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## **Challenges of Third Party Funding to Arbitral Autonomy: A Discussion of Possible Solutions in the Chinese Context**

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Arbitration is an autonomous mechanism for solving disputes, which flows above the domestic procedural rules for litigation. In today's world, the amendments to the domestic arbitration legislation have been directed at minimising the court's intervention in order to uphold arbitral autonomy. Yet this process has been greatly complicated in recent years by the increasing use of Third Party Funding (TPF). Modern international arbitration is interspersed with TPF – a legal investment arrangement under which the funder is obliged to pay the cost of arbitration in exchange for a part of the final recovery. TPF has not only increased the court's willingness to impose and supervise arbitrations but it has also created a larger desire for the party to bring TPF-related issues arising from the arbitration procedure to court. It has been observed that arbitral proceedings that are fuelled by TPF attract more judicial supervision than those that are not. This paper will first explain the challenges posed by TPF to arbitration and then address the uncertainty of what the future might hold for arbitral autonomy as TPF becomes more widespread. This question is asked and answered in China, where recently TPF and its impact have provoked fierce debate. This paper presents and analyses the possible solutions of the issues associated with TPF before concluding that it is possible for China to promote the use of TPF in arbitration without causing harm to arbitral autonomy.

### **I Introduction**

TPF has been recently discussed more frequently in the legal sphere. In narrow terms, TPF is a funding arrangement under which the funder is obliged to pay part of or the whole cost of arbitration in exchange for a share in the final proceeds. The use of TPF in arbitration is increasing with the rise of the costs of arbitration and the growth of trade, which in turn leads to the need for arbitration. Traditionally, funding arranged by the parties does not concern the

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court or tribunal in the Chinese context.<sup>1</sup> Only after TPF has evolved into a widely used financing tool and has even become a built-in feature of arbitration did regulators and practitioners start contemplating the potential impact of TPF on the arbitration procedure.

The interaction between TPF and arbitral autonomy contains multiple layers. On the one side, TPF is likely to influence arbitration in both positive and negative ways. Arbitral autonomy not only asks whether the parties have the opportunity to settle their disputes in a consensual manner but also whether they have sufficient resources to do that. For this reason, TPF has the potential to contribute to the autonomy of the parties to arbitration. Nonetheless, TPF is commercially motivated and largely unregulated in most jurisdictions at the moment, which increases the willingness of the court to impose more supervision, as well as the desire of the parties to bring TPF-related issues to the court's attention. These factors undoubtedly constitute a challenge to arbitral autonomy. On the other side, arbitration, as an autonomous procedure, allows TPF to carve out a distinctive place for itself. It is therefore almost inevitable that TPF for arbitration is addressed separately from TPF for litigation.

It is hard to deny that more attention should be paid to the integrity and fairness of the arbitration procedure in cases where there are third party funders. The follow-up question would be whether this is doomed to lead to arbitral autonomy shrinking. If the answer is affirmative, are there any steps that could be taken to mitigate the negative effects of TPF and thereby keep the level of court intervention moderate? As an answer to the above questions, this paper looks closely at the regulation of TPF for arbitration in China. The author believes that the solutions of the problems caused by or connected to TPF should be addressed by both domestic and international rules, despite that the former being more relevant than the latter. Although arbitration may encompass international elements, arbitral proceedings are inevitably shaped in one way or another by domestic regulations. In particular, TPF-related issues are often categorised as procedural ones, which should be subject to the law of the seat of arbitration. Globally, there is an obvious lack of uniformity and an array of conflicting laws in the area of the regulation of TPF.<sup>2</sup> As such, it makes more sense for now to discuss TPF according to the domestic law of a specific jurisdiction.

This paper first highlights the connotations and the significance of arbitral autonomy. It then moves on to examine the effects of TPF on the funded arbitration proceedings and the autonomy of arbitration. On this basis, the paper has singled out certain steps that could be taken by the Chinese regulators in the future in order to promote the use of TPF in arbitration without triggering too many judicial concerns. These efforts usher the following points of

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<sup>1</sup> The situation may be different in other jurisdictions, especially those with common law traditions. For instance, TPF was historically prohibited by the law of maintenance and champerty in England. See: The Law Commission, 'Proposals for reform of the law relating to maintenance and champerty: Laid before Parliament by the Lord High Chancellor pursuant to section 3(2) of the Law Commissions Act 1965' (1966) 4–5. Criminal and civil liability for maintenance and champerty was not abolished by English law until the 1960s when the legislators realized that the retention of the maintenance and champerty prohibition might be inconsistent with the developments in the practice of litigation. See: *ibid.*, 5; Criminal Law Act 1967, section 14.

<sup>2</sup> Victoria Sahani, 'Harmonizing third-party funding regulation' (2015) 36 *Cardozo Law Review* 861.

view: first, the effects of TPF on arbitration do not necessarily lead to the shrinking of arbitral autonomy. Second, the regulatory framework of arbitration needs to be reformed so that it will be able to cope with TPF and eliminate the concerns of the national courts regarding arbitration procedures when TPF is involved.

## II The Significance of Arbitral Autonomy

To litigate is a right and not an obligation and therefore the aggrieved parties may decide not to contest in court but to arbitrate their disputes. To acquire the required efficiency of arbitration, a certain degree of autonomy of the procedure must be guaranteed. In addition, arbitral autonomy is arguably a natural implication of the strong commitment in arbitration law and in other civil legislation to the ideal of personal autonomy.<sup>3</sup>

Arbitral autonomy as a legal term has many connotations. It is sometimes used to suggest the separability of the arbitration agreement from the main contract. Other times, it is referred to as the underpinning principle of the distinctive rules of how the proceedings are conducted or the choice of applicable laws.<sup>4</sup> It is worth noticing that the autonomy thesis does not point in the direction of completely excluding court intervention.<sup>5</sup> The state delegates jurisdictional power to the arbitral tribunal in order to issue a final and binding decision to settle civil disputes. Such delegation comes as a type of trade-off in the form of standards of quality that are applicable to arbitration.<sup>6</sup> Judicial supervision and assistance are considered as inevitable in order to achieve this quality.

Arbitral autonomy is the cornerstone on which arbitration rests and has a significant impact on the conduct and the regulation of TPF for arbitration and vice versa. To better understand the interaction between the two, a revision of some key attributes of arbitral autonomy is needed. The first one treats the parties to arbitration as equals. Any factors that can force the parties into settlement or unjustly deprive them of their procedural rights should be deterred or eliminated. TPF contributes to the efforts by putting the parties on an equal footing. If both parties enter into the arbitration process without much fear of the financial burdens, it falls into the category of what arbitral autonomy implies.

The second attribute of arbitral autonomy provides TPF with more room for development. Compared to litigation, arbitration views TPF with less suspicion. After common law gave up

<sup>3</sup> Hiro N. Aragaki, 'Does rigorously enforcing arbitration agreements promote autonomy' (2016) 91 (4) *Indiana Law Journal* 1145.

<sup>4</sup> Aragaki argued that autonomy can be broadly construed as the freedom to design a process tailored to the parties' needs... See *ibid*, 1147.

<sup>5</sup> Davis Mavunduse, 'Party autonomy in international commercial arbitration: a look at freedom, delimitation and judicialisation' (2019) 25 (2) *International Trade Law & Regulation* 95.

<sup>6</sup> Matti Kurkela, Santtu Turunen, and Conflict Management Institute, *Due process in international commercial arbitration* (2nd edn, Oxford University Press 2010) 1–2.

its historical hostility towards maintenance and champerty,<sup>7</sup> the issue of how to fund legal claims in arbitration was free from procedural coercion in both common law and civil law jurisdictions.<sup>8</sup> It is common sense that arbitration fundamentally differs from litigation, as some public policies borne in mind by national courts can be ignored in arbitration, leading to a distinctive approach in dealing with the impact of TPF on arbitration.<sup>9</sup>

There is no lack of cases illustrating that it would not be artificial to distinguish arbitration from litigation in the context of non-party funding in the light of arbitral autonomy. In *Cannonway Consultants Ltd v Kenworth Engineering Ltd* [1995] 1 HKC 179,<sup>10</sup> Kaplan J said that

it is not appropriate to extend the doctrine (the champerty doctrine, which can prevent the use of TPF in dispute resolution) from public justice to a private consensual system, that is, arbitration, especially when faced with the diminution of the role of the court in relation to arbitration and the introduction of the UNCITRAL Model Law, which gave supremacy to the doctrine of full party autonomy.<sup>11</sup>

In order to implement arbitral autonomy, the English court upheld the tribunal's decision that the costs of TPF were recoverable as part of the costs of arbitration in *Essar v Norscot* [2016] EWHC 2361 (Comm).<sup>12</sup> In the funding agreement, the successful party Norscot agreed to pay the funder Woodsford a fee of 300 percent of the funding, or 35 percent of the recovery, which turned out to be around £2 million.<sup>13</sup> In contrast, recoverable success fees for TPF are unheard of in English court proceedings. The English court has taken the view that the costs of TPF for litigation are a price that can be expected to be paid by the funded party for the funding service.<sup>14</sup> This is in line with the English legislators' dismay over the recovery of the success fees of conditional fees agreements and the premiums for after-the-event insurance.<sup>15</sup> *Essar v Norscot* serves as a useful reminder of the importance of arbitral autonomy. Meanwhile, it

<sup>7</sup> In medieval England, maintenance was defined as 'the giving of assistance or encouragement to one of the parties to an action by a person who has neither an interest in the action nor any other motive recognized by the law as justifying his interference'. Champerty was 'a particular kind of maintenance, namely maintenance of an action in consideration of a promise to give to the maintainer a share in the subject-matter or proceeds thereof, if the action succeeds'. See: The Law Commission (n 1) 3.

<sup>8</sup> Olga Owczarek and Marie Stoyanov, 'Third-Party Funding in International Arbitration: Is it Time for Some Soft Rules?' (2015) 2 (1) BCDR International Arbitration Review 174–175.

<sup>9</sup> Jern-Fei Ng, 'The role of the doctrines of champerty and maintenance in arbitration' (2016) 75 (2) Arbitration 210.

<sup>10</sup> *Cannonway Consultants Limited v Kenworth Engineering Ltd*, [1995] 1 HKC 179.

<sup>11</sup> *Ibid*.

<sup>12</sup> Jeffrey Sullivan, 'Essar v Norscot: Are The Costs Associated With Third Party Funding Recoverable?' (2018) 15 (4) Transnational Dispute Management; Duarte Henriques, 'The Essar v. Norscot Case: A Final Argument for the 'Full-Disclosure-Wingers' of TPF in International Arbitration' in Kluwer Arbitration Blog (2016); *Essar Oilfields Services Limited v Norscot Rig Management Pvt Limited*, [2016] EWHC 2361 (Comm).

<sup>13</sup> *Essar Oilfields Services Limited v Norscot Rig Management Pvt Limited*, [2016] EWHC 2361 (Comm), para 5.

<sup>14</sup> *Arkin v Borchard and others*, [2005] EWCA Civ 655.

<sup>15</sup> Alex Allan, 'Recoverability as costs of cfa success fees and ate premiums: Plevin v Paragon Personal Finance Ltd' (2017) 36 (4) Civil Justice Quarterly 401.

demonstrates the English court's willingness to promote arbitration as an autonomous procedure, flowing above the domestic procedural rules for court proceedings. This case also indicates that it is undeniable that TPF has a significant impact on the interests of the parties and can therefore increase the desire of the parties to seek court scrutiny on arbitration.

The existing Chinese law gives no regard to the interaction between arbitration and TPF, but it acknowledges the importance of arbitral autonomy. In the 1994 Arbitration Law of the People's Republic of China, which is currently effective for all arbitration cases seated in Mainland China,<sup>16</sup> the autonomy theory is recognised as one of the main characteristics of arbitration. It is devoted to limiting to a minimum the domestic elements and national courts' intervention in arbitration.<sup>17</sup> Accordingly, the parties can decide on key issues of arbitration, such as the arbitration institution, the arbitrator, the place of the hearings and so on. In addition, an arbitration agreement shall remain valid and enforceable when the main contract has been revoked or has not yet come into force.<sup>18</sup> Although the Chinese arbitration law does not explicitly state non-interference of the national court in arbitration, it provides in article 8 that the arbitral proceedings should be conducted independently from any intervention by administrative or governmental institutions, social organisations or individuals.<sup>19</sup> On choice of law issues, party autonomy also has an important role to play. The law of the People's Republic of China on the Laws Applicable to Foreign-related Civil Relations has confirmed that the parties may agree upon the applicable law of the arbitration agreement.<sup>20</sup> Before this statute entered into force, similar rule can be found in a judicial interpretation issued by the Supreme People's Court (SPC).<sup>21</sup>

Looking at the recent developments, legal reforms in China continue to strive for the elimination of court intervention and try to safeguard the autonomy of arbitration. In 2017, a new judicial interpretation was issued by the SPC to further reduce the chance of arbitrary and intrusive decisions on the validity of arbitral awards by lower courts.<sup>22</sup> As a result of this change, the gap between foreign and domestic arbitral awards in the process of judicial review has been narrowed. The pre-reporting system, which used to be applied to foreign and foreign-related arbitral awards, is currently applicable to negative decisions on the validity of the arbitral awards in all arbitral proceedings.<sup>23</sup> In other words, whenever the courts make the

<sup>16</sup> Mainland China, also known as the Chinese Mainland, is the geographical area of the People's Republic of China, excluding Hong Kong, Macau and Taiwan.

<sup>17</sup> Yifei Lin, *Judicial Review of Arbitration: Law and Practice in China* (Kluwer Law International 2018) 4.

<sup>18</sup> Giovanni Pisacane, Lea Murphy, Calvin Zhang, *Arbitration in China: Rules & Perspectives* (Springer 2016), 11.

<sup>19</sup> *Arbitration Law of People's Republic of China*, article 8.

<sup>20</sup> *Law of the People's Republic of China on the Laws Applicable to Foreign-Related Civil Relations*, article 18.

<sup>21</sup> *Interpretation of the Supreme People's Court concerning Some Issues on Application of the Arbitration Law of the People's Republic of China (2008 Adjustment PKULAW Version)*, article 16. This judicial interpretation provides in article 16 that 'the examination of the effectiveness of an agreement for arbitration which involves foreign interests shall be governed by the law agreed upon between the parties concerned...'

<sup>22</sup> *The Provisions of the Supreme People's Court on Report for Approval of the Arbitration Cases that are Subject to Judicial Review*.

<sup>23</sup> *Ibid*, article 2.

decision to reject the recognition of arbitral awards, it needs to be reported and reviewed by a higher court so that the autonomy of arbitration can be better protected from local protectionism and other unjust actions.<sup>24</sup>

The above findings nevertheless have to be understood in light of the Chinese legislators' view that arbitration derives its legitimacy from both the parties' consent and the law, and therefore the conduct of arbitral proceedings and the enforcement of arbitral awards must be subject to judicial supervision.<sup>25</sup> Indeed, arbitration cannot be a 'blackout' that hurts the weaker or third party or the public interest.<sup>26</sup> No one can be forced into arbitration and therefore the court has to be involved when the existence of an arbitration agreement is in question. In the final stage, the court has to review the arbitral award and hear the views of the party against whom enforcement of the award is sought. This imposes limits on arbitral autonomy.

### III TPF and Its Impact on Funded Arbitral Proceedings

As mentioned earlier, TPF is, by nature, an investment that can help the parties shift the financial risks of pursuing the case to external third party funders.<sup>27</sup> In law and in academic discussions, it is usually isolated from leading, insurance, claim assignment, legal aid and other funding options.<sup>28</sup> In many jurisdictions, TPF for arbitration is not only promoted but even glorified, so that the arbitration industry can better adapt to the increase in the scale and complexity of arbitration cases, which leads to a rise of the costs of arbitration. In the meantime, regulators in these jurisdictions acknowledge that TPF poses threats, not only to the integrity of the arbitral proceedings but also to the independence of legal practitioners. China is not insulated from these threats. The desire for a proper regulatory framework for TPF has already been demonstrated by the introduction of new provisions to arbitration guidelines and rules in order to reflect the potential negative impact of TPF.<sup>29</sup>

Chinese law does not raise the question of the legality of TPF. In academic discussions, however, views are divided on whether arbitral autonomy implies the involvement of TPF

<sup>24</sup> Ibid.

<sup>25</sup> Lin (n 17) 13.

<sup>26</sup> L. Ali Khan, 'Arbitral autonomy' (2013) 74 (1) *Louisiana Law Review* 1; 韦伟强, '《仲裁法》的修改和完善——从一起仲裁执行异议之诉案件所进行的实证分析' (2018) (253) *社会法学家*.

<sup>27</sup> Nick Rowles-Davies, *Third Party Litigation Funding* (Oxford University Press, 2014) 4; Catherine Rogers, *Ethics in International Arbitration* (Oxford University Press 2014) 182–185; *Hong Kong Arbitration Ordinance (Cap. 609)*, section 98G; 'Report of the ICCA-Queen Mary task force on third-party Funding in international arbitration' (2018) 50.

<sup>28</sup> Duarte Henriques, 'Third-Party Funding: A Protected Investment?' (2017) (30) *Spain Arbitration Review*.

<sup>29</sup> Singapore International Arbitration Centre, 'Investment arbitration rules of the Singapore International Arbitration Centre' (2017); *International Investment Arbitration Rules of the China International Economic and Trade Arbitration Commission*; Beijing Arbitration Commission, 'Public Consultation on Draft BAC Investment Arbitration Rules' <<http://www.bjac.org.cn/english/news/view?id=3370>> accessed 3 May 2020.

without mutual consent. One view is that the party's right to shape the proceedings hints at the discretionary use of TPF. The other view is that TPF is an arrangement between one of the parties of the dispute and an external funder, and therefore, does not fall within the contractual agreement of the parties. Following this line of thinking, the presence of TPF is already a challenge to arbitral autonomy. Nevertheless, neither of the above views negates the fact that TPF has the potential to facilitate access to arbitration and it should be treated as an experiment that is worth taking, if not an integral part of arbitration.

The existence of TPF is not yet a reason for the Chinese court to step in and review the impact of the funding arrangement on arbitration cases. Disputes between parties may end up in the state court when serious procedural issues associated with TPF lead to suspicion of the integrity of the arbitral procedure. In other words, TPF does not create new escape routes to litigation. It actually increases the use of these routes for issues governed by the law of the seat of arbitration that may require a higher level of scrutiny. To further elaborate, it is useful to look again at the case of *Essar v Norscot* before the English High Court. In this case, an ICC tribunal decided that the costs of TPF incurred by the successful party constituted part of the costs of arbitration and are therefore recoverable. The losing party brought the tribunal's decision to the English court, which is the court of the seat of arbitration, with the claim that the tribunal had no power to order recoverable success fees of TPF.<sup>30</sup> With TPF in the picture, the parties clearly have less confidence in the self-regulating character of arbitration. In that case, TPF-related issues are likely to spark further proceedings, on not only on the scope of the power of the tribunal but also on the scope of the costs of arbitration.

In investment arbitration, TPF could be more intricate, given that the state's right to arbitrate is limited.<sup>31</sup> Normally, international investment arbitration treaties only apply to 'qualified investors'. The question could be whether investors who are pursuing claims that will mostly benefit external funders are still 'qualified'.<sup>32</sup> Compared to commercial arbitration, the parties in investment arbitration are more likely to challenge the arbitration proceedings and the final award when there is TPF involved. In *Teinver S.A., Transportes de Cercanías S.A. and Autobuses Urbanos del Sur S.A.*, for instance, the respondent sought annulment of the arbitral award on the grounds that the tribunal ignored a fundamental rule of procedure by allowing a third party funder, Burford Capital, together with King & Spalding, to be the principal beneficiary of the proceeds of the final award.<sup>33</sup> To ensure the finality of the results of arbitration, which is implied by the principle of arbitral autonomy, the post-investment arbitration remedies have to be limited and exclusive of direct court intervention. However, TPF is still likely to increase the use of such remedies, which threatens the autonomy of the original

<sup>30</sup> *Essar Oilfields Services Limited v Norscot Rig Management Pvt Limited*, [2016] EWHC 2361 (Comm), para 6.

<sup>31</sup> Angelynn Meya, 'Chapter 10. Third-Party Funding in International Investment Arbitration The Elephant in the Room' in *Third-Party Funding in International Arbitration (ICC Dossier)* (2013) 122.

<sup>32</sup> *Ibid.*

<sup>33</sup> *Teinver S.A., Transportes de Cercanías S.A. and Autobuses Urbanos del Sur S.A. v. Argentine Republic (ICSID Case No. ARB/09/1) Decision on Argentina's Application for Annulment.*

tribunal.<sup>34</sup> It is worth noting that post-arbitration remedies are not the only danger to the autonomy of arbitration in the context of TPF. In some cases, the tribunal decides on the request for security for the costs considering the participation of third party funders.<sup>35</sup> Such security is likely to put a halt on the party's actions to bring up the claims,<sup>36</sup> which contradicts the autonomy thesis.

It is clear that TPF's lack of transparency deters problem-solving. In the absence of a disclosure obligation, an unjust situation is created if the opponent of the funded party shoulders the obligation to investigate whether and how a third party funder is involved in the case and how the funding arrangement impacts the arbitration procedure. If conflicts of interest and other abuses of arbitral proceedings associated with TPF are found after the delivery of the final award, the losing party that is likely to challenge the validity of the award in setting aside or enforcement proceedings. As such, the related arbitral proceedings might become a waste of time and money for everyone.

#### **IV A Case for Mandatory but Targeted Regulatory Measures for TPF for Arbitration in the Chinese Context**

In international arbitration, the tribunal hopes that TPF leaves the procedure unaffected; however, it is constantly facing the situation where the parties have disputes on the legality and impact of the TPF arrangement. It is not impossible that the Chinese court is needed by the parties in order to help resolve the TPF-related issues. Although the law does not object to the right of the party to make such requests, future legal reforms should be geared to eliminating the number of those requests, so that arbitral autonomy can be upheld. To do that, this section first presents empirical findings from China regarding the concerns of arbitration practitioners over TPF, then it brings forward a dual track approach to the regulation of TPF in the belief that if certain precautions are taken, the use of TPF for arbitration does not necessarily weaken arbitral autonomy.

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<sup>34</sup> Gary J. Shaw, 'Third-party funding in investment arbitration: how non-disclosure can cause harm for the sake of profit' (2016) (advance access) *Arbitration international* 120.

<sup>35</sup> Umika Sharma, 'Third Party Funding in Investment Arbitration: Time to Change Double Standards Employed for Awarding Security for Costs?' in *Kluwer Arbitration Blog* (2018).

<sup>36</sup> *Ibid.* In investment arbitration, the tension between access to arbitration and the party's right to ask for security for defending an expansive and prolonged case is outstanding. As Sharma has noted, 'on one side is the respondent State which seeks security for defending a claim with the taxpayers' resources'. On the other side, 'there is the claimant who might become financially incapable of accessing justice if it is asked to put up security for costs.'

## 1 Empirical Findings: Arbitration Practitioners' Concerns About TPF

The Chinese TPF market has not been well described in the English literature. The Report of the ICCA-Queen Mary Task Force on TPF in International Arbitration is believed to be the first attempt to narrate the Chinese TPF industry, although the findings are rather preliminary.<sup>37</sup> Beyond that, what we have is no more than a few papers dealing with TPF on the theoretical level. In the Chinese literature, TPF is also a relatively underexplored area. In order to fill the information gap, the author conducted empirical research on the Chinese TPF market from October 2017 to December 2017 in Shenzhen, China, with the assistance of DS Legal Capital and some local institutions and authorities. In the process, two questionnaires were sent as part of the survey research. The first one received 175 responses from lawyers (63), arbitrators (12), in-house counsels (23), judges or judge assistants (16), governmental officers (12), arbitration institutions (18) and others (31). The second one specifically targeted in-house counsels with companies that have subscribed to the membership of the Legal Executive Board. There were 18 responses. The following are the findings from this empirical research.

### a) The legality of TPF

Chinese law contains no prohibition of non-party funding for dispute resolution. At the moment, arbitration seems to be more prepared for TPF than litigation. Even though Chinese arbitration law does not directly deal with TPF-related issues, it does not prevent institutions from adopting rules with regard to the use of TPF. The China Economic and Trade Arbitration Commission (CIETAC) and Beijing Arbitration Commission (BAC), for instance, have adopted safeguards against the risks of TPF in their investment arbitration rules.

Notwithstanding the lack of statutory prohibition of the involvement of third party funders, it could be interfered from the regulation of lawyer funding and contingency fees that external funding is not preferable in some areas of law. The 2006 Measures for the Administration of Lawyers' Fees have outlawed contingency fees from the following cases:

(1) cases of marriage or inheritance; (2) cases of asking for social insurance or minimum living costs; (3) cases of asking for child support or for alimony, pensions for the disabled or for the family of the deceased or welfare payments, or compensation for work-related injuries; or (4) cases of asking for payments for labour remunerations, etc.; (5) criminal cases, administrative cases, cases of state compensation and cases of collective litigation.<sup>38</sup>

<sup>37</sup> 'Report of the ICCA-Queen Mary task force on third-party Funding in international arbitration.' The findings about China do not touch on the specific legal issues associated with TPF. This report only points out that third party funders have emerged in China. And as a response to this change, some Chinese arbitration institutions have issued guidelines to define and to regulate TPF for arbitration.

<sup>38</sup> 国家发展改革委 (State Development & Reform Commission) and 司法部 (Ministry of Justice), '律师服务收费管理办法 (Measures on Payment of Litigation Fees)' (2006), articles 12 and 13.

The rationale underlying the above is presumably that the nature of these cases is not compatible with the commercial incentives of non-party funders. Hence, it is reasonable to ask whether the permission of TPF will be reversed in the above cases. The author tends to believe that, in arbitration that is focused on commercial cases, there is no reason to brush aside TPF. Both common law and civil law jurisdictions have shown that the involvement of TPF for arbitration does not go beyond the administrative capacity of arbitration if proper safeguards are put in place.

#### **b) The qualification of third party funders**

The Chinese third party funders approached by the author portray themselves as investment companies focusing on funding legal claims in both litigation and arbitration. They offer not only funding but also case and budget management, case strategy design and other related services. To expand their business, Chinese funders are cooperating with insurance companies and law firms. Parties can integrate legal insurance, TPF and contingency fees in the same proceedings. TPF is conceived by practitioners and regulators as an investment, separate from other funding options such as loans and lawyer funding. With substantial financial stakes in the funded case, the funder normally seeks to investigate the case beforehand and to monitor the funded proceedings closely. Its investigation is likely to cover the nature, legal merits and value of the claims, as well as the financial status of the opposing party and maybe the whole investment portfolio. The decision on whether to fund a specific legal claim requires both legal and non-legal considerations. During the procedure, the funder is likely to engage in the funded case to such an extent that it would become the one in charge of the proceedings.

Despite that, imposing statutory qualification requirements on third party funders is not necessarily favoured by domestic laws. Exceptions however exist. In Singapore, for instance, the Civil Law (Third-Party Funding) Regulations 2017 have provided that third party funders must (1) give the principal business funding for the costs incurred during the dispute; (2) have capital of not less than \$5 million or the equivalent amount in foreign currency in managed assets. Failure to comply with either of the above requirements will be subject to legal liabilities. That is, the rights of the funder under the TPF contract that is affected by or connected with the disqualification or non-compliance may not be enforceable by action or other legal proceedings.<sup>39</sup>

In jurisdictions where the above statutory rules are absent, it is left to the court or to the tribunal to decide whether the funders are in good shape or have engaged properly in the funded proceedings in light of the general procedural rules. In the *Excalibur* case, the English court found that funders encouraged and maintained claims that were extremely weak and were conducted in an aggressive way.<sup>40</sup> The court in the first instance ordered the plaintiff (the

<sup>39</sup> *Civil Law Act of Singapore (Chapter 43)*, section 5B(4).

<sup>40</sup> *Excalibur Ventures LLC v. Texas Keystone Inc & Ors*, [2016] EWCA Civ 1144; The Association of Litigation Funders, 'Statement from the Association of Litigation Funders of England and Wales regarding the Court of Appeal Judgment in *Excalibur*' <<http://associationoflitigationfunders.com/wp-content/uploads/2016/11/ALF-Excalibur-Press-Release-181116-.pdf>> accessed 3 May 2020.

losing party) and its funders to pay the defendants' costs on an indemnity basis for the following reasons: (1) Excalibur is 'nothing more than a brass plate' that had advanced and aggressively pursued serious and wide-ranging allegations of dishonesty or impropriety over an extended period of time; (2) Excalibur's claims could not have been pursued without third party funders and failed on every material issue; (3) The plaintiff's claims imposed an enormous drain on judicial resources; (4) The funders behind Excalibur would recover up to seven times their funding if they won the case. Arbitration is also exposed to the above risks. However, the tribunal would hardly issue cost orders directly against third party funders. Noticeably, the self-regulation of third party funders supervised by the Association of Litigation Funders (ALF), which provides the standards for the qualification and for the behaviour of the funders in England and Wales, plays a role in reducing abuses associated with the disqualification of third party funders.<sup>41</sup> However, this self-regulation only applies to those that have subscribed to ALF membership.

In China, there are currently no requirements for eligibility or any punitive norms for third party funders. In the empirical research, some of the respondents were arbitrators who think that they are entitled to play a role in regulating third party funders. However, this has not become a widely accepted idea. Some arbitrators believe that, by doing so, they risk going beyond their mandate.

### c) Lack of transparency of funding arrangements

Lack of transparency regarding TPF arrangements distances the Chinese arbitration law from international standards. A series of recent developments in the arbitration community have set the trend towards mandatory disclosure of TPF,<sup>42</sup> although it is still debatable who should bear the obligation of disclosure. Widely recognised, the increasing involvement of third party funders in arbitration justifies mandatory disclosure of the funding arrangement. In the 2015 Queen Mary Arbitration Survey, the disclosure issue was singled out by the results. The report reads 'a point made in a number of interviews was that regulation should mainly focus on disclosure rather than on the creation of a prescriptive, substantive regime.'<sup>43</sup> In the empirical research conducted by the author, among 14 responses from arbitration institutions, half of them indicate that the disclosure of TPF is a necessity. The funded party's disclosure obligation is favoured by all of the respondents from the arbitration institutions.

In some Asian arbitration centres, the disclosure of TPF has already become part of the statutory law. In Singapore, the disclosure obligation is imposed on legal practitioners in order to guarantee compliance.<sup>44</sup> Hong Kong followed suit but had chosen to force this obligation

<sup>41</sup> The Association of Litigation Funders, 'Code of Conduct for Litigation Funders' (2018).

<sup>42</sup> Marius Nicolae Iliescu, 'A Trend Towards Mandatory Disclosure of Third Party Funding? Recent Developments and Positive Impact' in Kluwer Arbitration Blog (2016).

<sup>43</sup> Queen Mary University of London; and White & Case LLP, '2015 International Arbitration Survey: Improvements and Innovations in International Arbitration'.

<sup>44</sup> *Legal Profession (Professional Conduct) Rules 2015*.

on the funded party. Both agree that limited disclosure, with only the existence of the funding arrangement and the identity of the funder, would be enough to satisfy the regulatory purposes. In the absence of proper disclosure, the parties in China are exposed to many of the risks of TPF. The most alarming one could be that the involvement of TPF affects the independence of the arbitral tribunal and, by necessary implication, the integrity of the arbitral award.<sup>45</sup>

#### d) Conflicts of interest

The risk of conflicts of interest in cases with TPF is real. This has led to the modification of the IBA Guidelines on Conflicts of Interest in International Arbitration (hereafter referred to as 'IBA Guidelines'). According to them, 'third-party funders and insurers in relation to the dispute may have a direct economic interest in the award, and as such may be considered to be the equivalent of the party'<sup>46</sup>.

In China, conflicts of interest might arise not only from the funder's relationship with the tribunal but also with the lawyers. As noted before, funders often have business connections with law firms, which puts lawyers at risk of a conflict of interests and therefore threatens the integrity of the legal profession. This view, however, may be exaggerated, considering that the problem of conflict of interests in the legal profession is hardly new and arguably cannot be seen in black and white. In reality, lawyers operate a business and always have their own financial interests at heart when working on a case, with or without the involvement of TPF. Despite that, it is undeniable that TPF amplifies the financial incentives of lawyers and third party funders, to the extent that the funded party may no longer be the main beneficiary of the funded legal proceedings. Arguably, the regulation of the legal profession should reflect on TPF in order to guarantee that (1) the line between third party funders and the funded parties' lawyers is not blurred; and (2) if the interest of the funded party and that of the funder collide, lawyers must prioritise the former over the latter.

#### e) Confidentiality of arbitration

In the surveys conducted by the author, respondents were concerned about potential breaches of confidentiality of arbitration. Users of commercial arbitration appreciate the confidentiality of arbitration,<sup>47</sup> as it prevents case materials being shared with outsiders.<sup>48</sup> However, confidentiality of arbitration does not have a statutory basis in every jurisdiction. In fact, it is not a well-established principle in either domestic or international laws.<sup>49</sup> Chinese law allows

<sup>45</sup> William Stone, 'Third Party Funding in International Arbitration: A Case for Mandatory Disclosure?' (2015) 17 (2) *Asian Dispute Review* 66.

<sup>46</sup> International Bar Association, 'IBA Guidelines on Conflicts of Interest in International Arbitration' (2014) Explanation to General Standard 6.

<sup>47</sup> Elza Reymond-Eniaeva, *Towards a Uniform Approach to Confidentiality of International Commercial Arbitration* (Springer, 2019), 1.

<sup>48</sup> *Ibid.*, 1.

<sup>49</sup> 辛柏春, '国际商事仲裁保密性问题探析' (2016) 30 (2) *当代法学* 120-121.

for arbitration proceedings to be conducted in private,<sup>50</sup> but this is not equivalent to confidentiality in arbitration. Despite that, arbitration institutions often provide confidentiality obligations. Discussing details with third party funders appears to be outright incompatible with these obligations according to some scholars.<sup>51</sup> In the author's view, the impact of TPF on the confidentiality of arbitration can be linked to the qualification of third party funders. In order to maintain an appropriate level of confidentiality, the tribunal needs the participation and cooperation of the funders. They must be required to have mechanisms that can prevent case materials from being shared with or misused by parties who have no legal connection to the case.

#### f) The impact of TPF on the costs of arbitration

At the moment it is unknown whether TPF contributes to the disproportionate costs of arbitration. In international commercial arbitration practices, it is likely that the success fee in TPF is categorised as part of the 'costs of arbitration', leading to a large financial exposure for the opponent of the funded party. Therefore, on the micro level, it can be argued that TPF affects the parties' liabilities for costs. This explains the increasing concern over whether the recoverable success fees in TPF need to be capped or even suspended from arbitration. There is also a question whether the tribunal is empowered to issue cost orders against the funders if they can directly affect the parties' procedural liabilities.

Similar to litigation, there are two approaches to cost allocation in arbitration. The first one is the 'loser pays' rule and the other one is the American model, that parties bear their own costs.<sup>52</sup> When the first approach is applied, the costs of TPF are likely to equal the costs of the opponent who might not know of the existence of TPF until then. This could undermine the attractiveness of arbitration, since the financial risk of losing the case becomes unpredictable. Apart from that, TPF gives rise to more concerns about undue proceedings. Parties and their lawyers who pay nothing when they lose under the terms of their TPF agreement tend to be optimistic about the case and are likely to initiate unnecessary pleadings. In this sense, TPF increases the costs of arbitration, regardless of the cost allocation rule being applied.

Under the TPF agreement, funded parties normally pay several times over the original investment or a certain percentage of the final award in the event of success. The amount of the costs of TPF could be exploitative. The situation is worsened if the funded party's lawyers have business connections with the funder that can affect their independence. In some jurisdictions, the risk of exploitative TPF success fees has triggered broad academic discussions in certain areas of law, such as class action. Dutch law, for instance, empowers the court to investigate TPF for collective redress proceedings. Legislators there believe that

<sup>50</sup> Arbitration Law of People's Republic of China, article 40. This provision states that 'arbitration shall be conducted in camera. If the parties agree to public arbitration, the arbitration may be public unless state secrets are involved.'

<sup>51</sup> Jonas von Goeler, 'Show Me Your Case and I'll Show You the Money – How to Balance Conflicts Between Third-Party Funding and Confidentiality in Arbitration Proceedings' in Kluwer Arbitration Blog (2016).

<sup>52</sup> Micha Bühler, 'Awarding Costs in International Commercial Arbitration: an Overview' (2004) 22 (2) ASA Bulletin 250–251.

exploitative success fees constitute a violation of the interests of the parties and pose a threat to the integrity of the legal proceedings. In the context of arbitration, there is no scrutiny over the funding arrangement. Chinese law does not deal with the amount of the success fee of TPF for arbitration and neither do the arbitration rules. This seems to be an oversight, since the law does not allow priority to be given by third party funders to the generation of financial profits.

The costs of arbitration have been noticeably, rising in the recent years, which can be for a variety of reasons.<sup>53</sup> These costs can be broadly categorised into two groups, procedural costs and parties' costs. The increases in the parties' costs, which are the main contributor to the rise of the overall costs of arbitration, are linked to lawyers' fees and therefore can hardly be controlled by state authorities. In fact, it is debatable whether those authorities have the obligation to make arbitration affordable and lower the price for TPF for arbitration. Having this in mind, the paper argues that, although regulators should keep an eye on the impact of TPF on costs of arbitration, such an impact should not necessarily be regulated by statute.

## 2 A Dual Track Approach to the Regulation of TPF for Arbitration in China

Despite substantive efforts having been made to impose regulations for the minimum standards for practicing TPF, harmonisation is still lacking. The proliferation and sophistication of TPF-related issues require Chinese legislators to investigate the scattered and divergent regulatory measures beyond the Chinese borders in order to come up with solutions. This section first identifies some international trends in regulating TPF, and then makes proposals for this process in China. Finally, it points to the unsolved issues that might be the subject of future research.

### a) The regulation of TPF beyond Chinese borders

Looking beyond the Chinese borders, there are three trends that can be observed in the area of regulating TPF. The first concerns the disclosure of the TPF agreement in arbitration. We have seen both soft rules and hard laws being introduced to ensure sufficient disclosure.<sup>54</sup> The primary purpose of it is to ensure that TPF does not create conflicts that could compromise the integrity of the whole arbitration procedure. Disclosure also serves the purpose of maintaining a certain level of predictability of arbitration. It informs the other party of what they are getting into at the preliminary stage, which meets the requirements of procedural justice. Arguably, it is unjust for one of the parties to investigate the funding arrangement made by the opponent with an external party, especially when such an arrangement is likely to give rise to conflicts of interest.

<sup>53</sup> Christoph Stippl and Gunnar Pickl, 'Chapter II: The Arbitrator and the Arbitration Procedure – Limiting Costs in Arbitration' in *Austrian Arbitration Yearbook 2009*, 213.

<sup>54</sup> For instance, section 98U of the Arbitration Ordinance Cap. 609 has imposed a disclosure obligation on the funded party.

The second trend is to set up qualification requirements for the funders. In England, such requirements are contained in the ALF code of conduct. Singapore provides similar requirements for the funders in international arbitration. Failure to comply will directly give rise to legal consequences,<sup>55</sup> meaning that the rights of the funder under or arising out of the TPF contract affected by or connected with the disqualification or non-compliance are not enforceable by action or any other legal proceedings.<sup>56</sup> Hong Kong has a code of practice applicable to all third party funders. Section 2.5 of the code states that a third party funder must (a) ensure that it will be capable of paying all debts when they become due and payable; and (b) cover all of its aggregate funding liabilities under all of its funding agreements in less than 36 months.

The third trend is regulating TPF in order to manage conflicts of interest. IBA Guidelines, which were modified in 2014, reinforce this trend. General Standard 7 of these Guidelines requires the parties to disclose the relationship with an arbitrator in order to reduce the risk of a challenge of an arbitrator's impartiality or independence because of information learnt subsequently. This requirement extends to third party funders that have a direct economic interest in the final award. In some jurisdictions, domestic regulation has a similar effect. The Hong Kong code of practice for third party funders, for instance, requires a funder to maintain effective procedures for managing conflicts of interest. Section 2.6 states the details in this regard:

the third party funder has effective procedures for managing a conflict of interest that may arise if it can show through documentation that (1) the third party funder has conducted a review of its business operations that relate to the funding agreement to identify and assess potential conflicting interests; (2) the third party funder: (a) has written procedures for identifying and managing conflicts of interest; and (b) has implemented the procedures; (3) the written procedures are reviewed in intervals no greater than 12 months; (4) the written processes include procedures about the following: (a) monitoring the third party funder's operations to identify and assess potential conflicting interests; (b) disclosing conflicts of interest to the funded parties; (c) managing situations in which interests may conflict; (d) protecting the interests of funded parties and potential funded parties; (e) dealing with situations in which a lawyer acts for both the third party funder and a funded party or potential funded party; (f) dealing with a situation in which there is a pre-existing relation between a third party funder, a lawyer and a funded party (or potential funded party)...<sup>57</sup>

#### **b) A proposed regulatory framework: mandatory but limited regulatory measures**

Regarding the measures that have to be adopted to ensure the quality of arbitration and to prevent parties from bringing arbitration-related issues to the court, the above three trends should be considered in future Chinese legal reforms, since they represent the efforts to adapt

<sup>55</sup> *Civil Law (Third-Party Funding) Regulations 2017*, section 4.

<sup>56</sup> *Ibid.*

<sup>57</sup> Secretary for Justice of HKSAR, 'Hong Kong Code of Practice for Third Party Funding in Arbitration' (2019) section 2.7.

to the increasing use of TPF. Bearing these trends in mind and taking into consideration the conditions in China, the following regulatory approach is proposed: an adoption of both hard and soft rules with awareness that the regulatory approach ought to be moderate, since TPF has positive effects on arbitration and is currently in its preliminary stage of development. In the author's view, most of the issues related to TPF should be subject to soft rules, which are more flexible and compatible with international standards. However, for issues directly affecting the integrity of arbitration and that of the legal profession, mandatory rules are required. The recommended approach has contemplated the concerns of TPF that have been discussed in section 4.1 of this paper. This approach can be specified as follows.

First of all, TPF for arbitration needs to be regulated separately from TPF for litigation. The key features of the funded procedure play an essential role in shaping the rules for TPF. China has civil law traditions without legal doctrines preventing the use of non-party funding with commercial motives, but the regulators are required to consider the scope for the practice of TPF. As stated earlier, the nature of the case is not compatible with non-party funders' commercial incentives in some litigation cases. It therefore can be reasonably expected that TPF is subject to more legislative restrictions in litigation than in arbitration.

Second, it is suggested that legislators consider imposing mandatory qualification requirements for third party funders. Beyond the Chinese borders, there is no consensus on who should be allowed to fund arbitration, despite the obvious trend of setting up some standards of capital adequacy and the behaviour of the funders. At this moment, it is crucial to define the line between legal practitioners and third party funders. Chinese law does not prevent partners of local law firms from becoming the founder or the shareholder of third party funders. Some firms have even signed cooperative agreements with third party funders and, as a result, they are obliged to send clients to each other. With the absence of requirements for the quality and the business model of third party funders, it is likely that parties would object to the funding agreements based on procedural irregularities.

The author also argues that Chinese regulators should consider integrating TPF disclosure into mandatory rules. On the one hand, an appropriate level of transparency of external funding agreements is at the core of managing conflicts of interests. On the other hand, disclosure of TPF is needed to protect the opposing party. Arbitration guarantees a certain level of predictiveness as to the amount of recoverable costs.<sup>58</sup> To achieve that, arbitration rules normally allow parties to shape the cost rules. However, TPF could have a significant impact on the costs of arbitration. As previously discussed, *Essar v Norscot* demonstrates the possibility of recoverable success fees in TPF.<sup>59</sup> Even though the theory in the *Essar* case will not be applied, there are many ways through which TPF could increase the costs of arbitration. For instance, TPF might be related to the issue of security for costs. It is reasonable to ask whether the funded party is assumed unable to pay the costs of arbitration and therefore

<sup>58</sup> Michael O'Reilly, 'Rethinking costs in commercial arbitration' (2003) 69 (2) *Arbitration* 125.

<sup>59</sup> *Essar Oilfields Services Limited v Norscot Rig Management Pvt Limited*, [2016] EWHC 2361 (Comm).

should not be allowed to proceed without posting a proper guarantee.<sup>60</sup> In the above scenarios, if TPF is not subject to disclosure, the parties to arbitration are likely to be shocked by the costs incurred by or connected to TPF.

Based on the disclosed information, the tribunal is able to investigate the impact of TPF on arbitration proceedings. From this point forward, legislators can rely on soft laws to deal with conflicts of interest, excessive success fees, and many other issues that are deemed important. The value of soft laws in the context of TPF can be justified by the fact that Chinese practitioners and regulators still lack an adequate understanding of the risks of TPF. Moreover, soft laws are an expression of the non-domestic nature of commercial arbitration and can enable China to be included in the process of unifying the rules on the international front. They may also be used to educate inexperienced practitioners regarding the possible impact of TPF. Very often, soft laws only become applicable if the parties agree on them, which is in line with the autonomy thesis underlying arbitration.

## V Conclusion

TPF constitutes a challenge to arbitral autonomy. However, this does not mean that arbitral autonomy is inevitably discounted in cases where TPF is involved. This paper acknowledges the principle of arbitral autonomy as one of the pillars of arbitration,<sup>61</sup> which expresses the idea that the arbitral process is partially, instead of completely, isolated from national courts.<sup>62</sup> As an implication of the above principle, the parties are free to enter into funding agreements with third party funders or other financiers for business reasons. However, the way that the funder is involved has an effect on the wider interests of justice and therefore should be checked by the tribunal and probably the court. Arguably, the tribunal is best-suited to supervise TPF for arbitration, though there are exceptional circumstances where there is a good reason for the court to step in.

In cases with TPF for arbitration, national courts may continue to be benevolent supporters of arbitration rather than hostile interferers, with the precondition that arbitration has the ability to deliver justice. In the Chinese context, preventing the use of TPF from going beyond the administrative capacity of arbitration calls for a hybrid regulatory approach, combining both mandatory and voluntary rules. The focus of mandatory rules should be on the disclosure of TPF, with the understanding that such disclosure can help shorten the list of things that can go very wrong and subsequently reduce the possibility of the court's intervention. Other than that, some mandatory requirements for the governance, structure, and behaviours of the funders are necessary. In particular, the blurred line between third party funders and lawyers should be singled out, since it compromises not only the quality of the arbitration

<sup>60</sup> Duarte Henriques, 'Arbitrating disputes "in" third-party funding' (2019) 85 (2) *Arbitration* 169.

<sup>61</sup> N. H. Andrews, *Andrews on Civil Processes: Arbitration and Mediation* (Intersentia 2013) 94.

<sup>62</sup> *Ibid.*

procedure but also that of the legal profession. On top of mandatory rules, the use of arbitration rules and various international instruments with regard to the negative effects of TPF should be encouraged. The parties are advised to contemplate TPF and its potential impact by the time they enter into an arbitration agreement. They may exclude TPF by mutual consent. If third party funders are involved, they may need to investigate the arbitration rules regarding cost allocation and other related factors to see how TPF could affect the independence of the tribunal, the quality of the legal advice as well as adverse costs liabilities.