

October 2016

# THIRD PARTY FUNDING

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A New Era?

## Summary

In a landmark decision, the English High Court has upheld the decision of the arbitrator in an ICC arbitration to allow the recovery of the costs of third party funding in addition to the award of legal costs and damages, finding that the arbitrator's general powers extended to include the power to award third party funding costs.

Whilst not a new issue, and indeed an issue explored at length by commentators and a number of the arbitral institutions, this decision propels into the spotlight the question increasingly being asked of arbitrators in often private and confidential proceedings, to award the cost of funding as well as the legal costs themselves.

As discussed below, it is a decision that may embolden arbitrators faced with similar circumstances and similar arbitration agreements/rules. It will certainly encourage more parties to reach for the support of a funder when the cost of arbitration proceedings is overwhelming. It may also encourage parties to use funding for reasons other than necessity – such as where a party does not want the cost or risk of the proceedings on its balance sheet, or where a party wants to use the adverse cost risk as a tactical ploy (in a similar way to the manner in which Conditional Fee Arrangements were often used prior to Lord Justice Jackson's reforms).

The judgment is good news therefore for funders and those with claims to pursue, but insufficient funds. On the flip side, the judgment is potentially extremely painful for the losing party. This leads us to question, does the decision open up the floodgates for recovery of third party funding costs in arbitration in a manner akin to the position of claimants in the English courts with condition fee agreements and ATE policies prior to 1 April 2013? Probably not, or at least not yet.

## Background

Following a dispute relating to an offshore drilling platform, an ICC arbitration was commenced by Norscot Rig Management PVT Limited (**Norscot**) against Essar Oilfields Services Limited (**Essar**). In order to advance with the proceedings, Norscot entered into a third party funding arrangement consisting of an advance of approximately £650,000. The terms of the arrangement provided that, if successful, Norscot had to pay to the funder either 300% of the sum advanced or 35% of the damages received – whichever was greater.

When Norscot succeeded in the arbitration, it sought its costs from Essar including the costs of the third party funding. The arbitrator made an award ordering Essar to pay costs on an indemnity basis, including £1.94 million which Norscot had paid to its third party funder - Woodsford Litigation Funding - who had advanced a sum of around £647,000 to Norscot for the purpose of the arbitration.

The arbitrator was critical of Essar's conduct and concluded that Essar had deliberately put Norscot in a position where it did not have the resources to fund the arbitration and it was therefore reasonable for it to seek third party funding.

Essar proceeded to challenge the Award in the English High Court on the ground of serious irregularity under section 68(2)(b) of the Arbitration Act 1996 (the **Arbitration Act**), arguing that the arbitrator had exceeded his powers by extending the definition of "other costs" within section 59(1)(c) of the Arbitration Act to include third party litigation funding.

## Judgment

The English High Court dismissed the appeal and upheld the arbitrator's ruling. The full transcript of the judgment can be found [here](#). However, there are two key points to note:

- ▶ First, at the outset of his judgment, His Honour Judge Waksman QC, makes an important point of context by highlighting the limited scope of section 68 of the Arbitration Act quoting paragraph 280 of the DAC Report which said:

*"Section 68 is really designed as a longstop, only available in extreme cases where the tribunal has gone so wrong in its conduct of the arbitration that justice calls out for it to be corrected"*

*... it is a decision that may embolden arbitrators faced with similar circumstances and similar arbitration agreements / rules*

In other words, the English Courts will only interfere with the decision of an arbitrator in very exceptional circumstances. The judgment goes on to conclude that there was no serious irregularity within the meaning of s.68(2)(b) of the Arbitration Act, and so even if the arbitrator had been wrong in his construction of “other costs” the appeal would have failed. This reinforces, yet again, the reluctance of the English courts to interfere with arbitral awards – an important reminder for parties considering the most appropriate seat in their arbitration agreements.

▶ Secondly, the judgment concludes that, in any event, the arbitrator was entitled to interpret “other costs” so as to include the costs of third party funding. There was therefore no error of law anyway. In reaching this conclusion His Honour Judge Waksman QC explored a number of issues that will be of interest to parties considering third party funding:

▶ The approach taken by the English courts under the Civil Procedural Rules (where third party funding is not recoverable) as to what can and cannot be awarded by way of costs is of little direct relevance. The relevant context is the Arbitration Act itself and the scope of procedural powers conferred upon the arbitrator by the agreement between the parties.

▶ The analysis of the arbitrator's power to award costs starts with the scope of the powers conferred upon the arbitrator by the agreement between the parties because section 63 of the Arbitration Act provides that “[t]he parties are free to agree what costs of the arbitration are recoverable”. In this case the parties had agreed to arbitrate by reference to the ICC Rules (the 1998 version) and Article 31(1) of those rules states;

*"The costs of the arbitration shall include the fees and expenses of the arbitrators and the ICC administrative expenses fixed by the Court, in accordance with the scale in force at the time of the commencement of the arbitral proceedings, as well as the fees and expenses of any experts appointed by the Arbitral Tribunal and the reasonable legal and other costs incurred by the parties for the arbitration"*

▶ The judgment explores the meaning of “costs of the arbitration” as defined by section 59 of the Arbitration Act and also used in Article 31(1) of the ICC Rules (1998 version). It concludes that the wording “other costs” – also used in both the Arbitration Act and ICC Rules - should to be “regarded in a broad sense” and can be construed as including third party funding. The right test to apply when assessing what should be classed as “other costs” is a “functional” one and the costs incurred in bringing or defending the claim should be considered.

▶ The ICC Commission Report of 2015 - “Decisions on Costs in International Arbitration” - was “relevant” and “highly pertinent” and supported “the functional view” used to construe the meaning of “other costs”. Whilst “not determinative” it does demonstrate the important role played by the large volume of commentary that surrounds this issue.

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## Further Observations

As explained above, seeking to recover the costs of third party funding in arbitration proceedings is not a new concept. However, arbitration proceedings are often concluded behind closed doors and shrouded in confidentiality and therefore it is difficult to conduct any proper analysis of the circumstances in which funding costs have been sought and awarded and the reasons for doing so.

This decision propels the confidential findings of the arbitrator in the Norscot proceedings into the public eye and will no doubt heighten interest in third party funding and alternative funding options for arbitration, particularly as the decision is contrary to the position on third party funding in litigation in the English Courts.

Third party funding is not a cheap option for progressing litigation or arbitration proceedings. In fact, as the Norscot decision highlights, the cost can often be high – in this case a 300% plus return for funders, which was accepted by the judge, on hearing expert evidence from a well known broker, to be a market rate (although for the right case, funding costs can be much lower). If funding costs are not recoverable, the issue facing many parties looking for funding is one of

simple economics. Is the claim of sufficient value and the legal costs low enough to make funding a realistic commercial option? The answer is often no and even if the claim is of sufficient value, the prospect of giving away a substantial proportion of the award can be, at the very least, unpalatable. The upshot of this is that historically, third party funding has only been used by those who genuinely do not have the funds to progress the claim and/or with a strong enough case to negotiate better terms with funders.

The decision of the English High Court in Norscot may well be a game changer – if there is a reasonable prospect of recovering the third party funding cost, then these historical concerns and the economics of funding arrangements are less problematic.

However, before potential claimants rush to obtain third party funding, a few words of caution.

**First**, the conclusion reached by the English High Court that the arbitrator **had the power** to award third party funding costs, was based on the specific wording of the Arbitration Act and the ICC Rules. Whilst many of the main arbitral institutional rules contain similar wording around "costs" (see comparison below), an arbitrator will only have the power to award funding costs if a) the arbitration agreement between the parties confers power to do so; and b) the law of the seat of the arbitration permits it.

**Secondly**, the decision is limited to the question of whether the arbitrator in the Norscot proceedings had the power to award third party funding costs. It does not address all the circumstances in which it will be appropriate for an arbitrator to award the costs of third party funding. For example:

- ▶ Essar's conduct in relation to the agreement and during the course of proceedings was criticised by the arbitrator. Is bad conduct a prerequisite to recovery?
- ▶ The arbitrator found that Essar had deliberately forced Norscot to seek third party funding; does the decision also apply to those parties who voluntarily choose a third party funding option?
- ▶ Would the decision extend to third party funding options which were not, as in this case, based on standard market rates?

## A comparison of the cost provision in the main institutional rules (latest rules)

As the comparison below highlights, the majority of the arbitration institutions' rules, except for DIAC and HKIAC, provide that an arbitrator may award "other costs". Notably, under the DIAC rules, in the absence of any agreement by the parties or provision in the local arbitration law, the tribunal has no power to allow the recovery of legal fees at all. Under the HKIAC rules the provisions on costs extend to "legal representation and assistance". It may therefore be that "assistance" could be interpreted in the same way as "other costs".

The comparison below does not consider the law of the seat of the arbitration which will also need to be considered in an assessment of the likelihood of the recoverability of third party funding in any particular arbitration. However it is worth noting that:

- ▶ Whilst not yet widely used in the UAE, litigation funding is not contrary to UAE law. As a matter of practice, DIAC tribunals will typically record in the minutes of the preliminary meeting (or a separate Arbitration Deed or Terms of Reference) the agreement of the parties as to the issues which will be addressed in the arbitration. The Arbitration Deed will often vest the tribunal with the authority to include in its final award the issue of legal costs, which it will do taking into account the relative success and failures in each parties' case and the reasonableness of the fees claimed.
- ▶ Third Party Funding is not currently permitted under Singapore law. However, this is expected to change soon. Singapore's Ministry of Law published draft legislation (Civil Law (Amendment) Bill 2016 and Civil Law (Third Party Funding) Regulations 2016) to put in place a framework for third party funding for international arbitration proceedings. The draft legislation was open for public consultation from 30 June to 29 July 2016. It is anticipated

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that the proposed legislative amendments will be passed by the Singapore Parliament in the near future.

- ▶ It has remained unclear as to whether or not the doctrines of champerty and maintenance also apply to third party funding for arbitrations taking place in Hong Kong. In 2013, the Chief Justice and the Secretary for Justice asked the Law Reform Commission of Hong Kong to review this subject. On 19th October 2015, the Law Reform Commission (the "Commission") released a consultation paper recommending that third party funding be permitted for arbitrations in Hong Kong (the "Consultation Paper"). The Law Commission's final report was published on 14 October 2016 and it recommends that the law should be amended to clarify that the common law principles of maintenance and champerty do not apply to arbitration and associated proceedings under the Hong Kong Arbitration ordinance, with appropriate safeguards in place.

| RULES   | ARTICLE NO. | PROVISION   |
|---|-------------|---|
| International Chamber of Commerce (ICC)   | 37.1        | <p>The costs of the arbitration shall include:</p> <ul style="list-style-type: none"> <li>▶ the fees and expenses of the arbitrators and the ICC administrative expenses fixed by the Court;</li> <li>▶ the fees and expenses of any experts appointed by the arbitral tribunal; and</li> <li>▶ the reasonable legal and <b>other costs</b> incurred by the parties for the arbitration.</li> </ul> |
| The London Court of International Arbitration (LCIA)  | 28.3        | <p>The arbitral tribunal has the power to decide by an award that all or part of the legal or <b>other expenses</b> incurred by a party be paid by another party.</p> <p>The arbitral tribunal shall decide the amount of such legal costs on such reasonable basis as it thinks appropriate.</p>   |
| The London Court of International Arbitration - Mauritius International Arbitration Centre (MIAC) | 28.3        | <p>The arbitral tribunal has the power to order in its award all or part of the legal or <b>other costs</b> incurred by a party, unless the parties agree otherwise in writing.</p> <p>The arbitral tribunal is able to determine and fix the amount of each item comprising such</p>   |

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|  |                                       | costs on such reasonable basis as it thinks fit.   |
| Dubai International Arbitration Centre (DIAC)  | 2.1 of Appendix – Cost of Arbitration | <p>The costs of the arbitration shall include:</p> <ul style="list-style-type: none"> <li>▶ the Centre's administrative Fees for the claim and any counterclaim;</li> <li>▶ the fees and expenses of the tribunal fixed by the Centre in accordance with the Table of Fees and Costs in force at the time of the commencement of the arbitration;</li> <li>▶ any expenses incurred by the tribunal; and</li> <li>▶ fees and expenses of any experts appointed by the tribunal.</li> </ul>  |
| Hong Kong International Arbitration Centre (HKIAC) - Institutional Arbitration Rules | 33.1                                  | <p>The arbitral tribunal can determine the costs of the arbitration in its award. The term “costs of the arbitration” includes only:</p> <ul style="list-style-type: none"> <li>▶ the fees of the arbitral tribunal, as determined in accordance with Article 10;</li> <li>▶ the reasonable travel and other expenses incurred by the arbitral tribunal;</li> <li>▶ the reasonable costs of expert advice and of other assistance required by the arbitral tribunal;</li> <li>▶ the reasonable travel and other expenses of witnesses and experts;</li> <li>▶ the reasonable costs for legal representation and assistance if such costs were claimed during the arbitration;</li> <li>▶ the registration fee and administrative fees</li> </ul> |

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|  |    | payable to HKIAC in accordance with Schedule 1.  |
| American Arbitration Association (AAA) – International Dispute Resolution Procedures | 34 | <p>The arbitral tribunal shall fix the costs of arbitration in its award(s). The tribunal may allocate such costs among the parties if it determines that allocation is reasonable, taking into account the circumstances of the case. Such costs may include:</p> <ul style="list-style-type: none"> <li>▶ the fees and expenses of the arbitrators;</li> <li>▶ the costs of assistance required by the tribunal, including its experts;</li> <li>▶ the fees and expenses of the Administrator;</li> <li>▶ the reasonable legal and <b>other costs</b> incurred by the parties;</li> <li>▶ any costs incurred in connection with a notice for interim or emergency relief</li> <li>▶ pursuant to Articles 6 or 24;</li> <li>▶ any costs incurred in connection with a request for consolidation pursuant to Article 8; and</li> <li>▶ any costs associated with information exchange pursuant to Article 21.</li> </ul> |
| Singapore International Arbitration Centre (SIAC)                                    | 37 | The tribunal has the authority to order in its award all or part of the legal or <b>other costs</b> of a party to be paid by another party.  |

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