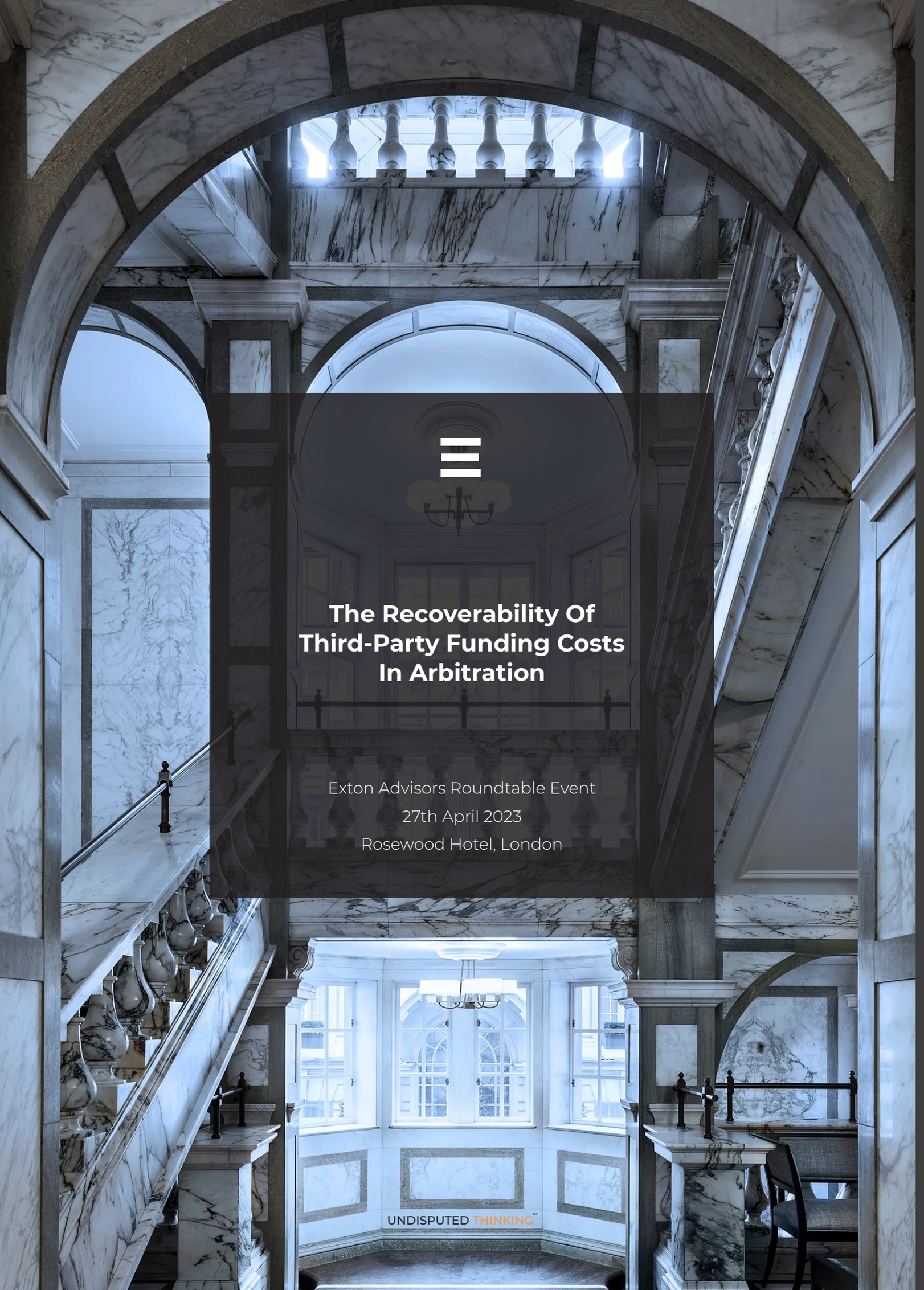

The Recoverability Of Third-Party Funding Costs In Arbitration

Exton Advisors Roundtable Event

27th April 2023

Rosewood Hotel, London

UNDISPUTED THINKING™

On the 27th April 2023, Exton Advisors were delighted to bring together leading professionals from across the arbitration space to discuss the recoverability of third-party funding costs in arbitration. This summary of the roundtable aims to reflect the current thinking on the topic and the development of the law in this area, as well as the potential for future changes in policy and practice.

Roundtable participants:

Manish Aggarwal // Partner, Three Crowns

Philippa Charles // Arbitrator, Twenty Essex

Alejandro Garcia // Partner, Stewarts

Camilla Godman // Investment Manager, Omni Bridgeway

James Leabeater KC // 4 Pump Court

Matthew Lo // Director, Exton Advisors

Cameron Murphy // Director, Profile Investment

Samantha Rowe // Partner, Debevoise & Plimpton

Daniel Spendlove // Partner, Signature Litigation

EXTON ADVISORS ROUNDTABLE
27TH APRIL 2023

As third-party funding has become more mainstream in recent years, courts and tribunals alike have been confronted more and more frequently with issues surrounding its application.

Our roundtable discussion explored the commercially significant and increasingly common question of the circumstances in which a successfully funded claimant is permitted to recover the funder's "success fee" from its opponent in arbitration. It goes right to the heart of the civil justice system that a successful claimant should be returned to the position it would have been in had the wrongful conduct never occurred. However, where a claimant has been funded by a third-party, unless recovery of its funding costs is allowed, it will be left to foot the bill for those costs out of any damages recovered, meaning that this overarching aim is not achieved.

"Whether as a matter of law you can recover third-party funding costs under the Arbitration Act 1996 is a point that remains undecided"
James Leabeater KC, 4 Pump Court

Clearly, it would not be right for respondents to be held liable for any and all funding costs without limitation – but where is the line to be drawn? What guidance is required on this important topic and how can future policy and practice be developed to best suit the needs of the civil justice system as a whole?

Prior to the 1st April 2013 Jackson Reforms, lawyers' success fees under a Conditional Fee Agreement (CFA) were recoverable from the losing party in English proceedings. As a result, CFAs were once a highly attractive and common form of funding for claimants in England. However, since the reforms, the CFA success fee, and any ATE insurance premium, ceased to be recoverable in English litigation and arbitration. This change made CFAs a less appealing option and may have increased opportunities for third-party funders, even though there was, at that stage, no market-wide expectation that a funder's fee could be recovered.

The position changed in September 2016 with the seminal Commercial Court decision in *Essar Oilfields Services Ltd v Norscot Rig Management PVT Ltd*, upholding an ICC tribunal's award requiring the respondent to pay funding costs amounting to three times the claimant's costs, which the court confirmed fell within the ambit of "other costs" under section 59(1)(c) of the Arbitration Act 1996 (Act). Here, the award was based on the unusual facts of the case, in particular, the respondent's *"reprehensible conduct going far beyond technical breaches of contract"*. Essar had *"set out to cripple Norscot financially"*, effectively forcing Norscot to resort to third-party funding.

This principle was then confirmed (and arguably extended) in the 2021 case of *Tenke Fungurume Mining S.A. v Katanga Contracting Services S.A.S.* where the Commercial Court upheld another ICC award of funding costs. In contrast, there was no suggestion in that either party had behaved improperly. Instead, the tribunal's focus was on whether the costs were *"reasonable"*, first as to the principle of the claimant having sought funding and secondly as to the amount. On the first issue, the tribunal held that there was no need for the claimant's financial difficulties to be caused exclusively by the respondent – the fact that it needed funding to pursue its claim was sufficient. As to the second issue, a return of 1 times the claimant's costs of US$1.3m plus a variable fee of c.US$214,000 was deemed reasonable.

The topic has also been addressed, albeit briefly, by arbitral institutions and other bodies. For example, it is clear from the ICC Commission's 2015 Report on Decisions on Costs in International Arbitration that the ICC considers there may be circumstances where it would be reasonable for the successful funded party to recover the costs of funding. Principle C3 of the final report of the ICCA Queen Mary Taskforce on TPF provided that the question of recoverability *"will depend on the definition of recoverable costs in the applicable national legislation and/or procedural rules, but generally should be subject to the test of reasonableness and disclosure of details of such funding costs from the outset of or during the arbitration so that the other party can assess its exposure"*.

Following the above decisions, as things stand under English law, a curious divergence has emerged between litigation (where funding costs are not recoverable) and English-seated arbitrations, where these costs have been held to fall within the ambit of recoverable costs under the Act. There is no obvious principled reason for this difference. From a claimant's perspective, on this basis alone, arbitration must currently be seen to have a material advantage over litigation in England.

The commercial implications of this issue may be obvious but they are also hard to overestimate – if a funded claimant is allowed to recover some or all of the funding fee from its opponent, that will mean it can retain all or more of the damages recovered. Since litigation funding is generally non-recourse, this claimant will have reaped these rewards without having taken any of the downside risk associated with its claim failing. In other words, funding in arbitration becomes a win/win scenario.

It is important to note that the above cases involved challenges under Section 68 of the Act alleging *"serious irregularity"*. As is often the case with institutional arbitrations, the right to appeal for an error of law under Section 69 of the Act was excluded under the applicable rules. Section 68 challenges cannot be used to challenge the correctness of legal decisions, which are limited to appeals under Section 69. As **James Leabeater KC** of **4 Pump Court** observed in our roundtable, *"whether as a matter of law you can recover third-party funding costs under the Arbitration Act 1996 is a point that remains undecided"*.

It will be interesting to see whether the court would take a different view in circumstances where the legal appeal right has not been excluded (for example, in an LMAA or ad hoc arbitration) and it is required to address the same essential question but through the lens of an error of law.

In view of the commercial dynamics, it is perhaps unsurprising that the funders in attendance at the roundtable reported an uptick in this point being argued in arbitrations since the *Essar* and *Tenke* decisions. **Cameron Murphy** of **Profile Investment** noted that *"there is certainly momentum for claiming funding costs – we've argued it in four cases this year already"*. The funders reported that tribunals have also been willing to include the costs of obtaining ATE insurance in costs awards on the same basis as third-party funding costs.

Our roundtable participants heard that there were two key considerations that tribunals have focused on when considering applications to recover funding costs. First, although not an absolute requirement, early disclosure of the funding arrangements, including the commercial terms, is generally viewed favourably by tribunals, as it is seen as giving the respondent fair warning of their potential exposure. The second factor is reasonableness – tribunals will be interested in the claimant's financial position (even more so if it has been impacted directly by the respondent's conduct) and the amount of the funder's success fee.

The funders reported that, rather than being left to the post-award stage, increasingly these issues are being considered at the outset of an arbitration. **Camilla Godman** of **Omni Bridgeway** noted *"We work with the claimant and lawyers to ensure they are in the best position possible to recover their funding costs. There will be a number of factors in play when a tribunal is ruling on this point, but we want to avoid failure to disclose at the appropriate stage in the proceedings or unreasonable costs being the reason that funding costs do not get awarded"*.

Cameron Murphy of **Profile Investment** added *"Funders are incentivised to ensure claimants take home as much of the award as possible. This is positive for the industry, the funders and the claimants"*.

Increasingly, institutional rules and local legal professional conduct rules are mandating early disclosure of third-party funding. Wherever disclosure isn't mandatory, claimants and their advisors face a strategic choice. Failing to disclose the funding arrangement at an appropriate time in the arbitration (or at all) may be seen by the tribunal as putting the respondent at a disadvantage by denying them advance notice of the extent of their potential exposure. Disclosure of funding arrangements is also likely to have a material impact on the settlement dynamic.

"Funders are incentivised to ensure claimants take home as much of the award as possible. This is positive for the industry, the funders and the claimants"
Cameron Murphy, Profile Investment

Although there was a consensus that tribunals are generally likely to view early disclosure favourably, failure to disclose may not be an absolute bar. Indeed, in *Tenke,* it was only during the cost submissions stage that the claimant revealed for the first time that it had obtained third-party funding, by way of the shareholder loan. The tribunal's assessment will always be fact-specific, for example, it may be less inclined to allow recovery where the claimant failed to disclose the funding in circumstances where it had made a free choice to obtain it, rather than having done so out of necessity.

"An analogy might usefully be drawn with costs budgeting in English civil litigation – this forces parties, their advisers and the Court to focus on costs from the start, with the aim being more effective and transparent costs management" observed **Daniel Spendlove** of **Signature Litigation**. *"It also provides more certainty as to what is likely to be recoverable at the end of the case, and what is not. Early disclosure of funding could be seen in a similar light and may therefore serve a useful purpose."*

While there may be advantages in terms of maximising the prospects of recovering the costs of funding in the event of success, the roundtable heard that in almost all cases where funding is disclosed, respondents will consider making an application for security for costs, as the existence of funding may be seen as evidence of impecuniosity on the part of the claimant. As **Cameron Murphy** of **Profile Investment** observed, *"there is certainly a trend in favour of security for costs being granted where the claimant is impecunious – a funder will generally look to ATE insurance to cover this"*.

> "It is not always straightforward to determine what impecuniosity really means. Interesting questions will also arise if a claimant is asset rich but cash poor"
> Daniel Spendlove, Signature Litigation

According to **Alejandro Garcia** of **Stewarts**, *"This can put the claimant's lawyers in an awkward position when advising on disclosure of third-party funding, where you need to balance maximising the prospects of the claimant recovering the funding fee against the near certainty that a security for costs application will be launched – in some ways the dynamic is easier where disclosure is mandatory because there is no longer a tension"*. Interestingly, **Cameron Murphy** of **Profile Investment** reported that one tribunal had granted security for costs, but on the condition that the respondent would reimburse the claimant for the costs of obtaining ATE insurance – including a multiple of the premium that the funder paid on behalf of the claimant – in the event the case went on to succeed.

As to reasonableness, the court in *Tenke* took a two-tiered approach: first as to the principle of having obtained funding and secondly as to the cost. As for the first question, the roundtable considered whether this might be seen a low bar, given there may be very limited circumstances where it would be *"unreasonable"* for a claimant to seek third-party funding, which is, after all, increasingly viewed as a prudent financial and risk management tool by well-capitalised corporates.

It is perhaps inevitable that tribunals will have greater sympathy for impecunious claimants who had no option but to resort to third-party funding, especially if the financial distress was contributed to by the respondent. However, as **Daniel Spendlove** of **Signature Litigation** observed, *"It is not always straightforward to determine what impecuniosity really means. When does a claimant become unable to sue – how poor must it be? And at what point in time is this defined? Interesting questions will also arise if a claimant is asset rich but cash poor."*

As regards the reasonableness of the funding cost, this can also be a tricky question in circumstances where the cost for each case will inevitably depend on the level of perceived risk. When looking to satisfy the tribunal that the cost was reasonable, according to **Samantha Rowe** of **Debevoise & Plimpton**, *"primarily you would look to rely on evidence from the claimant, but beyond that – and depending on the responsive evidence put forward by the respondent (if any) – there may be a need for input from an independent expert in the funding market"*.

Broadly, there was a feeling amongst our participants that it would be helpful if the claimant could demonstrate that it had tested the funding market and made an objectively justifiable choice. However, it is important to recognise that whilst price is always important, it may not be the only factor that a claimant weighs up when accepting an offer from one funder over another. *"As time goes on, just as Courts and Tribunals become more familiar with what level of costs is typically incurred by parties in complex disputes with the benefit of experience and first-hand knowledge of those matters, tribunals ought to become well versed in determining for themselves what is a reasonable funding fee"* commented **Daniel Spendlove** of **Signature Litigation**. Ultimately, a tribunal will look at all of the circumstances in determining whether it is reasonable for the cost of funding to be shifted to the respondent.

The roundtable also explored whether there might be a grey area in terms of whether recovery of a funder's success fee might be included in the claimant's pleaded case for damages rather than as part of costs submissions. *"Arguably,"* as **Alejandro Garcia** of **Stewarts** explained, *"if the respondent has caused the claimant to seek funding as a result of its behaviour, then this could form part of the damages sought as opposed to the application for costs, which generally isn't intended to cover compensation as such"*. As the approach to this issue continues to mature over time, it will be interesting to see whether increasing numbers of claimants look to recover funding costs in this way.

> "There is certainly now an opportunity to argue this point in investment treaty arbitration"
> Alejandro Garcia, Stewarts

In addition, the roundtable considered the position in investment treaty arbitration and in particular the (as yet unpublished) case of *Dominion Minerals v Panama*, in which it has been stated that the successful funded claimant sought reimbursement of its funding fees in circumstances where only a fraction of the damages sought were awarded. It is understood that an ICSID tribunal stated that the question of whether funding fees could be recovered remained unresolved in investor-state arbitration.

EXTON ADVISORS ROUNDTABLE
27TH APRIL 2023

Although it indicated that those costs could, in certain situations, be recovered, this could only be the case if the funding fee was reasonable. The majority of arbitrators decided against ordering reimbursement of the funding fee in this case. **Alejandro Garcia** of **Stewarts** suggested that *"there is certainly now an opportunity to argue this point in investment treaty arbitration, and claimants are likely to do it where they had to disclose the existence of funding under any relevant rules. This is likely to be the case, for example, under the current ICSID rules where disclosure is mandatory."*

"There is a lack of certainty and consistency in terms of common principles and practices across various institutions"
Phillippa Charles, Twenty Essex

Philippa Charles, arbitrator at **Twenty Essex** identified the challenges involved in dealing with this question in practice. She observed that interim issues will likely arise in relation to security for costs, as well as the extent to which a funding agreement should be disclosed. In addition, there may be issues concerning governing law (both of the seat and any jurisdiction where enforcement may take place), given third-party funding is not treated equally in all jurisdictions. As always, an arbitrator is concerned to ensure neutrality of position is maintained pending the determination of the substantive issues and, ultimately, that an enforceable award is delivered. The *Essar* and *Tenke* decisions are limited to their own facts and it is at present hard to discern any common practice in dealing with this issue amongst institutions, making matters more difficult for arbitrators.

Philippa Charles of **Twenty Essex** added, *"There is a lack of certainty and consistency in terms of common principles and practices across various institutions in respect of this issue that needs to be addressed for the benefit of the dispute resolution community (users, practitioners, funders, and decision-makers) as a whole"*. There was a clear consensus amongst our participants that there is a need for further clarity and guidance to assist practitioners in dealing with this issue.

"As things stand", observed **Samantha Rowe** of **Debevoise & Plimpton**, "there is an absence of authority on the point – there is a need for guidance on a transnational basis". **Manish Aggarwal** of **Three Crowns** agreed, commenting, *"there is scope for more institutional guidance on this issue, although, of course, regard would always have to be had to the law of the seat"*. The roundtable heard that one of the biggest challenges faced by practitioners is the lack of publicised awards, or any resource synthesising the approach to the issue taken to date. Such a resource would be helpful in generating a baseline understanding of how the question has been treated.

Pending further guidance, in circumstances where funding costs are increasingly being sought (and successfully recovered) in arbitration, this is an issue which prospective funded claimants and their advisors must now be factoring into their strategic thinking from an early stage.

The good news is that there are steps which can be taken to optimise a claimant's chances of recovery, especially in relation to the crucial question of whether and how it will be demonstrated that the cost of funding was reasonable. Key questions include:

- Have you tested the funding market?
- How have you negotiated pricing and the structure of the success fee?
- Have you taken independent advice as to the commercial terms on offer and how they compare to market standards?
- Have you discussed disclosure with the funder?
- Have you catered for security for costs being sought as a consequence of the disclosure of funding?

"There may be a need for input from an independent expert in the funding market"
Samantha Rowe, Debevoise & Plimpton

As the leading independent advisors in disputes finance and insurance, Exton Advisors are well placed to advise on all of these issues and more. For more information on this event or to discuss any of the topics covered further, please contact:

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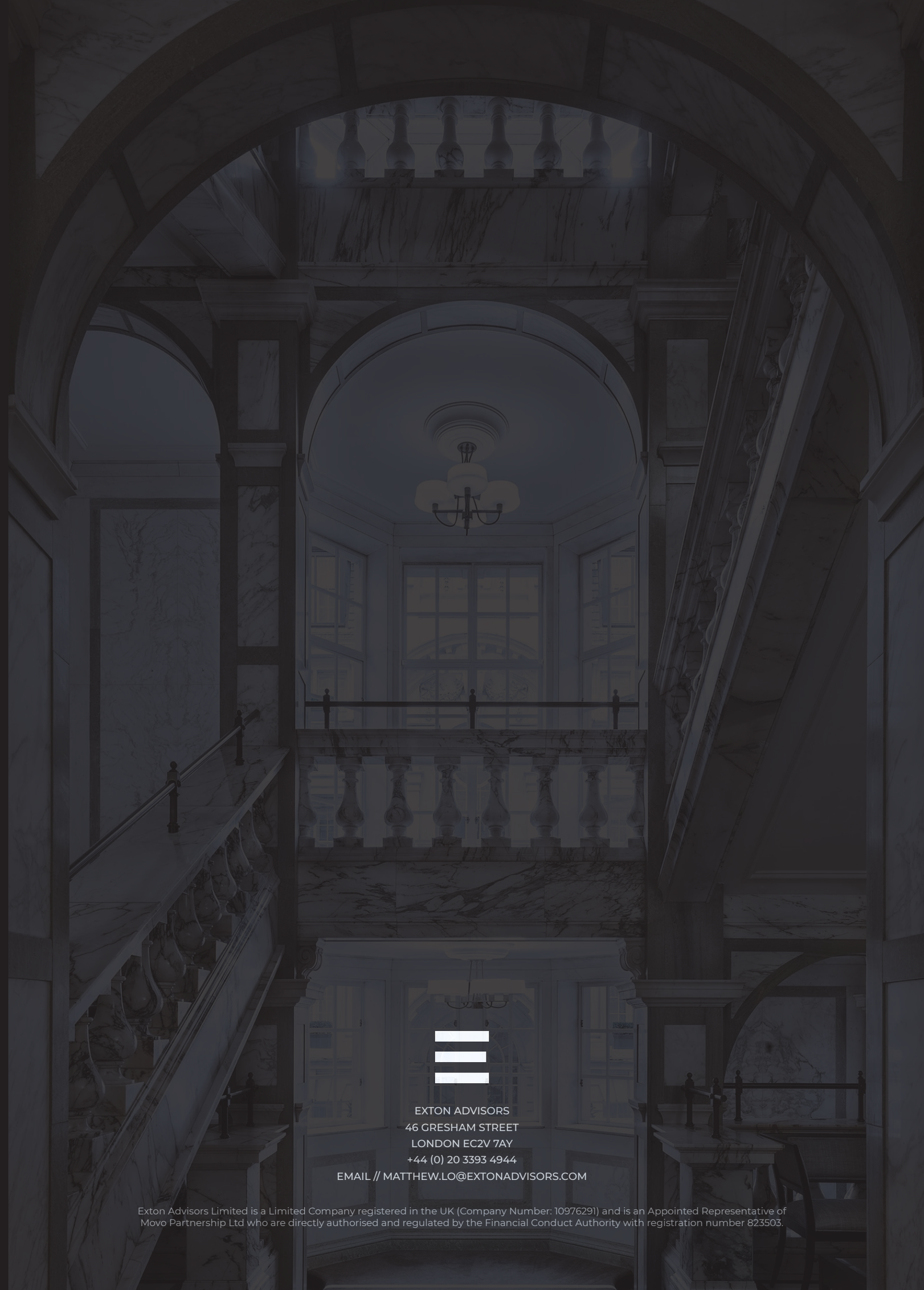

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