Light the beacons – it is time to test third-party funding in India

Non-recourse third party funding of disputes, where an investor / funder invests in, or provides funding by way of monetary support to a litigant for pursuing and often, also enforcing a claim in exchange for a share in any ensuing award or settlement, has emerged as something of a global phenomenon in recent times.¹ From the funder’s point of view, it is an investment exactly because it is "non-recourse", as the investor recovers its investment only upon a successful outcome of the litigation (which is the asset), and not otherwise.

Generally litigation financing (as it is also called), takes two forms:

- Funding of fees and expenses that are incurred by the litigant in the pursuit of their claim (through court proceedings or arbitration, which funding is advanced as and when required, to reimburse such fees and expenses.
- Monetisation of the claim or award, by making payment of the entire funded amount in advance of the outcome of the claim.

In either case, the investor, viz. the funder, takes the entire risk of the outcome of the proceeding. Through finding value in contingent assets such as claims and awards, litigation finance offers businesses unique means by which to manage, and in some cases overcome, the limitations and risks inherent in enforcing rights through legal proceedings.

The state of play in India:

While there is no specific legislation dealing with third party funding in litigation in India, an unorganized secondary market for decrees and claims has existed for decades. The most vocal opposers to the legality of litigation funding rely on the principles of champerty and maintenance, concepts first introduced in medieval England, mainly to prevent abuse of justice and vexatious litigation by corrupt nobles and royal officials who put their might behind often frivolous claims, in consideration for a share of the proceeds.

As early as 1876, the Privy Council² observed that the English law principles of maintenance and champerty were not applicable to India, and a fair agreement to advance funds to pursue a suit in consideration of a share in the claim is not opposed to public policy.³ Similarly, in 1939, it held that an agreement between a disputant and a third party to finance the cost of litigation in consideration for a share of the proceeds arising out of said litigation, was not per se illegal.⁴

¹ Report of the ICCA-Queen Mary Task Force on Third-Party Funding in International Arbitration, April 2018
² Decisions of the Privy Council (pre-independence), are binding on Indian courts today, unless they conflict with any decision on the same issue by the Indian Supreme Court
³ Ram Coomar Coondoo v. Chunder Cato Mookerjee [1876, Privy Council]
⁴ Ram Sarup v. Court of Wards [1939] ILR 1 (PC)
The legality of third party funding per se, is however subject to the contract itself not being opposed to public policy. In that respect, the 1876 Privy Council decision (supra), also observed that a funding agreement that is extortionate, unconscionable, inequitable, for improper objects, as for the purpose of gambling in litigation, or of injuring or oppressing others by abetting and encouraging unrighteous suits, would be contrary to public policy.

The permissibility in India of third party funding, (as long as the third party is not the lawyer handling the case), has been acknowledged in several cases. The Supreme Court in Bar Council of India v. A.K. Balaji (a decision known more for the restriction on foreign lawyers practicing in India), t noted (in obiter), that “there appears to be no restriction on third parties (non-lawyers) funding the litigation and getting repaid after the outcome of the litigation”. 5

The Code of Civil Procedure, 1908 (“CPC”) as amended for the State of Maharashtra, deals with the power of a court to impale and demand security from a third person financing litigation – an assumption that such financing is permitted. 6 The amendment, which empowers a court to impale the financier as a plaintiff to the suit in certain circumstances, and to give security for the payment of all costs incurred and likely to be incurred by any defendant, has since been adopted in the States of Madhya Pradesh and Gujarat as well.

India’s Arbitration and Conciliation Act 1996 (the “A&C Act”), as amended in 2015, inserted the 5th and 7th Schedules which set out a list of circumstances which would guide in determining whether there may be justifiable doubts as to the independence or impartiality of an arbitrator. The Schedules recognise situations where “the arbitrator or a close family member of the arbitrator has a close relationship with a third party who may be liable to recourse on the part of the unsuccessful party in the dispute”,7 in which case, the arbitrator is ineligible to act unless there is an express waiver of this condition. One more indication that there may be cases that are funded by a party not otherwise concerned with the dispute.

The Indian Government having recognised that increasing efficiencies in arbitration and strengthening the enforcement process would increase its attractiveness as an investment destination, has taken various initiatives to strengthen the regime for enforcement of contracts. The High Level Committee set up by the Government to prepare a roadmap for making India “a robust centre for international and domestic arbitration”, suggested progressive amendments to the A&C Act, including legislation to regulate third party funding. The Committee noted global developments, including the recent legislations issued in Hong Kong and Singapore, expressly legalizing third party funding for arbitration and related proceedings. Unfortunately, this recommendation did not culminate in consequential amendments.

Contingency fees:

A big differentiator between India and other major jurisdictions in which litigation funding is an accepted practice, is the ability of attorneys to work on a contingency or success fee basis.

Chapter II of the Bar Council of India Rules prohibit an advocate from stipulating a fee contingent on the results of litigation or sharing the proceeds thereof. Various decisions of superior courts in India have taken the view that contingency fee arrangements fall foul of India’s public policy because they compromise on a lawyer’s ability to render professional services in line with the standards of the bar. 8

The Supreme Court considered a case where ‘Mr. G’, a lawyer had funded his client in a litigation in consideration for 50% share of the amount recovered. 9 Observing that a contract of this kind would be legally unobjectionable if no lawyer were involved, the Apex Court confirmed the view taken in re N. F. Bhandara,10 that for an advocate to stipulate a remuneration proportioned to the results of litigation, is reprehensible, and by so acting, he would offend the rules of his profession and so render himself liable to the disciplinary action. Mr. G was ultimately suspended from practicing for some time.

5 (2018) 2 SCC (LS) 39 @ para. 35
6 Order XXV, Rule 3, CPC
7 Taken from Paragraph 2.2.3 of the Waivable Red List of the IBA Guidelines on Conflicts of Interest in International Arbitration, 2014
8 See for instance, Ganga Ram v Devi Das, 61 P.R. 1907
9 In Re: Mr. ‘G’, A Senior Advocate, 1955 1 SCR 490
10 3 Bom. L.R. 102
Indian law firms have been lobbying for some years now, for the lifting of some archaic restrictions in relation to their fees to enable them to be competitive on the global stage. Both Singapore and Hong Kong are seriously considering permitting lawyers to offer conditional fee arrangements. With legal fees and costs anticipated to become a major pressure-point in the post-COVID world, the biggest business challenge for Indian lawyers to compete globally, will be to offer more flexible terms, in the teeth of domestic professional regulations.

**Cases amenable to funding:**

History is replete with tales of farmers (who eke a hand to mouth existence), taking loans from their local money lender at usurious rates to pay for litigations regarding disputes over their property. Often unable to repay the loan, the land is confiscated along with their only means to livelihood. Clearly, funding for such litigations should not and will not, be permitted (nor would a sophisticated funder be interested in the poor farmer – but that is another story).

For a vast and emerging economy like India, with more than a billion people, the importance of infrastructure and connectivity cannot be overstated. The number of infrastructure projects (many of which are public-private partnerships) has been increasing exponentially. Foreign direct investment through equity inflows in India over the last decade were approximately US$ 456.79 billion.11 Not surprisingly, the number of disputes with massive claims, are also on the rise. Most commercial contracts contain provisions for arbitration and these disputes (where a monetary award is usually the primary remedy sought) are most conducive for third party funding. Similarly, commercial litigation claims with a reasonably good chance of success, against solvent respondents, would be interesting to funders.

As it attracts more investment and as companies begin to invest in other countries, India and Indian companies have been involved in more treaty disputes (usually conducted under UNCITRAL Arbitration Rules, as India is not a signatory to the ICSID Convention).

Another area to watch is the class action regime introduced in the Companies Act, 2013, for the protection of minority interests in a company.12 Individual complainants who may not have the resources to initiate individual proceedings may join together as a class, benefitting from economies of scale and costs to seek reliefs, including monetary compensation or damages.

The relatively recent Insolvency & Bankruptcy Code, 2016 (“IBC”), overhauled the regime in relation to winding up of companies. Litigation finance first emerged in Australia as a solution to claimants in bankruptcy, enabling them to recover high-value claims for which they were unable to bankroll legal expenses. In India, the resolution professional is entitled to file or take over proceedings filed by the corporate debtor for recovery of claims. These claims, or a portfolio of such claims, would be a viable proposition to funders.

**The practicalities and the uncertainties:**

India is a jurisdiction that quick to regulate every sector. The lack of a regulatory framework in place could create problems for a foreign funder who intends to repatriate its recovered investment out of India.

From the foreign exchange perspective, it is not fully clear whether a funding transaction, and a repatriation of proceeds of recovered claims, is a capital account transaction (a transaction which alters the assets or liabilities, including contingent liabilities, outside India of persons resident in India), for which approval of the Reserve Bank of India (the “RBI”), is required, or a current account transaction (a transaction other than a capital account transaction, including a payment due in connection with foreign trade, other current business, services and short term banking and credit facilities in the ordinary course of business), for which no approval is required. Non-recourse litigation financing being an unnamed beast as yet, one can expect that an authorised dealer would refuse to remit funds without RBI approval, and that the RBI would be unlikely to give such approval, in the absence of clear regulation.

For the ambitious funder who is willing to set up a domestic fund and avoid the uncertainties around repatriation, there is also no clear path. An obvious thought would be to set up an Alternative Investment Fund, i.e. a fund established/incorporated in India as a privately pooled investment vehicle to collect funds from sophisticated investors, whether Indian or foreign, for investing in accordance with a defined investment policy. However, claims and litigations are not investments envisaged under the relevant Regulations.13

Even assuming that repatriation is permitted in the future, the funder will have to account for Indian tax authorities seeking to tax as income, profits received by the funder on its funding / investment.

The issue of enforcement too needs consideration. Though huge strides have been made by the Government in terms of speeding up and streamlining the litigation process, including by way of setting up of specialised Commercial Courts to deal with commercial disputes, the

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12 Section 245 of the Companies Act, 2013
13 SEBI (Alternative Investment Funds) Regulations, 2012
challenge and appeal process can consume several years till ultimate enforcement. This uncertainty is a worry for foreign claimants and funders alike, but having taken note of the problem, Indian courts are now consciously pro-enforcement, including by penalising frivolous challenges with costs.\textsuperscript{14}

The issues and questions raised above are not unique to India and have been faced by several jurisdictions before third party funding was regulated in some way. The time is however ripe and we are fielding more and more questions from Indian clients inquiring whether their claim could be an opportune case for litigation financing.

For the moment, in view of the gaps in the regulatory framework, most funding arrangements take place off-shore, i.e. by Indian claimants who have off-shore arbitrations against off-shore respondents, or foreign claimants against Indian respondents who have off-shore assets, so that all recoveries and payments can be made outside India.

The way forward

Given the hints spread across India’s statute book about the legality of third party funding, and the experience of leading common law jurisdictions, there is little cause to delay officially acknowledging / clarifying its legality in India (and indeed a compelling case in favour of making it available at the earliest, as a tool for litigants to cope with post-COVID markets). The lessons from other jurisdictions are already out there today, to ensure we learn what we can, through vicarious experience.

By virtue of sustained business reforms (along with its ‘Make in India’ campaign), over the past several years, India jumped several places, to 63rd, in the World Bank’s Ease of Doing Business rankings for 2020.\textsuperscript{15} Some of the critical reforms included an overhaul of the arbitration regime, introduction of the IBC and setting up specialised Commercial Courts, recognising that in order to become an attractive investment destination, a robust framework for dispute resolution and enforcing contracts was critical. Facilitating the financing of specific types of disputes, would only further India’s agenda, bringing in funding for Indian claimants, who could then better utilise their revenues for expansion of operations rather than expensive litigations.

Nonetheless the potential impetus to arbitration would make it the perfect testing ground for formally rolling out a framework for litigation funding in India. Commercial arbitration is also the ideal guinea pig because India’s arbitration regime is already in line with international standards – the A&C Act is based on the UNCITRAL Model Law on International Commercial Arbitration and it is a signatory to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (commonly known as the New York Convention). This makes learnings from other jurisdictions more immediately transferrable.

Commercial arbitration is also a purely private means of dispute resolution, which would allow India to take a more considered decision when finally progressing to approving financing of commercial litigation.

There is every reason for the Indian Government to welcome third party funding and other litigation finance innovations, on the basis of global best practices and experience. The easiest way to do this would be to start with international commercial arbitration and then roll it out when ready, to other aspects of dispute resolution. This is an opportune and existential time all at once, and India should act now.

\textsuperscript{14} Vijay Karia v. Prysmian Cavi E Sistemi SRL, 2020 SCC OnLine SC 177  
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