Landmark Judgment in *Essar v Norscot* (2016) published

The High Court judgment in *Essar Oilfields Services Limited v. Norscot Rig Management Pvt Limited* [2016] EWHC 2361 (Comm) brought down by His Honour Judge Waksman QC (sitting as a deputy High Court judge). The report of its delivery on 15 September 2016 had already sparked great interest in the world of litigation finance and for good reason. But its implications go well beyond that as we show.

The alternative bases claimed

The relief sought by Norscot in respect of the cost of the funding was claimed on the alternative basis that it could be:

- Costs of the arbitration other than legal costs under section 59(1)(c) of the Act; or
- Interest on legal costs paid or incurred prior to the award under section 49(3)(a) of the Act.

The alternative claim for recovery of the funding as interest

The sole arbitrator, Sir Phillip Otton, preferred to award relief for this cost of the funding on the basis that it was to be considered as an "*other cost*" of the arbitration incurred by Norscot, and found that the alternative claim for interest, therefore, fell away. In argument before the court, Essar contended that interest was the proper basis for compensating this cost outlay in view of the wide scope of the tribunal's power to award interest under section 49 – a power going beyond that of the court.

As counsel for Norscot pointed out in argument, this came tantalising close to an acknowledgment that the cost of funding could be met by an award of interest. The judge referred to this – without analysing the scope of section 49 – but rejected the proposition that the scope of section 49 implied any restriction on the scope of section 59. He considered that the two could co-exist "*side by side*".

The inherent contradiction of Essar's challenge

Essar's challenge to the arbitrator's award involved an inherent contradiction: it was brought on the ground that the arbitrator had exceeded his powers under the Arbitration Act 1996 and the ICC Rules of Arbitration, by misconstruing the scope of a power that the Act did give him to award 'other' costs. The excess of power was said by Essar to lie in awarding Norscot recovery of the cost of its third party litigation funding that did not fall with the scope of the power granted by the Act. But that was not the same as saying that there was *no* power for him to exceed.

It was clear that the arbitrator exercised – rightly or wrongly – a power he did have to award costs pursuant to sections 63(3) and 59, being the two provisions of the Act upon which the arbitrator based himself. Since there was no excess of power involved with the award, the technical ground of the challenge under section 68 failed.

'Other costs' extends to litigation funding costs

The construction of the expression 'other costs' in section 59 was, anyway, not erroneous, and does "*include the costs of obtaining litigation funding in respect of the arbitration in question*". This was

an alternative basis for dismissing the appeal. The judge based himself essentially on the language, context and logic of the provisions in sections 63 and 59 and reasoned:

- Both employ wide language: Section 63 permits a tribunal to determine the recoverable costs "*on such basis as it thinks fit*", while section 59 "*deliberately includes a head of costs, other than legal costs*". He rejected Essar's argument for cutting down the scope of 'other costs'.

- In particular, he rejected the argument that the reference to "*legal or other costs*" involved a defining genus of legal costs that limit the scope of 'other' to 'legal' costs. For the judge, there were legal costs *and* there were other costs.

- The scope of 'other costs' was not restricted by the fact that the costs of litigation funding are not recoverable under the CPR. He recognised that the Arbitration Act stands alone and is not to be limited by the CPR.

- The class of 'other costs' is not closed, and the judge expressly cited the examples of management time and the costs of obtaining funding for the dispute. On the other hand, there are limits: in the context of its efforts to characterise the award as an excess of power, Essar cited compensation for emotional or inconvenience 'cost'. The judge agreed that this would involve an excess of power, but this was because such examples do not constitute 'costs'. Indeed, they are damages.

- The logic of the situation militated in favour of a construction that upheld the award. The arbitrator had taken the view that, "*it is difficult to see the difference between allowing a party to recover pre-judgment interest on costs* [for his own expenditure]*, which is routinely awarded, and allowing a party to recover the interest it has had to pay a third party to cover those pre-judgment legal fees on his behalf*". The judge concluded that the award was "*a telling example of the good sense of reading 'other costs' in this way*".

The discretion to award litigation funding costs

Ultimately, the power found by the judge under sections 63 and 59 was coupled with a discretion. That discretion derives from sections 61 and 63: under the former, the tribunal can determined whether circumstances exist in which it becomes appropriate to allocate costs between the parties to the detriment of the successful party; while section 63 permits the tribunal to determine the recoverable costs "*on such basis as it thinks fit*". The tribunal must specify the basis on which it has acted and the cost items. The Act does not require the basis to be limited to the CPR measure of 'standard' and 'indemnity' although it does provide in section 63(5) for the 'standard' basis as the default measure unless the tribunal otherwise determines. This implies a requirement to assess a reasonable amount for a cost reasonably incurred.

In this case, the arbitrator determined that Norscot should be awarded its legal costs on the indemnity basis. Still it does not follow from this that an order for indemnity costs is a necessary prerequisite to an award of funding costs.

The factors relevant to exercising the discretion

When it came to considering the claim for the funding costs, the arbitrator considered that the "*overarching consideration* [was] *'what justice requires'*". In assessing this, he enumerated the following factors, which the judge recited and implicitly endorsed as the basis for his ruling on the "*perhaps unusual*" facts at hand:

- **The conduct of the parties**
- **The relative financial situation of the parties**
- **The losing party has knowledge of the successful party's financial predicament**
- **The magnitude of the costs incurred by the successful party**
- **The successful party has no credible alternative source of financing**
- **The losing party is aware at least that such recourse has been contracted**
- **The successful party establishes that the funding was properly utilised**
- **The successful party has contracted the funding on standard market rates and terms for such facility**

The factor of reasonableness

This latter factor highlights the potential hurdle posed by section 63(5) that, unless otherwise determined by the tribunal, 'recoverable costs' must be in a reasonable amount, reasonably incurred. This then would also apply to recoverable litigation funding costs. Although neither Sir Philip nor the judge referred to this expressly, the arbitrator's acceptance that the terms and rates were standard implicitly found that it was a reasonable outlay for a cost reasonably incurred. At the same time, the fact that rates and terms might not be standard does not mean that they are not reasonable. It may be that under the prevailing conditions they were the only rates that could be obtained by the claimant concerned, although any doubt in that regard might have to be resolved in favour of the paying (losing) party by force of the section.

The judge considered and referred to an external source of guidance in the form of the ICC Commission Report of 2015 entitled '*Decisions on Costs in International Arbitration*'. This specifically countenanced the award by tribunals of relief in respect of 'third party funded costs', including success fees and uplifts for third party funders. The Report added at paras 92 and 93 reference to the need for the tribunal to satisfy itself that the cost was 'reasonable'.

The judge endorsed the observations in the Report as "*highly pertinent*" to his view of the independent foundation of an arbitrator's discretion to award funding costs, and by implication, as a statement of the criteria to be considered in doing so.

The consideration of 'reasonableness' accords with the 'standard' criterion for allowing recoverable costs under section 63(5). There is, therefore, no reason in principle for an award of litigation funding to be linked or limited to circumstances justifying awards of indemnity costs. Certainly, the factors relevant to such award – particularly Essar's conduct – were prominent factors in granting the funding relief. The predominate consideration was seemingly the finding that "*Norscot's impecuniosity was deliberately caused, or substantially contributed to by Essar*" and left Norscot with no alternative other than to resort to this sort of facility. This is not to say that other claimants who find themselves impecunious in circumstances that were not caused by their respondent could not expect to obtain such relief, as attested to by the ICC Report.

Policy implications of this view

The judge's view was straightforward and practical: why impose an artificial restriction on the scope of wide words in section 59 where to do so inhibits the tribunal from doing justice by the exercise of a very broadly expressed discretion under section 63. This is all the more pertinent in the context of international arbitration, and for London's place in it. It may be thought that current expressions of domestic policy militating against the recovery of litigation funding costs, ATE insurance premiums, contingency fees for lawyers, etc as legal, costs carry less weight in the context of international arbitration, which is likely to involve a higher degree of sophistication on the part of the litigants. As noted in the ICC Commission Report of 2015, tribunals internationally have seen fit on occasion to award litigation funding, so it would be inapt and regrettable if arbitrators in England were to be denied that discretion.

If parties wish to limit the scope of the tribunal's discretion to grant such relief, the Act expressly provides in section 63(1) that they are free to do so. There would seem to be nothing inherently unjust or undesirable about litigants having to 'take your victim as you find him', which is a fundamental premise of both English criminal and tort law.

Recovery for both claimant and respondent in principle

The implications of the decision are not merely limited to facilities providing third party litigation funding for a claimant: it extends to all manner of funding facilities for them. And not just for them but also for respondents: be it ATE insurance premiums or contingency fees for lawyers, or other arrangements. The judge viewed it essentially in terms of functionality.

> "*The real limiting factor* [on the scope of 'other costs']*, in my view, is the functional one. Do the costs relate to the arbitration and are they for the purposes of it?*"

He then continues:

> "*If the costs have not been incurred in order to bring <u>or defend</u> the claim in question, I would accept that they fall outside the definition of 'other costs' and they would not relate to the arbitration*…" (emphasis added) (Para 58)

A new era of recoverable costs

In summary, this judgment holds that arbitrators have the power to go further than the courts to award a claimant the cost incurred for litigation funding. Whether that cost will be recoverable is a matter of the tribunal's discretion and the array of potential factors to be taken into account in reaching that award has been compiled above for guidance. Echoing Sir Philip, the factors must only "*remain within the overarching consideration of 'what justice requires'*", and both this and the Act import the consideration of reasonableness.

As to the limits of the type of the 'other costs', this is a question of function. This decision means that the reference to 'other costs' is equally likely to apply to ATE insurance premiums given that ATE insurance has the same basic function as third party funding. There is no reason why this should not also apply to lawyer's contingency fees. In all cases, there is the limiting requirement that the funding arrangement be functionally necessary for the proceedings and not just financially desirable.

Funders and ATE insurance providers will rarely fall outside the function test, but the question of reasonableness may pose a more stringent test and act as the safeguard for the interests of a respondent faced with an order to pay a claimant's litigation or other funding costs. It is the reasonableness test that puts the brakes on any fears that respondents are disproportionately

disadvantaged by the inclusion of litigation funding costs within an arbitrator's discretion: it is perhaps a future battleground between claimants and respondents now that the power of the arbitrator has been revealed. It is a new era indeed.

By Matthew Amey, Director at TheJudge (www.thejudge.uk) and Marc Sturzenegger, Sturzenegger & Co LLC.