

Strategies for China's Response to and Improvement of Third-Party Funding in International Investment Arbitration

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Abstract: China should prioritize the establishment and enhancement of a third-party funding system. It should actively refine the existing arbitration rules, addressing any loopholes in the current regulatory framework. Comprehensive measures should be implemented to regulate third-party funding, aligning with international trends. This is crucial not only to safeguard the foreign investment of the Chinese government and enterprises but also to position China as a globally influential arbitration center.

Keywords: Third-party funding; International investment; Arbitration

Online publication: December 22, 2023

1. Necessity of introducing third-party funding in China

Generally, third-party funding in international arbitration involves a third-party institution providing financial support to the parties involved in an arbitration case, typically arbitration applicants, primarily investors in international investment arbitration. This financial support is facilitated through a corresponding funding agreement, covering all associated arbitration costs, including fees related to arbitration. The specific support standards are outlined in the funding agreement, and the third-party institution follows a profit investment model, obtaining an agreed proportion of the amount from the winning verdict. If the award determines that the funded party loses the lawsuit, the third party bears the risk of not recovering the invested amount, and receiving no compensation or indemnity.

Prior to 2013, China maintained a conservative stance in the realm of international investment, emphasizing adherence to Chinese domestic law in numerous Bilateral Investment Treaties (BITs) and Multilateral Investment Treaties (MITs) agreements. However, since 2013, China has progressively eased restrictions on both inward and outward foreign investment, particularly through initiatives such as the Belt and Road Initiative. By the end of 2021, China had signed more than 200 cooperation documents with 147 countries and 32 international organizations to build the Belt and Road Initiative, and in 2021, China's

outward foreign direct investment flow reached US\$178.82 billion, a 16.3% increase from the previous year, consistently ranking among the top three globally for a decade. The stock of foreign direct investment stood at US\$2.79 trillion, maintaining a top-three global position for the fifth consecutive year. To facilitate international investment, China has formulated outward investment cooperation guidelines for 162 countries. These guidelines objectively introduce the investment cooperation environment of each country (region) and provide insights on issues enterprises should consider in carrying out outward investment cooperation, which will play a positive role for enterprises to carry out transnational business activities in the complex and volatile international market, reduce the blindness of investment cooperation, and effectively prevent all kinds of risks.

With the expanding investment market, the number of arbitration cases stemming from investment disputes is on the rise. To address commercial disputes along the Belt and Road Initiative, the Supreme People's Court organized a symposium in December 2018 on the diversified settlement mechanism of international commercial disputes. It subsequently issued and implemented three normative documents, namely the Notice of the General Office of the Supreme People's Court on the Determination of the First Batch of International Commercial Arbitration and Mediation Institutions Incorporated into the "One-Stop" International Commercial Dispute Resolution Mechanism, the Rules of Procedure of the International Commercial Court of the Supreme People's Court (Trial), and the Rules of Procedure of the International Commercial Expert Committee of the Supreme People's Court (Trial).

Despite signing numerous BITs and MITs in recent years, China lacks substantial research and legislative regulation on many issues in the field of international investment arbitration. Consequently, investors and governments often find themselves at a disadvantage after submitting international investment disputes to arbitration. To protect the legitimate rights and interests of domestic investors and their governments, it is imperative to study and implement the third-party funding system, an emerging system widely recognized and accepted in the international investment field.

2. Regulatory model for third-party funding in China

2.1. The proposal document submitted to ICSID advocates a relatively strict regulatory model

China's proposal document to the International Centre for Settlement of Investment Disputes (ICSID) adopts a regulatory model that is relatively strict. While China supports the reasonable regulation, rather than prohibition, of third-party funding in international investment arbitration, its proposed regulation is more stringent than the provisions in the draft revision of the ICSID Arbitration Rules. China emphasizes enhancing transparency in third-party funding in investment arbitration, highlighting ongoing disclosure obligations for the receiving party and the consequences for breaching these obligations. In terms of disclosure content, China proposes a more detailed approach, including information beyond the basic details of the third-party funder required by Article 21(2) of the Arbitration Rules, such as the content of the funding agreement, nationality, shareholding structure, effective controller, and the funder's interest in the arbitration outcome. To prevent potential conflicts of interest, the scope of disclosures is expanded to cover affiliations or other relationships between the funder and the funded party. China also suggests consequences for non-compliance, such as the suspension of proceedings or the bearing of a reasonable amount of proceeding costs by the funded party^[1]. It is underscored that a funded party cannot refuse disclosure by claiming that the information is a trade secret.

2.2. Regulation by Chinese arbitration institutions reflects a modest regulatory model

Rules on third-party funding developed by Chinese arbitral institutions align with international standards,

reflecting common international practices in addressing third-party funding issues. For instance, the Arbitration Rules for International Investment Disputes of the China International Economic and Trade Arbitration Commission (CIETAC) address third-party funding regulation. The funded party is required to promptly disclose basic information related to third-party funding after signing the funding contract. The existence of third-party funding and the parties' adherence to disclosure obligations are considered in handling cost-related issues. Both the Arbitration Rules for International Investment Disputes of CIETAC and the CIETAC Hong Kong Arbitration Center Guidelines for Third-Party Funding for Arbitration adopt a moderate regulatory approach. They specify that the arbitral tribunal should consider third-party funding as a relevant factor in cost-related matters, reflecting the evolving trend in reforming the international investment arbitration regime. The challenge now lies in disseminating this exemplary experience in arbitration rule-making to make it a common practice in China.

2.3. Reasonable regulatory posture inferred from alternative forms of funding regulation

Given the current uncertainty in third-party funding regulation in China, an analysis of the regulation of alternative funding forms can offer insights into the anticipated regulatory posture. Drawing parallels with contingent fees and insurance, third-party funding resembles contingent fees, with the primary distinction being the entity providing external funding (a specialized funding company for third-party funding and an attorney-at-law for contingent fee^[2]). China's Measures for the Administration of Lawyer's Fees permit risk representation in civil cases not involving identity rights and interests, limiting the lawyer's contingent fee to a maximum of 30% of the contracted amount. Comparatively, third-party funding, being managed by specialized firms, presents a lower cost for clients, allowing lawyers to concentrate on legal matters. In terms of insurance for litigation and arbitration costs, third-party funding and insurance share the commonality of transferring case risk through external funding, with insurance typically receiving a fixed premium benefit. As various insurance policies for litigation and arbitration become more prevalent, it is reasonable to expect that third-party funding, as another risk transfer tool, should be subject to reasonable regulation in China.

3. Suggestions for improving third-party funding in China

3.1. Enhance existing disclosure rules

Paragraph 2 of Article 27 of the Investment Arbitration Rules mandates the grantee to promptly disclose the existence of a third-party funder to the arbitral tribunal. From a fairness perspective, early disclosure benefits arbitrator selection and the progression of arbitration proceedings. However, the term "without delay" introduces ambiguity, as third-party funding agreements may be initiated before the dispute or during the arbitration. The grantee may interpret this term to its advantage, potentially jeopardizing the legal rights of the other party. The provisions of this article are similar to Article 44 of the Hong Kong Rules 2018. To ensure a more reasonable time frame for disclosure, it is recommended to stipulate a specific period, such as within "three days" after signing the funding agreement. This allows the grantee a grace period and effectively mitigates the risk associated with third-party funding in a more rational manner.

3.2. Establish a system for bearing arbitration costs

The lack of provisions regarding the bearing of arbitration costs in international investment arbitration poses challenges, particularly for respondents investing considerable resources to participate in arbitration proceedings. The absence of a cost-bearing system increases the likelihood that claimants may not bear the consequences of an unfavorable arbitration outcome. To address this, there is a need to establish a robust system

for bearing arbitration costs, emphasizing fair protection of the respondent's rights and interests. The criteria for implementing such a system should consider that costs are borne when there is a higher likelihood of the arbitration respondent not obtaining a successful claim^[3]. Explicit agreements between the claimant and the third-party funder should be acknowledged, ensuring disclosure of funding agreement terms during arbitration proceedings.

3.3. Limit the time point for third-party participation in arbitration proceedings

A significant drawback of third-party funding is the potential control exerted by the third party over the arbitration process. Third-party funding agreements often grant procedural control rights to the funder, allowing intervention at any point^[4]. International perspectives, such as the UK ALF Rule 2018, require that the third party shall not take measures on the final course of the case in litigation or arbitration cases, influence the funded person's lawyers through various means, ensure that the funded person can obtain independent advice from a professional body before signing the agreement. This discouragement of third-party funder procedural control stems from concerns about its impact on the judicial process. To mitigate this, the time point for the third-party funder's participation in arbitration should be strictly limited. An optimal approach involves restricting participation to the funding of fees and the collection of returns. The funder should withdraw after providing fee support, enabling the grantee to independently arbitrate throughout the process. While a strict limitation system may face resistance, a more flexible system could permit limited third-party participation, confined to expressing opinions on arbitration request determination and counsel selection at the commencement, without influencing subsequent stages of the proceedings. Such a balanced approach aims to ensure fair arbitration processes while considering the interests of third-party funders.

4. Conclusion

In recent years, third-party funding arbitration has gradually gained acceptance in China. CIETAC, being the largest arbitration institution in the country, has adopted a policy allowing third-party funding in international investment cases. Additionally, the Supreme People's Court has issued a judicial interpretation providing guidance on the use of third-party funding in international investment disputes.

The development of third-party funding arbitration in international investment marks a significant stride toward fostering a fair and just legal system in China. By enhancing access to third-party funding, claimants can effectively pursue their claims, ensuring a balanced legal process that safeguards defendants from excessive liability. With ongoing legislative and judicial reforms, there is optimism that third-party funding arbitration in international investment will see broader acceptance and utilization in China.

Funding

National Social Science Fund project (23BGL052); Shandong Key R&D Program (Soft Science Project) (2023RKY03009); Qingdao Social Science Fund Project (QDSKL2301121)

Disclosure statement

The authors declare no conflict of interest.

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