The Impact of the COVID-19 Pandemic on Third Party Funding and Security for Costs in International Commercial Arbitration

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The COVID-19 pandemic has already created market volatility and adversely affected the financial position of companies and individuals around the world. This post explores two main ideas: (1) whether the pandemic is likely to result in an upturn in recourse to third party funding arrangements; and (2) whether arbitrating parties should anticipate increased exposure to applications for security for costs in international commercial arbitrations.

Will Interest in Third Party Funding Increase Following the Impact of COVID-19?

According to the Report of the ICCA-Queen Mary Task Force on Third Party Funding in International Arbitration, a growing number of parties to arbitrations are seeking third party funding, either due to lack of funds to commence or continue arbitral

proceedings or a desire to maintain cash flow and balance the risk of an unfavourable or uncertain outcome in the proceedings.

Today, many companies around the world face serious revenue reduction and liquidity risk because of the pandemic and state measures taken to mitigate the transmission of COVID-19. The impact of COVID-19 thus may lead to a rise in interest and potential usage of third party funding.

First, parties to commercial arbitrations are likely to face difficulties in meeting the costs of commencing arbitration proceedings or continuing existing proceedings, and therefore to seek to enter into third party funding arrangements.

Second, a number of disputes necessitating arbitration are likely to be created from the pandemic itself.

Third, delays in arbitral proceedings prolong the parties' uncertainty over their outcome and require cash flow to be directed towards funding the proceedings for a longer period of time. From the outset of the pandemic, arbitrations have been severely disrupted and delayed. These delays are due in large part to extensions of deadlines for written submissions, postponements of in-person hearings and the difficulties for counsel and clients to meet, discuss matters and arrange for documents. As more arbitrations dispense with in-person hearings and proceed with virtual hearings, even against the objection of (one of) the parties, there is also a potential that an award rendered through a virtual hearing may be challenged on this basis. The above issues will in turn cause corresponding delays to the issue of a final award and/or its enforcement. Parties are therefore likely to seek to enter into third party funding arrangements in order to mitigate the risks associated with delays in arbitral proceedings.

Fourth, third party funders often follow a relatively long period of due diligence prior to committing to a funding arrangement, which may affect a party's ability to commence proceedings on an urgent basis. Whilst more parties are likely to wish to have recourse to third party funding, it remains to be seen whether the likely delay of recovery associated with the impact of the pandemic in new or ongoing arbitral proceedings will influence a funder's decision to provide the funding sought.

Lastly, as parties may wish to avoid the lengthy process of obtaining third party funding which is urgently needed, they may turn to arrangements to make funding

available more swiftly. In particular, parties who wish to bring or continue arbitration claims are more likely to enter into *ad hoc* and non-formalised arrangements, such as through another company within the corporate group undertaking to cover the costs of the arbitration. These arrangements can be entered into with relatively more ease and provide more flexible terms, as they will likely be internal within the corporate group. As discussed below however, *ad hoc* arrangements may expose parties to a security for costs order, as far as they do not render the third party liable to meet an adverse costs order or award.

A Potentially Greater Role for Security for Costs Following the Impact of COVID-19

Data published in the LCIA Annual Casework Reports between 2017 and 2019 suggest that whilst applications for security for costs are rare, once made, they are more likely to succeed than any other application for interim measures. The likelihood of success of such an application has steadily risen through the years – the LCIA's data indicate that the majority of applications were granted in 2019, whereas around less than a third of applications were granted in 2018 and 2017. However, the data from the LCIA may reflect that arbitrators with a common law background or arbitrating in common law jurisdictions, where the relief is well-known, might be more prepared to grant it.

Notwithstanding the above, security for costs is still viewed as an exceptional measure. Commentators and tribunals generally agree that an order should be issued where there is at least *prima facie* evidence that a party will not be able to meet an adverse costs order or award.[fn]*See* Report of the ICCA-Queen Mary Task Force On Third Party Funding in International Arbitration, April 2018, page 168.[/fn] In addition, some tribunals may also consider whether there has been a material and unforeseeable change in financial circumstances since the conclusion of the arbitration agreement, which justifies the issue of an order. This latter approach considers that parties are ordinarily aware of the financial position of their counterparty at the time of entering into the arbitration agreement, and have agreed to resolve disputes against this party through arbitration. It is therefore inappropriate for a party to rely simply on the fact that, for instance, the counterparty is a special purpose vehicle with no assets in order to support an application for security for costs, where this was known and understood at the time

the contract was concluded.

Institutional rules and national arbitration laws do not (yet) address the impact of a third party funding arrangement in determining whether security for costs should be granted against the funded party. The key question in assessing an application for security for costs is the party's ability to meet an adverse costs order or award. Although the existence of a funding arrangement should not in and of itself justify the granting of security for costs, it may indicate that the party is itself impecunious and may also constitute a fundamental change in circumstances. It should remain open for the parties against which security is sought to establish that they are not impecunious and have sought funding for other purposes.

In addition, the funder's liability to meet an adverse costs order or award and the circumstances under which it may terminate the arrangement will ordinarily be relevant when considering an application for security for costs. If the funder is not liable to meet an adverse costs order, this may be a key argument in favour of ordering security, particularly if there is also evidence that the party against which security is sought is impecunious. The same may apply to *ad hoc* funding arrangements within the corporate group. Parties seeking to enter into arrangements with external third party funders or within their corporate group should be mindful that, unless such arrangements create a legally enforceable obligation on the party providing the funding to satisfy a costs order or award, tribunals may not be satisfied that security for costs ought not to be ordered.

In this regard, earlier court and tribunal decisions provide guidance as to the importance of the terms of the funding arrangement when considering an application for security for costs and may indicate the approach tribunals will follow in the COVID-19 era.

In *Progas Energy Limited v Islamic Republic of Pakistan* [2018] EWHC 209 (Comm) the English High Court concluded that two letters from a third party funder, confirming that it would ensure the payment of an adverse costs award if the claimants failed to pay, did not constitute a legally enforceable commitment on the part of the funder or the claimants. Consequently, the arrangement failed to make assets available to the respondent through which it could recover the costs. The claimants were therefore ordered to provide security for costs in the proceedings, which related to a challenge to an investment arbitration award.

Similarly, in a recent non-public private commercial arbitration,[fn]The authors were part of the team representing the respondent in this case.[/fn] a tribunal held that an undated letter by a company – within the claimant's corporate group – promising to cover the costs of the proceedings did not constitute a legally enforceable obligation. It followed that it could not assist the claimant, who had no available assets, in resisting an application for security for costs.

Lastly, as analysed above, when considering the basis for ordering security for costs, arbitral tribunals often assess whether there has been a material and unforeseeable change in the financial circumstances of the party against which security for costs is sought. In theory at least, it could be argued that the adverse financial impact of the pandemic, and related state measures, has changed a party's financial position to an unforeseen extent that justifies an order for security for costs. While it remains to be seen how tribunals will look into such arguments, a mere deterioration in a party's financial position, without rendering it impecunious, should not ordinarily result in the grant of an order for security for costs. Inversely, a threatened or actual insolvency of a party as a result of the pandemic may tip the scales in the applicant's favour.

Conclusion

The financial impact of the COVID-19 pandemic on arbitrating parties is likely to increase recourse to third party funding arrangements and, consequently, exposure to security for costs applications. The deterioration of a party's financial position due to the pandemic is also likely to provide grounds for a security for costs application. This is a further example of how the pandemic may have a long-lasting impact on international disputes, and should remind parties and counsel to keep the potential consequences of third party funding in mind when negotiating such arrangements.