or settle.
Secondly, Sales LJ’s comments support the principal argument of the author that current judicial
approaches to incurred costs are to impliedly approve those costs despite the formal prohibition on
approval. The importance of judicial comments and the “practical effect” of those comments was, as
Sales LJ made clear, “similar to...formal approval of the estimated costs element in a cost budget.”27

As stated earlier, this judicial approach is not to be criticised. Rather it is to be commended because
it illustrates how the judiciary is attempting to discharge its costs management duties in ensuring
that costs are proportionate and reasonable by paying attention to both incurred and future costs. It
also reinforces the contention that the formal prohibition on the approval of incurred costs is simply
artificial and unnecessary and requires reform. Incurred costs are being approved, or not, albeit
impliedly by the judiciary, so why should the formal prohibition remain?

Way forward and conclusion

There is an urgent need for reform in respect of this vital aspect of civil procedure. Jackson LJ’s
reforms on civil litigation costs were to secure access to justice at proportionate cost and in doing so
the mechanisms to control costs were to be clear for all who engaged with the court process,
including the judiciary. As this paper has illustrated, the formal position on incurred costs, that they
cannot be approved, is unclear and unhelpful. Despite the formal prohibition on the courts in
approving incurred costs, in reality they are assessing and impliedly approving those costs. Indeed,
this argument is supported by Sales LJ’s comments on the effects of a judge’s comments on incurred
costs as being similar to formal approval.

In his Harbour Lecture, Jackson LJ’s preferred option to remedy the problems with incurred costs
was to provide the courts with the power to (a) comment on the incurred costs; (b) summarily to
assess the incurred costs; or (c) set a global budget figure for any phase, including both incurred and

25 [42]. Emphasis added.
26 Lord Justice Jackson Interim Report Chapter 40 para. 7.15 (n 1).
27 Sarpd Oil (n 21).
future costs. These options are in the alternative. The first, to provide the court with the power to comments on the incurred costs, has already been dealt with earlier in this paper. Paragraph 7.4 provides for this and there is now helpful judicial guidance from Sarpd as to what weight the courts are likely to attach to those comments when assessing the reasonableness and proportionality of the overall costs. The second option is to provide the courts with the power to summarily assess the incurred costs element in a budget. This option would be the most effective because it would mean that the current artificial and unnecessary divide between the incurred and estimated future costs elements of the costs budget will no longer apply and there would be greater clarity. Jackson LJ’s final option of setting a global figure is unhelpful and it is difficult to see how the courts would exercise their powers in calculating that figure and what weight each of those elements would carry when determining costs at the end of trial. Jackson LJ himself alludes to the disadvantage of extra costs of carrying out a separate investigation for the purposes of the three options outlined above. Jackson LJ’s argument that a separate investigation into incurred costs would incur costs does hold weight. However, given the current practice of the judiciary in reviewing, considering and impliedly approving those costs, it is argued that incurred costs are being “approved” in any event and that the courts are exercising their powers to try to manage costs in the most appropriate manner.

There is a further option which may be considered and that is to remove the official prohibition on the approval of incurred costs. To achieve this, CPR 3.12(2) should be amended so that it provides that the purpose of costs management would include the court managing the steps of litigation by having regard to the costs that have been incurred as well as the costs to be incurred. The parties and the courts will be aware that incurred costs are a fundamental aspect of the costs management process and this would impress on the parties the importance of carefully managing costs and ensuring those costs are reasonable and proportionate from the early stages of the litigation process. The next step would be to amend paragraph 7.4 of Practice Direction 3E in order to reflect the reality of judicial approaches to incur costs and to introduce greater clarity. Paragraph 7.4 should be amended to provide that the courts will approve costs incurred before the date of any budget. It would mean that courts would be required to consider and formally (not impliedly) approve the incurred costs elements in costs budgets. Clearly not all cases will have incurred substantial costs at an early stage of the litigation process and therefore the approval exercise should not be time consuming. There will, no doubt, be circumstances where substantial costs are incurred and more judicial time will be required in considering and proving those incurred costs. But that would be consistent with the whole philosophy underpinning the costs management regime which is to control civil litigation costs so that they are reasonable and proportionate and if that means having to incur more time at the costs management stage then this should be done if it means costs will be effectively controlled.

It follows that in order to make the author’s proposal effective, Precedent H, the form which the parties’ costs budgets must take, must be amended. Currently it includes both incurred and future costs. Further, legal representatives who verify the costs budget must certify that “This budget is a fair and accurate statement of incurred and estimated future costs which it would be reasonable and proportionate for my client to incur in this litigation.” A simple yet effective amendment to Precedent H would be to include a clear statement at the very beginning of each page of Precedent H to the effect that the court will approve incurred costs as well as future estimated costs. This

28 Lord Justice Jackson ‘Confronting Costs Management’ (n 4).
simple amendment would make clear that the courts will formally approve incurred costs and therefore give effect to current, implied judicial practice.

In his IPA Lecture, Jackson LJ argued for the introduction of an extensive regime of fixed costs for cases up to £250,000. When implemented, this could see the end of costs management for many cases. However, until those reforms are implemented, we continue to have costs management. It has been embraced by the senior judiciary and a culture of ‘costs consciousness’ is beginning to take hold. However, there are problems with the issue of incurred costs and the implied manner in which those cost are being approved by the judiciary. The need for clarity and consistency demands that incurred costs be formally made part of the judicial costs management process.

29 Lord Justice Jackson ‘Fixed Costs – The Time Has Come’ (n 6).