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Third Party Litigation Financing: Asset or Liability

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ABSTRACT

The people focus on problems faced by litigants due to cost of litigation and the possible solutions available. It is important to study the gap between affordability of a litigation and the possible benefit from the outcome of a case or suit as in some cases it is the difference between access to justice. A third party is a party that is not involved in the matter or an outsider. When a third party independently provides funds to parties for a dispute in exchange of any fraction of monetary rewards that's recovered from the proceedings is called Litigation Financing. This paper intends to draw a direct connection between litigants dropping their cases or withdrawing their cases or not pursuing their cases in the 1st place because of high litigation cost and there am inability towards litigation financing as a solution to the predicament of high litigation costs. Third-party litigation funding is legally recognized in India. The concept of third-party funding is allowed under the Civil Code of Procedure, 1908 in some states. Financiers are fascinated towards new business openings, Litigation Funds anticipate on the high-stake legal proceedings, they support the expenses of a litigation and in return they reap the yield of the proceedings.

Article 39A of the Constitution of India provides that the State shall secure the operation of the legal system should promote justice on a basis of equal opportunity, and shall in particular, provide free legal aid service, by suitable legislation or schemes or in any other way, to ensure that opportunities for securing justice are not denied to any citizen for the reason of economic or any other disability. It is an interesting concept and practiced globally. Though, it is not prohibited in India but there is a necessity of a dedicated regulation through laws, rules and directives that can govern TPF.

I. INTRODUCTION

The people focus on problems faced by litigants due to cost of litigation and the possible solutions available. It is important to study the gap between affordability of a litigation and the possible benefit from the outcome of a case or suit as in some cases it is the difference

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between access to justice. The concept of litigation financing is not new however is vastly unexplored and comparatively less exploited. There are studies that have addressed the problem of litigation costs and there are other studies that have proposed litigation financing however this paper suggests litigation financing as a prime solution to the problem of litigation costs.

A third party is a party that is not involved in the matter or an outsider. When a third party independently provides funds to parties for a dispute in exchange of any fraction of monetary rewards that's recovered from the proceedings is called Litigation Financing. It is also referred as Third-Party Funding (TPF). This type of funding or financing adjudges the value of legal claims even before they can be adjudicated upon and recovered before a court or tribunal. Many times, right to justice is impeded because meritorious claims are delayed or dropped due to high costs of litigation. Litigation funding helps parties understand the full potential of their claims and dissuade long-drawn-out litigation process. As funders analyse the claims using different methods to know its actual worth and potential.

This funding not only gives confidence to parties to approach best of legal talents but also allows them to pursue any legal claim without compromising their existing income and expenditure flow. However, financiers who may benefit from this new asset class can earn enormous returns in comparison to other investment options within the same time frame. Litigation funding has become a rather common way in jurisdictions like United States of America, United Kingdom and Singapore.

II. THE STUDY

This paper intends to draw a direct connection between litigants dropping their cases or withdrawing their cases or not pursuing their cases in the 1st place because of high litigation cost and there an inability towards litigation financing as a solution to the predicament of high litigation costs. There are diverse samples in terms of gender, occupation, age and geographical location in the survey conducted and after the survey as well as reviewing the existing literature, the paper attempts to draw a wholesome image of litigation costs being a problem and litigation financing being a solution among many. The paper is focused on this social legal aspect of litigation financing as a solution to high litigation costs and an investment opportunity to be exploited by the multi asset fund investors.

The results of the study conducted through the questionnaire is provided in *Appendix – II* of this paper.

Which clearly depicts that the current legal as well as financial scenario of the public

supports Third-Party Funding for Litigations. The structure of the funding may differ as per the need and provisions of law but the utility and demand can be seen.

Methodology

The data for this paper has been collected through an online floated multi-tiered questionnaire provided in *Appendix – I* of this paper. The data collected has been instrumental in understanding the need of Third-Party Litigation Funding and the public's susceptibility towards such options.

III. LITIGATION FINANCING IN ACTION

As infrastructure companies struggle in India with stressed assets and massive imminent claims, there was the case of Patel Engineering, which had set an example in litigation funding. The Hindustan Construction Company (HCC) and Era Infra Engineering were also walking the same path to look for litigation funding.

HCC has been involved in long-drawn arbitrations with different government entities and public sector utilities such as the National Highways Authority of India (NHAI) and the National Thermal Power Corporation Limited (NTPC) amongst others. In order to tone down the resulting damage placed on its finances, HCC announced that it shall be conveying all its beneficial interests and rights in a pool of claims and arbitration awards, amounting to a value of roughly Rs 2,000 crore, to an SPV controlled by a consortium of funders led by BlackRock. As concern for this assignment, HCC will receive Rs 1,750 crore as litigation capital from this consortium.

Irrespective, of the participation of the entities, the type of the transaction is in the form of contingent contract, where all the profits are dependent on the allotted claims. The one inevitable backdrop is the fact that if the party loses, there will be no return in the investment. In addition to that, the investor/financier/funder might also not obtain any compensation because of the financial distress of the Company.

This is generally the longest part of the paper. It's where the author supports the thesis and builds the argument. It contains most of the citations and analysis. This section should focus on a rational development of the thesis with clear reasoning and solid argumentation at all points. A clear focus, avoiding meaningless digressions, provides the essential unity that characterizes a strong education paper.

Laws

Third-party litigation funding is legally recognized in India. The concept of third-party

funding is allowed 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 of the Civil Procedure Code, 1908² (CPC). Hence, the authorization of third-party funding in India can be illustrated from the CPC. Although the remaining states have also not expressed any bar under any legislation against the same.

Judicial precedents in this regard goes back to 1876, when the Privy Council, in the case of Ram Coomar Coondoo vs. Chunder Canto Mukherjee³ revealed the tenuous link between the torts of champerty and maintenance and their impact on public policy. It held that:

“a fair agreement to supply funds to carry on a suit in consideration of having a share in the property, if recovered, ought not be regarded as, per se, opposed to public policy...But agreements purporting to be made to meet such cases, when found to be extortionate and unconscionable so as to be inequitable; or to be entered into for improper objects...are contrary to public policy and ought not to have effect given to them.”

The above observation was upheld in the judgment rendered in the case of Kunwar Ram Lal vs. Nil Kanth⁴. Furthermore, in the case of Lala Ram Sarup vs. Court of Wards and Ors.⁵, the Privy Council made mention of the unpredictable nature of ‘agreements of finance’ but ultimately they held as follows:

“Champertous agreements are in their essence speculative and the fairness of a particular bargain is almost always open to some debate...and where [the concerned parties] have viewed the probabilities in a manner which has not operated unfairly, it is more reasonable to regard this as confirming their shrewd estimate of chances than to condemn the agreement outright as unfair, by reason only of the possibility that a great gain to the claimant would have to be shared with the financier...the uncertainties of litigation are proverbial; and if the financier must need risk losing his money he may well be allowed some chance of exceptional advantage.”

More recently, the Supreme Court in the case of Bar Council of India vs. A.K. Balaji and

² Act No. 05 of 1908

³ [1876 PC 19]

⁴ 1893) L.R. 20 I.A. 112,

⁵ AIR 1940 PC 19

Ors⁶, acknowledged that “there appears to be no restriction on third parties funding the litigation and getting repaid after the outcome of the litigation.”

While stating the above, the Apex Court made sure to strengthen the established fact that funding of litigation by advocates on behalf of their clients would be unethical and would come under foul play and violate of the code of conduct that each lawyer in India must adhere to. In *Re: Mr. ‘G’, A Senior Advocate of the Supreme Court*⁷, the Supreme Court unequivocally held that a profit-sharing arrangement between an advocate and his client would amount to professional misconduct.

The above instances lay credence to the steady evolution and even slower acceptance of TPF arrangements in India, wherein other jurisdictions are witness to these agreements on an every-day basis. It becomes crucial to note however that litigation in India can be an arduous and long drawn process and might work as a discouraging factor for TPF transactions due to the risks involved. On the flip side, a strong case can be made for making TPF arrangements the mainstay of arbitrations, which are much more streamlined and operate under strict, statutorily mandated timelines.

IV. PRACTICAL APPLICATION

Financiers are fascinated towards new business openings, Litigation Funds anticipate on the high-stake legal proceedings, they support the expenses of a litigation and in return they reap the yield of the proceedings. They exhibit their interest in the disputes which are connected to Commercial Contracts, Commercial Arbitration, infrastructure, tortious claims like medical malpractice and personal injury claims, anti-trust proceedings, insolvency proceedings, and other like claims that mainly have an estimated chance of winning substantial monetary awards as damages of compensation. When clients suffer loss in the proceedings, they also don't receive anything. The Financiers investment seems to be based on computations of winning the pecuniary awards. Hence, the claimants who have a chance to be credited with a substantial settlement or award (if they win), make the best recipient of the Third-Party Funding (TPF).

Thus, for the flourishing boost up of the TPF capital, the litigating parties, according to its case, generally advance the funders a premium. On this, the assertion of the party, alongside the due diligence on the part of the funders, the value of the suit is appraised thoroughly. The litigating parties have to deliberate over their cause based on the laws, rules and command or

⁶ AIR 2018 SC 1832

⁷ AIR 1954 SC 557

the authority which the financiers may hold in lieu of the legal representation or the stakes that could be claimed from them in reward granted by the Court/ Tribunal.

There can be 3 structures by which TPF can be done:

1. The funders are allocated the claims by the party in itself.
2. The funders are allocated the proceeds of the claims by the party.
3. The party could direct the claim in the trust in which the investor/financier/funder is a beneficiary.

Meanwhile, it seems unfavourable to structure the transaction as a loan since the litigant who lost shall have a duty to repay the whole advanced amount. Besides, at this point the claims are already fixed, while a debt involves interest rate and a maturity period.

Investor/financier/funder's Focus⁸

The investor/financier/funder may generally focuses on six essential criteria when assessing a claimant-side of litigation funding prospects:

1. Merits of the Claim - The scope of the investor/financier/funder's review will be dependent mainly on the type of case, the significance of the action, the complications of the issues concerned, the setup of the diligence materials and litigation counsel's capability to concisely articulate its case.
2. Claimant - Claimants and their counsel should also understand that the investor/financier/funder along with analysing the merits of the case is also assessing the claimant as well. How involved claimant is in the dispute, as it will help the investor/financier/funder consider if the parties are likely to act reasonably when discussing settlement offer.
3. Claimant's Legal Representation - The investor/financier/funder should also review the experience of the legal team working on the case and engagement agreement with the claimant to understand the economics of the strategy and analyze if the interests of the claimant and its law firm are aptly aligned.
4. Litigation Budget - Litigation funding proposes a predetermined assurance of capital to pay for fees and expenditures in relation to the litigation. Investor/financier/funder will rely on the claimant or counsel if there is an overrun of the anticipated budget.

⁸ <https://www.mondaq.com/india/trials-appeals-compensation/957212/litigation-financing-general-perspective>
last accessed on 08.02.2021 at 12:03AM

5. Expected Damages - The size of a potential award will need to be enough to provide the investor/financier/funder with a return to equal the investment risk and cover the charge of running the chances through the investor/financier/funder's meticulous diligence and transactional practice.
6. Respondents and Recovery - The worst-case scenario for a investor/financier/funder is to fund a litigation that sails through the trial, concludes with a successful verdict, having an attractive judgement or award, but the recovery cannot be proceeded with because the respondent is insolvent or judgment-proof.
7. Quicker Solutions - Funders want to be invested in cases that can have quick resolutions. They are not willing to be part of the cases that have the chances of a prolonged legal battle. As it will increase the uncertainty factor and at the same time impede their chances of earning costs.

V. OTHER SOLUTIONS

Article 39A of the Constitution of India provides that the State shall secure the operation of the legal system should promote justice on a basis of equal opportunity, and shall in particular, provide free legal aid service, by suitable legislation or schemes or in any other way, to ensure that opportunities for securing justice are not denied to any citizen for the reason of economic or any other disability. Articles 14 and 22(1) of the Constitution of India also make it obligatory for the State to ensure equality before law and a legal system which promotes justice on a basis of equal opportunity to all. Legal aid strives to guarantee that constitutional pledge is fulfilled in its letter and spirit and equal justice is made accessible to the poor, downtrodden, subjugated, exploited and weaker sections of the society.

To provide free Legal Services to the weaker and under-privileged sections of the society and to regulate Lok Adalats for amicable settlement of disputes, the National Legal Services Authority (NALSA) has been established under the Legal Services Authorities Act, 1987. The statutes and the bodies established thereunder draw their genesis as well as legal validity from Article 39A of the Constitution of India.

NALSA is located at New Delhi. To give effect to the policies and directions of the NALSA and to give free legal services to the people and conduct Lok Adalats, in every state, the State Legal Services Authority has been constituted. The Hon'ble the Chief Justice of the respective High Court of the states head the State Legal Services Authority and are given the position of the Patron-in-Chief of the State Legal Services Authority.

In every District, District Legal Services Authority has been constituted to implement Legal Services Programmes in the District. The District Legal Services Authority is situated in the District Courts Complex in every District and chaired by the District Judge of the respective district.

The provisions of Free legal services entails certain conditions, provided in *Appendix – III* of this paper, free legal aid in civil and criminal matters is for those poor and marginalized people who cannot afford the services of a lawyer for the conduct of a case or a legal proceeding in any court, tribunal or before an authority. However, a middle-class medium income earner who do not fall into the low-income category for eligibility of Free Legal Aid cannot afford to disturb the flow of money and pour his earnest money into litigation but that doesn't mean he/she should give up his legal claim.

VI. CONCLUSION

It is an interesting concept and practiced globally. Though, it is not prohibited in India but there is a necessity of a dedicated regulation through laws, rules and directives that can govern TPF. There are arguments that in a country like India many litigants don't have access to justice because of lack of funds. But, the question arises that will the funders be keen on investing in such cases or they would be eyeing on big projects. Well, the risk-reward depends on case to case basis centered on the stake and merits of the case.

This is an ever-expanding market in India, at the same time it should also be taken care that principles of justice are not defeated at any cost. Another, issue that arises is that of confidentiality this can be tackled by drafting contractual clauses carefully.

TPF, is growing slowly and gradually and soon it will take a form of structured investment business that can be used in benefit of both funders and party in dispute. There is a growing interest among international funders in India and its exponentially evolving economy.

APENDIX – I

1. Occupation
 - a. Service
 - b. Retired Serviceman
 - c. Private Sector Employee
 - d. Self-Employed Professional
 - e. Unemployed
 - f. Others
2. Gender
 - a. Male
 - b. Female
 - c. Other
3. Age Group
 - a. Minor (Below 18)
 - b. Youth (18-24)
 - c. Adult (25-64)
 - d. Seniors (65 Above)
4. Have you ever been a party to a dispute?
 - a. Yes (to Q 5)
 - b. No (to III)
5. Have you ever taken any matter to court/forum/tribunal?
 - a. Yes (to I)
 - b. No (to II)
- I. In your dispute-
6. Was the Dispute –
 - a. Civil
 - b. Criminal
 - c. Consumer
 - d. Other
7. Were you awarded compensation or damages by the court/forum/tribunal?
 - a. Yes
 - b. No
8. Did the cost of litigation exceed the compensation or damages?
 - a. Yes
 - b. No
9. Would you have accepted funding for your case/suit?
 - a. Yes
 - b. No
 - c. Maybe
- II. Never taken any matter to court/forum/tribunal
 - d. Was the dispute-
 - e. Civil
 - f. Criminal
 - g. Consumer
 - h. Other
10. Why didn't you pursue the case?
 - a. Litigation cost was too high.
 - b. There was no point in fighting.
 - c. The cost was higher than the possible gain.
 - d. I was wrong
 - e. Other
- III. Never Been a party to dispute-
11. If you were would you litigate it?
 - a. Yes
 - b. No
 - c. Maybe
12. Would you accept funding for your case/suit?
 - a. Yes (to IV)
 - b. No (to V)
 - c. Maybe (to IV)
- IV. Yes, to funding-
13. Would you accept a:
 - a. Loan to be paid irrespective of the decision.
 - b. Funding in form of investment to be paid back from damages/compensation.
 - c. Other

V. No, to funding-

14. Why would you not accept funding?

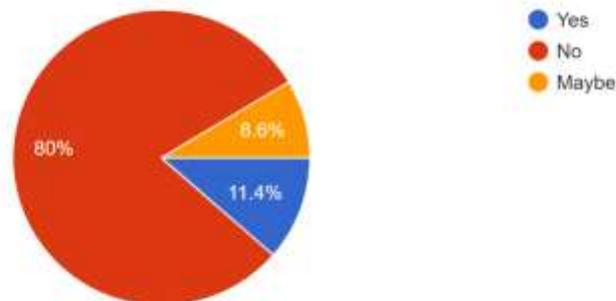
- a. Too much of a hassle
- b. Did not think that the case is worth it
- c. Too much of a liability
- d. Other

APENDIX – II⁹

The important questions pertinent to the paper yielded the following results:

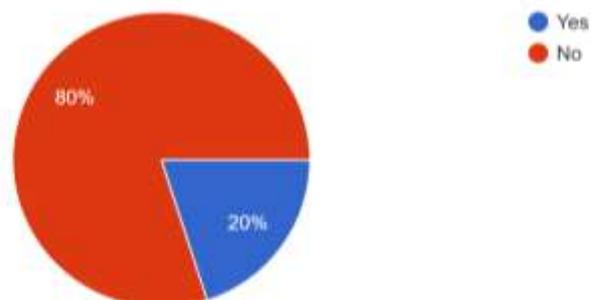
Have you ever been a party to a dispute?

35 responses



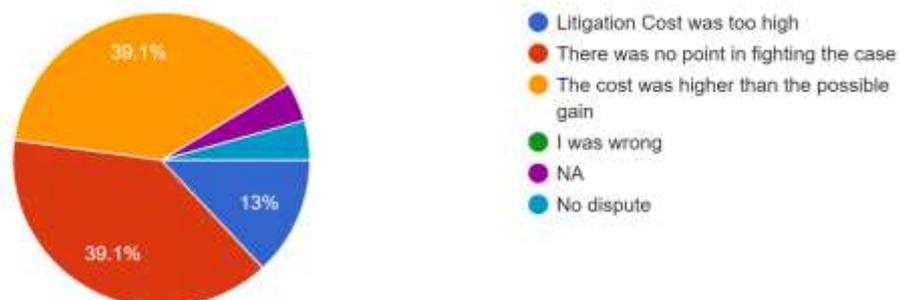
Have you ever taken any matter to court/Forum/Tribunal?

35 responses



Why didn't pursue the case ?

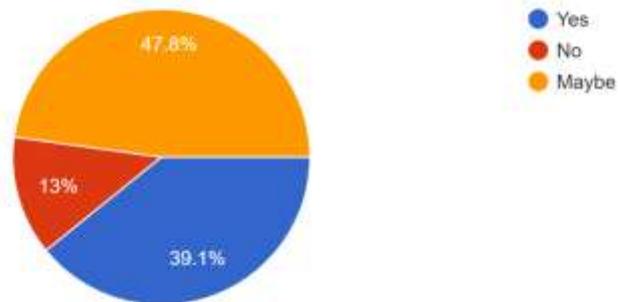
23 responses



⁹ Responses to Questionnaire, (08.02.2021 at 12:03AM), https://docs.google.com/forms/d/140eDE9HiiuLnsjeVDwDXIf_YdQQ6gqxe8OVCqBCACdU/view

Would you have accepted funding for your case?

23 responses



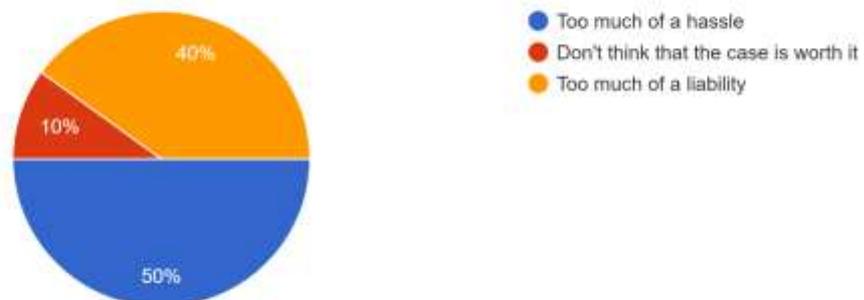
Would you accept a:

26 responses



Why would you not accept funding?

10 responses



APENDIX – III¹⁰

Q: Who are Entitled to Free Legal Services?

A: The sections of the society as enlisted under Section 12 of the Legal Services Authorities Act are entitled for free legal services, they are :

- a) A member of a Scheduled Caste or Scheduled Tribe;
- b) A victim of trafficking in human beings or begar as referred to in Article 23 of the Constitution;
- c) A woman or a child;
- d) A mentally ill or otherwise disabled person;
- e) A person under circumstances of undeserved want such as being a victim of a mass disaster, ethnic violence, caste atrocity, flood, drought, earthquake or industrial disaster; or
- f) An industrial workman; or
- g) In custody, including custody in a protective home within the meaning of clause (g) of Section 2 of the Immoral Traffic (Prevention) Act, 1956(104 of 1956); or in a juvenile home within the meaning of clause(j) of Section 2 of the Juvenile Justice Act, 1986 (53 of 1986); or in a psychiatric hospital or psychiatric nursing home within the meaning of clause (g) of Section 2 of the Mental Health Act, 1987(14 of 1987);or
- h) a person in receipt of annual income less than the amount mentioned in the following schedule (or any other higher amount as may be prescribed by the State Government), if the case is before a Court other than the Supreme Court, and less than Rs 5 Lakh, if the case is before the Supreme Court.

The Income Ceiling Limit prescribed u/S 12(h) of the Act for availing free legal services in different States has been stated below:

S. No.	States/Union Territories	Income Ceiling Limit (Per Annum)
1.	Andhra Pradesh	Rs. 3,00,000/-
2.	Arunachal Pradesh	Rs. 1,00,000/-

¹⁰ National Legal Service Authority, more on Eligibility of Legal Aid (08.02.2021 at 12:03AM), <https://nalsa.gov.in/services/legal-aid/eligibility>.

3.	Assam	Rs. 3, 00, 000/-
4.	Bihar	Rs. 1,50,000/-
5.	Chhattisgarh	Rs. 1,50,000/-
6.	Goa	Rs.3,00,000/-
7.	Gujarat	Rs.1,00,000/-
8.	Haryana	Rs. 3,00,000/-
9.	Himachal Pradesh	Rs. 3,00,000/-
10.	Jammu & Kashmir	Rs. 1,00,000/-
11.	Jharkhand	Rs. 3,00,000
12.	Karnataka	Rs. 1,00,000
13.	Kerala	Rs. 300,000
14.	Madhya Pradesh	Rs. 1,00,000
15.	Maharashtra	Rs. 3,00,000
16.	Manipur	Rs. 3,00,000
17.	Meghalaya	Rs. 1,00,000
18.	Mizoram	Rs. 25,000
19.	Nagaland	Rs. 1,00,000
20.	Odisha	Rs.3,00,000
21.	Punjab	Rs. 3,00,000
22.	Rajasthan	Rs. 1,50,000
23.	Sikkim	Rs. 3,00,000
24.	Telangana	Rs.1,00,000

25.	Tamil Nadu	Rs. 3,00,000
26.	Tripura	Rs. 1,50,000
27.	Uttar Pradesh	Rs. 1,00,000
28.	Uttarakhand	Rs. 3,00,000
29.	West Bengal	Rs. 1,00,000
30.	Andaman & Nicobar Islands	Rs.3,00,000
31.	Chandigarh UT	Rs. 3,00,000
32.	Dadra & Nagar Haveli UT	Rs. 15,000
33.	Daman & Diu	Rs. 1,00,000
34.	Delhi	General –Rs. 1,00,000 Senior citizen- Rs. 2,00,000 Transgender – Rs. 2,00,000
35.	Lakshadweep	Rs. 9,000
36.	Puducherry	Rs. 1,00,000