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Litigation Funding

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Abstract

India's emergence as one of the top five economies in the world made it one of the most preferred destinations for foreign investment in recent years. However, disturbances and uncertainties brought by the COVID-19 pandemic could give rise to a new wave of litigation.

Due to widespread economic distress, parties to such disputes may find themselves unable to bear the high costs of litigation or arbitration. India is but a cost-effective jurisdiction for litigation and dispute resolution.

Shortage of resources triggered by the COVID-19 pandemic has already made business operations for industries extremely onerous. Businesses are combating shrinking balance sheets and sudden reduction in the available credit. These factors could increase opportunities for litigation funding and for funders to help businesses pursue their litigation claims through the Third Party Funding route.

This article discusses on the emerging trend in litigation where third parties fund the litigants to bear the expenses incurred while conducting the litigation proceedings. Then the article highlights the complexities that are created when third party funding is opted by the litigants and further concludes by discussing the way forward.

Keywords: *Third Party Funding, Legal financing agreement, Doctrines of maintenance and champerty, Public policy*

I. Introduction

Third Party Funding (TPF) is an agreement whereby an entity who is not party to a dispute agrees to provide a party, an affiliate of that party, or a law firm representing that party, funds or other material support in order to finance part or all of the cost of the proceedings, either individually or as part of a specific range of cases. Such support or financing is either provided in exchange for remuneration or reimbursement that is wholly or partially dependent on the outcome of the dispute, or provided through a grant or in return for a premium payment.

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Over recent years, the concept has attained global impetus and jurisdictions such as Australia, Germany, United Kingdom, Singapore, and Hong Kong have taken steps to abrogate the legal barriers associated with TPF. Evidently, these jurisdictions have acknowledged the benefits associated with the concept, which include enhanced capital, effective recovery mechanism, and facilitating access to justice etc.

ORIGIN OF TPF: MAINTENANCE & CHAMPERTY

At its inception in the UK, TPF was intended to facilitate access to justice for poor litigants. However, the practice witnessed abuse in medieval times by powerful English barons. Buying weak claims as a gamble in litigation, usurping claims in the hope of power-based success; wanton and officious intermeddling or control over others disputes without any interest therein; inflating damages, suppressing evidence and suborning witnesses for personal gain gave rise to doctrines of maintenance and champerty.

Maintenance is defined as the giving assistance to a party by a person who has neither an interest in the action nor any other motive legally / lawfully justifying interference. Champerty is a particular kind of maintenance in consideration for a share of the proceeds if the action succeeds. Founded on considerations of public policy, the actions constituting maintenance and champerty attracted criminal and tortious liability in England and Wales.

II. TPF IN THE INDIAN SCENARIO

Third-party litigation funding is permitted in India. The concept of third-party funding is statutorily recognised under the Civil Code of Procedure, 1908 in some states (eg, Maharashtra, Gujarat, Madhya Pradesh and Uttar Pradesh) by their respective state amendments to Order XXV rules 1 and 3 of the Civil Procedure Code, 1908 (CPC). Therefore, the permissibility of third-party funding in India can be adduced from the CPC. Even though the remaining states have not statutorily recognised the concept of third-party funding, there is no express bar under any legislation against the same.

As on date, there is no piece of legislation that limits or regulates third-party funding for litigations and arbitrations in India. However, the terms of the contract entered into for the purpose of third-party funding are subject to scrutiny and review by the courts. The terms of such contracts have been subject to judicial scrutiny since 1867 in the case of *Ram Coomar Coondoo v Chunder Canto Mookerjee*.[2] The Privy Council in this case acknowledged that a fair agreement to supply funds to carry on a suit in consideration of having a share of the

[2] Ram Coomar Coondoo v Chunder Canto Mookerjee (1876-77) 4 IA 23

property, if recovered, may not be opposed to public policy. However, the Privy Council did caution that such agreements, if found extortionate and unconscionable, not made with the bonafide object of assisting a claim believed to be just, for improper objects, as for the purpose of gambling in litigation, ought not to be effectuated being opposed to public policy. Hence, the agreements for third-party funding must be entered into with good conscience and the courts may limit the fee or interest being charged if the agreement is contrary to these principles. The Courts in India are wary of these agreements being used as a tool of vendetta against a specific individual or entity.

The Supreme Court of India in *Re: 'G', A Senior Advocate of the Supreme Court,*[3] expressed that the rigid English rules of champerty and maintenance do not apply in India. If there is an agreement of the nature of a TPF, it could be legally enforceable and good. Though the question was not directly before Court, it can be deduced from the Court's observations that there is nothing morally wrong, nothing to shock the conscience, nothing against public policy and public morals in a TPF arrangement per se.

A Division Bench of the Kerala High Court in *Damodar Kilikar and Ors. v. Oosman Abdul Gani,*[4] considered the question as to whether champerty agreements are illegal in India. The Court held that if no advocates are involved in the agreement, the agreement does not become illegal or enforceable in India for the sole reason that the same is champerty.

Further the Supreme Court in *Bar Council of India v. AK Balaji*,[5] acknowledged that funding of litigation by advocates in India may be impermissible and observed that however, there appears to be no restriction on third parties (non-lawyers) funding the litigation and getting repaid after the outcome of the litigation. The Court also noted that the United Kingdom and United States of America are open to the concept of third-party litigation funding and legal financing agreements.

In a country like India, where there is liberalisation of economic policies and doors are thrown open to foreign investments, disputes and differences are bound to arise between parties. In fact, it is this upward graph of economic activities of recent years that has led to India becoming one of the most upcoming hubs for commercial arbitrations. As a result, it cannot be denied that India eventually would need a comprehensive and progressive legal framework that would support convenient dispute-resolution, providing for maximum judicial support for arbitration and minimal intervention. However, it is well-established law in India

[3] Re: 'G', A Senior Advocate of the Supreme Court, 1955 1 SCR 490
[4] Damodar Kilikar and Ors. v. Oosman Abdul Gani, 1961 KLJ 356
[5] Bar Council of India v. AK Balaji, AIR 2018 SC 1382.

that advocates are expressly barred from funding any sort of litigation and / or arbitration when representing a party in the underlying dispute. This in turn could raise eyebrows for funders that seek contingency fees of legal counsel as a critical factor to determine an investment decision.

III. INTRICACIES ASSOCIATED WITH TPF

While there appears to be no legal bar to a third party funding arrangement, yet in India, there could be certain intricacies associated with such arrangement.

a) Public Policy considerations

For one, the rules of public policy do not belong to a fixed or customary law. The question whether a contract is opposed to public policy or not is to be decided on general principles only. Public policy could include violation of a statute and whatever is against the good morals when made the object of a contract.

b) Mere right to sue

In addition to the argument that the agreement is opposed to public policy, one could argue that a particular arrangement is nothing but a clothed assignment of a mere right to sue which is prohibited by Section 6(e) of the Transfer of Property Act, 1882.

In *Union of India v. Sri Sarada Mils Ltd*.[6], the Supreme Court observed that claims to damages for breach of contract or claims to damages for tort and assignment of the mere right of litigation, are bad. The reason behind the rule is that a bare right of action for damages is not assignable because the law will not recognize any transaction which may savour of maintenance or champerty. It is only when there is some interest in the subject matter that a transaction can be saved from imputation of maintenance. That interest must exist apart from the assignment, and to that extent, must be independent of it.

c) Conflict of Interest

A third party funder could have a pre-existing relationship with a member of the Arbitral Tribunal, in which case the independence and impartiality of an arbitrator may be challenged if such factum comes to the knowledge of the opposite party. From the Fifth Schedule of the Arbitration and Conciliation Act, 1996 (as amended), which considers an arbitrator's indirect interest, one can deduce that it may envisage TPF.

[6] Union of India v. Sri Sarada Mils Ltd, 1973 AIR 281

d) **Confidentiality**

The Arbitration and Conciliation (Amendment) Act, 2019 has inserted Section 43A which obliges the parties and the Tribunal to maintain confidentiality of all arbitration proceedings. Though the said provision is yet to be notified, in a given circumstance, the possibility of the opposite party alleging breach of confidentiality on account of such TPF arrangement cannot be ruled out.

e) Qualifications & conduct of third-party funders vis-à-vis the party receiving the funding

Another aspect of TPF that requires regulation is the qualification and conduct of such third-party funders vis-à-vis the party receiving the funding, as well as the adjudication process. In England and Wales, for instance, a code of conduct is administered for litigation funders, requiring the funders, among other things, to 'act reasonably', resist from withdrawing such funding except under certain specific circumstances, maintain confidentiality, and not take control of the litigation or settlement negotiations. Similar regulations governing conduct and qualification of third party funders have also been introduced in Singapore and Hong Kong.

In the absence of such regulatory checks being in place in India, there will always be a looming threat of parties receiving TPF here being exposed to issues relating to dilution of autonomy, breach of confidentiality, and discouragement of a potential settlement process.

IV. TPF AS THE WAY FORWARD?

As already highlighted, some states in India including Maharashtra, Gujarat, Madhya Pradesh, Uttar Pradesh, Andhra Pradesh, Orissa and Tamil Nadu have expressly recognized TPF after bringing in an amendment in Order XXV Rule 1 of the Code of Civil Procedure, 1908, which empowers the courts to secure costs for litigation by asking the financier to become a party and depositing the costs in court. Taking a cue, infra majors like Patel Engineering and Hindustan Construction Company have already secured TPF with regard to their pending claims in arbitrations. The primary objective appears to be to ease their leveraged positions. It is thus evident that TPF is now emerging as a preferred route for tackling stress in debt-laden engineering and construction companies.

The uncertainty looming over market conditions resulting from the COVID-19 pandemic, along with the global economic slowdown, could dissuade claimants having meritorious claims from pursuing these on account of a financial crunch. Dispute financing as a mechanism in the present economic scenario could aid small companies and other claimants facing hardship in meeting their general operating expenses or expanding their business by infusing the capital saved on litigation.

V. Conclusion

The growth of TPF in India is still at an embryonic stage. Yet, it has the potential to grow manifold in light of the COVID-19 pandemic, which may drive many businesses to the verge of bankruptcy. These businesses will thence explore the means to recover their receivables. Banks and other institutions which are not affected by the erratic market conditions can aid such businesses, in the bargain, making India an attractive dispute resolution hub.

The practicalities associated with implementing TPF mechanisms into and outside India, could also involve an examination of the Foreign Exchange Management Act, 1999 (‘FEMA’) and rules and regulations thereunder.

The asset class of litigation finance is still in a nascent stage in India, owing to both lack of a regulatory regime surrounding this process as well as scepticism associated with businesses in identifying and engaging litigation finance firms.

Having said that, global litigation financiers are planning to enter the Indian market, anticipating a rise in contractual disputes and bankruptcy related cases. Some of the funding firms have also expressed their inclination towards collaborating with law firms to set up an Indian Association for Litigation Finance to promote their business in the country.

One can therefore hope that the government proactively engages with stakeholders on evolving a robust mechanism to support the TPF infrastructure in India and eliminate the ambiguities associated with this concept in the current regulatory environment.

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