



INDIA THE INTERNATIONAL ARBITRATION HUB IN THE ERA OF THIRD-PARTY FINANCING

By *Sanchi Chiripal, Sulagna Goswami and
Tushti Aneja*
From *Amity University, Noida*

Concept of Third-Party Financing

Arbitration at international level has gained wide-scale acceptance for its flexibility, timely settlement and also offers an advantage of judicial neutrality. While this type of alternative dispute resolution ensures speedier results, the higher operation cost cannot be denied. Exorbitant litigation costs often cause hindrance in the way of getting justice.

The concept of the 'third-party' is a legal fact known to all yet is still hidden under the mask of secrecy. Third-party financing is the outcome of the development in the International Arbitration sector. However, it is still a concept yet to be entangled and considered admissible regulation in the ambit of national arbitration laws. The concept of Third-Party financing accelerates the number of specific virtuous and procedural issues both in International commercial and investment arbitration. These issues comprise of investor's relationship with parties and counsels in governing the dispute, the appropriation of costs and the security for costs, clarity and the disclosure of the funding arrangements and lastly the arbitrator's conflict of interest.

Third-Party financing is a way out to reduce or knock out the potential risk associated with the destructive outcomes of litigation. Third-party financing takes place when the third

party that is the party which is not involved or an external party agrees to pay one's legal fees which is usually a claimant. Such legal fees mostly include the of fees of the lawyer, experts, outside counsel or any other cost which is incurred in civil litigation in conformity with the stipulated agreement and postulated budget. However, the funder shall undertake the risk of losing it all as the Third-Party funding business model is non-recourse and the funder may lose all its investment if the funded party's claim does not prevail. Further, if a situation so arises where the host country issues regulation which bars the exercise of the industry of Third-Party funding, forcing it to shut down and incur losses, the funder will be entitled to bring a claim against the host country in suitable forums and hold it liable for the losses that it has incurred.

The problems that arise concerning Third-Party financing is the economic interest and various complications which may arise due to the unforeseen circumstances in the future and lack of exploration in this domain. In simple words the concept of third party financing means the fund which is provided by the natural or a legal person who is not the party of the dispute and that person enters into an agreement with the disputed party to finance the same with regards to all the cost of proceedings in return of an agreed percentage of the damages awarded to the funded party. However, if the funded party fails and is not awarded any damages the funder will not receive any payment for the financial support so provided. The percentage of damages so paid to the funder is an already decided and agreed amount and falls outside the scope of what must be paid to the lawyers and any other litigation expenses so incurred.



However, Third-Party financing has gained wide-scale acceptance throughout the globe for its flexibility and timely disposal of proceedings. The main reason behind the parties opting for International arbitration is that the parties are not from the same country and are unaware of local laws of the state. Third-party funders provide access to justice for those who cannot afford due to financial incompetence, unable to bear the costs of expensive and unpredictable litigation. In this situation for a claimant to pursue meritorious proceedings, third-party funding is the only option left. Third-party funding helps the company to invest the money in other projects such that money does not get stuck in the litigation process, rather it is used to expand the company or invest in other aspects. But before making such a huge commitment funder conduct due diligence and the legal analysis on the merits of the pursuant case. This reduces the chances of losses on the part of the funders and ensures a surety of returns. Even though funders are generally prohibited from taking undue control in the arbitration proceedings, the funded party may to a certain extent lose its autonomous power to the funding party while considering the percentage of damages as the funder may reserve the right to approval of the settlement.

Champerty and Third-Party Financing

The doctrine of champerty was derived in ancient Greek and Roman statutory system which eventually emerged in the common-law system of England during primitive times and spread to the other territories largely through the British Empire. Some of the nations preferred the modern laws which aimed at preventing frivolous and forged

claims. Others have rehabilitated the doctrine of champerty in recent years and used them as a glass through which they weigh the importance and legality of the Third-Party financing agreements.

Champerty is the maintenance that is provided as financial assistance to the party of the suit to receive a share of money recovered if the party wins. It would often lead in excessive exhilaration of litigation cost and creation of forged claims which was then used as a shield against the extortion and abuse of indigent client by upscale Third-Party funders. It was also considered to be the reason for endangering the inherent integrity of the judicial process which has always been deemed as a private matter restricted between the judge and the two parties. The rationale that 'all men are equal before the law' lead to the restrictions in the concept of champerty and maintenance to stop the unscrupulous practices of targeting the weak and demanding for frivolous and vexatious claims often leaving the claimant at a poor bargain.

However Third-Party financing arrangements are presently considered as prima facie permissible and is even deemed to be plausible for promoting easy access to justice. Such fundings are enforceable unless the integrity is not tarnished by the excessive control and over-involvement of the funder in the litigation process. The integrity of the litigation at the end depends upon the extent of influence exercised by the funder. On the face of it, the mere application of champerty and maintenance would not automatically make the Third-Party funding arrangement unenforceable just because some damages are 'up for grabs.'



To make the third-party agreements enforceable and to ensure that it does not fall in the ambit of champerty, certain necessary measures are to be taken to avoid any kind of frauds and to keep its legality intact. Funders under the agreement should not exercise undue influence over the funded party as it may lead to losing the autonomous position of the claimant in settlement of recovery. Further, the funded party should be the actual party to the proceeding and not act to be an ostentatious party. Even though funders perform due diligence and legal analysis of the case, the decision and strategies should be a matter of concern between the attorney and the client and not the funder. The communication between the client and attorney should be direct and not routed through the funder. In case of a dispute stemming between the client and the funding party, the attorney should have an ethical obligation to choose the client over the funder. The funder must not tamper with the shreds of evidence and must not meddle in the dispute in any such manner which might raise a question on the legality of the entire litigating process and its funding arrangements.

Third-Party Financing in India

With Third-Party financing gaining increasing global significance in providing justice to parties, the time has come for India to open its gate for financing International Commercial Arbitration as well. The pendulum of judicial opinion in India has remained uniform about the agreement between the claimant and the funder. Third-Party funding agreements would be tested on the foundation of equity, reasonableness and legality of the object behind the contracts and unconscionable terms.

Third-Party financing agreements merely on the face of it cannot be taken as an action towards the welfare of the public. Acquisition of interest in good faith is not enough to ensure that the funders have no ill faith and no such action will be taken such that it will make the entire arrangement unenforceable in the eyes of law. However, if the construction of the funding agreement is such that it is exorbitant or is affected by the undue influence of the funder, it is declared unenforceable as it offends the principle of public policy.

Third-party financing has been accepted in pro-arbitration jurisdiction by the introduction of new legislation or by amending the already existing regulations. Though it is still invalid in some territories, funders do face recovery issues which often discourages them to enter into such agreements.

The legality of Third-party financing litigation in India can be traced under the Civil Code of Procedure. High Courts of various states such as Gujarat, Maharashtra, Madhya Pradesh and Uttar Pradesh have amended Order XXV of the Code of Civil Procedure to cover the cases where the plaintiff is financed by a third-party and he agrees to provide for the security within a prescribed time limit for all the litigation cost which are likely to be incurred in the litigation process. However, this financing is available only for indigent parties and not for financially equipped parties.

A favourable report by *Srikrishna committee* signalled that it is time for India to formally consider permitting Third-Party financing in International Arbitration. The advantage of



Third-Party financing cannot be refuted in International Arbitration as the dispute resolution tends to be heavy-costed. Currently, there is a vital absence of regulatory framework, even Arbitration and Conciliation act 1996 does not mention anything about Third-Party funding.

The validity of the Third-party funding agreement depends upon the Indian Contract Act, 1872. As per Section 23, of the act, it provides that if the object or consideration of the agreement is unlawful and the court regards it immoral or opposed to public policy then such agreements are void. The Supreme Court in the *ONGC Pipes Case* observed '*what is public policy or public interest...has varied from time to time*'. In the absence of express regulations on the doctrine of champerty and maintenance, the focus objection of such agreements remains that it should not defy public policy. Section 70 of the Indian Contract Act states that where a non-gratuitous act by a person (third-party) benefits another person, the person receiving the benefit is bound to do good or compensate the person engaging in the non-gratuitous act. The Supreme Court observed that Section 70 will not apply to subsisting contracts and if pure funding is done then the act by the third party will become gratuitous.

The Supreme Court held in *G, A Senior Advocate* that the contract of champerty in which returns are contingent on the success of the case is not illegal per se, except if the other party is an advocate it is illegal. There has been no case as on date to discuss the validity of the award which has been obtained by the Third-Party funding. A recent matter of Execution Petition is filed before Hyderabad High Court, where the respondent has sought to oppose the execution of the

arbitral award made by the London seat of arbitration. One of the grounds on which it has been challenged is that the petitioners have entered into the third-party financing agreement and the agreement is of the champertous nature which is against the public policy of the country. The matter is sub-judice before the court. The decision will thereof give clarity of legality of the third-party funding agreements and the execution thereof.

If a party to an arbitration proceeding is being funded by a Third-Party, the seat being in India or if the funder is in India the rules of Foreign Exchange Management Act, 1999 (FEMA) would be attracted. FEMA does not explicitly mention Third-Party funding. It classifies all the transaction of foreign exchange and/or non-resident into two categories- current and capital amount transactions. The current account transactions include 'payment due as net income from investments' while third-party financing can be assumed to be 'investment'. Capital account transactions include 'borrowing or lending by whatever name called'. Thus, in the absence of legislative clarification, a single foreign funder could end up attracting a large number of FEMA regulations making Third-Party financing both burdensome and uncertain.

The Law Commission of India has an exclusive place in the Indian legislative system. It is an advisory committee formed under the Government of India and is empowered to recommend legislative reforms. A mandate so passed after due deliberation by the Law Commission on the matters of Third-Party financing by following the Indian perspective is necessary for the development of Third-Party funding



in India. Further amendments should be made in the Arbitration and Conciliation Act 1996, passing special legislation and to provide room for such Third-Party funding so that least amount of discrepancies and questions arise regarding this financial arrangement. An initiation of Law Commission with public consultation regarding the registration of Third-Party funders, transparency and disclosure of the agreements, duties and services of the funders would aid in spreading awareness about third-party financing.

Third-Party funding regulations in other prominent countries

Third-Party Funding was prohibited in Singapore until 10th January 2017, and funding of state court litigation is still prohibited. The act passed by the Singapore Parliament, Civil Law (Amendment) Act, permits Third-Party funding for international arbitration and related court proceeding with certain conditions. With the addition of the legislation in Singapore, Investment Arbitration Rules of the Singapore International Arbitration Centre (SIAC) 2017, permits the arbitration tribunals to order for the disclosure of the existing funding agreements, the identity of the third-party funder, interests and involvement of the third-party funders in the outcome of the case. Besides of the guidelines provided by SIAC, it also issued a note on the standards of arbitration practice and conduct providing arbitrators with guidance for impartiality, cost, disclosure and independence.

Third-party funding was a previously prohibited concept in International Arbitrations in Hong Kong. It approved the Third-party funding in arbitration through the adoption of Arbitration and Mediation

Legislation (Third-Party Funding) (Amendment Bill) 2017. The China International Economic and Trade Arbitration Commission Hong Kong Arbitration Centre (CIETAC) released their guideline in 2017 regarding the Third-Party funding in International arbitration. They carved out principles and guidelines for the arbitrators regarding the code and conduct to be followed and the observations to be made in respect of arbitration. Before the amendment, the laws were based on the common law doctrine of champerty and maintenance. The new legislation not only allows Third-Party funding but also makes it mandatory for the claimants to disclose the existence of third-party funders and their respective identity.

Over recent years there has been a surge in the Third-Party financing disputes throughout the United Kingdom after the abolition of the doctrine of maintenance and champerty. Large corporates consider Third-Party funding a major deliberation while entering a complex court action in arbitration in the UK. Third-party Financing is used as a pathway to justice with the full support of judiciary as well as legislature. The legislature has not specifically drafted any legislation to regulate Third-Party financing but Association of Legal Funders (ALF), has been appointed to self-regulate litigation funding in England and Wales. The ALF has designed the code of conduct to be followed for the Third-Party funding disputes and the procedure of complaints made thereof. Currently, there are little or no regulations for international arbitration in the UK but the code that applies to arbitration is silent about international disputes.



The United States of America is the largest litigation market has developed a major Third-Party financing base. Third-party financing extends to both domestic and international markets. Even though with the wide acceptance, regulatory work remains unclear. Despite lack of regulatory framework in arbitration, it has gained majority support in the favour of Third-Party financing in International Arbitration.

Conclusion

Regulations supporting Third-Party financing in International Commercial Arbitration would be a step towards achieving public policy objective. It will pave the way for improvement in case management, effective representation and easy access to justice. However, lack of legal mechanism and regulatory framework has prevented the funders to make an entry in the Indian market. The recent amendments in Hong Kong and Singapore regarding Third-Party financing shows that it is high time that our country to take the edge of rejection of champerty to make Third-Party funding a viable source of financing which will in return make India the hub of International Commercial Arbitration.

To nurture a market for third-party funding, India should adopt the vision of Hong Kong and Singapore's research by creating guidelines for the funders. However, India should also consider these issues with both the procedural as well as the ethical significance such as confidentiality, costs, disclosure of the funding agreement, termination of funding etc. Establishment of a centralized data bank will applaud the transparency and voluntary disclosures by the funders. In addition to the model of

Singapore, India can also draw its vision from the UK amendment ordinance, where the conformity of disclosure will not be mandatory but the evidence of noncompliance would be admissible and can be taken in account by the courts and tribunals for determining the liability.

The rise in the International Arbitration claims finance with specialised funds has led to this inchoate industry being hyped as 'the biggest and the most influential trend in civil justice'. Therefore, the present time is ripe for India to indisputably pave way for Third-Party financing, a measure that is certain to benefit the citizens of India as well as its reputation in the global market of International Arbitration. It is only after this we can make India a preferred International Arbitration seat and would be able to "resolve in India".
