Tipping the balance

Andrew Hogan on the costs advantages of arbitration for Covid-related insurance disputes

At the beginning of this year, the Supreme Court gave judgment in the business interruption insurance litigation brought by the Financial Conduct Authority. The case was reported as the *Financial Conduct Authority (Appellant) v Arch Insurance (UK) Ltd and others (Respondents)* [2021] UKSC 1. It was a ground-breaking piece of insurance litigation, where the Financial Conduct Authority (FCA) acted swiftly by taking proceedings to seek to clarify the law on the insurance industry's liability to make payments on policies which paid compensation for business interruption, in the context of a global pandemic.

As the Supreme Court noted: 'COVID-19 and the resulting public health measures taken by the UK government have caused heavy financial losses to businesses around the country. Many businesses have insurance policies which cover them against loss arising from interruption of the business due to various causes. Thousands of claims have been made under such policies, which the insurers have declined to pay on the ground that the policies do not cover effects (or certain effects) of the pandemic.

'This appeal has been heard urgently in a test case brought to clarify whether or not there is cover in principle for COVID-19 related losses under a variety of different standard insurance policy wordings.'

The scale of the litigation was emphasised by the Supreme Court in these terms: 'The FCA has brought the proceedings for the benefit of policyholders, many of whom are small and medium enterprises (SMEs). The defendants are eight insurers who are leading providers of business interruption insurance. As set out in a Framework Agreement between the parties, the aim of the proceedings is to achieve the maximum clarity possible for the maximum number of policyholders and their insurers, consistent with the need for expedition and proportionality.

'The approach taken has been to consider a representative sample of standard form business interruption policies in the light of agreed and assumed facts. It is estimated that, in addition to the particular policies chosen for the test case, some 700 types of policies across over 60 different insurers and 370,000 policyholders could potentially be affected by the outcome of this litigation.'

As is well known, the FCA was successful in its arguments and made clear its expectations that there would be swift settlements and payments. But although many claims will undoubtedly be paid, the judgment certainly did not represent 'Mission Accomplished'. Not all questions were answered by the Supreme Court judgment, and there is plenty of scope for insurance companies to dispute causation and quantum. Claims will rumble on for a considerable time yet.

More prosaically, although the business interruption litigation shone a spotlight on insurance litigation, it is material to note that the FCA acted so swiftly, precisely to ensure that the law was clarified quickly and with the benefit of resources that few private litigants can match when taking proceedings. But if litigation has its perils, might arbitration be deployed more readily in the coming years to resolve insurance disputes - whether Covid-related or not?

ARBITRATION

The question is particularly pertinent in the context of insurance disputes, as many policies will contain an arbitration clause, providing for disputes to be resolved by arbitration. Historically, the clauses have been common, but some commentators have observed that the number of policies providing for disputes to be resolved by arbitration may well be decreasing.

They point to the low cost of court fees when compared to an arbitrator's fees; the availability of specialist courts not only in London, but also in the regions; and the fact that arbitration may no longer be speedy: arbitrators who are in demand can be very busy; and pre-pandemic, courts in England and Wales were increasingly focused on case management, and procedural reforms such as disclosure, costs management, and now latterly controls on witness statements.

But the course of the pandemic may yet reverse this trend: the court service of England and Wales is under immense strain; delays are now increasingly common across all jurisdictions and all work streams, and there is scope for arbitration to recover lost ground. One aspect of the benefits of arbitration which has not, perhaps, received the attention that it might is how the costs regime can compare favourably with costs in litigation.

COSTS

Proceedings before an arbitrator are regarded as contentious business: as defined by the Solicitors Act 1974, contentious business 'means business done, whether as solicitor or advocate, in or for the purposes of proceedings begun before a court or before an arbitrator, not being business, which falls within the definition of non–contentious or common form probate business contained in section 128 of the Senior Courts Act 1981'. But costs in an arbitration are not governed by section 51 of the Senior Courts Act 1981, and in particular, the Arbitration Act 1996 has its own costs regime, which is wider in scope than that which applies under the Senior Courts Act 1981.

Section 59 of the Arbitration Act 1996 provides as follows:

'(1) References in this Part to the costs of the arbitration are to–

'(a) the arbitrators' fees and expenses, and

'(b) the fees and expenses of any arbitral institution concerned, and

'(c) the legal or other costs of the parties.

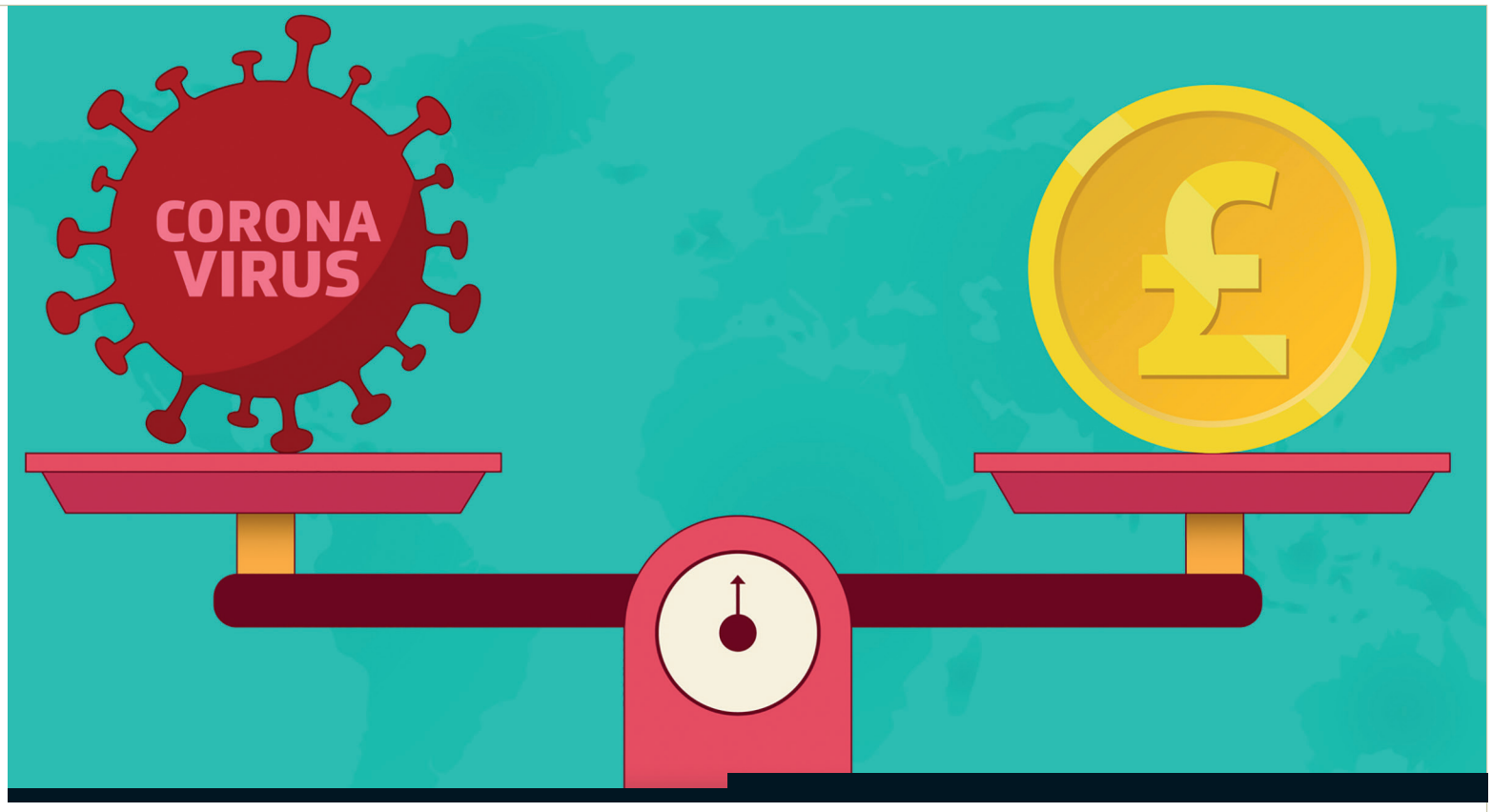
'(2) Any such reference includes the costs of or incidental to any proceedings to determine the amount of the recoverable costs of the arbitration.'

It is the reference to other costs that is intriguing. What does this section mean by 'other costs'? The case of *Essar Oilfields Services Limited v Norscot Rig Management PVT Limited* [2016] EWHC 2361 (Comm) HHJ Waksman QC (as he then was) was concerned with a legal challenge to an arbitration award, where the arbitrator had, as part of the costs, awarded to the victorious party the fees they had incurred in securing litigation funding: the sums were very substantial.

The losing party sought to challenge this part of the award, on the basis that 'other costs' could not include the costs of funding the arbitration costs, and that the arbitrator had acted in excess of his powers under section 68 of the Arbitration Act 1996. No appeal was possible on a point of law under section 67 of the Arbitration Act 1996, due to the terms of the arbitral agreement. In the ratio of the case, the judge found that the arbitrator had not acted in excess of his powers when making the award:

'As Lord Steyn noted, in order to see if what the arbitrator did fell within s.68(2)(b) as being in excess of his powers or whether it was no more than an erroneous exercise of a power that he did have, it is necessary to focus "intensely on the power concerned". In my judgment, the relevant power here is the undoubted power to award costs. If the arbitrator fell into error, it was an error as to the scope of such costs by reason of his allegedly erroneous interpretation of s.69(1)(c) and Rule 31(1).'

He dismissed the challenge: 'For all those reasons, I conclude that



there was no serious irregularity within the meaning of s.68(2)(b), even if the arbitrator was wrong in his construction of "other costs". That disposes of this application altogether. But, in deference to arguments made on the other issues, I deal with them as well.'

And this is where it gets interesting, because the judge went onto find, albeit *obiter dicta*, that section 59 was wide enough to include a power to the arbitrator to award the costs of funding as 'other costs':

'Therefore, as a matter of language, context and logic, it seems to me that "other costs" can include the costs of obtaining litigation funding. The expression should not be confined by some legal straitjacket imposed by reason of what a court might or might not be permitted to order. All that this conclusion entails is that such litigation funding costs falls within the arbitrator's general costs discretion. Whether and, if so, how the arbitrator exercises that discretion in any particular case is an entirely different matter. Indeed, the ICC bulletin at para.93 reminds one that the overall requirement of reasonableness can act as an important check and balance here.

'The arbitrator's exercise of his discretion here to award to Norscot the costs of its third-party funding, while of course itself not under challenge, is nonetheless a telling example of the good sense of reading "other costs" in this way. This was a case, perhaps unusual, where the arbitrator ruled in detailed and robust terms that Essar drove Norscot into this expensive litigation because of its own reprehensible conduct going far beyond technical breaches of contract, in order to vindicate its rights. Further, as the tribunal found, Norscot had no option, but to obtain this funding from this third-party funder. As a matter of justice, it would seem very odd and certainly unfortunate if the arbitrator was not entitled under s.59(1) I to include the costs of obtaining third-party funding as part of "other costs" where they were so directly and immediately caused by the losing party.

'In my judgment, therefore, I unhesitatingly conclude that the arbitrator's interpretation of "other costs" was correct, in that it extended in principle to the costs of obtaining third-party legal funding. Whether then to award it is a matter of discretion.'

The potential of this judgment has not been explored, but logically, if other costs includes the cost of funding, then there is no reason why it should not include other well-known costs of funding, including after-the-event insurance premiums and success fees. In effect, section 59, untouched and unsullied by the passage of the Legal Aid Sentencing and Punishment of Offenders Act 2012, may exist as an island of recoverability, in a sea of non-recoverability.

The decision in *Essar* has only been considered in passing in later authorities. It may be that it is one of those interesting judgments which proves a legal cul-de-sac and does not lead to further development. Equally, however, it provides a springboard to argue that a far higher quantum of costs, and costs that would be irrecoverable in the Commercial Court or Business and Property Courts, should be awarded in arbitration proceedings.

The question then shifts to whether claimants and those acting for them, when weighing up the benefits of arbitration v litigation, should consider the possibility of recovering the funding costs under section 59: if funding costs are a cost representing 30% of the typical award, then it is certainly something to think about.

Andrew Hogan practises from King's Chambers in Manchester, Leeds and Birmingham. His blog on costs and litigation funding can be found at www.costsbarrister.co.uk