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# Third-Party Funding: Liability of Third-Party Funders to Pay Costs in Arbitration; Entitlement of Successful Claimants to Costs of Third-Party Funding

As third-party funding carves inroads into financing of arbitration proceedings, a host of novel issues have arisen to garner the attention of the business and legal stakeholders. This article analyses the legal feasibility and repercussions of an award of costs—for and against the third party funder, in the event of success or failure of the claim, respectively.



## Introduction

Third-party funding ('TPF') is a financing method whereby an entity that is not party to a dispute and the proceedings arising therefrom, finances all or part of a party's costs of proceedings, in return for a percentage of recovery made under the judgment or award. TPF is commonly associated with non-recourse outcome-based financing—where funder's fees are repaid only upon success. Historically, TPF was introduced to facilitate access to justice for an impecunious party (usually the claimant). Today, the need to manage and allocate risks of proceedings; maintain healthy cash flow in business; or find alternative avenues for investment have led to exploring TPF for diverse goals.

'Funding' includes classic costs of proceedings viz. attorney fees, evidentiary hearings, arbitrator fees, administrative fees, payment under judgment or award or others. It may also include exceptional costs such as security and adverse costs of the successful party. A funding agreement may stipulate a cap on funding, deposit of security, percentage of return, success fee, payment of adverse costs and termination rights among other conditions. An arbitral tribunal holds discretion to award or allocate costs of proceedings. Typically, costs are awarded *vis-à-vis* 'parties'. This article examines the issue of liability as well as entitlement of funders in arbitration proceedings. It analyses whether a third-party funder ('funder'), being 'third' to the proceedings, can be ordered to step into the shoes of a party and pay the adverse costs of the successful party? Conversely, can the losing party be ordered to pay the costs of the TPF incurred by the funded party? This is confined to funders and no other mode of financing such as bank loans and insurance.

## Liability of Funders to Pay Costs of the Successful Party Litigation

Typically, courts have powers to make orders against third parties. With respect to funders, the situation is atypical and fact based. A funder may merely fund a genuine claim. To hold him liable as a 'party' by default would deter funding, thereby hindering access to justice. However, where the funded claim is spurious, speculative and opportunistic,<sup>1</sup> such that due diligence by the funder (rigorous analysis of law, facts, witnesses, review at regular intervals—not interfering with administration of justice thereby being champertous)<sup>2</sup> would adequately reveal its nature and character of action, courts in the United States and the United Kingdom have ordered costs against funders.<sup>3</sup>

Where a funder uses a spurious claim to gain access to justice, he usurps the 'real party' position.<sup>4</sup> It may exercise control over proceedings in a manner that steers the conduct of the party and has a causal link with its impact on the other party. Considering the extent of economic interest, involvement, control and the derivative nature of a funder's involvement,<sup>5</sup> courts ordinarily consider it just and equitable to order adverse costs against funders as it would be assessed against the funded party.



### Final Allocation/Award of Costs in Arbitration

In contra-distinction with courts, arbitration is consent-based. A tribunal derives powers to award costs from the arbitration agreement or institutional rules of arbitration. Several institutional rules prescribe recovery of costs that are 'reasonable'.<sup>6</sup>

An award of costs depends on the cost-allocation approach of the tribunal, often also reflected in institutional rules.<sup>7</sup> The tribunal may follow the 'costs follow event' approach (where the unsuccessful party pays costs unless circumstances call for a different order) or where each party pays its own costs. Issues of funder's liability arises when tribunals employ the former approach. Akin to Courts, can an arbitral tribunal pass an order of costs against funders?

Upon disclosure, the tribunal will assess if the funding agreement stipulates funder's liability to pay adverse costs. Where silent, the tribunal would turn to the arbitration agreement to assess if the same extends to the funder. This may be rare since parties do not contemplate disputes, let alone funding, during the signing of the agreement. Since a funder is not involved

in negotiation and performance of the agreement and may emerge only post-dispute, he is not a 'party' to the agreement. Majority institutional rules<sup>8</sup> and national laws<sup>9</sup> provide that costs may be ordered against 'parties' to the agreement. Hence, in principle, a tribunal will lack jurisdiction to issue a costs order against a funder.<sup>10</sup>

International Centre for Settlement of Investment Disputes. This may justify a wider interpretation of the term 'parties' today for the purposes of costs.


Although tribunals exercise jurisdiction over 'parties', it is not uncommon to employ common law principles to implead third parties in arbitration. Some principles are: (1) involvement of third party in performance of contract; (2) intrinsic linkage between the parent agreement and contracts involving third parties; (3) incorporation of arbitration by reference; (4) necessity of third party for adjudication; (5) agent-principal relationship; (6) assignment; (7) subrogation; (8) implied consent; (9) third party beneficiaries; (10) interest in the dispute; (11) control over proceedings; (12) piercing of corporate veil (alter ego); (13) estoppel; and (14) good faith and equity.

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3. The article is not written to publicise the expertise, specialization, or network offices of the writer or the firm at which the writer is based;
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Historically, TPF was introduced to facilitate access to justice for an impecunious party.

Can third party principles be extended to funders? At the outset, it is essential to note that third-party principles are widely used by courts. The rigors of the principles diminish, although not disappear, in the case of consensual arbitration. For example, principles of agency or assignment are inapplicable due to lack of transfer of contractual rights in a TPF agreement. Funders also have no involvement in performance of the contract. However, principles of interest, control and the umbrella of equity may encompass the funder. If it can be established that a funder has a substantial interest (economic or otherwise) in the proceedings, such as to be the real interested party; or that the funder has sufficient control over the proceedings to steer its course and be responsible for the conduct of the funded party; or that the award has an effect on the third party funder, other than loss of its funding in the event of defeat, it would be equitable for the tribunal to award adverse costs against the funder. However, it is essential to note that the mere fact of third party funding is not conclusive of determination of costs—neither against the funded party nor in favour of the successful party.<sup>11</sup> In parallel with third party principles, the tribunal may find it relevant to consider other circumstances such as the nature of the claim, extent of benefit from the funding, economic interest and control, among others, to fasten liability on funders.

### Security for Costs in Arbitration

Another species of costs that tribunals can award is security for costs ('security'). This is a discretionary power of exceptional nature. Tribunals derive this power from arbitration agreements, institutional rules, national laws on interim measures or even from inherent powers to preserve integrity of the proceedings.<sup>12</sup> Considering the arduous path to a final costs order, a procedural order of security against impecunious claimants appears more effective for the defendant, when the factum of TPF has been disclosed. Primarily, a security would appear contrary to the essence of an arbitration agreement since parties are deemed to accept risks for costs or damages associated with future disputes while signing the agreement.<sup>13</sup>

The first threshold for a security order is to *prima facie* assess the case and the likelihood that final costs may be awarded to the defendant. Again, the approach of the tribunal (costs follow event or each party pays its own) would determine its approach towards security. Akin to final costs order, TPF *per se* does not entail security by default.<sup>14</sup> A security also envisages a material change in the circumstances of the party that were not foreseeable at the signing of the agreement,<sup>15</sup> since parties would not enter into an agreement while one is impecunious. Material change in circumstances is therefore a crucial determinant for security.



It is notable that funders may voluntarily pay security to prevent undermining their investment and to continue proceeding with a genuine claim.

Upon arriving at a finding of financial doldrums or the possibility of potential default at the final stage, various circumstances can merit the passing of a security order. Clauses in a funding agreement on termination rights and funder's liability to pay adverse costs may inform the decision of the tribunal while it balances the funded party's access to justice with the need of the unfunded party to recover its costs.<sup>16</sup> If a security results in renegotiation of a TPF arrangement and prejudice to the funded party, or 'walking out' by the funder as per a termination clause, this may stifle a meritorious claim. On the contrary, this may fortify the demand of security by the unfunded party since this increases the risk of non-recovery. Tribunals may order security and cast onus upon the funded party to disclose other factors to prevent security.<sup>17</sup> The other circumstances would be classic circumstances for grant of interim measures, namely urgency of relief (for continuing legal costs and potential future losses)<sup>18</sup> and potential prejudice. The stage of the application for security and the potential or resultant delay in proceedings are other relevant circumstances. It is notable that funders may voluntarily pay security to prevent undermining their investment and to continue proceeding with a genuine

claim.<sup>19</sup> In investment arbitrations where the State and the investor seldom sign an arbitration agreement (in the wake of Bilateral Investment Treaties), bad faith or abusive conduct of the funded party are prevalent determinants.

### Entitlement of Successful Funded Party to Receive Costs of TPF

The primary concern is: does a 'funded' party 'incur' any costs of funding at all, when all its costs are borne by the funder? Indeed, if successful, the funded party often pays a percentage of its proceeds to the funder. In addition, it may also pay a 'success fee' over and above the percentage of proceeds—thereby reducing the effective quantum of recovery of the funded party. This implies that a funded party does bear the costs of TPF—when successful.<sup>20</sup> Certain tribunals refuse to consider TPF in determining the amount recoverable by the funded claimant for its costs,<sup>21</sup> at the cost of reduced recovery by the funded party.

Are TPF fees 'costs' within the purview of applicable laws? Can the successful funded party be entitled to an order for costs of its TPF? Various arbitral institutions<sup>22</sup> and national laws<sup>23</sup> include 'other costs' within the definition of 'costs'. In *Essar Oilfields Services Ltd v Norscot Rig Management Pvt Ltd*,<sup>24</sup> the United Kingdom High Court included TPF costs within 'other costs', giving it a functional construction. Majority laws also indicate that such 'costs' shall include 'reasonable' costs for the purposes of arbitration proceedings. Legal costs paid by the funder for the party would constitute costs incurred 'for the purposes of arbitration'. However, is it just to impose the burden of a private TPF agreement between the funder and the funded—on the shoulders of the unsuccessful unfunded party? It would be so if the costs awarded are 'reasonable' and have been utilized for the purposes of arbitration.

However, would a 'success fee' be construed as being 'for the purposes of arbitration'? This is not procedural costs but costs agreed upon as a trade-off between the funder and the funded<sup>25</sup> owing to the risk assumed by the funder for investing in the proceedings. Since a 'success fee' is a creature of the commercial agreement between the funder and the funded party and is not related to the arbitration proceedings, it would not be just to order the unfunded unsuccessful party to pay a success fee. In view thereof, the *Essar* decision cannot be considered bad in law since the court heavily relied on

conduct of the unsuccessful party in driving the claimant to bankruptcy and compelling it to seek the TPF. If not 'other costs', can TPF costs be claimed as 'damages' if permitted under substantive law? This would have to satisfy the test of causation and foreseeability and remains to be seen.<sup>26</sup>

## Conclusion

In its recent years of development, TPF has been engulfed by diverse issues. Presently, the restrictive nature of applicable laws (including the definition of 'party' and 'costs') and the exceptionally exercised jurisdictional powers of tribunals on third parties (except traditional principles of agency and assignment) result in a shortfall of arbitral practice *vis-à-vis* third party funders. Interestingly, while the majority of applicable laws state that the award shall be binding between parties, the English Arbitration Act 1996 also includes within the ambit of 'party'—'persons claiming under or through them'. This could be interpreted to include funders. However, courts have accorded a narrow interpretation to the term 'party' to only include parties by way of principles of agency and subrogation. Unless arbitral practice establishes, or applicable laws evolve, to expressly include funders in costs orders, this power remains largely subject to discretion and application of third party principles, keeping alive the pervasive foundation of arbitration, that is, party consent. While it will be quintessential to consider the roots of consensual dispute resolution, arbitral practice beckons wider purview to encompass third party funders in certain circumstances to meet the interests of justice and equity.

## Notes:

- 1 *Excalibur Ventures LLC v Texas Keystone Inc & Ors* [2014] EWHC 3436 ('Excalibur').
- 2 *Excalibur* *ibid* at para, ¶31.
- 3 *Arkin v. Borchard Lines Ltd.* [2005] EWCA Civ.655; *Excalibur*; *Abu Ghazaleh v. Chaul* (Florida District Court of Appeal, 36 So.3d 691).
- 4 *Excalibur*, at para, ¶1.
- 5 *Excalibur* *ibid*, at para, ¶27.
- 6 ICC, Art 37(1); LCIA, Art28(3); HKIAC, Art 33.1; AAA, Art 34; UNCITRAL, Art 40(2)(e).
- 7 LCIA, Art 28(4); UNCITRAL, Art 42; DIS, Art 35(2).
- 8 ICC, Art 37(1); LCIA, Art 28(3); AAA, Art 34.
- 9 English Arbitration Act 1996, s S.61(1);, Indian Arbitration and Conciliation Act 1996, s S.31A.
- 10 ICCA-QMUL TPF Task Force Report on Security for Costs and Costs, p 10 ('*ICCA Report*').
- 11 *Kardassopoulos & Fuchs v Republic of Georgia*, ICSID ARB/05/18 and ARB/07/15 ('*Kardassopoulos*').
- 12 Craig, Park and Paulsson, ICC Arbitration, p 467 on finding of inherent powers by ICC tribunals.
- 13 *Third Party Funding in International Arbitration*, Nieuwveld *et al* (2012), p 27.
- 14 *EuroGas Inc v Slovak Republic*, ICSID ARB/14/14.
- 15 *XXX Inc v YYY S.A.*, ICC Case No 15951/FM; ICCA Report p 13.
- 16 *X v Y & Z*, ICC Case, Procedural Order 3 August 2012, published in Pinsolle, *Cah.Arb.* (2013).
- 17 Lucia, Assenting Reasons of Gavan Griffith, paras ¶16,18.
- 18 '*Provisional Measures in International Commercial Arbitration*', Ali Yesilirmak (2005), p 149.
- 19 Kirtley *et al*, *Journal of International Arbitration* 30, No 1 (2013).
- 20 ICCA Report, p 3.
- 21 *Kardapossoulos; RSM Production Corporation v. Grenada*, ICSID ARB/05/14.
- 22 ICC, Art 37(1); LCIA, Art 28(3); SIAC, Art 37.
- 23 English Arbitration Act 1996, sS. 59(1)(c), Indian Arbitration and Conciliation Act 1996, s S. 39A.
- 24 [2016] EWHC 2361 (Comm).
- 25 ICCA Report, p 10.
- 26 ICCA Report, p.10 *Ibid*.



### Vyapak Desai Partner, International Litigation and Dispute Resolution Practice, Nishith Desai Associates

Vyapak Desai heads the International Litigation & Dispute Resolution Practice at Nishith Desai Associates, holding a Bachelors degree in law and a Masters degree in Commercial Laws. He is a trained Mediator and member of the Arbitration Committee of the International Bar Association (IBA) and the Bar Council of Maharashtra & Goa.



### Kshama Loya Modani Senior Member, International Litigation and Dispute Resolution Practice, Nishith Desai Associates

Kshama completed her LL.M. in International Commercial Laws from King's College London in 2011, and a postgraduate diploma on Negotiation & Dispute Resolution from Harvard Law School in 2012. She has taken specialised courses in International Investment Law from the World Trade Institute, Switzerland; Skills and Techniques for Cross-Examination of Witnesses in International Arbitration in London and taught advocacy skills to students in London. She graduated from ILS Law College, Pune in 2009 with distinction in legal practical training. Kshama focusses on international arbitration, litigation and pre-litigation strategies and has handled complex civil, criminal and commercial disputes. She has previously worked in London in the field of international commercial and investment arbitration. She began her practice in the chambers of Justice S.V. Gangapurwala, has appeared independently in various High Courts and Tribunals, and has conducted several arbitrations. Kshama also serves as an arbitrator in the global rounds of Foreign Direct Investment International Arbitration Moot since 2012.