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Regulate Funding in International Arbitration: Old Issue Still New

Vikas H. Gandhi

Professor, Law, Gujarat National Law Universoty

Abstract:
Third-party funding (TPF) provides easier access to arbitration for disputants who may not have sufficient funds available. It similarly helps parties to arbitration, who have the funds but would prefer to utilize them elsewhere in their business rather than be blocked from running a claim. A non-party (funder) bears the arbitration costs and, in return, expects either a percentage of the amount awarded in a successful claim or the amount specified in the agreement between the funded party and the funder. While TPF facilitates access to justice, it has also raised challenges such as disclosure requirements, transparency, and potential conflicts of interest. Many arbitral institutions and State jurisdictions have either introduced or updated their laws and rules related to the above concerns. This article explains the concept of TPF in various jurisdictions and its application in arbitration and litigation. The article examines the existing legal framework of TPF in the arbitration process, including the award-making process.

Keywords: International Arbitration, Litigation, Third Party Funding, Disclosure Clause, Awards.

1. Introduction

TPF has its roots in the common law doctrines of maintenance and champerty, which were originally intended to prevent wealthy individuals from meddling in legal disputes in which they had no direct interest.[1] Maintenance comprises the financial assistance of one person to another to carry on or defend civil proceedings without lawful justification. [2] Champerty involves maintaining a civil action in consideration of a promise to share in the proceeds, should the action be successful.[3] TPF is no longer novel in international arbitration. It is gradually being accepted by business parties. This can be mapped by looking into the following data. The data on arbitration funding from the annual Global Arbitration Review (GAR) 100 survey indicates that there were an average of 196 funded arbitrations per year between 2019 and 2023, with a peak of 208 funded arbitrations in 2023.[4] The number of firms reporting funded arbitrations has also increased, from 54 in 2019 to 72 in 2023.[5] Leading jurisdictions, such as England, the U.S. and Singapore, support the mechanism of third-party funding.[6] However, India is still trembling from having TPF in place.

1.I Fragile progress of TPF in England:

In 1275, TPF was made illegal in England under the Statute of Westminster.[7] The Privy Council, seated in the UK, observed in Ram Coomar Coondoo v Chunder Canto Mookerjee (1876) that agreements where a third party funds litigation in exchange for a share of the proceeds are permissible, provided they do not shock the conscience or undermine public policy. The first instance of liberalization of TPF was in 1908 in British Cash and Parcel Conveyors v. Lamson Store Service Co., [1908] 1 K.B. 1006, the court held that the common law of maintenance and champerty had become obsolete in the modern context. The

doctrines of maintenance and champerty have been further read down and apply only to deter third-party financiers from exercising undue influence in a dispute resolution process.[8]

In Campbells Cash and Carry Pty Limited v Fostif Pty Ltd. (2006) 229 CLR 386), the High Court held that litigation funding was not an abuse of process or contrary to public policy and was valid not just in insolvency matters, but across the board, as a policy that promoted access to justice.[9]

A recent UK Supreme Court ruling in the case of PACCAR Inc. and others v Competition Appeal Tribunal and others [2023] UKSC 28 held that litigation funding agreements (LFAs) that entitle funders for payments based on the amount of damages recovered would be classified as damages-based agreements (DBAs). In turn, they would have to comply with the Damages-Based Agreements Regulations 2013 (DBA regime) or risk being deemed unenforceable. The decision brought the enforceability of many pre-existing LFAs.[10]

1.II Costs against third-party funders in England:

English courts have protected third-party funders against adverse costs through the "Arkin Cap". In the Arkin v. Borchard Lines Ltd. and Others ("Arkin Case", [2005] EWCA Civ 655), the court of appeal held that if the funded party is not successful, the third-party financiers are liable for adverse costs up to an amount equivalent to the sum of funding already provided by them ("Arkin Cap").[11]

However, in Bailey v. GlaxoSmithkline UK Ltd. ([2017] EWHC 3195 (QB)), the England &Wales High Court passed an order of imposition of security for costs and did not follow Arkin's ratio of 'Cap'. The Court held that while the Arkin Cap principle must be considered when the question of imposing actual costs arises. The court reserves the discretion to exceed the capped amount.[12]

1.III US:

Third-party funding in U.S. arbitration involves an external entity providing funds for legal costs in exchange for a share of the award. U.S. courts generally uphold these arrangements, particularly in commercial international arbitration. The U.S. is an arbitration-friendly jurisdiction. Third-party funding of international arbitration is typically upheld and enforced by U.S. courts in commercial international arbitration cases that do not involve ordinary consumers as parties.[13] In 2012, the ABA Commission on Ethics 20/20 issued an informational report on "alternative litigation finance" detailing how attorneys should handle their professional ethical obligations when third-party funding is involved in their clients' cases.[14] In the PCA case South American Silver v. Bolivia, Bolivia "requested the tribunal to order the Claimant to 'disclose the identity of the funder of this arbitration, as well as the terms of the funding agreement signed with him. Bolivia cited the 2014 IBA Guidelines for the proposition that "that third-party funders should be equated with the funded party to verify the existence of a conflict of interest, and that the funded party is obliged to disclose any relationship that exists between her (including third-party funders) and the arbitrators."[15] The tribunal decided to order the disclosure of name of the funder "for purposes of transparency, and given the position of the Parties" but determined that there was no basis to order disclosure of the terms of the funding arrangement.[16]

I. IV Singapore:

The legal framework in Singapore was established by the Civil Law (Amendment) Act 2017, which came into force on 1 March 2017. According to the investment arbitration rules of 2017, tribunals are now authorized to order disclosure of the existence and identity of third-party funders and details of their involvement in a case.[17]

Singapore has adopted a 'light touch' regulatory scheme. If the relevant requirements set out in the regulatory scheme are not met, funders may be disqualified from enforcing their third- party funding

contracts in the Singapore courts.[18] In Singapore, third-party funding may only be provided by organizations whose principal business involves the provision of such funding.
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I.V. Cost orders by tribunals in Singapore:

In conventional circumstances, only the parties to an arbitration agreement may be subject to cost orders. The existence of a third-party funder raises questions as to whether it may be held liable for costs orders made against the funded party.[20] Regarding this question, the Singapore Courts have the power to impose cost orders on third parties in court proceedings; however, this power does not extend to arbitration.[21] In the context of third-party funding of arbitration, the Singapore Government has apparently been persuaded that 'parties have sufficient levers, including seeking security for costs'.[22]It has therefore been concluded that this issue is 'best left to the parties and tribunals'.[23]

I.VI. TPF in India:

In India, there is no explicit legal prohibition against TPF in India. However, the practice has not grown extensively. There are significant regulatory uncertainties.[24] Courts in India have yet to develop a comprehensive body of case law addressing the legality and enforceability of TPF agreements.[25] However, following a few cases may gain momentum, leading to the acceptance of TPF in India.

In India, the case of Bar Council of India v. A.K. Balaji (AIR 2018 SC 1382), the Supreme Court established the legitimacy of third-party litigation funding by non-lawyers. It shows that while TPF is gaining legitimacy, the courts can still refine its application, particularly in terms of cost recovery against funders.[26] However, in India, the cautious yet evolving approach of Indian courts towards TPF. In Tomorrow Sales Agency Pvt Ltd v SBS Holdings Inc, 2023 SCC OnLine Del 3191, the Delhi High Court refused to impose a security for costs against a third- party funder, distinguishing the case from the English Arkin and Excalibur cases.[27] The court noted that Indian legislation does not explicitly provide courts with broad discretion to order costs against third-party funders, a power that is well-established in English law.[28]

For funders, international arbitration is a highly attractive area of investment. And this is due to the high values of the claims, the speed of the proceedings, the potential for significantly reduced evidentiary costs, the greater predictability of the outcome compared to litigation, the industry expertise of the decision-makers, and the high enforceability of arbitration awards.[29]

2. Parties in Third Party Funding

A funder refers to any person or entity that is contributing funds to the prosecution or defence in the arbitration case and has a direct economic and commercial interest in the award to be rendered in arbitration.[30] The party that seeks fund from an external source is known as the funded party. The funded party may seek funding for several reasons, and the primary one being the mitigation of loss caused by the dispute.[31] The party against whom the funded claim is brought is referred to as the opposing party. The opposing party also aspires to ensure that no jeopardy lies with respect to either the efficiency of the proceedings or the enforceability of the award at a later stage (due to the presence of a funder).[32]

Third-party funding is generally derived from an agreement between the funder and the funded party, who is not a party to a dispute.[33] The expectation of a funder may be in the form of a percentage of the proceeds, a fixed amount, or a combination of these.[34]

3. Assessment of a Claim to Fund

A funder contributes funds to the prosecution or defence. And funding is being implemented in several stages.[35] Generally, funders assess potential arbitration cases based on merits, quantum, and enforceability. For this very purpose, funders conduct evaluations of the case, including legal analysis and financial projections.[36] This is referred as the due diligence process. The following are certain criteria that most funders consider. First is damages.[37] It conducts an assessment of reasonably-to-be-expected damages. Funders make use of these findings on whether the plausible damages value offers a sufficient rate of return or not.[38] For that reason, a good rule of thumb to work on is a ratio of 10 (damages): 1 (funded costs).[39] Second is the budget and Timeline. This includes anticipated attorneys' fees, the fees of any expert(s), translation costs, and the fees and expenses of arbitrators and the expenses of the arbitral institution administering the case, apart from the timeline that outlines the anticipated steps in the process up to the final award.[40] Third is Recoverability. It considers the respondent's financial position and calculates how confident they are that recovery will be possible if the claimant's case is successful.[41] Fourth is the Strength of Legal Claims. It is a summary of the case's facts, affirmative arguments, anticipated counterpoints, and relevant case laws, both for and against the claimant's position.[42] And fifth is Factual Evidence Supporting the Claim. It includes financial statements, transcripts, contracts, lawful recordings, and affidavits.

IV: Issue of NDA clause in TPF

During the process, the funder and the client may enter into a Non-Disclosure Agreement (NDA) to protect the confidential information shared.[43]

TPF is becoming a crucial component of international arbitration practice. And this is well illustrated by the recent ICSID case of Nachingwea and others v. Tanzania[44], where the tribunal's award, delivered in 2023. Tribunal provides partial insights into the regulation of TPF and claims for costs in investment arbitrations. The case raises questions about the implications of TPF on resource-constrained States in navigating disputes involving well- funded claimants in investment arbitration.[45]

Funders have an interest in concealing their identity from the opposing party and the tribunal to protect their interests regarding the terms of the funding agreement.[46] However, ICCA- Queen Mary task force principles on third-party funding create an obligation on one party or its representatives to disclose third-party funding.[47] To prevent a delay in arbitration proceedings that may arise from a conflict of interest between the funder and the arbitrator, which could raise challenges to the arbitrator's appointment.[48] The opposing party may seek disclosure of the funder's identity to ensure that no potential conflict of interest exists between the funder and any member of the arbitral tribunal, thereby preventing a violation of the standard of impartiality and independence required of the tribunal.[49] For instance, situations that may give rise to conflicts of interest where arbitrators act as advisors to funders, and where an arbitrator or an arbitrator's law firm has a recurring relationship with a third-party funder, and the arbitrator or the firm receives income from this relationship.[50]

During the arbitral proceedings, the funded party generally seeks to maintain maximum control over the proceedings and aspires to make independent decisions regarding settlement.[51] And, since the dispute is being funded settlements would be expressed by the funder.[52] Hence, retaining a certain degree of decisional autonomy is one of the main interests of the funded party.

V. Different kinds of Funding

The funded party may opt for a funding agreement, depending on the level of financial assistance required. For this purpose, legal expenses insurance is a common practice. It means that a business takes out insurance policies to cover the legal costs associated with future claims disputed by the insured.[53] In insurance liability, the insurer is under a duty to defend the insured during proceedings (as a result, liability insurance largely covers legal expenses) as well as a duty to indemnify the insured in case of an unfavourable decision.[54] In contemporary times, the ATE (After the Event) and BTE (Before the Event) insurance funding system is considered. It includes various types of legal expenses that cover the costs associated with legal action. In other words, put simply, legal expenses insurance provides cover for the costs of your legal action.[55] However, the funder exercises no control over the management of the arbitration proceedings and has no say in settlement agreements.[56]

A wide range of mechanisms have been developed today to support disputing parties, like contingency fee arrangements, liability insurance, portfolio funding, law firm financing, before-the-event and after-the-event insurance, litigation loans, and philanthropic arrangements.[57] Also, Third-party funding may be structured around a single claim, where funding applies to individual cases, or a portfolio of claims.[58]

VI.
Practical implications of TPF on Agreements and potential challenges in International Arbitration

Imagine that an arbitrator has been appointed by the same funder multiple times in the past. [59]The right to challenge the appointment of an arbitrator is a core principle.[60] This right has been under various institutional arbitration rules[61] and the UNCITRAL Model Law.[62] The principle of procedural fairness and equal treatment of parties is one of the paramount principles of international arbitration. Article 18[63] of the UNCITRAL Model Law, which reads as "[t]he parties shall be treated with equality and each party shall be given a full opportunity of presenting his case", and reflects international due process rights.[64]TPF arrangement could therefore open up a Pandora's Box of potential challenges being made, not just to the arbitrators and the ongoing proceedings, but even to the validity of the award if such discovery occurs after the tribunal renders the award. [65]The TPF approach in England and Wales characterises disclosure of funding arrangements as a "voluntary process", which may only be moderated by an order from the tribunal to disclose the same.[66] Meaning by, unless the tribunal orders for such explicit disclosure, no such obligation rests upon the funded party to provide any notice of such arrangements.[67] Due to lack of any inclusive legal framework for disclosure, such funding arrangements often go entirely undisclosed and undetected.[68] It is an unfair burden placed upon the opposing party, that not only affecting the procedural fairness of the proceedings but also the subsequent enforceability of the award itself.[69]

Lacunae persist in the law of most jurisdictions regarding mandated the disclosure.[70] However, in contemporary times, rules are being place on disclosure. As per Article 44 of the HKIAC Rules, disclosure of a funding agreement (before, or even after the commencement of the arbitration) must be made. [71]A failure to do so may be considered an act of bad faith on the part of the funded party.[72] The tribunal may accordingly choose to exercise its powers to impose sanctions on the funded party at the time of deciding the allocation of costs and attorney fees. [73]A disclosure regime could be enforced in India by amending S.12 (a) of the Arbitration Act. By including the phrase "third-party funders" or "parties with a direct economic interest in the dispute" as persons with whom the arbitrator's relationship must be scrutinised for justifiable doubts as to impartiality and independence. As a result, a relationship with the funder would constitute a potential basis for challenging the appointment of the arbitrator.[74]

VII: Confidentiality in TPF Arbitrations

The principle of confidentiality is one of the cornerstones on which arbitration is strictly based. One of the primary arguments presented by those who oppose the practice of TPF in arbitration is the threat to the confidentiality. This threat to the parties involved and also the funder itself.[75] At the very outset, a substantial amount of information regarding the dispute must necessarily be divulged to the prospective funder. The funder has an equal interest in ensuring that the specific terms of the TPFA remain confidential. This naturally puts the confidentiality of matters concerning the dispute at risk of a potential violation. One of the most important recommendations put forth by the ICCA report[76] was that "in all jurisdictions, a Party seeking funding and its counsel should ensure that a robust NDA is entered into before any substantive discussions with a funder to protect against the disclosure of confidential communications".[77] However, questions at stake relate to whether, how, to what extent and by whom disclosure of third-party funding should be made in order to allow arbitrators, parties and institutions to assess potential or actual conflicts of interest involving funders.[78] Another question is whether disclosure should be limited to the existence and identity of the funder, or it should extend to the terms of the funding agreement. This remains a controversial issue.[79] There is a trend in regulation that requires the disclosure of the existence of funding and the identity of funders. This practice allows arbitrators to make informed decisions regarding conflicts of interest.[80] Accordingly enacted legislation on third-party funding mandates such disclosure.[81]

In practice, Attorney-client privilege is a common law rule. It allows the disclosure of confidential communications between a client and its legal counsel which to be refused to any other person. [82] However, this principle is not always mandatory, and the client may waive this privilege with the funder. Once such privilege is waived, the information becomes discoverable by the opposing side. [83]Since there exist several exceptions to the rule of attorney-client privilege, (like the "common interest" doctrine, whereby, without waiving the attorney-client privilege) disclosures may be made to third parties.[84] England & Wales, Singapore, and Australia have been popularly applied this waiver doctrine to contracts which involving an insurer and an insured.[85]

VIII. Third Party Funding & Awards

The funding arrangements entered into between parties are of relevance at the time of awarding costs and enforcing the award rendered by the tribunal. The tribunal must determine the allocation of costs between the parties, and that is naturally impacted by the existence of any funding arrangements. The tribunal may re-determine and reallocate the costs between the parties. The costs of arbitration are divided into two general categories: Procedural costs & Party Costs. Few studies have found that legal fees account for more than eighty per cent of the total costs of the arbitration. [86]Thus, in such circumstances, it becomes crucial to enable the successful party to recover the costs it has incurred. As per S. 31A (1) of the Act, the tribunal has complete "discretion" order for costs.[87]

Security for costs is an interim measure that may be sought by a party to protect themselves.[88] Security for costs is especially relevant in the case of TPF, as the existence of a TPF arrangement is often considered reasonable grounds to suspect that the party may not have the financial capability to pay an award of costs on its own.[89] However, parties, especially commercial parties, may well choose to avail of TPF simply because of its convenience.[90] To avoid unnecessary ordering for security for costs, many State jurisdictions in India have established a general test for courts and tribunals to apply when determining whether an order for security for costs is required.[91] Order XXV, Rule 1 of the CPC (as amended by Maharashtra, Gujarat, Madhya Pradesh, and Uttar Pradesh) provides that courts have the power to secure costs for litigation by requiring the funder to become a party and depositing the costs in Court.[92] Lastly, one of the greatest concerns that arises with respect to TPF arrangements is that the funder is not a party to the arbitration, and therefore, the tribunal's award does not bind the funder. The tribunal's award is only binding on the parties, but it has no authority over non- parties to the arbitration. [93]Extending the applicability and binding nature of the arbitral award to a non-party would also compromise the general in personam nature of arbitral claims and awards.[94] Based on a global analysis of jurisdictions with well-established TPF frameworks, no special statutory or institutional provisions have been put in place to extend the applicability of the arbitral award to the funder.

IX. Conclusion

TPF in international arbitration is a booming business, primarily driven by the substantial amounts of money involved. TPF in international arbitration allows greater access to justice for litigants that would otherwise have no way of defending their rights; it implies a double assessment that leads to only the meritorious claims, and it levels the playing field among the parties, especially in the earlier stage when settlement is considered. If we consider ethical concerns, promoting transparency and establishing regulatory guidelines serve as a means of greater access to justice and fair resolution of disputes. In fact, TPF presents both opportunities and challenges. By adopting a proactive and thoughtful regulatory approach, TPF can ensure fairness and equity. Improvement in regulatory frameworks, harmonisation of standards across jurisdictions, and leadership by leading arbitral institutions. This further clarifies key issues, including disclosure requirements, cost liability, and the integrity of the arbitral process. Jurisdictional harmonisation may lead to increased international efforts and promote consistency. And at last, TPF will continue to expand into new areas, such as the funding of digital asset disputes.

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