

ETHICAL CONCERNS SURROUNDING THIRD-PARTY FUNDING IN INDIAN ARBITRATIONS: THE NEED FOR LEGISLATION

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Introduction

The concept of third-party funding [“**TPF**”] is uncharted territory in the Indian legal system. It is the financing of arbitration expenses by “strangers to the arbitration” which enables the claimants to access justice in meritorious cases, in exchange for a monetary share in the final award.¹ It proves to be an unconventional investment opportunity with almost concrete returns for the funder. Third-party funders act as enablers for cash-strapped parties to access justice, which would be unobtainable in other circumstances.² TPF is not alien to common law jurisdictions; it has been legalised by several countries such as the United Kingdom, United States of America, Australia and Singapore.³

In India, the Arbitration and Conciliation Act, 1996 [“**the Act**”] provides for termination of arbitral proceedings in the event of failure to deposit amounts fixed by the tribunal.⁴ Without the financial support of a sponsor, a claimant may be deprived of the opportunity to pursue a meritorious claim.⁵ Hence, TPF becomes especially relevant in a developing country like ours, where litigants come from diverse socio-economic backgrounds. Owners of cottage industries, small-scale businesses, traders and employees may lack the financial wherewithal to finance necessary, but long-drawn-out arbitration proceedings. Exorbitant arbitration expenses can cause them severe financial distress and interfere with their day-to-day operations.⁶ TPF offers a panacea to such parties and enables them to stand toe to toe with corporate behemoths.

¹ Indu Malhotra, *Commentary on the Law of Arbitration* vol 1 (4th edn, Wolters Kluwer 2020) 1524.

² *Arkin v Borcard Lines Ltd* [2005] EWCA Civ 655.

³ Malhotra (n 1).

⁴ Arbitration and Conciliation Act 1996, s 38(2).

⁵ Chiranjivi Sharma, ‘Third-party Funding needed in Arbitrations’ (*India Law Business Journal*, 7 May 2020) <<https://law.asia/third-party-funding-arbitrations/>> accessed 1 November 2020.

⁶ Gregory J Myers, ‘When the Small Business Litigant cannot Afford to Lose (Or Win): Consequences for Small Businesses, Strategies for Managing Costs, and Recommendations for Courts and Policymakers’ (2012) 39(1); William Mitchel L Rev <<https://open.mitchellhamline.edu/cgi/viewcontent.cgi?article=1479&context=wmlr>> accessed 4 November 2020.

There is no express acceptance or prohibition of TPF under the Act. Even the Supreme Court of India in *Bar Council of India v. A.K. Balaji* [“BCI”] observed thus: “*There appears to be no restriction on third parties (non-lawyers) funding the litigation and getting repaid after the outcome of the litigation.*”⁷ Although there is no specific national legislation governing TPF in India, state amendments in Order XXV of the Code of Civil Procedure, 1908 have statutorily recognised TPF in some states.⁸

The keen attitude of the judiciary to incorporate TPF has already resulted in the opening of a new form of market for investors to plough funds into.⁹ However, the transformation of the landscape of TPF in India will entirely depend upon the development of the legal and regulatory mechanisms. More importantly, TPF includes certain ethical concerns that legislators need to address to remove the ambiguities present in such arrangements. This article aims to analyse these ethical concerns associated with allowing TPF in Indian arbitrations, and further, to emphasize the need for legislation to address these concerns.

Ethical concerns associated with third-party funding

i. May Transgress the Boundaries of Privilege and Violate the Opposing Party’s Confidentiality

Privilege has been defined as “*a legally recognized right, belonging to a client, to withhold certain testimonial or documentary evidence from a legal proceeding, including the right to prevent another from disclosing such information.*”¹⁰

Ordinarily, only the claimant and his lawyer will have access to privileged documents and information. This information will be protected due to attorney-client privilege.¹¹ However, if the claimant is being funded by a third party, privileged documents may be shared with the funder so that he can conduct “due diligence”.¹² The problem with divulging such information to the sponsor is that it could result in a potential waiver of privilege.¹³ Taking advantage of such a situation, an

⁷ *Bar Council of India v A K Balaji and Ors*, AIR 2018 SC 1382 [35].

⁸ Shreya Yadav, ‘The A-Z of ADR: Third Party Funding in Arbitration’ (*Bangalore International Mediation, Arbitration and Conciliation Centre BIMACC*, 11 September 2020) <<http://www.bimacc.org/a-z-of-adr-third-party-funding-in-arbitration/>> accessed 27 November 2020.

⁹ Soham Banerjee, ‘Third Party Funding of Disputes: Easing the Burden on Stressed Litigants’ (*India Corp Law*, 18 June 2020) <<https://indiacorplaw.in/2020/06/third-party-funding-of-disputes-easing-the-burden-on-stressed-litigants.html>> accessed 2 November 2020.

¹⁰ C F Dugan, ‘Foreign Privileges in U.S. Litigation’ (1996) 5 J Int’l L & Prac 33, 34.

¹¹ Malhotra (n 1) 1529.

¹² Andreas Frischknecht and Vera Schmidt, ‘Privilege and Confidentiality in Third Party Funder Due Diligence: The Positions in the United States and Switzerland and the Resulting Expectations Gap in International Arbitration’ (2011) 4 TDM <<https://www.transnational-dispute-management.com/article.asp?key=1746>> accessed 6 November 2020.

¹³ Nadia Hubbeck, ‘Third party funding and the pitfalls of privilege’ (*Practical Law Arbitration: Thomas Reuters*, 7 June 2017) <<http://arbitrationblog.practicallaw.com/third-party-funding-and-the-pitfalls-of-privilege/>> accessed 3 November 2020.

adroit respondent may, under Section 27 of the Act, take the approval of the arbitral tribunal and approach the courts to demand disclosure of privileged documents which are in possession of the funder.¹⁴ In an arbitration petition under Section 27, the Bombay High Court directed a third party to produce documents and material to assist the arbitral tribunal in effective determination of the dispute.¹⁵ Compromising the claimant's privilege in such a situation can be harmful to his interests.

Confidential communication with third-party sponsors could be protected under the common law doctrines of litigation privilege and the concept of common interest.¹⁶ However, limited jurisprudence on the application of either common law doctrine in relation to TPF prevents us from knowing whether these principles can apply in reality.¹⁷

In order to evaluate the merits of the claim and conduct due diligence, third party funders could circulate either party's confidential and privileged information among their own experts, accountants and financial advisors. While this may be acceptable to the claimant, absence of the respondent's express consent can render him vulnerable and compromised. Since such outsider parties are not bound to maintain secrecy, they may, wittingly or unwittingly, end up breaching the parties' confidentiality.

To preserve the sanctity and confidentiality of arbitration proceedings, it would be prudent for both parties to enter into a confidentiality agreement with the funder.¹⁸ The Code of Conduct for Litigation Funders [**"Code of Conduct"**], applicable to England and Wales, states:

*"A Funder will observe the confidentiality of all information and documentation relating to the dispute to the extent that the law permits, and subject to the terms of any Confidentiality or Non-Disclosure Agreement agreed between the Funder and the Funded Party. For the avoidance of doubt, the Funder is responsible for the purposes of this Code for preserving confidentiality on behalf of any Funder's Subsidiary or Associated Entity."*¹⁹

Alternatively, the respondent may approach the tribunal to prohibit the funder from viewing any evidentiary hearings.²⁰ Most international arbitration institutions are in unanimous agreement that

¹⁴ Susanna Khouri, Kate Hurford and Clive Bowman, 'Third Party Funding in International Commercial and Arbitration – A Panacea or a Plague? A Discussion of the Risks and Benefits of Third Party Funding' (2011) 4 TDM <www.transnational-dispute-management.com/article.asp?key=1747> accessed on 1 November 2020; Malhotra (n 1) 1529.

¹⁵ *Nilesh Exim Pvt Ltd v PFS Shipping (India) Ltd* [2002] BHC 1340.

¹⁶ Hubbuck (n 13).

¹⁷ *ibid.*

¹⁸ David St. John Sutton, Judith Gill and Matthew Gearing, *Russel on Arbitration* (24th edn, Sweet & Maxwell 2015) [1-049].

¹⁹ ALF Code of Conduct for Litigation Funders 2014, cl 7.

²⁰ St John Sutton, Gill and Gearing (n 18) 17.

hearings must remain private and outsiders not directly involved in the proceedings should not be admitted.²¹ An amendment of the Act in 2019 has imposed an obligation on the arbitral tribunal, parties to the arbitration and arbitral institutions to maintain confidentiality of arbitration proceedings.²² However, there is no mention of the responsibility of the funder to maintain confidentiality in this regard.

Drafting an Indian Code of Conduct for third party funders will provide sponsors, especially foreign sponsors, with clarity regarding the procedure to be followed while funding arbitration expenses in India. The Code of Conduct may be directory in nature, however it should have a strong disciplinary effect on funders. It should include a clause which asserts that the funder and claimant enter into a confidentiality agreement. Additionally, there must be a specific mention of liability or responsibility that may befall the funder if there is a breach of confidentiality of either party.

ii. Potential Conflict of Interest between the Arbitrator and Third-Party Funder

Unless specifically instructed by the arbitral tribunal, there is no obligation for the claimant to reveal that TPF has taken place. If there is no voluntary disclosure of the existence of TPF, the respondent and arbitral tribunal will not have knowledge of this arrangement.²³ Funders, on most occasions, prefer to not disclose their identity. If it comes to light that the claimant's arbitration expenses are fully funded, the tribunal will have to take such information into account while adjudicating on an application for security of costs.²⁴

Determining independence, transparency and impartiality of an arbitrator is simple: it involves ascertaining whether the arbitrator has a direct or indirect, past or present relationship with either arbitrating party, their attorneys, counsels or witnesses.²⁵ The grounds stated in the Fifth Schedule of the Act provide a benchmark for ascertaining whether circumstances exist which give rise to justifiable doubts regarding the independence or impartiality of an arbitrator.²⁶ If the funder's identity is disclosed after the commencement of arbitration and there is substantial proof that there

²¹ Nigel Blackbay, Constantine Partasides, Alan Redfern and Martin Hunter, *Redfern & Hunter on International Arbitration* (5th edn, Oxford University Press, 2009) [2-147].

²² Arbitration and Conciliation (Amendment) Act, 2019, s 42 (a).

²³ St John Sutton, Gill and Gearing (n 18) 17.

²⁴ *ibid.*

²⁵ Grant Hanessian and Lawrence Newman, '*International Arbitration Checklist*' (JurisNet, LLC, United States, 2009) 41.

²⁶ Shweta Sahu, Moazzam Khan and Payel Chatterjee 'Legitimacy of Arbitral Appointments in India' (*Kluwer Arbitration Blog*, 3 November 2018) <<http://arbitrationblog.kluwerarbitration.com/2018/11/03/legitimacy-arbitral-appointments-india/>> accessed 30 November 2020.

is a close nexus between the arbitrator and funder, it would give rise to justifiable doubts regarding the arbitrator's independence and impartiality.

Mandatory disclosure is provided by the arbitrator at the time of commencement and during proceedings in accordance with the provisions of the Act.²⁷ If the arbitrator discloses his relation with the funder after the proceedings begin, the respondent may challenge his right to continue as an arbitrator. The non-disclosure of the third-party funder in the initial stages of the proceedings may eventually put the arbitrator in an invidious position where he may have to recuse himself from the arbitration. If he recuses himself according to a challenge under Section 13 of the Act,²⁸ the arbitral process would be disrupted and time and money would be squandered. In the alternative, if the challenge fails and an adverse award is passed against the respondent, he may, under Section 34 of the Act,²⁹ approach the courts and raise the plea that the independence and impartiality of the arbitrator was compromised. This could result in the consequential setting aside of the award.

In a survey conducted by the Queen Mary University of London and White & Case LLP, a staggering 76 per cent of arbitration practitioners showed support for compulsory disclosure of the use of TPF by a claimant. 63 per cent indicated that the identity of the financier should be revealed to ensure transparency in the proceedings.³⁰

Article 24 of the Singapore Investment Arbitration Commission [“SIAC”] Rules empowers the tribunal to demand a disclosure of the funder's identity, along with details of the agreement.³¹ However, this is a voluntary disclosure.³² On the other hand, Article 8.26 of the Comprehensive Economic and Trade Agreement [“CETA”] makes disclosure of TPF mandatory.³³

Unless the problem of disclosure of identity is addressed, it will continue to plague the system of TPF in arbitrations. Hong Kong's Arbitration and Mediation (Third-party funding) (Amendment) Bill is a recently introduced legislation which requires parties to disclose to the arbitral tribunal and

²⁷ Arbitration and Conciliation Act 1996, s 12.

²⁸ *ibid*, s 13.

²⁹ *ibid*, s 34.

³⁰ Queen Mary University of London and White & Case, ‘2015 International Arbitration Survey: Improvements and Innovations in International Arbitration’ (2015) <http://www.arbitration.qmul.ac.uk/media/arbitration/docs/2015_International_Arbitration_Survey.pdf> accessed 31 October 2020.

³¹ Rachael Denae Thrasher, ‘The Regulation of Third Party Funding: Gathering Data for Future Analysis and Reform’ (2018) 59 B.C.L. Rev <<https://lawdigitalcommons.bc.edu/cgi/viewcontent.cgi?article=1009&context=ljawps>> accessed 27 November 2020.

³² *ibid*.

³³ *ibid*.

opposing parties if TPF has taken place, along with the identity of the funder.³⁴ The legislature should examine the provisions contained in the Hong Kong legislation, CETA and the SIAC Rules while drafting the proposed Indian law on TPF to deal with this predicament without compromising on the fairness of the arbitration proceedings.

iii. Disadvantageous Position of the Funded Party

The presence of a profit-driven sponsor may impede settlement discussions. A third-party funder may prevent the claimant from mending relations with the respondent and settling the dispute due to his overriding interest in the outcome.³⁵

Balancing the interests of a funder who may wish to conclude the arbitration and accept a quick settlement with those of the claimant who may wish to continue with arbitration till the final hearing, is an extremely difficult process. This difficulty arises solely because the claimant is not financing the arbitration expenses. More often than not, a claimant may not only long for monetary damages but also the specific performance of contracts, restitution etc. In such situations, the claimant ends up compromising his interests for the third-party funder. All these conflicts become even more pronounced when an impecunious claimant is being funded.

Consequentially, the claimant may find itself in a disadvantageous position and may feel compelled to yield to the demands of the funder while negotiating the terms of the funding agreement.³⁶ An opportunistic funder may demand a larger share in the final award. Moreover, the funder may also coerce the party to adopt a more monetarily beneficial strategy during the arbitration proceedings, one which the party may not have wished to deploy initially.³⁷

Additionally, a funder may wish to be actively involved in selecting his choice counsel, fixing a preferable fee structure with the lawyer and vet the legal course of action during the proceedings. In such a situation, the funder may hold the legal representatives of the claimant accountable for

³⁴ Norton Rose Fulbright, 'International Arbitration Report' (*Norton Rose Fulbright*, October 2017) 9 <<https://www.nortonrosefulbright.com/en-in/knowledge/publications/4f5fb25c/emerging-approaches-to-the-regulation-of-third-party-funding>> accessed 2 November 2020.

³⁵ Sri Ramani Garimella, 'Third Party Funding in International Arbitration: Issues and Challenges in Asian Jurisdictions' (2014) 3(1) AALCO J Int'l L 45, 52.

³⁶ Malhotra (n 1) 1531.

³⁷ Garimella (n 35).

the outcome of the arbitration.³⁸ The lawyer may struggle to prioritize his client's interests, as there is a lack of clarity as to which client's interests he represents: the funders or the funded party's.³⁹

An active funder may wish to attend client meetings and provide strategic inputs on the matter.⁴⁰ In such a situation, deciding the level of control to be allocated to the funder will be key in determining how smoothly the relationship between the parties proceeds. To consolidate the claimant's bargaining position, the best course of action would be to prepare a watertight funding agreement at the outset. During the nascent stages of drafting the funding agreement, the funder and claimant should discuss the decision-making power and degree of control that the funder may exercise. Negotiating on these aspects beforehand will certainly help in reducing the chances of fallouts in later stages of the proceedings.

Another aspect which must be addressed is whether a funder can renege from the funding agreement if the claimant decides to pursue a different course of action during the arbitration proceedings. Section 73 of the Indian Contract Act, 1872 states the measure of damages payable as compensation for breach of contract.⁴¹ The claimant may be entitled to damages under this Section if the funder withdraws from his funding agreement. This reinforces the need to draft a transparent and exhaustive funding agreement. Funding agreements must also provide unequivocally that the lawyer's duty, both professional and fiduciary, is solely owed to the claimant.⁴² This will help in addressing the issue of divergent interests of the funder and the claimant.

Common law jurisdictions like England have allocated control in the hands of the litigant and its lawyers, with the funder's control being limited to an entitlement to be "*informed about the progress of the proceedings.*"⁴³ England's Code of Conduct seeks to regulate the funder's control, namely by ensuring that the funder "*will not seek to influence the Funded Party's solicitor or barrister to cede control or conduct of the dispute to the Funder,*"⁴⁴ and by providing that the Litigation Funding Agreement shall state how the funder "*may provide input to the Funded Party's decisions in relation to settlements.*"⁴⁵ Including

³⁸ St John Sutton, Gill and Gearing (n 18) 17.

³⁹ Oscar Suárez Bohórquez and Lena Stoll, 'Third party Litigations funds and the lawyer's ethics' (*Leiden Law Blog: Universiteit Leiden*, 28 September 2018) <<https://leidenlawblog.nl/articles/third-party-litigations-funds-and-the-lawyers-ethics>> accessed 5 November 2020.

⁴⁰ International Council for Commercial Arbitration, 'Report of the ICCA-Queen Mary Task Force on Third-Party Funding in International Arbitration' (April 2018) 28 < https://www.arbitration-icca.org/media/10/40280243154551/icca_reports_4_tpf_final_for_print_5_april.pdf> accessed 31 October 2020.

⁴¹ The Indian Contract Act, s 73.

⁴² Khouri (n 14).

⁴³ *Re the Valetta Trust* [2012] 1 JLR 1 [8].

⁴⁴ ALF Code of Conduct for Litigation Funders 2014, cl 9.3.

⁴⁵ *ibid*, cl 11.1.

a provision of a similar nature in the proposed Indian Code of Conduct shall preserve the balance of power between the funder and the claimant in India as well.

iv. Fear of encouraging meritless claims

Critics claim that TPF may lead to an increase in arbitrations based on meritless claims, thus creating a strain on institutionalised state arbitration.⁴⁶ Frivolous cases, too, are just as likely to receive funding depending upon the potential of getting substantial returns on the risk undertaken.⁴⁷ However, no court or arbitral tribunal has found these criticisms to be true thus far.⁴⁸

It is imperative to note that that TPF is an investment opportunity for funders, on which they expect considerable returns. Hence, they will never agree to fund a party whose claims are baseless. Careful due diligence itself can reveal if the party is capable of getting an award in its favour or not. This proves that, contrary to the criticism, TPF encourages meritorious claims.

Nonetheless, while legislating on a bill pertaining to TPF, the legislature could consider introducing provisions to impose exemplary costs on the claimant and the third party if claims made are frivolous. This will act as a deterrent for parties planning to engage in frivolous arbitration and make funders wary before they enter into funding arrangements.

Conclusion

With the law of arbitration constantly evolving, it is the need of the hour for the parliament to develop suitable legislative instruments to address the looming ethical concerns that surround TPF in Indian arbitrations. These legislative instruments may particularly include an amendment of the Act, along with any additional guidelines that can solidify the TPF system in India. Greater emphasis needs to be placed upon this in light of the financial strain during the current pandemic, which has increased the support for TPF considerably.⁴⁹ Given the economic slowdown, cash-

⁴⁶ Ylli Dautaj and Bruno Gustafsson, 'Access to Justice: Rebalancing the Third-Party Funding Equilibrium in Investment Treaty Arbitration' (*Kluwer Arbitration Blog*, 18 November 2017) <<http://arbitrationblog.kluwerarbitration.com/2017/11/18/access-justice-rebalancing-third-party-funding-equilibrium-investment-treaty-arbitration-2/?print=print>> accessed 1 November 2020.

⁴⁷ Mark Kantor, 'Third-Party Funding in International Arbitration: An Essay About New Developments' (2009) 24(1) *ICSID Review- Foreign Investment Law Journal* 65, 74.

⁴⁸ Angus Fei Ni, 'Third Party Funding in International Arbitration: A Slippery Slope or Levelling the Playing Field?' (*Lexology*, 8 September) <<https://www.lexology.com/library/detail.aspx?g=9a714d90-769c-4c4b-81f5-90bb4137f279>> accessed 1 November 2020.

⁴⁹ Amita Katragadda, Shrey Srivastava and Priyal Modi, 'Cash constrained and need to litigate? Third-Party Funding may be the solution' (*India Corporate Law*, 22 June 2020) <<https://corporate.cyrilamarchandblogs.com/2020/06/need-to-litigate-third-party-funding/>> accessed 2 November 2020.

constrained parties will be in need of external sponsorship to sustain their claims. Hence, TPF will prove to be a saviour for those in need.

It may even be beneficial for India to take a lesson from England's self-regulation model pertaining to TPF. There exists the Code of Conduct for Litigation Funders, and only those who join the Association of Litigation Funders are expressly bound by the Code.⁵⁰ Framing an Indian Code of Conduct along similar lines would provide claimants and funders with much-needed clarity when they enter into funding arrangements.

TPF is undoubtedly a constructive method for enhancing access to justice by having an outsider sponsor lengthy and expensive arbitration proceedings. However, unless the complications pertaining to the above-mentioned ethical concerns are focused upon, parties will always be wary of putting their faith in this system for fear of abuse of such "grey areas". Enacting a law to deal with these ethical concerns will go a long way in promoting the growth of TPF in Indian arbitrations.

⁵⁰ Rachael Mulheron, 'England's Unique Approach to the Self-Regulation of Third-Party Funding: A Critical Analysis of Recent Developments' (2014) 73(3) CLJ 570, 571.