The long and tort of it

Third-party arbitration funding is now a multi-billion Euro industry, but what happens when a case is lost? With reference to Danish law, Jacob C Jørgensen FCIArb explores the conditions under which arbitrators may face a tort liability

The industry of funding major arbitrations has experienced a substantial surge in recent years[1]. Arbitration funders are not, however, parties to the arbitration, nor do they sign the terms of reference or similar procedural agreements used under the rules of different arbitration institutions. In light of the considerable investments made by funders in major commercial disputes, it is not unlikely that some might explore the possibility of raising claims against both counsels and arbitrators (or their insurance companies) where a funded case is lost.

ARBITRATOR IMMUNITY

Arbitrator immunity is a fundamental principle aimed at protecting arbitrators from personal liability for their actions or decisions made during arbitration proceedings. The concept is enshrined in various arbitration rules: article 41 of the International Chamber of Commerce 2021 Arbitration Rules stipulates:

"The arbitrators, any person appointed by the arbitral tribunal, the emergency arbitrator, the ►

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Court and its members, ICC and its employees, and the ICC National Committees and Groups and their employees and representatives shall not be liable to any person for any act or omission in connection with the arbitration, except to the extent such limitation of liability is prohibited by applicable law."

Similar rules are found in the rules for the International Centre for Dispute Resolution (ICDR) (article 38), Singapore International Arbitration Centre (SIAC) (rule 38), Hong Kong International Arbitration Centre (HKIAC) (article 46), article 31.1 of the London Court of International Arbitration (LCIA) Rules 2020 and the Stockholm Chamber of Commerce (SCC) Rules (article 52).

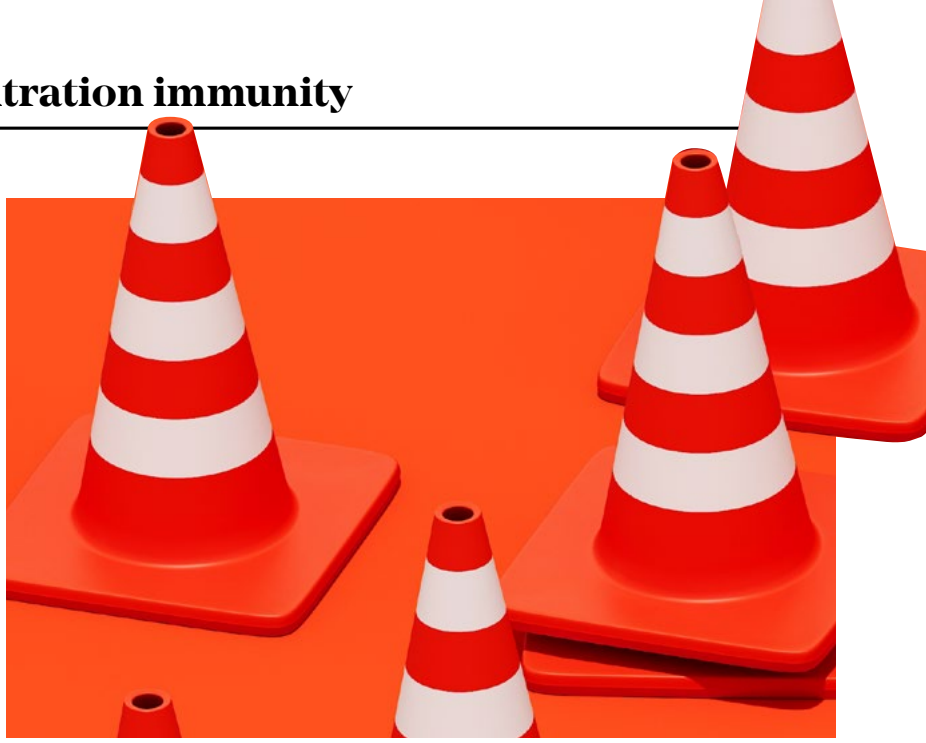
However, the immunity provided by these clauses is not absolute, and does not generally apply in cases of deliberate default or gross negligence that may give rise to liability under the *lex arbitri* (or possibly under the laws of other jurisdictions where damages are incurred as a result of the wrongdoings of an arbitrator). In fact, there is a noteworthy and fundamental difference in how common law and civil law approach the topic of immunity.

The common law approach is based on the concept of 'judicial immunity' in that judges and arbitrators are perceived as performing, essentially, the same role. Under common law, arbitrators are therefore entitled to an almost unqualified immunity by virtue of their 'quasi-judicial' function.[2] This principle is embedded in section 29 of the English Arbitration Act 1996, which stipulates:

"An arbitrator is not liable for anything done or omitted in the discharge or purported discharge of his functions as arbitrator unless the act or omission is shown to have been in bad faith."

On the other hand, the United Nations Commission on International Trade Law (UNCITRAL) Model Law on International Commercial Arbitration, which has been used as a template for the Arbitration Acts in more than 120 jurisdictions worldwide, addresses neither the issue of the arbitrators' liability nor their immunity.[3]

The civil law approach to immunity is based on the view that there is a contractual relationship between the parties and the arbitrators, and that the parties have agreed to grant the arbitrators immunity from liability under their contract – much like under a commercial agreement excluding a party's liability.[4] However, under most civil law jurisdictions, it is not possible to exclude the liability of a party in case of wilful misconduct or gross negligence.[5]



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By way of example, under Dutch law an arbitrator may be held liable for damages in the event of gross negligence without any requirement for the arbitrator to have acted in bad faith.[6]

Similarly, under Swedish law, where the Arbitration Act does not contain any provisions specifically regulating the liability of arbitrators, the prevailing view is that an arbitrator's liability is treated much the same as any other party in a contractual relationship when it comes to assessing the applicability of liability excluding clauses. Accordingly, article 52 of the SCC Rules (2023)[7] limits the arbitrator's liability *"unless an act or omission constitutes wilful misconduct or gross negligence"*.[8]

Under Danish law and Norwegian law, which have both based their Arbitration Acts on the UNCITRAL Model Law, the position is the same as under Swedish law.[9]

ARBITRATOR LIABILITY

What is the liability of arbitrators *vis-à-vis* third-party arbitration funders? Under the laws of the Scandinavian countries, the immunity of arbitrators is solely based on the articles in the rules of procedure, which apply by virtue of the contract that the arbitrators are seen to have entered into with the parties to the arbitration. ▶

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Seeing that there is no direct contractual relationship between the arbitrators and any third parties funding the arbitration, and in the absence of a general immunity protection at law (as the one found in the English Arbitration Act), the arbitrators are not protected against possible claims raised in tort by an arbitration funder who has funded an unsuccessful arbitration.

Accordingly, a third-party arbitration funder can raise a claim in tort against the arbitrators asserting that they breached their duty of care to the funder by failing to perform their duties diligently and competently when they decided the dispute.

Under the laws of the Scandinavian jurisdictions, the requirements for successfully raising a tort claim in this context can briefly be summarised as follows:

1 Negligence To establish whether there is negligence, one will generally have to compare the actual conduct of the arbitrators to the hypothetical conduct of experienced international arbitrators. Arbitrators are expected to conduct themselves professionally and with a reasonable level of international dispute resolution experience when it comes to resolving procedural issues, interpreting the contract, assessing the evidence and applying the governing law of the contract correctly. In this regard, the conduct of the arbitrators can be juxtaposed with the different guidelines on international arbitration issued by UNCITRAL or Ciarb when assessing whether the arbitrators have acted negligently. Where the arbitrators have conducted themselves in a manner that deviates from what an experienced international arbitrator would have done, they risk being deemed to have acted negligently.

2 Proof of loss Secondly, a tort liability requires proof that a loss has been incurred. This condition will rarely pose a problem in that the third-party funder will usually have lost its 'invested' funds in the dispute in the form of legal, expert and administrative costs, etc. The more difficult question in this regard is whether the third-party funder can successfully claim loss of profits (i.e. loss of the portion of the amount claimed by the funded party in the arbitration that was not awarded).

3 Causality This condition is more challenging as is the case in most tort claims. The third-party funder would have to show that the loss was incurred as a result of the negligence of the arbitrators and that their negligence was a '*conditio sine qua non*'– that is, that the loss would not have occurred 'but for' the negligent conduct of the arbitrators.

4 Foreseeability This condition requires the third-party funder to show that it was foreseeable for the arbitrators that their negligence would result in the loss incurred. Where the tribunal has been informed that one of the parties (or both) are being funded by a third party, this condition will rarely present a challenge.

5 Absence of contributory negligence Finally, the third-party funder will likely face challenges where the arbitrators can point to 'ineffective representation' by the counsel representing the funded party in the arbitration. Where the counsel has failed to offer substantiated arguments the arbitrators will often be able to exonerate themselves from liability with reference to the fact that their findings were dictated by the manner in which the 'case was presented' to them by counsel for the funded party in the arbitration.

The fact that arbitrators may attract liability for gross procedural errors despite the immunity protection embedded in most institutional rules of procedure has been established several times in both common law and civil law jurisdictions. Errors that may give rise to liability include: excluding an arbitrator from the deliberation process[10], lack of impartiality and/or independence, an unreasonable or unjustified resignation by an arbitrator, corruption, fraud, forgery, etc.[11]

The more difficult question is whether – and if so under which conditions – arbitrators can be held liable in tort for having failed to correctly apply the governing law of the contract or for having misinterpreted the contract.

The general view under Scandinavian law seems to be that arbitrators will likely be given considerable wiggle room when determining whether a failure to correctly decide a case on its merits can give rise to a tort liability – provided, of course, that the arbitrators have acted in good faith and have complied with the ▶

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rules of procedure. 'Honest mistakes' made in the assessment of the evidence and/or in relation to applying the contract and/or the governing law correctly will therefore only very rarely give rise to a tort liability.[12]

CASE LAW

The available reported case law on the issue of tort liability of arbitrators is scarce, although some guidance may be found – for example, in tort cases where a lawyer has prepared a testament for a client designed to ensure that a certain beneficiary receives a certain portion of the probate estate of the client. Where the testament fails to meet this goal, the lawyer may face a claim in tort raised by the disgruntled beneficiary

In the Danish case, *UfR 2008.1324 V*,[13] a lawyer was thus held liable in tort for the loss suffered by a foundation, which had been established in connection with a testament drafted by the lawyer. It had been a clear prerequisite for the testator that the foundation would be tax exempt, which turned out not to be the case.[14]

Another group of cases concerns the tort liability of lawyers *vis-à-vis* buyers of real estate. In the Danish case *UfR 2010.2375 H*,[15] the lawyer represented the seller of an apartment. The lawyer failed to observe the rules on the maximum price that could be demanded for the apartment as regulated in the Danish Cooperative Housing Association Act and consequently the buyer of the apartment suffered a loss when he resold the property at a lower price (as allowed by said Act). The Supreme Court found that the lawyer should have informed both his client (the seller) and the buyer that the transaction was governed by the special rules set out in the mentioned Act. The lawyer was thus held liable for damages and was ordered to pay compensation to the buyer for the incurred loss.

Finally, a lawyer may attract a tort liability *vis-à-vis* the tax authorities. In *UfR 2000.365/2 H*[16] (often referred to as the *Thrane* case), a company in which there were only liquid assets and a tax debt was sold at an inflated price after the business had ceased. The sale was assisted by the seller's lawyer, by an accountant and by the buyer's bank. It was agreed between the parties that the purchase price would be transferred from the buyer's bank to the seller's bank and that the company's funds would be transferred to the buyer's bank on the same day. This emptied the company of funds without any tax being paid. In their assessment of the lawyer's liability, the Danish Supreme Court

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emphasised that the transfer was not a normal business transaction. Therefore, the advisers should have been aware of the risk that the tax authorities could suffer a loss. The seller's lawyer was therefore held liable for the tax authorities' loss.

The *Thrane* case has attracted renewed interest and attention in recent years due to the 'dividend washing' scandal, in which a number of major law firms across Europe have been involved and have subsequently been sued in tort by, among others, the Danish tax authorities. One particular case should be mentioned in this context as it may serve to illustrate the extent of the duty of care that lawyers are deemed to have towards third parties.

On 2 November 2023, the Danish Supreme Court ordered one of Denmark's largest law firms, Bech-Bruun, to pay more than half a billion DKK (including interest) in tort damages to the Danish tax authorities.[17] The case, which was initiated in April 2020 in the Eastern Division of the Danish High Court, arose out of a tax opinion prepared by Bech-Bruun in 2014 for German bank the North Channel Bank. In the tax opinion, Bech-Bruun gave advice on how the bank could participate as a depository bank in so-called '*cum-ex*' transactions, also known as 'dividend washing', involving double refunds of dividend withholding tax – in other words, tax fraud.

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In its judgment the Supreme Court held, among other things, that Bech-Bruun's tax lawyer who had prepared the tax opinion "had to realise that there was an obvious risk that North Channel Bank, together with others, was involved in preparing a model for unjustified refunds of dividend tax". In this connection, the Supreme Court emphasised that, in an email from the bank's German lawyers, the lawyer had been "made aware of the risk of double refund of dividend tax" and that he therefore had "to be aware of the risk of setting aside the interests of the tax authorities". Further, the Supreme Court emphasised that the lawyer had found himself in "an elevated responsibility risk environment" as the envisaged '*cum-ex*' transactions appeared to have no commercial justification.

Danish case law (and in particular the *Bech-Bruun* case) clearly demonstrates that lawyers in a variety of cases can be held liable in tort *vis-à-vis* third parties that suffer a loss as a result of legal services provided to a client. In the context of dispute resolution services, it is thought, however, that arbitrators will be allowed a considerable margin of error when it comes to deciding a commercial dispute on its merits. That said, where procedural errors are made or where it is evident that certain key findings in the award are not in line with the contract or with the applicable law, arbitrators may suddenly find themselves 'on the other side of the bench' facing an uncomfortable degree of scrutiny in a tort action brought by a financially strong arbitration funder with substantial litigation experience.

CONCLUSIONS

The use of third-party arbitration funding has increased over recent years and is today a multi-billion Euro industry. In light of the considerable investments made by funders in major commercial disputes, it is not unlikely that some might explore the possibility of raising claims against both counsels and arbitrators (or their insurance companies) where a funded case is lost.

International arbitrators should be aware of this risk – in particular since the *lex arbitri* will generally not grant immunity and since the waiver of liability set out in the rules of procedure of most arbitration institutions will not protect arbitrators against tort claims raised by a third-party arbitration funder given that they, the funder, is not a party in the arbitration and thus not a party in the contractual relationship between the arbitrators and the claimant and the respondent.

Moreover, arbitrators acting in *ad hoc* arbitrations[18] should verify whether their professional indemnity insurance policies provide adequate cover both in terms of limits and scope. In this connection it is worth mentioning that some policies afford only limited cover or no cover at all for legal work involving foreign law.

Finally, the large arbitration institutions could consider expanding the usual immunity protection set out in their procedural rules – for example, with a provision whereby a funded party undertakes to hold harmless indemnity and protect the arbitrators from and against tort claims raised by that party's third-party arbitration funder. ■

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13. Judgment rendered by the Western Division of the Danish High Court (*Vestre Landsret*) printed in the *Danish Weekly Law Reporter*, Vol 2008, p1324ff.
14. See also the similar decision *FED 2008.235 V* concerning errors made by a lawyer in relation to a prenuptial agreement. The judgment, which was rendered by the Western Division of the Danish High Court, is printed in the journal *Forsikrings- og Erstatningsretlig Domssamling*, Vol 2008, p235ff.
15. Judgment rendered by the Danish Supreme Court (*Højesteret*) printed in the *Danish Weekly Law Reporter*, Vol 2010, p2375ff.
16. Judgment rendered by the Danish Supreme Court printed in the *Danish Weekly Law Reporter*, Vol 2000, p365ff.
17. A transcript of the judgment is available at domstol.dk/media/apsbobj0/20331-2022-anonym-dom.pdf
18. In arbitrations under the auspices of large institutions, the arbitrators will usually be covered by the third-party indemnity policy of the institution.

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