

# Kluwer Arbitration Blog

## How to Fund Construction Disputes – Relying on Third-Party Funding?

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It is well known that disputes arising from the realisation of major energy and infrastructure projects are often exceptionally complex, long, and expensive. They are of high factual and technical complexity with a great volume of evidence, witnesses and experts and involve multiple parties with the fragmentation of responsibilities. As such, one of the main concerns of parties involved is how disputes can be resolved in the most beneficial and cost-saving manner (more KAB posts on efficient arbitration can be found [here](#)). Now, with the rise of [third-party funding](#) (“TPF”) of disputes, or so-called litigation finance, the burden on parties to a potential dispute may be alleviated (more KAB posts on third-party funding can be found [here](#)). TPF generally involves a separate entity becoming involved in a legal dispute by providing financing of all or a part of the legal costs to one of the parties, in return for an agreed percentage of the winning award, or a lump-sum fee paid on success of the dispute.

### Using TPF in Construction Cases

The use of TPF arrangements is reportedly still “in its early stages”, according to the International Arbitration Survey on Driving Efficiency in International Construction Disputes.<sup>1)</sup> This seems to be in contrast to the fact that TPF has long been a hotly debated topic within the arbitration community for years now and that the market for funding disputes has grown to over US\$ 10 billion globally.<sup>2)</sup> As stated in the ICCA-QMUL Report of 2018, TPF can hence be described as an “an integral part of the future of the global arbitration and litigation markets”.<sup>3)</sup>

According to a non-representative survey conducted by the authors of this post among leading funders in preparation of this blog post, the [construction and engineering](#) sector seems to be an attractive sector for TPF.<sup>4)</sup> As such, some funders currently expect at least 20% of their funding portfolio to consist of construction and energy cases in this financial year. Other funders state that they make up for a “notable portion” of the funded cases. Again, others report that such disputes only make up for a comparably small percentage of their overall portfolio but expect to see a growing number of cases from this industry in the future.

Funders see benefits in the fact that claims in this sector not only have the potential to be very large and so may yield high returns, but construction contractors also often have multiple claims that

require funding enabling a cost-effective funding portfolio for the funders. Such a portfolio approach to litigation financing allows for a diversification of risks, which then also allows for the price to clients to be made more attractive. On the downside, the funders note that the high complexity and technicalities of the cases are challenging and require extensive due diligence leading to significant costs sometimes outweighing the benefits of funding.

### **Getting a Clear View on the Validity of Claims**

Due to the high funding application rejection rates of 90% of applications for funding,<sup>5)</sup> the process of applying is demonstrably stringent. As a result, an applicant party must be diligent in its preparation of the facts, documents, and details of the case. Furthermore, it will be elucidated in the course of the application whether the dispute could be awarded enough money for an adequate profit share. Seeing as how construction projects are often exceptionally complex and detailed, a party can greatly benefit from such a process, as it has the inherent capacity to crystallise a case and help to develop a realistic view of the claim.

While the process of preparing a funding application has its benefits, it must also be noted that pursuing it involves high effort, considerable time, and resources. Although usually no application fee itself is expected, the process of applying itself requires considerable investment on behalf of the applying party. Taking into consideration the high rejection rate, it is not unlikely that the preparation of the many intricate and vast amounts of fact-based documentation of a construction claim is in vain for the attempt to receive TPF. Even if that is the case, the applicant party would, however, benefit from the preparation and analysis of amounts of fact-based documentation which is key for the further pursuance of its claims.

### **Pursuing Claims despite Tight Project Budgets**

It may be possible that a party has no money to start a claim, or, even if you are dealing with a large energy or construction corporation, it is often the case that individual project managers have their separate budgets that may not allow for arbitration or litigation proceedings to be initiated. As such, TPF embodies an opportunity to strategically pursue claims. The most obvious benefit of TPF is that it can enable parties to make claims and initiate disputes that they would otherwise not have funding or time for.<sup>6)</sup> In essence, TPF stems from the necessity of a potential claimant to acquire funding to be able to initiate arbitration or litigation. In the context of energy and construction disputes, this is as relevant as in any other sector. In fact, considering the especially high technical and legal complexity of construction cases, and the need to consider a large number of documents and expert evidence, some funders have suggested that funding in the early stages may be especially helpful. Early-stage funding can enable a claimant to obtain the necessary evidence and help in the development of the claim.

### **Gaining Leverage in Settlement Negotiations**

Most construction disputes are eventually settled between the parties. Even in these settlement

scenarios, TPF may be beneficial as having a third-party funder implicitly demonstrates the worth of the claim to the other party because the counterparty will be aware of the extensive scrutiny conducted by the funder during the application process. The fact that funders are on board does not only mean that the claims “survived” the high rejection rate, but also that the funder assessed the claim with a high return benchmark. This assessment is an especially prominent benefit in energy and construction disputes because of their inherent intricacy and the high cost of arbitration. The approval by a third-party funder of the funding application, therefore, becomes a pressure point for settlement discussions.

### **Fighting for Margins**

Not only is there the risk that the effort, time and money put into an application will become a sunk cost, but even if funding is granted, the return for the claiming party may not be financially rewarding after the lender’s payment is deducted from the successful arbitral award. As margins are characteristically slim in construction projects, it may prove short-sighted to seek funding. While it may seem convenient to seek TPF at the beginning of the dispute, where the costs still lie ahead, it may be a losing decision when 7.5-40% of a winning award must be paid back to the funder.

This might only be alleviated if third party funding costs are **recoverable** from the counterparty. This will depend on the definition of recoverable costs in the applicable national legislation/procedural rules. For instance, both the Civil Procedure rules in the UK and the German Code of Civil procedure do not allow recovery of third-party funding costs.<sup>7)</sup> In arbitration, on the other hand, it seems that the door has been opened to full recovery of costs that include third-party funding costs. As previous posts have discussed, in the 2016 *Essar v. Norscot* case, the UK High Court upheld an English seated ICC arbitral award that included almost £2 million in funding costs.<sup>8)</sup> This approach is further supported by the ICCA-QMUL Task Force’s Report that found that the allocation of costs should not be affected by the existence of third-party funding.<sup>9)</sup>

### **Conclusion**


A number of unresolved issues continue to revolve around the topic of TPF beyond the advantages and disadvantages mentioned. For instance, the question remains whether policy problems will prevent TPF in future as there are no comprehensive rules under any arbitral frameworks or in national law that require the declaration of TPF and conduct remains **unregulated**. Therefore, it remains to be seen whether the advantages will prove to outweigh the disadvantages of TPF or *vice versa*. However, with specific regard to the construction sector, funders have identified construction cases to lend themselves well to the funding process and expect to see growth in the number of such cases that rely on third-party funding. Although construction cases are universally seen as higher in cost, this can constitute a business opportunity for funders that can alleviate the financial burden for claimants and expect equally higher rewards in doing so. While TPF also provides for some advantages for the construction company taking it out, it remains to be seen if they outweigh potential disadvantages.

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### References

- ?1 QMUL International Arbitration Survey November 2019, p. 37.
- ?2, ?5 ICCA-QMUL Report April 2018, p. 25.
- ?3 ICCA-QMUL Report April 2018, p. 17.
- ?4 We would like to thank the funders *Augusta Ventures*, *FORIS*, *Vannin Capital*, and *Burford Capital* for their valuable input given to us in this informal survey.
- ?6 International Chamber of Commerce Report 2013, p. 5.
- ?7 UK Civil Procedure Rule 44.1(2)(a) and Section 91 of the German Code of Civil Procedure.
- ?8 *The Essar v. Norscot Case: A Final Argument for the ‘Full-Disclosure-Wingers’ of TPF in International Arbitration.*
- ?9 ICCA-QMUL Task Force Draft Report on Security for Costs and Costs 2015, p. 10.

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