THIRD-PARTY LITIGATION FUNDING FOR AVOIDANCE ACTIONS: THE KEY TO TRAPPED RECOVERIES FOR CREDITORS

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*The clawback of value lost by a debtor's estate due to avoidance transactions is a notoriously fact-intensive, time-consuming and expensive affair. This paper examines whether third-party litigation funding ("**TPLF**") can mitigate these issues and improve the speed and outcome in avoidance actions. The paper undertakes this evaluation in the context of the Indian avoidance transactions framework, but pulls together what research shows in the Indian context for other jurisdictions. First, the paper identifies key bottlenecks under the current framework and argues that the availability of TPLF can markedly improve the Indian avoidance transactions regime. Second, the paper explores whether the current legal landscape presents a viable market for funding. Even if TPLF could improve the Indian framework in theory, funders will only invest in Indian claims if they are confident that the investment will give a good return within a predictable time horizon. The paper therefore looks at the current legal framework from a funder's perspective. It outlines key parameters that funders typically assess while considering a proposal for litigation funding and evaluates challenges that funders are likely to face in funding avoidance claims in India.*

Overall, the paper concludes that the Indian market for avoidance claims offers funders an untapped investment avenue, but the legal framework requires critical reforms to make outcomes in avoidance actions faster and more predictable. This is crucial to attract funding for avoidance actions and build a robust market for TPLF. Although the paper is set in the Indian legal context, the issues and reforms discussed hold relevance for other jurisdictions seeking to bolster their avoidance transactions regime through TPLF. For instance, the issues identified in the current regime, such as an acute shortage of funds to pursue avoidance actions, are not unique to India. Similarly, the discussion on key parameters considered by funders before making funding decisions will be useful for any jurisdiction looking to attract funders for avoidance actions.

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1. INTRODUCTION

The implementation of the Insolvency and Bankruptcy Code, 2016 ("**IBC**") marked a pivotal moment in corporate India. Introduced at a time when Indian banks and financial institutions were plagued by an alarming NPA crisis, ineffective debt recovery mechanisms and a promoter-driven credit culture, the IBC made a valiant attempt to address deep-rooted cracks in the Indian credit industry. It repealed the existing debtor-driven rescue mechanisms and replaced them with a time-bound, creditor-driven framework for insolvency resolution. A default in repayment of debt now exposes Indian companies to the risk of 'corporate insolvency resolution process' ("**CIRP**") under the IBC, which has serious ramifications for company managers and promoters. Once admitted into CIRP, the board of directors of the company is suspended and an insolvency practitioner ("**IP**") is appointed to take charge of company operations and the resolution process. More significantly, the company's promoters are prohibited from retaining any direct or indirect ownership in the company and from participating in its resolution.[1] By ousting promoters from the rescue process, the IBC has made crucial strides in dismantling the 'promoter's paradise'[2] that was pervasive under the erstwhile restructuring and insolvency regimes. In fact, it has raised the stakes of responsible credit behaviour and good corporate management for Indian promoters "in a single stroke"[3]

Nevertheless, there remains one area where the statute has made little progress in checking errant promoter behaviour – the avoidance transactions regime. As the company's descent into insolvency becomes inevitable, promoters can feel inclined to execute dubious transactions that benefit select creditors, group companies, family members or other third parties. For instance, promoters may choose to settle debts of certain creditors key to the group business, or transfer company assets to group companies at undervalue or to relatives as 'gifts'.[4] The avoidance provisions, set out in Sections 43-51 of the IBC, are designed to enable IPs to unwind such opportunistic transactions and augment the value of the debtor's estate. To this end, the IBC tasks the IP with investigation of transactions undertaken by the debtor during a 'twilight period' prior to the commencement of CIRP. Any transactions occurring during this period and falling within the scope of the avoidance provisions, are reported by the IP to the insolvency tribunal supervising the CIRP by way of an avoidance application.

Unfortunately, the avoidance transactions framework under the IBC has proved to be inefficient. Until 31 December 2022, IPs had filed 847 avoidance applications before insolvency tribunals, involving claims worth a staggering INR 2.8 trillion.[5] Tribunals have only managed to deal with 143 applications so far and clawed back a meagre 1.8% of the amounts involved.[6] In addition, practitioners have voiced concerns that the voidable transactions

[1] IBC, s 29A.
[2] Madhavi Divan and Sahil Monga, 'Promoter's Paradise Lost' in *Quinquennial of Insolvency and Bankruptcy Code, 2016* (IBBI 2021) 188.
[3] ibid. See also Ministry of Finance, Government of India, *Economic Survey: 2022-23* (2023) 93.
[4] United Nations Commission on International Trade Law, *Legislative Guide on Insolvency Law* (2005) 148 <https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722_ebook.pdf> accessed 15 March 2023.
[5] IBBI, 'Quarterly Newsletter for October-December 2022' (2022) 17.
[6] ibid.

reported to insolvency tribunals over the last 7 years may only be a fraction of the real figures.[7] IPs face a strenuous uphill battle in pursuing avoidance actions, as they encounter difficulties in obtaining access to debtor records, cooperation from debtor personnel and adequate funds to meet the costs of litigation. These challenges have disincentivised IPs from investigating and reporting avoidance transactions, often rendering this a 'tick in the box' exercise among the IP's many duties.[8]

The Insolvency and Bankruptcy Board of India ("**IBBI**"), the Indian insolvency regulator, has taken note of the poor state of avoidance actions under the IBC and pushed for reform in this area. In June 2021, the IBBI hosted discussions with practitioners from the UK, US and Singapore to discuss strategies for better case management of avoidance applications.[9] It noted that there was a need to incentivise IPs to investigate and report these transactions and devise a framework that is effective in clawing back value lost by creditors to suspect transactions.[10] Between December 2021 and June 2022, the IBBI published discussion papers and implemented amendments geared towards improving the avoidance regime. The climate of discussion and reform around the avoidance framework presents a fitting opportunity to explore the issues that afflict this area. Crucially, such an exploration also opens up opportunities to consider potential solutions.

In this paper, I evaluate how third-party litigation funding ("**TPLF**") can address existing challenges. TPLF entails the process of a third-party, which has no direct interest in a litigation, funding the costs of the litigation for one party in exchange for a share in the proceeds recovered.[11] The return for the funder is conditional on the success of the case. If the litigant wins the case, it shares an agreed portion of the proceeds with the funder. If it loses, the funder receives no return on its capital. The funder does not exercise control over the litigation or the litigant's decision-making, even where the funding arrangement contemplates active involvement of the funder in certain aspects like settlement negotiations.[12] In cases where funders would prefer to have a monopoly over the litigation process and proceeds, they purchase the claim from the litigant against upfront consideration.[13]

In considering the application of TPLF to avoidance actions, I have set out two ambitions for this paper. First, the paper evaluates how TPLF can help mitigate deficiencies in the Indian avoidance transactions framework and identifies some key legal reforms that will be necessary to attract funders. Second, the paper pulls together findings from the evaluation of TPLF in the Indian insolvency framework for other jurisdictions. This is possible because several issues and reforms explored in the paper are not unique to India. Further, TPLF is not widely used for

[7] IBBI, 'Consultation paper on issues related to reducing delays in CIRP' (2022) 3.
[8] *In the matter of Suraj Fabrics Industries Limited* CP (IB) No 1635/KB/2018; Manish Aggarwal, 'Making the IBC more effective' *Financial Express* (5 August 2021) <www.financialexpress.com/opinion/making-the-ibc-more-effective/2304475/> accessed 15 March 2023.
[9] IBBI, 'Quarterly Newsletter for January-March 2021' (2021) 24.
[10] International Insolvency Institute-III 'Avoidance/Vulnerable Transactions Case Management INDIA/US' (2 June 2021) <www.youtube.com/watch?v=M5uzA_b4g28> accessed 15 March 2023.
[11] Nick Rowles-Davies, *Third Party Litigation Funding* (Jeremy Cousins ed, Oxford University Press 2014) 4.
[12] Gian Marco Solas, *Third Party Funding: Law, Economics and Policy* (Cambridge University Press 2019) 118. See also Sam Eastwood, 'Litigation Funding: A changing Market' (2008) 1 Corporate Rescue and Insolvency Journal 30.
[13] ibid.

pursuing avoidance actions, or in insolvency litigation generally. The discussion in the paper is thus relevant for any jurisdiction that is considering bolstering its avoidance transactions regime through the development of a TPLF market.

With these goals in mind, the paper is structured as follows: In section 2, I identify some key bottlenecks in the current avoidance framework and examine each on two fronts. First, I consider how the introduction of TPLF can help mitigate the existing challenge. Second, I evaluate reforms implemented by the Indian government to address the issue. I argue that: (a) an active TPLF market can improve outcomes in avoidance actions; and (b) the ongoing reform work has improved the avoidance transactions framework, setting the stage to make this an attractive market for funders. In section 3, I turn to examine whether the Indian avoidance transactions regime presents a viable framework for use of TPLF in practice. Even if a market for TPLF can *theoretically* improve outcomes for avoidance actions, in practice, funders will only finance claims if they are confident that their investment can provide a good return within an identified time horizon. Taking the funders' perspective, I discuss key parameters that funders typically assess while considering a proposal for litigation funding. I evaluate the difficulties that the current landscape might present to funders and consider reforms that will facilitate TPLF. Section 4 concludes the paper.

Overall, I conclude that the growth of TPLF will undoubtedly strengthen the Indian avoidance transactions regime and reforms should be implemented to facilitate its development. For commercial funders, the market for avoidance actions presents opportunities for enormous returns, but further reforms are required to make the legal framework fast and predictable. The paper limits its scope of examination to issues that arise in pursuing avoidance actions in the CIRP, whereby the IP attempts to resolve the debtor's insolvency as a 'going concern'. Similar challenges are likely to be prevalent in the corporate liquidation process as well.

2. DEFICIENCIES IN THE CURRENT FRAMEWORK

Avoidance claims that are high-value and meritorious can be among the most valuable assets of an insolvent debtor. For creditors under the IBC, these actions can take even more significance. As of 31 December 2022, banks and financial institutions have only recovered 32.59% of the value of their claims through resolution plans under CIRP and less than 8% in liquidation processes.[14] Avoidance actions can therefore present a vital avenue to reduce creditor haircuts and improve recoveries. Unfortunately, the current regime suffers from some significant deficiencies. Without claims of exhaustiveness, I identify four key issues: (a) lack of funding avenues available to IPs to pursue litigation involving avoidance claims ("**Avoidance Litigation**"); (b) lack of reporting of avoidance actions; (c) delays and backlogs in the adjudication process; and (d) the absence of a settlement mechanism. This section of the paper examines these issues and considers whether TPLF can help mitigate these challenges. In addition, the section evaluates reforms implemented by the Indian government to address the challenges. This evaluation provides a holistic view of the current regime and gains greater relevance in section 3, where the regime's attractiveness is scrutinised from a funders' perspective.

[14] Newsletter 2022 (n 5) 14.

2.1. Lack of funding avenues

Globally, the most significant impediment in the pursuit of avoidance actions has been the unavailability of funds to pursue these claims.[15] The situation is no different in India. For IPs, the most straightforward means to meet the costs associated with avoidance actions is to draw on the internal funds of the insolvency estate.[16] However, the insolvency of the debtor means that it is likely to be facing a liquidity crisis. Any funds available in the debtor's estate will usually be applied in meeting the immediate administrative costs of the CIRP and maintaining the debtor as a going concern. The second and more common alternative available to the IP is to request the members of the debtor's committee of creditors ("**COC**")[17] to inject funds into the debtor as interim finance.[18]

Interim finance constitutes part of the 'insolvency resolution process costs' and is paid in priority to all other distributions from the estate.[19] However, IPs have faced considerable challenges in raising interim finance as creditors are often reluctant to throw good money after bad.[20] A study of 1,962 companies in CIRP and liquidation proceedings under the IBC confirms this view – finding that only 7% of debtors received *any* form of interim finance.[21] Creditors may be even more reluctant to spend money on Avoidance Litigation. First, they may be wary of the uncertainty involved in pursuing the action to its fruition, especially as the duration of the legal process and the quantum of returns may be difficult to assess.[22] Second, they may fear that the respondent will deploy "wrecking tactics", [23] such as seeking adjournments, or filing appeals, further piling up costs. Third, creditors may have competing interests *inter se*.[24] IPs are thus left to look to third parties to obtain interim finance.

<u>Impact of TPLF</u>

Given the limitations on existing funding avenues under the IBC, TPLF can provide IPs with a promising channel for funding Avoidance Litigation. In a TPLF arrangement, the funder agrees to meet some or all of the legal costs associated with the litigation. As payment to the funder is contingent on the success of the case, TPLF provides IPs with a low-risk avenue to

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[15] UNCITRAL (n 4) 150.
[16] Sumant Batra, *Corporate Insolvency: Law and Practice* (Eastern Book Company 2017) 337.
[17] The committee of creditors comprises of financial creditors of the debtor (such as banks and financial institutions) and makes key decisions regarding the administration of the CIRP and the course of the debtor's insolvency resolution. For example, the COC decides on availing of interim finance, selection of the most viable resolution plan, and where appropriate, recommends the debtor to liquidation.
[18] ibid; Ashwin Bishnoi, 'Third Party Litigation Funding: Opportunities under the IBC' in *Quinquennial of Insolvency and Bankruptcy Code, 2016* (IBBI 2021) 315.
[19] IBC ss 5(13)(a), 30(2)(a) and 53(1)(a).
[20] International Finance Corporation, *A Handbook on Understanding the IBC: Key Jurisprudence and Practical Considerations* (IFC 2020) 110; Bishnoi (n 18) 315; Gopika Gopakumar, 'Banks wary as IRPs look to raise funds in insolvency cases' *LiveMint* (6 September 2017) <<u>www.livemint.com/Companies/ApPt3UuHj0rEsYTxojb96J/Banks-wary-as-IRPs-look-to-raise-funds-in-insolvency-cases.html</u>> accessed 15 March 2023.
[21] Ajanta Gupta and Ritesh Kavdia, 'Last Mile Funding: A Way Forward' in *Anusandhan: Exploring New Perspectives on Insolvency* (IBBI 2022) 17, 22.
[22] Vanessa Finch and David Milman, *Corporate Insolvency Law: Perspectives and Principles* (3rd ed, Cambridge University Press 2017) 473.
[23] ibid.
[24] Bishnoi (n 18).

fund avoidance actions.[25] For funders, the benefit is a significant return on the investment. This could be agreed as a percentage of the amount recovered upon success of the case (typically between 15-40%);[26] multiples of the amount of funding provided (usually 3 or 4 times);[27] or some other bespoke arrangement.[28] Funders will usually tie the disbursement of funds and return-sharing arrangements to milestones in the case, adjusting them based on the risks involved and the expected duration of the case.[29]

TPLF thus allows IPs with meritorious claims to bring litigation that they would otherwise have been unable to pursue.[30] The creditors benefit as well, as they retain nearly 60% of the total recoveries without spending any amount on litigation and bearing any financial risk.[31] Their only downside is the time and effort spent in the litigation and the portion of proceeds paid to the funder.

Reforms

The IBBI has tried to tackle the glaring gap in funding avenues, but only in liquidation proceedings. It has introduced a mechanism that allows the liquidator to assign certain statutory 'rights of action' to third parties against upfront consideration. The IBBI discussion paper underlying this mechanism ("**Discussion Paper**") notes that the liquidation estate may consist of assets that cannot be readily converted into cash and may require an indefinite period of time for their realisation.[32] This includes contingent assets as well as assets underlying avoidance actions. The liquidation regulations define these as 'non readily realisable assets' ("**NRRA**"). The IBBI recognises that NRRAs can pose hurdles in the liquidation procedure as their realisation can take a long time and the realisable amount is at best, a 'guesstimate'.[33] Further, the lack of funding available to realise such assets adds to delays and depletes the value of the estate. Given these issues, the IBBI observed that it was worth considering assignment of NRRAs "*for whatever amount the market is willing to pay and distribute the same among stakeholders*."[34] The liquidation regulations have thus empowered the liquidator to assign NRRAs against upfront consideration to eligible parties. Two aspects of this mechanism are relevant from a TPLF lens.

First, it is imperative that the option to assign rights over avoidance actions be introduced for CIRPs. Where the IP fails to procure funding for Avoidance Litigation, assignment of avoidance actions can improve recoveries for creditors.[35] This flexibility will give IPs a menu

[25] Batra (n 16) 338.
[26] Jasminka Kalajdzic, Peter Cashman and Alana Longmoore, 'Justice for Profit: A Comparative Analysis of Australian, Canadian and US Third Party Litigation Funding' (2013) 61(1) The American Journal of Comparative Law 93, 100; Rowles-Davies (n 11) 63.
[27] Rowles-Davies (n 11) 63.
[28] Solas (n 12) 138.
[29] ibid 6; Solas (n 12) 258.
[30] Maya Steinitz, 'Whose Claim Is This Anyway? Third Party Litigation Funding' (2011) 95(4) Minnesota Law Review 1269, 1276.
[31] ibid.
[32] IBBI, 'Discussion Paper on Corporate Liquidation Process' (2020) 1.
[33] IBBI (Liquidation Process) Regulations 2016, reg 37A.
[34] ibid 3.
[35] Pooja Mahajan and Clare Tanner, 'Assignment of Actionable Claims' in *Insolvency: Now and Beyond* (IBBI 2022) 61, 83.

of funding options – they may take up TPLF themselves, or sell the avoidance claim to creditors, a purchaser of the business out of insolvency ("**Successful Bidder**") [36], or a funder at discount. In fact, the difference in risk appetite and incentives for potential assignees can help develop an active market for such claims. For instance, the Successful Bidder may wish to purchase a claim if it lies against a key vendor whose favour it requires to turnaround the business.[37] Creditors may purchase the claim if they wish to hold leverage over the respondents involved. Funders of course, may be interested in pursuing a promising claim for profit. As each of these actors will have varied incentives and risk appetites towards a particular avoidance action, a menu of options will give the IP the greatest chance of maximising recoveries from avoidance claims. This will also strengthen the avoidance regime, as more cases are likely to be reported and pursued. For funders, this translates to a larger market. Notably, the sale of avoidance claims as an asset class is a practice allowed in the UK,[38] Australia[39] and Singapore,[40] including in insolvency proceedings outside of liquidation. Its introduction for CIRPs is worth considering.[41]

A second issue that deserves attention is the manner of assignment. The discussion paper had proposed that assignment should be made possible in two ways: (a) by absolute assignment, where the assignee will have full rights over the assets, including the power to bring the action to an end; or (b) by assignment with recompense facility, which allows the liquidator to assign the asset for certain upfront initial consideration.[42] Any subsequent value recovery above the initial consideration would be shared between the assignee and the assignor. However, when the relevant amendments were introduced, the IBBI only provided option (a). It noted that a recompense facility would require continuous monitoring of the claim by the liquidator and the establishment of an effective distribution mechanism after dissolution of the debtor.[43] This would be difficult to achieve if the liquidator is subsequently discharged and would also involve additional costs.[44] However, these challenges could have been left to market players to overcome through transaction structuring and documentation.

The absence of a recompense facility deprives creditors of the option to partake in recoveries where a well-resourced third-party, like a funder, purchases the claim. For funders, absolute assignment of the claim can give them control over the litigation and a monopoly over the recovered proceeds. But it also increases risks due to adverse selection and moral hazard issues. Since the IP will have more information than the funder, there is a possibility that IPs may try to sell weak claims to funders in an attempt to increase recoveries.[45] They may highlight only the merits or hide some critical information, leading the funder to misprice the risk of a claim

[36] The purchaser is selected by the COC through a bidding process from among the bidders who submit a 'resolution plan' for acquisition and turnaround of the debtor.
[37] See Insolvency Institute (n 10).
[38] Small Business, Enterprise and Employment Act 2015, s 246ZD.
[39] Bankruptcy Act 1966, sch 2 – Insolvency Practice Schedule (Corporations), s 100-5.
[40] Insolvency, Restructuring and Dissolution Act 2018, First sch, para (f).
[41] See, Mahajan (n 35) and Bishnoi (n 18), who also take this view.
[42] Discussion Paper (n 32) 3.
[43] IBBI, 'Gist of public comments on Discussion Paper on Corporate Liquidation Process and views of the Board thereon' (2020) 3.
[44] ibid.
[45] Solas (n 12) 153, 200.

or purchase a well-packaged unmeritorious claim. The information asymmetry thus creates an adverse selection problem for funders. If the information asymmetry becomes widely prevalent in the market, the issue of adverse selection may snowball into a 'market for lemons' problem. Funders will continuously face informational asymmetry and fear that they may be investing in an unmeritorious claim (a sour 'lemon'), so they will minimise risks by refusing to pay more than an average market price for *all* claims – irrespective of the actual merits of a particular case. The meritorious claims in the market will not find a suitable buyer, as no funder will be willing to pay as much as the actual value of the claim. These claims will leave the market to explore more commercially worthwhile avenues, ultimately leaving the market flooded with unmeritorious claims or lemons – creating a 'market for lemons'.[46] These risks may be reduced under the IBC as IPs are required to act on the instructions of the COC and are subject to the supervision of the IBBI. However, risks arising on account of information asymmetry cannot be eliminated altogether.

This apart, funders also face the risk that IPs or creditors will lose the incentive to assist them or engage in behaviour detrimental to their interests once the claim is purchased. This is a moral hazard problem, as parties who can impact the matter have no stake in its outcome.[47] Given these issues, funders may wish to align interests and risks, preferring that litigants maintain an interest in the outcome of the case. If this is not possible, funders will need to address these risk management issues through other means, including costly and extensive due diligence and documentation. These problems will be resolved to some extent if a recompense option is available, as funders will have flexibility in structuring the assignment.

2.2. Lack of reporting

The IBC requires IPs to file applications for avoidance transactions identified by them to the relevant insolvency tribunal within 135 days of the commencement of CIRP.[48] Currently, IPs lack incentives to investigate, report and pursue avoidance actions. Instead, they regard this as a 'tick in the box' exercise.[49] There are several reasons for this. First, IPs often lack adequate time to investigate transactions of the debtor, especially in large companies where administration of the CIRP within the tight timelines prescribed under the IBC is a challenge.[50] Second, IPs may lack requisite information to identify an avoidance transaction. This arises where the debtor lacks adequate systems of record-keeping or where the management refuses to cooperate.[51] An empirical study of 1,189 companies in CIRP found that 80% of the debtors maintained poor accounting records and lacked in proper documentation and filing practices.[52] The study also surveyed 431 IPs, finding that 75% of those surveyed believed there were

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[46] See George Akerlof, 'The Market for "Lemons": Quality Uncertainty and the Market Mechanism' (1970) 84(3) Quarterly Journal of Economics 488.
[47] Solas (n 12) 201. See also Steinitz (n 30) 1323; Aaron Katz, 'Third-Party Litigation Financing in the US' (Practical Law, 2022).
[48] IBC, s 25(2)(j) read with IBBI (Insolvency Resolution Process for Corporate Persons) Regulations 2016 ("**CIRP Regulations**"), reg 35A.
[49] Aggarwal (n 8).
[50] *Tata Steel BSL Limited v Venus Recruiter Private Limited* 2023/DHC/000257.
[51] Neeti Shikha and Urvashi Shahi, 'Assessment of Corporate Insolvency and Resolution Timeline' (IBBI Research Initiative 2021) 6; IBBI Consultation Paper (n 7) 3, MCA, *Report of the Insolvency Law Committee* (2022) 26.
[52] Shikha (n 51).

"general inhibitions in sharing information with them."[53] Even though IPs are empowered to approach insolvency tribunals and obtain orders directing the debtor personnel to cooperate, only 3% of the IPs surveyed had taken this route.[54] Lack of proper record-keeping and cooperation from debtor personnel is therefore a significant hurdle in the identification of avoidance transactions under the IBC.

Third, even where IPs identify suspect transactions, they may find that evidence to build a compelling case is lacking – especially as each avoidance action reported under the IBC needs to be proven on merits and adjudicated to finality in insolvency tribunals.[55] In such cases, IPs choose to forego filing the avoidance application, rather than pursue a case that has some *prima facie* merit but does not meet the evidential burden of proof. Fourth, the adjudication of avoidance claims is also a lengthy process[56] and often involves levels of appeals, requiring great fortitude from IPs. Finally, a lack of funding further disincentivises IPs from pursuing these claims, as discussed in section 2.1. Some or all of these problems are likely to exist in different degrees in other jurisdictions as well, particularly those where the existing management is displaced, and an independent IP is appointed to administer the insolvency proceedings.

<u>Impact of TPLF</u>

A market for TPLF has the potential to spur IPs to investigate the debtor's business with more vigour and thus identify and report more avoidance actions. Presently, even if IPs identify a meritorious claim, the near absent avenues for funding Avoidance Litigation prevents them from pursuing it. This may cause IPs to lose the motivation to thoroughly investigate the business or report even meritorious claims. Once the core issue of funding is resolved, IPs will have greater incentives to report avoidance transactions. In addition, creditors will be induced to contribute more funds into investigations and hold IPs more accountable for failure to pursue claims. Where the IP's challenge relates to issues with investigation, such as poor record-keeping or lack of cooperation from debtor personnel, there is little help that litigation funding can provide. However, the IBBI has taken the mantle to bring reform in this regard.

<u>Reforms</u>

In June 2022, the IBBI amended the CIRP Regulations to require that debtor personnel, promoters and any other persons associated with the debtor's management provide information to the IP within such time and in such format as requested by her.[57] This is expected to assist IPs in obtaining information from debtor personnel in a more useful and timely fashion. More crucially, the regulations extend the obligation to cooperate to all creditors of the debtor, stating that creditors *shall* provide the IP with information in respect of the assets and liabilities of the debtor from the last valuation report, audit report etc and other information that the IP may require to conduct the CIRP.[58] This equips the IP with alternative means to access information

[53] ibid.
[54] ibid.
[55] ILC Report 2022 (n 51).
[56] ibid.
[57] CIRP Regulations, reg 4(2).
[58] ibid reg 4(3).

where debtor personnel are reluctant to cooperate. The IP is thus expected to have a more efficient flow of information. Finally, the Insolvency Law Committee ("**ILC**")[59] in its February 2020 report ("**2020 Report**")[60] has also recommended that creditors, individually or in groups, as well as the COC be permitted to file avoidance applications if IPs fail to do so. At present, creditors are permitted to bring proceedings in relation to transactions executed at undervalue only.[61] If this recommendation is implemented, as the government is proposing to do,[62] the volume of avoidance cases will rise further.

2.3. Challenges in the adjudication process

The Indian judicial system has gained notoriety for an enormous backlog of cases. To ensure faster and more expert disposal of commercial matters, 15 specialised National Company Law Tribunals ("**NCLTs**") have been established to deal exclusively with matters arising under company law and the IBC, including avoidance applications.[63] NCLTs have made strides in meeting this goal, with data suggesting that 75% of cases filed before tribunals have been disposed of.[64] In the insolvency context, NCLTs have significantly improved timelines for recoveries, bringing down the average time taken to complete insolvency proceedings from 4.3 years under the previous insolvency regime[65] to about 1.3 years (464 days) under the IBC.[66] Despite these wins, NCLTs have fallen short of the expectations set for the resolution regime under the IBC. The adjudication process suffers from lengthy delays, an increasing backlog of cases and inconsistency in adjudication of similar issues.

2.3.1. Delays in adjudication

The IBC requires that the CIRP be completed within a maximum period of 330 days.[67] However, this outer limit is only directory in nature.[68] Recent data from the IBBI indicates that as of March 2022, the average time taken to conclude CIRPs was 536 days (where the debtor was resolved) and 414 days (where the debtor proceeded to liquidation). Between April 2022 – December 2022, the average time increased further to 813 days and 626 days respectively.[69] Delays have been attributed to a variety of reasons, including: (a) delays in adjudication by NCLTs, particularly at the admission and plan approval stage;[70] (b) excessive litigation

[59] The ILC is a standing committee of experts in insolvency law, appointed by the Ministry of Corporate Affairs, Government of India ("**MCA**") to act as an advisory body for issues relating to the implementation of the IBC.
[60] MCA, *Report of the Insolvency Law Committee* (2020) 85.
[61] IBC, s 47.
[62] MCA, 'Invitation of comments from public on proposed changes to the CIRP and Liquidation Framework under Insolvency and Bankruptcy Code, 2016' (2021) 4.
[63] See Balakrishna Eradi and others, 'Report of the High Level Committee on Law Relating to Insolvency and Winding Up of Companies' (2000).
[64] MCA, 'NCLT organised Colloquium on "NCLT - The Road Ahead"' (2022) <https://pib.gov.in/Pressreleaseshare.aspx?PRID=1810037> accessed 15 March 2023.
[65] Standing Committee on Finance, 'Report on Implementation of Insolvency and Bankruptcy Code – Pitfalls and Solutions' (2021) 9.
[66] See Newsletter 2021 (n 9), where the average time taken for conclusion of CIRP as of March 2021 was 464 days (in case of resolution) and 352 days (in case of liquidation).
[67] IBC, s 12(1).
[68] *Essar Steel India Ltd. Committee of Creditors v. Satish Kumar Gupta* Civil Appeal No 8766-67 of 2019.
[69] Newsletter 2022 (n 5) 19.
[70] Shon Gadgil and others, 'Timely Resolution of Cases under the Insolvency and Bankruptcy Code, 2016' (2019) 6(6) Journal of Critical Reviews 156; Shikha (n 51) 8; Nikhil Shah and Khushboo Vaish, 'The Next Phase of IBC Must Focus on Efficiency' (Alvarez & Marsal India 2021) 9-13.

including multiple levels of appeals by promoters, operational creditors, dissenting creditors etc;[71] (c) inadequate judicial strength to deal with the volume of cases;[72] and (d) weak administrative infrastructure.[73] Apart from these systemic issues, delays have been exacerbated by pandemic induced lockdowns. Emperical data suggests that the NCLTs' rate of hearings and case disposals fell significantly during lockdowns compared to pre-pandemic levels.[74] This is likely to further increase timelines for conclusion of CIRPs across the board.

2.3.2. Backlog of cases

When the NCLTs were first established, approximately 25,000 company and insolvency law matters pending before certain specialised tribunals and the high courts were transferred to them.[75] Commentators at the time had extrapolated available empirical data on adjudication of these matters to the proposed NCLT framework, concluding that the NCLTs would be thoroughly ill-equipped and understaffed to deal with this caseload – much less the additional cases that will knock on tribunal doors.[76] These fears appear to have come true – as of 31 March 2022, NCLTs were dealing with a pending caseload of 21,089 cases, with more than half of these cases arising out of the IBC.[77]

2.3.3. Conflicting judicial positions

As the IBC is a complex and nascent law, NCLTs are often presented with issues that are not addressed in statute. Certain principles have become well-established through precedents, but it has taken extensive litigation to obtain clarity. Several NCLT benches have taken contradictory views on the same issue.[78] Sometimes, NCLTs have decided matters independently rather than following precedents set by higher courts and tribunals.[79] These issues have added to the uncertainty around outcomes in litigation under the IBC, even where the matter involves legal questions that have been previously decided.

Impact of TPLF

The challenges above pose significant 'procedural risk' in the adjudication of avoidance actions. Procedural risks arise where obstacles in the dispute resolution framework make it difficult for claimants to succeed, even on meritorious claims.[80] In the current framework,

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[71] Shah (n 70) 11.
[72] ibid 14; Standing Committee (n 65); Renuka Sane, 'Insolvency code is one of India's success stories. But it now needs a new life' *The Print* (20 July 2022) <https://theprint.in/opinion/insolvency-code-is-one-of-indias-success-stories-but-it-now-needs-a-new-life/1044138/> accessed 15 March 2023.
[73] Gadgil, 'Timely Resolution' (n 70) 14-15; Nikhil Shah, Khushboo Vaish and Kavya Ramanathan, 'The National Company Law Tribunal (NCLT) Readiness' (Alvarez & Marsal India 2017) 3.
[74] Pavithra Manivannan, Susan Thomas and Bhargavi Zaveri-Shah, 'How did courts respond to the pandemic lockdowns: Evidence from the NCLT' (*The Leap Blog*, 27 March 2022) <https://blog.theleapjournal.org/2022/03/how-did-courts-respond-to-pandemic.html> accessed 15 March 2023.
[75] Shah, 'NCLT Readiness' (n 73) 6; Devendra Damle and Prasanth Regy, 'Does NCLT Have Enough Judges?' (*The Leap Blog*, 6 April 2017) <https://blog.theleapjournal.org/2017/04/does-nclt-have-enough-judges.html> accessed 15 March 2023.
[76] ibid.
[77] Business Today Desk, 'Taking all necessary steps to augment capacity of NCLT: Govt' *Business Today* (21 March 2022) <www.businesstoday.in/latest/economy/story/taking-all-necessary-steps-to-augment-capacity-of-nclt-govt-326689-2022-03-21> 15 March 2023.
[78] Shah, 'Timely Resolution' (n 70) 14; Sane (n 72).
[79] ibid.
[80] Solas (n 12) 197.

respondents have ample opportunity to deploy delay tactics and zealously defend their position by going through all possible appeal mechanisms. The systemic dealys and backlogs in the tribunals further choke the resolution system. For the Indian insolvency landscape, and for other countries whose judicial systems suffers from similar drawbacks, TPLF can help mitigate procedural risks.

First, if the insolvency framework permits a settlement mechanism for the resolution of avoidance actions (as argued in section 2.4), TPLF can assist in arriving at a quick settlement of the dispute and obtain recoveries for creditors. This is owing to 'soft' advantages provided by TPLF. Funders always conduct extensive diligence of the case to ensure that they only risk capital where the case has substantial merit.[81] This acts as a 'screening process' for avoidance claims as it provides an impartial assessment of the merits of the case.[82] Given the rigorous screening process, the act of funding performs a signalling function – a show of strength – to respondents. It signals to them that the case against them has enough merit that a funder is willing to stake its capital (and returns) entirely on the success of the case.[83] It also informs them that the claimant has the financial resources to pursue the case to finality. These signals can induce respondents towards a settlement – leading to an early resolution of avoidance claims and a reduction in the backlog of cases pending in tribunals.

Second, if the case is litigated, TPLF can assist with a faster adjudication. The presence of a commercial funder can signal to courts that the case has merit and could improve recoveries for creditors. This may incentivise courts to pay greater attention to avoidance applications. It may also discourage well-resourced respondents from taking advantage of gaps in the adjudication process and engage in wrecking tactics in hopes to drain the IP's otherwise limited fighting funds.[84] Third, TPLF can also allow IPs to leverage support from funders with case strategy and negotiation, as well as ancillary services such as asset-tracing and enforcement assistance.[85] The availability of TPLF and the presence of a funder can thus materially impact the dispute resolution process.

Reforms

The issue of delays and backlogs in insolvency tribunals is a regular feature in the discourse around IBC reform. In 2021, the Supreme Court directed the government to fill vacancies in insolvency tribunals at the earliest to augment tribunal capacity.[86] The government has taken steps to appoint members to pending vacancies, increase the number of courtrooms at popular benches and improve administrative infrastructure.[87] In addition, the national e-courts project is being implemented at all tribunals, which will digitalise judicial infrastructure and introduce

[81] Kalajdzic (n 26) 101; Rowles-Davies (n 11) 116.
[82] ibid.
[83] Rowles-Davies (n 11) 19; Solas (n 12) 209; Rupert Jackson, *Review of Civil Litigation Costs: Preliminary Report* (The Stationery Office 2010) 163.
[84] Rowles-Davies (n 11) 18.
[85] Solas (n 12) 58.
[86] *National Company Law Tribunal and Appellate Tribunal Bar Association v Ministry of Corporate Affairs* (2021)3CompLJ78(SC).
[87] Press Trust of India, 'Centre says taking all steps to strengthen National Company Law Tribunal' *Business Standard* (6 December 2021) <www.business-standard.com/article/economy-policy/centre-says-taking-all-steps-to-strengthen-national-company-law-tribunal-121120601204_1.html> accessed 15 March 2023.

decision support systems.[88] This is intended to make the justice delivery system faster, accountable and predictable.[89] In May 2022, the ILC also made recommendations aimed at speeding up the completion of CIRPs.[90] These reforms are expected to reduce the lengthy adjudication timelines. Addressing the issue of inconsistency in judicial decision-making may be a greater challenge, especially given that the IBC is an evolving legislation. However, as the legal position on key issues becomes more firmly entrenched, NCLTs will be steered to adjudicate matters following precedent. This apart, the government has taken measures to train judges in technical aspects of the law and appoint well-qualified members to tribunals.[91] The uncertainty around legal outcomes in the IBC should therefore reduce with time.

2.4. Absence of a settlement mechanism

The IBC does not offer the option to settle avoidance claims. All avoidance applications are adjudicated to finality, often involving multiple levels of appeals. The absence of a settlement mechanism is a fatal drawback. Adjudicating avoidance claims to their finality is a fact-intensive, expensive, time-consuming and unpredictable exercise. Coupled with the protracted dispute resolution process under the IBC, Avoidance Litigation can be arduous for all parties involved. In addition, current trends evidence that 83% of avoidance applications filed before tribunals are still pending adjudication.[92] The NCLTs' lamentable performance in dealing with these applications further affirms the need to introduce a more efficient dispute resolution mechanism.

Impact of TPLF

As the absence of a settlement mechanism arises from a drawback in the legislative framework, only the will of the legislature can address this issue. However, the availability of a settlement mechanism will make this area a far more attractive market for funders, as section 3.5 below argues.

Reforms

At present, neither the IBBI nor the Indian government appear to be considering the introduction of a settlement mechanism for avoidance actions. However, recourse to an out-of-court dispute resolution mechanism is the need of the hour. It can help increase the debtor's asset pool quickly and economically. Where respondents are wary of the costs and uncertainties of litigation, it can provoke a settlement.[93] It will also give creditors the breadth to develop more tailored and creative solutions than would otherwise follow from formal adjudication, especially in complex factual situations where the legal position or the business solution is unclear.[94] Moreover, recourse to settlement will reduce the caseload on tribunals and improve

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[88] ibid.
[89] See E-committee of Supreme Court of India 'National Policy and Action Plan for Implementation of Information and Communication Technology in the Indian Judiciary' (2005).
[90] ILC Report 2022 (n 51) 37-38.
[91] Press Trust, n (87).
[92] Newsletter 2022 (n 5).
[93] See text to n 82-84.
[94] Misha, Shreya Prakash and Kritika Poddar, 'Applying Mediation in Corporate Insolvency Situations in India' in *Anusandhan: Exploring New Perspectives on Insolvency* (IBBI 2022) 131, 139.

the dispute resolution process.[95] Global trends also support the use of settlements to resolve avoidance actions. Settlements are actively encouraged in several jurisdictions, including in the UK, US, France, Spain and Germany.[96] If parties cannot settle the claim, insolvency courts often direct them to mediation.[97] A full litigation is only a last resort. A settlement mechanism can thus eliminate the costs, time and risks associated with litigation and improve outcomes in avoidance actions. To ensure fair dealing and prevent further litigation on settlement terms, the IBC may charge NCLTs with approving the settlement agreement – a practice followed in the US.[98] Alternatively, a mediation mechanism may be considered.[99]

3. THE FUNDERS' PERSPECTIVE

Indian law does not impose any explicit restrictions on TPLF. The English rules of champerty and maintenance are inapplicable in India[100] and litigation funding agreements have not been considered to be *per se* void or against public policy.[101] In the IBC context, the ILC briefly reviewed the use of TPLF arrangements for IBC disputes in its 2020 Report.[102] It noted that there is no bar to TPLF in India and funding of any litigation arising under the IBC, whether by creditors or third parties, is a purely commercial decision. Recourse to TPLF has thus been left to the market entirely.

In practice, TPLF arrangements have been used by distressed companies in the infrastructure sector. Major market players have monetised portfolios of claims tied up in litigation by selling them to investors like BlackRock.[103] Specialised litigation firms are also exploring the Indian claims market, with companies such as Burford Capital, Omni Bridgeway and Phoenix Advisors expressing interest.[104] The reduced timelines to resolve commercial disputes and continuous reforms to speed up dispute resolution appears to have incentivised these players to look to India.[105] More locally, start-ups such as LegalPay have emerged as an alternative investment option for retail investors, with the funds being deployed towards providing interim

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[95] Laura Coordes, 'Litigate or Mediate? Lessons from US Bankruptcy Mediation' in *Anusandhan: Exploring New Perspectives on Insolvency* (IBBI 2022) 115, 120.

[96] See Suzzanne Uhland and others 'Insolvency Litigation Guide' (Lexology 2021) 65-67 <www.lw.com/en/insights-landing/admin/upload/SiteAttachments/Insolvency%20Litigation.pdf> accessed 15 March 2023; Misha (n 94) 135-137; David Milan and Rebecca Parry, 'A study of the operation of transactional avoidance mechanisms in corporate insolvency practice' (Insolvency Lawyers' Association 1997).

[97] ibid.

[98] Federal Rules of Bankruptcy Procedure, rule 9019. See also American Bankruptcy Institute, 'Settlement of Avoidance Actions in Bankruptcy' (NYU School of Law 2013).

[99] See Misha (n 94); Coordes (n 95).

[100] *Re: 'G', A Senior Advocate of the Supreme Court* 1954(2)BLJR 477.

[101] *Ram Coomar Coondoo v Chunder Canto Mookerjee* (1876) 2 Cal 233; *Bar Council of India v. AK Balaji* (2018)2SCC(LS)39. See Bishnoi (n 18) for further discussion.

[102] 2020 Report (n 60) 89.

[103] Beena Parmar, 'Can the BlackRock-HCC transaction trigger more litigation funding deals in India?' *VCCircle* (3 April 2019) <www.vccircle.com/can-the-blackrock-hcc-transaction-trigger-more-litigation-funding-deals-in-india> accessed 15 March 2023; Amritha Pillay, 'Infrastructure companies eye litigation funding to settle claims' *Business Standard* (18 February 2019) <www.business-standard.com/article/companies/infrastructure-companies-eye-litigation-funding-to-settle-claims-119021800035_1.html> accessed 15 March 2023.

[104] 'Global litigation financiers plan India entry to target company disputes' *Reuters* (14 December 2020) </www.reuters.com/article/india-legal-financiers-idUSKBN28O1XE> accessed 15 March 2023; Jessica Seah, 'Litigation funders set sights on India' *ALM Intelligence* (16 December 2020) <www.law.com/international-edition/2020/12/16/litigation-funders-set-sights-on-india/> accessed 15 March 2023.

[105] ibid.

finance under IBC and funding domestic litigation.[106] Given the growing interest in litigation funding, several industry players have also established the Indian Association for Litigation Finance in 2021.[107] The organisation intends to create a self-regulatory code for governance of TPLF and promote the development of its practice in India.

There are significant opportunities for use of TPLF in Avoidance Litigation, including under the IBC. Applications for avoidance claims pending before the NCLTs involve claims worth INR 2.8 trillion.[108] These are only the cases reported by IPs – if the avoidance regime is reformed into a framework that incentivises reporting and facilitates a swift resolution of avoidance actions, this area can become highly profitable for funders. More generally, IPs can represent the 'ideal client' for funders in several ways.[109] IPs are not personally attached to the claim – their interest lies in effectively administering the insolvency proceedings. They are therefore unlikely to waste time and resources pursuing cases that lack merit.[110] They also provide the benefit of a first-level independent investigation and case review. As seasoned practitioners, they provide expertise in law and practice and a broad professional network of lawyers, valuers, audit firms etc to obtain high-quality services. For funders however, the promise of a good return and adept claim managers is not enough. Before investing, funders evaluate a case on certain key parameters: (a) the value of the claim; (b) prospects of success; (c) recoverability of proceeds; (d) return horizon; and (e) scope for settlement.[111] This section considers these parameters in the context of Avoidance Litigation, identifying areas where the current IBC landscape presents a challenge for funders.

3.1. Value of the claim

Litigation is not a science – the litigation process and the outcome are inherently uncertain. Litigation funding is therefore regarded as a fairly 'risky investment.' Consequently, funders expect high returns[112] and only consider claims that are sufficiently high in value that the proceeds will leave enough for the funder to recover its litigation expenses, an additional return on investment and still leave significant recoveries for the litigant (usually at least 50%).[113] In addition, funders draw on their experience with other similar matters to price in the risk that

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[106] Sudhir Chowdhary, 'LegalPay: Easing the financial burden of litigation' *Financial Express* (29 November 2021) <www.financialexpress.com/industry/technology/legalpay-easing-the-financial-burden-of-litigation/2376785/> accessed 15 March 2023.
[107] See 'About IALF' (Indian Association for Litigation Finance) <https://ialf.co.in/> accessed 15 March 2023; BW Bureau, 'Global and Indian Companies form Indian Association of Litigation Finance to Promote and Self-Regulate Litigation Finance in India' (*BW Legal*, 17 February 2021) <http://bwlegalworld.businessworld.in/article/Global-and-Indian-Companies-form-Indian-Association-of-Litigation-Finance-to-Promote-and-Self-Regulate-Litigation-Finance-in-India/17-02-2021-378664/> accessed 15 March 2023.
[108] Newsletter 2022 (n 5) 17.
[109] Marius Nasta, 'Third party litigation funding in insolvency' (*Financier Worldwide*, September 2016) <www.financierworldwide.com/third-party-litigation-funding-in-insolvency#.YuZ0PBzMIQ8> accessed 15 March 2023.
[110] ibid.
[111] Rowles-Davies (n 11) 12; Alex Jay, 'Funding Insolvency Litigation: A New Dawn' 8(5) (2015) Corporate Rescue and Insolvency 184.
[112] Rowles-Davies (n 11) 4.
[113] ibid 10.

the litigation budget may increase or the quantum of recoveries may reduce.[114] The pricing offered ensures that their returns remain attractive, should things change for the worse.[115] This means that the returns for the funder need to be high enough to withstand these events.[116] Given these considerations, TPLF will be available in cases where the avoidance claim involves much higher recoveries relative to the litigation budget. Initially, these are likely to be big-ticket cases involving high-value claims and obvious elements of errant behaviour.

For lower value claims, the funding market may need to develop further. As funders become repeat players in the market, they are likely to develop more legal sophistication and deploy more financial resources. Some of these funders will expand to the medium and low-value claims market to build a diversified portfolio of claims to manage costs, spread risks and maximise returns at scale. [117] These trends are evident in more developed jurisdictions.[118] The use of TPLF under the IBC is thus likely to begin with the pursuit of high-value meritorious claims, especially as funders test the waters in the NCLTs. Lower value meritorious claims will likely see the funder's purse only once the market matures enough to develop varied funding models.

3.2. Prospects of success

Funders are not interested in blazing a trail or settling legal positions.[119] The general view in the TPLF industry is that a case must have at least a 60% prospect of success to be considered for funding.[120] The ideal case for a funder is one that offers a quick result and a good return. If the litigation involves doubtful legal issues or contentious facts, funders will find the outcome of the case to be unpredictable, with the added disadvantage that there will be appeals.[121] Such a case spells uncertainty, delay and expense. From the funders' perspective therefore, the most essential part of the funding process is the due diligence.[122]

Funders must have enough information to assess the potential risks involved in the case, including the adequacy of evidence and issues with enforceability.[123] At present, this may be a challenge. As section 2.2 highlights, a significant roadblock for IPs looking to bring avoidance actions is the lack of proper record-keeping and cooperation from debtor personnel. In the absence of adequate information, IPs cannot convince funders of the legal and commercial prospects of the case. However, the IBBI has now empowered IPs with tools to demand information from creditors and debtor personnel. This should equip them with information that is better in quality and quantity.[124] This apart, a settlement mechanism, if introduced, will also give greater comfort to funders as the uncertainties arising from a full-blown litigation are minimised – further improving the prospects of success from a funder's perspective.

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[114] ibid 110.
[115] ibid.
[116] ibid 68.
[117] ibid 5; Solas (n 12) 223, 135.
[118] Rowles-Davies (n 11) 218.
[119] ibid 67.
[120] ibid; Eastwood (n 12) 31; Batra (n 16) 341.
[121] ibid.
[122] Rowles-Davies (n 11) 116.
[123] ibid 115, 68.
[124] See discussion on reforms in section 2.2 above.

3.3. Recoverability of proceeds

Funders need to have comfort that once the case is won, they will be able to recover their share of the proceeds. First, cases where the respondent lacks creditworthiness or is facing insolvency proceedings are of no interest to funders. Pursuing such actions will be futile as the respondent lacks resources to meet a successful award.[125] Second, as funders typically make returns from monetary proceeds, claims for injunctive relief or business solutions rather than financial outcomes will be poor candidates for funding.[126] This means that avoidance actions where IPs seek relief in the form of specific performance or restitution of property (other than cash or liquid assets) may face a greater challenge in obtaining funds.[127] Third, funders differ in their appetite for enforcement risk and will diligence possible roadblocks to actual recovery,[128] for instance where assets are located in a foreign jurisdiction or are at risk of being attached by investigative agencies.

Notably, the IBC presents opportunities for funders where issues around enforcement and recovery involve assets located in foreign jurisdictions.[129] In several instances, IPs have discovered fraudulent dealings involving siphoning of funds from the distressed company to overseas entities or offshore personal accounts.[130] Pursuit of such offshore assets can involve substantial costs and legal risk for IPs, as successful recovery will require proficiency in the laws and procedures of the foreign jurisdiction. Funders can assist IPs in this regard and several TPLF firms provide ancillary services such as asset-tracing and enforcement assistance.[131] Recourse to enforcement funding and assistance can be a handy tool in the IP's arsenal and another investment opportunity for funders.

3.4. Return horizon

The case duration is important to funders for two reasons: First, the capital invested by the funder is tied up in the litigation and not deployed elsewhere. The longer the case duration, the greater the opportunity cost to the funder.[132] Second, the longer the case goes on, the more

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[125] ibid; Eastwood (n 12) 32.

[126] Rowles-Davies (n 11) 10; Christopher Bogart, 'The Case for Litigation Financing' (2016) 42(3) American Bar Association Litigation Journal 46, 47.

[127] See for example, the CIRP of Jaypee Infratech Limited where the IP filed avoidance applications seeking to set aside the mortgage of 858 acres of land valued at INR 55 billion by the debtor in favour of creditors of its parent company.

[128] ibid.

[129] See panel discussions with Burford Capital, Omni Brideway, Phoenix Advisors and Innsworth Advisors in Khaitan & Co, 'Is India Ready for Litigation Finance?' (22 February 2021) <www.youtube.com/watch?v=LCY5asIZ-rg> accessed 15 March 2023 and Indian Association for Litigation Finance, 'Litigation Finance in India: Industry Perspective' (16 February 2021) <www.youtube.com/watch?v=uHE_2_j4IcU> accessed 15 March 2023.

[130] Sundaresha Subramanian, 'Fraud cases under IBC cross Rs 40,000 crore' *Economic Times* (30 September 2018) <https://economictimes.indiatimes.com/news/economy/finance/fraud-cases-under-ibc-cross-rs-40000-crore/articleshow/66015840.cms?from=mdr> accessed 15 March 2023; Mohit Bhalla, 'Unlawful deals: Claims of Rs 1.6 lakh crore filed at NCLT by resolution professionals of companies gone bankrupt' *Economic Times* (29 July 2021) <https://economictimes.indiatimes.com/news/economy/finance/unlawful-deals-claims-of-rs-1-6-lakh-crore-filed-at-nclt-by-resolution-professionals-of-companies-gone-bankrupt/articleshow/84846888.cms> accessed 15 March 2023.

[131] See for example, Burford Capital <www.burfordcapital.com/how-we-work/with-companies/> accessed 15 March 2023.

[132] ibid.

likely it becomes that the case will be litigated rather than settled early (where settlement is an option).[133] Litigation proceedings translate to increased costs and investment risks for funders.[134] Funders thus require a greater return for a longer case duration, and the assessment of the return horizon forms a critical aspect of the initial diligence.

Funders may however struggle to ascertain the return horizon where they are not comfortable with the jurisdiction or the law in which they operate.[135] In the Indian context, some funders looking to invest in India have already expressed a preference to fund claims related to international arbitrations involving Indian parties, due to risks associated with dispute resolution in Indian courts and tribunals.[136] Concerns include the unpredictability of the judicial process and the inability to quantify the duration of the case.[137] The conclusion of CIRPs within 2.5 years on average may have allayed these concerns. However, the low priority accorded by NCLTs to avoidance applications lends credence to these fears.[138] The apprehensive response from funders towards investment in Indian claims provides an important takeaway for other jurisdictions. If an out-of-court settlement mechanism is not available for avoidance actions, the judicial process will need to be swift, efficient and predictable, to attract funders. A shroud of uncertainty around the duration of avoidance actions will mean that funders will be wary of deploying capital in the field. For the Indian avoidance transactions regime, this signals the need for an alternative dispute resolution mechanism that can give funders confidence to invest in Indian claims.

3.5. Scope for settlement

The choice of settlement provides an alternative, faster and more efficient avenue to resolve the dispute and cash proceeds for litigants and funders.[139] It also averts the expense of litigation and the risk of a "worse-than-expected outcome".[140] Funders typically evaluate each case to assess the scope for settlement and the litigant's receptiveness to accepting one. Specifically, funders want to determine whether the litigant is "likely to push for a gladiatorial battle to the bitter end, or whether they are more likely to adopt a commercial and pragmatic approach."[141] As funders cannot exert direct control over the litigant, they will endeavour to understand motivations, case strategy and acceptable outcomes to ensure that they are comfortable with the litigant's approach to the case.[142] The funding agreement is drawn up accordingly. For example, if the funder believes that the case has good merits to provoke a settlement but is unattractive from a litigation perspective, the funding may be structured to disburse funds in tranches, with the percentage of the recovery share owed to the funder increasing for each

[133] ibid.
[134] Rowles-Davies (n 11) 118.
[135] Rowles-Davies (n 11) 68.
[136] Parmar (n 103).
[137] ibid.
[138] See Newsletter 2022 (n 5).
[139] Solas (n 12) 279.
[140] Jonathan Molot, 'Litigation Finance: A Market Solution to a Procedural Problem' (2010) 99 Geo LJ 83.
[141] David Walker, 'Yes and no: How funders decide' (*PLC Dispute Resolution Blog*, 17 October 2019) <http://disputeresolutionblog.practicallaw.com/yes-and-no-how-funders-decide/?sourceassetid=&source=updateemail> accessed 15 March 2023. See also Rowles-Davies (n 11) 118.
[142] ibid.

tranche. [143] This encourages the litigant to consider earlier settlements than chase larger but unlikelier recoveries in court.

From the funders' perspective, opportunities to fund Avoidance Litigation under IBC will be far more attractive if a settlement mechanism is introduced. Litigation significantly increases investment risks for funders.[144] The risk is likely to be even more substantial in Avoidance Litigation, where there is considerable uncertainty in litigation outcomes and timelines.[145] The delay in adjudication also means that the rich jurisprudence available in other aspects of insolvency litigation under the IBC, such as the moratorium provisions, is not yet firmly developed for avoidance claims. The introduction of a settlement mechanism will ease these risks for funders.

3.6. Other aspects

In addition to the parameters mentioned above, the Indian framework for avoidance actions is likely to raise two more challenges for funders. These relate to: (a) the manner in which avoidance applications will be continued after the IP is discharged; and (b) the distribution of proceeds between the litigant and the funder.

3.6.1. Pursuit of avoidance applications post-CIRP

The IBC treats avoidance proceedings as separate from and independent of the CIRP proceedings.[146] The CIRP is usually completed prior to the adjudication of the avoidance applications in the matter, either by way of approval of the resolution plan submitted by the Successful Bidder, or, by the passing of an order for liquidation where there is no Successful Bidder. Upon conclusion of the CIRP, the IP stands discharged. If the debtor is ordered to liquidation, the liquidator carries the avoidance application forward. In case a resolution plan is approved, the IBC requires that the resolution plan provide for the manner in which: (a) avoidance proceedings will be pursued after the approval of the plan; and (b) the proceeds, if any, from such proceedings will be distributed ("**Avoidance Claims Provisions**").[147]

Notably, the Avoidance Claims Provisions lay the onus to chart the course for continuation of avoidance actions after the CIRP on the Successful Bidder – a role that until then, is discharged solely by the IP. This assumes importance for funders. If a funder agrees to finance an avoidance application pending identification of the Successful Bidder, it will need to ensure that Avoidance Claims Provisions proposed in the successful resolution plan, including on the distribution of proceeds, align with the terms agreed in the funding agreement. The funder may also require cooperation from the Successful Bidder during the litigation process, as the Successful Bidder will have custody over the debtor's records after acquisition of the debtor. The funding arrangement will need to account for such matters from the outset. Moreover, the process for negotiation and selection of a resolution plan is confidential and funders will not

[143] Solas (n 12) 279; Elizabeth Korchin and others, 'The Third Party Litigation Funding Law Review: USA' (*The Law Reviews*, 22 November 2021) <https://thelawreviews.co.uk/title/the-third-party-litigation-funding-law-review/usa> accessed 15 March 2023.
[144] Rowles-Davies (n 11) 118.
[145] See Newsletter 2022 (n 5).
[146] IBC, s 26.
[147] CIRP Regulations, reg 38(2)(b)

have visibility as to the terms of the plan. The funding arrangement will therefore need to bind COC members to ensure that they account for funders' interests during plan negotiations. This may prove to be a challenge, as COC members might view this as compromising their ability to select the best plan and creating a conflict of interest. Further, bidders may come with their own views regarding the treatment of avoidance claims in the case. The entry of a new player in the Avoidance Litigation can thus complicate matters. Funders and stakeholders in the CIRP proceedings alike will need to devise creative solutions to the unique challenges presented by the Indian statutory framework.

3.6.2. Distribution of Proceeds

At present, there is a lack of clarity in the IBC about whether the proceeds recovered from avoidance actions can be shared with parties other than the debtor's creditors. The IBC is silent on how such recoveries should be treated. In considering this question, the 2020 Report observed that:

> "[I]n most cases it may be better suited to distribute recoveries amongst the creditors of the corporate debtor. While the Committee agreed on this principle, it noted that factual factors such as - the kind of transaction being avoided, party funding the action, assignment of claims (if any), creditors affected by the transaction or trading, etc. - may need to be taken into account when arriving at a decision regarding distribution of recoveries. Thus, it was recommended that instead of providing anything prescriptive in this regard, the decision on treatment of recoveries may be left to the adjudicating authorities."[148]

In its latest report, the ILC built on this further, recommending that: (a) the resolution plan should provide for the manner of distribution of recoveries, as acceptable to the COC in its commercial wisdom; and (b) the insolvency tribunal should give regard to the COC's decision when giving the final orders in avoidance transactions.[149]

A decision of the National Company Law Appellate Tribunal ("**NCLAT**") takes a different view.[150] Here, the COC and the Successful Bidder agreed in the resolution plan that any recoveries from avoidance applications filed in respect of fraudulent or wrongful trading, which amounted to claims of over USD 5 billion, would be appropriated by the Successful Bidder. This was agreed in exchange for the Successful Bidder allegedly paying a higher amount to the creditors under the plan. This arrangement was challenged by a creditor during the plan approval hearing, but the objections were dismissed by the NCLT. On appeal, the NCLAT rejected this split and directed the COC to revisit the resolution plan. It held that the insolvency tribunal should decide on the manner of distribution of recoveries and found that the tribunal had failed to perform this role. The tribunal had plainly accepted the COC's decision without an independent scrutiny of the objections raised as to the distribution of proceeds. The bench also held that the debtor's creditors should be the beneficiaries of avoidance actions, as the

[148] 2020 Report (n 60) 86.
[149] ILC Report 2022 (n 51) 28-30.
[150] *63 Moons Technologies Limited v Administrator of DHFL* Company Appeal (AT) (Insolvency) No 454/2021.

applications are pursued for their benefit. The Successful Bidder could not lay claim to the recoveries at the expense of other creditors.

The case leaves more questions than answers – it appears to place the insolvency tribunal in a supervisory role over any distributional arrangement that the creditors and Successful Bidder may have negotiated. In addition, it appears to prohibit the exclusion of the debtor's creditors from participating in recoveries. The NCLAT decision was appealed in the Supreme Court, which stayed the NCLAT order pending adjudication of the matter.[151] A decision from the Supreme Court on this issue should bring more clarity.

A scrutiny of the IBC landscape from the funder's perspective suggests that further improvements to the statutory framework are required to make the market attractive for funders. Even with improvements, the untested waters will mean that very few avoidance actions will initially see funding. In addition, funders, IPs and creditors will need to devise creative solutions to meet the challenges presented by the CIRP procedure and the Indian corporate landscape.

4. CONCLUSION

Currently, the Indian avoidance transactions regime sets up challenges for IPs from stem to stern. The statutory and infrastructural reforms being implemented can help address the existing deficiencies. But TPLF holds the potential to do more – it can galvanise the avoidance transactions framework and help resolve the mammoth volume of avoidance claims present in the underbelly of insolvent Indian debtors. A TPLF market will offer a new avenue for financing avoidance claims and incentivise IPs to investigate and pursue avoidance actions with more intensity – substantially enhancing recoveries for creditors. If a settlement mechanism for avoidance actions is introduced, the presence of a well-resourced funder will encourage settlements. TPLF can thus give the avoidance transactions framework more teeth. A stronger avoidance regime will mean that promoters and managers are more likely to be held accountable for executing dubious transactions in the vicinity of insolvency. In the longer term, greater accountability can have a deterrent impact and improve corporate culture among Indian companies. In addition to improvements in the avoidance framework, TPLF can also help reduce the delays and backlogs in adjudication, as the presence of funders will push more cases to be settled outside of tribunals. The bolstering effects of TPLF on the avoidance transactions regime, though discussed in the Indian context in this paper, are also likely to be applicable to other jurisdictions that face issues similar to those discussed in section 1 of the paper, or more generally, have a weak avoidance transactions framework like India.

However, any transformative impact of TPLF is only possible if the market for Avoidance Litigation is attractive for funders. Examining the IBC landscape from a funders' perspective suggests that there may be a few stumbling blocks. The first key change required in the current landscape is the introduction of a settlement mechanism, as funders are wary of uncertain and protracted litigation in domestic courts and tribunals. The lack of priority given to avoidance applications by insolvency tribunals further exacerbates this concern and reinforces the need

[151] *Piramal Capital and Housing Finance Limited v 63 Moons Technologies Limited* Civil Appeal Nos 1632-1634/2022.

for an out-of-court mechanism. The second key change that may be considered is the introduction of a soft-touch statutory framework that anticipates critical issues likely to arise in the use of TPLF in avoidance actions. This may include issues such as the distribution of proceeds, the contours of control exercised by the funder, conflicts of interest etc. This will give funders confidence that their funding arrangements will withstand a challenge in court and prevent respondents from engaging in a flaw-finding exercise. For India, the increasing interest in the Indian claims market from key players in the global TPLF industry means that the time is ripe for building more speed, flexibility and certainty in the IBC's avoidance transactions framework and opening up a new avenue to recover the staggering amounts trapped in Avoidance Litigation under the IBC.