DREW & NAPIER

LEGAL UPDATE

CASE UPDATE

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RECOVERY OF THIRD PARTY FUNDING FEES AS COSTS OF THE ARBITRATION

***Essar Oilfields Services v Norscot Rig Management* [2016] EWHC 2361**

SUMMARY

In this case, the English High Court ("**Court**") held that a tribunal has the power under s 59(1) of the English Arbitration Act 1996 ("**1996 Act**") to award the cost of third-party litigation funding as costs of the arbitration.

BACKGROUND

The underlying dispute concerned a claim for repudiatory breach of an operations management agreement brought by Norscot against Essar.

The sole arbitrator found in favour of Norscot and awarded damages of around US$8m.

The arbitrator further awarded Norscot costs of US$4m, which included an approximately US$2.5m fee that Norscot would have to pay the third-party funder pursuant to a funding agreement ("**Funding Costs**").

Essar applied to the English High Court to have the costs award set aside.

ENGLISH HIGH COURT'S DECISION

Essar contended that the arbitrator had no power to grant the Funding Costs; accordingly, the arbitrator had exceeded his powers which would cause substantial injustice to Essar if the amount had to be paid. This was rejected by the Court.

The Court held:

(a) The expression "*other costs of the parties*" in s 59(1)(c) of the 1996 Act, which the arbitrator relied on to justify his award, was wide enough to cover Funding Costs.

(b) The meaning of "*other costs*" should not be construed through the prism of court proceedings.

The fact that "*costs of the arbitration*" in s 59(1) of the 1996 Act is defined as including "*legal or other costs of the parties*" suggests that it is meant to be wider than costs that are generally permissible under the rules applicable to court proceedings.

(c) "*Other costs*" must be costs aside from conventional legal costs. It should be understood functionally, that is to say, whether the costs were incurred for the purpose of the arbitration.

(d) The construction of Rule 31(1) of the ICC Rules of Arbitration ("**ICC Rules**") is instructive because the ICC Rules governed the arbitration and moreover Rule 31(1) is expressed in substantially the same terms as s 59(1)(c) of the 1996 Act.

Therefore, it was materially relevant that the ICC Commission Report of 2015 stated that a successful party may be entitled to recover costs from the losing party that it may be liable to the third-party funder for.

(e) In any event, even if "*other costs*", properly construed, does not include Funding Costs, the arbitrator had not exceeded his powers because he had the power to award "*other costs*".

In this analysis, the arbitrator's error would be one of construction of the scope of the power and not an excess of power as such.

COMMENT

Essar Oilfields Services v Norscot Rig Management is an interesting decision in the Singapore context for three reasons.

First, there is no equivalent of s 59(1) of the 1996 Act in the Singapore International Arbitration Act (Cap. 143A) ("**IAA**") or the Model Law. In other words, questions relating to what may be

recovered as costs of the arbitration may not be resolved by reference to the *lex arbitri*.

Second, assistance would, instead, have to come from the arbitral rules applicable to the arbitration, assuming there is one.

Here, it is important to note that the construction of Rule 31(1) of the ICC Rules was a relevant, if not major, consideration in *Essar*, because the ICC Rules was the applicable institutional rules for the arbitration.

Had the arbitration been subject to arbitral rules which, on their express language, adopt a less expansive approach in relation to costs of the arbitration or legal or other costs – an example of this is the Hong Kong International Arbitration Centre Rules 2013, specifically, Article 33 – the outcome in *Essar* might well have been different, notwithstanding that s 59(1)(c) of the 1996 Act is wide enough to cover Funding Costs.

Third, flowing from the foregoing, costs awards by tribunals in Singapore-seated arbitrations allowing recovery of Funding Costs are likely to face serious challenges if the award:

(a) is inconsistent with the rules applicable to the arbitration; or

(b) falls within one of the non-jurisdictional grounds for setting aside or refusing enforcement of awards, *ie*, fraud, breach of the rules of natural justice and public policy.

In relation to (a), it may be worth noting that Rule 37 of the Singapore International Arbitration Centre ("**SIAC Rules 2016**") similarly provides that the tribunal shall have the authority to order "*the legal or **other costs** of a party be paid by another party*" (emphasis added).

The same distinction between "legal costs" and "other costs" appears to be recognised under SIAC Rules 2016 (although "legal or other costs" is regarded as a distinct concept from "costs of the arbitration" under the SIAC Rules 2016).

In relation to (b), it is relevant to refer to the Singapore High Court decision of *VV and another v VW* [2008] 2 SLR(R) 929, a leading decision on costs in arbitrations governed by the IAA. The issue there was whether an award of costs should be set aside on the ground that the costs awarded was disproportionately high.

In upholding the award, the Court noted that the "*merit of the arbitral process as opposed to civil litigation is that the parties have many liberties in the process of adjudication of their dispute*".

The Court concluded in no uncertain terms that "*it is not part of the public policy of Singapore to ensure that the costs incurred by parties to private litigation outside the court system, eg, arbitration, whether the same is domestic or international, are assessed on the basis of any particular principle including the proportionality principle*" and that "*it would be odd for the courts to be able to justify interfering with the quantum of costs awarded by an arbitrator by invoking public policy.*"

Nevertheless, it may be argued that the Court of Appeal decision in *Otech Pakistan v Clough Engineering* [2007] 1 SLR 989 supports the proposition that Funding Costs cannot be claimed as costs of or in the arbitration.

In that case, the Court declined to enforce a claim by the third-party funder for fees due to it under the funding agreement with a party that had successfully settled its dispute.

The Court observed that the law of champerty applies to funding agreements in the arbitration context as it does in litigation, and a funding agreement for arbitration would therefore not be enforced by the Court.

It should be noted, however, that the law governing the funding agreement in *Otech* appears to be Singapore law, and further, the dispute there was between parties to the funding agreement. Thus, *Otech* may not apply where the issue is whether a cost award which gives effect to a funding arrangement is liable to be set aside on public policy grounds under the IAA, particularly if the funding agreement is governed by a foreign law which does not consider such an arrangement to be champertous.

In any case, any doubts over the enforceability of funding agreements are likely to be put to bed, once the proposed amendments to the Civil Law Act are enacted. Earlier this year, the Ministry of Law opened the Draft Civil Law (Amendment) Bill 2016 and the Civil Law (Third Party Funding) Regulations 2016 up for public consultation. The proposed provisions in the Bill clearly contemplate giving effect to third-party funding contracts in the arbitration context.

Therefore, moving forward, the applicable arbitral rules are likely to be the primary obstacle to any recovery of Funding Costs in arbitrations governed by the IAA.

Parties who may wish to access third-party funding in the event of a dispute should therefore choose their arbitral rules with that consideration in mind. Third-party funders should also pay attention to the applicable arbitral rules before entering into a funding agreement.

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