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Research

Third-Party Funding for Dispute Resolution in India

Exploring Recent Developments and the Legal Landscape

April 2024

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Introduction

Third-party Funding (“**TPF**”) is commonly understood as a type of funding or financing made in favour of a party to a dispute by an entity that is itself not a party to the dispute. Typically, a third-party financier funds a party in consideration for an entitlement to receive a share in the proceeds of the outcome of the dispute if the funded party were to succeed.[1]

TPF was prohibited in England since medieval times to combat its potential for abuse by persons in positions of power.[2] Both, criminal and tortious laws were enacted against maintenance and champerty. Maintenance means the assistance provided by a third-party in either prosecuting or defending a lawsuit, who has no legitimate interest in the claims made therein.[3] Champerty is where a third-party assists in either prosecuting or defending a case in consideration for a share in the proceeds from the outcome of the lawsuit.[4]

These archaic laws on maintenance and champerty had made TPF illegal in most common law jurisdictions. However, there has been an overhaul in the outdated understanding of TPF, and jurisdictions are now moving towards adopting appropriate regulatory frameworks to govern TPF. This paper discusses the evolving law on TPF across jurisdictions along with the practical aspects of a TPF agreement.

The main contention for legalizing TPF is that TPF promotes access to justice by providing a level playing field for all litigants.[5] Many litigants lack the resources to enforce their legal rights, leading to an inherent structural imbalance in the judicial system favoring deep-pocketed litigants. Examples of the benefits of TPF to society can be seen across jurisdictions that have legalized TPF. For example, a class action suit was filed against Facebook for the privacy breach of its users by supplying the data of 50 million users to Cambridge Analytica without the consent of the users. The suit is being funded by IMF Bentham (now Omni Bridgeway).[6] Another case, which represents the first commercial case funded in a Singapore court, involves a copyright infringement claim of a creative designer against entities that span the entire globe for unauthorized use of images produced by her.[7] In another instance, the third-party funder undertook extensive enforcement actions across nations to realize the awarded amount due to an infrastructure construction company from an African nation.[8]

1 William Park & Catherine A. Rogers, “Third-Party Funding in International Arbitration: The ICCA Queen-Mary Task Force”, No. 42-2014, Penn State Law Legal Studies Research Paper Series (2014).

2 Bradlaugh v. Newdegate [1883] 11 QBD 1

3 Lisa Bench Nieuwveld, “Third-Party Funding – Maintenance and Champery – Where is it Thriving?”, Kluwer Arbitration Blog (November 7, 2011), available at: http://arbitrationblog.kluwerarbitration.com/2011/11/07/third-party-funding-maintenance-and-champerty-where-is-it-thriving/

4 Ibid; Victoria Shannon Sahani, “Rethinking the Impact of Third-Party Funding on Access to Civil Justice” (2020) 69 DePaul L Rev 611; Lisa Bench Nieuwveld & Victoria Shannon Sahani, Third-Party Funding in International Arbitration (2017) 1 (2nd ed.).

5 Victoria Shannon Sahani, “Rethinking the Impact of Third-Party Funding on Access to Civil Justice” (2020) 69 DePaul L Rev 611.

6 Christopher Knaus, “Compensation sought for Australians caught up in Facebook privacy breach”, The Guardian (July 10, 2018), available at: https://www.theguardian.com/technology/2018/jul/10/compensation-sought-for-australians-caught-up-in-facebook-privacy-breach

7 Omni Bridgeway, “In Singapore’s first funded commercial litigation, Omni Bridgeway assists an artist to recover revenue”, available at: https://omnibridgeway.com/insights/case-studies/all-case-studies/case-study/case-studies/2020/05/28/in-singapore’s-first-funded-commercial-litigation-omni-bridgeway-assists-an-artist-to-recover-revenue

8 Omni Bridgeway, “An infrastructure construction company turns to Omni Bridgeway”, available at: https://omnibridgeway.com/insights/case-studies/all-case-studies/case-study/case-studies/2020/05/28/an-infrastructure-construction-company-turns-to-omni-bridgeway

Position in England, Singapore, Hong Kong

A. England

Maintenance and champerty were made illegal in England in 1275 under the Statute of Westminster.[1] The first instance of liberalization of TPF was in 1908 in *British Cash and Parcel Conveyors v. Lamson Store Service Co.*, the court held that the common law of maintenance and champerty had become obsolete in the modern context.[2] Further progress was made by enacting the Criminal Law Act, 1967 ("**Criminal Law Act**"), which abolished maintenance and champerty as crimes and torts subject to public policy.[3]

Historically viewed as an unethical practice, TPF has evolved and become a widely accepted practice in the UK.[4] 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. In *R (Factortame Ltd.) v. Secretary of State for Transport*, the Court of Appeal held that only funding agreements that are against the *integrity of the judicial process and that undermine the ends of justice* would violate the law on maintenance and champerty.[5]

Recently, in *R (on the application of PACCAR Inc. and others) v. Competition Appeal Tribunal and others*,[6] ("**PACCAR**") the United Kingdom Supreme Court rendered litigation funding agreements ("**LFAs**") entitling the funder to recover a percentage of any damages (referred to as Damages-Based Agreements, or "**DBAs**") as unenforceable under the Courts and Legal Services Act 1990 ("**CLSA**").[7]

Due to PACCAR, funders may have to renegotiate existing LFAs to either link fees contingent on a portion of the funding provided or the outcome of the dispute, rather than as a percentage/share of the expected damages. Alternatively, funders and claimants can also ensure that the LFAs, if DBAs, comply with the other conditions stipulated in Section 58AA of the CLSA.

The implication of PACCAR was briefly discussed in *Therium Litigation Funding AIC v. Bugsby Property LLC*.[8] The England and Wales High Court ("**EWHC**") examined whether the separability of a provision which was a DBA from the rest of the agreement satisfied the threshold of a "serious issue to be tried". This determination was necessary to ascertain for granting/declining an asset preservation/freezing injunction sought by the funder against the funded party to prevent dissipation of monies which, according to the funder, the funded party owed to it. The LFA contained a provision which entitled the funder to recover the funded amount, a return based on a multiple of the amount funded, as well as a percentage of recoveries obtained.

1 Statute of Westminster, 1275 (England); Pranav V Kamnani and Aastha Kaushal, "Regulation of Third Party Funding of Arbitration in India: The Road Not Taken" (2020) 8 Indian J Arb L 151.

2 British Cash & Parcel Conveyors v. Lamson Store Service Co., [1908] 1 K.B. 1006.

3 Sections 13 and 14, The Criminal Law Act, 1967 (United Kingdom).

4 UK Trucks Claim Limited v. Fiat Chrysler Automobiles NV and Others [2019] CAT 29; Road Haulage Association Limited v. Man SE and Others, [2019] CAT 26.

5 R (Factortame Ltd.) v. Secretary of State for Transport, [2002] EWCA Civ 932.

6 R (on the application of PACCAR Inc. and others) v. Competition Appeal Tribunal and others, [2023] UKSC 28.

7 Section 58AA, The Courts and Legal Services Act 1990 (United Kingdom).

8 Therium Litigation Funding A IC v. Bugsby Property LLC, [2023] EWHC 2627 (Comm).

Relying on *Zuberi v. Lexlaw Ltd.*[9] the EWHC held that the provisions which constituted a DBA (percentage of the recovery) – now unenforceable due to PACCAR – could be separated from the provisions which did not (the funded amount and recovery based on the multiple of costs incurred to fund the proceedings). While doing so, the EWHC stated that this satisfied the threshold of a "serious issue to be tried" in favour of granting the asset preservation/freezing order. Whether such severability is actually possible will be subject of the arbitral tribunal constituted to resolve disputes arising out the concerned LFA.

Costs against third-party funders in the UK

English courts have protected third-party financiers against adverse costs through the *"Arkin Cap"*. In the *Arkin v. Borchard Lines Ltd. and Others* ("**Arkin Case**"), the court of appeal held that if the funded party is unsuccessful, 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**").[10] The decision was welcomed by funders as the amount of their liability in an adverse cost order was limited by the Arkin Cap.

In *Bailey v. GlaxoSmithkline UK Ltd.*,[11] the England & Wales High Court did not apply the Arkin Cap to an order of imposition of security for costs. The Court held that while the Arkin Cap principle must be considered when the question of imposition of actual costs is concerned, the court reserves the discretion to exceed the capped amount when security for costs has to be ordered.

The Arkin Cap came to be diluted over the subsequent years. In *Chapelgate Credit Opportunity Master Fund Ltd. v. Money*,[12] (also known as *Davey v. Money*), the Court of Appeal disapplied the Arkin Cap for it being unjust in certain circumstances. To illustrate, the court provided an instance where a funder contributes £100,000 out of total costs of £300,000 to pursue a claim for £10 million but would take 90% of the net proceeds if the claim succeeded. In such a case, a judge may deem it just to order the funder to bear an amount exceeding £100,000 since the funder stood to gain an amount far exceeding his contribution. Hence, the Arkin Cap was held to be not binding, and the Courts retained discretion of considering factors other than the extent of the funding – like the proximity and control of a funder over the claim such that it can be said to be a "real party" to the proceedings, and the prospective gains of the funder vis-à-vis the funding provided.

In *Laser Trust v. CFL Finance Ltd.*, the England & Wales High Court observed that third-party cost orders against a "pure funder" in its capacity as a non-party cannot be issued as a matter of course. However, in cases where the funder goes beyond mere funding and exercises a massive degree of control in the proceedings, costs can be issued against the funder and the Arkin Cap would be inapplicable.[13]

In *Excalibur Ventures LLC v. Texas Keystone Inc. & Ors.*, ("**Excalibur**") the English Court of Appeal deliberated on the misuse of TPF for furthering frivolous litigations and supplemented the jurisprudence on adverse costs.[14] The Court held that an order directing a third-party financier to pay the costs of litigation awarded in favour of the other side on an indemnity basis would be appropriate because the third-party financier had funded the litigation for his own monetary interest and had become "a real party" to the litigation.

9 Zuberi v. Lexlaw Ltd., [2021] EWCA Civ 16.

10 Arkin v. Borchard Lines Ltd. and Others, [2005] EWCA Civ 655.

11 Bailey v. GlaxoSmithkline UK Ltd., [2017] EWHC 3195 (QB).

12 Chapelgate Credit Opportunity Master Fund Ltd. v. Money, [2020] EWCA Civ 246.

13 Laser Trust v. CFL Finance Ltd., [2021] EWHC 1404 (Ch).

14 Excalibur Ventures LLC v. Texas Keystone Inc. & Others, [2016] EWCA Civ 1144.

The funder had a substantial economic interest, involvement and control over the litigation, which made the imposition of costs on the funder just and equitable.[15] While ordering the financier to pay costs, the court did not consider the point of an Arkin Cap limiting the liability of the funder, merely noting, in passing, that some consider the Arkin Cap to be *"over-generous to commercial funders"*.

B. Singapore

Traditionally, maintenance and champerty were applicable in Singapore and TPF agreements were restricted on the breach of public policy grounds. In the case of *Otech Pakistan v. Clough Engineering*, the Singapore Court of Appeal extended the scope of champerty and held that the doctrine is applicable in the private adjudication process as well.[16] However, Singapore, being at the forefront of adopting a pro-arbitration stance, has since evolved and changed its position regarding TPF.

Singapore became the first country in Asia to legalize TPF for arbitrations. It passed the Civil Law (Amendment) Act, 2017, and the Civil Law (Third-Party Funding) Regulations, 2017 which abolished the tort of champerty and maintenance with respect to international arbitration and associated proceedings, including enforcement proceedings in Singapore Courts.[17]

Subsequently through the Civil Law (Third-Party Funding) Amendment Regulations 2021, Singapore's Ministry of Law introduced a framework for TPF for domestic arbitrations, court proceedings related to domestic arbitration proceedings, proceedings commenced in the Singapore International Commercial Court ("**SICC**") as long as such proceedings remain in the SICC, and proceedings in relation to any of the aforementioned proceedings.[18]

TPF has been widely integrated into the dispute resolution systems in Singapore. Singapore International Arbitration Centre and the Law Society of Singapore have issued separate guidelines on TPF, aiming to create a fair and transparent mechanism on TPF.[19] The measures laid down in both the guidelines include disclosure of TPF to ensure there is no conflict such that the impartiality of the arbitrators is maintained, to determine the rights and obligations of third-party financiers, etc.[20] Singapore International Arbitration Centre also introduced various provisions in the Singapore Investment Arbitration Rules, 2017 ("**SIAC Investment Rules**"), adopting and acknowledging TPF arrangements.[21] Rule 24(l) renders power to the tribunal to order the disclosure of the existence of TPF arrangements, the identity of the funder, and where appropriate, the funder's interest in the outcome of the proceedings. Further, the SIAC Investment Rules also give discretionary power to the tribunal to consider the TPF arrangement in apportioning costs of the arbitration[22] and legal costs.[23]

15 Ibid.

16 Otech Pakistan v. Clough Engineering, [2006] SGCA 46.

17 Civil Law (Amendment) Act, 2017 (Singapore); Civil Law (Third-Party Funding) Regulations, 2017 (Singapore).

18 Civil Law (Third-Party Funding) Amendment Regulations, 2021.

19 Singapore International Arbitration Centre, "Practice Notes on Arbitrator Conduct in Cases Involving External Funding", PN – 01/17 (March 31, 2017); Law Society of Singapore, "Guidance Note 10.1.1 on Third-Party Funding" (April 25, 2017).

20 Ibid.

21 Rule No. 24(l), SIAC Investment Rules, 2017.

22 Rule No. 33.1, SIAC Investment Rules, 2017.

23 Rule 35, SIAC Investment Rules, 2017.

Further, lawyers in Singapore are no longer barred from entering into Conditional Fee Arrangements ("**CFA**") with their clients through the recent promulgation of Legal Profession (Amendment) Act, 2022 as well as the Legal Profession (Conditional Fee Agreement) Regulations, 2022 ("**CFA Regulations**"). Such agreements allow lawyers to claim their fees contingent on the outcome of the dispute. Presently, the CFA Regulations prescribe that such agreements can only be entered into with respect to international and domestic arbitration proceedings, certain SICC proceedings and related court and mediation proceedings.[24]

In a boost to litigation funders, the Singapore High Court, in the recent case of *Hyflux Ltd. (in compulsory liquidation) and others v. Lum Ooi Lin*, held that an irrevocable and unconditional undertaking by the plaintiffs' litigation funder towards security for the defendant's costs is an adequate form of security, as it "*provides a fund or asset against which the defendant can readily enforce an order for costs if necessary*". [25] This has the potential of reducing upfront litigation funding costs, as the alternatives to this are the more traditional forms of providing security such as deposit of the security amount into court, a banker's guarantee or a solicitor's undertaking. The principles applied by the Singapore High Court in arriving at this conclusion were affirmed by the Singapore Court of Appeal.[26]

C. Hong Kong

Maintenance and champerty are still recognized as legal doctrines in Hong Kong. However, certain exceptions have been carved out by the courts. In *Siegfried Adalbert Unruh v. Hans- Joerg Seeberger*, the Court of Final Appeal held that merely because an agreement is caught by the broad scope of champerty and maintenance, that in itself would not invalidate it. The facts would require an examination to determine —

1. if the arrangement poses a genuine risk to the integrity of the court's processes;
2. the countervailing public policies in favour of ensuring access to justice and of recognizing where appropriate, legitimate common interests of a social or commercial character in a piece of litigation; and
3. if it involves other factors such as exploitation of a vulnerable litigant or arrangement with solicitors etc. The court found that there are certain exceptions to the common law doctrines of maintenance and champerty which are: (i) persons with legitimate interest in the outcome of the litigation; (ii) cases where TPF furthers the cause of access to justice; and (iii) a miscellaneous category of matters wherein TPF can be considered to be lawful including sale and assignment by a trustee in bankruptcy proceedings.[27]

With regard to the arbitral process, *Cannonway Consultants Ltd. v. Kenworth Engineering Ltd.* held that doctrines of maintenance and champerty may still hold validity in traditional litigations, but cannot be said to apply to arbitrations.[28] Recently, Hong Kong passed the Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Ordinance, 2017 on June 23, 2017 ("**Arbitration Ordinance**") which legalized TPF for arbitration and mediation proceedings including proceedings before emergency arbitrators and ancillary court proceedings.[29] Section 3 of the abovementioned ordinance that provided for the use of TPF in arbitration proceedings, was brought into force on February 1, 2019.

24 Legal Profession (Amendment) Act, 2022; Legal Profession (Conditional Fee Agreement) Regulations, 2022.

25 Hyflux Ltd. (in compulsory liquidation) and others v. Lum Ooi Lin, [2023] SGHC 113.

26 Lum Ooi Lin v. Hyflux Ltd. (in compulsory liquidation) and Others, [2023] SGCA 43.

27 Siegfried Adalbert Unruh v. Hans- Joerg Seeberger, [2007] HKCU 246.

28 Cannonway Consultants Ltd. v. Kenworth Engineering Ltd., [1995] 1 H.K.C 179.

29 Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Ordinance, 2017 (Hong Kong).

A code of practice ("**Code of Practice**") was also released by the Secretary of Justice, which prescribed the standards and practices in TPF including capital adequacy requirements, mandatory disclosure of conflicts of interest, terms in a funding agreement, and adverse costs on third-party financiers.[30] A committee consisting of three senior Hong Kong lawyers is to oversee the compliance of the Code of Practice as an advisory body.[31] The Hong Kong International Arbitration Centre also revised its arbitration rules with effect from November 1, 2018. The revised rules reinforced the obligations to disclose a TPF agreement, in consonance with the Arbitration Ordinance and the Code of Practice.[32]

In light of the amendments, the Hong Kong International Arbitration Centre laid down specific rules in relation to third-party funding i.e. the Hong Kong International Arbitration Centre, Administered Arbitration Rules, 2018. These rules lay down detailed provisions relating to the disclosure of the TPF arrangement, and the discretion of the arbitral tribunal to consider TPF arrangements while ascertaining the cost of arbitration.[33]

Further, certain types of outcome-based fee arrangements between a lawyer and a client in arbitration and related court proceedings are now permitted in Hong Kong. The Arbitration and Legal Practitioners Legislation (Outcome Related Fee Structures for Arbitration) (Amendment) Ordinance, 2022, and Arbitration (Outcome Related Fee Structures for Arbitration) Rules in force from 16 December 2022 permit and regulate three types of such agreements — (a) conditional fee agreement; (b) a damages-based agreement and (c) a hybrid damages-based agreement.[34]

30 Code of Practice for Third Party Funding in Arbitration, 2017 (Hong Kong).

31 Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Ordinance, 2017 (Hong Kong).

32 Hong Kong International Arbitration Centre, Administered Arbitration Rules (2018).

33 Article 34.4 and 44, Hong Kong International Arbitration Centre Administered Arbitration Rules, 2018.

34 Section 98ZB, The Arbitration and Legal Practitioners Legislation (Outcome Related Fee Structures for Arbitration) (Amendment) Ordinance, 2022.

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Position in India

In India, there has never been an express legislative bar against TPF. In fact, certain States have impliedly recognised TPF agreements by amending the provision for security of costs under the Civil Procedure Code, 1908 ("**CPC**") i.e. Order XXV.[1] 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.

Courts in India have also enforced TPF agreements.[2] The Privy Council in *Ram Coomar Coondoo v. Chander Canto Mookerjee* recognized that an equitable agreement funding a litigant to fight a suit, in consideration of a share in the property to be recovered, is permissible under law. It was held that since the laws of maintenance and champerty are not applicable in India, TPF agreements are legal unless they are opposed to public policy.[3] However, the Privy Council advised caution while entering into TPF agreements. Accordingly, the law laid down held that doctrines of maintenance and champerty would only be applicable to a TPF agreement which is unequal, extortionate, immoral in nature resulting in such TPF agreement being invalidated.[4] Various factors, such as the returns from the outcome of a litigation that are promised to the third-party financier, are relevant to judge the validity of a TPF.[5] The Division Bench of the Bombay High Court, in *Harilal Nathalal Talati v. Bhailal Pranlal Shah*, dealt with an agreement where a person was litigating to get a share in his father's estate and had agreed to give half of the share of the property he was to receive, to the third party financier if the litigation was to be successful. Since the third-party funding agreement stipulated for a share disproportionate to the amount of money spent on litigation, the Court held that such an agreement *"was extortionate and unconscionable and opposed to public policy"*.[6]

In a suit where the funded party incurred an expenditure of INR 6,000 in pursuing the litigation, a Division Bench of the Andhra Pradesh High Court upheld the validity of an agreement which entitled the third-party funder to a sum of INR 8,000 for financing the suit as well as rendering assistance throughout the proceedings.[7] In another judgment of the Madras High Court, the Court upheld an agreement where the financier who agreed to advance a sum of about INR 1 Lakh and was entitled to a sum of INR 5 lakhs without interest for funding a litigation where the suit property was worth INR 30 lakhs. The Court held that the funder had rendered assistance beyond merely providing funds, like engaging lawyers, keeping records etc.

1 Order XXV Rule 1, Civil Code of Procedure, 1908 (India) (as amended by Maharashtra, Tamil Nadu, Orissa, Madhya Pradesh and Uttar Pradesh).

2 Raje Dattaji v. Mangesh, AIR 1932 PC 278.

3 Ram Coomar Coondoo v. Chunder Canto Mookerjee, [1876] 2 AC 186, 208 (PC); See also Banarsi v. Sital, AIR 1930 Lah 392; Raje Dattaji v. Mangesh, AIR 1932 PC 278.

4 Ibid; Raja V.V. Subhadrayamma v. Poosapati Venkatapati, [1924] SCC OnLine PC 22; Khaja Moinuddin v. S.P. Ranga Rao [1999] SCC OnLine AP 583.

5 Nuthaki Veukataswami v. Katta Nagireddy, [1962] SCC OnLine AP 100; Suganchand v. Balchand [1956] SCC OnLine Raj 127; Lal Ram Sarup v. Court of Wards through Deputy Commissioner, Delhi AIR 1940 Privy Council 19.

6 Harilal Nathalal Talati v. Bhailal Pranlal Shah, AIR 1940 Bombay 143.

7 Pandragi Gopalam v. Chidamana Chinnayya, AIR 1958 AP 630.

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Further, despite the litigation lasting for over 12 years, no interest had to be paid on the amount of INR 5 lakhs even though the funder had to incur expenditure in excess of the agreed INR 1 lakh. In these circumstances, such a third-party funding agreement cannot be said to be unconscionable or extortionate.[8]

In *Re: 'G' A Senior Advocate of the Supreme Court,*[9] the Supreme Court considered whether an advocate can enter into an agreement providing for fees contingent on the outcome of the legal proceedings. The Court held that TPF agreements are not immoral and do not shock the conscience or against public policy, provided an advocate is not involved in the transaction. The Supreme Court relied upon Rules 20 and 21 of the Bar Council of India Rules, 1975, which prohibit an advocate from *"entering into a fee arrangement which is contingent on the outcome of a dispute"* and from *"buying or agreeing to receive any share or interest in an actionable claim"*.[10] This position of law was further propounded in the Supreme Court decision of *Bar Council of India v. A.K Balaji* wherein it was held that there is no bar on third-parties, that are not lawyers, from funding a litigation and getting repaid from the outcome of the litigation.[11] The Supreme Court observed that the explicit bar on advocates from partaking in TPF arrangements was well founded under the Bar Council of India Rules, 1975, that aim to prevent conflict of interest and to maintain the professional standards of advocacy.[12]

As regards exposure of funders to adverse costs, the Delhi High Court in *Tomorrow Sales Agency Pvt. Ltd. v. SBS Holdings Inc. & Ors.* ("**Tomorrow Sales**") refused to order security for the awarded amount against the funder of the award-debtor in an arbitration.[13] It differentiated the *Arkin Case and Excalibur* on the following grounds: (1) The power to order costs against third-party funders was well-placed in English statutes which conferred broad discretion to courts in determining who will pay costs. Such legislative provisions were absent in India; (2) The *Arkin Case and Excalibur* were instances where funders were ordered to pay costs by the courts, whereas *Tomorrow Sales* concerned an arbitration where the funder was neither a signatory to the arbitration agreement, nor a party to the arbitral proceedings. Hence, consent to be bound by the award was an important consideration in *Tomorrow Sales.*

Accordingly, TPF agreements are considered to be a valid way of funding litigants who would otherwise have to go through inordinate hurdles to procure reliefs. While such agreements are subject to invalidation if they are extortionate or grossly unequal to either party, the level at which typical commercial funders operate are rarely hit by this bar.

8 The Executive Officer for Sri Navaneethakrishnaswami Devasthanam Veekeralampudur v. Rukmani and Co. Ltd., through its Director L. Muthiah and Ors., (1955) 2 Mad LJ 339.

9 Re: 'G' A Senior Advocate of the Supreme Court; B. Sunitha v. State of Telengana [2017], SCC OnLine 1412.

10 Rules 20, 21, Bar Council Rules, 1975 (India)

11 Bar Council of India v. A.K. Balaji, AIR 2018 SC 1382.

12 Ibid; Re: K L Gauba, AIR 1954, Bom 478.

13 Tomorrow Sales Agency Pvt. Ltd. v. SBS Holdings Inc. & Ors., FAO(OS)(COMM) 59/2023 and CM Nos. 14793/2023 & 14794/2023 (Delhi High Court).

Insolvency Claims and Third-Party Funding

Liquidators of insolvent companies usually suffer from a cash crunch and are more often lacking the resources to recover their claims from their debtors. TPF agreements can assist the liquidators of insolvent companies to pursue such claims and recover more money for the benefit of the creditors. This has gained traction over the years and has led to rising acceptance of TPF agreements in insolvency and bankruptcy cases across jurisdictions like Singapore and Hong Kong.

A. United Kingdom

The law on applicability of the torts of champerty and maintenance to insolvency claims has evolved in the UK. The insolvency professional/liquidator has the power to sell the property of the company undergoing insolvency under Schedule 1 and 4 of the Insolvency Act, 1986.[1] Under Section 436 of the Insolvency Act, 1986, *"property"* includes *"every description of interest, whether present or future or vested or contingent, arising out of, or incidental to, property"*.[2]

In earlier cases such as *Greenwood Holdings plc v. James Capel*, it was held that the doctrines of champerty and maintenance would apply to agreements executed by the liquidator with a third-party financier, to fund a debt-recovery claim in exchange for a share in the proceeds of the recovery.[3] However, this position was liberalized by judgements such as *Seear v. Lawson*, wherein it was observed that if TPF helps realise the loans of the creditors, it should not matter that a third-party is pursuing the claim that generates more money for the creditors.[4] The House of Lords in *Circuit Systems Ltd. and Anr. v. Zuken-Redac (U.K.) Ltd. and Norglen Ltd. and Ors. v. Reeds Rains Prudential Ltd. and Ors.*, established that an insolvency professional/ liquidator could assign a cause of action to a third-party financier provided he has sufficient funds to pursue that action.[5]

B. Singapore

Singapore recently enacted a law consolidating and governing the insolvency process. The Insolvency, Resolution and Dissolution Act, 2018 expressly provides that for a certain type of claims, TPF agreements can be entered into by the liquidator with the permission of the court or the committee of inspection.[6] These include *"undervalued, prejudicial preference transactions, extortionate credit transactions, fraudulent trading, wrongful trading and assessment of damages against delinquent officers of the company."*[7]

Alongside legislative reforms, the Singapore courts have recognized TPF in certain insolvency and bankruptcy disputes as an exception to the doctrines of maintenance and champerty.[8]

1 Schedule 1 and 4, Insolvency Act, 1986 (England).
2 Section 436, Insolvency Act, 1986 (England).
3 Greenwood Holdings plc v. James Capel, [1995] Ch 80.
4 Seear v. Lawson, (1880) 15 Ch. D. 426, 433; Whitehouse v. Wilson, [2005] EWCA 1688.
5 Circuit Systems Ltd. and Anr. v. Zuken-Redac (U.K.) Ltd. and Norglen Ltd. and Ors. v. Reeds Rains Prudential Ltd. and Ors., [1997] UKHL 51.
6 Section 144(1)(g), Insolvency, Restructuring and Dissolution Act, 2018 (Singapore).
7 Sections 224, 225, 228, 238, 239 and 240, Insolvency, Restructuring and Dissolution Act, 2018 (Singapore).
8 Re Vanguard Energy Pte Ltd., [2015] 4 SLR 597.

In *Re Fan Kow Hin*, the Singapore High Court held that TPF agreements are legally permissible for insolvency and bankruptcy matters where the third-party financiers can claim a share of the proceeds from the claw-back of the insolvency claims.[9] The Singapore High Court in *Solvadis Commodity Chemicals Gmbh v. Affert Resources Pte Ltd.*, observed the advantages of TPF agreements in insolvency cases and approved a TPF agreement entered into by the liquidator even though it was opposed by the creditors.[10] Since there was opposition from the creditors, the Court directed the liquidator to provide quarterly updates regarding the progress of the recovery proceedings.[11]

C. Hong Kong

The Court of First Instance in *Re Cyberworks Audio Video Technology Ltd.* held that a TPF agreement to sell a cause of action to a financier by the liquidator to pursue a claim is valid.[12] However, considering that maintenance and champerty are still outlawed in Hong Kong, it became a general practice for liquidators and insolvency professionals to apply to company courts for their approval before entering into TPF agreements. Decisions such as *Osman Mohammed Arab & Anor v. Chu Chi Ho Ian*[13] and *Re A*[14] furthered this practice by holding that it was mandatory under law for liquidators and insolvency professionals to seek the approval of the courts for validating TPF agreements. This position of law was overturned in the decision of *Patrick Cowley and Lui Yee Man, Joint and Several Liquidators of the Company*, wherein the High Court of Hong Kong held that the liquidators of an insolvent company were not mandated by law to obtain the approval of the court for executing TPF agreements which benefit the insolvent company.[15]

D. India

The Insolvency and Bankruptcy Board of India (“**IBBI**”) recently came out with a *‘Discussion Paper on Corporate Liquidation Process’*.[16] The paper focuses on a proposed policy around assignment of not readily realisable assets (“**NRRA**”) of a corporate debtor, which includes assets and claims that cannot be pursued by the liquidator due to lack of resources. IBBI has recognized the potential benefit of assignment of such NRRAs (such as avoidance transactions actions, contingent claims etc.) to third party financiers on the market, for them to pursue the claims at their pace without impeding the completion of the liquidation process.[17]

9 Re Fan Kow Hin, [2018] SGHC 257.

10 Solvadis Commodity Chemicals Gmbh v. Affert Resources Pte Ltd., [2018] 5 SLR 1337.

11 Ibid.

12 Re Cyberworks Audio Video Technology Ltd., [2010] 2 HKLRD 1137.

13 Osman Mohammed Arab & Anor v. Chu Chi Ho Ian, [2016] HKCU 149.

14 Re A, [2020] HKCFI 493.

15 Patrick Cowley and Lui Yee Man, Joint and Several Liquidators of the Company, [2020] HKCFI 922.

16 Insolvency and Bankruptcy Board of India, “Discussion Paper on Corporate Liquidation Process”, (August 26, 2020).

17 Ibid.

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Section 5(7) of the Insolvency and Bankruptcy Code, 2016 provides that a *"financial creditor"* is *"any person to whom a financial debt is owed and includes a person to whom such debt has been legally assigned or transferred to"*.[18] This is interpreted to imply that the Insolvency and Bankruptcy Code, 2016 provides for the assignment of debt by a creditor to a third party, who then would have the right to initiate insolvency proceedings against the corporate debtor. Under Indian law, it is an established principle that contractual rights are assignable provided the contract is not personal in nature or the rights are not incapable of assignment by law or by agreement.[19] Further, a benefit under a contract can always be assigned to a third party.[20]

Section 132 of the Transfer of Property Act, 1882, a transferee (assignee) of an actionable claim will be subjected to all the liabilities with respect to the actionable claim, that were previously directed towards the transferor (assignor).[21] There is nothing under Indian law that prevents a liquidator from selling actionable claims of the corporate debtor, to third-party financiers provided all the liabilities are also transferred to the third-party financiers.

18 Section 5(7), Insolvency and Bankruptcy Code, 2016 (India); Pankaj Yadav and Anr. v. State Bank of India and Anr., Company Appeal (AT) (Insolvency), No. 28 of 2018 (August 7, 2018); Pr. Director General of Income Tax (Admn. & TPS) v. M/s. Synergies Dooray Automotive Ltd. & Ors., Company Appeal (AT) (Insolvency), No. 205 of 2017 (March 20, 2019).

19 ICICI Bank Limited v. Official Liquidator of APS Star Industries Ltd. & Ors., [2010] 10 SCC 1.

20 Ibid.

21 Section 132, Transfer of Property Act, 1882 (India).

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Assignment of Claims

It is imperative that third party financiers be prudent about the legality and financial security of the structure created under a TPF agreement. The structure should be such that if the claim that was funded by a third-party financier were to succeed, the third-party financiers can legally enforce the TPF and recover the returns they are entitled to. Amongst the various methods that are used by third party financiers to secure the proceeds from a successful dispute resolution, assignment of claims and/or proceeds is a common practice. However, a complete assignment of 'claims' is impermissible under Indian law.

Assignment is the transfer of rights or liability in a property to a third party. Section 6(e) of the Transfer of Property Act, 1881 ("**TOPA**") prescribes that a *"mere right to sue"* cannot be transferred or assigned in India.[1] However, an *incidental* right to sue along with the property can be validly transferred.[2] Further, Section 130 of the TOPA provides for the transfer of an *"actionable claim"* by execution of an instrument in writing.[3] An actionable claim is different from a right to sue and is defined as a claim to *"(i) a debt; or (ii) a beneficial interest in movable property."*[4] A debt is defined as an ascertained sum of money that is owed by one party to another due to an existing obligation.[5] Unlike a mere right to sue, an actionable claim must have a liquidated money obligation, payable either in the present or in the future.[6] For example, a debt due on a policy of insurance[7] and book debts.[8]

Assignment of a Decree

Under both arbitration and litigation, if a claim is successful, it is enforced as a decree to recover the amounts due. Therefore, if a third-party financier is entitled to the proceeds from a claim, they would be entitled to the proceeds obtained through the execution of the decree when the claim succeeds. Section 2(2) of the CPC defines a decree as a conclusive determination of the rights of the parties in relation to the matters in controversy.[9] Order XXI, Rule 16 of the CPC, provides for a mechanism wherein the transferee can get themselves impleaded as a decree-holder and replace the transferor in the decree execution proceedings.[10] Assignment of a decree is legally valid because a decree is considered to be a form of property.[11]

However, at the time of entering into a TPF arrangement, the dispute has not yet concluded and crystallised into a decree. It is still an actionable claim for the purposes of assignment. Hence, it is important to see the position of law regarding the assignment of proceeds from a *future decree.*

1 Section 6, Transfer of Property Act, 1882 (India); Economic Transport Organization v. Charan Spinning Mills Pvt. Ltd., (2010) 4 SCC 114.

2 Jewan Ram v. Ratan Chand, AIR 1921 Cal 795; Union of India v. Sri Sara Mills Ltd., AIR 1973 SC 281; New Central Jute Mills Co. Ltd. v. Rivers Steam Navigation Co. Ltd., AIR 1959 Cal 352.

3 Section 130, Transfer of Property Act, 1882 (India).

4 Section 3, Transfer of Property Act, 1882 (India).

5 Banchharam Majumdar v. Adyanath Bhattacharjee, (1909) ILR 36 Cal 936.

6 Moti Lal v. Radhey Lal, AIR 1933 All 642.

7 Varjivandas Jamnadas v. Maganlal Chhabildas, AIR 1937 Bom 382.

8 Jugal Kishore v. Raw Cotton Co. Ltd., AIR 1955 SC 376.

9 Section 2(2), Code of Civil Procedure, 1908 (India).

10 Order XXI, Rule 16, Code of Civil Procedure, 1908 (India); Govindarajulu Naidoo v. D.H. Ranga Rao, AIR 1921 Mad 113.

11 Govindarajulu Naidoo v. D.H. Ranga Rao, AIR 1921 Mad 113.

In *Purna Chandra Bhowmik v. Barna Kumari*, the Calcutta High Court held that assignment of a future decree would be treated as an assignment of property once the decree comes into existence and it would not be considered as an assignment of the *"mere right to sue"* for damages.[12] This position was affirmed by the *Supreme Court in Jugal Kishore Saraf v. Raw Cotton Co. Ltd.*[13] The Supreme Court held that the assignment of future decrees can be done through an *"equitable assignment"* wherein once the decree comes into existence, it would be transferred to the transferee as per the terms of the contract between them. Such a transfer would result in a complete equitable assignment of the property, provided that the contract to assign is in writing and was entered into before the decree came into existence.[14]

Thus, the Supreme Court has confirmed that the principle of equity would be applied in such cases and after a decree comes into existence, the transferee would be entitled to beneficial interest in it. Thereafter, the transferee can invoke Section 146 of the Code of Civil Procedure, 1908, which enables persons who have succeeded to an interest in the decree, in whole or in part, to execute the decree.[15]

Assignment of an Arbitral Award

An existing or future arbitral award is enforced in the form of a decree pursuant to Sections 36 (for domestic awards) and 49 (for foreign awards) of the Arbitration and Conciliation Act, 1996.[16] The position of law for the assignment of an arbitral award is the same as that of assignment of an existing or future decree.[17]

In *Compania Naviera 'SODNOC' v. Bharat Refineries Ltd.*,[18] the Madras High Court observed that under the Arbitration & Conciliation Act, 1996, ("**Arbitration Act**") a foreign award is already stamped as a decree and the party having a foreign award can straight-away apply for its enforcement. The Court was faced with a situation wherein an award-holder had assigned its rights and claims under a foreign arbitral award to a third-party assignee and the assignee attempted to execute the foreign arbitral award under the Arbitration Act. The Court held that *"the property is a decree passed to the transferee under a deed of assignment when the parties to the deed of assignment intend such property to pass. Therefore, once it is proved that there is a deed of assignment of the award by the petitioner, there ends the matter and the award is enforceable in the hands of the assignee."*

12 Purna Chandra Bhowmik v. Barna Kumari, AIR 1939 Cal 715.

13 Jugal Kishore v. Raw Cotton Co. Ltd., AIR 1955 SC 376.

14 Ibid.

15 Section 146, Code of Civil Procedure, 1908 (India).

16 Section 36, Arbitration and Conciliation Act, 1996 (India).

17 Modi Chimanlal Hargovinddas v. Shaikh Gulam Nabi Gulam Mohammad, [1946] ILR 276.

18 Compania Naviera 'SODNOC' v. Bharat Refineries Ltd., 2008 (1) ARBLR 334 (Madras).

Other Similar Products

Various models of TPF and similar products exist across jurisdictions. Some examples include success-based legal fee arrangements, litigation insurance, conventional forms of corporate finance (debt and equity), legal aid, factoring, loan agreements, etc.[1]

Success-based fee arrangements include contingency fee arrangements and conditional fee arrangements, both of which revolve around the payment of the litigation fees to the legal counsel basis the outcome of the litigation. However, both these types of success-based fee arrangements are expressly barred by the Bar Council of India and subsequent judicial precedents.[2]

If companies need financing to pursue legal claims, they may resort to raising the capital of the company by either debt or equity, to pay for the litigation costs. The stakeholders, either the equity shareholders or the corporate debtors, become the third-party funders in such cases.[3]

In monetization of pending claims, a portion of pending claims are converted to cash which third-party financiers pay companies upfront to alleviate their cash flow concerns. In exchange, beneficial rights and interest in the pending claims are assigned to the financier. The primary objective is to control the timing and certainty of the claim, since claims that are not crystallised yet are converted and given as capital to the funded company upfront. In India, two infrastructure companies viz. Hindustan Construction Company and Patel Engineering have recently decided to monetize claims arising out of a specific portfolio of claims, including arbitral awards.[4]

Litigation insurance typically takes two forms – before the event (“**BTE**”) insurance and after the event (“**ATE**”) insurance. BTE insurers cover the risk of a potential litigation in exchange for a premium paid beforehand. Separately, the unsuccessful party is typically held liable to pay the legal costs of the successful party. ATE insurance addresses this situation and covers this payment in exchange for a premium. It is purchased after the dispute has arisen and covers the insured in case of an adverse costs order against it if is unsuccessful in the dispute. It can also cover the unsuccessful party’s own legal costs depending on the terms of the policy.

Although there are other variations of products similar to TPF exist, the validity of majority of these has not been tested by Indian courts. We may have to wait for legislative clarity or more judicial pronouncements on other emerging, non-conventional products and services.

1 International Arbitration and its Impact on Procedure, “Chapter 2: The Various Forms of Third-Party Funding in International Arbitration” (Von Goeler; January 2016).

2 Rule 20, Bar Council Rules; Bar Council of India v. A.K. Balaji & Ors., AIR 2018 SC 1382; Jayaswal Ashoka Infrastructures Pvt. Ltd. vs. Pansare Lawad Sallagar, (2019) 5 Mah LJ 689.

3 International Arbitration and its Impact on Procedure, “Chapter 2: The Various Forms of Third-Party Funding in International Arbitration” (Von Goeler; January 2016).

4 Amritha Pillai, “Infra companies consider monetising litigation claims for offshore assets” Business Standard ((October 3, 2019), available at: https://www.business-standard.com/article/companies/infra-companies-consider-monetising-litigation-claims-for-offshore-assets-119100201028_1.html.

Exchange Control Law Considerations

TPF by foreign funding entities would be routed as foreign investments that may invite the application of the Foreign Exchange Management Act, 1999 ("**FEMA**"). FEMA has classified transactions into two broad categories, *capital account transactions and current account transactions.* Section 2(e) of FEMA defines *"capital account transaction"* as *"a transaction which alters the assets or liabilities, including contingent liabilities, outside India of persons resident in India or assets or liabilities in India of persons resident outside India, and includes transactions referred to in sub-section (3) of section 6"*.[1] Section 2 (j) of FEMA defines *"current account transaction"* as *"a transaction other than a capital account transaction and without prejudice to the generality of the foregoing such transaction includes,— (i) payments due in connection with foreign trade, other current business, services, and short-term banking and credit facilities in the ordinary course of business, (ii) payments due as interest on loans and as net income from investments, (iii) remittances for living expenses of parents, spouse and children residing abroad, and (iv) expenses in connection with foreign travel, education and medical care of parents, spouse and children."*[2]

Under FEMA, both these types of transactions are treated very differently and therefore it becomes essential to understand which category TPF would fall under. Current account transactions are to record the daily transactions such as import and export of goods, whereas capital account transactions are to record the net balance of international investments. If it is a current account transaction, the general rule is that it is permitted unless prohibited or specifically regulated by FEMA.[3] However, if it is a capital account transaction, the general rule is that unless it is specifically permitted, it is prohibited by FEMA.[4]

As per the existing law, FEMA does not specifically categorize or classify TPF as a *current* or *capital* account transaction. Further, no guidelines have been released by RBI on this subject matter. This lack of clarity has on occasion hindered the ability of Indian parties to access the global pool of funds.

1 Section 2(e), Foreign Exchange Management Act, 1999.

2 Section 2(j), Foreign Exchange Management Act, 1999.

3 Section 5, Foreign Exchange Management Act, 1999.

4 Section 6, Foreign Exchange Management Act, 1999.

Tax Considerations

Income tax in India is levied under the Income Tax Act, 1961 ("**ITA**"). Under the ITA, residents are taxed on their worldwide income in India, whereas non-residents are taxed only on income sourced in India.[1] TPF would have income tax implications in the hands of the recipient of the funds as well as the third-party financier. Income received is characterised under five different heads under the ITA: Income from salary, income from house property, profits and gains from business or profession, capital gains and income from other sources. Depending on the characterisation of the income, different tax rates would apply.

Implication in the Hands of Recipient of Funds

Funds received by a person resident in India from a third-party financier should be considered as income in the hands of the recipient. In the case of a TPF arrangement, the funding received by a person should be characterised as income from other sources. Section 56(2)(x)(a) of the ITA provides that where a person receives *"any sum of money, without consideration, the aggregate value of which exceeds fifty thousand rupees, the whole of the aggregate value of such sum"*, such amount is chargeable to tax under the head of income from other sources. Accordingly, the funded amount would be subject to tax at the rate of 30% (exclusive of cess and surcharge). The payment made to the third-party financier after the outcome of the litigation or dispute may be considered as an expenditure, for which a corresponding deduction may be allowed under the ITA.[2] In case of TPF by way of a loan agreement, the payments made to the third-party financier may be considered as interest payments in lieu of the loan received, and accordingly, a deductible expense under the ITA. The payments made to a non-resident third party financier would be subject to withholding tax under at the applicable rates in force.[3]

Implication in the Hands of the Third-party Financier

The third-party financier would receive income based on the outcome of the dispute. For a third-party financier in the business of financing disputes, the income would be categorised as income from business or profession.[4] Resident companies receiving this income are taxed in India at the rate of 25-30%, while non-resident companies are taxed at the rate of 40%. A non-resident may also take recourse to the tax treaty (if any) entered into between the country of which they are a resident and India. To the extent a tax treaty offers a more beneficial rate of tax as compared to the ITA, the non-resident financier may choose to avail the more beneficial tax treatment under the tax treaty, subject to the required conditions to avail such benefit being met. If such recourse is availed, the business income of the non-resident third-party financier would be taxable only in the state of residence of the financier. The income would be taxable in India only if the non-resident has a permanent establishment situated in India.[5]

1 Section 5, Income Tax Act, 1961.
2 Section 57, Income Tax Act, 1961.
3 Section 195, Income Tax Act, 1961.
4 Section 28, Income Tax Act, 1961.
5 Article 7, OECD Model Tax Convention.

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In a scenario where the proceeds received from the outcome of the dispute is not in respect of the business of the third-party financier, the proceeds received by the third-party financier would qualify as income from other sources, taxable at the rate of 30% (exclusive of surcharge and cess). As mentioned above, a non-resident third-party financier may avail the benefit of a tax treaty entered into by its resident country and India. In such a case, the income is taxed as per the rules for business profits under the tax treaty (as discussed in the above paragraph) or categorised as other income.[6]

Lastly, if the funding by the third-party financier is by way of a loan agreement or in the nature of a debt, the amount received from the proceeds of the outcome of the dispute may qualify as repayment of loan, to the extent of the amount of loan (funding) given. To the extent the amount constitutes repayment, it should not be taxable under the ITA. Any amount over and above the funding amount would be taxed as income in the hands of the third-party financier in the manner discussed above.

6 Article 21, OECD Model Tax Convention.

Conclusion

TPF has gained a lot of traction globally and has become an effective means to provide litigants with access to justice. While India does not have a comprehensive statutory framework to regulate TPF, courts have widely recognized TPF agreements as a valid way of funding litigants unless they are unequal, extortionate, immoral in nature. However, considerable gaps remain with respect to TPF agreements in India — like the classification of TPF under foreign exchange laws, the power of courts to order costs and/or security for costs against third-party funders (in relation to arbitrations and otherwise), validity of non-conventional models of products resembling a TPF arrangement, etc. It remains to be seen how these questions are addressed through legislation and judicial pronouncements.

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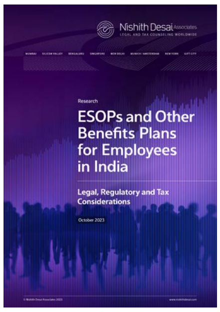

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