Krrishan Singhania & Alok Vajpeyi, highlight the various issues which the legislature should consider while framing rules to regulate third party funding in arbitration.

With the advent of Covid-19, an unprecedented economic slowdown has occurred, and the companies are struggling to maintain their cash flow. In such a situation, it is extremely difficult for companies and businesses to gather the courage to enter into, or even continue, existing arbitration proceedings. The concept of third-party funding seems to be of uttermost importance in the present times taking into account the surge in commercial suits triggered by the advent of the pandemic.

Third party funding is a financing method whereby an entity which is not party to a dispute, without having any interest in the dispute, funds the legal costs and other costs in consideration of certain percentage in the award amount. Third party funding is required as the companies running under financial stress need funds to pursue their rightful claims and therefore funders become essential. Moreover, considering the economic disruption caused by the pandemic in the present times, third party funding becomes an essential tool to meet the rising demand of capital to pursue legal claims.

In India, the discourse on third party funding gained fuel post the judgment of the Apex Court in the case of Bar Council of India v. A.K. Balaji . In this judgment, while discussing the right of foreign lawyer to practice in India, the Court passively recognized that there is no bar to third party funding in India. In context of civil suits, third-party funding is expressly recognized in States such as Gujarat, Madhya Pradesh, Maharashtra and Uttar Pradesh and is well reflected in the Civil Procedure Code, 1908, (CPC) Order 25 Rule 1 (as amended by Gujarat, Madhya Pradesh, Maharashtra and Uttar Pradesh) which provides that the Courts have the power to secure costs for litigation by asking the funder to become a party and depositing the costs in Court. Currently, there is no statutory provision in India allowing or barring third party funding of the arbitration disputes. Considering the judicial pronouncements, it can reasonably be concluded that there is a passive recognition of third-party funding of arbitration disputes in India. As India is thriving to become an arbitration hub, specific legislation for both domestic and International arbitration should be promulgated as this will bring in certainty with regard to third party funding of arbitration matters in India.

Conflict of Interest

Conflict of interest arises where there is a prior relationship, any financial or personal interest between the funder and a party or law firm involved in the proceedings or between the funder and an arbitrator. Conflict with a law firm should also be checked as there can be a case where the arbitrator was a partner at a law firm that received significant financing from a funder based on a portfolio of the firm's cases. Such conflicts can lead to costly satellite disputes, including challenges to

Specific legislation for both domestic and International arbitration should be promulgated as this will bring in certainty with regard to third party funding.

The terms of the funding agreement should ensure that the funder does not have excessive control over the arbitral proceedings.

Krrishan Singhania,
K Singhania & Co.

the arbitrator's appointment and in certain cases may even lead to challenging the arbitral award itself.

In order to remedy the situation of conflict of interest, reasonable diligence should be conducted by the funder and the funded party, and there should be mandatory disclosure of the funding agreement at the time of filing the claim and in any other case not later than the first hearing after the funding agreement has been entered into. The mandatory disclosure of the existence of the funder has been suggested by various jurists across the globe. Further, any objections or challenges by the respondent in relation to the funder or the funding agreement should be raised within a period of 15 days after becoming aware of the existence of any circumstance that give rise to the justifiable doubts as to independence and impartiality of the arbitrator. The said 15 day time limit is provided under Section 13(2) of the Arbitration and Conciliation Act, 1996.

The IBA Guidelines on Conflict of Interest 2014 state under the General Standard 6(b) that the third-party funders have a direct economic interest in the matter and therefore are considered equivalent to the party receiving the funding. Adapting this approach and treating funders' equivalent to the parties can be other way of regulating the issue of conflict of interest as it broadens the scope of justifiable doubts that may arise as to the independence and impartiality of the arbitrator and discourages the funder to fund any dispute where there is an indirect nexus between the funder and the arbitrator. Even in the Code of Practice of Third Party Funding of Arbitration ('HK Code'), passed by the Hong Kong government, this issue of conflict of interest is dealt with as follows, "a funder must maintain effective procedures for managing conflicts of interest and must not take any steps that may cause the funded party's legal representative to act in breach of its professional duties".

The government while framing regulations relating to third party funding in arbitration should consider the above mentioned standards to deal with the issues arising from conflict of interest due to involvement of the funder.

Extent of Funders' Control over the Proceedings

As the funder has a direct economic interest in the outcome of a dispute, there is a risk that it might seek to interfere with the conduct of the arbitral proceedings. In variety of instances tensions could develop – for example, if it is in a funder's interest, it might pressurize a party to dispute the settlement even if this is not in the party's best interest. Another concern is that, a funder may influence the decision making of the counsel/firm representing the client.

In order to avoid these issues, the terms of the funding agreement should ensure that the funder does not have excessive control over the arbitral proceedings. The HK Code requires a funded agreement to set out clearly that the funder will not seek to influence the funded party or the funded party's legal representative to give control or conduct of the arbitration to the third party funder. Further, the SIArb Guidelines for the third party funders ('SIArb Guidelines') advocate including a dispute resolution provision for managing conflicts between the funder and funded party.

Certain basic terms of the funding agreement should be prescribed by the legislature in order to reduce the control of the funder over the arbitral proceedings. These terms can go to the extent of providing an upper limit to the share of the funder in the final award. Moreover, the legislature should consider framing a code of conduct for the funders as it has been done in other jurisdictions.

Confidentiality & Privilege

A "privileged communication" is a protection awarded to a communication between the legal adviser and the client. Such professional communication with the legal advisors has been accorded protection under The Indian Evidence Act, 1872. Obtaining funding generally requires disclosure of information that would otherwise be privileged, either because it involves communications between a client and its counsel, or analysis by a client's counsel in preparation for legal proceedings. Before entering into correspondence with third- party funders, the issues of confidentiality and privilege should be considered.

The SIArb Guidelines recommends that certain terms be included in an initial confidentiality or non-disclosure agreement between the funder and the funded party. The terms should be designed to protect confidentiality and privilege in documents disclosed to a funder before it decides to fund a claim. Additionally, the SIArb Guidelines prohibit a funder from seeking disclosure of information from a funded party's legal practitioner that might amount to a breach of privilege or the practitioner's confidentiality obligations.

The legislature should introduce certain provisions in the statute in line with the SIArb Guidelines for addressing these confidentiality and privilege concerns.

Cost

Section 31-A of the Arbitration and Conciliation Act, 1996 ('the Act') contains the provision for cost. However, the tribunal may not have jurisdiction to make a costs award against a third-party funder, considering that it is unlikely to be a party to the arbitration agreement. Moreover, if an unsuccessful party which has received the funding is not able to meet an adverse costs award, the successful party may find itself unable to recover the full amount from the funder as there is no relationship between them.

The HK Code contains that the issue of cost and security of cost should be contained in the funding agreement. This is also reflected in the SIArb Guidelines. Further, it is advisable that a party whose opponent is funded should consider making an early application for security for its costs. Furthermore, the legislature should consider amending the provisions for costs and give the Tribunal the jurisdiction against the third-party funders for ordering cost against them in the arbitration proceedings.

Changes under FEMA

The funding arrangement between a foreign funder and an Indian party will invite the application of Foreign Exchange Management Act, 1999 ('FEMA'). It is uncertain that whether the third-party funding will be treated as capital account transaction or the current account transaction under the FEMA regulations. Therefore, the legislature should clarify as to what compliances are required to be made in terms of FEMA so as to provide better regulation standards to deal with the issues arising from the involvement of the funder.

Conclusion

In the recent times of pandemic, one cannot deny that the economic slowdown would definitely affect bona fide parties from entering in arbitrations. Further, with the litigation witnessing a surge and the parties to the suit dependent on external sources to aid their legal struggle involving enforcement of their rights, the concept of third-party funding is of uttermost relevance in the current times. India lacks legislation with respect to aiding the cause of third-party funding, on the contrary, both Hong Kong and Singapore have allowed third party funding of arbitration and have a definite law on the same. Therefore, considering the demand of the market, the Indian government should also pass a law regulating third party funding of arbitration disputes in India. These regulations should be framed taking into account some of the issues highlighted above. Moreover, the legislature should consider the best practices across jurisdictions which have allowed third party funding of arbitration disputes.

Allowing third party funding of arbitration disputes will be the right step to help companies which are in financial stress in times of the pandemic or otherwise and are unable to pursue their rightful claims. Third party funding will also ensure access to the best legal services and efficient dispute resolution. Therefore, third party funding of arbitration disputes should be given active recognition and the government should regulate it, so as to meet the demands of the market and this will further attract commercial parties to choose Indian law as the seat of arbitration. CT

> Third party funding of arbitration disputes should be given active recognition and the government should regulate it.

Alok Vajpeyi
Associate
K Singhania & Co.