Kluwer Arbitration Blog

Recovery of Third Party Funding Ordered by ICC Tribunal and Confirmed by the English High Court – An Under-Theorised Area of the Law

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A new development in the third party funding arena prompts an increased analysis of the theoretical foundations of the nature of third party funding. At the moment, there are divergent views on its proper place and treatment, and with increased prevalence a piecemeal approach with little theoretical groundwork risks creating a minefield resulting in unpredictability and lack of proper assessment of financial risks when engaging in proceedings. The debate on whether or not third party funding should exist in the first place seems to have been overtaken by reality; the question now is how to treat it.

In a London-seated ICC arbitration, the Tribunal ordered the Respondent to pay the Claimant's costs on an indemnity basis. This costs award included the amount the Claimant had to pay its third party funder ("TPF") as a result of prevailing in the arbitration.

The TPF had provided funding of around £ 650,000, in exchange for an uplift of either 300% of the funding or 35% of the damages recovered, whichever was greater.

As explained further below, the Respondent challenged in the High Court its liability to indemnify the Claimant for the amount payable to the TPF. The court ruled in *Essar v Norscot* [2016] EWHC 2361 (Comm) that the Tribunal was had the power to make the order, as the amount payable to the TPF was covered by "other costs of the parties" (s59(1)(c) of the English Arbitration Act, the "Act").

This post seeks to highlight several aspects flowing from the decision that, under English law, amounts payable to a TPF are, in principle, recoverable.

Reasoning in *Essar*

Essar brought a challenge to the costs award under s68 of the Arbitration Act, alleging that the arbitrator had exceeded his powers in awarding TPF costs. The court analysed sections 59(1)(c), 61(1) and 63(3) of the Act and Rule 31(1) of the applicable 1998 ICC Rules and found that (as a matter of construction) the arbitrator was correct "as a matter of language, context and logic" [Judgment §68] to find that he had the power to award TPF costs. As to the traditional concerns regarding funding of claims, the judge cited without disagreement the arbitrator's comment that "[a]rguments based on 'maintenance' and 'champerty' are outdated and can be safely ignored." [Award §86]

The arbitrator was strongly influenced by his findings that Norscot's impecuniousness had a strong causal connection with Essar's conduct [Award §84]; at the same time, the arbitrator found that "[t]he claimant's conduct throughout … cannot be faulted" [Award §24]. Following from this, the judge found that "[a]s a matter of justice, it would seem very odd and certainly unfortunate if the arbitrator was not entitled under s.59(1) (c) to include the costs of obtaining third party funding as part of "other costs" where they were so directly and immediately caused by the losing party" [Judgment §79].

He further emphasised the restricted scope of s68 and, even on the assumption of an error on the part of the arbitrator, rejected the attempted re-characterisation of the arbitrator's decision as an excess of power open to the court's scrutiny as opposed to an error of law (which by virtue of ICC Rule 28(6) was not subject to review): "if that was the correct approach, one could re-describe many, if not all, errors of law in that way. Indeed, an erroneous exercise of power itself could in theory almost always be re-described as an excess of power", [Judgment §42] followed by an emphatic rejection of that "re-describe" reasoning.

A more detailed analysist of the *Essar* judgment is available on the HSF Arbitration Notes Blog. The remainder of this post is less concerned with the precedential value of this particular decision, but, as mentioned above, makes a number of observations flowing from the possible recoverability of TPF under English law.

1. Should claims become risk-free for Claimants?

Subject to arguments about reasonableness (as to which, see further below), allowing recoverability of amounts payable to a TPF results in an effective negation of risk by a Claimant: if it loses, the TPF covers the costs; if it wins, the Respondent tops up the damages award by the amount payable to the TPF.

This would be an upgrade to a Claimant's general position, which is that in bringing a claim there is always an inherent element of risk: uncertainty of what the other side may throw at you, how a Tribunal behaves at the hearing etc, while at the same time continuously having to fund the proceedings. The Claimant's price for minimising the financial risk of failure is shifted onto the Respondent.

This raises the question whether it is always the goal to make the Claimant whole, irrespective of how it goes about obtaining a successful award?

A Respondent that puts up a strong fight demanding a lot of resources from the Claimant may find itself at the receiving end of a larger costs award than if it had only done the bare minimum to defend a claim, especially if with hindsight the Tribunal decides the Respondent's case was weak. Here the amount of the costs award is a clear and logically immediate consequence of the Respondent's conduct. Less clear and logically immediate, however, is a Claimant's decision to involve a TPF in cases not involving necessity. Is it right, in such cases, that a Claimant's choice should reduce the ability for it to be made whole again? Faced with the prospect of recovering the TPF payables from the other side, it would have a reduced incentive to drive a hard bargain with the TPF and it might involve a TPF where otherwise it would not have done. Should a Respondent "take a victim as it finds it", including a victim that turns out to be a TPF-supported Claimant, with the consequent additional financial consequences?

A potential constraint could be the requirement of reasonableness: both in terms of obtaining TPF funding in the first place, and the precise terms thereof. An example might be, as is understood from the *Essar* case, where the Claimant's impecuniousness was brought about by the Respondent's conduct. However, assessing questions of reasonableness surrounding TPF funding might cause further and potentially suboptimal use of resources.

2. Irrespective of the costs-treatment in *Essar*, should amounts payable to a TPF properly be treated as damages or costs?

This distinction only matters if there is a practical consequence: in practice, damages and costs are usually assessed separately; in arbitration, costs are rarely subject to a detailed assessment, whereas it is not uncommon for the Tribunal to grapple with the nuances of the quantum stage of a claim.

Classifying TPF payables as costs, therefore, may remove them from the Tribunal's keen scrutinising eye, although in *Essar* the Tribunal still heard evidence on the reasonableness of costs from a Mr Blick, a "broker in litigation funding" on whether the TPF costs reflected standard market rates and terms. In contrast, if subject to a detailed inquiry under the "damages" assessment, there may be questions as to the Claimant's correct cost of capital, how this compares with the return required by the TPF, whether the risk was appropriately quantified etc. This may be opening a can of worms in terms of resources: fully to present one's side may easily tempt a party to throw an expert report and a significant portion of pleadings at that issue, in addition to or to the detriment of the "real" underlying case. TPF, in this case, would lead to a significant increase to the costs of arbitration.

Without wading into precise delineations between the two terms, damages normally refers to a financial detriment incurred generally as a result of the Respondent's wrongful conduct, while costs refers to that financial detriment incurred specifically with a view to recovering some or all of that general financial detriment (still a consequence of the Respondent's conduct).

On that basis, it seems more appropriate to treat sums payable to a TPF as costs.

On the other hand, the nature of a TPF arrangement distinguishes it from what are traditionally viewed as costs. At its heart, it is a sale of what both the Claimant and the TPF consider be a valuable asset at the time of the transaction (hence the TPF's investment): a stake in the potential proceeds in exchange for a promise to cover unquantified – at that point – legal expenses. At the point of the award, this asset may turn out to be worthless (if the claim fails) or of greater worth (hence the high return to the TPF). As with any investment or divestment, the value of the transferred asset may change over time. The TPF's profit is, in one sense, the Claimant's "loss", as it is the element preventing it from being made whole. This analysis suggests a distinction from what are classically viewed as "costs".

The distinction may be unnecessarily formalistic: if so minded, there is, of course, nothing preventing the Tribunal from opening up a more invasive inquiry into the TPF arrangement, regardless of how it is characterised. While it may be intellectually unappealing given *Essar*, it may also still be open to the Tribunal to decide on how it wishes to characterise TPF payables at the start of the arbitration. An order by a Tribunal that TPF payables should be included in the damages analysis would also lead to disclosure of a funding agreement at an early stage.

3. Does it matter whether the claimant was impecunious and "had to" resort to using a TPF, as opposed to the claimant freely (and legitimately) allocating risk by engaging the services of TPF?

If the position is that only a Claimant resorting to a TPF by force of circumstances is entitled to recover amounts payable, then an impecunious Claimant is in a better position than a solvent Claimant.

Conversely, a Claimant that legitimately wishes to hedge its risk and outsources cash outflows against an uplift or portion of an eventual award, would seem to be disadvantaged by having to bear the costs of that outsourcing. Is this simply a price to pay for adjusting its risk position, since no-one forced the Claimant to do this? But does it not make sense from an economic perspective for actors to be able to adjust their risk positions, and hence any counter-incentives should be kept minimal?

From an "access to justice" perspective, do we want to facilitate the opportunity to resort to legal proceedings to vindicate rights by removing barriers to using TPF (by making TPF payments recoverable)? Or is there a danger of excess incentives to institute claims?

A risk-averse and prudent Claimant that has taken care to maintain a cash flow source would be at a disadvantage to a Claimant that, even though acting reasonably, finds itself without a cash flow source; where would one draw the line of reasonableness and how actively would this be monitored?

4. At what stage should the details of a TPF arrangement be made known to the Respondent?

A Respondent may legitimately wish to take the TPF arrangement into account when assessing its potential economic exposure; indeed, it may well prove to be the tipping point when agreeing to a settlement.

On the other hand, a Claimant will be wary of inadvertently divulging any legal assessments by providing financial details. Further, it is questionable whether disclosure of TPF terms in isolation, without reference to the exact circumstances in which the Claimant has turned to TPF, would allow a Respondent to assess the likelihood of the tribunal awarding the costs of the funding.

If sums payable to a TPF are potentially recoverable, then a Respondent may legitimately feel it ought to have an opportunity to scrutinise the arrangement and object to it, the way it would with any other items of financial exposure (which are typically heads of damage). Since a Respondent normally sees costs only at the end, these potentially large sums at stake may merit the Tribunal's intervention at an early stage to enable the Respondent to assess its potential exposure.

Concluding thoughts

The above are intended only as discussion points, without claiming to be a complete analysis. This is an exciting development and we await further arbitral and judicial evolution with great interest. At any rate, it will add to the debate surrounding TPF, particularly as the decision highlights a further distinction between English court proceedings (where it is highly unlikely any TPF costs would be recoverable) and English-seated arbitration.

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