



Hong Kong

November 2015

HONG KONG LAW REFORM COMMISSION CONSULTS ON THIRD PARTY FUNDING FOR ARBITRATION

Introduction

In October 2005 a Sub-Committee of the Law Reform Commission of Hong Kong published a detailed Consultation Paper on Third Party Funding for Arbitration proposing that third party funding for arbitration taking place in Hong Kong should be allowed under Hong Kong law. Comments on the Consultation Paper should be submitted by 18 January 2016. The common law doctrines of maintenance and champerty are major obstacles to Third Party Funding of litigation, but it is not clear whether these doctrines apply to arbitration. Nor is it clear whether the exceptions to the common law doctrines extend to arbitration. Given that the Hong Kong courts have left open the legal position, the Consultation Paper has made four recommendations which, if enacted, will ensure legal certainty for parties who resolve disputes through arbitration. The justification for reform is to maintain Hong Kong's status as a "pro-arbitration regime" thereby ensuring its continued success as a major regional and international arbitration centre.

Background

Third Party Funding involves payment of the legal expenses and outgoings by a commercial body that is not a party to the legal dispute, in return for a share of the judgment or arbitration award. The rationale for Third Party Funding is to assist a party who does not have sufficient financial resources to pursue its claim, and also to manage the risks of litigation or arbitration. The need for Third Party Funding is especially important in

arbitration where the parties are required to pay upfront all the legal costs and expenses, including those of the lawyers, arbitrators, expert witnesses, court reporters and the venue.

The legality of Third Party Funding depends on whether and the extent to which the medieval doctrines of maintenance and champerty continue to apply in Hong Kong. Maintenance involves a person giving assistance to a party to a claim where that person has no interest in the matter, while champerty involves maintenance of an action in consideration of a promise to share in the proceeds of the claim.

Third Party Funding of litigation is not permitted in Hong Kong because it violates the doctrines of both maintenance and champerty. The law has evolved to create three significant exceptions to the doctrines, namely "(1) where a third party can prove that it has a legitimate interest in the outcome of the litigation; (2) where a party can persuade the court that it should be permitted to obtain Third Party Funding to enable it to have access to justice; and (3) in a miscellaneous category of proceedings including insolvency proceedings". These exceptions are widely used by Third Party Funders in Hong Kong litigation.

In jurisdictions permitting Third Party Funding, the principal methods of such funding are: investment by payment of funds by a third party funder; brokers arranging loans through banks and other types of financial institutions; and lawyers funding their own costs and expenses through fee agreements, such as conditional or contingency fee arrangements (which are prohibited in Hong Kong).

In the case of arbitration, the legal position of Third Party Funding is not clear. The Hong Kong courts have not decided whether a Third Party Funding agreement is valid in relation to an arbitration taking place in Hong Kong; nor have the courts recognised any of the exceptions as applicable to Third Party Funding of arbitrations conducted in Hong Kong.

A key concern of the Law Reform Commission is the importance of maintaining Hong Kong's "competitiveness as an international arbitration centre". Indeed, the uncertainty surrounding the acceptability of Third Party Funding for arbitration has led to a common view in Hong Kong that such funding is illegal. This general perception of the unlawfulness of Third Party Funding has made Hong Kong a less attractive option for conducting arbitration, especially given that parties to a dispute are increasingly looking at potential financing options when deciding where to conduct an international arbitration. This has reduced Hong Kong's competitiveness as an arbitration centre.

The Consultation Paper provides an extensive review of the law of Third Party Funding in various jurisdictions, including Australia, England and Wales, Singapore, Mainland China and the United States. Singapore is the only major arbitration centre examined by the Sub-Committee which prohibits Third Party Funding of arbitration, with Singaporean courts continuing to apply the maintenance and champerty doctrines to Third Party Funding. The Singapore Ministry of Law in its 2011 Review of the International Arbitration Act proposed legalising Third Party Funding for Arbitration. However, the statute subsequently enacted did not contain provisions relating to Third Party Funding. Third Party Funding of arbitration is currently a significant issue in Singapore.

The Consultation Paper's four recommendations are set out below.

Recommendation 1: We recommend that the Arbitration Ordinance should be amended to provide that Third Party Funding for arbitration taking place in Hong Kong is permitted under Hong Kong law.

Following its review of the law in Hong Kong and in other jurisdictions and the potential benefits and risks, the Sub-Committee recommended that Third Party Funding of Hong Kong arbitration should be allowed.

The potential benefits extend beyond Hong Kong's competitiveness, and include a series of public benefits, such as improving the efficiency of the legal system. If arbitration

becomes more widely used, then this will reduce the burden on the Hong Kong courts in commercial cases, so that public resources may be utilised in matters of greater concern to the public, such as criminal matters. Another benefit is that Third Party Funding facilitates access to justice to those who do not have the financial resources to fund a good claim.

Recommendation 2: We recommend that 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.

After reviewing models in other jurisdictions and in order to manage the risks associated with Third Party Funding, the Sub-Committee proposed that clear ethical and financial standards should be in place. Hong Kong should examine the various approaches and experiences of other arbitration centres, and implement standards which are adapted to fit its own culture and needs.

Recommendation 3: We invite submissions as to:

1. **Whether the development and supervision of the applicable ethical and financial standards should be conducted by: (a) a statutory or governmental body, whether existing or to be established, and if so, what type of body; or (b) a self-regulatory body, whether for a trial period or permanently and how any ethical and financial standards should be enforced.**
2. **How the applicable ethical or financial standards should address any of the following matters or any additional matters:**
 - a) capital adequacy;
 - b) conflicts of interest;
 - c) confidentiality and privilege;
 - d) extent of extra-territorial application;
 - 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 complaint procedure and enforcement.

The Sub-Committee has no fixed opinion as to the method of monitoring such standards, which may be through either statutory regulation (e.g. Australia) or self-regulation (e.g. England and Wales). Statutory regulation is somewhat inflexible and future amendments may involve time delays. The difficulty with self-regulation is that unlike England and Wales, Third Party Funders are generally neither registered nor conduct business in HK, raising questions of enforcement.

The standards will deal with various risks which arise from Third Party Funding Schemes.

Recommendation 4: We invite submissions as to:

- a) Whether or not a Third Party Funder should be directly liable for adverse costs orders in a matter it has funded;**
- b) If the answer to sub-paragraph (a) is “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;**
- c) Whether there is a need to amend the Arbitration Ordinance to provide for the Tribunal’s power to order Third Party Funders to provide Security for Costs; and**
- d) If the answer to sub-paragraph (c) is “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.**

The Sub-Committee considers that if Third Party Funders should be the recipient of a share in a successful claim, there is no reason why they should not also bear liability for costs where they have financed an “unmeritorious claim or breached ethical and financial standards”.

Conclusion

The Sub-Committee’s recommendations and detailed analysis in the Consultation Paper provides a substantial framework for discussing reform of Third Party Funding of arbitration in Hong Kong. The conclusion reached by the Sub-Committee was that law reform is important in this area so as to increase Hong Kong’s competitiveness as an international arbitration centre.

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