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Panel on Administration of Justice and Legal Services

**Background brief prepared by the Legislative Council Secretariat
for the meeting on 28 November 2016**

**Law Reform Commission's
Report on Third Party Funding for Arbitration**

Purpose

This paper gives an account of the past discussions of the Panel on Administration of Justice and Legal Services ("the Panel") on the Law Reform Commission ("LRC")'s Consultation Paper on Third Party Funding for Arbitration ("the Consultation Paper").

Background

What is Third Party Funding

2. 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 percentage of the judgment or award or some other financial benefit from any

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).

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 have been held by the Hong Kong courts to prohibit third party funding to litigation both as 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 Court of Final Appeal has observed that the scope of what constitutes maintenance and champerty in Hong Kong has been narrowed over the years reflecting the changed public policy considerations to allow recognised exceptions in litigation (with the leave of the court) where third party funding of litigation will be permitted. However, the current position as to third party funding of arbitration in Hong Kong is not clear.

8. It is undecided in Hong Kong whether or not the application of the doctrines of maintenance and champerty prohibit third party funding for arbitration. In *Unruh v Seeberger*, the Court of Final Appeal upheld the validity of a third party funding agreement for an arbitration conducted in a foreign jurisdiction. The Court expressly left open the question of whether the doctrines of maintenance and champerty applied to third party funding agreements

concerning arbitrations taking place in Hong Kong, as the issue did not arise in that case³.

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

Scope of the Third Party Funding for Arbitration Sub-committee's review

10. 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.

11. The Sub-committee has focused in its review on the issues raised by third party funders of commercial, commodities, contractual, construction, financial, investment, trade and similar disputes. Litigation associated with arbitration, mediation and other alternative forms of dispute resolution, such as adjudication, are outside the scope of the review.

The Consultation Paper

12. On 19 October 2015, the Sub-committee released a consultation paper to seek the public's view and comments on whether reform was needed of the current position relating to third party funding for arbitration in Hong Kong and, if so, what kind of reform was appropriate. The Sub-committee's recommendations were:

- (a) the Arbitration Ordinance (Cap. 609) ("AO") should be amended to expressly provide that third party funding for arbitration taking place in Hong Kong was permitted under Hong Kong law;
- (b) clear ethical and financial standards for third party funders providing third party funding to parties to arbitrations taking place in Hong Kong should be developed;
- (c) submissions should be invited as to:

³ *Unruh v Seeberger* (2007) 10 HKCFAR 31, at para 123 (*per* Ribeiro PJ).

- (i) whether the development and supervision of the applicable ethical and financial standards should be conducted by a statutory or governmental body (whether existing or to be established, and if so, what type of body); or a self-regulatory body (whether for a trial period or permanently and how any ethical and financial standards should be enforced); and
 - (ii) how the ethical or financial standards should address relevant ethical and financial matters such as capital adequacy, conflicts of interest, confidentiality and privilege, extent of extra-territorial application, control of the arbitration by third party funder, disclosure of third party funding to a tribunal and other party/parties to the arbitration, grounds for termination of the third party funding, and complaints and enforcement procedures under the third party funding agreement; and
- (d) submissions should also be invited as to:
- (i) whether or not a third party funder should be directly liable for adverse costs orders in a matter it had funded;
 - (ii) if the answer to sub-paragraph (d)(i) was yes, how such liability could be imposed as a matter of Hong Kong law, and for the purposes of recognition and enforcement under the Convention for Recognition and Enforcement of Foreign Arbitral Awards 1958;
 - (iii) whether there was a need to amend the AO to provide for the tribunal's power to order third party funders to provide security for costs; and
 - (iv) if the answer to sub-paragraph (d)(iii) was yes, the basis for such power as a matter of Hong Kong law, and for the purposes of recognition and enforcement under the Convention for Recognition and Enforcement of Foreign Arbitral Awards 1958.

13. The consultation period was originally set to end on 18 January 2016. Due to a number of requests to extend this period to allow adequate time to fully consider the Sub-committee's proposals, the deadline for submission of responses was extended to 1 February 2016.

Past discussions

14. The Panel was briefed on the Consultation Paper at its meeting on 23 November 2015. Views and concerns expressed by members and the LRC's responses are summarized in the ensuing paragraphs.

15. 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.

16. 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.

17. 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. The LRC supplemented that 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.

18. A member asked 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.

19. 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.

20. Noting 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, 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.

21. Question was raised as to why arbitration was rarely used by individuals to settle consumer disputes, employment disputes and disputes relating to medical incidents. The LRC explained that whether a dispute could be settled through arbitration depended on the existence of an arbitration agreement entered into between the parties involved. In the majority of cases involving consumer disputes, employment disputes and disputes relating to medical incidents, an arbitration agreement did not exist and the parties had no alternative but to bring the case to court if they could not settle the disputes amongst themselves.

22. 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 had hitherto not permitted third party funding for arbitration taking place in Singapore.

23. 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 was 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 in its review of the current position relating to third party funding for arbitration.

Latest position

24. On 12 October 2016, the LRC released a report on Third Party Funding for Arbitration ("the Report") discussing the responses received to the Consultation Paper and setting 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.

25. The LRC will brief the Panel on the Report at the Panel meeting on 28 November 2016. The Administration will also brief the Panel on its proposed response to the LRC recommendations and related matters.

Relevant papers

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

Council Business Division 4
Legislative Council Secretariat
22 November 2016

**Law Reform Commission's
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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

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