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INTERNATIONAL ARBITRATION

Expert Analysis

Can Arbitrators Award Third-Party Funding Costs?

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Whether you are a supporter of third-party funding—believing that it promotes access to justice, or a detractor—believing that it encourages frivolous claims, one thing is clear: Third-party funding is here to stay. This is attested to by the growing number of funders around the world, new legislation in Singapore and Hong Kong—both leading arbitral seats—authorizing the use of third-party funding in international arbitration, and pronouncements by professional bodies, such as a recent one by the Paris Bar Counsel, to the effect that third-party funding is a positive development in international arbitration. (One blip in this general trend in favor of third-party funding was a decision of the Irish Supreme Court last month holding that third-party funding is unlawful.).

The growth of third-party funding has raised certain novel issues in international arbitration. These issues relate to the disclosure obligations of arbitrators who may have some connection to a funder, the impact of the use of third-party funding on the attorney-client privilege, and the award of costs. This article will focus on one of those issues—costs.

For those accustomed to U.S. litigation, where cost-shifting is rare, a distinctive feature of international arbitration is that it is relatively common for arbitrators to order one party (almost invariably the losing party) to pay some or all of the "costs" of the other (the prevailing party). The term "costs" when used in the international arbitration context is commonly understood to include both the attorney fees and other expenses involved in pursuing or defending against a claim. The authority of arbitrators to award costs is embodied in the rules of the main international arbitral institutions. For example, the ICC Rules permit an arbitral tribunal to award "the reasonable legal and other costs incurred by the parties for the arbitration," and provide that, in making decisions as to the award of costs, the tribunal may "take into account such circumstances as it considers relevant." Article 38(1) and (5). And while the Federal Arbitration Act (FAA) does not itself address costs, some states have adopted international arbitration statutes (as distinct from statutes governing domestic arbitration) authorizing arbitrators to award costs. See, e.g., Cal. Civ. Proc. §1297.318(a) ("Unless otherwise agreed by the parties, the costs of an arbitration shall be at the discretion of the arbitral tribunal") and § 1297.318(b)(2) (defining "costs" to include "[l]egal fees and expenses").

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It is generally agreed that certain categories of "costs" are the legitimate objects of an application for an award of costs. These include attorney fees and expenses such as arbitrator fees, expert witness fees, and the costs of travel, copying, research and transcripts, to name a few. The use of third-party funding has introduced a

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new category of potential costs—the costs of the funding.

One common way in which third-party funding operates is that the funder provides finance on a non-recourse basis to the claimant in an arbitration proceeding. Those funds are in turn used to pay the claimant's attorneys and to cover the other expenses involved in pursuing the case. If that party loses, the party owes nothing to the funder because of the non-recourse nature of the transaction. If that party prevails, however, under the funding agreement, the funder is entitled to a premium. Typically, that premium is either a multiple of the amount advanced (e.g., 200 percent to 300 percent) or a percentage of the recovery (e.g., 30 percent to 40 percent). For example, if a funder advances $2 million to a party pursuing a claim, in the event that party prevails, the funder could be entitled to the return of a $4 million premium in addition to the $2 million invested.

This raises the question of whether the funder's premium can be the legitimate object of a costs application. This question is complicated by the fact that funding costs not only differ in kind from the other types of costs traditionally sought by a prevailing party, but also that they differ in size. The costs of funding are often a multiple of all the other costs (including attorney fees) put together.

A task force formed under the auspices of the International Council for Commercial Arbitration and Queen Mary University of London recently concluded that "[i]t is not appropriate for tribunals to award funding costs … as they are not procedural costs for the purpose of an arbitration." Rather, "[t]he success portion payable to a third-party funder results from a trade-off between the funded party and the funder, where the funder assumes the cost and risk of financing the proceedings and receives an award if the case is won."

However, in a recent case, E*ssar Oilfields Services v. Norscot Rig Management Pvt,* [2016] EWHC 2361 (Comm), the English High Court rejected a challenge to an arbitrator's decision to award funding costs. Essar arose out of an ICC arbitration seated in London. Norscot, the claimant in the arbitration, had received a loan of £647,000 from a funder to pursue the arbitration. Norscot had agreed with the funder that, if it prevailed, it would pay the funder the larger of 300 percent of the funding or 35 percent of the recovery. When Norscot prevailed, it applied for costs from the arbitrator, seeking not just the amount it spent on attorney fees and other expenses, but also the funder's premium, which was £1.94 million.

> If an arbitrator in a case sited in New York were to award funding costs based on her interpretation of the term "other costs" in the governing arbitration rules, it is doubtful that such an award would be vacated by a New York court.

In *Essar*, the sole arbitrator had two sources of authority to award costs. One was the ICC Rules, which, as noted, authorize an arbitrator to award "reasonable legal and other costs." The other was the English Arbitration Act of 1996, which applied because the arbitration was seated in London. Unlike its U.S. equivalent, the FAA, the English Act explicitly grants authority to arbitrators to award "the legal or other costs to the parties." §59(1)(c).

In *Essar*, relying on the English Act and the ICC Rules, the arbitrator determined that he had the discretion to include in "other costs" the costs of third-party funding. And he went on to decide that it was appropriate to exercise his discretion to award the funding costs to the claimant based on the specific facts of the case, which the English court characterized as "a David and Goliath battle." The arbitrator found the following facts significant:

(1) That Essar sought to exert commercial pressure on Norscot, including by, among other things, failing to pay sums due under the underlying contract and making unjustifiable personal attacks;

(2) That, as a result, Norscot had no choice but to enter a funding arrangement if it was to pursue its claims;

(3) That the costs of the funding obtained by Norscot reflected standard market rates, a finding based on an expert opinion from a litigation funding broker; and

(4) That "Essar was undoubtedly aware that Norscot's costs could not be financed from its own resources … and it was forced into litigation funding … ."

Essar applied to set aside the arbitrator's award of funding costs. It based its challenge on §68 of the English Act, which permits a challenge where there was a "serious irregularity affecting the tribunal, the proceedings or the award" which a court considers will cause "substantial injustice to the applicant." The Act identifies nine categories of "serious irregularity," with some corresponding to the

grounds for the set aside of an arbitral award in §10 of the FAA.

In its application, Essar relied on §68(2)(b) of the English Act—"the tribunal exceeding its power." The English court disposed of this argument quickly. It is settled in English law that for an arbitrator to exceed her jurisdiction, she must exercise a power she does *not* have; it is not enough that she makes an error exercising a power she *does* have. *Lesotho v. Impregilo* [2001] 1 AC 221. Here, the English court found that since the arbitrator had the power to award "other costs," if he made an error at all, it was only that he interpreted the term "other costs" incorrectly, not that he exercised a power he did not have. The English court did, however, go on to consider whether the arbitrator's construction was correct, and held that "as a matter of language, context and logic, … 'other costs' can include the costs of obtaining litigation funding."

What if *Essar* were transposed to New York? Would the outcome be the same? The first point to consider is that, unlike the English Arbitration Act, the FAA does not give an arbitrator the authority to award costs. And unlike the arbitration statutes of some other states, New York's arbitration law contains no specific authority for arbitrators to award costs. Thus, for an arbitrator to have that authority, she would have to rely on the arbitration clause or the rules under which the arbitration is conducted, such as the ICC Rules which applied in the *Essar* case.

In this context, it is worth stressing that it is not simply the ICC Rules that authorize arbitrators to award the "reasonable legal and other costs." Others do as well. See, e.g., Article 34 (d) of the International Centre for Dispute Resolution (ICDR) Rules (arbitrator may award "the reasonable legal and other costs incurred by the parties"); Article 40 of the UNCITRAL Arbitration Rules ("legal and other costs … to the extent that the arbitral tribunal determines the amount of such costs reasonable"); Article 37 of the SIAC Rules ("all or a part of the legal or other costs"). See also Article 28.3 of the LCIA Rules ("the legal or other expenses incurred by a party").

If an arbitrator sitting in New York were to interpret the term "other costs" to permit the award of funding costs, as did the arbitrator in *Essar*, could such an award be successfully challenged? There would be two potential challenges to such an award under the FAA: one under §10(a)(4) of the FAA—"the tribunal exceeded its powers, or so imperfectly executed them that a mutual, final and definite award upon the subject matter submitted was not made"; the other "manifest disregard of law."

It seems unlikely that a challenge on either of these grounds would be successful. It is settled that deference is given to an arbitrator's interpretation of a contract, and arbitration rules referenced in an arbitration clause are best understood as part of the contract. See, e.g., *ReliaStar Life Ins. Co. v. EMC Nat'l Life Co.,* 564 F.3d 81, 86 (2d Cir. 2009) ("As long as the arbitrator is even arguably construing or applying the contract and acting with the scope of his authority, a court's conviction that the arbitrator has 'committed serious error' in resolving the disputed issue does not suffice to overturn his decision"); *Commercial Risk Reinsurance v. Security Insurance*, 526 F. Supp. 2d 424, 432 (S.D.N.Y. 2007) ("The interpretation of contractual terms by arbitrators is not subject to judicial challenge, even when the award may be grounded on an erroneous construction of the parties' agreement.").

In fact, there is authority for the proposition that even more deference is due when arbitrators are interpreting the rules under which they are operating. See, e.g., *Howsam v. Dean Witter Reynolds*, 537 U.S. 79 (2002) (arbitrators, "comparatively more expert about the meaning of their own rule, are comparatively better able to interpret and to apply it.") This is especially the case where the rules themselves provide that the arbitrators have the authority to interpret the rules, as do the ICDR Rules, for example. *Ecopetrol S.A. v. Offshore Exploration and Production* 46 F. Supp. 3d 327 (S.D.N.Y. 2014) ("When parties have adopted rules conferring on an arbitral panel authority to interpret the rules governing arbitration, courts should defer to the panel's interpretation of the rules governing arbitration.").

What this all means is that if an arbitrator in a case sited in New York were to award funding costs based on her interpretation of the term "other costs" in the governing arbitration rules, it is doubtful that such an award would be vacated by a New York court. However, this entails only that an arbitrator has the discretion to award funding costs, not that she should necessarily exercise her discretion to do so. That ultimately will depend on the facts of the particular case before her.