LitiCap PARTNERS

# Guide to Third Party Litigation Financing in India

# THIRD PARTY LITIGATION FUNDING IN INDIA, explained

Third-party litigation funding is a fast-emerging area in India, and with good reason - it allows businesses to access capital and expertise to litigate commercial claims, improve liquidity and increase their chances of a favourable outcome, and it offers investors an attractive product decoupled from other market forces.

# WHAT IS THIRD PARTY LITIGATION FUNDING (TPLF)?

All businesses encounter commercial contractual disputes that are a costly affair involving expenses of legal counsel, jury, tribunal, arbitration proceedings etc. These expenses can debilitate businesses, leading to bankruptcy before they receive their earnings and claims. Even companies that can afford the expenses typically have to divert cash flows away from their core business leading to an adverse impact on their business.

The defining feature of litigation finance is that it is non-recourse, or only paid back if the underlying cases are successful.

**Third-Party Litigation Financing is the financial support for litigation costs, provided by an entity that is not a party to the litigation. In return, the financier is the first to receive an agreed percentage of the claim amount recovered by way of decree, from a Court or an out-of-Court settlement.**

30,000 Cr

Total litigation expenses in India (2019)

78,000 Cr

Outstanding claims against a single entity - National Highways Authority of India

# Types of litigation suitable for litigation finance

**TPLF can potentially fund all kinds of lawsuits and disputes**

Commercial disputes involving breach of contract, intellectual property enforcement, anti-trust - funding can be accessed to release pressure on working capital and improve the chances of a favourable outcome

International arbitration - litigation finance can be accessed for international disputes. Such cases are complex and access to litigation finance can mean access to better legal representation

Post settlement monetisation - funding can also be accessed once a settlement is done but the final award is awaited. This can help liquidity and raise funds for working capital

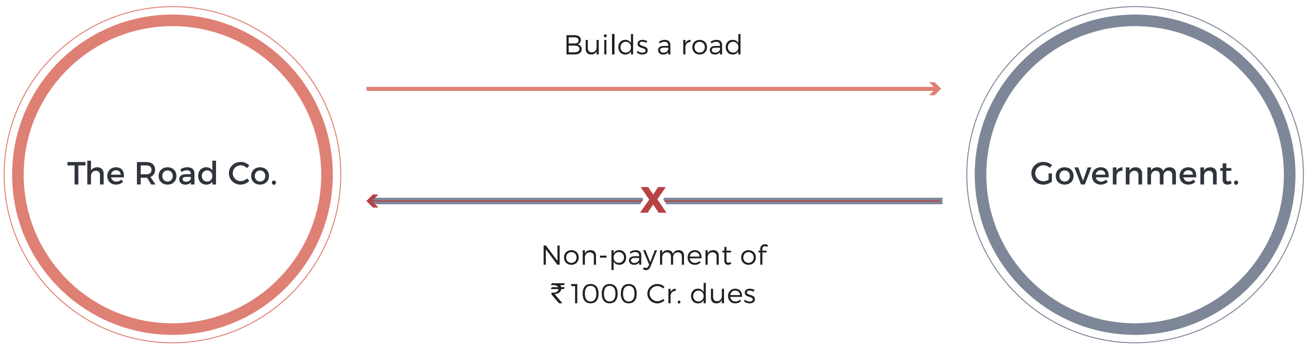
Disputes between businesses and government entities - such funding can help monetise claims against government entities

Tort or class action lawsuits - this is typically for civil class action lawsuits where a third party finances the cost of litigation for plaintiffs

Multi-claim portfolios - multiple claims can be bundled to access litigation financing at a larger scale

# HOW **TPLF** WORKS

## Here's an example of how TPLF works



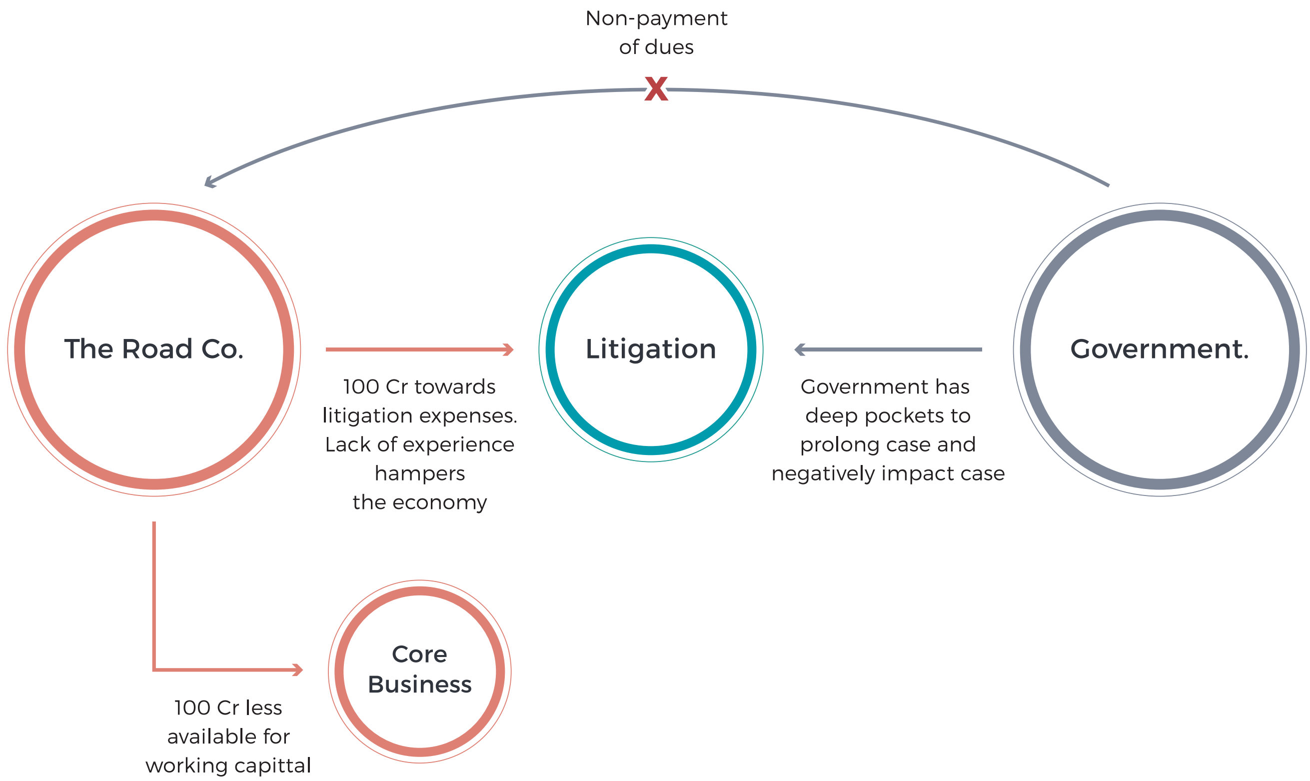

The Road Company, which builds roads, has a contract worth Rs. 1000 Cr with the Govt entity to build a road. The company has delivered on the contract but the payment has not been made due to contractual disputes and bureaucratic delays. The company enters into litigation to claim its dues. Here are 2 ways in which it could play out.

Claim amount
**Rs. 1000 Cr**

Legal expenses
**Rs. 100 Cr**

## Scenario A

The Road Company decides to enter litigation on its own




The firm decides to engage its own lawyer and enter into litigation at its own expense.

The funds for litigation expenses need to be diverted from working capital, so the company misses out on a couple of other large contract opportunities, adversely impacting future cash flows.

The company does not have a solid litigation strategy since this is the first litigation they have entered into.

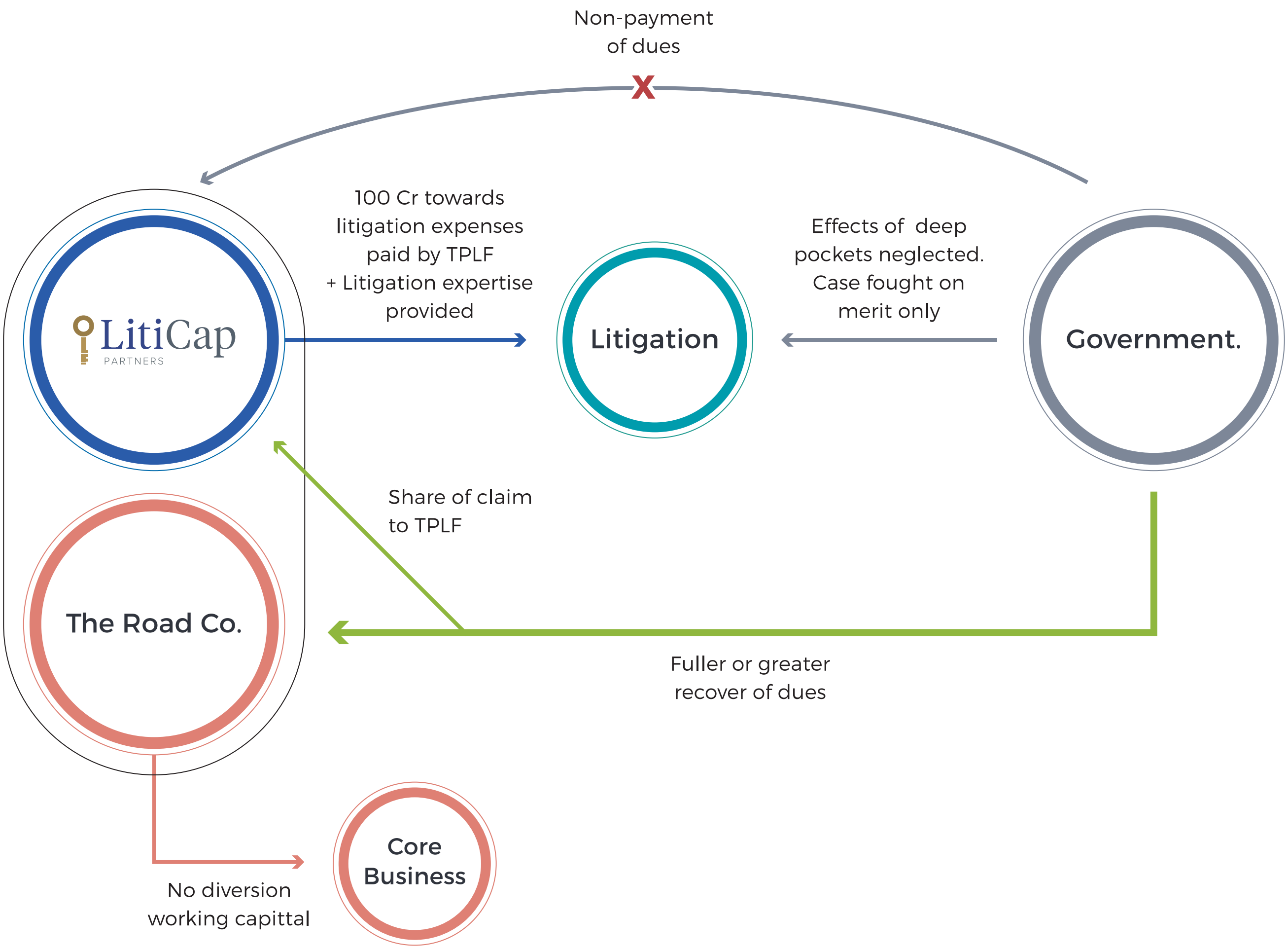
They also engage a legal firm that may not be suited to the specific type of litigation, impacting their chances of a positive outcome.

The Govt entity has much deeper pockets, and because the Road Company does not have a solid strategy, the case gets prolonged, legal expenses keep adding up and the firm may either need to settle for an amount lesser which is lesser than what the claim merits, or in the worst case the company may have to declare bankruptcy due to crippling legal costs.

Without income and with high expenses of litigation, business cash flows are crippled and operations come to a standstill -  the company risks losing everything.

## Scenario B

### The Road Co engages a third party ligitation financier like LitiCap




The firm engages a third party litigation fund to cover the litigation expenses and assist with legal strategy.

The firm's cash flows can now be put towards working capital instead of legal expenses and the firm is able to win a couple of more large contracts.

The TPLF partner outlines a litigation strategy based on its past experiences with such cases and proposes engaging one of the top law firms suited to such a case.

With financial backing, a sound strategy and the top legal expertise, The Road Company is awarded the entire claim quickly. Part of the proceeds goes to the TPLF partner. All this while, The Road Company has deployed its own funds wisely towards working capital and has bagged a few other large contracts.

# ADVANTAGES OF TPLF

# Advantages for businesses

## Offset risk

TPLF is provided on a non-recourse basis, which means that the financier only gets paid if the claim is successful. This can help businesses offset the risk of expensive litigation to a third party. This can help companies turn what would normally be a cost centre into a profit centre.

## Improved liquidity and working capital

TPLF covers the cost of expensive litigation so that companies can deploy their funds on working capital for their core business.

## Access to expertise

TPLF firms usually have a great network of law firms and legal experts. Financing for legal expenses also means that businesses can access top notch talent which otherwise may not have been possible

## Level the playing field

Parties with deep pockets usually have an inherent advantage in litigation. TPLF can help businesses avoid David vs Goliath scenarios and levels the playing field - which means that outcomes are more aligned with the merit of the claim instead of the size of the party.

> “Litigation funding allows lawsuits to be decided on their merits, and not based on which party has deeper pockets or stronger appetite for protracted litigation.”

**- Eileen Bransten**
New York Supreme Court Justice

# Advantages for investors

## High returns and historical performance

Litigation finance has historically given high returns to investors. For instance, LexShares, a leading fund, reports a 52% annualised return.

> “Litigation finance, as an asset class, has outperformed private equity, real estate, credit and hedge funds.”
>
> **- Bloomberg**

Indeed, a study by Professor Michael McDonald in 2016 on the litigation funding industry ROI indicated an average annual return of 36 per cent.

## Independent of other market forces

TPLF is decoupled from other market instruments like equity, debt, derivatives and the returns are based solely on the merit of the claim.

## Opportunity to diversify portfolio

The fact that TLPF is independent of other market based instruments also offers investors a great chance to diversify their portfolio and reduce risk.

## Moderate durations

Average life cycle of litigation is becoming shorter with each passing year, resulting in quicker monetisation of claims. Ongoing strengthening of arbitration frameworks is set to improve this even further. The lifecycle in of arbitration in India is typically 36 to 72 months.

## Lower risk

Depending on the type of litigation being financed and the selectiveness of the financier, litigation finance can have low capital risk. For instance, in contractual claims disputes the legal framework and outcomes are largely pre-determined within the contractual terms and the award is more a question of 'when' than 'if', so the risk of capital loss is low. In post-award financing, the risk is even lower since the award has already been determined. Various forms of litigation finance offer different risks.

# Advantages for law firms

## Lower liquidity risk

Delayed payments and protracted cases can be crippling for both clients and attorneys. Law firms can reduce risk by generating liquidity for clients to cover legal expenses.

**In 2018 survey of US lawyers, 70% said that their law firms had used litigation finance, up from 10% in 2012.**

- www.lexshares.com

## Acquire clients with credible claims

In India, Lawyers are not permitted to litigate cases based on contingencies. This means that often lawyers are unable to litigate cases that have credible claims. With the help of a third party financier, lawyers can work with clients with credible claims who would otherwise have issues with liquidity and managing legal expenses.

## Achieve better outcomes

Litigation is unfortunately often skewed towards the party with deeper pockets rather than solely based on the merit of the claim. By having the backing of a third party fund, law firms can litigate cases on an even footing and the outcome can be more aligned to the merits of the case.

# TPLF
# ABROAD

## TPLF is a mature industry in developed economies and has been around for decades. TPLF is fairly common in the US, UK, Australia, Singapore and Hong Kong.

The largest TPF funder in the world has an investment portfolio of approximately **US$ 2.4 Billion.**

The Global Litigation Funding Investment Market was valued at **US$ 10,916.3 Mn** in 2018 and is expected to reach **US$ 22,373.3 Mn** by 2027 growing at a CAGR of 8.3%

In Australia, a recent study found that almost **50% of federal class actions** in the last six years were funded by third parties.

## Notable examples

In a recent landmark decision, the High Court of Justice in London held that a prevailing party in arbitration could recover not only its legal costs, but also the £1.94 million that it was required to pay to its third party funder.

A TLPF firm, Augusta Ventures, funded class actions against mining company BHP and the labour contractors it used to employ workers. The claims demand compensation and penalties on behalf of workers, alleging that the workers were deliberately hired as 'casuals' when they were regular workers.

Burford Capital, the largest litigation funder funded the defence in 'The Gillette Company v. Provost, et al'. In 2015, Gillette sued startup ShaveLogic and former Gillette employees who had developed and patented technology to deliver a closer shave. The defendants were financially hard-pressed to defend themselves while still trying to build their business. Burford Capital underwrote both the defense and counter-claims, retaining the blue-chip law firm Bartlit Beck LLP. A favorable court ruling in April 2017 led to a quick settlement.

A Citigroup backed finance company made USD 11 million profit on a USD 35 million investment in class action lawsuit brought by workers who developed illnesses working at Ground Zero, following the September 11, 2001 terrorist attacks.

# TPLF
# LANDSCAPE IN INDIA

## The Indian litigation and arbitration landscape are ripe for disruption by Third-Party Litigation Finance due to a combination of improved policy frameworks for arbitration, lower risk claims against Government entities. and the establishment of greater legal precedent for TPLF.

According a Government of India Press Note the total amount currently tied up only in infrastructure project related arbitrations in 2016 is estimated at **Rs 70,000 crores.**

In India, total litigation expenses **exceeded 30,000 crores in 2019** while a single govt entity, National Highway Authority of India (NHAI), has outstanding arbitration **claims of 78,000 crores** against it.

In fact, it is estimated that Indian companies currently make up **30% of the total arbitration cases** handled by Singapore and London.

**Indian companies in sectors such as infrastructure, construction and energy often get into contractual disputes with the state. Companies entering into international contracts and joint ventures among Indian and foreign partners are other potential areas suitable for litigation funding in India**

# Legality of TPLF in India

The Supreme Court in Bar Council of India v. AK Balaji (2015), has clarified the legal permissibility of TPF in litigation and observed that

**"There appears to be no restriction on third parties (non-lawyers) funding the litigation and getting repaid after the outcome of the litigation."**

The (Indian) Code of Civil Procedure, 1908, Order XXV Rule 3)

However, as on date, there is no legislative instrument that regulates such funding.

**Currently, there is no law which expressly bars or allows third-party funding agreements in arbitration. The Arbitration and Conciliation Act, 1996 (1996, Act) governs arbitration in India.**

Third-party funding is expressly recognised in the context of civil suits in States such as Maharashtra, Gujarat, Madhya Pradesh and Uttar Pradesh. This consent to third-party funding can be found in the Civil Procedure Code, 1908, (CPC).

# Greater predictability and lesser risk

The Indian TPLF market brings a factor of greater predictability than any other in the world. The majority of commercial disputes in India are a violation of contractual agreements between the government and a business, unlike private party litigations in U.S. Early mover funds like LitiCap, exclusively fund claimants that have delivered their contractual obligations, and where the respondent is shrugging the payment obligation due to bureaucratic indecisiveness and inaction from Government entities.

**Additionally, any unforeseen delays in recovery of dues are also covered by interest payments on the amount due. This is unique to TPF as an asset.**

This means the predictability of these outcomes is entirely pre-determined by an existing contractual agreement. There are few other investment instruments that provide this degree of predictability against.

Also, since the claims in such cases are due from the Government, it is free of risk of bankruptcy of the debtor.

# Improved arbitration framework

The Arbitration and Conciliation Act, 1996 (1996, Act) governs arbitration in India. A 2015 amendment brought some much-needed changes to improve the predictability and outcomes of cases in arbitration

Prime Minister Modi addressed the **"Global Conference on Strengthening Arbitration and Enforcement in India"** held in October 2016 and declared that a **"vibrant ecosystem for institutional arbitration"** was one of his government's priorities.

TPLF is an attractive investment opportunity in India more than ever due to recent amendments that limit the timelines of commercial dispute resolution and increase the predictability of outcomes.

## Some of the key highlights of 2015 Amendments to the Arbitration and conciliation Act, 1996 ("2015 Amendment Act") include

Setting up of an Arbitration Promotion Council of India for grading arbitral institutions in India,

Addressing delays in the conduct of onshore arbitration, by providing that all Indian-seated arbitral tribunals must render their award within 12 months from the date of appointment.

Creation of a specialist arbitration bar,

Removal of the 'automatic stay' previously applied which prevented enforcement while an onshore award is subject to appeal in a court.

Set a one-year time limit for the decision on a challenge application which is likely to reduce the number of awards being challenged in the Indian courts.

Creation of a specialist arbitration bench,

Only providing a six month period for submission of pleadings,

Immunity for arbitrators,

Confidentiality of arbitration proceedings,

Appointment of arbitrators to be made by arbitration institutions,

Provisions enabling recognition of emergency awards by emergency arbitrators,

Maintaining an electronic depository of arbitral awards, amongst others.

**Taking its support one step further, the Maharashtra Government recently announced that all cases of a value of more than five crore INR will have to compulsorily contain institutional arbitration clauses as the mode of dispute resolution.**

# Notable recent arbitrations awards in India

### Hindustan Construction Company (HCC)

Arbitration started in 2013
Year of Payment - 2019

**HCC has 56 arbitration awards outstanding totalling to INR 6,419 Crores of this INR 2,532 Crores has been withdrawn against Bank Guarantee (BG), remaining INR 3,887 Crores yet to be received.**

### Bangalore Elevated Tollway Private Limited (BETPL)

Arbitration started in 2015
Year of Payment - 2019

**Claim of Rs. 492 Cr awarded by an Arbitration Tribunal.**

### IL&FS Engineering & Construction Co. Joint Venture with Gayatri Projects

Arbitration started in 2014
Year of Payment - 2019

**The firm won the arbitration claim worth INR 914.3 Crores for a Nagaland Project. Additionally, the award amount also accrued an interest @12% p.a.**

### Infrastructure Leasing & Financial Services (IL&FS) Transportation Network's Subsidiary "Pune Sholapur Road Development Company (PSRDCL)

Arbitration started in 2013
Year of Payment - 2019

**An Arbitral Tribunal directed National Highways Authority of India (NHAI) to pay INR 547.96 Crores to PSRDCL. NHAI challenged the arbitral award (passed by the Arbitral Tribunal in 2017) before the Delhi High Court. The High Court dismissed NHAI's petition & affirmed the arbitral award passed in favour of PSRDCL.**

### L&T Infrastructure Development Projects Limited

Arbitration started in 2016
Year of Payment - 2019

**L&T IDPL - In April 2019 NHAI & L&T IDPL concluded a settlement payment for a project been completed & handed back to NHAI. L&T has received 75% advance against three arbitration awards that the National Highways Authority of India (NHAI) has appealed against.**

# An emerging international hub for arbitration

India is set to try and become an international hub for arbitration along the lines of Singapore and Hong Kong. The set-up of the Mumbai Centre for International Arbitration (MCIA) in October 2016 and the recent promulgation of the New Delhi International Arbitration Centre (NDIAC) Ordinance 2019 are steps in this direction.

“It is an interesting time for arbitration in India and the MCIA is well-placed to take advantage of growth in the market.”

**- Neeti Sachdeva,**
MCIA Registrar

The MCIA is the first of its kind arbitral institution in India providing dedicated arbitration hearing facilities and has conducted over 100 arbitrations at its premises. It emerged from a joint initiative between the State Government and the domestic and international business and legal communities. It now boasts of a full set of institutional rules, a Council composed of Indian as well as overseas members, and a top-notch arbitration centre with hearing facilities in Mumbai.

Naveen Raju, legal head of Mahindra and Mahindra, also says institutional arbitration is preferred to ad hoc arbitration.

“In the past two years, we have introduced institutional arbitration as our preferred mode of dispute resolution in standardised contracts and use the MCIA as the administering institution. We have experienced shortcomings of ad hoc arbitrations and believe that institutional arbitration is a better alternative in relation to time, cost and efficiency in administration of disputes. We rarely face resistance from our business partners in agreeing to using MCIA.”

Litigation finance is an industry that seems set for rapid growth in India. Plenty of large foreign TPF firms and private equity firms have shown interest in TPF in India. Indian businesses are beginning to consider litigation finance seriously as a risk and cost management tool for arbitration. With an improved regulatory framework, solid legal grounding and a lot of cases that would qualify as low hanging fruit, like contractual claims against government entities, the market is ripe for disruption.

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