

LEGISLATIVE COUNCIL BRIEF

**Commencement of Section 3 of
Arbitration and Mediation Legislation (Third Party Funding)
(Amendment) Ordinance 2017**

INTRODUCTION

The Secretary for Justice has on 7 December 2018 gazetted the notice at **Annex A** appointing 1 February 2019 as the date on which Section 3 of the Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Ordinance 2017 (“Amendment Ordinance”), in so far as it governs the application of Divisions 3 and 5 of the new Part 10A in relation to an arbitration within the meaning of that Part only of the Arbitration Ordinance (“New Arbitration Ordinance Provisions”), shall come into operation.

BACKGROUND

2. As one of the major centres of international arbitration and one of the top most globally preferred seats of arbitration, clarifying the uncertainty as to whether the doctrines of maintenance and champerty apply to third party funding of arbitrations can enable Hong Kong to stay abreast of latest international developments.

3. In light of the above, the Amendment Ordinance was enacted on 14 June 2017 to clarify that third party funding of arbitration, mediation and related proceedings is permitted under Hong Kong law by amending the Arbitration Ordinance (Cap. 609) and the Mediation Ordinance (Cap. 620).

The proposed amendments were based on the recommendations made in the Report on Third Party Funding for Arbitration published by the Law Reform Commission of Hong Kong in October 2016 and the views of the Steering Committee on Mediation.

4. The Amendment Ordinance came into operation upon gazettal on 23 June 2017, except for section 3 in so far as it relates to the New Arbitration Ordinance Provisions, and section 4 in so far as it relates to the new section 7A(c) and (d) of the Mediation Ordinance (“New Mediation Ordinance Provisions”).

5. Pursuant to section 98X(2) of the Arbitration Ordinance, the Secretary for Justice was appointed on 18 May 2018 as the authorized body to issue a code of practice anticipated under section 98P of the Arbitration Ordinance.

6. Pursuant to section 98X(1) of the Arbitration Ordinance, an advisory body is to be appointed by the Secretary for Justice to monitor and review the operation of the provisions on third party funding of arbitration and mediation. On 24 August 2018, the Secretary for Justice appointed Mr Anthony Chow, Mr Robert Y H Pang, SC, and Mr Victor Dawes, SC as members of the advisory body to serve a term expiring on 23 August 2021. It is expected that the advisory body will issue a report reviewing the implementation of the code of practice after three years and make recommendations on the way forward.

7. In accordance with section 98R of the Arbitration Ordinance, the Department of Justice (“DoJ”) launched a public consultation (“Consultation”) on a draft Code of Practice for Third Party Funding of Arbitration and Mediation (“Draft Code”) on 30 August 2018. The consultation period ended on 30 October 2018.

8. A total of 15 responses on the Draft Code were received from professional bodies, arbitral, mediation and dispute resolution institutions,

academics, practitioners and dispute resolution funders, making various suggestions over the Draft Code.

9. After due consideration of the comments received as a result of the Consultation, the Secretary for Justice, as the authorized body, has decided to issue the Code of Practice for Third Party Funding of Arbitration (“Code”)¹ at **Annex B** and to bring the New Arbitration Ordinance Provisions into commencement.

10. While the commencement of the New Mediation Ordinance Provisions will be deferred to a future date following further deliberation on the way forward at the Steering Committee on Mediation, the DoJ will continue to engage the mediation community and relevant shareholders on certain issues concerning third party funding of mediation with a view to addressing them in order that the New Mediation Ordinance Provisions may be brought into operation as soon as practicable with the necessary code of practice to complement it.

LEGISLATIVE TIMETABLE

11. The legislative timetable is as follows –

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| Publication of the commencement notice in the Gazette | 7 December 2018 |
| Tabling of the commencement notice at LegCo | 12 December 2018 |
| Commencement | 1 February 2019 |

¹ The Code is not subsidiary legislation and is not required to be tabled before the Legislative Council for vetting or approval.

IMPLICATIONS

12. Upon commencement of the New Arbitration Ordinance Provisions, there will be greater certainty that third party funding of arbitration in Hong Kong is not prohibited by the common law doctrines of maintenance and champerty.

13. The issue of the Code will help set the practices and standards with which third party funders are ordinarily expected to comply in carrying on activities in connection with third party funding of arbitration. The introduction of a regulatory framework for third party funding of arbitration in Hong Kong, including matters regarding funding agreements, internal procedures of third party funders and measures to facilitate monitoring by an advisory body, will enhance protection of funded parties.

14. The New Arbitration Ordinance Provisions and the Code are in conformity with the Basic Law, including the provisions concerning human rights. They will not affect the binding effect of the Arbitration Ordinance. They do not have any economic, environmental, sustainability, civil service, gender or productivity implications, and it does not have any significant family implications.

15. The New Arbitration Ordinance Provisions and the Code might have financial implications. By clarifying the legal position on permissibility of third party funding of arbitration in Hong Kong, it is expected that more parties will be attracted to resolving their disputes by arbitration in Hong Kong, thereby possibly reducing the Judiciary's workload and expenses. However, we consider that it is not possible to quantify with certainty the extent of impact, if any, on reduction of the litigation costs and Government's expenditure at this stage.

PUBLICITY

16. We will publish the commencement notice and the Code in the Gazette. A press release will be issued. A spokesperson will be available for media enquiries.

ENQUIRIES

17. Enquiries on the Code may be directed to Mr. LEE Tin-yan, Senior Assistant Solicitor General (Arbitration), at tel. 3918 4038.

Department of Justice

December 2018

**Arbitration and Mediation Legislation (Third Party
Funding) (Amendment) Ordinance 2017
(Commencement) Notice 2018**

Under section 1(3) of the Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Ordinance 2017 (6 of 2017), I appoint 1 February 2019 as the day on which section 3 (in so far as it relates to the application of Divisions 3 and 5 of the new Part 10A in relation to an arbitration within the meaning of that Part only) of the Ordinance comes into operation.

Secretary for Justice

2018

**Code of Practice for
Third Party Funding of Arbitration**

Preamble

The authorized body is empowered under Part 10A of the Arbitration Ordinance (Cap. 609) to issue a code of practice setting out the practices and standards with which third party funders of arbitration (including emergency arbitrator proceedings, mediation and court proceedings) under Cap. 609, are ordinarily expected to comply in carrying on activities in connection with third party funding of arbitration in Hong Kong. The code is now issued and named the Code of Practice for Third Party Funding of Arbitration (“Code”).

Relationship with the Arbitration Ordinance

This Code should be read in conjunction with Cap. 609, which Ordinance shall prevail in the event of uncertainty or inconsistency with this Code. The terms used in this Code, where they are defined in Cap. 609 (including for the purposes of Part 10A of Cap. 609), are intended to carry the same meanings as for Cap. 609 or Part 10A as the case may be.

Application

Except in the circumstances specified in section 98O(1) of Cap. 609, this Code applies to all third party funders within the meaning of Division 2 of Part 10A of Cap. 609.¹

Purpose

The purpose of this Code is to set out the practices and standards that third party funders are ordinarily expected to comply in carrying on

¹ For the purpose of this Code, a third party funder includes each of the third party funder’s subsidiaries and associated entities and to investment advisors acting as its agents.
For reference only: Under the Code of Conduct for Litigation Funders issued by the Association of Litigation Funders of England & Wales in January 2018 a third party funder having access to funds immediately within its control, including within a corporate parent or subsidiary is known as ‘Funder’s Subsidiary’ and a third party funder acting as the exclusive investment advisor to an entity or entities having access to funds immediately within its or their control, including within a corporate parent or subsidiary is known as ‘Associated Entity’.

activities in connection with third party funding of arbitration in Hong Kong.

The Code

1. Introduction

Interpretation

- 1.1 The terms defined in Cap. 609 (in particular in its Part 10A) are incorporated by reference into this Code.

Scope of Code

- 1.2 This Code applies to any funding agreement commenced or entered into on or after the date of commencement of the Code between a third party funder and a funded party (including a potential funded party) for third party funding of arbitration.

Consequences of non-compliance with the Code

- 1.3 Section 98S of Cap. 609 sets out the consequences of failing to comply with the Code.

2. Standards and practices in third party funding of arbitration

Responsibility for Subsidiaries and Associated Entities

- 2.1 A third party funder shall accept responsibility for compliance with this Code by its subsidiaries and associated entities and any investment advisors acting as its agent.

Promotional Materials

- 2.2 A third party funder must ensure its promotional materials are clear and not misleading.

The Funding Agreement

- 2.3 The third party funder must:

- (1) take reasonable steps to ensure that the funded party is made aware of the right to seek independent legal advice on the funding agreement before entering into it;
- (2) provide a Hong Kong address for service in the funding agreement subject to such mode of service as may be agreed with the funded party;
- (3) set out and explain clearly in the funding agreement all the key features and terms of the proposed funding and the funding agreement including, without limitation, the matters set out in Part 10A of Cap. 609 and in this Code; and
- (4) set out the name and contact details of the advisory body responsible for monitoring and reviewing the operation of third party funding under Part 10A of Cap. 609.

2.4 The obligation under paragraph 2.3(1) is satisfied if the funded party confirms in writing to the third party funder that the funded party has taken independent legal advice on the funding agreement before entering into it.

Capital Adequacy Requirements

2.5 A third party funder must:

- (1) ensure that it maintains the capacity to:
 - (a) pay all debts when they become due and payable; and
 - (b) cover all of its aggregate funding liabilities under all of its funding agreements for a minimum period of 36 months;
- (2) maintain access to a minimum of HK\$20 million of capital;

- (3) provide the advisory body with either:
 - (a) a copy of the audit opinion on the third party funder's most recent annual financial statements (but not the underlying financial statements) within 1 month of receipt of the opinion and in any case within 6 months of the end of each fiscal year; or
 - (b) reasonable evidence from a qualified third party (preferably from an auditor, but alternatively from a third party administrator or bank) that the third party funder satisfies the minimum capital requirement set out in subparagraph (2); and
- (4) accept a continuous disclosure obligation under each funding agreement in respect of its capital adequacy, including:
 - (a) a specific obligation to give timely notice to the funded party if the third party funder believes that its representations to the funded party in respect of its capital adequacy as required by the Code are no longer valid because of changed circumstances; and
 - (b) a specific undertaking that if an audit opinion provided for any audit period is qualified (except as to any emphasis of matters relating to the uncertainty of valuing relevant dispute resolution funding investments) or expresses any question as to the ability of the third party funder, to continue as a going concern:
 - (i) it will promptly inform the funded party; and
 - (ii) the funded party will be entitled to enquire further into the qualification or

question expressed and take any further action it deems appropriate.

Conflicts of Interest

2.6 The third party funder must:

- (1) maintain, for the duration of the funding agreement, effective procedures for managing any conflict of interest that may arise in relation to activities undertaken by the third party funder in relation to the funding agreement;
- (2) follow the written procedures mentioned in paragraph 2.7 for the duration of the funding agreement; and
- (3) not take any steps that cause or may cause the funded party's legal representative to act in breach of its professional duties.

2.7 For paragraph 2.6(2), the third party funder has effective procedures for managing a conflict of interest that may arise if it can show through documentation that:

- (1) the third party funder has conducted a review of its business operations that relate to the funding agreement to identify and assess potential conflicting interests;
- (2) the third party funder:
 - (a) has written procedures for identifying and managing conflicts of interest; and
 - (b) has implemented the procedures;
- (3) the written procedures are reviewed at intervals no greater than 12 months;
- (4) the written procedures include procedures about the following:

- (a) monitoring the third party funder's operations to identify and assess potential conflicting interests;
 - (b) disclosing conflicts of interest to funded parties and potential funded parties;
 - (c) managing situations in which interests may conflict;
 - (d) protecting the interests of funded parties and potential funded parties;
 - (e) dealing with situations in which a lawyer acts for both the third party funder and a funded party or potential funded party;
 - (f) dealing with a situation in which there is a pre-existing relationship between any of the third party funder, a lawyer and a funded party (or potential funded party);
 - (g) reviewing the terms of a funding agreement to ensure the terms are consistent with Part 10A of Cap. 609 and this Code; and
 - (h) marketing to potential funded parties;
- (5) the terms of the funding agreement are reviewed to ensure the terms are consistent with Part 10A of Cap. 609 and this Code; and
- (6) the matters mentioned in subparagraphs (1) to (5) (including those procedures mentioned in subparagraph (4)(a) to (h)) are implemented, monitored and managed by:
- (a) if the third party funder is an entity other than an individual - the senior management or partners of the third party funder; or

- (b) if the third party funder is an individual that represents an entity - the senior management or partners of the entity.

Confidentiality and Legal Professional Privilege

2.8 A third party funder will observe the confidentiality and privilege of all information and documentation relating to the arbitration and the subject of the funding agreement to the extent that Hong Kong law, or other applicable law, permits.

Control

2.9 The funding agreement shall set out clearly:

- (1) that the third party funder will not seek to influence the funded party or the funded party's legal representative to give control or conduct of the arbitration to the third party funder except to the extent permitted by law;
- (2) that the third party funder will not take any steps that cause or are likely to cause the funded party's legal representative to act in breach of professional duties; and
- (3) that the third party funder will not seek to influence the arbitration body and any arbitral institution involved.

Disclosure

2.10 The third party funder must remind the funded party of its obligation to disclose information about the third party funding of arbitration under sections 98U and 98V of Cap. 609.

2.11 To avoid doubt, the funded party to an arbitration does not have any obligation to disclose details of the funding agreement except as required by the funding agreement, or

as ordered by the arbitration body in an arbitration, or as otherwise required by law.

Liability for Costs

2.12 The funding agreement must state whether (and if so to what extent) the third party funder is liable to the funded party to:

- (1) meet any liability for adverse costs;
- (2) pay any premium (including insurance premium tax) to obtain costs insurance;
- (3) provide security for costs; and
- (4) meet any other financial liability.

Grounds for Termination

2.13 The funding agreement must state whether (and if so, how) the third party funder may terminate the funding agreement in the event that the third party funder:

- (1) reasonably ceases to be satisfied about the merits of the arbitration;
- (2) reasonably believes that there has been a material adverse change of prospects to the funded party's success in the arbitration or recovery on success; or
- (3) reasonably believes that the funded party has committed a material breach of the funding agreement.

2.14 The funding agreement must not establish a discretionary right for a third party funder to terminate the funding agreement in the absence of the circumstances described in paragraph 2.13.

2.15 The funding agreement must provide that if the third party funder terminates the funding agreement, the third party funder is to remain liable for all funding obligations accrued

to the date of termination unless the termination is due to a material breach as mentioned in paragraph 2.13(3).

- 2.16 The funding agreement must provide that the funded party may terminate the funding agreement if it reasonably believes that the third party funder has committed a material breach of the Code or the funding agreement which may lead to irreparable damage.

Dispute regarding Funding Agreement

- 2.17 The funding agreement must provide a neutral, independent and effective dispute resolution mechanism for settlement of any dispute arising under or in connection with the funding agreement between the third party funder and the funded party.

Complaints Procedure

- 2.18 The third party funder must maintain an effective procedure for addressing complaints against it as follows:
- (1) the third party funder must ensure that complaints from a funded party under or in connection with the funding agreement are handled in a timely and appropriate way;
 - (2) steps must be taken to investigate and respond to a complaint in a timely way;
 - (3) if a complaint has been received, the subject matter of the complaint must be properly reviewed;
 - (4) if a complaint is not remedied promptly, the third party funder must advise the funded party of any further steps which may be available to the funded party under the funding agreement, the Code and the Ordinance; and
 - (5) if the subject matter of the complaint raises issues of more general concern, the third party funder must take

steps to investigate and remedy such issues, even if other funded parties may not have complained.

Annual Returns

2.19 The third party funder must:

- (1) submit annual returns to the advisory body of:
 - (a) any complaints against it by funded parties received during the reporting period; and
 - (b) any findings by a court or arbitral tribunal of its failure to comply with the Code or Division 5 of Part 10A of Cap. 609 during the reporting period; and
- (2) respond to any request from the advisory body for further information or clarification concerning any matter.