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Bills Committee on Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Bill 2016

Background brief prepared by the Legislative Council Secretariat

Purpose

This paper provides background information on the Administration's proposal to amend the Arbitration Ordinance (Cap. 609) ("AO") and the Mediation Ordinance (Cap. 620) ("MO") to implement the recommendations made in the Report on Third Party Funding for Arbitration ("the Report") published by the Law Reform Commission ("LRC"). The past discussions of the Panel on Administration of Justice and Legal Services ("the Panel") on the subject are summarized and included in the paper.

Background

What is third party funding

2. According to the Report by the LRC, third party funding has been described as "*the funding of claims by commercial bodies in return for a share of the proceeds.*"¹ It involves a "*third person*" to the proceedings providing financial "*assistance or support to a party to*" the proceedings.²

3. Third party funding arrangements are usually motivated by a party's lack of financial resources to pursue its own claims in arbitration or litigation. A third party funding contract commonly provides that the third party funder will pay for the funded party's costs of arbitration or litigation proceedings in return for a

¹ Lord Justice Jackson, "Third Party Funding or Litigation Funding" (Speech delivered at the Sixth Lecture in the Civil Litigation Costs Review Implementation Programme, The Royal Courts of Justice, 2011).
<<http://associationoflitigationfunders.com/wp-content/uploads/2014/02/Sixth-Lecture-by-Lord-Justice-Jackson-in-the-Civil-Litigation-Costs-Review-.pdf>>, at para 2.1.

² *Unruh v Seeberger* (2007) 10 HKCFAR 31, at para 118 (*per* Ribeiro PJ).

percentage of the judgment or award or some other financial benefit from any proceeds recovered by the funded party from such funded proceedings. If there is no recovery from the proceedings, the third party funder will not receive any repayment or return on the funds it has advanced to the funded party.

Current position of third party funding of litigation in Hong Kong

4. Hong Kong's common law system has continued to apply the doctrines of maintenance and champerty which originated in England in medieval times with the intention of preventing unnecessary litigation proceedings being promoted or financed by powerful individuals for the sole purpose of furthering their own interests.

5. The doctrines of maintenance and champerty, developed some 700 years ago in England, have been held by the Hong Kong courts to prohibit third party funding to litigation both as a tort (civil wrong) and as a criminal offence, save in three exceptional areas: (1) in cases involving third parties with a legitimate interest in the outcome of the litigation; (2) where "access to justice considerations" apply; or (3) in a miscellaneous category including insolvency litigation.

Current position of third party funding for arbitration in Hong Kong

6. International arbitration is increasingly used to resolve investment and commercial disputes involving parties and assets from different countries and jurisdictions. Hong Kong is one of the major centres of international arbitration. It is likely that a party to an arbitration taking place in Hong Kong may wish to consider whether or not it should seek third party funding of its participation in such an arbitration if it is permitted by Hong Kong law to do so.

7. The current position as to third party funding of arbitration in Hong Kong, however, is not clear. While the Hong Kong courts do not object, in principle, to Third Party Funding for arbitration, as may be seen from the Hong Kong Court of Final Appeal decision in *Unruh v Seeberger*,³ the Court of Final Appeal has left open the question of whether or not Third Party Funding for arbitration is permitted at case.⁴

8. The uncertainty in Hong Kong law as to whether third party funding for arbitration taking place in Hong Kong is permitted, is leading to the general view that it is not permitted, potentially making Hong Kong less attractive as a place

³ *Unruh v Seeberger* (2007) 10 HKCFAR 31.

⁴ *Unruh v Seeberger* (2007) 10 HKCFAR 31, at para 123 (*per* Ribeiro PJ).

to conduct arbitration and damaging its competitiveness as an arbitration centre whether for international, Mainland Chinese or Hong Kong disputes.

LRC's study

9. Against the above background, in June 2013, the Secretary for Justice and the Chief Justice asked the LRC to establish the Third Party Funding for Arbitration Sub-committee ("the Sub-committee") to review the current position relating to third party funding for arbitration for the purposes of considering whether reform was needed, and if so, to make such recommendations for reform as appropriate.

10. On 19 October 2015, the Sub-committee released a consultation paper on Third Party Funding for Arbitration ("the Consultation Paper") with a proposal to amend the relevant legislation. In total, 73 submissions were received during the public consultation conducted by the Sub-committee from 19 October 2015 to the end of February 2016.

11. Based on the submissions received, the LRC concluded that the reform of Hong Kong law is needed to clearly state that the said common law doctrines do not prevent third party funding of arbitration and associated proceedings under the AO. The LRC considered that such reform would be in the interests of arbitration users and of the Hong Kong public and consistent with the relevant principles that the Court of Final Appeal has formulated.

12. The LRC recommended that third party funders funding arbitration should be required to comply with a Third Party Funding for Arbitration Code of Practice ("Code") issued by a body authorized under the AO. The LRC took the view that the Code should set out the standards and practices (including financial and ethical standards) with which third party funders would ordinarily be expected to comply in carrying on activities in connection with third party funding of arbitration.

13. The LRC also recommended that consideration should be given to whether to make consequential amendments to the MO to extend such non-application of the common law doctrines of maintenance and champerty (both as to civil and criminal liability) to mediation within the scope of the MO ("the MO mediation"), including whether the proposed regulatory regime for third party funding of arbitration should apply to MO mediation.

14. After the completion of its study, the LRC released the Report on Third Party Funding for Arbitration on 12 October 2016. The Report discussed the

responses received to the Consultation Paper issued by the Sub-committee and set out the analysis and final recommendations on third party funding for arbitration and related matters, including a set of draft provisions to amend the AO ("the Proposed AO Amendment").

The Government responses to the Report

15. The Government takes the view that, from the perspective of promoting Hong Kong's arbitration services, the proposed law reform is desirable, so that Hong Kong, as one of the leading centres for international legal and dispute resolution services in the Asia Pacific region, can keep up with the latest practice in international arbitration and hence enhance its competitive position.

16. The Government, having consulted the Steering Committee on Mediation, agrees with the recommendation of the LRC that consequential amendments should be made to the MO at the same time as the above proposed amendments to the AO.

17. The Government also agrees that the Code should be issued by an authorized body in accordance with the procedure to be set out in the AO and the MO. The authorized body will be required to consult relevant stakeholders on the draft Code in accordance with the procedures to be laid down in the AO and the MO respectively.

18. A draft Code was prepared by the Department of Justice for reference purpose only. This draft Code focuses on the standards and practice with which third party funders will ordinarily be expected to comply in carrying on third party funding arbitration. Relevant stakeholders and the public will also be consulted on a draft third party funding for mediation code of practice in the course of being drawn.

The Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Bill 2016 ("the Bill")

19. The Bill seeks to amend Cap. 609 and Cap. 620 to ensure that third party funding of arbitration and mediation is not prohibited by the common law doctrines of maintenance and champerty, and to provide for related measures and safeguards. The main provisions of the Bill are summarized below.

New Part 10A added to the AO

20. Clause 3 adds a new Part 10A to the AO. The new Part 10A, which is based on the draft provisions in the LRC Report, contains 6 Divisions:

- (a) Division 1 states the purposes of that Part;
- (b) Division 2 provides for the interpretation of key concepts. Amongst others, the new section 98G provides for the definition of third party funding of arbitration which is central to the new Part 10A;
- (c) Division 3 seeks to ensure that third party funding of arbitration is not prohibited by the said common law doctrines (both as to civil and criminal liability);
- (d) Division 4 seeks to facilitate the regulatory framework for third party funding of arbitration in Hong Kong;
- (e) Division 5 provides for certain measures and safeguards where an arbitration involves third party funding; and
- (f) Division 6 contains a new section 98W, which empowers the Secretary for Justice to appoint an advisory body and an authorized body for the purposes of the new Part 10A and provides that the appointments are to be made by notice published in the Gazette.

New section 7A added to the MO

21. The new section 7A to the MO extends the application of the new Part 10A of the AO to MO mediation and to funding of services provided in Hong Kong for non-Hong Kong mediation ("funding of HK services"). In particular the financial and ethical safeguards proposed above for third party funding of arbitration and associated proceedings under the AO will also be applicable to MO mediation and funding of HK services.

22. Some modifications are also made to fit the provisions of the new Part 10A of the AO into the context of the MO, including modifications to construe references to arbitration and arbitration body in the new Part 10A as references to mediation and mediator covered by the MO.

Past discussions

23. The Panel was briefed on the Consultation Paper and the Report at its meetings on 23 November 2015 and 28 November 2016 respectively. Views and concerns expressed by members, the Hong Kong Bar Association ("the Bar Association") as well as the Administration and the LRC's responses are summarized in the ensuing paragraphs.

Third party funding for arbitration in Hong Kong

24. Responding to a member's enquiry as to what extent was third party funders of litigation funding arbitration in Hong Kong, how it was done and what was the market practice, the LRC responded that whilst it could not be ruled out that third party funding for arbitration was taking place in Hong Kong, it was impossible for the Sub-committee to obtain any market data on such as funders all seemed to carry out their funding activities in a coy manner.

25. Having regard to the long time that would take the Administration to amend the AO to expressly permit third party funding for arbitration taking place in Hong Kong, a member asked whether consideration would be given to bringing a test case to the court to see if the operation of the doctrines of maintenance and champerty also applied to third party funding for arbitrations taking place in Hong Kong.

26. The LRC advised that the Sub-committee considered that the most effective way to provide for third party funding for arbitration taking place in Hong Kong under Hong Kong law was to amend the AO. Although bringing a test case to the court was one way to establish whether the doctrines of maintenance and champerty in Hong Kong also applied or did not apply to third party funding for arbitration taking place in Hong Kong, there were uncertainties as to whether the court would again leave the legal question open and whether the court ruling on exempting third party funding for arbitration taking place in Hong Kong from the doctrines of maintenance and champerty in Hong Kong could address all the legal issues involved.

27. Question was raised as to whether parties to an arbitration agreement reached in a place which permitted third party funding for arbitration, such as England, and who were funded by third party funders could be permitted to have their arbitration taking place in Hong Kong.

28. The LRC advised that that it was unclear under the current Hong Kong law whether the operation of the doctrines of maintenance and champerty in

Hong Kong also applied to third party funding for arbitration taking place in Hong Kong. Hence, the Sub-committee recommended to amend the AO to expressly provide for third party funding for arbitration taking place in Hong Kong.

29. Noting that many arbitrators were practising lawyers, a member expressed concern about conflict of interests which might arise in an arbitration if the arbitrator had previously been the counsel of a party to the arbitration. The member further enquired whether such conflict of interest was the reason why Singapore authorities had hitherto not permitted third party funding for arbitration taking place in Singapore.

30. The LRC responded that there were very strict rules governing the conduct of arbitrators for avoidance of conflict of interest. The LRC further advised that there were recent reports that Singapore authorities were reviewing its law to expressly provide for third party funding for arbitration taking place in Singapore to ensure its competitiveness as an international arbitration centre. A member considered that the Sub-committee should also take into account the concerns of Singapore authorities in its review of the current position relating to third party funding for arbitration.

Consultation with relevant stakeholders

31. At the Panel meeting on 23 November 2015, members noted that arbitrations taking place in Hong Kong generally involved commercial or contractual dispute and that the Sub-committee did not consult the views of the major chambers of commerce in Hong Kong in drawing up the Consultation Paper. In this connection, a member hoped that the Sub-committee would give due regard to the views expressed by the major chambers of commerce in Hong Kong before concluding its final recommendations.

The membership of advisory body and authorized body

32. The Bar Association in general supported the recommendations in the Report. Noting that the authorized body would be responsible for drafting the Code, the Bar Association suggested that its membership or the standing consultation committee to the authorized body should include practitioners from the third party funded arbitration field or those with such experience. As regards the advisory body, since it would be responsible to review the development of the new "industry" and subsequently the improvements of the regulation and supervision, the Bar Association believed that its membership, or at least a

sub-committee of the advisory body, should include practitioners from the third party funded arbitration field or those with such experience as well.

Definition of third party funding of arbitration

33. Whilst agreeing the recommendation in the Report that the definition of "third party funding of arbitration" had excluded lawyers and persons providing legal services from its scope, a member asked about the regulation with regard to foreign lawyers (but who were not registered foreign lawyers) who participated in Hong Kong based arbitration and if they did have funding arrangement with their clients in Hong Kong.

34. According to the LRC, the scope of the proposal made under the Report was restricted to arbitration to which the AO applied, to proceedings before Emergency Arbitrators as defined under the AO, and to mediation and court proceedings under the AO ("Arbitration") taking place and/or work being done in Hong Kong. Foreign lawyers, despite not being registered foreign lawyers, could engage in cases funded by third party funders in Hong Kong. The LRC supplemented that the focus of the proposed reform would be the regulation of the third party funders under the current regime of arbitration.

Third party funding for arbitration code of practice

35. Noting that the third party funder should have a duty to provide further information or clarification of any matter as requested by the advisory body with regard to the annual return, a member asked about the consequence of failure to comply with such duty by the third party funder. The Administration advised that a "light touch" approach to the regulation of third party funding of Arbitration should be adopted at the moment. The Administration added that whether the non-compliance with the Code could be a factor to be taken into account by the courts in subsequent proceedings (particularly in proceedings where the third party funders would like to enforce any of their rights under the third party funding agreement against the funded parties) would be, from the commercial point of view and the perspective of the third party funders, one of the most important considerations and thus that would be an important aspect to be borne in mind when fine-tuning and finalizing the draft Code.

36. The member was also concerned that the advisory body had no power, under the law, to request for information (as set out under paragraph 6.68(10) of the Report) from the third party funders nor could the advisory body do anything if the third party funders refused to provide the information requested from them. The LRC clarified that the obligation of the third party funders to provide

information as required by the advisory body was stated in the statute (please refer to section 98M(1)(j) of the draft provisions to amend the AO on page 124 of the Report in English). If the third party funder failed to comply with the requirements, the advisory body was proposed to be taking the role of monitoring, supervising and recommending, which was, in a way, a "carrot and stick" approach. The Administration added that such approach would be similar to the Consumer Council's way of handling the situation and that the Administration would resort to both legal and extra-legal means to ensure compliance by the third party funders.

37. A member expressed concern that a third party funder would have certain extent of control over the arbitration through the funding agreement and probably have the right to make the final decision which might turn out not to be in the best interest of the funded party. The Administration advised that as stated in the draft Code, the control by third party funder, whether direct or indirect, would not be allowed since it would be contrary to the initial rationale of allowing third party funding. The LRC supplemented that it did look at the issue of "Control" and had made reference to what had been done in other common law jurisdictions, for example, in the United Kingdom and Australia. The recommended approach was more on the English line, that was "to keep control in the party".

38. In reply to a member's enquiry whether the Administration would keep a "list of satisfactory third party funders" and publish for public information, the Administration responded that it was a good suggestion and would keep an open mind on this matter.

Other concerns

39. In response to a member's enquiry as to whether third party funding was equivalent to conditional fee arrangement and whether there would be any cap on the amount of third party funding arrangement, the LRC replied that the arrangement of conditional fees and contingency fees was not permitted in Hong Kong and the LRC's proposals did not seek to change the current situation. Under the current situation, the lawyers would still be paid (regardless whether the cases were successful or not) and that the share of the proceeds of the successful cases would only be paid to funded parties and third party funders, but not to the lawyers. As regards whether there would be any cap on the amount of third party funding arrangement, the Administration replied in the negative as there was no policy justification to impose such a cap. The Administration further explained, by way of an analogy, that the rule of maintenance and

champerty did not apply in a situation where a liquidator was allowed to conduct litigation through third party funding and in the same vein there was no cap.

40. On the question as to whether the security for costs arrangement was adequate, the LRC responded that the reason for not recommending to give the arbitral tribunal ("Tribunal") the additional power to order security for costs against a third party funder was that under the AO the Tribunal already had the power to order security for costs against the funded party. The LRC had also recommended that the funded party must disclose the existence of the funding at the beginning of a proceeding so that the other parties would be aware of the funding arrangement and it would be up to them to decide whether to apply for security for costs.

41. A member enquired whether the after the event ("ATE") insurance was permitted under Hong Kong law; and if not, whether reference would be made to the practice adopted in the United Kingdom. The LRC pointed out that such insurance was not being done in Hong Kong and that the relevant law in the United Kingdom had been amended not so long ago to provide that the costs of ATE insurance could not be recovered in arbitration proceedings. The LRC believed that the issue would be looked at further in the future.

42. Question was raised as to whether the LRC's proposals would apply to arbitration involving Government as a party to the funding arrangement, for instance, under the pilot scheme of arbitration for resolving land premium disputes launched by the Government, and whether the land acquirer, normally the developer, could be a third party funder under this kind of land premium arbitration in the given example. The Administration responded that the LRC's proposal did not distinguish the type of arbitration to which the proposed amendment would apply. In the example given by the member, the developer involved in the said pilot scheme (after the passing of the legislative amendment) could seek to obtain third party funding in the land premium arbitration pilot scheme cases if it so wished.

43. Regarding a member's enquiry on the reasons why the LRC considered that it was premature at this stage to amend the AO to provide a Tribunal the power to award costs against a third party funder in appropriate circumstances, the LRC advised that since arbitration was a consensual and contractual arrangement between parties that privity of contract was very important. Hong Kong had a very detailed framework to make arbitration work and to allow for the recognition and enforcement of arbitration awards in Hong Kong and overseas. Such framework operated on the premise that the parties to the arbitration had entered into an agreement to arbitrate, while third party funders

were not parties to the arbitration agreement, i.e. third party funders did not fall within the scope of the current framework. In considering whether to amend the AO to give power to a Tribunal to award costs against a third party funder, careful consideration had to be given to due process to the third party funders, who were the subjects of the cost application, but who were not parties to the arbitration, and so that the integrity and enforcement of the arbitration process would be preserved. The LRC added that the recommendation of not providing such power to a Tribunal was in line with international practice.

Latest position

44. The Administration introduced the Bill into the Legislative Council on 11 January 2017. The House Committee decided on 13 January 2017 to set up a Bills Committee to scrutinize the Bill.

Relevant papers

45. A list of relevant papers is in the **Appendix**.

Council Business Division 4
Legislative Council Secretariat
13 February 2017

Appendix

List of relevant papers

Date	Meeting	Paper
23 November 2015	Panel on Administration of Justice and Legal Services	Paper on " Executive Summary of the Law Reform Commission's Consultation Paper on Third Party Funding for Arbitration " provided by the Law Reform Commission LC Paper No. CB(4)226/15-16(04) Minutes of meeting LC Paper No. CB(4)422/15-16
28 November 2016		Executive Summary of the Law Reform Commission's Report on Third Party Funding for Arbitration LC Paper No. CB(4)150/16-17(05) Administration's paper on "Response to the Law Reform Commission of Hong Kong Report on Third Party Funding for Arbitration and Proposed Amendments to the Arbitration Ordinance (Cap. 609) and the Mediation Ordinance (Cap. 620)" LC Paper No. CB(4)150/16-17(06)