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Arbitrator's award of third party funding costs upheld by High Court

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A recent High Court decision[1] upheld a costs award in arbitration proceedings that included third party funding costs. The Court concluded that the arbitrator had wide discretion to award costs, which included the award of third party funding costs. The arbitrator concluded (and the Court did not disagree) that the Respondent's "reprehensible" conduct forced the Claimant to obtain litigation funding to pursue its claim. Whether this decision sets a precedent that will impact the funding market, or is just a unique decision that turns on its facts remains to be seen; either way, it confirms the pro-arbitration stance of the English courts.

The Claimant obtained third party funding at market rates

Following an arbitration in respect of a repudiatory breach of an operations management agreement, the Respondent in the arbitration was found liable to the Claimant for around US$12 million in total (including costs).

This amount included an award of US$4 million in costs of which just over £1.94 million (i.e., about half) were the Claimant's litigation funding costs. The Claimant's third party funding arrangement consisted of an advance of £647,000 which was repayable either at 300% of the sum advanced from the damages recovered, or 35% of the damages, whichever was the greater. The arbitrator was satisfied that the funding terms were in line with market rates.

The Respondent's conduct justified third party funding costs being awarded against it

The arbitrator was highly critical of the conduct of the Respondent in the arbitration, stating that the Claimant was at a clear financial disadvantage and was faced with no alternative but to seek third party funding because the Respondent:

- "*had set out to cripple [the Claimant] financially by resolutely refusing to make payment*";
- "*created a vicious circle by which their withholding of funds meant that the crew could not be paid*"; and
- "*intended to exert and did, in fact, exert commercial pressure on [the Claimant] before and throughout the arbitral process*".

[1] [2016] EWHC 2361 (Comm)

The arbitrator characterised the dispute as a "*David and Goliath battle*" and noted that the Respondent's conduct was such that it forced the Claimant's managing director to re-mortgage his home. The Respondent had also made personal attacks and allegations of fraud and dishonesty against one of the Claimant's employees, which turned out to be unfounded. This led the arbitrator to award costs on an indemnity basis to the Claimant.

A functional approach to recoverable costs

Both s.59(1)(c) and s.63(3) of the Arbitration Act 1996, along with Article 31 of the ICC Rules, give an arbitrator wide discretion to award costs. Under Section 59(1)(c) an arbitrator may order a party to pay the "legal or other costs" of the other party and this was held by the arbitrator to be wide enough to permit the recovery of third party litigation funding costs as "other costs".

The High Court confirmed that in exercising their discretion, arbitrators are entitled to take into account the conduct of the parties. In this case the extreme conduct of the Respondent merited an award of costs on an indemnity basis.

The Court held that the correct approach to the construction of the term "other costs" in s.59(1) is a functional one. It should consider what other costs were incurred in bringing or defending the claim that "*relate to the arbitration*" and are "*for the purpose of it*".

Given the arbitrator's findings about the Respondent's conduct, it is not surprising that in this case both the arbitrator and the judge were willing to read s.59 widely so as to include funding costs as "other costs" and reject the Respondent's argument for a narrow definition. The arbitrator also relied on the ICC Commission Report of 2015 findings on third party funders, which has been (and will likely continue to be) the subject of considerable discussion within the arbitration community. Costs may now be recoverable if they allow a party to specifically enforce their legal rights, as "something necessary to get the arbitration off the ground or on the road".

A landmark decision?

The arbitrator's decision displays logic in that the arbitrator was satisfied on the facts that the Claimant had been forced to obtain third party funding as a result of the Respondent's conduct. The Court found that the arbitrator was entitled to construe funding costs as "other costs" under s.59(1)(c), recoverable on the grounds that they were directly caused by the opposing party.

The Respondent sought to characterise the arbitrator's award of funding costs as an act in excess of his powers, and claimed that there was a serious irregularity under s.68(2)(b). The High Court dismissed both claims. If the arbitrator had made an error (which the High Court held he had not) this would not have constituted an action in excess of his powers but rather an error in the interpretation of s.59(1)(c). This underlines the courts' reluctance to challenge an arbitrator's decision and to confine their exercise of power.

By upholding the arbitrator's decision on costs, this decision appears to set a new precedent as to the award of costs in arbitration. Construing the funder's success fee as "costs incurred" may be viewed as a departure from the principle that only costs actually incurred should be recoverable.

Both claimants and third parties may now view third party funding as a more attractive option if the costs of such funding can be recovered. However, the Court's decision should be viewed in context: here the conduct of the Respondent was deemed to be so reprehensible that the arbitrator was able to use his wide discretion in respect of costs to ensure that justice prevailed. The facts may not always be so compelling and so the arbitrator's discretion may not always be exercised to allow such recovery. Notwithstanding that, a potential consequence of the decision is that parties may increasingly seek to recover funding costs and may look to cast the net wider than pure third party funding to claim other funding, such as parent company loans or bank financing, if this can be construed as "other costs" for the purposes of s.59. Whether such attempts will succeed and whether this decision leads to a rise in third party funding remains to be seen.

Whilst this case may turn on its facts in relation to the conduct of the Respondent, the decision confirms the courts' reluctance to challenge an arbitrator's decision and highlights its pro-arbitration approach.

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