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AUTUMN 2019 ISSUE

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Legal finance in Korea: Lawyers weigh in

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Given growing interest in legal finance in South Korea, Quentin Pak asked a group of international arbitration lawyers from leading law firms to address questions relating to the legal framework regulating funding, common misconceptions, as well as predictions for the future of legal finance in the region. Their answers are gathered below, and we thank them for their perspective.

There is currently no legal framework in South Korea regulating the funding of litigation or arbitration by a third party. Do you foresee the formalization of guidelines for legal finance similar to recent arbitration funding frameworks in Singapore and Hong Kong? What would the likely impact be?

EUN YOUNG PARK: The maintenance and champerty principle does not exist in Korea. Instead, Article 6 of the Trust Act provides “any trust, the main purpose of which is to have the trustee to proceed with litigation, shall be null and void.”. This prohibition of trusts aimed at lawsuits differs from the maintenance and champerty principle in that it applies only to the acts of trust where the party delegates his rights in litigation to the trustee. Maintenance and champerty, on the other hand, apply to a broader range of interference by a third party in litigation, including funding or material assistance. Thus, Article 6 of the Trust Act would not be applicable to third-party funding as long as the third party would not be exercising rights of the litigant. As such, to the extent that the terms of third-party funding do not constitute a trust aimed at a lawsuit, there is currently no law or regulation prohibiting third-party funding in lawsuits or arbitration similar to the maintenance and champerty principle in common law.

However, to the extent that a monetary judgment or award granted to the plaintiff in a litigation or arbitration is shared with a third-party funder, such funding can be subject to restrictions set forth in the Attorney-at-Law Act. Article 34(5) of Attorney-at-Law Act stipulates that “no fees and other profits earned through services that may be provided only by attorneys-at-law shall be shared with any person who is not an attorney-at-law”. The main

legislative purpose of this provision is to restrict non-Korean lawyers from practicing law in Korea, rather than aiming to restrict third-party funding. Despite the lack of any precedents, however, we cannot rule out the possibility of applying the Attorney-at-Law Act to a third-party funding case, depending on the structure of the funding.

We believe that when it comes to the actual implementation of third-party funding, issues such as conflict of interest, ensuring fairness of the process and conflict with domestic law such as Article 34(5) of the Attorney-at-Law Act will need to be addressed. Furthermore, methods of regulating third-party funding such as 1) restriction of interference by the third party on the case, 2) disclosure, 3) qualification requirements and a registration system for the third party, and 4) an obligation of the third party to provide security, are expected to be discussed further.

In this regard, many Korean companies are becoming more interested in the availability of third-party funding, particularly for cross-border disputes. We think that there is a momentum to formalize and implement third-party funding guidelines in the near future, including a potential amendment to the Arbitration Industry Promotion Act and/or adding an exemption clause to Art. 34(5) of the Attorney-at-Law Act. This amendment would certainly clarify potential issues of regulation on the third-party funding by the Attorney-at-Law Act. We would expect that such formalization of the third-party funding framework is likely to result in a substantial ripple effect and create a stable legal finance market in Korea.

JAE MIN JEON, SEUNGMIN LEE AND ARIE

EERNISSE: In line with the recent growth of Korea as one of the hubs of international arbitration in East Asia, there is also growing interest in the field

of legal finance among Korea-based arbitration practitioners. However, there is currently no legal jurisprudence directly addressing legal finance issues and no legal framework clearly setting out what is permitted and what is not in relation to third-party funding. Also, at present, there are no third-party funders or funds in Korea that openly provide services in relation to Korean domestic litigation or arbitration matters seated in Korea.

Since at least 2010, arbitration practitioners in Korea have been actively discussing the necessity of adopting a legal framework for third-party funding, but there have not been any noteworthy developments. Notably, the Ministry of Justice recently released its blueprint to promote the arbitration industry for the coming years from 2019 to 2023, but it did not include any discussion of adopting a legal framework for third-party funding.

Nevertheless, arbitration practitioners in Korea are very open to the concept of third-party funding. Many Korean conglomerates are already receiving support from third-party funders in matters involving litigation in the US or UK.

Given this situation, it is difficult at this point to say whether or not Korea will enact formalized guidelines for the use of legal finance that are similar to the arbitration funding framework recently introduced in Singapore and Hong Kong. Arguably, it is only a matter of time before such a legal framework is established to regulate the funding of Korea-related litigation or arbitration by a third party. However, it remains to be seen how attorneys, parties and other stakeholders will be regulated once a framework is in place.

KYONGWHA CHUNG AND BHUSHAN SATISH: Korea's fast-evolving arbitration landscape has proactively kept pace with the latest global thinking on various arbitration-related issues. In 2017, the National Assembly passed the Arbitration Industry Promotion Act, recognizing that the arbitration was an "industry" in its own right, and accordingly putting in place a basic legislative framework for the long-term growth of this industry. Improving the legal framework for arbitration is a critical part of this strategy, and we expect legal finance to be a part of the agenda.

There is considerable uncertainty in the Korean arbitration community regarding the use of legal

finance. "Third-party funding" as conventionally understood in international practice is an unfamiliar concept in Korea. While there are no explicit prohibitions under Korean law analogous to common law doctrines of champerty and maintenance, there is also no established legal framework for third party funding, no specific legislation or court judgments in this area and no known instances of its use in litigations or arbitrations based in Korea. Formalizing the use of legal finance will go a long way.

Burford's latest research shows that lawyers are under pressure to remain competitive and provide clients innovative financing solutions. What do you perceive to be the main business challenges faced by lawyers in South Korea?

EUN YOUNG PARK: In Korea, lawyers generally do not offer innovative financing solutions to clients and do not yet see that as a part of lawyer's job. However, there are cases, particularly in large international arbitrations, where the party ultimately decides not to pursue the arbitration due to costs, despite having a legitimate claim. Therefore, if a law firm can propose innovative financial solutions together with its legal proposal, it would gain a significant competitive advantage in the Korean market. However, the clients will expect the lawyers to bear the burden of financing in such circumstances.

JAE MIN JEON, SEUNGMIN LEE AND ARIE EERNISSE: Korea used to be a jurisdiction in which the government strictly limited the number of qualified lawyers. The number of new lawyers admitted each year was limited to 1,000. Because of this, even until recently, there were only approximately 20,000 qualified lawyers in the market, which meant that, on average, there was only one Korean lawyer for every 2,500 Korean people. However, this strict control of the number of lawyers generated market distortions and did not provide society with adequate means of accessing legal services.

In 2007, Korea established a graduate law school system similar to that of the US, and the number of new lawyers admitted each year has now risen to 1,700 lawyers. The increase in the number of lawyers changed the market dynamics drastically, adding competitiveness and many other challenges to the market. One of the noteworthy trends is

a decrease in legal costs, especially for disputes. There are many young lawyers in the market who are willing to represent clients for a nominal amount but tied to a handsome success fee. This trend shows that lawyers are willing to be creative—and, to a certain extent, that they must be creative—in structuring their fee arrangements in the reformed legal market.

Faced with a public that is trying to reduce legal fees and with courts that have taken a stricter stance on types of fee arrangements and amounts of fees, lawyers in the Korean market are more likely to think outside the box and creatively structure their legal fees, while taking into consideration any accompanying risks and limitations. As such, third-party funding is definitely one of the options that practitioners will consider seriously in the coming years.

However, as mentioned above, the main business challenge for lawyers in Korea when it comes to third-party funding is that there is currently no legal framework regulating it. Therefore, there is uncertainty and ambiguity with respect to legal finance governed by Korean law. Although there are no explicit restrictions on legal finance under the current legal system, it is still unclear whether Korean courts can be expected to uphold a third-party funding agreement in the absence of express legislative or regulatory approval. Thus, it is imperative for lawyers in Korea and their clients to determine how the existing laws and regulations would apply to third-party funding and how to avoid any potential pitfalls.

What are the biggest misconceptions lawyers and their clients have about legal finance?

EUN YOUNG PARK: One of the biggest misconceptions about legal finance would be that the control over decision making will be taken away from the client/lawyer. Some even worry of losing their right/claim and the negative influence that legal financing might have on their reputation. There is also the concern regarding the risk of third-party funding as it is still not considered as “an established practice” in Korea.

JAE MIN JEON, SEUNGMIN LEE AND ARIE EERNISSE: The two most commonly discussed (and sometimes not fully understood) issues are (i) whether third-party funding is in violation of the

Attorney-at-Law Act or (ii) the Interest Limitation Act in Korea.

First, Article 34(5) of the Attorney-at-Law Act provides that non-lawyers are prohibited from sharing in any fees or other profits earned through services that may be provided only by attorneys. Therefore, unless and until third-party funding is legalized in Korea, third-party funding agreements involving any nexus to Korea should be structured carefully to ensure that they are in compliance with the relevant Korean laws. At the same time, considering the language and the legislative history of Article 34(5), it arguably cannot be interpreted as an outright ban on funding agreements.

Second, under the Interest Limitation Act and the relevant decree, interest rates must not exceed 24 percent. Any violation of these laws may result in criminal charges. However, the Korean courts take a restrictive approach when deciding whether a contract qualifies as a money lending contract (Seoul High Court Case No. 2014Na8532, dated 14 May 2015). Therefore, if the arrangement is on a non-recourse basis, it is unlikely that a third-party funding arrangement will be viewed as money lending.

Our view is that third-party funding would not violate the relevant laws if the arrangements are made carefully. However, interested parties would of course benefit from legislative and regulatory certainty in relation to third-party funding, and it would be ideal if Korean authorities enacted relevant laws to legalize and adopt third-party funding based, for example, on the Singapore or Hong Kong model.

Apart from dealing with legal technicalities, the legal industry may also face a cultural challenge to the wide-scale acceptance of legal finance in Korean society. The prestige traditionally accorded to lawyers in Korea came with the expectation that they would also serve as defenders of public interest, meaning that there was a certain culturally imposed restriction as to how and to what extent lawyers could gain profit. Despite the recent changes in the market, the public’s expectation remains the same. For third-party funding to be institutionalized, the public needs to be persuaded that the adoption of third-party funding will provide them with an option to pursue justice even when one party does not have the means to do so, instead

of letting the market be swayed by questionable lenders and forcing people without means to sell out their entitlements to bring lawsuits.

How would the growth of the legal finance market in South Korea potentially impact the use of contingency fee arrangements? Would legal finance expand the types of matters that can be taken on risk, either by the lawyer or a legal finance provider?

JAE MIN JEON, SEUNGMIN LEE AND ARIE

EERNISSE: Third-party funding may serve as a flexible financial and risk management tool to benefit a wide range of parties within the Korean market. Firms may utilize third-party funding to meet their regular overhead needs as well as other disbursements in exchange for a share of the contingency or future success fees. Thus, third-party funding is expected to reduce the cost barriers associated with commercial disputes and provide better access to justice. Although the Korean courts have imposed limitations on contingency fees in certain types of cases, we do not believe this will have a negative effect on the viability of legal finance, considering that contingency fee arrangements and third-party funding arrangements have different features.

KYONGWHA CHUNG AND BHUSHAN SATISH: Contingency fee arrangements—typically a retainer deposit plus a success fee—are legal and widely available in Korea, both for litigation and arbitration. We expect that the introduction of legal finance in Korea would have a positive impact on the use of contingency fee arrangements for arbitration matters.

The types of matters taken on risk would be expanded as legal finance is provided to clients in Korea. Given that Korean courts dispense civil justice quickly and cheaply, arbitration is viewed as a costly procedure in Korea especially to clients with little means to fund their case. However, legal finance, if introduced through explicit legislation, would definitely have an impact on expanding the matters that can be taken by lawyers, which otherwise were restricted due to limited funding.

Looking ahead to the next decade, what are your predictions for how legal finance will impact the business of law in South Korea?

EUN YOUNG PARK: We see a positive opportunity to develop the legal finance industry in Korea in the near future. It will be more so if certain policy

decisions are made to remove regulatory risks associated with third-party funding. The interest of Korean companies in third-party funding, especially for complex international arbitration cases seated outside of Korea, is increasing and lawyers who can propose innovative financing alternatives to Korean clients would gain a competitive edge. It is possible that such momentum may also carry over to the domestic legal market and help create a platform to establish a solid framework for legal finance market within Korea.

JAE MIN JEON, SEUNGMIN LEE AND ARIE

EERNISSE: Having the means to resolve a legal dispute is one key factor in promoting investment and business in a country. We believe that the adoption of a legal framework for the use of third-party funding and other legal finance tools will be essential in this regard. For Korea, the issue remains when and how such tools will become legally sanctioned and commonly accepted by users. Our view is that if users are provided with more flexible options, it will definitely promote business overall and have a positive impact on the business of law in Korea.

KYONGWHA CHUNG AND BHUSHAN SATISH:

Arbitration in Korea, as a function of the Korean economy, most of which is outward facing and international, is brimming with potential. The growth of legal finance will give a much-needed impetus to realize this potential and will play a crucial role in the development of arbitration in Korea. Legal finance and its innovations are essential in this growth and the professionalization of this “arbitration industry”. Legal finance providers are expected to offer another source of potential instructions for law firms and constitute an additional client base.

Korea could be a promising market for funders. It is, after all, home to giant conglomerates with complex business activities worldwide giving rise to disputes. Many Korean corporates are likely to find legal finance attractive, either because they cannot fund their own claims or because they prefer to use resources for other purposes.

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Eun Young Park is Co-Chair of the international arbitration & cross-border litigation practice at Kim & Chang. Mr Park is currently serving as the Vice President of LCIA Court and a member of the SIAC Court of Arbitration. He is also on the board of Korean Council of International Arbitration and is an Executive Member of the Seoul International Dispute Resolution Center.

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