

# Dispute Resolution Hotline

June 03, 2023

## THIRD PARTY FUNDING: IS FUNDER BOUND BY AN AWARD FOR COSTS? INDIAN COURT RULES

- A third party may be bound by an arbitral award only if it has been compelled to arbitrate and is a party to the arbitration proceedings.
- An award for costs cannot be enforced against a third-party funder, who is neither a signatory to the arbitration agreement nor a party to the arbitral award, merely because it funded a party to the arbitration.
- Unlike the UK Civil Procedure Rules, the Indian Civil Procedure Code (except to the limited extent of providing security of costs in certain States) does not contain any provision which contemplates recovery of costs from non-parties to a suit / action. In any case, any such rules would have no bearing while deciding the enforcement of an arbitral award against a non-party to such award.
- Parties and third-party funders should carefully draft their funding agreements to delineate the funder's exposure in the arbitration proceedings.

In **Tomorrow Sales Agency Pvt. Ltd. v SBS Holdings Inc. and Ors.**,<sup>1</sup> the Delhi High Court held that interim relief (at the enforcement stage of an arbitral award for costs) cannot be sought against a third-party funder. The court held that the third-party funder merely provided funding to the Claimants to the arbitration, and was neither a signatory to the arbitration agreement nor a party to the arbitration proceedings.

## FACTUAL BACKGROUND

Tomorrow Sales Agency Pvt. Ltd. ("**Funder**") was approached by the promoters of SBS Transpole Logistics Pvt. Ltd. ("**Transpole**") to fund a claim against SBS Holdings Inc. ("**SBS**"). The promoters alleged that the financial distress of Transpole was a result of SBS's actions. The Funder agreed to fund the claim of approximately INR 2,500 million of the promoters and Transpole against SBS, in an arbitration governed by the SIAC Rules. The Funder and the promoters entered into a Bespoke Funding Agreement ("**BFA**") for this purpose.

Transpole and its promoters were unsuccessful and were directed to pay the costs of the entire arbitration proceedings, including the legal costs of SBS. Since Transpole and the promoters failed to pay the awarded costs and considering that Transpole was financially distressed, SBS demanded that the Funder pay the awarded costs. Accordingly, a petition was filed by SBS under Section 9 of the Arbitration & Conciliation Act, 1996 ("**Arbitration Act**") seeking directions to the Funder to disclose details of its assets and bank accounts and to furnish security for a sum aggregating to INR 96,208,119. ("**Requested Reliefs**").

## Judgment of the Single Judge of the Delhi High Court

Before the Single Judge, SBS argued that the Promoters were directors of companies most of which were struck-off or under liquidation, along with Transpole. Therefore, the awarded costs to SBS were not realizable by the Promoters and Transpole. Further, the Funder had exercised substantial control of the arbitration proceedings and would have benefitted from a favourable result. This was evident from various provisions of the BFA.<sup>2</sup> Resultantly, it had become a "real party" to the proceedings.

The Single Judge accepted the arguments of SBS and ordered the Requested Reliefs on the following grounds:

**First**, a Funder, having financed a litigation for gain, could not escape liability just because the result was contrary to its expectations. Referring to **Arkin v. Borchard Lines Ltd. and Ors.**,<sup>3</sup> ("**Arkin**") and **Excalibur Ventures LLC v. Texas Keystone Inc. and Ors.**,<sup>4</sup> ("**Excalibur**") the Single Judge held that a balance should be struck between "the need to ensure access to justice through funding arrangements, and the cost that a defendant would bear in case the litigation fails due to being found meritless, as in the present case." If not for the funding arrangement, the meritless claim may not have been initiated.

**Second**, since the costs under the award were costs of litigation of the Promoters, these would be recoverable under the BFA. SBS was merely seeking to enforce the award in terms of the BFA. The BFA would not be terminated until the delivery of the award i.e. till costs recoverable under the award are satisfied.

Aggrieved by the judgment of the Single Bench, the Funder filed an appeal under Section 37 of the Arbitration Act.

## Judgment of the Division Bench of the Delhi High Court

The Division Bench set aside the judgment of the Single Judge on the following grounds:

**First**, the Division Bench acknowledged that where the real beneficiaries of the contract (for example, through

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assignment of the benefit) were not parties to the arbitration agreement, such non-signatories could invoke the arbitration agreement since consent could be imputed basis such assignment. After a perusal of precedent on this issue,<sup>5</sup> the Division Bench held that the point here is different – a non-signatory may be made a party to an arbitration proceeding, however, an award can only be enforced against a party to the proceeding.

**Second**, under Rules 7.1 and 7.8 of the SIAC Rules,<sup>6</sup> an additional party can only be joined to the proceedings if: (a) it is prima facie bound by the arbitration agreement; or (b) all parties, including the additional party, have consented to the joinder of the additional party. The Funder could not have been joined as an additional party under either of these grounds. Since the Funder was not - and could not have been - a party to the proceedings, no action of enforcement can be brought against it.

**Third**, the Single Judge had relied on **Gemini Bay Transcription Pvt. Ltd. v. Integrated Sales Service Ltd.**<sup>7</sup> (“**Gemini Bay**”) to order the Requested Reliefs against the Funder. However, the Division Bench distinguished the present case on the ground that in Gemini Bay, the non-signatory which resisted the enforcement of the award was a party to the proceedings and the award was directed against it. Here, the Funder was not a party to the arbitral proceedings, nor was the award directed against it.

**Fourth**, according to the SIAC Practice Note dated 31 March 2017,<sup>8</sup> the tribunal can consider the existence of a third-party funding arrangement while apportioning costs. However, it cannot order costs against the third-party funder itself.

**Fifth**, the Funder denied being indebted to the Promoters. This was evident according to certain provisions of the BFA.<sup>9</sup> Therefore, the existence of an asset which could be attached as part of enforcement proceedings could not be shown.

**Sixth**, Arkin and Excalibur were inapplicable in the present case. Both judgments were founded upon statutory provisions in England, like Section 51(1) and (3) of the Supreme Court Act [now Senior Court Act, 1981],<sup>10</sup> which vested courts with the discretion to determine which party should be liable to pay costs. The procedure to exercise the court’s discretion under Section 51 of the Senior Court Act, 1981 is given in Rule 46.2 of the Civil Procedure Rules, 1997 (“**CPR**”). Rule 46.2 dictates that the person not a party to the main proceedings must be joined to cost proceedings in case the court finds such non-party liable to pay costs. Such power and procedure are absent in India, except to the limited extent of ordering security for costs where there exists an external funding arrangement in certain States.<sup>11</sup>

Further, Arkin and Excalibur concerned cases where costs were imposed by trial courts and not the arbitral tribunal. Since consent is paramount in the realm of arbitration, a third-party funder who was not a party to the proceedings cannot be held liable for an award for costs.

## CONCLUDING REMARKS

The Delhi High Court was quick to point out the distinction in England where third-party funders can be held liable for adverse costs based on statutory provisions, which are absent in India [except to the limited extent of providing security for costs in certain States]. However, when faced with the principle behind holding third-party funders liable for costs in potentially meritless litigations which could not have been pursued but for the funding provided, the Delhi High Court stated that “[t]hird-party funding is essential to ensure access to justice. In absence of third-party funding, a person having a valid claim would be unable to pursue the same for recovery of amounts that may be legitimately due [...] A person without the necessary means would have no recourse, in the absence of third party funders. Third party funders play a vital role in ensuring access to justice.”

This judgment is a welcome step in recognizing the importance of consent and third-party funding in arbitration. However, there may be situations where a respondent is made to incur costs of arbitration and is then rendered remediless due to the incapacity of the judgment/award debtor to pay such costs. Considering the lack of sufficient precedent, it remains open for the Supreme Court of India and the legislature to provide more clarity on exposure of third-party funders to adverse costs in conventional litigations as well as arbitrations. Until then, it is important for parties and third-party funders to carefully draft funding agreements to delineate the funder’s exposure in the arbitration proceedings. A third-party funder who agreed to pay any adverse costs resulting from an arbitration may not be able to avoid its liability to pay such costs under this judgment.

– Ansh Desai , Ritika Bansal & Ashish Kabra

You can direct your queries or comments to the authors

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<sup>1</sup>FAO(OS)(COMM) 59/2023 and CM Nos. 14793/2023 & 14794/2023 (Delhi High Court)

<sup>2</sup>The BFA contained provisions which pointed to substantial control over the arbitration proceedings and that it would have benefitted from a favourable result, like

1. the budget plan could not be exceeded without prior consent of the Funder;
2. the Funder had absolute discretion to halt funding of the arbitral proceedings if the tribunal found that SBS was not a proper party to the proceedings;
3. no settlement could be entered into by the Promoters without informing the Funder;
4. the Funder had an exclusive, unfettered right on the damages recovered and would take precedence over any right of the Promoters.

<sup>3</sup>[2005] EWCA Civ 655

<sup>4</sup>[2016] EWCA Civ 1144

<sup>5</sup>Chloro Controls (India) (P) Ltd. v. Severn Trent Water Purification Inc., (2013) 1 SCC 641; Cheran Properties Ltd. v. Kasturi & Sons Ltd., (2018) 16 SCC 413

<sup>6</sup>Article 7.1 and 7.8 of the SIAC Rules read as –

### Joinder of Additional Parties

7.1 - Prior to the constitution of the Tribunal, a party or non-party to the arbitration may file an application with the Registrar for one or more additional parties to be joined in an arbitration pending under these Rules as a Claimant or a Respondent, provided that any of the following criteria is satisfied:

1. the additional party to be joined is prima facie bound by the arbitration agreement; or
2. all parties, including the additional party to be joined, have consented to the joinder of the additional party.

7.8 - After the constitution of the Tribunal, a party or non-party to the arbitration may apply to the Tribunal for one or more additional parties to be joined in an arbitration pending under these Rules as a Claimant or a Respondent, provided that any of the following criteria is satisfied:

1. the additional party to be joined is prima facie bound by the arbitration agreement; or
2. all parties, including the additional party to be joined, have consented to the joinder of the additional party.

Where appropriate, an application to the Tribunal under this Rule 7.8 may be filed with the Registrar.

<sup>7</sup>(2022) 1 SCC 753

<sup>8</sup>SIAC Practice Note – PN 01/17/31, On Arbitrator Conduct in Cases Involving External Funding, available at <https://siac.org.sg/wp-content/uploads/2022/08/Practice-Note-for-Administered-Cases-%E2%80%93-On-Arbitrator-Conduct-in-Cases-Involving-External-Funding.pdf>

<sup>9</sup>Article 1(C) of the BFA reads as–

The fund provides financial assistance in pursuit of the Claim in accordance with the Budget Plan on a non-recourse basis. In the event that the Claim is not successful the Fund will not seek financial recourse from either the Lawyers or the Claimants for its lost investment.

Article 7(a) of the BFA -

### Duration and Termination

a) This BFA shall become effective upon signing and shall remain in effect until the earliest of the following occur:

1. The Recovered Damages are distributed to the Parties in accordance with the BFA; or
2. The Fund thinks or believes that winning of the Claim is no longer realistically achievable;
3. SBS Japan is no longer a party to the Arbitration; or
4. The Claim is not a Success

<sup>10</sup>Section 51 of the Senior Court Act, 1981 reads as–

### Costs in civil division of Court of Appeal, High Court and county courts.

■ Subject to the provisions of this or any other enactment and to rules of court, the costs of and incidental to all proceedings in—

- the civil division of the Court of Appeal;
- the High Court; and
- the family court;
- the county court,

shall be in the discretion of the court.

■ Without prejudice to any general power to make rules of court, such rules may make provision for regulating matters relating to the costs of those proceedings including, in particular, prescribing scales of costs to be paid to legal or other representatives or for securing that the amount awarded to a party in respect of the costs to be paid by him to such representatives is not limited to what would have been payable by him to them if he had not been awarded costs.

■ The court shall have full power to determine by whom and to what extent the costs are to be paid."

<sup>11</sup>Certain States have amended the provision for security of costs under the Civil Procedure Code, 1908 ("CPC") i.e. Order XXV. In Uttar Pradesh and Madhya Pradesh, Order XXV Rule 1 of the CPC has been amended to require Courts to mandatorily order security for costs if the plaintiff is being financed by another person. In Tamil Nadu and Orissa, Order XXV Rule 1 of the CPC prescribes that where an element of champerty or maintenance is proved, the Court may order the plaintiff to furnish security for the estimated costs of the defendant. Further, in Maharashtra and Madhya Pradesh, Courts can order the funder directly to furnish security for costs under Order XXV Rule 3. It states that where the plaintiff is being financed by another person, such person may be impleaded as a plaintiff to the suit (or a defendant if he declines to be added as a plaintiff) and the Court may order such third-party financier to furnish security for costs. In the event the funder does not furnish security, the Court may make an order declaring that he shall be debarred from claiming any right to or interest in the property in the suit.

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