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Third Party Funding in Japan: Opportunity for a Clear Policy

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The economic turmoil brought about by the COVID-19 pandemic will undoubtedly give parties pause in weighing the potential benefits of pursuing an arbitration claim, no matter how strong it is believed to be.[1)] Yet international disputes and arbitration cases will only increase as parties tussle to determine the allocation of risk and responsibility for additional costs, delays, or disruptions flowing from the pandemic. Indeed, even as businesses tightened their belts during this economic climate, statistics for 2020 show that international commercial and investor state arbitration cases remain on the rise, with the ICC, the LCIA, ICSID, and the SIAC reporting record filings.

Japanese companies have likewise had to grapple with the specific issues caused by the pandemic's disruptive effects on supply chains and the free movement of people. In addition, a future rise in international disputes involving Japanese parties or Japanese-seated arbitration proceedings is inevitable given Japan's ambitious goals for her own energy and construction sectors, her continued policy of investing in and developing overseas energy and connectivity infrastructure, and her trade commitments under recently signed bilateral and multilateral economic agreements.

A user of arbitration would be prudent to consider financing options to hedge the inherent financial risks of arbitration and remove some financial pressure from its resources and cash flow. We can expect third party funding to become a more common feature of international arbitration, having now found its place in the latest version of the ICC arbitration rules, and with pro-arbitration jurisdictions Singapore and Hong Kong shedding their historical impediments to permit and regulate third party funding in arbitration and in court proceedings related to arbitration. Even when third party funding is permitted, there are various rules and jurisprudence parties must consider. In this post, I take a look at the status of third party funding in Japan.

Current Position in Japan

The option of financing the costs of arbitration proceedings through third party funding could provide some financial reprieve for Japanese parties. Yet uncertainty hovers over the question of whether a third party funding arrangement is legal or operable in Japan as there are currently no laws forbidding, permitting, or regulating the use or the provision of third party funding in Japan, even if in principle, concepts of champerty and maintenance, which derive from a fear of encouraging manipulation or gambling in litigation, do not exist in Japan.

Thus, while the Japanese Arbitration Act (Law No. 138 of 2003, amended by Act No. 147 of 2004) does not mention funding, and while a funding arrangement for arbitration proceedings may not directly infringe Japanese law per se, it may contravene laws and regulations designed to preserve the integrity of legal services and intended to prevent non-lawyers from circumventing the qualification, conduct, and ethical requirements and regulations applicable to lawyers[2)] and to prevent non-lawyers from abusing process.[3)] The Japanese Attorney Act (Act No. 205 of 1949, amended by Act No. 87 of 2004), for example, contains a blanket prohibition on the provision of legal services by non-attorneys (Article 73). Attempts to circumvent this may be restrained by other provisions that prohibit the business of non-lawyers enforcing assigned rights (Attorney Act, Article 72), creation of a trust structure for the prosecution of legal suits (Trust Act (Act No. 108 of 2006, amended by Act No. 53 of 2011), Article 10), and sharing legal fees with non- lawyers (Japan Federation of Bar Associations, Basic Rules of Duties of Lawyers, Article 12).

Depending on how a funding arrangement is structured, Japanese financial regulations pertaining to raising funds, money lending, and interest—in particular, the Money Lending Business Act (Act. No. 32 of 1983, amended by Act No. 69 of 2014) and the Interest Rate Restriction Act (Act No. 100 of 1954, amended by Act No. 115 of 2006)—may apply. It is also not known whether a funding arrangement would be recognised by a Japanese court or arbitral tribunal. It is understandable, therefore, that Japanese parties would be more inclined to choose the prudent course of self-funding, even if they meet the funder's criteria for funding.

Future Developments

The benefits that third party funding may offer Japanese international arbitration have been acknowledged at a policy level, but it is not clear when or how Japanese third party funding will be developed. Specifically, the session notes of a meeting between the Japanese Ministry of Justice ("MOJ"), the Japanese Commercial Arbitration Association, and the Japan International Dispute Resolution Center ("JIDRC") record that third party funding may play a role in promoting the use of international arbitration by mitigating the burden of arbitration costs on Japanese arbitration and Japanese parties.

That said, it is possible that a regulatory framework for third party funding will follow only after changes to the more foundational aspects of the international arbitration infrastructure have been implemented. Since announcing its intent to stimulate Japanese international arbitration in 2017, the Japanese government has called regular meetings with the private sector, including arbitration practitioners, to discuss practical measures. Recent changes include the establishment of the JIDRC and amendments to the Foreign Lawyers Act (Act No. 66 of 1986, amended by Act No. 33 of 2020) which, among other things, expand the scope of international arbitration services that foreign lawyers can provide. Separately, the Japanese MOJ is currently working on amending the Arbitration Act to bring it in line with the latest UNCITRAL Model Law. A provisional draft of the amendment has been made available for public comments.

Even without a regulatory framework, arrangements with foreign funders may be available. Given the private nature of the arbitral process, there is no comprehensive data published on how many Japanese parties have actually availed themselves of third party funding, or how many parties to Japan-seated arbitration proceedings have been funded. Funders spoken to report that substantial

Japanese companies and conglomerates show an active interest in third party funding. This is perhaps particularly unsurprising with regard to the heavy industries and infrastructure sector, which gives rise to the sorts of complex, multi-faceted disputes that lend themselves well to the funding process.

However, in terms of usage, there have been only limited reports of actual funding arrangements involving Japanese parties, including at least one investor-State arbitration. This suggests that arrangements that a party considers to be acceptable can be reached through careful drafting, although where the proceedings were seated, which jurisdictions the parties were incorporated in, how funds were moved, and precisely what contractual framework was used are not known. In the context of Japanese court proceedings, it does appear that Japanese litigants have received the benefit of financing in class action suits (see examples here and here). But again, there are doubts about the basis of this funding arrangement. Practitioners have noted that there is no express permission for third party funding in the context of litigation in the Japanese courts.[4)]

Japanese international arbitration would benefit from clear legislative and regulatory frameworks for the implementation of funding arrangements. This would conceivably be implemented by amendments to existing legislation (including the Arbitration Act and the Attorneys Act), as well as ancillary regulations and guidelines. In addition to specifically permitting funding arrangements for international arbitration proceedings, these frameworks would address, among other things:

- the class of dispute resolution proceedings that may be funded (and, if appropriate, any exclusions of proceedings that must not be funded);
- the regulatory, licensing, capital adequacy, or reporting criteria a funder must comply with;
- any concessions considered appropriate to encourage the establishment of funders in Japan;
- the role of the funder and the extent to which a funder may be involved or control the proceedings;
- the consequences of a funder failing to comply with regulatory or conduct obligations; and
- the role of the lawyer in a funding arrangement, including whether and how client introductions to third party funders may be made, how a lawyer should manage potential conflicts of interest (for example, any financial interest the lawyer may have in the funder), and the disclosure of the funding arrangement to the court or tribunal.

Conclusion

As things stand, Japan appears to tacitly permit third party funding, but there is an opportunity for Japan to affirm her support for international arbitration by offering a comprehensive system expressly enabling parties' access to financing by professional funders. Now more than ever, this would benefit Japanese parties and Japanese-seated arbitration, and enhance Japan's position as a pro-arbitration jurisdiction.

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References

?1 The author thanks and acknowledges Mr. Akihiro Hironaka and Mr. Mihiro Koeda for their comments on this piece.

?2 Japanese Supreme Court Judgment, 14 July 1971, Keishu Vol. 25, No. 5, p. 690.

?3 Japanese Supreme Court Judgment, 22 January 2002, Minshu Vol. 56, No. 1, p. 123.

?4 *See also* A. Hironaka and Y. Takahata, *Is the Opt-in System Doomed to Fail? An Experience with the New Japanese Legislation on Collective Redress* (Dispute Resolution International, Vol. 14, No. 1, p. 27, at p. 37).

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