

Consultation Paper on Third Party Funding for Arbitration

Comments of the Hong Kong Bar Association

1. The Third Party Funding for Arbitration Sub-committee of the Law Reform Commission of Hong Kong issued in 19 October 2015 a consultation paper on third party funding for arbitration in Hong Kong (“the Consultation Paper”). The Consultation Paper makes 4 recommendations, including the principal recommendation that third party funding for arbitration taking place in Hong Kong should be permitted.

2. The Hong Kong Bar Association (“the HKBA”) is invited to comment on the Consultation Paper and provides below its comments in relation to the 4 recommendations therein. The HKBA is in general support of these recommendations.

Recommendation 1:

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.

3. The HKBA notices the trend of the growing use and impact of third party funding in international arbitration and sees that, with such changes to the arbitration landscape for an expressly allowed and appropriately regulated legal regime, as one of the major centres of international arbitration, Hong Kong will be upgraded with enhanced attractiveness of Hong Kong as a seat for international arbitration.

4. As said, the HKBA supports in principle to amend the Arbitration Ordinance (Cap.609) to clarify the legal status and to expressly permit Third Party Funding for arbitration taking place in Hong Kong.

Recommendation 2:

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.

5. For the proper and healthy development of Third Party Funding in Hong Kong, the HKBA in general agrees that clear ethical and financial standards for regulating Third Party Funders should be developed.
6. In this regard, the HKBA takes note of the approaches adopted in other jurisdictions, including the latest development of litigation funding in Australia and United Kingdom, and believes these may provide the starting points to build up a model tailored for Hong Kong.

Recommendation 3:

The Sub-committee 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.*

7. The HKBA is of the view that the development and supervision of the applicable ethical and financial standards should be conducted by a self-regulatory body. The HKBA does not object to the idea for this to be initially for a trial period.
8. The HKBA considers that the third party funding market is still far from being well established in Hong Kong. A self-regulatory body

appropriately represented by all stakeholders, including those users, funders, lawyers and arbitrators from the arbitration communities, may contribute in time to come up with the applicable ethical and financial standards / code, creating the right balance on practicality and public interest safeguards.

9. On the issues of enforcement of such ethical and financial standards, the HKBA sees that bodies such as the Association of Litigation Funders of England & Wales (“the ALF”) may provide the appropriate approach for the way forward. The HKBA is of the view that the ethical and financial standards should be enforced by a comprehensive complaint procedure and sanctions imposed on members of self-regulatory body in case of breach of the code / standards.

10. A set of comprehensive complaint procedures which emphasizes party protection is essential in ensuring public confidence in the self-regulatory code. In this regard, it is noted that the ALF complaint procedures adopt a two-stage approach, i.e. the “Independent Legal Counsel” and “Appeal Tribunal” mechanisms, which helps ensuring the due process in the complaints / disputes between the funders and parties.

11. More specifically, in relation to Recommendation 3(2), the HKBA is of the view that the key matters in the applicable ethical or financial standards should address the key components below.

(a) **Capital Adequacy:** There should be proper provisions for capital adequacy. On this, the HKBA believes that the requisite amount of minimum capital should be at a level that is commercially viable for Third Party Funders of different resources and sizes. The HKBA sees that the ALF requirement is currently set at £2,000,000 and there are further duties imposed as set out in the concerned standards, which are quoted as follows for easy reference:-

“9. A Funder will:-

...

9.4 Maintain at all time access to adequate financial resources to meet the obligations of the Funder, its Funder Subsidiaries and Associated Entities to fund all of the disputes that they have agreed to fund and in particular will;

- 9.4.1 *Ensure that the Funder, its Funder Subsidiaries and Associated Entities maintain the capacity;*
 - 9.4.1.1 *to pay all debts when they become due and payable; and*
 - 9.4.1.2 *to cover aggregate funding liabilities under all of their LFAs (Litigation Funding Agreement) for a minimum period of 36 months.*
- 9.4.2 *Maintain access to a minimum of £2m of capita or such other amount as stipulated by the Association*
- 9.4.3 *Accept a continuous disclosure obligation in respect of its capital adequacy, including a specific obligation to notify timeously the Association and the Funder Party if the Funder reasonably believes that its representations in respect of capital adequacy under the Code are no longer valid because of changed circumstances;*
- 9.4.4 *Undertake that it will be audited annually by a recognized national or international audit firm and shall provide the Association with:-*
 - 9.4.4.1 *A copy of the audit opinion given by the audit firm on the Funder's or Funder's Subsidiary's most recent annual financial statement (but not the underlying financial statements), or in the case of Funders who are investment advisors to an Associated Entity, the audit opinion given by the audit firm in respect of the Associated Entity (but not the underlying financial statements), within one month of receipt of the opinion and in any case within six months of each fiscal year end. If the audit opinion provided is qualified (except as to any emphasis of matters relating to the uncertainty of valuing relevant litigation funding investments) or expresses any question as to the ability of the firm to continue as a going concern, the Association shall be entitled to enquire further into the qualification expressed and take any further action it deems appropriate; and*
 - 9.4.4.2 *Reasonable evidence from a qualified third party (preferably from an auditor, but alternatively from a third party administrator or bank) that the Funder or Funder's Subsidiary or Associated Entity satisfies the minimum capital requirement prevailing at the time of annual subscription."*

- (b) **Conflict of interest:** Some provisions for conflict of interest should be added in. Despite that the Third Party Funders are not parties to the arbitration proceedings / arbitration agreement and have no control over the outcome of the proceedings, they still are potential “beneficiaries” to

the outcome of the proceedings. The HKBA is also of the view that it is prudent for the Third Party Funders to withdraw from funding the parties in the event of conflicts of interest. As such, they should not be allowed or have themselves placed in conflicts of interest situation accordingly. Likewise, the HKBA believes that barristers and solicitors of the Funded Parties should be discouraged from being the Third Party Funder of the individual case because of the penitential conflicts of interests.

- (c) **Confidentiality and Privileges:** The HKBA is of the view that the Third Party Funding Agreements should remain confidential and protected by legal privileges, save and except as to their existence as well as the identities and relevant contact information of the Third Party Funders. It may be left for better management of the regulatory body over its members / Funders to work on the scope of further disclosure that should be required.
- (d) **Extent of Extra-territorial Application:** The HKBA considers that Oversea Third Party Funders who intend to participate in Hong Kong should be required to apply for such membership in Hong Kong in accordance with the Hong Kong Third Party Funding codes / rules of the regulatory body. Such Funders should also observe and abide by the Hong Kong codes / rules when they are taking part in arbitrations taking place in Hong Kong as Third Party Funders.
- (e) **Control of Arbitration by Third Party Funders:** While the details may be further ironed out, it appears obvious to the HKBA that there should be proper provision to prevent the Funders from usurping control of the arbitration. In this regard, the ALF code is quoted below for easy reference and the relevant part of it provides:-

“9. A funder will:-

9.1 take reasonable steps to ensure that the Funded Party shall have received independent advice on the terms of the LFA prior to its execution, which obligation shall be satisfied if the Funded Party confirms in writing to the Funder that the Funded Party has

taken advice from the solicitor or barrister instructed in the dispute;

9.2 not take any steps that cause or are likely to cause the Funded Party's solicitor or barrister to act in breach of their professional duties;

9.3 not seek to influence the Funded Party's solicitor or barrister to cede control or conduct of the dispute to the Funder."

(f) **Disclosure of Third Party Funding to the Tribunal and Other Party/Parties to the Arbitration:**

The HKBA takes note of one of the views, e.g. in Australia, that the disclosure by a party that it is receiving third party funding should be voluntary, as the funding agreements may be subject to valid claims of legal professional privileges. However, for a fair playing field for parties to arbitration, the HKBA takes the view that the existence of Third Party Funding and the identities and relevant contact information of the Third Party Funders should be disclosed to the Tribunal and other party/parties to the arbitrations. This also affects the issues of liabilities towards any adverse costs orders or security for costs in arbitral proceedings and inter-linking with the liabilities of the Third Party Funders for such costs as outlined below.

(g) **Grounds for Termination of Third Party Funding:** The HKBA is in the opinion that there should be appropriate control placed upon the freedom of Funders to withdraw funding support for ongoing proceedings. This should be properly addressed in the funding agreement. Reference may be made to the ALF code, which provides:-

"11. The LFA shall state whether (and if so how) the Funder or Funder's Subsidiary or Associated Entity may:-

.....

11.2 terminate the LFA in the event that the Funder or Funder's Subsidiary or Associated Entity:

11.2.1 reasonably ceases to be satisfied about the merits of the disputes;

11.2.2 reasonably believes that the dispute is no longer commercially viable;

11.2.3 reasonably believes that there has been a material breach of the LFA by the litigant.

12. The LFA shall not establish a discretionary right for a Funder or Funder's Subsidiary or Associated Entity to terminate a LFA in the

absence of the circumstances described in clause 11.2.”

- (h) **A Complaint Procedure and Enforcement:** The HKBA takes the view that a comprehensive complaint procedure should be imposed with enforcement mechanisms. Reference may likewise be drawn from the ALF code and the practice in international arbitration. The HKBA believes that a complain system shall be established by the regulatory body in discharging part of its regulatory function over Third Party Funders in Hong Kong. Complaint procedures and procedures regarding the hearing of the compliant and appeal thereof could be set out in the code / rules formulated by the regulatory body. A committee may be formed to deal with complaints and / or hearing of the complaints and disciplinary actions, such as removing and deregistering Third Party Funders from the list under the regulatory body, may also be provided for.

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.*

12. In Australia, while review for reform is on the way, Third Party Funders are generally not required to provide indemnity for Adverse Costs Orders. For instance, in the Australian case of *Jeffrey and Katauskas*

*Pty Ltd v SST Consulting Pty Ltd*¹, it was illustrated that the relevant court procedural rules had in effect provided that the court could not make any order for costs against a person who is not a party, subject to the exception where the non-party had committed an abuse of process. There is no general proposition that those who fund another's litigation must place the party funded in a position to meet any adverse order for costs.²

13. In England & Wales, there are comments to the contrary in this regard. For instance, in the Review of Civil Litigation Costs: Final Report, it was remarked that:-

- (a) *"... it was wrong in principle that a litigation funder, which stands to recover a share of damages in the event of success, should be able to escape part of the liability for costs in the event for defeat"*³;
- (b) *"Third party funder should potentially be liable for the full amount of adverse costs, subject to the discretion of the judge"*⁴; and
- (c) *"...there is no evidence that full liability for adverse costs would stifle Third Party Funding or inhibit access to justice."*⁵

14. In this regard, there are also cases that support a limitation of liabilities on the part of the Third Party Funders. In *Arkin v Borchard Lines Ltd*⁶, Lord Philips MR stated that: *"...a professional funder, who finances part of a claimant's costs of litigation, should be potentially liable for the costs of the opposing party to the extent of the funding provided"*; in *Excalibur Ventures LLC v Texas Keystone Inc*⁷, Clarke LJ stated that *"...in short, in a case of this kind, justice requires that, when the case fails so comprehensively, not merely on the facts but because it was*

¹ (2009) 239 CLR 75.

² In the dissenting judgment, Heydon J expressed the view that a Third Party Funder (in litigation) who did not provide an indemnity to a party for Adverse Costs Order could be regarded as having committed an abuse of process.

³ Lord Justice Jackson's Review of Civil Litigation Costs: Final Report (2009), at 123, para 4.6.

⁴ Lord Justice Jackson's Review of Civil Litigation Costs: Final Report (2009) at 124, para 6.1.

⁵ Lord Justice Jackson's Review of Civil Litigation Costs: Final Report (2009) at 123, para 4.5.

⁶ [2005] 1 WLR 3055 (CA).

⁷ [2014] EWHC 3426 (Comm) at para 110.

wholly bad in law, the funder should subject to the Arkin cap, bear the costs ordered to be paid by the person whom or which he has unsuccessfully supported, assessed on the scale which the court thinks it just for that person to pay in light of all the circumstances, including but not limited to that person's behavior and that of those whom that person engaged. In short, he should, absent special circumstances, follow the fortunes of those from whom he himself hoped to derive a small fortune."

15. While there are diverging views and approaches to this matter, for a fair playing field for parties to arbitration, the HKBA is of the general view that, in appropriate cases, Third Party Funders could be directly liable for adverse costs orders in a matter it has funded. Along the same vein, the HKBA is in the view that the Arbitration Ordinance (Cap. 609) may be amended to provide the Tribunal with the power to order Third Party Funders to provide Security for Costs.
16. On these issues, the HKBA believes that enforcement may be achieved through amendments, regulations, standards, code, rules, procedures and/or practice in international arbitration proceedings, such as by requiring / treating the Third Party Funders as joined in third parties via agreement.

Dated this the 15th day of January 2016

HONG KONG BAR ASSOCIATION