THIRD PARTY FUNDING: THE NEXT STEP IN ARBITRATION

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Introduction

When a person, institution or organisation not involved in the arbitration provides funding to a party of that arbitration, for an agreed return, it is termed as third party funding. The third party usually covers the party’s legal fees and expenses incurred in the arbitration.

Insurance agencies, venture banks, law offices have now entered the third party funding market. Third party funding, or “case fund” as it is referred to, has undergone an era of development and it is being utilised for a more extensive scope of purposes.

Law in India

In India with the advent of the Arbitration and Conciliation (Amendment) Act, 2015 and the establishment of the MCIA†, India has expressed its inclination towards Arbitration. The concept of third party funding is still an unexplored concept in India.

In India, third party funding is expressly recognised in the context of civil suits in states such as Maharashtra, Gujarat, Madhya Pradesh and Uttar Pradesh. But there is no express or implied law that bars or allows third party funding in India. As of 2017, no precedent on third-party arbitration funding exists and thus, these funding agreements are uncommon.

Concerns regarding the commercialisation of the process of arbitration pose certain challenges that go against the Grund norm of the legal system. Further, in the face of so much pressure and seemingly endless resources, defendants could feel pressured to settle for far more than they should. Conversely, plaintiffs could be pressured to settle for less, in order for the fund to safely recoup as much of the initial investment as possible, as soon as possible.

Advantages and Disadvantages of third party funding

There are certain focal points due to which a potential inquirer may approach a funder for different reasons like – Risk Management, validation and necessity.

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**Necessity** - Arbitration is an expensive affair; if the claimant does not have the necessary means to pursue the claim funding might be the only option.

**Validation** – The party funding the Arbitration will conduct extensive due diligence and extensive research on the merits of the case before agreeing to provide funds. They are interested only in good claims. This helps the claimant as it shapes the case procedure and the backing of the funding party empowers the position of the claimants.

**Risk Management** - As already established arbitrations can entail exorbitant costs and the claimants with funds might want to lay off a certain amount of risk associated with the arbitration. It also allows the claimant company to use assets for other investments. The same waives the cost weights and income issues of the claimants in relation with the lawful expenses of the arbitration.

Since the legislature or executive have not provided an opinion on the concept of third party funding agreements, the judiciary has not had a chance to verify their validity due to the absence of these agreements. Considering if the third party agreements are rendered legal for arbitrations, the following would be the risks:

- If the arbitration is funded by a third party, they have an interest in the rewards and usually a significant amount of the rewards are given to the funder.
- In theory, the funding party is estopped from taking undue control in the matter but in practise autonomy is lost as the funding party may hold the privilege of endorsement of the settlement.
- A considerable sum of money is spent on pitching the case to the funding party, which is a trial and error method and funders are not typically at risk for any expenses brought about before the financing game plan is instituted, including the expenses of bundling and the transaction of the funding courses of action.
- The right to terminate the funding agreement and duress – the party requesting for the funds might be subject to duress and coercion to share information and perform certain activities which favour the financier.

The threat regarding confidentiality and disclosures- the third party finding may in certain cases cause the loss of certain confidential and privileged information.
Applicable provisions for Third Party Funding in India

A study of certain provisions of the Indian legal system reveals that the existing legislation provides adequate scope for both the express recognition of third party funding and also provide certain safeguards against threats or risks.

- **Disclosure by the Arbitrators**
  Arbitrators may be directed by Section 12 of The Arbitration and Conciliation Act, 1996 ("Act") to disclose any information which comes under the purview of "justifiable reservations" of the impartiality and independence of the arbitrator. Section 34 of the Act further holds the awards of the arbitration up to be challenged if such material information is not disclosed. The Supreme Court of India also has established the Porter and Magill test as a reasonable assessment to cognise whether "the fair-minded and informed observer, having considered the facts, would conclude that there was a real possibility that the tribunal was biased." This test read along with section 12 of the Act places an inescapable obligation on an arbitrator where the arbitrator bears a ‘direct economic interest’ in the outcome of the case, and that he must, under all circumstances, make full disclosure of the same.

- **Disclosure of funders**
  There have been numerous deliberations and debates worldwide over the question of whether there must an obligation on the parties to disclose any existence of a funding arrangement required for transparency purposes. As of 2017 there are no general norms that specifically mention mandatory disclosure of the involvement of third party funders, however procedural issues have often triggered the parties to disclose the assistance of third party funders. It should, however, not be necessary to reveal the essentials of the funding agreement unless the terms are material facts to the case and have a significant impact on the case if left undisclosed. Thus, there is a need for a domestic legal system to regulate and identify conditions of mandatory disclosure in order to prevent conflicts of interest between the parties, funders and arbitrators.

- **Security of costs**
  The concept of third party funding also brings in the issue of security for costs. English courts recently held that the liability of a third party funder, in case of failure of the funded party, can be limited only on two grounds; Firstly, the liability is limited to the maximum amount of funding agreed upon and secondly, the funder’s liability...
will be limited to the costs sustained during the time the funder has been involved. However in recent amendment to the Act, the rule of ‘costs follow event’ has now been statutorily recognised under section 31A of the Act. It is pertinent to note that sections 9 and 17 of the Act recognise the right of a party in both court and arbitral proceedings to secure their costs as an interim measure at the time of the proceedings, in accordance with section 31A of the Act. However, the existing statute is insufficient to compel a third party funder to pay security for costs i.e., in the absence of any express provision for security of costs for third party funders in India. There are no penalties in case such an order is disobeyed by a funder.

**Conclusion**

The arbitration system in India has for long remained silent on the issue of third party funding. The lack of concrete legislation regarding the acknowledgment of the validity of the concept makes parties apprehensive to choose India as the seat of arbitration on grounds of alleged abuse of power or award being granted contrary to public policy. Due to this shortcoming there is an exponential increase in the probability of parties being exploited by funders while third party funding is carried on illegally and silently. It is indeed ironic to witness legalised corporate funding in the country whereby contingency fees are prohibited and a concept such as Third party funding is not even raised. While disclosure and security for costs are provisions that are already addressed in the statute and/or precedents in India; it is essential to adopt a definition of third party funding, mechanisms to regulate disclosure in the proceedings and to limit the scope for ‘frivolous procedural motions related to TPF.’

Policy formulation must devise upon due diligence of the funder and disclosure of relevant information to the funder before a funding arrangement is encompassed between the parties. With new advancements in the field of arbitrations and other ADR systems, India must acknowledge the exponential growth in third party funding and must seek to reap advantage of its benefits while regulating the same to mitigate the associated risks. Such measures are the only way to ensure transforming India into a pivotal seat of arbitration.
ENDNOTES:

1 The Mumbai Centre of International Arbitration (‘MCIA’) inaugurated on October 08, 2016 is the first International Arbitration Centre India.


5 JONAS VON GOELER, THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION AND ITS IMPACT ON PROCEDURE 125 – 162 (2016).


7 JONAS VON GOELER, THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION AND ITS IMPACT ON PROCEDURE 125 – 162 (2016).


