# THIRD-PARTY ARBITRATION FUNDING IN THE PHILIPPINES: EVOLVING A LOCAL FRAMEWORK FROM GLOBAL PERSPECTIVES*

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## ABSTRACT

Third-party funding ("TPF") is a popular dispute resolution practice that has recently gained traction in various jurisdictions. This Note examines the nature of TPF, recent trends in third-party arbitration funding ("TPAF"), and its possible application in the Philippines. The Philippines should consider embracing TPAF as it has potential benefits not only for parties involved, but also the dispute resolution system as a whole. Further, the accommodation of TPAF into the Philippine legal framework requires no additional legislation; the regulatory status quo on privilege and conflict of interest is largely sufficient to protect parties' interests. Although the doctrine of champerty is an apparent barrier to TPAF in the Philippines, it is in fact formulated very narrowly only as a safeguard against violations of the fiduciary duty of lawyers to their clients. Consequently, it should not be regarded by the courts as a basis to rule that TPAF violates public policy.

## I. INTRODUCTION

Sue now, pay later—and only if you win. Too good to be true? Not by a long shot. Disputes are an inevitable part of commercial life, and lawyers are not the only ones earning from the arms race. With opportune odds, you could secure a deal whereby someone else agrees to foot the bill for your legal expenses to pursue a claim, in exchange for a cut in the proceeds

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only if and when the case is won. This, in perhaps overly simplified terms, is third-party funding.

Third-party funding (TPF) is a growing practice in dispute resolution. Arguably one of the most discussed topics in arbitration at the moment, it has caused enough stir in the legal community that jurisdictions such as Singapore and Hong Kong have been prompted to legislate in favor of its use. Sung praises to as "the best thing since sliced bread"[1] and demonized as the "arbitration antichrist" and "a wolf in sheep's clothing,"[2] TPF inspires a whole gamut of reactions that are a testament to its undeniable impact.

The question now arises whether such an arrangement would be valid in the Philippines. Of this, there is doubt; it is not expressly prohibited, but it is also not expressly allowed. One might surmise that the common-law doctrine of champerty, which prohibits disinterested persons from meddling in an action, would not prohibit such a scheme in arbitration as it is a private dispute resolution process, as opposed to traditional litigation.[3] Another view is that Philippine rules on legal ethics are binding only on lawyers and, thus, do not apply to non-lawyer third-party funders or party representatives.[4] Notably, other jurisdictions that recognize champerty have recently legalized third-party arbitration funding (TPAF), subject to the appropriate financial and ethical safeguards.

This Note seeks to examine the global trends in the legal treatment of TPAF and to situate the Philippines therein.[5] Part II will explore the nature of TPF and recent trends in its use in arbitration, and compare its legal treatment across jurisdictions. Part III will discuss the Philippine arbitration system as well as legal and commercial instruments present in the Philippines that are similar to TPF. Comparing their use in the Philippines to their treatment in countries whose stance on TPF is known will help predict whether the Philippine legal climate will accommodate it in arbitration. Part IV will examine the most common issues surrounding TPAF vis-à-vis existing

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[1] INTERNATIONAL COUNCIL FOR COMMERCIAL ARBITRATION-QUEEN MARY TASK FORCE [HEREINAFTER "ICCA-QUEEN MARY TASK FORCE"], REPORT ON THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION 5 n.12 (2018).

[2] *Id.*; Caroline Dos Santos, *Third-party funding in international commercial arbitration: a wolf in sheep's clothing?*, 35 ASA BULLETIN 918 (2017).

[3] BAKER MCKENZIE, INTERNATIONAL ARBITRATION YEARBOOK 242 (2018)

[4] *Id.*; Marvin V. Masangkay, *Third-Party Funding in International Arbitration,* 2018 PHIL. ADR REV. 2, 3 (2018).

[5] This Note focuses only on commercial arbitration. Investment arbitration, which involves additional considerations and has narrower application, is beyond its scope.

regulation in the Philippines, clarify the extent to which champerty might affect it, and lay down recommendations for regulating it in our jurisdiction.

This Note seeks to reassure the legal community that TPAF is a practice not to be shirked away from, but rather, embraced if the Philippines is to pursue the goal of fostering a dynamic business climate for both foreign investors and small businesses alike. A survey of jurisprudence will show that TPAF may be legally accepted even without additional legislation or case law to make specific accommodations for it. Although TPAF has not yet become an issue in any judicial proceeding, courts can and should confidently rule in favor of its validity.

## II. THIRD-PARTY FUNDING

TPF is an arrangement whereby a person, not party to a dispute, funds the expenses of a party in exchange for a share in the award if the funded party is successful. This is usually done on a non-recourse basis so that the funder bears the risk of zero recovery if the claim does not succeed.[6] This definition is by no means perfect; legal scholars and practitioners differ in opinion as to what specific funding relations constitute TPF.[7] In essence, however, the idea is fundamentally the same: someone takes a risk and funds one party—usually a claimant—in the hopes of winning and making a profit. TPF in any of its forms involves the following elements: *first*, a person or entity that is not a party to the dispute; *second*, the provision of financing or material support; and *third*, remuneration that is either dependent on the outcome of the dispute or is given as a grant or in return for a premium.[8]

### A. Forms of Third-Party Funding

Depending on how it is characterized and in which jurisdiction it is situated, TPF may or may not run afoul certain public policy considerations. In common law, it is traditionally characterized as violative of champerty and maintenance, as well as the principle that litigation should not be the subject of speculation.[9] Depending on their interpretation by national courts, these

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[6] *See Masangkay*, *supra* note 4, at 2.

[7] Anish Wadia & Shivani Rawat, *Third-Party Funding in Arbitration: India's Readiness in a Global Context*, 15(2) TRANSNAT'L DISPUTE MGMT. 16 (2017); Duarte G. Henriques, *Third-Party Funding: In Search of a Definition*, 28 AM. REV. INT'L. ARB. 405, 414-15 (2017); *ICCA-Queen Mary Task Force*, *supra* note 1, at 51.

[8] *Id.* at 51.

[9] Nicolás Costábile & Anthony Lynch, *Applicable Law in Arbitrations Involving Third-Party Funding Agreements*, 30/2017 SPAIN ARB. REV. 165, 167-69 (2017).

doctrines may pose an obstacle to the continued development of TPF. In civil law jurisdictions which do not have specific regulations for TPF, it is understood to be permissible, as maintenance and champerty are generally not part of the civil law tradition.[10]

The most basic arrangement of TPF is one where an entity, called the funder, agrees to pay part or all of the costs of litigation of a claimant in exchange for a percentage in the recovery should the claim succeed. This shall be referred to as the traditional model.[11] At its core is the element of risk, which is the common denominator among all kinds of TPF. Funders are nothing if not creative. Many have devised several means to hew their services as closely as possible to those that are already established as valid. One may refer to them collectively as TPF in the broad sense, as opposed to the traditional model, which is TPF in the strict sense.[12]

Dispute-related insurance, which is aimed at covering potential expenses in legal proceedings, may be considered TPF in its broad sense.[13] In the area of liability insurance, there are two major products: before-the-event insurance and after-the-event insurance. The difference between the two is, to state the obvious, when the policy is taken out. As with all insurance, the goal is to distribute risk, which in this case is that of incurring liability. The insurer agrees to cover this risk in exchange for the payment of premiums.

It is debatable whether liability insurance is a form of TPF because the payment is guaranteed and not directly dependent on the outcome of the dispute. In its report on TPAF, the International Council for Commercial Arbitration ("ICCA") ultimately decided to exclude before-the-event insurance and include after-the-event insurance from its working definition of TPF.[14] Regardless of the direct interest insurers have or lack in any one case, they have an interest in keeping their portfolio of covered cases successful so as to shell out as little money as possible in the ordinary course of business.

TPF in the broad sense is also available between related entities: a parent company may extend a loan to a subsidiary, or the shareholders or creditors of an entity may fund its claim.[15] Money does not have to change hands between the funder and the funded for their relations to be considered TPF. Corporate financing arrangements can take the form of equity-based

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[10] *Id.* at 169.

[11] ICCA-Queen Mary Task Force, *supra* note 1, at 40-41.

[12] Wadia & Rawat, *supra* note 7, at 16.

[13] Baker McKenzie, *supra* note 3, at 178.

[14] ICCA-Queen Mary Task Force, *supra* note 1, at 53-55.

[15] *Id.* at 35.

investments or control over corporate governance.[16] Other funders keep their distance and instead make loans which they can secure through an assignment of the proceeds.[17]

TPF can be availed of not only by a party for one case, but also by a law firm for the claims of its clients or by an entity for multiple disputes it is involved in.[18] Termed "portfolio funding," this arrangement allows for the funding of cases which might not have been accepted on their own, since cases which operate below budget may be offset by those which have earned overruns.[19] Indeed, TPF is anything but restricted to the traditional non-recourse funding model. As long as disputes exist, business opportunities will arise. The possibilities are as endless as the desire to profit.

### B. Benefits of Third-Party Funding

Proponents of TPF, whether of litigation or arbitration, most often cite access to justice as its principal benefit.[20] The argument is that it allows impecunious claimants with meritorious cases to litigate or arbitrate matters that they would not have otherwise been able to bring forward for lack of funds. Although part of the proceeds of the award, if and when given, would be paid to the funder, TPF still results in a net gain on the part of the clients. To quote the Ministry of Justice of Great Britain, "it is better for [a claimant] to recover a substantial part of his damages than to recover nothing at all."[21]

The circumstances under which access to justice comes into play, however, are very specific. For TPF to bring forth access to justice, a party must have been otherwise unable to pursue a claim because of an insufficiency of funds. Many of the claims that funders will find profitable to fund, however, might not be the sort that impecunious parties would have in the first place. Thus, funders may be inclined to intervene only when there is a chance of a large award for damages.[22]

Nevertheless, even in cases where the party availing of TPF could have brought or defended against the claim with its own existing assets, there is still value to its use. Costs are significant even for those who can afford

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[16] *Id.*

[17] Baker McKenzie, *supra* note 3, at 70.

[18] ICCA-Queen Mary Task Force, *supra* note 1, at 38.

[19] *Id.*

[20] Baker McKenzie, *supra* note 3, at 368.

[21] Dos Santos, *supra* note 2, at 921, *citing* GREAT BRITAIN MINISTRY OF JUSTICE & RUPERT M. JACKSON, REVIEW OF CIVIL LITIGATION COSTS (2010).

[22] Baker McKenzie, *supra* note 3, at 179.

them, and TPF allows entities to pursue claims without disrupting their cash flow. It affords them flexibility in terms of where and how to invest their money by transferring the risk of arbitration.[23] Financial risk management allows parties to conduct business without straining their liquidity, and TPF gives them that option.[24]

Ostensible downsides to TPF are the increase of trivial claims and a clogging of dockets brought about by the commercialization, so to speak, of justice. The operative term is "ostensible," because practice shows that funders filter frivolous claims rather than encourage them. Because recovery is contingent on the success of the claim, funders are incentivized to perform extensive due diligence and research into the merits of the claim. According to a study by the International Chamber of Commerce, only 5% to 10% of all cases submitted are eventually funded.[25] Some have expressed fears that TPF may result in protracted proceedings caused by a refusal to settle. In theory, this is a sensible concern. A party who has secured TPF no longer carries the burden of the financial risk of an unsuccessful outcome and therefore loses its incentive to settle.[26] On the contrary, funders might actually encourage settlement, since they also bear the risk of non-enforcement of awards and are only too happy to be assured of a return on their investment.[27]

This can be demonstrated in funding arrangements on an installment basis, as opposed to a lump sum contract, where funders can make further payments conditional to a party adopting a certain strategy or taking particular actions in the case. A party might want to see the adjudication process to its end because TPF has made that option affordable to him, but his funder might push him to settle for a lower amount if it does not see the full claim as worth the extra time it has to wait. While this dynamic may present problems for counsel in terms exercising independent professional judgment, lawyers need only to go over the terms and conditions of a funding agreement with their clients and advise them as to whether it gives the funders too much control.[28] One benefit specific to TPAF is that access to justice and financial risk management will encourage parties of all levels of economic security to resort to arbitration as an alternative to litigation.[29] This diversion of would

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[23] Wadia & Rawat, *supra* note 7, at 10.
[24] *Id.*
[25] Dos Santos, *supra* note 2, at 925.
[26] *Id.* at 926.
[27] *Id.*
[28] Baker McKenzie, *supra* note 3, at 53-54.
[29] Wadia & Rawat, *supra* note 7, at 10.

be litigants to another forum can, in the long run, reduce the workload of the court system and improve the quality of litigation proceedings.[30]

### C. Third-Party Funding Across Jurisdictions

Introduced in Australia and exported to the United States. and England, TPF has quickly risen to prominence as a financing tool in arbitration, gaining varying degrees of acceptance around the world.[31] As an emerging practice, TPAF is a matter which only a few countries have expressed a clear public policy on. In turn, their general stance on TPF may offer guidance on how they would later on treat TPAF once put into practice.

Some countries have expressly embraced TPF.[32] In 2004, the Swiss Federal Supreme Court struck down a cantonal law prohibiting TPF in consideration of its role in providing access to justice.[33] Although TPF is still not common in Switzerland and none of its legislative measures contain specific provisions dealing with it, the country's legal environment is favorable to funders.[34] In 2006, the Versailles Court of Appeal declined to declare void a TPF agreement in international arbitration,[35] ruling that it was a *sui generis* contract.[36] Where its previous position on TPF was that it was void, South Africa recently permitted TPF as a means of obtaining access to justice and declared that it would only strike it down as an abuse of process if parties lacked good faith in its performance.[37]

Still, other countries have permitted TPF with little express mention in law or jurisprudence, if at all. Germany, in particular, regards it without controversy[38] and interprets it as taking on the character of a silent or undisclosed partnership.[39] TPF is also largely unregulated in the Netherlands, where several civil litigation cases have been decided in which funding by third parties was made publicly known.[40] In the U.K., where the rules on champerty

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[30] *Id.*

[31] ICCA-Queen Mary Task Force, *supra* note 1, at 18.

[32] Baker McKenzie, *supra* note 3, at 1.

[33] *Id.* at 327; Daniel Kalderimis & Paula Gibbs, *Third party funding in international arbitration: lessons from litigation?*, KLUWER ARBITRATION BLOG, Dec. 15, 2014, *available at* http://arbitrationblog.kluwerarbitration.com/2014/12/15/third-party-funding-in-international-arbitration-lessons-from-litigation/ (last accessed May 15, 2019).

[34] Baker McKenzie, *supra* note 3, at 327-28.

[35] Kalderimis & Gibbs, *supra* note 33.

[36] Baker McKenzie, *supra* note 3, at 116.

[37] *Id.* at 285.

[38] *Id.* at 129.

[39] *Id.;* Costábile & Lynch, *supra* note 9, at 169.

[40] Baker McKenzie, *supra* note 3, at 226.

and maintenance have been relaxed, TPF has enjoyed frequent usage.[41] To illustrate, 54% of U.K. lawyers who have not used litigation funding expect to do so.[42] Australia, which was one of the first countries to embrace TPF, exercises supervision over such arrangements through the courts but does not have legislation regulating it.[43]

These countries have been confirmed to support or permit TPF, but the practice has not received express legal treatment in many others. Consequently, its permissibility under the law is uncertain and can only be conjectured from precedent.[44] On the other hand, a prohibition against TPF has been confirmed in only a few jurisdictions.[45]

## III. THE PHILIPPINE CONTEXT

### A. The Philippine Arbitration System

Arbitration in the Philippines is governed by the Alternative Dispute Resolution Act of 2004 ("ADR Act"),[46] which has not been amended since its enactment.[47] The ADR Act pertains to procedures by which disputes are resolved by a neutral third party, other than by adjudication of a court or of a government agency.[48] The ADR Act does not in itself lay down specific provisions governing the arbitration process. Instead, it adopts the Model Law on International Commercial Arbitration ("Model Law") by the United Nations Commission on International Trade Law ("UNCITRAL") for international commercial arbitration,[49] and refers to the Arbitration Law[50] for

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[41] *Id.* at 376.

[42] *Id.*

[43] *Id.* at 33.

[44] *Id.* at 2.

[45] Ireland and Thailand both prohibit TPF on the ground that it violates public policy. Ireland has a system separate from that of England or Wales. As far as Baker McKenzie (and consequently, this Note) is concerned, commentary on the United Kingdom refers only to the system of England and Wales. Baker McKenzie, *supra* note 3, at 369 n.1; *see* 340-341 for Thailand.

[46] Rep. Act No. 9285 [hereinafter "ADR Act"] (2004). This is the Alternative Dispute Resolution Act.

[47] Baker McKenzie, *supra* note 3, at 235.

[48] ADR Act, § 3(a), defining "Alternative Dispute Resolution System."

[49] § 19.

[50] ADR Act, § 32, *citing* Rep. Act. No. 876 (1953). The Arbitration Law.

domestic arbitration and the Construction Industry Arbitration Law[51] for the arbitration of construction disputes.

The Philippine Dispute Resolution Center ("PDRCI") is the main arbitration institution in the country,[52] administering arbitration in mediation in specialized fields such as maritime, banking, finance, insurance, securities, and intellectual property.[53] As of March 2019, the PDRCI has 57 accredited arbitrators and 242 trained arbitrators, with several more in training.[54]

In line with the State's policy to provide a more inviting climate for private investment in large-scale, capital-intensive infrastructure and development contracts,[55] government agencies are now mandated to include provisions on the use of alternative dispute resolution mechanisms in all contracts involving public-private partnership projects, build-operate and transfer projects, joint venture agreements between the government and private entities and those entered into by local government units.[56] Consequently, any development in ADR rules and procedures will affect not only parties to ordinary arbitration agreements in the private sector, but also government projects of national scope and importance.

Commercial arbitration (or ordinary arbitration) is distinguished from labor arbitration and construction arbitration in that jurisdiction over the former is conferred by stipulation of the parties, while the jurisdiction of the Construction Industry Arbitration Commission ("CIAC") and of voluntary arbitrators is conferred by statute.[57] The CIAC is a government agency tasked with the resolution of the construction-related disputes enumerated under its creating law. Voluntary arbitrators resolve labor disputes and grievances arising from the interpretation of collective bargaining agreements, which are matters expressly excluded from the coverage of the ADR Act.[58]

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[51] ADR Act, § 34, *citing* Exec. Order No. 1008 [hereinafter "CIAL"] (1985). This is the Construction Industry Arbitration Law.

[52] Baker McKenzie, *supra* note 3, at 237.

[53] Philippine Dispute Resolution Center, *About us,* PDRCI WEBSITE, *available at* https://www.pdrci.org/about-us/ (last accessed May 15, 2019).

[54] Philippine Dispute Resolution Center, *Accredited Arbitrators, Trained Arbitrators* PDRCI WEBSITE, *available at* https://www.pdrci.org/neutrals-members/accredited-arbitrators/trained-arbitrators/ (last accessed May 15, 2019).

[55] ADR Act, § 2.

[56] Exec. Order No. 78 (2012). This mandates the inclusion of provisions on the use of Alternative Resolution Mechanisms in Contracts.

[57] Fruehauf Electronics Phil. Corp. v. Technology Electronics Assemb. [hereinafter "Fruehauf"], G.R. No. 204197, 801 SCRA 280, 306-309, Nov. 23, 2016.

[58] ADR Act, § 6.

Because of the consensual nature of arbitration, an arbitral tribunal does not have any inherent power over the parties in the issuance of coercive writs or compulsory processes. Consequently, arbitral awards must be recognized and enforced by the courts, in accordance with the Arbitration Law for domestic awards, excluding those rendered by the CIAC,[59] and the New York Convention for foreign awards.[60]

Although awards are not executory in themselves, the Supreme Court has shown considerable commitment to their enforcement.[61] As elucidated by Justice Arturo Brion in a case involving the review of an arbitral award: "The errors of an arbitral tribunal are not subject to correction by the judiciary. As a private alternative to court proceedings, arbitration is meant to be an end, *not the beginning*, of litigation."[62] He further noted that an arbitral award can be modified or corrected by a Regional Trial Court only in the cases enumerated in the Arbitration Law and only through the modes prescribed by it.[63]

In its 2018 Arbitration Yearbook, multinational law firm Baker McKenzie placed TPAF under the spotlight and concluded, with regard to the Philippines, that it was not clear whether TPAF is valid.[64] The easiest answer would be that it is valid because it is not prohibited by law. Although not incorrect, this reasoning does not satisfy the rigorous demands of legal scholarship, which must keep abreast of the developing intricacies of legal problems that surround ostensibly simple concepts such as TPAF.

In the absence of express legal prohibition, the validity of TPAF must be extrapolated from known rules and jurisprudence on the same topic in other jurisdictions. Situating the Philippines along the continuum of permissibility, however, requires more than a mere survey of international jurisprudence. The search for an answer requires an examination of Philippine policy on legal concepts that share common elements with TPF. Contingency fees and claim assignment are the most notable of

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[59] § 40.

[60] § 42.

[61] Jay Santiago & Nusaybah Muti, *The Philippines' Pro-Arbitration Policy: A Step Forward Gone Too Far?*, KLUWER ARBITRATION BLOG, Apr. 9, 2019, *available at* http://arbitrationblog.kluwerarbitration.com/2019/04/09/the-philippines-pro-arbitration-policy-a-step-forward-gone-too-far/ (last accessed May 15, 2019).

[62] *Fruehauf*, 801 SCRA 280, 301. (Emphasis in the original.)

[63] *Id.* at 312-16. The grounds listed therein are exclusive, and relief cannot be invoked through a petition for certiorari under Rule 65 since an arbitral tribunal is not a branch or instrumentality of the Government to which the power of expanded judicial review properly pertains.

[64] Baker McKenzie, *supra* note 3, at 242.

such concepts,[65] and how they are treated in the Philippines is relevant to predict the general stance that our courts may take towards TPAF.[66]

## B. Instruments Similar to TPF: Starting Points for a Philippine TPAF Framework

*1. Contingency Fee Agreements*

A contingency fee is one received for legal services only if some recovery is achieved through the lawyer's efforts.[67] Sometimes called "no win no fee,"[68] the nature of this agreement is almost self-explanatory: it is contingent on the success of the lawyer.

In contrast to TPF, contingency fees are paid in consideration not of funding, but of the provision of a service, particularly legal services.[69] Nevertheless, both involve a transfer of the financial risk of litigation from the client to another person: the funder in TPF, and the counsel in a contingency fee agreement ("CFA"). As the transferee of risk, a lawyer goes through roughly the same decision-making process as a third-party funder in that he will generally take on cases that are likely to succeed.

Several jurisdictions either outright prohibit or permit only a very limited range of CFAs. In Australia (which was one of the first countries to use TPF),[70] Austria, Italy, the Netherlands, and India, CFAs are prohibited.[71] In the U.S., Saudi Arabia, Japan, and Hungary, CFAs are generally permitted.[72] Nuance is key in Belgium, Switzerland, and Poland, where compensation of counsel cannot be fully contingent on recovery but may be increased by an amount called a success fee in the event the case is won.[73] Stated otherwise, contingency must only be partial, affecting only the compensation beyond the

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[65] Costábile & Lynch, *supra* note 9, at 168, 170.

[66] *Id.*

[67] Siti Atikah Abd Halim et al., *The Practice of Contingency Fees in the Legal Profession in Malaysia,* ACADEMIA.EDU, *available at* https://www.academia.edu/17019120/the_practice_of_contingency_fees_in_the_legal_profession_in_malaysia_a_comparative_study_to_the_application_in_the_united_kingdom_south_africa_and_the_united_states_of_america.

[68] *Id.*

[69] Costábile & Lynch, *supra* note 9, at 168, fn20.

[70] Baker McKenzie, *supra* note 3, at 33.

[71] *Id.* at 34, 42, 177, 225; Wadia & Rawat, *supra* note 7, at 16.

[72] Baker McKenzie, *supra* note 3, at 392, 266, 183, 150.

[73] *Id.* at 52, 328, 252, respectively.

basic fees. In Germany, a success fee can only be agreed upon if the client is impecunious and would otherwise be unable to bring his claim.[74]

In the Philippines, CFAs are generally recognized to be valid.[75] Attorney's fees must be fair and reasonable, and the factors that guide a lawyer in determining his fees are enumerated in the Code of Professional Responsibility.[76] Although there are no fixed quantitative limits on the amount a lawyer can charge on a contingency basis, the Supreme Court will not hesitate to strike down a contract for attorney's fees if it finds that it is unconscionable.

In *Cortez v. Cortes*,[77] a contingency fee of 50% was struck down as grossly excessive and unconscionable because the subject litigation, which was for illegal dismissal, did not involve issues novel enough to justify so hefty a compensation, and the counsel knew for a fact that the client was in financial difficulty. Instead, the Court declared the lawyer entitled to only 12% of the recovered proceeds, which was the contingency percentage that the client alleged.

In *Cadavedo v. Lacaya*,[78] the Court found that the portion of a lot claimed by a lawyer as part of his contingency fee was still in litigation at the time he acquired it. This ran counter to Article 1491(5) of the Civil Code, which forbids lawyers from acquiring property subject of the litigation they took part in as counsel. The Court also noted that the CFA between Atty. Lacaya and his clients, which awarded him half of the lot under litigation, was champertous because he "assumed the litigation expenses, without providing for reimbursement, in exchange for a contingency fee consisting of one-half of the subject lot."[79] The Court then declared that the Philippines "maintain[s] the rules on champerty, as adopted from American decisions, for public policy considerations."[80] Champerty will be discussed at length in subsection C of Part IV.

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[74] Daniel Sharma, *Germany*, *in* THE THIRD PARTY LITIGATION FUNDING LAW REVIEW (Leslie Perrin ed., 2018), *available at* https://thelawreviews.co.uk/edition/the-third-party-litigation-funding-law-review-edition-2/1176841/germany (last accessed May 15, 2019), *citing* German Law on the Remuneration of Lawyers, § 4(a).

[75] Cortez v. Cortes, A.C. No. 9119, Mar. 12, 2018.

[76] CODE OF PROF. RESPONSIBILITY, Canon 20, Rule 20.01.

[77] A.C. No. 9119, Mar. 12, 2018.

[78] G.R. No. 173188, 713 SCRA 397, Jan. 15, 2014.

[79] *Id.* at 414.

[80] *Id.* at 416.

*2. Claim Assignment*

Claim assignment involves a complete transfer of the claim by which the assignee gains total control. This is opposed to TPF in which, although a third party may acquire some degree of control, ownership and legal interest over the claim is retained by the original claimant.[81]

The outright sale or assignment of claims is generally allowed in civil law jurisdictions but is not looked upon favorably in common law jurisdictions, particularly those where champerty still exists.[82] Argentina, Colombia, Venezuela, and Spain all expressly provide for assignment of claims.[83] Note, however, that the purchase of *claims* is to be distinguished from the related practice of selling *awards and judgments*, which goes into the risk, not of litigation or arbitration, but of non-enforcement.[84] The latter is permitted in most jurisdictions, although many of the entities engaged in this practice would not consider themselves to be funders.[85]

In the Philippines, claim assignment is allowed by express provision of law. The credit with all pertaining rights, either against the debtor or against third persons, is transferred to the assignee subject to stipulation.[86] Called conventional subrogation, it is essentially contractual. As it involves the substitution of a third person in the rights of the creditor, it is one of the modes by which an obligation may be modified.[87] While subrogation is most often encountered in insurance policies, any person with the capacity to contract is free to transfer obligations due to them. Certain claims cannot be transferred because of their personal nature, but the contractual nature of arbitration renders their discussion unnecessary in this paper.

## IV. ESTABLISHING THIRD-PARTY FUNDING IN PHILIPPINE ARBITRATION

### A. Key Issues in Third-Party Arbitration Funding

*1. Confidentiality*

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[81] Costábile & Lynch, *supra* note 9, at 168 n.20.
[82] ICCA-Queen Mary Task Force, *supra* note 1, at 40-41.
[83] Baker McKenzie, *supra* note 3, at 99.
[84] ICCA-Queen Mary Task Force, *supra* note 1, at 41.
[85] *Id.* at 42.
[86] CIVIL CODE, art. 1303.
[87] Art. 1291.

The process by which funders determine which cases to fund and which to reject is a rigorous one that demands disclosure of all the relevant and material facts. Funders may require as a condition for funding a certain level of access to information or control over the arbitration proceedings.[88] Particularly where the agreement to fund is on a piecemeal or installment basis, as opposed to a lump sum payout at the beginning of the proceedings, this would be a safeguard to protect the funder's investment.[89]

Under common law jurisdictions, the disclosure to a third party of communications between lawyer and client will strip them of their privileged character unless it is expressly stated: *first*, that no waiver of such privilege is made and *second*, that the third party is also bound to secrecy.[90] Called the *common interest doctrine*, it dictates that when a party—such as a third-party funder—has a legitimate interest in the outcome of a dispute, its access to information related thereto should not be considered a waiver of legal privilege.[91] Stated otherwise, privilege is not waived if privileged information is shared with an entity which shares a party's legal interest.[92] Whether the transfer of documents to a potential funder constitutes a waiver of this privilege, in turn determines, whether a request for discovery of such documents may be granted.

In contrast, discovery measures are not customary under civil law.[93] This reduces the attention to the issue of privilege in such jurisdictions, where the client and the funder may be compelled to disclose information.[94] Although the Philippine legal system has been characterized as a hybrid of civil and common law,[95] it is closer to civil law countries in terms of disclosure and privilege.

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[88] ICCA-Queen Mary Task Force, *supra* note 1, at 28.

[89] *Id.*

[90] Costábile & Lynch, *supra* note 9, at 178.

[91] Giorgio F. Colombo & Yokomizo Dai, *A Short Theoretical Assessment on Third Party Funding in International Commercial Arbitration*, 280 NAGOYA U. J. L. POL. 109, 118 (2018).

[92] Jeffrey Schacknow, *Applying the Common Interest Doctrine to Third-Party Litigation Funding*, 66 EMORY LJ. 1461, 1468 (2017).

[93] Costábile & Lynch, *supra* note 9, at 179, *citing* Meriam Alrashid et al., *Impact of Third Party Funding on Privilege in Litigation and International Arbitration,* 6 DISPUTE RESOLUTION INT'L 165 126-27(2012).

[94] *Id.* at 178.

[95] PACIFICO A. AGABIN, MESTIZO: THE STORY OF THE PHILIPPINE LEGAL SYSTEM 2 (2011).

In the Philippines, discovery measures in judicial proceedings are provided for in the Rules of Court.[96] Although some of these procedures involve compulsory disclosure or production,[97] they are meant to be used against the other party to the proceedings, and not against an outsider to the case such as a funder. This renders the issue of waiver of privilege moot, because a funder, as a non-party, cannot be compelled to disclose any information that the funded party shared with it.

The convention on disclosure is not much different in arbitration. In keeping with the principle that parties may be compelled to disclose information, the Philippines allows arbitrators wide latitude and discretion in an almost inquisitorial approach to evidence:

> At any time before the close of hearings, the arbitral tribunal may require the parties to produce oral or written testimony, documents, or other evidence and to allow the inspection and reproduction of such evidence, upon such terms as it shall determine.[98]

As to the details of the arbitration itself, the Philippines has a tight policy on disclosure with respect to third persons. Confidentiality is regarded so highly that courts are empowered to issue protective orders to prevent or prohibit the unauthorized disclosure of confidential information.[99] Although this more than adequately protects the interests of the funded party, this presents a problem when a funder wants to access more information about the proceeding than the funded party is willing to give, especially in cases where the funding is done on an installment or as-needed basis.

Where the funded refuses to disclose arbitral information to the funder, the latter cannot compel the disclosure of such information from the arbitration panel or the party's counsel. The only safeguard of the funder in this case is to formulate the TPF contract with such terms as to clearly delineate the information and involvement it will require, with a provision that the failure to provide the same would result in the contract being rescinded and the funding stopped.[100] In this case, although the funder cannot compel disclosure, it can reasonably guard its interests by stopping further investment on the ground of breach of contract. If the funder does so in accordance with

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[96] RULES OF COURT, Rules 23-28.

[97] Rules 25-27, pertaining to Interrogatories to Parties, Admission by Adverse Party, and Production or Inspection of Documents or Things, respectively.

[98] 2015 PHIL. DISPUTE RESOLUTION CENTER ARBITRATION RULES, art. 35(3).

[99] ADR Act, § 23.

[100] ICCA-Queen Mary Task Force, *supra* note 1, at 28.

the terms agreed upon, the funded party cannot compel it to continue financing the claim.

It is submitted that the rules on disclosure and privilege in the Philippines are sufficiently strict to protect the interests of the client. At the same time, although funders may not themselves be able to compel disclosure of information, they can be assured that no information about its funded cases will be disclosed outside the arbitration process without the express consent of the funded party.

*2. Conflict of Interest*

Disclosure of information and documents must be distinguished from disclosure of the TPF agreement. While the former affects primarily the willingness of funders to finance cases, the latter goes into the impartiality and independence of the arbitrator. Three main positions form the debate on whether a TPF agreement should be disclosed: *first*, its existence must be disclosed but not its content; *second*, both its existence and content must be disclosed; and *third*, neither should be disclosed.[101]

The impartiality and independence of an arbitrator or judge is among the most pressing concerns about TPF, as these qualities go into the very integrity of the dispute resolution process. The practical implication of this is that a final award may be unenforceable or unrecognizable by a court if it finds that the arbitrator had a conflict of interest.[102] Impartiality refers to the state of mind of the arbitrator, which is a more internal and covert manifestation of bias than the more-easily observable quality of independence, which refers to the arbitrator's relationships with other parties.[103]

Under the UNCITRAL Model Law, which governs international commercial arbitration in the Philippines, an arbitrator "shall disclose any circumstances likely to give rise to justifiable doubts as to his or her impartiality or independence."[104] This duty to disclose is owed to the parties by the arbitrator from the time he is approached for possible appointment and throughout the arbitration.[105]

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[101] Colombo & Yokomizo, *supra* note 91, at 113.

[102] Dos Santos, *supra* note 2, at 924.

[103] Sai Ramani Garimella, *Third Party Funding in International Arbitration: Issues and Challenges in Asian Jurisdictions*, 3 ASIAN-AFR. LEGAL CONSULTATIVE ORG. J. INT'L L. 45, 46 (2014).

[104] United Nations Commission on Int'l Trade Law Model Law, art. 12(1).

[105] Art. 12(1).

There are two grounds to challenge an arbitrator under the UNCITRAL Model Law, and these grounds are exclusive to all others. The gravity of the importance accorded to the actual and perceived integrity of the arbitrator is underscored in that actual bias need not be shown to mount a challenge: "An arbitrator may be challenged only if circumstances exist that give rise to justifiable doubts as to impartiality or independence, or if he does not possess qualifications agreed to by the parties."[106]

In Philippine domestic arbitration, the safeguard against conflict of interest is as follows:

> No person shall serve as an arbitrator in any proceeding if he has or has had financial, fiduciary or other interest in the controversy or cause to be decided or in the result of the proceeding, or has any personal bias, which might prejudice the right of any party to a fair and impartial award.[107]

The provision is worded as inclusively as possible to cover any interest which may prejudice the parties, the phrasing of "has or had" inevitably including even those interests held in the past. An explicit requirement of disclosure does not come into the picture until *after* appointment, where if during which a person appointed to serve as arbitrator discovers a conflict of interest, he has the duty to immediately disclose it to the parties. Where the conflict of interest is discovered only after an award has been rendered, the law still provides a remedy: the award may be vacated on the ground of evident partiality on the part of the arbitrator.[108]

Challenging an award is more narrowly drawn than that of challenging an arbitrator. While the arbitrator has the duty to disclose "circumstances likely to create a presumption of bias,"[109] the partiality of an arbitrator must be evident to properly constitute such ground. Note, however, that in arbitration by a panel, partiality need not be evident in a majority of the members. The presence of such circumstances in "any of them" will warrant vacation of the award.[110]

Evident partiality in the context of arbitration will undoubtedly be interpreted with authority by Philippine courts, but it is useful to note that any

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[106] United Nations Commission on Int'l Trade Law Model Law, art. 12(1).
[107] ADR Act, § 10.
[108] § 24(b).
[109] § 10 ¶ 3.
[110] § 24(b).

jurisprudence on the matter in litigation might be unavailing in arbitration for the reason that, unlike judges, arbitrators may be appointed by the parties.

In a 2018 decision, the U.S. Court of Appeals for the Second Circuit ruled that a higher burden of proof is required to establish evident partiality of a party-appointed arbitrator.[111] Noting that "[f]amiliarity with a discipline often comes at the expense of complete impartiality," the court ruled that "a showing of something more than the mere 'appearance of bias'" is required to vacate an arbitral award."[112] Consequently, evident partiality will be found in the case of a party-appointed arbitrator: *first*, if his nondisclosure violates the arbitration agreement, which may set limits on allowable personal or business relationships; and *second*, if his partiality had a prejudicial effect on the award.[113]

The Arbitration Rules promulgated by the PDRCI adopt the same rules of disclosure as the UNCITRAL Model Law. PDRCI arbitrators also have a continuing duty to disclose circumstances likely to give rise to justifiable doubts as to their impartiality or independence.[114]

Some jurisdictions such as Argentina, Brazil, and Singapore require disclosure of the TPF agreement. Argentina enacted a joint Civil and Commercial Code ("CCC") in August 2015, which governs all arbitration matters except those covered by the Buenos Aires Convention.[115] Under the CCC, arbitrators have a duty to disclose any connections they may have with funders.[116] In Brazil, the CAM-CCBC issued a resolution ordering parties to disclose, at the outset of arbitral proceedings, the existence and identity of a third-party funder and any relationship between the arbitrators and such funder.[117] In Singapore, lawyers are required to disclose to the court or tribunal and other parties to the proceedings the existence of any TPF relating to the case and the identity and addresses of the funders concerned.[118]

The prevailing practice is that TPF agreements are not disclosed at all, but it has been suggested that imposing a duty on the part of the funded party

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[111] BAKER MCKENZIE, INTERNATIONAL ARBITRATION YEARBOOK 366 (2019).

[112] *Id.* at 367.

[113] *Id.*

[114] 2015 PHIL. DISPUTE RESOLUTION CENTER ARB. RULES, art. 17.

[115] Baker McKenzie, *supra* note 3, at 15, *citing* the Mercosur Accord on International Commercial Arbitration (1998).

[116] Baker McKenzie, *supra* note 3, at 22.

[117] *Id.* at 61-62.

[118] Baker McKenzie, *supra* note 3, at 274, *citing* Legal Profession (Professional Conduct) Rules (Singapore), § 49A(1) (2016).

to disclose the existence of the agreement would better protect the integrity of the arbitration process,[119] such as when TPF agreements previously undisclosed come to the fore, and the funder has a significant relationship with the arbitrator.

Arbitrators have a duty to disclose not only those existing conflicts that are already known to him, but also those which he may learn of through reasonable inquiries.[120] This obligation weighs heavier upon arbitrators in regimes where there is no duty on a party to disclose the existence of a TPF agreement. However, it may be tempered by the courts. In Japan, an arbitral award was set aside by the Osaka High Court on account of the nondisclosure of the presiding arbitrator of the fact that an attorney in a firm of which he was partner represented an affiliate of the claimants in an ongoing matter.[121] The matter was unrelated to the arbitration, and the arbitrator and the attorney were assigned to different offices (Singapore and U.S., respectively) of the said firm. Japan's Supreme Court remanded the case because it was unclear if the arbitrator was aware of the relation or if he could have normally discovered it by conducting a reasonable investigation.[122]

The bar for evidence is set high to remove an arbitrator on the ground of bias.[123] This conclusion seems applicable to the Philippines as well, in view of the pro-enforcement stance of the Supreme Court.[124] Nevertheless, given that arbitral statutes themselves put a high premium on making sure that arbitrators have no conflicts of interest, or at least make potential ones known to the parties, disclosure by parties of their availment of TPF should be encouraged, especially by counsel who may advise them regarding the consequences should they choose to keep it a secret.

*3. Internationality*

What happens in a TPF operation which happens across borders? And what if an arbitration has its seat in a country where TPF is not permitted, but one of the parties is based in a country where TPF is allowed and is funded by an entity from a place where TPF is unregulated? In practice, this is almost

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[119] Colombo & Yokomizo, *supra* note 91, at 115.
[120] *Id.* at 116-117.
[121] Baker McKenzie, *supra* note 111, at 172-173.
[122] *Id.* at 174.
[123] Baker McKenzie, *supra* note 3, at 275.
[124] Santiago & Muti, *supra* note 61.

irrelevant for the reason that TPF is most likely an issue of substantive national law.[125]

Where TPF is entered into in arbitration either domestically or internationally, the Supreme Court is more likely to uphold it regardless of whether or not TPF is deemed valid in the Philippines (as the forum), or in the country or countries to which a foreign element is owed (as, for instance, the place of contract). This can be inferred from its decidedly pro-enforcement stance[126] evident in *Mabuhay Holdings Corp. v. Sembcorp Logistics Ltd.*, in which the Supreme Court upheld an arbitral award in favor of a Singaporean corporation despite the invocation of public policy by the Philippine defendant:

> Mere errors in the interpretation of the law or factual findings would not suffice to warrant refusal of enforcement under the public policy ground. The illegality or immorality of the award must reach a certain threshold such that, enforcement of the same would be against [the Philippines'] fundamental tenets of justice and morality, or it would blatantly be injurious to the public, or the interests of the society.[127]

*4. Costs*

How should costs be allocated between the parties? Should an award to a successful claimant include the funding cost? May an arbitrator order the funder to put up security for costs? Can the funder of a losing party be made to foot the bill for the adverse party?[128] These are questions presented by TPF that require a reexamination of what it means to give due process when rights and obligations are decided outside the judicial and quasi-judicial system.

Premises must first be reiterated. Arbitration is a private and consensual dispute resolution mechanism in which the principles of party autonomy and flexibility are central and inherent.[129] Arbitrators have no jurisdiction over the parties beyond the extent of the arbitration agreement and the institutional rules governing it.[130]

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[125] *Id.*

[126] *Id.*

[127] Mabuhay Holdings Corp. v. Sembcorp Logistics Ltd., G.R. No. 212734, Dec. 5, 2018.

[128] ICCA-Queen Mary Task Force, *supra* note 1, at 146.

[129] International Chamber of Commerce (ICC), *Decisions on Costs in International Arbitration*, ICC DISP. RESOL. BULL. 13, 15 ¶ 7 (2015).

[130] Dos Santos, *supra* note 2, at 925; Baker McKenzie, *supra* note 3, at 377.

i. Allocation of Costs

There are two basic approaches in cost allocation: either the loser pays the successful party's costs, otherwise known as the "costs follow the event" principle, or each pays its own costs without regard to the outcome.[131] In between these approaches lies a continuum of cost allocation dependent on how much discretion is given to arbitrators under the pertinent institutional rules. Tribunals may start from either approach and then order the shifting of costs on the basis of particular circumstances.[132] Costs generally follow the event for both litigation and arbitration in the Philippines, but they may be apportioned differently depending on the facts of the case.[133]

Among the factors arbitrators take into account are the extent to which the parties could have avoided the arbitration or reduced their expenses, prevailing cost allocation principles in the applicable law, agreements between the parties, and their behavior.[134] Bad faith and improper conduct are notable factors that frequently arise in cost allocation decisions.[135] Almost all of the awards rendered under the 2012 International Chamber of Commerce ("ICC") Rules took into account whether the parties had conducted the arbitration in an expeditious and cost-effective manner.[136]

Arbitrators can and will exercise whatever discretion the rules and the parties give them, and such discretion is broad even in cases where a presumption regarding costs is provided for.[137] Consequently, a decision on costs cannot be challenged on the ground merely that a tribunal did not take into account any of the considerations generally relied upon.[138] To the question of how costs should be allocated, the answer is almost frustratingly simple: it depends on the circumstances of the case.

ii. Recoverability of Legal and Funding Costs

Does a funded party actually incur costs? A gray area seems to arise in TPF, where the usual practice is that invoices are issued under the party's

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[131] ICC, *supra* note 129, 15 ¶ 5.

[132] *Id.* at 21.

[133] 2015 PHIL. DISPUTE RESOLUTION CENTER ARBITRATION RULES, art. 50(1). *See also* RULES OF COURT, Rule 142, § 1.

[134] ICC, *supra* note 129, ¶¶ 9, 19-21.

[135] *Id.*, ¶¶ 11, 14-16.

[136] *Id.*, ¶ 19.

[137] *Id.*, ¶ 11; *See also* Baker McKenzie, *supra* note 3, at 409 n.3.

[138] *Id.*, at 1.

name but are actually paid by the funder directly to the lawyer.[139] It has been suggested that such costs may not be recoverable because: *firstly*, the funder does not have standing to claim costs in the proceedings; and *secondly*, the party that was funded did not actually incur the costs.[140] The ICCA, however, answers this in the positive, as the funded party incurs the obligation to reimburse the funder for the costs advanced in case of successful recovery, aside from the obligation to pay a return.[141] This makes sense; albeit later in time and under more flexible terms depending on its terms with the funder, the legal costs ultimately land upon the party.[142]

There seems to be no obstacle to the recovery of costs that a funded party pays out of pocket later instead of sooner, but it is uncertain whether costs incurred should include the funding cost, which consists of all the expenses it incurred in obtaining TPF, including the funder's return, which in effect is the cost of capital or the success or uplift fee.[143] As is the case with many other legal questions, whether or not the successful funded party can claim funding costs depends on the applicable law[144] and the circumstances of the case itself.[145] Majority of jurisdictions cite no reported cases on the recovery of costs related to TPF.[146] The recent case of *Essar v. Norscot*,[147] however, may be persuasive. In this case, the English High Court ruled that funding costs are indeed recoverable from the losing party, upholding the award rendered by the arbitrator. Caution must be taken in citing this case as precedent, however, as "reprehensible" conduct on the part of Essar attended the case and may have had a significant impact on the decision on costs.[148]

Essar was adjudged liable to pay damages to Norscot. Aside from the amount of the claim, Norscot sought an additional GBP 1.94 million, which was the sum it owed its funder, inclusive of the funding costs. The arbitrator held that funding costs came under the category of "other costs" for which the applicable law prescribed recovery.[149] Essar contended that "other costs"

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[139] ICCA-Queen Mary Task Force, *supra* note 1, at 155.

[140] ICC, *supra* note 129, ¶ 22.

[141] ICCA-Queen Mary Task Force, *supra* note 1, at 155; Jeffrey Sullivan, *Essar v. Norscot: Are the Costs Associated with Third Party Funding Recoverable?*, 15 TRANSNAT'L DISP. MGMT 2 (2017).

[142] ICC, *supra* note 129, at 17.

[143] *Id.* ¶ 92.

[144] ICCA-Queen Mary Task Force, *supra* note 1, at 157. For example, national laws may require causation and foreseeability to be satisfied for such costs to be awarded.

[145] *Id.*

[146] ICC, *supra* note 129, at 6 ¶ 22.

[147] Essar Oilfield Services Ltd. v. Norscot Rig Mgmt. Pvt. Ltd, EWHC 2361 (2016).

[148] Dos Santos, *supra* note 2, at 928.

[149] Sullivan, *supra* note 141, at 6, *citing* U.K. Arbitration Act 1996, § 59(1)(c).

must be narrowly construed to cover only costs analogous to *legal* costs, and argued that TPF was not included because it represents not the cost of arbitration but rather the cost of *funding* it.[150]

Most institutional rules and conventions are silent on TPF in relation to awarding costs. To date, only Singapore has made express pronouncements thereon, stating that "[t]he Tribunal may take into account any third-party funding arrangements in ordering its Award that all or a part of the legal or other costs of a Party be paid by another Party."[151] Note, however, that this does not cover the accommodation of TPF in domestic arbitration, which is not part of Singapore's framework as amended.[152] Other institutional rules may accommodate the recoverability of funding costs under the phrases "other costs,"[153] "costs of [the] arbitration,"[154] or "expenses reasonably incurred [by the successful party] in pursuing the case."[155]

The bottom line for recoverability is that costs must have been reasonably incurred.[156] Tribunals may consider the following factors in determining recoverability: (1) whether the respondent made the claimant impecunious; (2) whether obtaining TPF was necessary for the claimant to pursue its claim; and (3) whether the respondent knew that the claimant had funding.[157] Also relevant to recoverability, however, is the purpose for which the party secured TPF. When costs are allocated to a successful party, it is so that it does not incur expenses for having to seek adjudication to enforce or vindicate its rights.[158] Consequently, a tribunal may find it unreasonable for a party to recover funding costs where it merely intended to hedge the financial risk of arbitration as opposed to where it depended solely on TPF to bring the claim.[159]

The Arbitration Law, the ADR Act, and the UNCITRAL Model Law do not define what expenses comprise costs. Among other items listed in its

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[150] Sullivan, *supra* note 141, at 7.

[151] SINGAPORE INTERNATIONAL ARBITRATION CENTER (SIAC), INVESTMENT ARBITRATION RULES 2017, Rule 35.

[152] Baker McKenzie, *supra* note 3, at 273.

[153] U.K. Arbitration Act (1996), § 59(1)(c)); ICC RULES OF ARBITRATION (2017), art. 378(1); LONDON COURT OF INTERNATIONAL ARBITRATION RULES (2014), art. 28(3).

[154] U.K. Arbitration Act (1996), § 63(3); UNCITRAL ARBITRATION RULES, art. 40(1).

[155] CHINA INTERNATIONAL ECONOMIC AND TRADE ARBITRATION COMMISSION (CIETAC) ARBITRATION RULES 2014.

[156] ICCA-Queen Mary Task Force, *supra* note 1, at 158.

[157] *Id.*

[158] ICC, *supra* note 129, 16 ¶ 86.

[159] ICCA-Queen Mary Task Force, *supra* note 1, at 158.

Rules, the PDRCI includes "the cost of legal representation and assistance reasonably incurred by the successful party in connection with the arbitration."[160] It is submitted that TPF may be considered assistance within the purview of this rule, as the services of a funder may extend beyond mere finance into professional case management.[161] This can be expected particularly where the funding agreement requires that the funder be notified and updated on the proceedings, with payments made on a continuing basis. This would necessarily require continuous approval on the part of the funder.

iii. Interim Measures and Final Awards in Favor of the Adverse Party

Security for costs may be granted upon application by the respondent where it is found that the claimant might not be able to pay an adverse costs award. Expressly prescribed in the English Arbitration Act of 1996[162] and the Rules of the London Court of International Arbitration,[163] but largely unaddressed in other laws and institutional rules, this practice has become more frequent.[164] To date, there are no known arbitration laws or rules addressing the implications of TPAF on security for costs orders, nor is there a uniform test for the application thereof in international commercial arbitration.[165]

It is generally accepted that even general provisions for interim measures empower arbitrators to order security for costs.[166] That tribunals have the power to do so, however, does not necessarily mean that they *should*. One position is that the existence of TPF implies that the funded party is impecunious *per se* and therefore justifies the grant of security. However, this stance fails to account for financially stable parties which avail of TPF to mitigate risk and stay liquid.[167] Going back to the general test of reasonableness will lead arbitrators to consider the financial situation of the funded party and the terms of the funding agreement. If the funder has, for

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[160] 2015 PHIL. DISPUTE RESOLUTION CENTER ARBITRATION RULES, art. 49(1)(e).

[161] Garimella, *supra* note 103, at 51.

[162] U.K. Arbitration Act (1996), § 28(3). The tribunal may order a claimant to provide security for the costs of the arbitration.

[163] LONDON COURT OF INTERNATIONAL ARBITRATION RULES (2014), art. 25.2.

[164] ICCA-Queen Mary Task Force, *supra* note 1, at 163.

[165] *Id.* at 164-65.

[166] *Id.* at 169.

[167] *Id.* at 171.

example, undertaken to finance adverse costs and established its capital adequacy, an order for security may be unnecessary.[168]

Because of the consensual nature of arbitration, it is generally accepted that tribunals have no authority to order a third party to pay costs.[169] In the UK, for example, there is express legislation to the effect that a tribunal does not have jurisdiction to make a costs order against a non-party to the arbitration.[170] This places parties at risk of not being able to recover from a funded party by reason of its impecuniosity, much like how enforcement poses a problem in litigation where the judgment obligor has no assets to attach or garnish. Fortunately, the danger of a hit-and-run arbitration can be prevented by specifically securing under the terms of the TPF agreement the funder's commitment to pay adverse costs, insurance premiums, security, and other liabilities.[171]

The undertaking of a funder to pay adverse costs is for the benefit of the adverse party. Notwithstanding the lack of coercive power on the part of tribunals to make funders liable for costs, they may still be instrumental in encouraging parties to secure such an assurance. Recall the broad discretion of arbitrators in determining the allocation and recoverability of costs, and it is easy to see how tribunals can incentivize parties to act in certain ways during the proceedings. For example, for a party to be allowed to recover funding costs, the tribunal may require it to secure the funder's unequivocal promise to pay adverse costs or to disclose in full the terms of the funding agreement at the onset of the proceedings. Despite the absence of coercive state power in the hands of a tribunal, there are steps that it can take to protect the interests of all those involved.

Outside of the arbitration proceedings, the other party would generally have no direct way of extracting money from the funder.[172] Should the funding agreement clearly provide for the funder's liability for costs, the party can demand its payment on the basis of the stipulation in its favor. Philippine law recognizes stipulations *pour autrui*,[173] and parties in domestic arbitration, as well as those in international arbitration where the *lex arbitri* provides for the same, can rely on such terms as are beneficial to them, subject to the guidelines of national law on how they may be enforced.

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[168] *Id.* at 172.
[169] Baker McKenzie, *supra* note 3, at 377.
[170] *Id.*, *citing* U.K. Arbitration Act (1996), § 61.
[171] Wadia & Rawat, *supra* note 7, at 18.
[172] Colombo & Yokomizo, *supra* note 91, at 123.
[173] CIVIL CODE, art. 1311.

### B. Champerty: A Potential Roadblock to TPAF

In private law, what is not forbidden is allowed.[174] Given the existing legal framework, TPF seems to pass legal muster by inductive reasoning. Dispute resolution funding practices such as CFAs, credit assignment, and liability insurance are common in the Philippines, leading to the conclusion that this validity is shared by all forms of TPF, including TPAF. Despite the precedent of similar instruments and the absence of an express prohibition under the law, however, TPAF may still face barriers to acceptance in our jurisdiction.

Courts may encounter TPAF in two instances: *first*, in a petition for recognition and enforcement of an award that asks the court to make an order respecting the funder, and *second*, in a collection case filed by the funder in the event that they are left unpaid or that they do not agree with the funded party on the amount due. The first instance includes cases where the arbitral award includes as costs the sum payable to the funder, or where the award orders a transfer of assets, such as equity or real property, to the funder.

In any of these situations, TPAF faces the obstacle of public policy prohibitions in the form of champerty, a concept that has prevented the use of TPF in jurisdictions that still enforce the doctrine.

Champerty is a common law tort defined as:

> [A]n agreement between an officious intermeddler in a lawsuit and a litigant by which the intermeddler helps pursue the litigant's claim as consideration for receiving part of any judgment proceeds; an agreement to divide litigation proceeds between the owner of the litigated claim and a party unrelated to the lawsuit who supports or helps enforce the claim.[175]

Together with its twin concept of maintenance,[176] it has held back the usage of TPF in Ireland, and, until only recently, Hong Kong and Singapore.

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[174] Charles Sampford, *Law, Institutions and the Public/Private Divide*, 20 FED. L. REV. 185, 201 (1991).

[175] BLACK'S LAW DICTIONARY (10th ed., 2014)

[176] *Id.*, defined as "improper assistance in prosecuting or defending a lawsuit given to a litigant by someone who has no bona fide interest in the case; meddling in someone else's litigation."

*1. A Tale of Three Countries: The Fate of Champerty in Common Law Jurisdictions*

As with almost everything else in the modern world, champerty and maintenance were born in ancient Greece and Rome, where those who found to be engaged in them were held liable for malicious prosecution and vexatious litigation.[177] Further developed in medieval England to prevent feudal lords and noblemen from intimidating adversaries through frivolous legal action,[178] champerty and maintenance have since fallen into disuse in most jurisdictions with the notable exceptions of Hong Kong, Singapore, and Ireland.

In the 2017 case of *Persona Digital Telephony Ltd. v. Minister for Public Enterprise*,[179] the applicants submitted that maintenance and champerty aid in the administration of justice and should be applied in light of modern conceptions of propriety. As applied to their case, they invited the court to assess whether the litigation funding agreement in question violated the public policy considerations that champerty and maintenance were intended to guard against instead of measuring it against the rules on champerty itself.[180]

Although the Supreme Court of Ireland held by way of *obiter dictum* that laws must be interpreted in the context of modern social realities,[181] the Court in *Persona Digital* ruled instead that champerty and maintenance remained good law and must be followed absent any constitutional challenge in the petition. Thus, unless and until the legislature removes champerty and maintenance from the law, these doctrines will warrant the striking down of any agreement that runs them afoul.[182] This ruling confirms that TPF is prohibited in Ireland, in sharp contrast to its liberal treatment in England and Wales.

Meanwhile, common law jurisdictions like Hong Kong and Singapore both carved out express permission for TPAF.

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[177] Wadia & Rawat, *supra* note 7, at 2.

[178] *Id.*

[179] Persona Digital Telephony Ltd. v. Minister for Pub. Ent., IESC 27 (2017).

[180] Shepherd & Wedderburn LLP, *TPF in Ireland: Persona non grata?*, May 2017, SHEPHERD & WEDDERBURN LLP WEBSITE, *available at* https://shepwedd.com/sites/default/files/Third%20Party%20Funding%20in%20Ireland%20persona%20non%20grata.pdf (last accessed May 15, 2019).

[181] Aoife McCluskey & Sharon Daly, *Is third-party litigation funding permitted? Is it commonly used? In Litigation Funding: Ireland*, LEXOLOGY, *available at* https://www.lexology.com/gtdt/tool/workareas/report/litigation-funding/chapter/ireland (last accessed May 15, 2019).

[182] Shepherd & Wedderburn LLP, *supra* note 180.

Hong Kong introduced TPAF through a two-step process.[183] An amendment to the Arbitration Ordinance was introduced in 2017, laying the legal framework for TPF in Hong Kong-seated and offshore arbitrations. A Code of Practice for Third Party Funding of Arbitration was issued in December 2018, and provisions expressly permitting TPAF and implementing regulations thereon became operative on February 1, 2019.

Meanwhile, Singapore amended its Civil Law Act in 2017 to clarify that champerty and maintenance are abolished therein, as well as to introduce a legal framework for TPF in international arbitration and related matters such as court and mediation proceedings.[184] At present, TPF is not yet permissible in domestic arbitration as it was not included in the amended framework. The government has indicated, however, that the framework may be extended in the future.[185]

Express permission was necessary for Hong Kong and Singapore as it would be uncertain whether champerty would render TPF in arbitration a tort. The same uncertainty besets the practice in Ireland, where it has been affirmed that champerty and maintenance remain criminal offenses.[186]

*2. Champerty as Formulated in the Philippines*

As jurisprudence currently stands, there seem to be at least two ways of defining champerty, one more restrictive than the other. Under the broad definition, which is its original form, funding by any disinterested party for profit is considered champerty.[187] Under the narrow construction, champerty arises only if the arrangement is entered into by a lawyer.[188] This distinction becomes relevant in assessing the extent to which a country that adheres to the doctrine of champerty will need to make adjustments to accommodate TPF. In a jurisdiction where champerty is painted in broad strokes, there will be dissonance in the law if TPF is declared valid in arbitration but not in litigation.

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[183] Baker McKenzie, *supra* note 111, at 127.

[184] Baker McKenzie, *supra* note 3, at 273.

[185] *Id.*

[186] Maintenance and champerty remain good law under the Maintenance and Embracery Act 1634. *See* Aoife McCluskey & Sharon Daly, *Litigation Funding: Ireland*, LEXOLOGY, *available at* https://www.lexology.com/gtdt/tool/workareas/report/litigation-funding/chapter/ireland (last accessed May 15, 2019).

[187] Paul Bond, *Making Champerty Work: An Invitation to State Action*, 150 U. PA. L. REV. 1297, 1302 (2002).

[188] Masangkay, *supra* note 4, at 3; *See also* Bond, *supra* note 187, at 1303.

It has been noted that arbitration is essentially a private operation while litigation proceeds through the instrumentalities of the state.[189] That arbitral procedures are flexible and not imbued with the coercive power of the state is the only salient difference between the two that could justify a divergence in their treatment under the law. Since the expenses in both arbitration and litigation are generally shouldered by private parties, TPF is liable to violate champerty in its broad sense.

Sir Richard Scott V.C. said it best in *Bevan Ashford v. Geoff Yeandle (Contractors) Ltd.*, which concerned the validity of contingency fees. Opining that there is no basis to differentiate between litigation and arbitration in the application of champerty, he posed the following questions:

> If it is contrary to public policy to traffic in causes of action without a sufficient interest to sustain the transaction, what does it matter if the cause of action is to be prosecuted in court or in an arbitration? If it is contrary to public policy for a lawyer engaged to prosecute a cause of action to agree that if the claim fails he will be paid nothing but that if the claim succeeds he will receive a higher fee than normal, what difference can it make whether the claim is prosecuted in court or in an arbitration?[190]

If non-lawyers are prohibited from funding litigation, there is no reason they should be allowed to fund other forms of dispute resolution that are sanctioned by the state. This was, in fact, the position of the Singapore Court of Appeal in 2007, when it ruled that champerty applied in arbitration just as it did in litigation.[191] Citing Lord Denning MR in *Re Trepca Mines* that "[t]he common law fears that the champertous maintainer might be tempted, for his own personal gain, to influence damages, to suppress evidence, or even to suborn witnesses," the Court recognized that the evils sought to be quelled by anti-champerty regulations existed even in dispute resolution mechanisms outside the state machinery.

At first glance, it would seem that the TPAF would be considered illegal in the Philippines to the extent that it involves funding by a disinterested party for profit. Upon closer analysis, however, this danger seems to be more imagined than real as the Philippines seems to follow the narrower definition of champerty. The only Philippine cases that have mentioned the concept

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[189] Baker McKenzie, *supra* note 3, at 242.

[190] Jern-Fei Ng, *The Role of the Doctrines of Champerty and Maintenance in Arbitration*, 76 ARB. 208 (2010), *citing* Bevan Ashford v. Geoff Yeandle (Contractors) Ltd., 3 W.L.R. 172 (1998).

[191] *Id.*, *citing* Otech Pakistan Pvt. Ltd. v. Clough Eng'g. Ltd., SCGCA 46 (2006).

pertain to situations in which lawyer's fees were challenged for being unconscionably high or violative of the prohibition against lawyers acquiring interest in property in litigation.[192]

The only real prohibition regarding third-party funding in the Philippines is one that is done by lawyers. This, in turn, finds its basis on the fiduciary duty of a lawyer towards his client, which may be compromised when he acquires an interest in the case. Arguably, interest *per se* does not prejudice the fiduciary relation, which is why contingency fee agreements, for example, are permitted in the Philippines. It is when such interest becomes disproportionate to what is due under the circumstances that the court strikes it down as champertous. This analysis leads to the conclusion that champerty in the Philippines is formulated very restrictively, and therefore will not bar local parties from availing of TPAF.

### C. Recommendations

The legal framework of the Philippines is ripe for TPAF to flourish. As previously discussed, our jurisdiction is not hampered by the same restrictions in Ireland. Although no professional funders currently operate in our jurisdiction, it will not be long before they do. Thus, it is never too early to start thinking about the direction national policy should take with respect to TPAF. The most important step in optimizing the regulation of TPAF is not to make any regulations—at least not right away. The prevailing opinion in the international arbitration community is that self-regulation is preferable to that which is imposed by legislation.[193]

However, regulation may have its place in establishing TPAF in capitalization requirements. This would not be a regulation of TPAF *per se* but merely of the viability of the entities that would offer it in the future in order to ensure that no fly-by-night funders take advantage of and wreak havoc on arbitration. Such measures would be akin to requirements for insurance

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[192] *See* Roxas v. Republic Real Est. Corp., G.R. No. 208205, 792 SCRA 31, June 1, 2016, in which a contingency fee agreement was struck down as champertous because it did not have a reimbursement agreement, thereby creating a conflict of interest on the part of counsel. *See also* Nocom v. Camerino, G.R. No. 182984, 578 SCRA 390, Feb. 10, 2009, which implies that champerty arises where a lawyer incurs such interest in a case that would conflict with that of his client and endanger their fiduciary relationship. For more cases mentioning champerty in passing, *see* Lopez v. Esquivel, G.R. No. 168734, 586 SCRA 545, Apr. 24, 2009, Baltazar v. Bañez, A.C. No. 9091, 712 SCRA 119, Dec. 11, 2013, *and* Bautista v. Gonzales, Adm. Matter No. 1625, 182 SCRA 151, Feb. 12, 1990.

[193] James Clanchy, *Champerty is dead; long live champerty*, THE LAW OF NATIONS BLOG, Jan. 31, 2018, *available at* https://lawofnationsblog.com/2018/01/31/champerty-dead-long-live-champerty/ (last accessed May 15, 2019).

companies and other financial institutions. In Singapore, for example, a funder must have a paid-up share capital of not less than SGD 5 million.[194]

Given the present lack of any professional funders engaged in the traditional model of TPF, it would be difficult and counter-productive for the legislature to try to create regulations specifically for TPAF as soon as the public starts making use of it. A more organic approach towards regulation might be for the PDRCI to create an accreditation or recommendation system for funders so that those with the expertise necessary to address technical questions peculiar to the arbitration process can assess them in a manner unhampered by legislative or administrative red tape.

Another potential area of regulation would be the relationship between lawyers and funders. Although the Philippines does not proscribe third-party funding *per se*, there remains a prohibition on lawyers against acquiring an interest in their clients' cases. There is nothing in this prohibition that would suggest that the danger of acquiring such an interest would be any less in arbitration than it is for litigation. The public-private distinction between the two is irrelevant in determining whether a conflict of interest has arisen between a party and its counsel.

Particularly suspect with regard to conflicts in interest is the equity composition of funders vis-à-vis lawyers and arbitrators, as it is possible to circumvent conflict of interest rules by acquiring interest in a funder. The extent to which a lawyer or arbitrator may hold shares of a funder should also be clarified. Is there a percentage of ownership small enough to be considered not constitutive of conflict of interest, or is any involvement *per se* already detrimental to the arbitral process or the lawyer-client relationship? In Germany, for example, the employment of funding vehicles in which lawyers hold an equity stake violates conflict of interest if they hold a majority portion, but an equity threshold of 30% has been proposed.[195] Meanwhile, Singapore prohibits lawyers from holding any ownership interest in funders, although they may introduce or refer funders to their clients.[196] Hong Kong, on the other hand, generally allows lawyers to be funders, provided they do not act for a party in relation to the arbitration.[197]

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[194] Baker McKenzie, *supra* note 3, at 273, *citing* Civil Law (Third-Party Funding) Regulations 2017 (Singapore), § 4(1).

[195] Baker McKenzie, *supra* note 3, at 131.

[196] *Id.* at 274, *citing* Singapore Legal Profession (Professional Conduct) Rules (2016), § 49B(1)(a).

[197] Baker McKenzie, *supra* note 3, at 141.

It is submitted that the Philippines would benefit from allowing lawyers and arbitrators to acquire interest in funders to an extent similar to the threshold suggested in Germany. If ownership interest were completely prohibited, it would almost certainly lead to enterprising lawyers and arbitrators bent on riding the TPF wave to devise schemes to circumvent the prohibition and evade the duty to disclose, thereby placing parties in a much worse position than if the acquisition of such interest were just allowed in the first place (subject, of course, to disclosure).

Arbitrators need not be lawyers, which means that there will be lawyer and non-lawyer arbitrators who may potentially invite conflicts of interest in cases they handle. The judiciary will, however, have indirect control over both classes of arbitrators in that they may remove an arbitrator duly challenged[198] and annul a domestic arbitral award on the ground of evident partiality,[199] thus assuring parties of a safeguard at the enforcement level outside the arbitration machinery and within the status quo.

Lastly, while issues such as disclosure and privilege may, at first glance, be sensitive so as to trigger calls for legislation and rulemaking, it is submitted that the existing legal framework likewise provides enough safeguards to ensure that the integrity of the arbitration process as well as the interests of the parties are upheld.

## V. CONCLUSION

As TPAF becomes increasingly pervasive, it is inevitable that one should ask where the Philippines stands on the matter, and more importantly, what direction it should take moving forward. While the features of TPAF may initially raise suspicion in legal circles, the experience of other countries is largely sufficient to allay fears about its effect on the integrity of the arbitration process, the fiduciary relations between lawyer and client, and due process in general. The issues this Note seeks to answer essentially boil down to two questions: Do we want TPAF in arbitration, and if so, what can we do to establish it?

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[198] UNCITRAL Model Law, art. 13(3), in relation to art. 6. Under Section 3(k) of the ADR Act, the Regional Trial Court has jurisdiction over the challenge procedure. Section 33 of the same law makes the challenge procedure applicable to domestic arbitration as well.

[199] Rep. Act. No. 876 (1953), § 24(b).

### A. TPAF Directly Benefits the Parties Involved and Indirectly Benefits the Public

Parties that would otherwise be unable to pursue their claims can gain access to justice through TPF. Those that could afford to absorb such costs can do so on terms less likely to impact their daily business operations. TPF can even benefit the parties opposite those being funded if the terms thereof include an undertaking by the funder to put up security or pay adverse costs.

As long as the usual rules on professional ethics are followed by arbitrators and counsel alike, TPAF has the potential to pave the way towards a more efficient and accessible mode of dispute resolution. More would-be litigants would be diverted to arbitration, and cases would be disposed of through simpler means since funded parties need not spend time finding ways to defray their expenses. A shift towards arbitration would likewise alleviate the burden on the court system, which would then be left with only those cases that must absolutely be dealt with judicially.

Finally, a more efficient and reliable dispute resolution system would increase foreign players' confidence in the Philippines, which, in turn, would contribute to a more favorable business climate for foreign investment.

### B. TPAF may be Sufficiently Accommodated by the Existing Philippine Legal Framework

With its highly permissive stance on CFAs and claim assignment, the Philippines is conducive to the development of TPAF. The worldwide debate on it presents potential problems that may arise as a consequence of its use, but an examination of Philippine law shows that there are enough safeguards in the status quo to protect the interests of the parties involved in the areas of privilege, conflict of interest, conflict of laws, and awarding of costs.

Although there are no concrete obstacles to the establishment of TPAF in the Philippines, a potential stumbling block comes in the form of champerty which has already demonstrated in other jurisdictions its ability to impede the development of TPAF. Champerty as understood in the Philippines, however, is really only another name for conflict of interest on the part of a counsel. As it is fundamentally different from the kind of champerty of which TPF would run afoul, courts should not invalidate or refuse to recognize TPAF on that basis.

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