Are Third-Party Funding Costs Recoverable in Arbitration?

Monday, July 23, 2018

Third-party litigation and arbitration funding is increasingly being utilized in the United States. Are the corresponding financing costs recoverable in arbitrations?

According to the N.Y. Times, dispute resolution funding was at least a $10 billion industry in 2018 and is expected to continue growing. Funders are expanding beyond their wide acceptance in IP litigation into new markets like international arbitration and complex commercial litigation. For instance, a recent study by funder Burford Capital found that 36% of U.S. law firms polled in 2017 said they used outside funding compared with only 3% in 2013. Funders are also underwriting case portfolios to hedge the risks of individual matters.

This rapid growth is giving rise to novel issues regarding privilege, conflicts of interest, and costs. This post will focus on a particular cost issue — specifically, the recoverability of third-party funding costs in arbitration proceedings. (We will address other pertinent issues in future posts.)

Costs that parties typically seek to recover after prevailing in an arbitration include attorneys’ fees and expenses such as arbitrator fees. Use of third-party funding adds a new wrinkle. The potential fee to a third-party funder — usually measured by a percentage of the funded party’s recovery (a contingent fee structure) or a multiple of the financing provided — would be in addition to attorneys’ fees and can be much larger than the typical attorneys’ fee award. Is that funding fee recoverable too? Although this question has received more attention in Europe, recent decisions in the U.S. suggest that arbitrators may have authority to award such expanded costs in cases where a contract or statutory provision allows for cost shifting.

A recent English decision in Essar Oilfield Services Ltd. V. Norscot Rig Management Pvt Ltd, Queen’s Bench Division (Commercial Court) 15 Sept. 2016, EWHC 2361 (Comm.), provides useful precedent for parties seeking to recover the costs of outside funding arrangements. See also Kardassopoulos and Fuchs v. The Republic of Georgia, ICSID Case Nos. ARB/05/18 and ARB/07/15, Award (3 March 2010) (third-party financing arrangement was not a factor in determining amount of attorneys’ fee recovery). In Essar, Norscot, the funded party, agreed that if it prevailed, the funder would be entitled to either 300% of the funding or 35% of the recovery, whichever was greater. When Norscot prevailed, it sought attorneys’ fees, costs, and the funder’s fee, which amounted to £1.94 million. The arbitrator’s award included the funder’s fee, and explained that the English Arbitration Act did not limit costs awards to legal costs, and that an arbitrator’s power in that regard extended to any other “reasonable” costs incurred by parties, including funding costs. Why were these costs “reasonable”? The arbitrator found it significant that Essar put undue financial pressure on Norscot by failing to pay sums due under the contract at issue, knowing that by withholding those funds Norscot would not be able to finance the prosecution of its claim on its own. Further, Norscot’s arrangement with the outside funder reflected standard market terms.

Although we have found no U.S. decisions directly addressing this issue, several cases provide at least some
pertinent guidance. For example, in Temme v. Bemis Co., 762 F.3d 544, 549 (7th Cir. 2014), the plaintiffs sued for a violation of ERISA and the Labor Management Relations Act. The defendant argued that he should not have to pay the plaintiffs’ attorney fees because the plaintiffs’ union financed the litigation, not the plaintiffs themselves. The court rejected the defendant’s argument, observing that “third-party financing of litigation is generally not a bar to an award of attorneys’ fees,” and that the result is “consistent with the more general proposition that a wrongdoer should not reap the windfall of the victim’s industry in having secured an alternative source of payment.” Id.; see Morrison v. C.I.R., 565 F.3d 658, 666 (9th Cir. 2008) (finding that recovery of third-party funding fees are allowed provided that the funded party is obligated to reimburse the funder for the costs advanced); American Council of the Blind of Colorado, Inc. v. Romer, 962 F.2d 1501, 1503-04 (10th Cir. 1992), vacated on other grounds, 506 U.S. 1075 (1993) (“If the Plaintiffs are determined to be prevailing parties under the relevant case law, this Court is of the opinion that the type of financing arrangement involved in the case should not be used as an independent basis on which to deny the Plaintiffs their deserved fees.”)

Furthermore, decisions in the class-action contingency fee context provide another possible basis for parties to recover third-party funding costs. Counsel for successful classes often recover a substantial percentage of the claim fund, which can be many times the “lodestar” or value of hours reasonably incurred at the reasonable hourly rate. See Boeing Co. v. Van Gemert, 444 U.S. 472 (1980) (approving fee award based on a percentage of the recovery in common fund cases); McDaniel v. County of Schenectady, 595 F.3d 411, 418-19 (2d cir. 2010) (“Particularly in cases that result in a very large monetary award, the percentage method holds the potential to result in attorneys’ fees many times greater than those that would have been earned under the lodestar of hourly rate multiplied by hours worked.”) We anticipate that prevailing parties in funded arbitrations will seek to analogize such authority to a third-party funding situation.

These decisions are of course far from definitive, but it seems inevitable that the issue will find its way to judicial review and published opinions in the U.S. in the next few years.

This post was also written by Edward Fallas.

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