It's All About The Money: The Impact Of Third-Party Funding On Costs Awards And Security For Costs In International Arbitration

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I. Introduction

Pursuing international arbitration proceedings can be costly and, as a result, it is becoming increasingly common for parties to transfer the costs and risks associated with international arbitration disputes to third-party funders. For the very same reason, *i.e.* the considerable sums incurred by parties for pursuing international arbitration, the question of how these costs are allocated between the parties at the end of the proceedings (and, if at this point, a party ordered to pay adverse costs is actually able to pay) may become decisive for the economic success of a claim or defense. It is no surprise, thus, that third-party funding has played a significant role in the determination of applications for costs and security for costs in international arbitration. Indeed, the relationship between costs-related aspects of arbitral procedure and third-party funding has already produced a considerable and ever growing body of arbitral case law,[1]) demonstrating that occasional concerns about whether the amount of attention third-party funding has been receiving for some time now is proportionate to its practical significance[2]) were unfounded. As arbitration practitioners, academics, funders and tribunals keep striving to provide guidance on third-party funding related issues, it is important

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[1]) *See* the cases discussed below.

[2]) Stephan Wilske, Lars Markert & Laura Bruninger, *Entwicklungen in der internationalen Schiedsgerichtsbarkeit im Jahr 2015 und Ausblick auf 2016,* SchiedsVZ 2016/3 (130).

to keep reflecting on the considerations and arguments behind the positions advanced in the process, bearing in mind that what makes third-party funding so challenging is not least the need to reconcile the (often conflicting) interests of a broad and diverse range of stakeholders.

II. Awarding Of Costs

An arbitral tribunal's decisions on whether all or part of the costs can be awarded against a party depending on the outcome of the case and, as the case may be, which costs the prevailing party can recover from the losing party (type and amount of recoverable costs) will depend on the applicable arbitral laws and rules.[3]) For example, section 61 English Arbitration Act 1996 provides that:

(1) The tribunal may make an award allocating the costs of the arbitration as between the parties, subject to any agreement of the parties.

(2) Unless the parties otherwise agree, the tribunal shall award costs on the general principle that costs should follow the event except where it appears to the tribunal that in the circumstances this is not appropriate in relation to the whole or part of the costs.

As regards the amount of recoverable costs, Section 63 English Arbitration Act 1996 states:

(3) The tribunal may determine by award the recoverable costs of the arbitration on such basis as it thinks fit.
If it does so, it shall specify –
(a) the basis on which it has acted, and
(b) the items of recoverable costs and the amount referable to each.

(4) If the tribunal does not determine the recoverable costs of the arbitration, any party to the arbitral proceedings may apply to the court (upon notice to the other parties) which may –
(a) determine the recoverable costs of the arbitration on such basis as it thinks fit, or
(b) order that they shall be determined by such means and upon such terms as it may specify.

(5) Unless the tribunal or the court determines otherwise –
(a) the recoverable costs of the arbitration shall be determined on the basis that there shall be allowed a reasonable amount in respect of all costs reasonably incurred, and
(b) any doubt as to whether costs were reasonably incurred or were reasonable in amount shall be resolved in favour of the paying party.

[3]) *See, e.g.*, Jonas von Goeler, Third-Party Funding in International Arbitration and Its Impact on Procedure 369–377, 379 (2016).

Default rules on costs shifting can also be found in the arbitration laws of Austria, Germany, Hong Kong, Spain, Brazil and Portugal.[4]) While the arbitration laws of France, Switzerland, and the United States as well as the UNCITRAL Model Law are silent on the issue of costs allocation, it is clear that tribunals sitting in these jurisdictions have the power to render awards on costs.

Many widely used arbitral rules also contain a presumption that costs should follow the event, or should be allocated based on the degree of success, unless particular circumstances call for a different approach.[5]) Other rules simply provide for wide arbitrator discretion.[6])

As regards the type and amount of recoverable party costs, Article 40 (2) (e) UNCITRAL Rules is representative, limiting recoverable costs to "[t]he legal and other costs incurred by the parties in relation to the arbitration to the extent that the arbitral tribunal determines that the amount of such costs is reasonable". Similar formulations can be found, for instance, in the VIAC Rules,[7]) the ICC Rules,[8]) the LCIA Rules,[9]) and the CIETAC Rules.[10])

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[4]) Austrian Code of Civil Procedure, s. 609 (outcome of the case as a particularly relevant factor); German Code of Civil Procedure, s. 1057 (1) (same); Hong Kong Arbitration Ordinance 2011, s. 72 (4) (written offer to settle as a particularly relevant factor); Spain, Art. 37 of Law 60/2003; Portugal, Art. 42 of Law 63/2011; Brazil, Art. 27 of Law 13.129 of May 26, 2015.

[5]) UNCITRAL Rules, Art. 42 ("costs of the arbitration shall in principle be borne by the unsuccessful party"); LCIA Rules, Art. 28 (4) ("costs should reflect the parties' relative success and failure in the award or arbitration or under different issues, except where it appears to the Arbitral Tribunal that in the circumstances the application of such a general principle would be inappropriate under the Arbitration Agreement or otherwise"); DIS Rules, s. 35 (2) ("[i]n principle, the unsuccessful party shall bear the costs of the arbitral proceedings", but the tribunal may order each party to bear its own costs or apportion the costs between the parties, in particular, where each party is partly successful and partly unsuccessful); WIPO Rules, Art. 74.

[6]) ICSID Convention, Art. 61 (2) ("the Tribunal shall, except as the parties otherwise agree, assess the expenses incurred by the parties in connection with the proceedings, and shall decide how and by whom those expenses, the fees and expenses of the members of the Tribunal and the charges for the use of the facilities of the Centre shall be paid"); SIAC Rules, Art. 31 (1) ("[u]nless the parties have agreed otherwise, the Tribunal shall determine in the award the apportionment of the costs of the arbitration among the parties"); ICC Rules, Art. 37 (5) ("[i]n making decisions as to costs, the arbitral tribunal may take into account such circumstances as it considers relevant, including the extent to which each party has conducted the arbitration in an expeditious and cost-effective manner").

[7]) VIAC Rules, Art. 44 (1.2) and (1.3) ("reasonable expenses of the parties for their legal representation" and "other expenses related to the arbitration").

[8]) ICC Rules, Art. 37 (1) ("reasonable legal and other costs incurred by the parties for the arbitration").

[9]) LCIA Rules, s. 28 (3) ("legal or other expenses incurred by a party … The Arbitral Tribunal shall decide the amount of such Legal Costs on such reasonable basis as it thinks appropriate").

[10]) CIETAC Rules, Art. 50 (2) (winner entitled to "the expenses reasonably incurred by it in pursuing the case").

For the purpose of the following analysis, we assume that costs are allocated based on the outcome of the case, and that recoverable party costs include the reasonable legal and other costs incurred by the parties for the arbitration. Within this procedural framework, the involvement of a third-party funder may raise a number of issues, which can affect both the non-funded party's liability for costs if it loses and its chances to recover costs if it wins.

A. Should A Prevailing Funded Party Be Able To Recover Party Costs At All Where These Costs Have Been Funded By A Third Party?

If the funded claimant or counterclaimant succeeds in its claim, the third-party funder will typically be entitled to recover the costs advanced ("outlay") out of the sum awarded as damages. Should the successful funded party be entitled to recover such costs from the unsuccessful party or should it bear such costs itself?

While the tribunal in *Quasar de Valores SICAV S.A. et al. v. The Russian Federation* ruled that the successful funded party should bear the arbitration costs itself, the factual circumstances of this case were highly unusual in that the funded party had no obligation whatsoever to reimburse the funder for the costs advanced, effectively giving the funded party a "total free ride".[11])

However, where a party is legally obliged to reimburse the funder in respect of the costs advanced, arbitral tribunals have held that this is sufficient for a funded party to have "incurred" costs.[12])

Although the details of the billing structures adopted by third party funders vary for each case, when a party is funded by a third party funder it typically assumes an obligation to reimburse the funder for the costs advanced. The usual practice where a funder is involved is that the lawyers' invoices are issued in the funded party's name and become payable by the funder as a result of the funding agreement. The funded party's lawyers would usually send the invoice to the funder (along with a monthly report). If the funded party and funder are satisfied that the invoice is consistent with the pre-agreed budget then the funder will pay the invoice directly to the lawyer. However, the fact that a funder is involved does not change the funded party's primary liability towards its lawyers to discharge the bill. The funded party incurs the obligation to reimburse the funder for the costs

[11]) *Quasar de Valores SICAV S.A. et al. v. The Russian Federation,* SCC Arbitration No. 24/2007, Award of 20 July 2012, para. 223. The funder, Group Menatep Limited, a former majority shareholder in the Russian oil company Yukos, had a strategic, indirect financial interest in the outcome of the case, namely to create a favourable "arbitral precedent" for its own, much larger majority shareholder claims filed against Russia under the Energy Charter Treaty.

[12]) Compare *Supplier v. First distributor, Second distributor,* ICC Case No. 7006, Final Award of 1992, ICC Bull 1993/5 (49); *Kardassopoulos and Fuchs v. The Republic of Georgia,* ICSID Case Nos. ARB/05/18 and ARB/07/15, Award of March 3, 2010.

so advanced in case of successful recovery (plus a return to the funder as per the funding agreement). For these reasons, the fact that the funder pays the bills should not give the opposing party a "free ride" on not having to repay any costs if it ultimately fails to defend the claim against it. More importantly, if we accept, on a normative level, that third party funding has an important role to play in supporting the system of international arbitration and providing access to justice for meritorious claims, it would be unwarranted to increase the costs of obtaining third party funding. Claimants could potentially be discouraged from seeking funding if they know that they might not be able to recover potentially substantial legal costs, even in case of success.

B. What Amount And Type Of Recoverable Can A Prevailing Funded Party Recover?

Funding arrangements will typically require the funded party not only to reimburse the funder for the actual arbitration costs covered, but also to pay for the cost of that capital, *i.e.* the funding costs (such as a conditional fee, an ATE-premium, or a litigation funder's return) over and above normal legal costs.

While in theory, the successful funded party could claim funding costs as damages against the unsuccessful party in a separate claim, the requirements for causation and foreseeability might be difficult tests to meet under most national substantive laws.[13])

It would seem more reasonable for the successful funded party to attempt to recover funding costs from the unsuccessful party as part of the costs allocation exercise at the end of the arbitration, although the power of arbitrators to allocate funding costs is highly disputed. On the one hand, these costs are not technically costs incurred for the conduct of the arbitration. However, taking a broader approach to this issue, it is arguable that these funding costs are necessary for the claimant to bring its claim, and therefore are part of the costs of the arbitration.

It is thus submitted that if the tribunal is satisfied that the funding cost has been incurred specifically to pursue the arbitration and is reasonable, such cost should be awarded to the successful party.[14]) While the success fee of the third-party funder is the result of a trade-off between the funded party and the funder, where the funder assumes the cost and risk of financing the proceedings and receives a reward if the case is won, it is not obvious why the funded party should eventually bear such risk and be out of pocket, especially where this party is successful. This may run counter to the principle that costs follow the event, at least where an arbitration is subject to such principle.

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[13]) *See* Jonas von Goeler, Third-Party Funding in International Arbitration and Its Impact on Procedure 414–415 (2016).

[14]) ICC Report on Costs in International Arbitration paras. 92–93; for the opposite view, *see* Jonas von Goeler, Third-Party Funding in International Arbitration and Its Impact on Procedure 387–409 (2016).