

THE LAW REFORM COMMISSION OF HONG KONG

REPORT ON

THIRD PARTY FUNDING FOR ARBITRATION

EXECUTIVE SUMMARY

Background

1. In June 2013, the Third Party Funding for Arbitration Sub-committee of the Law Reform Commission of Hong Kong was appointed to review this subject. The terms of reference are:

"To review the current position relating to Third Party Funding for arbitration for the purposes of considering whether reform is needed, and if so, to make such recommendations for reform as appropriate."

2. The Consultation Paper prepared by the Sub-committee, entitled *Third Party Funding for Arbitration*, was published on 19 October 2015.¹

3. The Sub-committee received 73 responses from members of the public during the consultation following the publication of the Consultation Paper in October 2015, including from Government bureaux and departments, accounting firms, arbitral institutions, arbitrators, barristers, chambers of commerce, consumer and public interest groups, the financial sector, Third Party Funders, insurers and insurers' associations, law firms, insolvency practitioners, professional bodies and academics (for the purposes of this Executive Summary defined as the "**Respondents**"). In addition, a supplementary submission was received from an arbitral institution expanding upon its submission as to the contents of a draft code of conduct.

4. Set out below is a summary of the responses received from the Respondents in relation to each of the Sub-committee's four recommendations contained in the Consultation Paper (referred to in the Report as the "**Preliminary Recommendations**"):

- (1) **Preliminary Recommendation 1** (that the law should be amended to allow Third Party Funding for arbitration) was supported by an overwhelming majority of the Respondents;²

¹ The Law Reform Commission of Hong Kong, Third Party Funding for Arbitration Sub-committee Consultation Paper, *Third Party Funding for Arbitration* (2015).

² 97% of those who commented on Preliminary Recommendation 1 supported it.

- (2) **Preliminary Recommendation 2** (that clear ethical and financial standards for Third Party Funders providing Third Party Funding to parties to arbitrations should be developed) was supported by an overwhelming majority of the Respondents³;
- (3) **Preliminary Recommendation 3** ((1) Recommendation for regulation of Third Party Funding and (2) a request for comments as to the form and nature of such regulation) Regulation of Third Party Funding was supported by the majority of Respondents⁴. However, the Respondents were fairly evenly divided between those who supported statutory regulation and those who supported self-regulation (at least on an initial basis). Respondents generally agreed with the potential areas for regulation identified in the Consultation Paper, namely:
- a) capital adequacy;
 - b) conflicts of interest;
 - c) confidentiality and privilege;
 - d) extent of extra-territorial application (as regards Hong Kong work on arbitration taking place outside Hong Kong);
 - e) control of the arbitration by the Third Party Funder;
 - f) disclosure of Third Party Funding to the Tribunal and other party/parties to the arbitration;
 - g) grounds for termination of Third Party Funding; and
 - h) a complaints procedure and enforcement.

A number of Respondents gave detailed comments as to the areas that should be regulated.

- (4) **Preliminary Recommendation 4** was supported by a substantial majority of the Respondents, who considered that the Arbitration Ordinance should be amended to provide the power to a Tribunal as follows:
- (a) **Preliminary Recommendation 4(a):** to make Adverse Costs Orders against a Third Party Funder in Hong Kong arbitrations; and

³ 89% of those who commented on Preliminary Recommendation 2 supported it.

⁴ 100% of those who commented on Preliminary Recommendation 3(1) supported it, with 45% favouring statutory regulation, 43% favouring self-regulation and 12% favouring both, with a period of self-regulation to be followed by statutory regulation.

- (b) ***Preliminary Recommendation 4(c)***: to make a Security for Costs order against a Third Party Funder.

5. Few Respondents commented on how such a liability for Adverse Costs Orders or Security for Costs could be imposed on Third Party Funders (who are not a party to the relevant arbitration agreement) as a matter of Hong Kong law, and for the purposes of recognition and enforcement under the New York Convention (the subject of Preliminary Recommendation 4(b) and (d) respectively).

6. While many Respondents addressed the four Preliminary Recommendations and issues relevant to them, some addressed other issues not specifically raised by the Sub-committee, including whether litigation funding should be permitted and whether conditional fees and contingency fees should be permitted.⁵

7. The Report discusses the responses received to the Consultation Paper and sets out the Law Reform Commission's analysis and final recommendations on Third Party Funding for Arbitration and related matters, including a set of draft provisions to amend the Arbitration Ordinance (the "Proposed AO Amendment") attached at Annex 1 to the Report.

Our Final Recommendations

8. The Law Reform Commission has concluded that the reform of Hong Kong law is needed to make it clear that Third Party Funding of Arbitration and associated proceedings under the Arbitration Ordinance is permitted under Hong Kong law provided that appropriate financial and ethical safeguards are complied with. We consider that such reform would be in the interests of the Arbitration users and the Hong Kong public and consistent with the relevant principles that the Court of Final Appeal has formulated. We also consider that a party with a good case in law should not be deprived of the financial support it needs to pursue that case by Arbitration and associated proceedings under the Arbitration Ordinance.⁶

9. We consider that compliance with the ethical and financial safeguards set out in the Report by Third Party Funders of Arbitration with the monitoring, supervision and review framework that we propose, will protect against potential abuse.⁷

⁵ These topics are addressed in the report only where they are relevant to Third Party Funding for arbitration, court proceedings and mediation under the Arbitration Ordinance.

⁶ See para 2.6 of the Report.

⁷ See para 2.6 of the Report.

10. We also consider that these reforms are necessary to enhance Hong Kong's competitive position as an international arbitration centre and to avoid Hong Kong being overtaken by its competitors.⁸

11. For the reasons set out in the Report, the Law Reform Commission makes the following recommendations.

Final Recommendation 1

We recommend that:

- (1) The Arbitration Ordinance should be amended to state that the common law doctrines of maintenance and champerty (both as to civil and criminal liability) do not apply to arbitration to which the Arbitration Ordinance applies, to proceedings before Emergency Arbitrators as defined under the Arbitration Ordinance, and to mediation and court proceedings under the Arbitration Ordinance ("Arbitration")⁹ (see sections 98H to 98K of the Proposed AO Amendment). The non-application of these doctrines in relation to Arbitration does not affect any rule of law as to the cases in which a contract is to be treated as contrary to public policy or otherwise illegal (see section 98J of the Proposed AO Amendment).¹⁰
- (2) Consideration should be given to whether to make consequential amendments at the same time to the Mediation Ordinance 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 Mediation Ordinance (the "MO Mediation"), including whether the proposed regulatory regime for Third Party Funding of Arbitration should apply to MO Mediation.¹¹
- (3) The Proposed AO Amendment should apply to Funding Agreements for Third Party Funding of Arbitration made on or after the coming into effect of the Proposed AO Amendment (see section 98G(4) read with sections 98H and 98I of the Proposed AO Amendment).¹²
- (4) If the place of Arbitration is outside Hong Kong, then, despite section 5 of the Arbitration Ordinance, the Proposed AO Amendment should apply in relation to funding of services provided in Hong Kong in relation to the Arbitration, as if the

⁸ See para 2.6 of the Report.

⁹ See paras 2.8(1), 3.26 to 3.44 and 3.48(1) of the Report.

¹⁰ See paras 2.8(1), 3.26 to 3.32 and 3.48(1) of the Report.

¹¹ See paras 2.8(2), 3.38, 3.39 and 3.48(2) of the Report.

¹² See paras 2.8(3), 3.45 and 3.48(3) of the Report.

place of Arbitration were in Hong Kong (see section 98K of the Proposed AO Amendment).¹³

- (5) The definition of "Third Party Funding" in the Proposed AO Amendment should not include any funding provided either directly or indirectly by a person practising law or providing legal services (whether in Hong Kong or elsewhere) (see section 98G(2) of the Proposed AO Amendment).¹⁴
- (6) The professional conduct rules applicable to barristers, solicitors, and foreign registered lawyers should be amended to expressly state the terms and conditions upon which such lawyers may represent parties in Arbitrations and related court proceedings funded by Third Party Funder.¹⁵
- (7) The Arbitration Ordinance should be amended to allow the communication of information relating to arbitral proceedings and awards to a Third Party Funder or its professional adviser (see section 98P of the Proposed AO Amendment).¹⁶
- (8) If a Funding Agreement is made, the Funded Party must give written notice of the fact that a Funding Agreement has been made and the identity of the Third Party Funder. The notice must be given, for a Funding Agreement made on or before the commencement of the Arbitration, on the commencement of the Arbitration; or, for a Funding Agreement made after the commencement of the Arbitration, within 15 days after the Funding Agreement is made. The notice must be given to each other party to the Arbitration and the Arbitration Body.¹⁷ However, if there is no Arbitration Body for the Arbitration at the time specified for giving the notice, the notice must instead be given to the Arbitration Body immediately after there is an Arbitration Body for the Arbitration (see section 98Q of the Proposed AO Amendment). There should also be disclosure about the end of third party funding (see section 98R of the Proposed AO Amendment).¹⁸

¹³ See paras 2.8(4), 3.33, 3.34 and 3.48(4) of the Report.

¹⁴ See paras 2.8(5), 3.35, 3.36 and 3.48(5) of the Report.

¹⁵ See paras 2.8(6), 3.37 and 3.48(6) of the Report.

¹⁶ See paras 2.8(7), 3.46 and 3.48(7) of the Report. The Third Party Funder or its professional adviser will be bound by confidentiality: see section 98P of the Proposed AO Amendment, at page 125 of the Report.

¹⁷ Arbitration Body is defined in section 98F of the Proposed AO Amendment: see page 121 of the Report.

¹⁸ See paras 2.8(8), 3.47 and 3.48(8) of the Report.

Final Recommendation 2

We recommend that clear standards (including ethical and financial standards) for Third Party Funders providing Third Party Funding to parties to Arbitration should be developed.¹⁹

Final Recommendation 3

We recommend that:

- (1) At this first stage of Third Party Funding of Arbitration in Hong Kong, a "*light touch*" approach to its regulation should be adopted *for an initial period of 3 years*, in line with international practice and in accordance with Hong Kong's needs and regulatory culture.²⁰
- (2) The "*light touch approach*" to regulating Third Party Funders funding Arbitration should apply irrespective of whether they have a place of business inside or outside Hong Kong.²¹
- (3) Third Party Funders funding Arbitration should be required to comply with a *Third Party Funding for Arbitration Code of Practice* (defined in the Report as the "Code") issued by a body authorized under the Arbitration Ordinance (defined in the Report as the "Authorized Body"). The Code should set out the standards and practices (including financial and ethical standards) with which Third Party Funders will ordinarily be expected to comply in carrying on activities in connection with Third Party Funding of Arbitration (see sections 98L and 98M of the Proposed AO Amendment).²²
- (4) Before issuing the Code (and before making any subsequent amendment to the Code), the Authorized Body should consult the public about the proposed Code (or amendment) (see section 98N of the Proposed AO Amendment).²³
- (5) A failure to comply with a provision of the Code should not, of itself, render a person liable to any judicial or other proceedings. However the Code should be admissible in evidence in proceedings before any court or Tribunal; and any compliance or failure to comply with a provision of the Code may be taken into account by any court or Tribunal if it is relevant to a question

¹⁹ See paras 2.9, 4.13 to 4.19 of the Report.

²⁰ See paras 2.10(1), 5.13 to 5.26 and 5.29(1) of the Report.

²¹ See paras 2.10(2), 5.19 to 5.22 and 5.29(2) of the Report.

²² See paras 2.10(3), 5.20 to 5.24 and 5.29(3) of the Report.

²³ See paras 2.10(4), 5.21 and 5.29(4) of the Report. In preparing the Code, the Authorized Body may consult persons with knowledge or experience of arbitration or third party funding of arbitration: see section 98N(2) of the Proposed AO Amendment, at page 124 of the Report.

being decided by that court or Tribunal (see section 98O of the Proposed AO Amendment).²⁴

- (6) A failure to comply with a provision of the Proposed AO Amendment should not, of itself, render a person liable to any judicial or other proceedings. However, any compliance or failure to comply with a provision of the Proposed AO Amendment may be taken into account by any court or Tribunal if it is relevant to a question being decided by that court or Tribunal (see section 98S of the Proposed AO Amendment).²⁵
- (7) The Advisory Committee on the Promotion of Arbitration (established by the Department of Justice in 2014, and chaired by the Secretary for Justice), should be nominated by the Secretary for Justice to be the Advisory Body to monitor the conduct of Third Party Funding for Arbitration following the coming into effect of the Proposed AO Amendment in regard to Arbitration (as defined in the Proposed AO Amendment) and the implementation of the Code, and to liaise with stakeholders. We suggest that the Advisory Body (or a sub-committee that it establishes to monitor Third Party Funding for Arbitration) should arrange to meet at least twice a year with representatives of primary stakeholders or interested parties in third party funding to discuss the implementation and operation of the Code and any matters arising.²⁶
- (8) After the conclusion of the first three years of operation of the Code, the Advisory Body should issue a report reviewing its operation and make recommendations as to the updating of the ethical and financial standards set out in it. At this time the Advisory Body should also make recommendations on whether a statutory or other form of body is needed, how it could be set up and as to the criteria for selecting members of such a body. In the meantime, the Advisory Body could at the end of each year review whether or not to speed up the process for regulation by an independent statutory or other form of body. The report should also deal with the effectiveness of the Code and make recommendations as to the way forward.²⁷
- (9) The Code should include provisions as set out below, and Third Party Funders should be required to include these terms in any third party funding agreement:

²⁴ See paras 2.10(5), 5.23 and 5.29(5) of the Report.

²⁵ See paras 2.10(6), paras 5.24 and 5.29(6) of the Report.

²⁶ See paras 2.10(7), 5.25 and 5.29(7) of the Report.

²⁷ See paras 2.10(8), 5.26 and 5.29(8) of the Report.

- (a) A Third Party Funder shall accept responsibility for compliance with the Code on its own behalf and by its subsidiary or an associated entity.
- (b) The promotional literature of a Third Party Funder in connection with Third Party Funding of Arbitration must be clear and not misleading.
- (c) As to the Funding Agreement, the Third Party Funder must:
 - (i) take reasonable steps to ensure that the Funded Party shall have received independent legal advice on the terms of the Funding Agreement prior to its execution, which obligation shall be satisfied if the Funded Party confirms in writing to the Third Party Funder that the Funded Party has taken legal advice from the solicitor or barrister instructed in the dispute;
 - (ii) provide a Hong Kong address for service in the Funding Agreement;
 - (iii) set out and explain clearly in the Funding Agreement the key features, risks and terms of the Funding Agreement including, without limitation, as to the matters set out in section 98M(1) of the Proposed AO Amendment, including as to:
 1. capital adequacy requirements;
 2. conflicts of interest;
 3. confidentiality and privilege;
 4. control;
 5. disclosure;
 6. liability for adverse costs;
 7. grounds for termination; and
 8. complaints procedure.²⁸

- (10) The following measures should be implemented to facilitate the monitoring of Third Party Funding of Arbitration by the Advisory Body:²⁹

²⁸ See paras 2.10(9) and 6.60 to 6.68 of the Report.

²⁹ See discussion at paras 6.60 to 6.67 and 6.68(10) of the Report.

- (a) A Third Party Funder must submit an annual return to the Advisory Body of any (a) complaints received, and (b) findings that the Third Party Funder has failed to comply with the Code or any of the provisions of the Proposed AO Amendment.
- (b) A Third Party Funder must provide to the Advisory Body any other information the Advisory Body reasonably requires.
- (c) A Third Party Funder must provide to the Funded Party the name and contact details of the Advisory Body.³⁰

Final Recommendation 4

We recommend that:

- (1) While we consider that, in principle, a Tribunal should be given the power under the Arbitration Ordinance to award Costs against a Third Party Funder, in appropriate circumstances, after according it due process, following any application for such Costs, we consider that it is premature at this stage to amend the Arbitration Ordinance to provide for this power. The Arbitration Ordinance (based on the UNICTRAL Model Law) applies only to parties to an arbitration agreement (as set out in its section 5(1)). We consider that further careful consideration of this issue is warranted bearing in mind the need to preserve the integrity of Hong Kong's regime for Arbitration, to provide due process to a third party, including a Third Party Funder, where an application for an Adverse Costs Order against it has been made, and to provide for equal treatment, fairness and efficiency for all involved.³¹
- (2) Further consideration should be given by the Advisory Body in the initial three year period following implementation of the AO Proposed Amendment as to providing for the power of a Tribunal to award Costs against a third party,³² including a Third Party Funder, in appropriate circumstances, including:
 - (a) considering whether this should be achieved by an amendment of the Arbitration Ordinance to empower a

³⁰ See paras 2.10(10), 6.60 to 6.67 and 6.68(10) of the Report.

³¹ See paras 2.11(1), 7.15 to 7.20, 7.29, 7.30 and 7.31(1) of the Report.

³² See paras 2.11(2), 7.15 to 7.20, 7.29, 7.30 and 7.31(2) of the Report. We note that this topic is the subject of review internationally, for example, by the Queen Mary International Council for Commercial Arbitration (ICCA) Taskforce on Third Party Funding in International Arbitration and the International Bar Association (IBA). The Advisory Body will have the benefit of being able to consider their final reports on this topic.

Tribunal to make Costs orders against third parties, including Third Party Funders, without joinder of such a third party to the arbitration (albeit for the sole purposes of the Costs application);

- (b) the formulation of the provisions for the third party's right to be heard, to equal treatment and to due process;
 - (c) the rules of procedure to be applied;
 - (d) the consequences of non-participation by a third party in any such Costs application following due notice and a reasonable opportunity to participate; and
 - (e) the form of any Adverse Costs Order against a third party that a Tribunal may make, including whether it may form part of a final award.³³
- (3) We consider that there is no need to give a Tribunal the power to order Security for Costs against a Third Party Funder, as the powers of a Tribunal under the Arbitration Ordinance to order a party to give Security for Costs afford adequate protection.³⁴

Secretariat
Law Reform Commission of Hong Kong
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³³ See para 2.11(2), 7.29, 7.30 and 7.31(2) of the Report.

³⁴ See para 2.11(3) and 8.10 to 8.14 of the Report.