THE THIRD PARTY LITIGATION FUNDING LAW REVIEW

Fifth Edition

Editor
Simon Latham

THE LAWREVIEWS

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PREFACE

This now represents my sophomore year as editor, a role I undertook during the onset of the covid-19 pandemic. As the global economy begins to creak back into motion, I'm reminded of my first steps into the legal profession as a law graduate following the last global financial crisis. Much like now, it was a challenging time for those entering the profession. By happenstance (sheer bloody-mindedness), I found myself at the doors of the London branch of a US plaintiffs' firm, little-known on these shores at the time (I still recall the firm's name was spelled incorrectly by the court on most documents in those days). The firm's proactive and innovative culture naturally meant they were early adopters of third party funding (TPF). As such, I had the great fortune of being immersed in the world of TPF from my very first day as a trainee solicitor. I witnessed, first-hand, how TPF catalysed both the firm's growth and their clients' paths to a healthier balance sheet, notwithstanding the burdens that the global financial crisis had left in its wake. A spark was lit.

Fast forward to the present and TPF is very much a mainstay across the legal landscape in the UK. It feels like every week there are press releases announcing the latest funder on the scene, the latest law firm facility, the latest representative action in the Competition Appeal Tribunal, etc. But how does it all work in practice? Well, just as the list of legal remedies available to litigants varies between jurisdictions, so too does the menu of TPF options. The past couple of years has seen both shifts and endorsements of the respective regulatory frameworks that underpin the sector across the globe. In contrast to the booming UK landscape, for example, the Australian market has found itself on the receiving end of stringent regulations, both in terms of operating structure and commercial terms (in class actions). The overwhelming bigger picture, however, is one of growth, development and innovation. Savvy investors continue to navigate the nuances of each jurisdiction to devise new ways to provide finance to the market, all of which ultimately facilitates broader access to justice. Personally, I'm excited to see how this positive force for change can progress into something even more impactful, as TPF helps facilitate the latest evolution of ESG-related disputes . . . watch this space!

I hope this publication provides a useful guide for litigants, lawyers and investors alike as we take on the challenges the new year brings.

Simon Latham
Augusta Ventures
London
November 2021

Chapter 10

JAPAN

Daniel Allen and Yuko Kanamaru[1]

I MARKET OVERVIEW

Japan is a frontier market for third party funding. With its massive economy and sophisticated financial sector, it is a sleeping giant. Uncertainty about the local regulatory position, coupled with relatively low rates of adversarial dispute settlement in the domestic courts, has caused it to be overlooked. But there is also deep, untapped potential.

Although contingency fee arrangements for attorney's fees have long been a staple of the Japanese litigation market, third party funding of litigation had until recently seen virtually no use in Japan, with no publicly reported cases of third party funding ever having been used in domestic Japanese litigation or Japan-seated arbitration. However, that landscape has now begun to shift, with multiple major Japanese companies now working with Japanese lawyers on funded international investment treaty arbitration brought under the auspices of the International Centre for Settlement of Investment Disputes (ICSID). That first step, alongside the recent opening of the Singapore and Hong Kong markets, has sparked considerable discussion in Japan about what might come next.

That said, the market remains partially gated by a lack of certainty as to whether and in what circumstances third party funding is permissible within Japan. While, unlike Singapore and Hong Kong, Japan is not encumbered by vestigial prohibitions in the mould of the common law doctrines of champerty and maintenance, the lack of explicit official approval of third party funding leads some to the view that its use might sometimes not be permissible. In particular, it is not currently clear to what degree the rules applicable to Japanese lawyers (and foreign lawyers in Japan) restrict their capacity to participate in funded cases and other activities relating to third party funding. Many are therefore reluctant to test the waters.

More generally, an important background feature of the Japanese market for third party funding is Japan's relatively low costs for litigants and low levels of adversarial dispute settlement. These factors may have held back the development of Japan's third party funding market. However, there is reason to believe that increased awareness of (and comfort with) third party funding might help to address some of the practical reasons why Japanese companies are more reluctant than others to seek vindication of their legal rights. While the reasons for Japan's low rates of adversarial dispute settlement are complex and a full exploration would be beyond the scope of this chapter, these authors would posit that at least part of the explanation can be found in how Japanese companies evaluate potential risk in

1 Daniel Allen and Yuko Kanamaru are partners at Mori Hamada & Matsumoto. Note that MHM is not engaged in the operation of a foreign law joint enterprise (gaikokuho kyodo jigyo).

legal disputes, and how they budget for legal expenditures. Third party funding may address these issues and therefore bring out beneficial change by helping Japanese companies to bring meritorious claims.

Despite Japan's highly sophisticated financial sector, there has been almost no homegrown funding activity (even directed outside Japan). But the past year has seen initial stirrings, which may portend more movement in the year to come.

II LEGAL AND REGULATORY FRAMEWORK

As a threshold matter, the authors would like to emphasise that third party funding has recently become a topic of serious discussion within the Japanese legal community, in part because of recent developments in other Asian jurisdictions, such as Singapore and Hong Kong. In other cutting-edge areas of finance, such as cryptocurrency, Japanese regulators have not hesitated to regulate, both reactively and proactively. In light of this experience, the possibility of material new regulatory developments in this space should be considered to be high. Potential users of third party funding in Japan (be they funders, litigants, or lawyers) should be mindful of the possibility that the information provided in this chapter is subject to change.

With that caveat, our view is that it is likely that any regulatory changes in Japan with respect to third party funding would tend to make it more clear that third party funding is permitted, and to clarify whatever exceptions there may be to that general position. While it is not impossible that significant regulatory restrictions to third party funding could be put in place, there is no current indication that Japanese authorities are minded to take that approach.

We turn then to the current state of play.

By way of background, lawyers and clients in Japan generally enjoy flexibility in structuring payment for legal services. Contingency fee structures are permissible in Japan and see frequent use. The few restrictions on contingency fees that do exist are not significant. In principle, the amount of a lawyer's payment can be derived from the amount recovered by the litigant in a successful litigation.

That said, Japanese rules on contingency fee arrangements have been determined by the Japan Federation of Bar Associations as a self-regulatory apparatus. Regulation of third party funding, on the other hand, would probably be carried out by law or regulation. It cannot be expected that the approach taken by the Japanese government would draw significant guidance from the Japanese Bar's approach to self-regulation of the legal profession.

At present, then, the situation remains unclear, with no rules aimed at addressing third party funding – no law explicitly permits it, but no law directly prohibits it. Below we discuss, in turn, several provisions of Japanese law that may bear on the topic of third party funding.

The first of these is Article 73 of the Attorneys Act, which provides that: 'No person shall engage in the business of obtaining the rights of others by assignment and enforcing such rights through lawsuits, mediation, conciliation or any other method.'

The key feature of this provision reducing its applicability to the case of third party funding is that it focuses narrowly on assignments of rights, which are then enforced by the assignee, in the assignee's own capacity. As typical third party funding arrangements do not involve an assignment of rights, instead imposing obligations with respect to the disposition of funds received as proceeds, it is unlikely that a typical third party funding agreement would be understood to violate this provision.

That said, some atypical investment structures could run into difficulty with this provision. Parties to funding agreements in Japan should be careful to avoid arrangements that appear in name or in substance to be claim assignments, such as by including limitations on the amount of control that the funder may exert over the claim. It should be emphasised that, whatever the scope of its restriction might be, Article 73 of the Attorneys Act applies not just to domestic court proceedings, but also 'any other method' of enforcing 'rights'. Arbitration would be one such method.

Another provision directly relevant to the business of third party funding is Article 72 of the Attorney Act, which provides that:

> *No person other than an attorney or a Legal Professional Corporation may, for the purpose of obtaining compensation, engage in the business of providing legal advice or representation, handling arbitration matters, aiding in conciliation, or providing other legal services in connection with any lawsuits, non-contentious cases, or objections, requesting for re-examination, appeals and other petitions against administrative agencies, etc., or other general legal services, or acting as an intermediary in such matters; provided, however, that the foregoing shall not apply if otherwise specified in this Act or other laws.*

This provision is also unlikely to prohibit the core business activities of third party funders, as it is generally the case that third party funding agreements strictly delineate the respective roles of legal counsel and funder, with the latter clearly identified as not acting as legal adviser or representative. Moreover, third party funders rarely engage in activities that could be interpreted as the provision of legal advice or services to the claimholder. However, the restrictions of this provision should be kept in mind and funders should avoid expressing views on claims or potential claims in a way that could be construed as legal advice.

Looking more closely at the wording of this Article, the term 'other legal services', could be interpreted to encompass third party funding. Because this term appears in a list that also includes 'providing legal advice or representation', it could be seen to refer to a broader set of activities – read broadly enough, that set might extend to financial services that relate to litigation. However, the inclusion in both instances of the adjective 'legal' makes that reading challenging. It is highly likely that a court would limit the scope of this term to services substantially similar to the provision of legal advice or representation, and not to extend it to financial services that have a connection to legal proceedings.

A further provision relevant to the business of third party funding is Article 10 of the Trust Act, which provides that: 'No Trust is allowed to be created for the primary purpose of having another person conduct any procedural act.'

This provision prohibits the assignment of rights for trust only for the purpose of handling litigation. As discussed above in the context of Article 73 of the Attorneys Act, this provision would appear not to apply to a typical investment structure not involving an assignment of rights.

Of course, we cannot avoid noting that our view that these provisions do not substantially restrict typical third party funding arrangements may not be universal.

However, it does not appear to be the case that there is any specific prohibition on a third party receiving, in exchange for providing the sole service of financial assistance with legal costs, a fee calculated with reference to the amount of the eventual proceeds in the litigation. As stated above, it is not likely that Article 73 of the Attorneys Act would be read

to include such a prohibition, as the narrow focus of Article 73 is to prevent those who are not legally qualified from charging fees for the types of services that can and should only be provided by those with legal qualifications.

As a matter of practice, the fact that multiple Japanese companies are using third party funding for ICSID claims means that, in each instance, several sophisticated parties with considerable interests at stake were able to reach a satisfactory arrangement. Moreover, while the validity of the agreements in those cases has not been tested in the Japanese courts, the revelation of their existence has not occasioned any official intervention from the Japanese authorities, and there does not seem to have emerged any view among Japanese legal professionals and commentators that the agreements might be invalid. Of course, the precise terms and conditions of those funding arrangements are not public, rendering this analysis speculative; for now, the most one can say is that there has been no blanket rejection of the concept of third party funding.

Beyond the funding relationship itself, one should consider the lawyer's potential role in helping a client to enter into a third party funding arrangement. The more prudent view is that, under Article 72 of the Attorneys Act, lawyers in Japan are not permitted to accept fees for brokering third party funding deals (either from a client or from a funder). Otherwise, there do not appear to be restrictions on attorneys' freedoms to assist in the arrangement of third party funding (such as by providing a client with a list of potential funders).

III STRUCTURING THE AGREEMENT

Third party funding arrangements can take a variety of forms and the legal instruments through which they are implemented are usually bespoke products of negotiation.

While, as discussed above, there are no general rules prohibiting third party funding as a concept, it is possible that certain types of contractual arrangements might not be acceptable from the perspective of Japanese law.

Most importantly, under Article 72 of the Attorney Act, lawyers are prohibited from sharing their fees with non-lawyers; it is therefore important that any third party funding deal be structured so as to maintain a distinction between the funder's payment and the satisfaction of the fees due to legal counsel.

In a similar vein, Japan does have laws against usury. In general, under the Interest Rate Restriction Act, the maximum allowable rate for loans above ¥1 million is 15 per cent on an annual basis, with interest charged in excess of that rate to be considered void. Usury rules apply only to loans (or transactions that are, in substance, equivalent to loans). Moreover, moneylending is a highly regulated industry in Japan, with strict licensing requirements under the Money Lending Business Act. It is therefore important to structure the funding agreement so as not to create a secured loan, with the potential proceeds of a claim as mere collateral.

Stepping back from regulatory concerns, there are some practical considerations that should be borne in mind when negotiating funding arrangements in Japan, as compared to other jurisdictions.

First, Japanese companies can be unusually deliberate when making major decisions and, for most Japanese companies, the institution of adversarial proceedings is a particularly difficult decision to take. It would therefore be prudent to expect that a Japanese company would need more time to decide whether to bring a claim than a company of similar size and sophistication elsewhere in the world. Funders that are keen to make investments in Japan should bear this point in mind.

Second, Japanese parties are accustomed to negotiated settlement of disputes, often in terms that focus on future opportunities rather than lump-sum cash payments. Moreover, Japanese dispute resolution proceedings (not only Japanese court litigation, but also domestic Japanese arbitration) often incorporate active intervention by the decision-maker to encourage the parties to reach a settlement of the dispute that can preserve a harmonious future relationship between them. For a funder seeking to invest in Japanese litigation or domestic arbitration, or even in an international arbitration claim to be brought by a Japanese company, it would be advisable to pay particularly close attention to the contractual provisions that govern what is to happen in the event of a settlement. At the same time, funders should be aware that Japanese companies are particularly averse to the idea of restrictions on their discretion to settle a case and may categorically resist the inclusion of such terms.

Third, where funders might consider portfolio arrangements with law firms (whereby law firms offer clients an effective contingency fee arrangement), lawyers based in Japan must be extremely cautious to avoid structures that could be interpreted as the sharing of fees for legal services between a law firm and non-lawyers, as that is clearly prohibited under Article 72 of the Attorneys Act. It may be permissible for lawyers based outside Japan to fund their offering of legal services to Japanese clients through a portfolio arrangement of this type, but care in structuring such an arrangement is also highly advisable in that context.

IV DISCLOSURE

There are no specific rules requiring disclosure of funding agreements, as there are not yet any specific rules on third party funding more generally. Moreover, in Japanese litigation, there are no procedural rules that might otherwise require disclosure of fee arrangements. Nor is there any such rule in the Japanese Arbitration Law, or in the rules of the Japan Commercial Arbitration Association (currently Japan's most popular domestic arbitration institution).

Although lawyers have a duty of confidentiality, the concept of legal privilege does not exist in Japan. Courts have considerable powers to order disclosure of documents if they deem it necessary to do so. Having said that, fee arrangements between lawyer and client may not be subject to disclosure under these powers, as fee arrangements are seldom likely to be relevant to underlying litigation.

V COSTS

The general rule in Japan is that parties bear their own costs. It would therefore be highly unusual for a party to be ordered to provide security for costs in Japanese court proceedings.

As the Japanese courts have not yet had occasion to examine the question of how the above analysis might differ if the losing party were to have used third party funding, no definitive answer is available. However, at present there is no reason to expect that special rules would apply.

The Japanese Arbitration Act closely tracks the UNCITRAL Model Law and does not include any special provisions relating to security for costs or that might otherwise lead to a different result in Japan-seated arbitration.

VI THE YEAR IN REVIEW

The past 12 months have seen the Japanese market for third party funding continue to develop in a positive way. Building off last year's reports of Japanese lawyers participating in funded ICSID cases, this year has brought news of a Japanese litigation finance entity beginning operations in the country, with support from an international funder. Third party funding has remained one of the topics of conversation among the Japanese legal profession – and among major Japanese companies – and continued positive development appears likely.

VII CONCLUSIONS AND OUTLOOK

There is reason to believe that third party funding has turned a corner in Japan. It is no longer a topic relegated to the fringe or addressed in hypothetical terms. Recent developments have demonstrated that third party funding is becoming a serious option for Japanese companies that are considering potential claims. While the principal focus for the development of the third party funding market in Japan remains foreign-seated international arbitration, it can be expected that increased familiarity with the concept and the processes involved will lead to increased consideration of its use in other applications.

Legally, while the position remains formally unclear, the most defensible view is that there is no blanket impediment to the use of third party funding in Japan. Some types of arrangements may be restricted, but the most common forms of arrangements used by third party funders are likely to be considered permissible. It is particularly important to avoid creating the appearance of a claim assignment and, as is the case in many jurisdictions, funders should remain careful to avoid appearing to offer legal services to litigants. Because of the general lack of legal infrastructure around third party funding, there are no specific rules regarding disclosure or adverse costs.

With the growing popularity of third party funding in Asia, and the growing conversation within Japan about the use of third party funding by Japanese companies and lawyers, it is likely that the topic soon will be addressed and clarified in an official way. These authors, however, are optimistic that the official response will be positive and that, once clarified, the market will be well-situated for further expansion.

Appendix 1

ABOUT THE AUTHORS

DANIEL ALLEN

Mori Hamada & Matsumoto

Daniel Allen is a partner at Mori Hamada & Matsumoto, recognised by *The Legal 500* as a 'next generation partner' for dispute resolution in Tokyo. He is an experienced advocate and has represented both companies and states in all types of international disputes, including in arbitration proceedings, investor–state disputes and construction matters. He has acted in arbitration proceedings under ICSID, UNCITRAL, ICC, SIAC and JCAA rules, among others.

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Yuko Kanamaru is a partner at Mori Hamada & Matsumoto. She studied at Keio University (LLB, 2002; LLM, 2005) and University of California, Los Angeles, School of Law (LLM, 2012). She was previously with Rajah & Tann LLP, Singapore (2012–2013), and was seconded to Sumitomo Electric Industries, Ltd (2013–2014). She was admitted to the Bar in Japan in 2006 by the Daini-Tokyo Bar Association, and in New York in 2013 by the New York State Bar Association. She has also been a lecturer in international commercial arbitration at Keio University Law School since 2018. She speaks Japanese and English.

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