

THE LAW REFORM COMMISSION OF HONG KONG

REPORT

THIRD PARTY FUNDING FOR ARBITRATION

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October 2016

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The members of the Commission at present are:

Chairman: The Hon Rimsky Yuen, SC, JP, Secretary for Justice

***Members: The Hon Chief Justice Geoffrey Ma, GBM
The Hon Mr Justice Robert Tang Kwok-ching, SBS, PJ
Ms Theresa Johnson, Law Draftsman
Ms Christine Fang, BBS, JP
Mr Eugene Fung, SC
Professor Christopher Gane
Professor Michael Hor
Ms Angela Lee, BBS, JP
Mr Allan Leung
Professor Lin Feng
Mrs Eleanor Ling, SBS, JP
Mr Robert Y H Pang, SC***

The Secretary of the Commission is **Ms Michelle Ainsworth, Principal Government Counsel** and the Commission's offices are at:

***4/F East Wing, Justice Place
18 Lower Albert Road
Central
Hong Kong***

***Telephone: 3918 4097
Fax: 3918 4096
E-mail: hklrc@hkreform.gov.hk
Website: <http://www.hkreform.gov.hk>***

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Defined Terms

<u>Abbreviation</u>	<u>Definition</u>
Adverse Costs Order	An order of a Tribunal or of a Court requiring a party to arbitration or court proceedings to pay all or some of the costs of the other party or parties involved.
Advisory Body	The body to be appointed by the Secretary for Justice as such.
ALF	The Association of Litigation Funders of England and Wales.
ALF Code	Code of Conduct for Litigation Funders issued by the ALF.
Arbitration	<p>For the purposes of the proposed amendment to the Arbitration Ordinance to allow for third party funding of arbitration, this term includes:</p> <ul style="list-style-type: none">(a) arbitration as defined in section 2(1) of the Arbitration Ordinance;(b) proceedings before an Emergency Arbitrator;(c) mediation proceedings referred to in the Arbitration Ordinance; and(d) court proceedings under the Arbitration Ordinance.
Arbitration Body	<ul style="list-style-type: none">(a) In relation to an arbitration (other than mediation proceedings referred to in the Arbitration Ordinance) — means the Emergency Arbitrator, arbitral tribunal or court, as the case may be; or(b) in relation to mediation proceedings referred to in the Arbitration Ordinance — means the mediator appointed under section 32 or referred to in section 33.

Abbreviation

Definition

Arbitration Funding	<p>Money, or any other financial assistance, in relation to any Costs of an Arbitration. For the purpose of this report—</p> <p>(a) arbitration funding is taken to be provided to a Funded Party even if it is provided to another person at the Funded Party's request (for example, if it is provided to the Funded Party's legal representative); and</p> <p>(b) arbitration funding is taken to be provided by a Third Party Funder even if it is arranged by the Third Party Funder and provided by another person.</p>
Arbitration Ordinance	Arbitration Ordinance (Cap 609) of the HKSAR.
Authorized Body	The body appointed by the Secretary for Justice as such.
Code	The code of practice issued by the Authorized Body under Division 4 of Part 10A of the Arbitration Ordinance (as amended) and as amended from time to time.
Conditional Fee	An arrangement where, in the event of success, the lawyer charges his usual fee plus an agreed flat amount or percentage " <i>uplift</i> " on the usual fee. The additional fee is often referred to as an " <i>Uplift Fee</i> " or a " <i>Success Fee</i> ". ¹
Consultation Paper	The Consultation Paper on Third Party Funding for Arbitration issued by the Third Party Funding for Arbitration Sub-committee of the Law Reform Commission of Hong Kong published on 19 October 2015.

¹ The Law Reform Commission of Hong Kong, *Consultation Paper on Conditional Fees* (2005), at para 7.

<u>Abbreviation</u>	<u>Definition</u>
Contingency Fee	An arrangement between lawyer and client whereby the lawyer receives additional fees or a percentage uplift of a lawyer's usual fees upon the success of litigation.
Costs	In relation to an Arbitration, means the costs and expenses of an arbitration and includes: <ul style="list-style-type: none"> (a) pre-arbitration costs and expenses; and (b) the fees and expenses of the Arbitration Body.
Emergency Arbitrator	An emergency arbitrator appointed under the arbitration rules (including the arbitration rules of a permanent arbitral institution) agreed to or adopted by the parties to deal with the parties' applications for emergency relief before an arbitral tribunal is constituted (as defined in section 22A of the Arbitration Ordinance).
Funded Party	A person who is provided Third Party Funding by a Third Party Funder under a Funding Agreement and is or will be, a party to an Arbitration.
Funding Agreement	A written agreement for Third Party Funding of Arbitration that is made between a Funded Party and a Third Party Funder on or after the commencement of Part 10A of the Arbitration Ordinance.
HKIAC	Hong Kong International Arbitration Centre.
HKSAR	Hong Kong Special Administrative Region of the People's Republic of China.
Jackson Report	<i>Review of Civil Litigation Costs: Final Report</i> by the Right Honourable Lord Justice Jackson dated December 2009 (Norwich: The Stationery Office).

<u>Abbreviation</u>	<u>Definition</u>
Jackson Review	<i>Review of Civil Litigation Costs: Preliminary Report</i> by the Right Honourable Lord Justice Jackson dated May 2009 (Norwich: The Stationery Office).
Mediation Ordinance	Mediation Ordinance (Cap 620) of the HKSAR.
Model Law/UNCITRAL Model Law	UNCITRAL Model Law on International Commercial Arbitration of 21 June 1985 as amended on 7 July 2006.
New York Convention	Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958.
Potential Third Party Funder	A person who carries on any activity with a view to becoming a Third Party Funder.
Security for Costs	An order made by a Tribunal or a court requiring a claimant or counterclaimant to deposit money into an escrow account (which can be a court or an arbitral institution's account) to secure a costs order in the event that the claims/counterclaims are unsuccessful.
Sub-committee	Third Party Funding for Arbitration Sub-committee of the Law Reform Commission of Hong Kong formed in June 2013.
Third Party Funder	A person who provides Arbitration Funding to a Funded Party under a Funding Agreement and does not, or will not, have an interest recognised by law in the Arbitration other than under the Funding Agreement.
Third Party Funding of Arbitration	The provision, under a Funding Agreement, of Arbitration Funding to a Funded Party by a Third Party Funder in return for the Third Party Funder receiving a financial benefit only if the arbitration is successful within the meaning of the Funding Agreement. (For the purposes

Abbreviation

Definition

of the recommended amendment to the Arbitration Ordinance, it does not include the provision of Arbitration Funding directly or indirectly by a person practising law, or providing legal services, whether in Hong Kong or elsewhere.)

Tribunal

The arbitral tribunal established by the agreement of the parties to finally resolve disputes or differences by arbitration.

2014 Australian
Productivity
Commission Final
Report

Australian Productivity Commission, *Access to Justice Arrangements, Final Report* (2014).

Chapter 1

Introduction

1.1 This report ("Report") discusses the responses received to the consultation paper issued by the Law Reform Commission's Third Party Funding for Arbitration Sub-committee in October 2015 ("Consultation Paper"),¹ and sets out our 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.²

Background

1.2 Third Party Funding for arbitration and other dispute resolution proceedings has become increasingly common over the last decade in numerous jurisdictions, including Australia, England and Wales, various European jurisdictions and the United States. To date, Third Party Funding arrangements have usually been motivated by a Funded Party's lack of financial resources to pursue its own claims in contentious proceedings. However, increasingly, parties who do have the financial resources to fund contentious proceedings may seek Third Party Funding as a financial or risk management tool. A Third Party Funding contract commonly provides that the Third Party Funder will pay for the Funded Party's Costs (including expenses) of the arbitration or other proceedings in return for a percentage of the arbitral award or judgment or other financial benefit from the Funded Party's recovery in the proceedings if successful, as defined in the Funding Agreement. If the proceedings are unsuccessful, the Third Party Funder will

¹ Apart from setting out the Sub-committee's Preliminary Recommendations, the content of the Consultation Paper will not be reproduced in this Report, but it should be read in conjunction with it. The Consultation Paper is available on the Law Reform Commission website at: <http://www.hkreform.gov.hk/en/publications/tpf.htm>.

² At Annex 2 to the Report is the List of Respondents who made submissions in response to the Consultation Paper.

not receive any repayment or return on the funds it has paid to, or on behalf of, the Funded Party, for the proceedings' costs (hence the common description of third party funding as "*non-recourse*" funding).

1.3 The forms of financial assistance offered by Third Party Funders and the structuring of these are becoming increasingly varied and sophisticated. For the present purpose, it is not necessary and we will not address each and every issue that can arise from the increasing number of ways in which Third Party Funders are providing financial assistance to parties to an arbitration (and related proceedings) or to their lawyers. We have adopted the approach that the recommendations as to any reforms should be focused on the consequences of expressly providing that the doctrines of maintenance and champerty (both as a tort and as a criminal offence) do not apply to Arbitration (and related proceedings) under the Arbitration Ordinance. Hong Kong's financial services and legal sectors are supervised by experienced bodies with the expertise and the skills to address the general issues that may arise. In addition, there is an extensive body of law, procedure and practice on arbitration and related proceedings (in both Hong Kong and internationally) that addresses important issues such as conflicts of interest. Arbitral institutions (including their rules, codes and guidelines) as well as institutions developing *ad hoc* international arbitration rules also play an important role in this area which is likely to grow.

1.4 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.

1.5 The legal doctrines of maintenance and champerty, developed some 700 years ago in England, have been held by the Hong Kong Courts to prohibit Third Party Funding of litigation both as a tort (civil wrong) and as a criminal offence, save in three exceptional areas: (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) a miscellaneous category of proceedings including insolvency proceedings.

1.6 It is currently unclear whether the doctrines of maintenance and champerty also apply to Third Party Funding for arbitrations taking place in Hong Kong, as appears from the Court of Final Appeal judgment in *Unruh v Seeberger*³ where the Court expressly left open this question. While earlier in *Cannonway Consultants Limited v Kenworth Engineering Ltd*⁴ Kaplan J had held that the law of champerty did not extend to arbitration in *Unruh v Seeberger*, the Court did not refer to this aspect of Kaplan J's judgment.

The LRC Sub-committee

Terms of reference

1.7 In early 2013, the Secretary for Justice and the Chief Justice asked the Law Reform Commission of Hong Kong 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."

Membership of the Sub-committee

1.8 In June 2013, the Third Party Funding for Arbitration Sub-committee of the Hong Kong Law Reform Commission ("the Sub-committee") was appointed to review the subject. The members of the Sub-committee are:

³ (2007) 10 HKCFAR 31, at para 123.

⁴ [1995] 2 HKLR 475.

Ms Kim M Rooney (Chair)	Barrister Gilt Chambers
Ms Teresa Y W Cheng, SC	Senior Counsel Des Voeux Chambers
Mr Justin D'Agostino	Global Head of Practice – Dispute Resolution Herbert Smith Freehills
Mr Victor Dawes, SC	Senior Counsel Temple Chambers
Mr Jason Karas	Principal Lipman Karas
Mr Robert Y H Pang, SC	Senior Counsel Bernacchi Chambers

1.9 Ms Kitty Fung, Senior Government Counsel in the Law Reform Commission Secretariat, is the secretary to the Sub-committee.

The Sub-committee's preliminary recommendations

1.10 The Consultation Paper prepared by the Sub-committee, entitled *Third Party Funding for Arbitration*, was published on 19 October 2015,⁵ and put forward four recommendations (referred to in this Report as "Preliminary Recommendations") set out below.

⁵ The Law Reform Commission of Hong Kong, Third Party Funding for Arbitration Sub-committee Consultation Paper, *Third Party Funding for Arbitration* (2015).

Preliminary Recommendation 1

1.11 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.⁶

Preliminary Recommendation 2

1.12 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.⁷

Preliminary Recommendation 3

1.13 Submissions were invited 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 or financial standards should be enforced;⁸ and
- (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;

⁶ See paragraphs 6.1 to 6.4 of the Consultation Paper.

⁷ See paragraphs 6.5 to 6.7 of the Consultation Paper.

⁸ See paragraphs 6.8 to 6.10 of the Consultation Paper.

- (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.⁹

Preliminary Recommendation 4

1.14 Submissions were invited 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 New York Convention;
- (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 New York Convention.¹⁰

⁹ See paragraph 6.11 of the Consultation Paper.

¹⁰ See paragraphs 6.12 to 6.14 of the Consultation Paper.

The Consultation process

1.15 The Sub-committee's extended consultation period closed at the end of February 2016 (the "Consultation Period"), during which time around 66 submissions were received from members of the public.¹¹ Subsequently, further submissions were received from Government bureaux and departments and a supplementary submission was received from an arbitral institution. In total, 73 submissions were received, ranging from a simple acknowledgement of the Consultation Paper to detailed submissions on the Sub-committee's Preliminary Recommendations and associated issues.

1.16 Those who submitted responses included accounting firms, arbitral institutions, arbitrators, barristers, chambers of commerce, consumer/public interest groups, the financial sector, Third Party Funders, Government departments, insurers/insurers associations, law firms, insolvency practitioners, professional bodies, and academics (each "Respondent" and collectively the "Respondents"). A list of the Respondents is set out in Annex 2 of this Report, unless the Respondent expressly requested anonymity. We are most grateful to all those who commented on the Consultation Paper. The submissions made are summarised in the following chapters.

1.17 In addition to attending two consultation forums, members of the Sub-committee attended the meeting of the Panel on Administration of Justice and Legal Services of the Legislative Council on 23 November 2015 and gave various interviews to the media as well as speaking at various conferences and writing articles. They have also consulted the Law Draftsman. The Sub-committee is grateful for the assistance of the Law Draftsman and her colleagues for their valuable contribution to its work.

¹¹ As of 3 March 2016. The Sub-committee had acceded to requests received from various respondents for an extension of time for the submission of written responses, since the extensions requested were not unreasonable and would not give rise to undue delay to the overall progress.

Chapter 2

Overview of the Consultation responses and our Final Recommendations

Responses received to the Consultation Paper

2.1 As noted in the previous chapter, 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. 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. A list of the Respondents can be found at Annex 2 of this Report.

2.2 Set out below is a summary of the responses received in relation to each of the Sub-committee's recommendations contained in the Consultation Paper (which, as mentioned earlier, are referred to in this Report as the Preliminary Recommendations):

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

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

to parties to arbitrations should be developed) was supported by an overwhelming majority of the Respondents;

(3) **Preliminary Recommendation 3** (form and nature of regulation of Third Party Funding for Arbitration) was supported by a substantial majority in that they supported regulation. 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. 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

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

2.3 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).

2.4 While a number of 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. We will only address these topics where they are relevant to Third Party Funding for arbitration, court proceedings and mediation under the Arbitration Ordinance.

Analysis and conclusions

2.5 In the chapters to follow, we will discuss in detail the comments received on each of the four Preliminary Recommendations during the Consultation. For each Preliminary Recommendation, we will first set out a statistical table of the responses received (sorted into four categories: "*agree*", "*oppose*", "*neutral*" and "*other comments*" (where applicable)), followed by a summary of the comments expressing support or opposition to it (as applicable), and including pertinent extracts from responses.² We then set out in each chapter an analysis of the issues arising, followed by the Law Reform Commission's final recommendation in each case. These final recommendations are also set out below.

Our Final Recommendations

2.6 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

² We have not found it necessary to refer to every one of the responses received, as there was substantial overlap between them.

financial support it needs to pursue that case by Arbitration and associated proceedings under the Arbitration Ordinance. We consider that compliance with the ethical and financial safeguards set out in this Report by Third Party Funders of Arbitration with the monitoring, supervision and review framework that we propose, will protect against potential abuse. 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.

2.7 For the reasons set out in this Final Report, the Law Reform Commission makes the following recommendations.

Final Recommendation 1

2.8 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") (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).
- (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 Arbitration should apply to MO Mediation.

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

- (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. 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).

Final Recommendation 2

2.9 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.

Final Recommendation 3

2.10 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.

- (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.
- (3) Third Party Funders funding Arbitration should be required to comply with a *Third Party Funding for Arbitration Code of Practice* (defined earlier as the "Code") issued by a body authorized under the Arbitration Ordinance (defined earlier 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).
- (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).
- (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 being decided by that court or Tribunal (see section 98O of the Proposed AO Amendment).
- (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).

- (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.
- (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.

- (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:
- (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;³
 - (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:

³ Code of Conduct for Litigation Funders, ALF (2014), paras 9.1 to 9.3.

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.

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

- (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.

Final Recommendation 4

2.11 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.
- (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,⁴ 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 Tribunal to make Costs orders against third parties, including Third Party Funders, without joinder of such a

⁴ 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.

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.
- (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.

Chapter 3

Recommendation:

The Arbitration Ordinance should be amended to provide that Third Party Funding for Arbitration is permitted under Hong Kong law

Number of responses to the Sub-committee's Preliminary Recommendation 1

3.1 Below is a summary of the responses received regarding Preliminary Recommendation 1: *The Arbitration Ordinance should be amended to provide that Third Party Funding for arbitration is permitted under Hong Kong law.*¹

3.2 Of the 38 Respondents who agreed with or opposed Preliminary Recommendation 1, 97% supported it.

	Number	Percentage (%)
Agree	37	51%
Oppose	1	1%
Neutral/No Comment	29	40%
Other Comments	6	8%
<u>Total</u>	<u>73</u>	<u>100%</u>

(Note: Percentages are rounded to the nearest whole number.)

¹ See paras 6.1 to 6.4 of the Consultation Paper.

Comments from Respondents who supported the recommendation

Summary of responses on general issues

3.3 An overwhelming majority of the submissions that commented on Preliminary Recommendation 1 supported the Sub-committee's recommendation 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 (approximately 97%).² They also suggested that Third Party Funding of court proceedings related to arbitration prescribed under the Arbitration Ordinance should be permitted. Those in favour included Respondents from the accounting firms, arbitral institutions, arbitrators, barristers, chambers of commerce, consumer/public interest groups, the financial sector, funders, Government departments, insurers/insurers associations, law firms, professional bodies and academics.

3.4 An international law firm observed that:

"The common law doctrines of maintenance and champerty do not necessarily suit the needs of modern commercial dispute resolution, in particular international arbitrations. We consider that access to justice outweighs concerns about people bringing unnecessary arbitration, as business entities in the international community are in the best position to make sound judgment as to whether particular commercial claims should be pursued."

3.5 One independent arbitrator commented that it is:

"...pointless to try to hold back the tide. In practice funding is available now in many situations. By way of example: In the construction industry many claims consultants provide their

² 37 out of 38 respondents who expressed a view.

services in a way which may include what is effectively Third Party Funding; (this is what was at issue in the Cannonway case.); Some forms of insurance amount to Third Party Funding; Subsidiaries are often funded by parent companies; and borrowing funds by rights issues may also amount to Third Party Funding."

3.6 Most Respondents agreed with the Sub-committee that Hong Kong law is unclear as to whether Third Party Funding for Arbitration taking place in Hong Kong is permitted, a number referring to the observations of Ribeiro PJ in *Unruh* and to the judgment of Kaplan J in *Cannonway*.³ For example an arbitral institution observed that in their view:

"Cannonway⁴ is good law. However, we accept that Ribeiro PJ's obiter comments in Unruh have created significant uncertainty as to whether Hong Kong law permits Third Party Funding for Arbitrations seated in Hong Kong. Consequently, parties and advisors generally err on the side of caution and assume that it is not permitted. [The Respondent] also agrees that this uncertainty is 'damaging to Hong Kong's competitiveness internationally as an arbitration centre', particularly since other major seats, including England, the US and most civil law jurisdictions, do permit such funding."

3.7 An arbitral institution observed that:

"We believe such a positive clarification on Hong Kong's position relating Third Party Funding may well enhance Hong Kong's status as a premium centre for legal and dispute resolution services in the Asia Pacific region and attracting more parties to arbitrate in Hong Kong."

³ *Unruh v Seeberger* (2007) 10 HKCFAR 31.

⁴ *Cannonway Consultants Limited v Kenworth Engineering Limited* [1995] 2 HKLR 475.

3.8 The majority of Respondents shared the view of an international law firm that Preliminary Recommendations 1 and 2 both needed to be implemented. The international law firm commented that:

"In summary, we are in principle supportive of the use of Third Party Funding in arbitrations held in Hong Kong. Specifically, we in principle support the first and second recommendations in the Consultation Paper..."

3.9 An accounting firm observed that the principal reason for its support of Preliminary Recommendation 1 was:

"to enhance Hong Kong as an international arbitration centre, as otherwise it is possible that arbitrations may be lost to London, Paris and other international arbitration centres where TPF is allowed."

It noted:

"the trend of shifting away from prohibition against champerty in various jurisdictions. As noted in the Consultation Paper, users of Hong Kong arbitration are overwhelmingly corporations engaged in commercial, financial and investment disputes. Such corporations should be free to obtain TPF for their disputes should they so wish. Further, TPF is unlikely to result in significant numbers of vexatious arbitrations since it will be in the funders' own interest to support only claims which are likely to succeed."

3.10 An organisation in the financial services sector commented that:

"Concomitant with the shifting of global economic activity from the economies surrounding the Atlantic Ocean to those of the Pacific Ocean, we anticipate that the demand for arbitration services in Asia will grow rapidly in the next 5 years. At the same time,

Hong Kong's role as a leading arbitration centre in Asia means it is well positioned to capture the growth in demand for arbitration in Asia if it continues to utilize every potential advantage through policy and structural reforms. In light of the fact that Hong Kong's peers still (at present) do not allow Third Party Funding for arbitration or litigation, we believe that an amendment of the [Arbitration Ordinance] to expressly permit Third Party Funding for arbitration will give Hong Kong another edge in attracting international arbitration cases to the city."

3.11 One Third Party Funder said that it: "...welcomes the Sub-committee's conclusion that Third Party Funding for arbitration taking place in Hong Kong should be permitted under Hong Kong law, subject to clear ethical and financial standards."

3.12 Another Third Party Funder commented that:

"We welcome this recommendation and agree with it entirely if Hong Kong wishes to maintain its position as a hub for dispute resolution in the region, it must clarify the position regarding the use of TPF in arbitration in Hong Kong... The cost and complexity of high-value arbitration cases makes TPF an important (in fact we would argue essential) option for impecunious claimants, as well as an attractive option for significantly capitalised claimant."

3.13 A professional body submitted that:

"Arbitration remains the main form of dispute resolution in the construction industry in Hong Kong today. As most construction disputes are commercial in nature, whether Third Party Funding for arbitration is available would naturally form part of the commercial consideration when parties pursue their claims in arbitration. Hong Kong is known for its multi-tiered

sub-contracting arrangements in the construction industry. Many of the smaller sub-contractors may not necessarily have the financial means or flexibility in resource allocation to pursue their claims against the larger, more resourceful contractors or project employers despite having meritorious claims. A third party may also have a vested interest in a dispute. Take the example when progress of work is disrupted when a small scale subcontractor is having a dispute with his supplier. It would be of genuine interest to the main contractor if he could fund the subcontractor's case. Third party funding for arbitration in Hong Kong should provide these less resourceful contractors or sub-contractors with alternative options when considering whether they should pursue their claims."

3.14 Another professional body said that it:

"generally supports this recommendation. It will make Hong Kong one of the viable options when corporate counsel chooses a place of arbitration where Third Party Funding is allowed. Third party funding for arbitration in Hong Kong should provide corporations with alternative options for funding claims and pursuing different risk strategies in arbitrations."

The professional body expressed concerns about the possible increase of costs of arbitration and the possibility an "adverse perception about Hong Kong's arbitration system with third parties influencing the decisions to initiate arbitration" if there was easy access to Third Party Funding.

3.15 An industry body said that:

"In general, we support this proposal, subject to the setting of various restrictions such as who can provide such Third Party Funding. If every individual is allowed to provide funding, it could lead to unmeritorious arbitration and injustice by funded parties

trying to delay specific performance or payment under a contract. Hence, there must be standards, code of ethics, financial restrictions, etc in place to govern such Third Party Funders. Consideration should be given as to any safeguards to prevent unmeritorious claims being encouraged."

3.16 Two public interest groups supported the recommendation on access to justice grounds, one stating *"as long as it may serve the purpose of enhancing the rights of consumers to access for justice."*

3.17 Some Respondents also proposed that Third Party Funding for litigation proceedings associated with arbitration should be permitted. Such litigation would include setting aside and enforcement proceedings and interim relief in aid of arbitration.

3.18 As to contingency and conditional fees it was proposed by an international law firm that:

"The Law Society of Hong Kong and Hong Kong Bar Association should make it clear that despite Third Party Funding being permitted in Hong Kong for international arbitrations (as recommended by the Consultation Paper), the current rules on contingency fees for their members still remain in place."

3.19 A division of a Government department referred to sections 5(3) and 7 of the Arbitration Ordinance the effect of which is that the Ordinance applies to arbitrations under other Ordinances commenting that: *"In this regard, it is noted that 'arbitration' is referred to in several such other Ordinance"*. It was suggested that the:

"Sub-committee may wish to direct its specific attention to the nature of the arbitral proceedings (to which Cap 609 applies by virtue of express provisions or merely by virtue of section 5(3) of Cap 609) conducted under such other Ordinances and consider

whether those arbitral proceedings may be funded by a Third Party Funder."

3.20 The division also suggested that the:

"Sub-committee may wish to consult the relevant government bureaux on whether Third Party Funding should be permitted in government-initiated non-statutory arbitration schemes, eg, the Pilot Scheme for Arbitration on Land Premium launched by the Development Bureau / Lands Department in October 2014 and the arbitral proceedings held at the Financial Dispute Resolution Centre."

Responses regarding the proposed amendments to the Arbitration Ordinance

3.21 Those who commented on the form of the amendment to expressly allow third party funding of arbitration the Arbitration Ordinance generally proposed that it should be simply expressed. For example, a professional body suggested that there should be:

"a short amendment to [section] 3 of the [Arbitration] Ordinance to provide for Third Party Funding for arbitration and any court applications under the Ordinance."

An international law firm proposed that:

"the proposed amendment should be kept simple; for example, an amendment to either section 3 ('Objectives and principles' of the Ordinance) or section 5 ('Arbitrations to which the Ordinance applies')."

3.22 One arbitral institution suggested that:

"Amendments to the Ordinance would apply only to arbitrations seated in Hong Kong. In the view of the [respondent], this is the correct outcome. Hong Kong cannot, and should not, attempt to legislate for funding in respect of arbitrations with their seats outside Hong Kong (even if hearings take place in Hong Kong)."

Responses regarding associated amendments to the Arbitration Ordinance

3.23 The definitions of "*Funder*" and "*Third Party Funding*" were the subject of a number of the Respondents' submissions. For example, an arbitral institution proposed that the amendments to the Arbitration Ordinance should include adding the definitions of "*Third Party Funding*" and "*Third Party Funder*". After referring to the relevant definitions in the Consultation Paper, the arbitral institution suggested that in essence a "*Funder*" is "*a person or entity making a non-recourse investment who or which has interest in the proceeds deriving from the resolution of the dispute in the arbitration.*" They referred to the definition of "*Funder*" in the *IBA Guidelines on Conflicts of Interest in International Arbitration (2014)* ("*IBA Guidelines*"), *Explanation to General Standard §6(b)* which is as follows:

"Any person or entity that is contributing funds, or other material support, to the prosecution or defence of the case and that has a direct economic interest in, or duty to indemnify a party for, the award to be rendered in the arbitration."

The arbitral institution also referred to the definition of "*Third Party Funding*" by Lord Justice Jackson in his Jackson Report namely:

"The funding of litigation by a party who has no pre-existing interest in the litigation, usually on the basis that (i) the funder will

*be paid out of the proceeds of any amounts recovered as a consequence of the litigation, often as a percentage of the recovery sum; and (ii) the funder is not entitled to payment should the claim fail."*⁵

Finally, the arbitral institution referred to the ALF's definition of "*Litigation Funding*" as follows:

*"Litigation funding is the provision by a third party of finance to a party to litigation or arbitration, which is used to pay for the legal costs of the dispute, in exchange for the funder taking a share of the proceeds in the event of a successful outcome."*⁶

3.24 An international law firm suggested that the definition of "*Third Party Funder*" should expressly exclude contingency fee arrangements by barristers and law firms. They also suggested that the term "*commercial bodies*" should be included in the Arbitration Ordinance amendment and defined to exclude barristers and law firms.

Comments from Respondents who opposed the recommendation

3.25 The one Respondent who opposed Preliminary Recommendation 1 in summary said that the reform of arbitration law should be slower than reform of law by the Courts. He expressed concern that the Courts could be embarrassed if the regime applicable to arbitration law was reformed before the reform of the regime applicable to litigation. He also said that he did not consider that the potential benefits of reform outweighed the disadvantages.

⁵ Lord Justice Jackson, *Review of Civil Litigation Costs*, Final Report (2009); <https://www.judiciary.gov.uk/wp-content/uploads/JCO/Documents/Reports/jackson-final-report-140110.pdf>.

⁶ ALF website: http://associationoflitigationfunders.com/about_us/.

Our analysis and response

3.26 When considering the approach to amendment of the Arbitration Ordinance to expressly allow third party funding of arbitration, we have considered the submissions received from the Respondents, current Hong Kong law and the approach adopted to addressing similar issues in the common law jurisdictions of the United Kingdom and various Australian states. We have also borne in mind that breaches of the doctrines of maintenance and champerty in Hong Kong may constitute common law criminal offences as well as torts, as observed in the Consultation Paper at paragraphs 3.53 to 3.56.

3.27 As we outlined in the Chapter 1, we have adopted the approach that any reforms should be focused on the consequences of expressly providing that the common law doctrines of maintenance and champerty (both as a tort and as a criminal offence) do not apply to Arbitration (and related proceedings) under the Arbitration Ordinance.

3.28 Thus, for the present purpose, we have not addressed each and every issue that can arise from the increasing number of ways in which Third Party Funders are providing financial assistance to parties to an arbitration (and related proceedings) or to their lawyers. Hong Kong's financial services and legal sectors are supervised by experienced bodies with the expertise and the skills to address the general issues that may arise. In addition, there is an extensive body of law, procedure and practice on arbitration and related proceedings (in both Hong Kong and internationally) that addresses important issues such as conflicts of interest. Arbitral institutions (including their rules, codes and guidelines) as well as institutions developing *ad hoc* international arbitration rules also play an important role in this area which is likely to grow.

3.29 After considering (a) the Consultation Paper, (b) the responses as to Preliminary Recommendation 1, including those summarised in this Report, (c) the current Hong Kong legal system, and having borne in mind the

public interest in access to justice and the preservation of the integrity of litigation, arbitration, and dispute resolution generally, the Law Reform Commission has the following analysis and response.

3.30 As we said in the introduction to this chapter, the vast majority of those who responded to the Consultation Paper supported the Sub-committee's Preliminary Recommendation 1 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.

3.31 We agree that the Arbitration Ordinance should be amended to state that Third Party Funding for arbitration is permitted under Hong Kong law. We recommend that this be done by amendment to the Arbitration Ordinance in the form of the Proposed AO Amendment set out in Annex 1 to this Report.

3.32 As will be seen from the Proposed AO Amendment, we propose that a new Part 10A should be added to the Arbitration Ordinance to provide for Third Party Funding for Arbitration (as defined therein), its purposes being stated to be as follows:

"98E. Purposes

The purposes of this Part are to—

- (a) ensure that third party funding of arbitration is not prohibited by particular common law doctrines; and*
- (b) provide appropriate measures and safeguards in relation to third party funding of arbitration."*

Hong Kong provision of services for arbitrations taking place outside Hong Kong

3.33 As the Sub-committee noted in the Consultation Paper, many lawyers and experts in Hong Kong, among other service providers, work on arbitrations that take place outside Hong Kong. We consider that it is important that their work should fall within the scope of the Proposed AO Amendment, in order to preserve Hong Kong's position as a leading arbitral jurisdiction and to avoid work on such arbitrations going to service providers outside Hong Kong (as anecdotally we understand is happening currently).

3.34 Accordingly, we recommend that any statutory amendment expressly providing that the common law doctrines of maintenance and champerty (both as a tort and as a criminal offence) do not apply to Arbitration should also apply to services provided in Hong Kong for Arbitrations taking place outside Hong Kong. We recommend this formulation to limit the extra-territorial effect of the provision to Arbitrations taking place outside Hong Kong. The terms "*arbitration*" and "*arbitration agreement*"⁷ are each defined in section 2(1) of the Arbitration Ordinance.⁸ Section 98K of the Proposed AO Amendment makes provision for this as follows:

"98K. Extension in relation to Hong Kong services despite place of arbitration being outside Hong Kong

(1) If the place of arbitration is outside Hong Kong, then, despite section 5, this Part applies in relation to the funding of related Hong Kong services, as if the place of arbitration were in Hong Kong."

⁷ "*Arbitration agreement*" has the same meaning as in section 19. Section 19 of the Arbitration Ordinance adopts Option 1, Article 7 of the UNCITRAL Model Law (as amended in 2006).

⁸ Pursuant to section 2 of the Arbitration Ordinance, "*Arbitration*" means any arbitration whether or not administered by a permanent arbitral institution.

Exclusion of lawyers from Third Party Funding

3.35 The definition of "*Third Party Funding*" has been drafted to exclude lawyers *and persons providing legal services* from its scope. Thus section 98G(2) of the Proposed AO Amendment provides:

*"(2) However, third party funding of arbitration does not include the provision of arbitration funding directly or indirectly by a person practising law, or providing legal services, whether in Hong Kong or elsewhere."*⁹

3.36 The Law Reform Commission considers that it is in the public interest, including that parties be represented by independent counsel focused on their service, and of maintaining the integrity of dispute resolution, that lawyers should focus on their provision of professional services to their clients and should not place themselves in a conflict of interest position by engaging in the business of Third Party Funding. Nor does Hong Kong law currently permit Hong Kong lawyers to charge conditional and contingency fees.¹⁰ The identity of those providing legal services (even if not admitted as lawyers), including on the internet, is expanding and we consider that similar considerations apply to such providers of legal services.

3.37 The professional conduct rules applicable to barristers, solicitors and foreign registered lawyers will also need to be amended to expressly provide for the terms and conditions under which a lawyer may represent a party in any arbitration or mediation or court proceedings under the Arbitration Ordinance that is funded by Third Party Funders.

⁹ Section 3 of the Interpretation and General Clauses Ordinance (Cap 1) provides that: "*'person'* (人、人士、個人、人物、人選) includes any public body and any body of persons, corporate or unincorporate, and this definition shall apply notwithstanding that the word '*person*' occurs in a provision creating or relating to an offence or for the recovery of any fine or compensation".

¹⁰ This was the subject of a separate Law Reform Commission reference: see The Law Reform Commission of Hong Kong, *Consultation Paper on Conditional Fees* (2005).

Arbitration Ordinance Mediation and Court Proceedings

3.38 We consider that the Proposed AO Amendment should also apply to mediation under the Arbitration Ordinance (such mediation being excluded from the scope of the Mediation Ordinance Cap 620). Mediation is increasingly being used with partnership and it is in the public interest to encourage amicable resolution of disputes.

3.39 We recommend that consideration should be given to whether to make consequential amendments at the same time to the Mediation Ordinance (Cap 620) to extend the Proposed AO Amendment to mediation within the scope of the Mediation Ordinance including whether the proposed regulatory regime for Arbitration should apply to such mediation.

3.40 We consider that the Proposed AO Amendment should also apply to court proceedings provided for under the Arbitration Ordinance. This is because, as a number of respondents submitted, such proceedings are an integral part of the arbitration process. The Arbitration Ordinance incorporates by section 12, Article 5 of UNCITRAL Model Law (Extent of court intervention) and by section 13, Article 6 of UNCITRAL Model Law (Court or other authority for certain functions of arbitration assistance and supervision) and provides for a range of proceedings in court under the Arbitration Ordinance including with respect to:

- (1) jurisdiction;
- (2) interim relief;
- (3) Emergency Arbitrators' orders;
- (4) confidentiality;
- (5) enforcement of a Tribunal's orders and directions;
- (6) costs;
- (7) setting aside; and

(8) recognition and enforcement of awards;¹¹

among other areas.

3.41 Courts in every developed arbitral jurisdiction have express powers to support arbitrations seated in their jurisdictions. This support, known as "*supervisory jurisdiction*", is an integral part of the arbitral process. In many circumstances, a party to an arbitration must invoke the court's jurisdiction in order to obtain the result or relief it seeks. For example, a party seeking to freeze its opponent's bank accounts must apply to the court where the account is located. The court can issue an order that binds the bank; the Tribunal has no power to bind the bank because it is not a party to the arbitration agreement. Another example is enforcement of arbitral awards. Where a losing party fails to comply with an arbitral award, the award creditor must apply to the relevant court for an order that will allow it to enforce the award, eg by seizing the debtor's assets. Only a court can make such an order; Tribunals have no power to do so.

3.42 Therefore, parties to arbitrations both in and outside Hong Kong frequently apply to the Hong Kong courts under the Arbitration Ordinance. Substantial injustice might occur, for example, if a claimant could rely on funding to pursue its claims in arbitration, but could not rely on funding to enforce that award and were unable to fund such proceedings itself. As is clear from the Consultation Paper that other international arbitration centres

¹¹ As to enforcement of foreign arbitral awards in Hong Kong, a division of a Government Department referred to statements in footnotes 40 to 41 under para 2.33 in Chapter 2 of the Consultation Paper, and clarified as to whether China's declarations under the New York Convention on both "*reciprocity*" and "*commerciality*" under Article I(3) of the New York Convention made upon its accession to the Convention on 22 January 1987 applied to the HKSAR. The Department clarified that in the Note of 6 June 1997 to the UN Secretary-General, the Permanent Representative of China to the UN stated that the application of the New York Convention to the HKSAR from 1 July 1997 is subject only to the following declaration as to reciprocity: "在香港特別行政區，只對在另一締約國領土內作出的仲裁裁決的承認和執行適用本公約" ("*the Convention will be applied in the Hong Kong Special Administrative Region only to the recognition and enforcement of awards made in the territory of another Contracting State*"). It was stated that "*The same has been communicated by the UN Secretary-General to all States and international organisations concerned in Depositary Notification C.N.273.1997 dated 8 August 1997 ... In other words, no declarations on the 'commerciality' of the dispute which gives rise to the arbitration (ie '商事保留')*" have been made in relation to the application of the New York Convention to the HKSAR."

allow Third Party Funding of court proceedings related to arbitration, to maintain the competitiveness of Hong Kong as an international arbitration centre, we consider that Third Party Funding of court proceedings under the Arbitration Ordinance should be permitted.

Definition of "arbitration" to include proceedings before an Emergency Arbitrator as defined in the Arbitration Ordinance

3.43 In 2013, the Arbitration Ordinance was amended to provide in section 22B for the enforcement, with the leave of the Court, of emergency relief that is granted by an Emergency Arbitrator as defined in 22A of the Arbitration Ordinance. We recommend that the proceedings before an Emergency Arbitrator as defined in the Arbitration Ordinance should fall within the scope of the definition of "*arbitration*" in the Proposed AO Amendment.

3.44 The definition of "*arbitration*" for the purposes of Part 10A, is set out in section 98F of the Proposed AO Amendment.

Effective date

3.45 We consider that the amendments in the Proposed AO Amendment should apply to Third Party Funding Agreements made on or after the date of the commencement of the amending legislation (see section 98G read with sections 98H and 98I of the Proposed AO Amendment).

Confidentiality

3.46 As we discuss further in Chapter 6, we recommend that section 18(2)(c) of the Arbitration Ordinance, providing for confidentiality of information obtained in the course of an arbitration except in certain prescribed circumstances, needs to be amended to permit provision of information by a

party to a Third Party Funder or potential Third Party Funder, provided they maintain confidentiality (see section 98P of the Proposed AO Amendment).

Disclosure

3.47 The Consultation Paper discussed at paragraphs 3.46 to 3.47 the ways in which conflicts of interest may arise as to parties' counsel, and also as to arbitrators. As we discuss in Chapter 6 to minimise the possibility of conflicts of interest being the subject of a challenge, we recommend that a party should be obliged under the Arbitration Ordinance to disclose to the other party/ies and to the Tribunal or to the Court the making and ending of a Funding Agreement (see sections 98Q and 98R of the Proposed AO Amendment).

Our Final Recommendation 1

3.48 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") (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).

- (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 Arbitration should apply to MO Mediation.
- (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).
- (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 place of Arbitration were in Hong Kong (see section 98K of the Proposed AO Amendment).
- (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).
- (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.

- (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).
- (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. 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).

Chapter 4

Recommendation: Clear standards for Third Party Funders providing Third Party Funding for Arbitration should be developed

Number of responses to the Sub-committee's Preliminary Recommendation 2

4.1 Below is a summary of the responses regarding Preliminary Recommendation 2 in the Consultation Paper, that *clear ethical and financial standards for Third Party Funders providing Third Party Funding for arbitration should be developed*.¹

4.2 Of the Respondents who agreed with or opposed Preliminary Recommendation 2, 89% supported it.

	Number	Percentage (%)
Agree	34	47%
Oppose	4	5%
Neutral/No Comment	31	43%
Other Comments	4	5%
<u>Total</u>	<u>73</u>	<u>100%</u>

(Note: Percentages are rounded to the nearest whole number.)

¹ See paras 6.5 to 6.7 of the Consultation Paper.

Comments from Respondents who supported the recommendation

4.3 An overwhelming majority of respondents to the Consultation Paper who commented on Preliminary Recommendation 2 (89%) favoured the development of clear ethical and financial standards applicable to Third Party Funders providing Third Party Funding to parties to arbitrations. Indeed, all but four of the Respondents who submitted views on Preliminary Recommendation 2 supported the introduction of such standards in some form. A number of Respondents also suggested regulating lawyers who represent clients in funded arbitrations.

4.4 There were differing views on the form and scope of such regulation. One international law firm, for example, advocated a *"mandatory code of conduct in [a] schedule to the Arbitration Ordinance applicable to arbitrations where the seat of arbitration is Hong Kong"*. A second international firm felt that statutory regulation should be implemented, *"as is the case with almost all financial products"*. Another international law firm proposed introducing *"only minimum ethical and financial standards"* on the basis that *"Third Party Funders should provide no more than a financing option for litigants"*, and that an application for Security for Costs will generally address any issues that arise from a Third Party Funding arrangement. One Hong Kong law firm stated that *"clear conflict guidelines are crucial"*, with another commenting *"[c]learly strict financial standards need to be introduced along with a code of conduct"*, and noting the difficulty of regulating *"overseas funders"*.

4.5 One Respondent stated that:-

"... from a business perspective, there is a potential for a whole new Third Party Funding industry to develop with multiple players competing with each other creating segmentation and specialisation. If something like this is to be developed, it has

the potential to shift the focus of the arbitration from litigants to the Third Party Funders and the law firms. To ensure that the ultimate purpose of the whole new set-up is to support litigants, a strong regulatory environment for the requisite ethical and financial standards is needed to monitor the activities of the stakeholders in this industry in particular the Third Party Funders. Such ethical and financial standards should apply to both Third Party Funders and lawyers who are effectively funding the proceedings."

4.6 A forensic accounting firm preferred the approach advocated by Australia's Productivity Commission, ie that "*the regulations and supervision of any applicable ethical and financial standards should be a function of the Tribunal or the Court*", and that both the Funded Party and Third Party Funder be required to "*obtain sanction of the funding arrangements from the Tribunal or the Court or any other relevant statutory authority*" to avoid subsequent challenge.

4.7 Most of the arbitral institutions that responded also favoured regulation of Third Party Funding in Hong Kong, although their views differed as to the form such regulation should take (please see the summary of responses to Preliminary Recommendation 3).

4.8 Industry bodies that responded in the construction and in-house counsel sectors supported the introduction of ethical and financial standards. A Respondent commented that a "*strong regulatory environment for the requisite ethical and financial standards is needed to monitor the activities of the stakeholders in this industry in particular the Third Party Funders*". It stated that, "*appropriate ethical and financial standards should be devised by relevant professional bodies of legal and financial background to ensure that the interest of [the] funded party is sufficiently protected*", although it did not suggest any specific body or bodies to perform this function.

4.9 A Government department advocated the promulgation of a suitable code of conduct, together with a system for licensing the operation of Third Party Funding. Other respondents suggested that the Department of Justice itself could establish a unit responsible for regulating Third Party Funders in Hong Kong, to be funded by fees payable by the funders (please see the summary of responses to Preliminary Recommendation 3).

4.10 Among the funders who responded, there was unanimous support for the introduction of ethical and financial standards. One funder commenting that while there are benefits with Third Party Funding, there are certain risks associated with its including the capital adequacy of the funder, conflicts of interest and confidentiality and privilege issues. Funders' views on the structure for providing for such standards differed, with one funder proposing a voluntary code of conduct for a trial period of five years, potentially followed by a mandatory regime on capital adequacy and conflicts of interest, together with a licensing regime under the Securities and Futures Commission to ensure compliance. Another funder respondent would prefer the immediate introduction of a statutory regime, noting that *"...while [self-regulation] works well for those Third Party Funders which elect to take up membership, such Third Party Funders are not necessarily those for whom regulatory supervision is most useful."* However, this funder recognizes that a *"phased approach"* might be more appropriate, with self-regulation as a *"first step"*.

4.11 The two bodies regulating the Hong Kong legal profession both support the introduction of ethical and financial standards in respect of Third Party Funding in Hong Kong.

Comments from Respondents who opposed the recommendation

4.12 Amongst the 73 responses received, four oppose Preliminary Recommendation 2. The key reasons were:

- (1) The law applicable to litigation should be revised before the law applicable to arbitration is.
- (2) Respondents were not persuaded that such safeguards are required and that there were many practical difficulties to regulation which make any attempt pointless. Given the international nature of arbitration and the possibility of funding coming from many disparate sources both in and outside Hong Kong, one Respondent did not believe regulation would be effective. One of these Respondents did not think it was clear who the standards intended to protect and why such protection is considered desirable.
- (3) It is unnecessary for Third Party Funding for arbitrations to be the subject of specific regulations as adequate protection is provided by the Funding Agreement combined with uncontentious legal and equitable principles. In particular, the "*light touch*" regulatory approach in Australia (which has been adopted in response to particular decisions of the courts) works well, and there has not been a need for anything more prescriptive.² A number of the concerns expressed with respect to litigation funding, generally, are relevant to the conduct of funded class actions but have little force in arbitrations. The regulation of litigation funding in class actions is sufficiently different from the funding of a party to an arbitration or an insolvency practitioner that different constraints are required and that it would not be appropriate for new

² The Australian legislation provides for mandatory conflicts procedures.

regulations to be introduced to address issues which are already addressed by the well-established legal and equitable principles.

Our analysis and response

4.13 The majority of Respondents who commented on Preliminary Recommendation 2 clearly agreed with the Sub-committee that having clear ethical and financial standards for Third Party Funders providing Third Party Funding to parties to arbitration is important to ensure that the public policy justifications for permitting Third Party Funding for Arbitration are the focus of the reforms and to promote the integrity of arbitration.

4.14 Such standards are in place to varying degrees in all of the jurisdictions that permit Third Party Funding that the Sub-committee reviewed as discussed in Chapter 4 of the Consultation Paper. While Third Party Funding for arbitration is permitted in all but one of the jurisdictions reviewed (and that jurisdiction, Singapore announced in June 2016 that it will be reforming its law to allow Third Party Funding for arbitration and arbitration related proceedings),³ there is little uniformity in the form of regulation of Third Party Funding. The main trend is towards a "*light touch*" approach, either by statutory regulation of financial and conflicts issues (eg, Australia and some US states) or self-regulation (eg, England and Wales).

4.15 All jurisdictions that the Sub-committee reviewed also impose ethical and professional rules on lawyers, of varying content. We also consider that Hong Kong should develop its own model of regulation that suits its culture and needs, which will be informed by the experience and approach of other relevant jurisdictions.

³ On 30 June 2016 the Singapore Ministry of Law announced a consultation period ending on 29 July 2016 of a draft Bill and draft Regulations permitting Third Party Funding of international arbitration and related Singapore litigation and mediation provided certain conditions were satisfied.

4.16 Having reviewed the range of submissions received on Preliminary Recommendation 2, and observed that all but four of those who commented on Preliminary Recommendation 2 supported it, we agree with the view expressed in the Consultation Paper that clear ethical and financial standards for Third Party Funders providing Third Party Funding to parties to arbitrations and court proceedings falling within the scope of the Hong Kong Arbitration Ordinance should be developed.

4.17 The mechanism for providing and enforcing such financial and ethical standards is discussed in Chapter 5 where Preliminary Recommendation 3(1) is considered.

4.18 The contents of such financial and ethical standards are discussed in Chapter 6 where Preliminary Recommendation 3(2) is considered.

Our Final Recommendation 2

4.19 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.

Chapter 5

Recommendation: Form of regulation

Number of responses to the Sub-committee's Preliminary Recommendation 3(1)

5.1 Below is a table summarising the responses regarding Preliminary Recommendation 3 (1) in the Consultation Paper: *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.*¹

5.2 The Respondents who commented on Preliminary Recommendation 3(1)(a) and (b) were fairly evenly split between supporting statutory regulation (45%) and supporting self-regulation (43%) with 12% supporting both.

	<i>Total</i>	<i>Statutory regulation</i>	<i>Self-regulation</i>	<i>Both Statutory and self-regulation</i>
<i>Regulation</i>	49 (100%)	22 (45%)	21 (43%)	6 (12%)
<i>Oppose any regulation</i>	2			

(Note: Percentages are rounded to the nearest whole number.)

¹ See paragraphs 6.8 to 6.11 of the Consultation Paper.

Comments from Respondents who supported the recommendation

5.3 Whilst the questions raised two specific sub-issues, it is appropriate to consider the responses to both Preliminary Recommendation 3(1)(a) and (b) in the Consultation Paper together.

5.4 A clear majority of the Respondents who commented on Preliminary Recommendation 3(1)(a) and (b) agreed that the development and supervision of the applicable ethical and financial standards should be supervised, regulated and enforced. Of the responses to Preliminary Recommendation 3(1), there are only two clear objections to any form of supervision or regulation (as outlined below).

5.5 As to the body by which such supervision and regulation is to be undertaken, there was an approximately equal number in favour of a statutory body and of a self-regulatory body. A minority of Respondents proposed a phased approach, in which there would be a self-regulatory body for a trial period and thereafter a statutory body would be established. One Respondent suggested that a self-regulatory body should be established and be permanently tasked with the supervision and regulatory function. Another Respondent suggested that a licensing regime for the operation of Third Party Funders be introduced.

5.6 As to the Respondents who preferred statutory regulation, the majority expressed the view that an independent statutory body should be set up. However some Respondents cautioned against this and expressed concern about how long it would take to establish a statutory body.

5.7 One Respondent suggested that the regulatory function should be carried out by the court or a tribunal.

5.8 One Respondent suggested that the HKIAC should take a primary role in overseeing any self-regulatory body and that the HKIAC should together with the Sub-committee develop the applicable standards.

5.9 One accounting firm commented that it should be necessary for the Funded Party and the Third Party Funder to obtain sanction of the funding arrangements from the Tribunal or the Court or any other relevant statutory authority. Once it is approved, the arrangement will be deemed to be valid and binding to avoid potential challenges by opponents in the proceedings or other stakeholders when recoveries are available.

5.10 One funder submitted that assuming the existing laws in Hong Kong regarding maintenance and champerty have been clarified to permit Third Party Funding in the first instance, it would be appropriate to introduce a voluntary code of conduct for Third Party Funding in Hong Kong in a manner equivalent to the ALF Code in the UK. The use of a trial period seemed sensible: the arrangements should be kept under review over a five year period, and conclusions can then be drawn as to whether any changes to the regulatory approach are desirable. As to the scope for future mandatory regulation, the funder recommended the approach of the Australian Productivity Commission, with mandatory provisions to be included in a code of conduct relating to capital adequacy and conflicts of interest with which funders must comply, and the remaining provisions to be voluntary guidelines. They suggested that the revised regime could be kept under review for a further period before any further substantive changes are made.

5.11 The funder also commented that effective compliance by a licensing regime should be introduced by an appropriate regulatory body, such as the Securities & Futures Commission (the "SFC") with compliance with the mandatory standards (ie capital adequacy and conflicts of interest) being a condition of maintaining a licence from the SFC. The SFC's regime (in common with the equivalent Australian licencing regime) could impose prohibitions on inappropriate conduct, require financial reporting, enable the

regulator to prevent the entry of inappropriate operators to the industry and remove operators when they breach the rules.

Comments from Respondents who opposed the recommendation

5.12 As outlined above, of the responses, there are two clear objections to any form of supervision or regulation. The primary reasons expressed for the opposition were:

- (1) Hong Kong already has a lot of statutory regulators. Unless a levy is imposed (which would make Hong Kong less competitive), funding a statutory regulator would impinge on the public purse.
- (2) It may inhibit the development of the Third Party Funding industry.

Our analysis and response

5.13 After considering the responses and comments including those summarised above, the approach to regulation of Third Party Funding, as outlined in the Consultation Paper, including the "*light touch*" approach that has generally been adopted, we have the following analysis and response.

5.14 Earlier in the Report, we have examined and accepted the justifications for allowing Third Party Funding in arbitration, proceedings before an Emergency Arbitrator, mediation and court proceedings under the Arbitration Ordinance.

5.15 We also recognise that the Third Party Funding sector in Hong Kong is relatively new and more knowledge and actual experience will be required for it to develop.

5.16 We have borne in mind that this Sub-committee's terms of reference concern the provision of funding by Third Party Funders to Funded Parties. We are not concerned with the raising of funds by Third Party Funders, which in Hong Kong will likely fall within the scope of one of the regulators of the financial services sector, depending on the nature and structuring of the financial assistance being provided to the Funded Party by the Third Party Funder.

5.17 We have noted the strong public support for the need to have some regulatory regime in place to ensure that the development of Third Party Funding for Arbitration in Hong Kong is fair and transparent, providing parties with access to further sources of funding for their cases while preserving the integrity of the arbitration process.

5.18 As to the possibility of statutory regulation, we bear in mind the concerns expressed regarding the early stage of development of the Third Party Funding for Arbitration sector in Hong Kong as well as the likely time that would be taken for a statutory regulatory body to be set up.

5.19 As to the possibility of a self-regulatory model, we bear in mind that currently most Third Party Funders are based outside Hong Kong. Even in England and Wales, where many Third Party Funders who provide funding have a place of business, a significant proportion have not joined the ALF, as was pointed out by one of the funders in their submission to the Sub-committee.

Code

5.20 Accordingly we consider that at this first stage, Third Party Funders funding arbitration, proceedings before an Emergency Arbitrator, mediation and court proceedings under the Arbitration Ordinance should be required to comply with a Code issued by an Authorized Body designated under the Arbitration Ordinance (sections 98F and 98T of the Proposed AO Amendment). The use of codes of conduct to promote best practices in the interests of the public is common in Hong Kong, including in the financial services sector.² In our view a Code is in line with the "*light touch*" approach to regulation adopted in other jurisdictions including in Australia and England and Wales while being a common way in Hong Kong of ensuring that high standards of probity, accountability and transparency are set. The Code would not be subsidiary legislation (see section 98N(6) of the Proposed AO Amendment).

5.21 As appears from section 98N of the Proposed AO Amendment, before issuing a Code, or amending any Code, the Authorized Body must prepare the proposed Code or amendment and publicly consult about it.

5.22 The Code would set out the standards and practices with which Third Party Funders providing Third Party Funding for Arbitration would be ordinarily expected to comply - please see section 98L of the Proposed AO Amendment. Our recommendations as to the Code's contents are set out in Chapter 6.

5.23 We consider that a person's failure to comply with a provision of the Code should not, of itself, render them liable to any judicial or other proceedings. However the Code should be admissible in evidence in proceedings before any court or Tribunal; and the compliance, or failure to comply, with the Code may be taken into account by the court or Tribunal if it is

² See for example the Securities & Futures Commission, the Hong Kong Federation of Insurers and the Hong Kong Monetary Authority.

relevant to a question being decided by that court or Tribunal (see section 98O of the Proposed AO Amendment).

5.24 The Proposed AO Amendment by which the doctrines of champerty and maintenance do not apply to Arbitration only extends to Third Party Funding for Arbitration as defined herein. These doctrines will continue to apply to other funding (including funding by persons practicing law or providing legal services).

Advisory Body

5.25 We recommend that 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 to be the Advisory Body that monitors 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 its sub-committee) should arrange to meet twice a year with representatives of primary stakeholders/interested parties in third party funding to discuss the implementation and operation of the Code and any matters arising.

5.26 We recommend that 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.

5.27 The implementation of the Code and the monitoring of the reform of the law in this area by the Advisory Body involving the various stakeholders would lay the ground for the development of a statutory body in the long-term if it is decided that it is necessary. The Advisory Body will be able to provide a report on how the Code has taken effect in an objective way thereby enabling the further development of the Third Party Funding sector. If it is felt that a three year period is not long enough to assess the effectiveness of the Code, the Advisory Body could also recommend extending this first phase.

5.28 We do not think that the grounds for opposition of any form of supervision or regulation raised by the two Respondents are justified when considering the important public interests involved including to ensure the integrity of arbitration infrastructure in Hong Kong. That it may not be easily ascertainable how such regulatory function is to be introduced or enforced does not mean, as a matter of principle, that it should not be pursued.

Our Final Recommendation 3(1) to (8)

5.29 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.
- (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.

- (3) Third Party Funders funding Arbitration should be required to comply with a *Third Party Funding for Arbitration Code of Practice* (defined earlier as the "Code") issued by a body authorized under the Arbitration Ordinance (defined earlier 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).
- (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).
- (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 being decided by that court or Tribunal (see section 98O of the Proposed AO Amendment).
- (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).

- (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.
- (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.

Chapter 6

Recommendation: How the applicable ethical or financial standards should address relevant issues

Number of responses to the Sub-committee's Preliminary Recommendation 3(2)

6.1 Below is a summary of the responses regarding Preliminary Recommendation 3(2) in the Consultation Paper: *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 complaints procedure and enforcement.*¹

Preliminary Recommendation 3(2)(a): Capital adequacy

6.2 Of the Respondents who agreed with or opposed Preliminary Recommendation 3(2)(a), 82% agreed with it.

	Number	Percentage (%)
Agree	18	25%
Oppose	4	5%

¹ Paragraph 6.11 of the Consultation Paper.

	Number	Percentage (%)
Neutral/No comment	51	70%
Other comments	0	0%
<u>Total</u>	<u>73</u>	<u>100%</u>

(Note: Percentages are rounded to the nearest whole number.)

Preliminary Recommendation 3(2)(b): Conflicts of interest

6.3 Of the Respondents who agreed with or opposed Preliminary Recommendation 3(2)(b), 85% agreed with it.

	Number	Percentage (%)
Agree	22	30%
Oppose	4	6%
Neutral/No comment	47	64%
Other comments	0	0%
<u>Total</u>	<u>73</u>	<u>100%</u>

(Note: Percentages are rounded to the nearest whole number.)

Preliminary Recommendation 3(2)(c): Confidentiality and privilege

6.4 Of the Respondents who agreed with or opposed Preliminary Recommendation 3(2)(c), 79% agreed with it.

	Number	Percentage (%)
Agree	15	21%
Oppose	4	5%
Neutral/No comment	52	71%
Other comments	2	3%
<u>Total</u>	<u>73</u>	<u>100%</u>

(Note: Percentages are rounded to the nearest whole number.)

Preliminary Recommendation 3(2)(d): Extent of extra-territorial application

6.5 A minority of Respondents commented upon this proposal and most focused on the extent of any extra-territorial application to enforcement proceedings and interim relief in aid of foreign arbitration.

	Number	Percentage (%)
Comments	17	23%
Neutral/No comment	56	77%
<u>Total</u>	<u>73</u>	<u>100%</u>

(Note: Percentages are rounded to the nearest whole number.)

Preliminary Recommendation 3(2)(e): Control of the arbitration by the Third Party Funder

6.6 Of the Respondents who agreed with or opposed Preliminary Recommendation 3(2)(e), 71% agreed with it.

	Number	Percentage (%)
Agree	15	21%
Oppose	6	8%
Neutral/No comment	52	71%
Other comments	0	0%
<u>Total</u>	<u>73</u>	<u>100%</u>

(Note: Percentages are rounded to the nearest whole number.)

Preliminary Recommendation 3(2)(f): Disclosure of Third Party Funding to the Tribunal and other party/parties to the arbitration

6.7 Of the Respondents who commented upon Preliminary Recommendation 3(2)(f), 85% agreed with it.

	Number	Percentage (%)
Agree	22	30%
Oppose	4	6%
Neutral/No comment	46	63%
Other comments	1	1%
<u>Total</u>	<u>73</u>	<u>100%</u>

(Note: Percentages are rounded to the nearest whole number.)

Preliminary Recommendation 3(2)(g): Grounds for termination of Third Party Funding

6.8 Of the Respondents who commented upon Preliminary Recommendation 3(2)(g), 76% agreed with it.

	Number	Percentage (%)
Agree	13	18%
Oppose	4	5%
Neutral/No comment	54	74%
Other comments	2	3%
<u>Total</u>	<u>73</u>	<u>100%</u>

(Note: Percentages are rounded to the nearest whole number.)

Preliminary Recommendation 3(2)(h): A complaints procedure and enforcement

6.9 Of the Respondents who commented upon Preliminary Recommendation 3(2)(h), 89% agreed with it.

	Number	Percentage (%)
Agree	16	22%
Oppose	2	3%
Neutral/No comment	54	74%
Other comments	1	1%
<u>Total</u>	<u>73</u>	<u>100%</u>

(Note: Percentages are rounded to the nearest whole number.)

Summary of responses on Preliminary Recommendation 3(2)

6.10 We next briefly summarise the responses received as to each issue raised by Preliminary Recommendation 3(2) in the Consultation Paper.

6.11 A number of Respondents provided detailed comments regarding the financial and ethical standards that they proposed. For example, one international law firm suggested that a mandatory code of conduct should be included in a schedule to the Arbitration Ordinance applicable to arbitrations seated in Hong Kong.

6.12 Many Respondents suggested that Hong Kong's financial and ethical standards should be drafted by reference to the standards below, as adapted to meet the specific needs of Hong Kong:

- (1) 2014 ALF Code;²
- (2) The current Australian regulatory regime for conflicts in the Corporations Amendment Regulation 2012 (No 6) of Australia, Regulation 7.6.01AB (2) to (4);³
- (3) The 2014 Australian Productivity Commission's Final Report.⁴

6.13 Respondents suggested that such standards should be devised by stakeholders, not just Third Party Funders or lawyers but also representatives from the Independent Commission Against Corruption, Consumer Council and the Hong Kong Monetary Authority. One construction

² The Code of Conduct can be found at: <http://associationoflitigationfunders.com/wp-content/uploads/2014/02/Code-of-conduct-Jan-2014-Final-PDFv2-2.pdf>. Please refer to para 4.81-4.85 of the Consultation Paper for further discussion.

³ The Regulation can be found at <https://www.legislation.gov.au/Details/F2013C00050>. Please refer to paras 4.33 to 4.40 of the Consultation Paper for further discussion.

⁴ The Commission Report can be found at: <http://www.pc.gov.au/inquiries/completed/access-justice/report/access-justice-overview.pdf>. Please refer to paras 4.41 to 4.50 for further discussion.

institution expressed the view that appropriate ethical and financial standards should be devised by relevant professional bodies of legal and financial background to ensure that the interest of Funded Party is sufficiently protected. An arbitral institution proposed that if any self-regulatory code of conduct is mandatory for funders offering funding in Hong Kong seated arbitrations, funders and Third Party Funding users in the United Kingdom, Australia, the United States and elsewhere should be consulted.

6.14 One legal professional body suggested that a strong regulatory environment for the requisite ethical and financial standards is needed to monitor the activities of the stakeholders in this industry, in particular the Third Party Funders. Such ethical and financial standards should apply to both Third Party Funders and lawyers who are effectively funding the proceedings.

6.15 An arbitral institution said that they would appreciate such standards and regulations being readily accessed by parties or potential parties of arbitration in Hong Kong who are, or anticipate to be funded by Third Party Funding.

6.16 One accounting firm observed that the regulations and supervision of any applicable ethical and financial standards should be a function of the Tribunal or the Court, which will also ensure a role for local legal practitioners, as officers of the court, in ensuring compliance with reasonable ethical and financial standards.

6.17 One international law firm suggested that Third Party Funders should provide no more than a financing option for litigants, and that as long as this role is made clear, only minimum ethical and financial standards are necessary. The international law firm provided detailed comments as regards the approach to the applicable ethical and financial standards in the code of conduct as follows:⁵

⁵ The Respondent noted that the ALF and the ALF Code adopted in England and Wales seem to be an appropriate approach as a starting point.

- (1) Issues of maintenance and champerty are difficult to raise before an arbitral tribunal as they are reluctant to entertain sanctions against counsel for violation of ethical standards.
- (2) Tribunals do not have jurisdiction to decide on issues in respect of a funding agreement between a Funded Party and the Third Party Funder. The best way of responding to Third Party Funding is consideration of a Security for Costs application (see Recommendation 4 below).
- (3) They considered that it is not only "*commercial bodies*" that fund claims but also lawyers from other jurisdictions where ethical rules allow for contingency fees. They had encountered counsel from US law firms not subject to the rules on professional conduct of the Law Society funding large international arbitrations seated in Hong Kong on a contingency fee basis. They said that the American Bar Association defines contingency fees as follows:

"A client pays a contingent fee to a lawyer only if the lawyer handles a case successfully. Lawyers and clients use this arrangement only in cases where money is being claimed-most often in cases involving personal injury or workers' compensation. In a contingent fee arrangement, the lawyer agrees to accept a fixed percentage (often one third) of the recovery, which is the amount finally paid to the client. If you win the case, the lawyer's fee comes out of the money awarded to you. If you lose, neither you nor the lawyer will get any money, but you will not be required to pay your attorney for the work done on the case."

- (4) The Law Society of Hong Kong and Hong Kong Bar Association should make it clear that despite Third Party Funding being permitted in Hong Kong for international arbitrations (as recommended by the Consultation Paper), the current rules on contingency fees for their members still remain in place.
- (5) The development and supervision of the applicable ethical and financial standards should be initially conducted by a self-regulatory body in the form of a code with input from all stakeholders.

Preliminary Recommendation 3(2)(a) – Capital adequacy

Comments from Respondents who supported the recommendation

6.18 In relation to the issue of capital adequacy, one accounting firm observed that it is in the public interest to ensure that Third Party Funders are duly established and fit and proper to provide Third Party Funding and that they have a sufficient minimum amount of capital.

6.19 A number of Respondents suggested⁶ that a Hong Kong Code of Conduct for Third Party Funding for Arbitration could include provisions on capital adequacy, either as a stand-alone obligation or as part of a broader licensing regime. It was suggested that the advantages of a licensing regime would be to provide regulatory oversight at the outset and to ensure that only reputable and capable funders can enter and operate in the market. Under the Hong Kong code or the licensing regime, funders could be required to adopt an approach similar to that under Article 9 of the ALF Code.⁷ Another

⁶ One Respondent noted that in Australia there is no regulation of capital adequacy requirements of funders. However, a Productivity Commission Report dated 5 September 2014 (at pages 631 – 633) has recently recommended the implementation of a licensing regime for funders that would address capital adequacy obligations.

⁷ Article 9 of the ALF Code includes an obligation to (i) maintain access to a minimum

Respondent proposed that such requirements could be imposed on cases of different amounts in dispute. For instance, there should be three categories of cases for amounts: (i) below \$1 million; (ii) \$1 million to \$10 million; and (iii) over \$10 million. They suggested that different capital adequacy requirements could be set for these cases.

6.20 One barrister suggested that there should be a reporting or alerting mechanism that requires the Third Party Funders to inform their Funded Parties when their financial positions fall below an alarming level that may affect the funding of the proceedings. He further explained that it is of the funders' benefit to inform and alert their Funded Parties before they are running out of funds for Funded Parties as Arbitration Funding continues as the arbitral proceedings continue.

6.21 The amounts proposed by Respondents to satisfy any capital adequacy arrangement ranged up to US\$5 million (in addition to satisfying other financial obligations).

Comments from Respondents who opposed the recommendation

6.22 Four Respondents opposed Preliminary Recommendation 3(2)(a) primarily on the grounds that:

- (1) The issue of capital adequacy is irrelevant, as all Third Party Funders should provide fortified security for the Respondents' costs for references seated in Hong Kong.

level of capital, to be determined by the regulatory body from time to time; (ii) demonstrate a financial ability to pay off all foreseeable debts and funding liabilities for the following 36 months, as and when such debts and funding liabilities become due and outstanding; (iii) engage an independent auditor to audit their accounts annually and to provide the regulatory body with a copy of this independent auditor's opinion; and (iv) be subject to continuous disclosure obligations regarding their capital adequacy, including a specific obligation to notify the regulatory body as soon as a Funder reasonably believes that it is no longer able to comply with any of the capital adequacy requirement.

- (2) It should be the obligation of the Funded Party to assess the credit rating of any prospective funder.

Preliminary Recommendation 3(2)(b) – Conflicts of interest

Comments from Respondents who supported the recommendation

6.23 As to the conflicts of interest that may arise for a Third Party Funder, a number of Respondents referred to section 911A of the Corporations Regulations 2011 (Cth) (sic)⁸ by which funders are required to maintain adequate practices for managing any conflicts of interest that may arise in relation to activities undertaken by the funder. These include: (i) having written procedures on monitoring, disclosing and managing situations where there are potential conflicts of interest; (ii) implementing the written procedures; and (iii) reviewing these written procedures.

6.24 A number of Respondents also referred to Article 9 of the ALF Code and proposed that funders should be required to:

- (1) Refrain from taking any steps that would cause or are likely to cause the Funded Party's arbitration counsel to act in breach of their professional duties to the Funded Party; and
- (2) Take reasonable steps to ensure that Funded Parties receive independent legal advice on the terms of the funding agreement prior to its execution.

6.25 One international law firm suggested that we should also consider the possibility that in future funders will employ their own arbitration counsel, who may represent a Funded Party in an arbitration in Hong Kong. They discussed this further in the context of an ethical code for arbitration

⁸ Section 7.6.01AB of the Corporations Amendment Regulations 2012 (No 6).

counsel, where this point particularly arises, but suggested that it may be worthwhile to address this situation in a code of conduct.

6.26 One accounting firm suggested that conflicts of interest raise concerns regarding counsel and arbitrators. They suggested that this is particularly so where litigation funding companies owned by the principals of law firms fund lawsuits in which the firms represent the claimants. They suggested that general principle of conflicts of interest should be adopted. They commented that existing statutory provisions and applicable professional conduct rules of the Law Society of Hong Kong already provide substantial protection to avoid the potential conflicts of interest of the legal profession. Any potential conflict of interest can be further addressed by the following guidelines as in France, Germany and Netherlands:

- (1) The law firms must take instructions from the Funded Party and act in the best interest of the Funded Party (and not the Third Party Funder);
- (2) The law firms shall not charge contingent fees;
- (3) The law firms shall not have any profit sharing interest in a funding arrangement or provide funding to their clients; and
- (4) The Court and Tribunal, when they review a funding arrangement, shall determine whether the Third Party Funder has too influential a role in the arbitration.

The accounting firm proposed that guidelines should be implemented to restrict the number of times that the Third Party Funder has funded the same law firms in any of the arbitration / proceedings.

6.27 A funder said that, as recognised at paragraph 4.37 of the Consultation Paper, providers of Third Party Funding in Australia are currently exempt from the requirement to hold an Australian Financial Services Licence

provided they have established adequate processes and procedures to manage conflicts of interest in respect of funded parties. As a consequence, the funder maintains a conflicts management policy containing provisions such as the following:

- (1) Disclosure of any pre-existing relationships between the Third Party Funding company and the lawyers in a particular case;
- (2) Recommendation that clients seek independent legal advice before signing a funding agreement;
- (3) Acknowledgement that the lawyers act for the client and not for the Third Party Funding company, and that the client can override any instructions given by the Third Party Funding company;
- (4) Provision of a mechanism for referring any disputes, such as conflicting views over settlement, to senior counsel; and
- (5) Specifying the circumstances in which the Third Party Funding company can terminate its funding agreement.

6.28 The same funder suggested that any code of conduct should state that all Third Party Funders seeking to operate in Hong Kong should maintain a publicly accessible conflicts management policy similar to the above. They observed that in time, as with the capital adequacy provisions, it may be desirable that the conflict of interest provisions of the code become capable of mandatory enforcement as a condition of holding a Third Party Funding licence. They referred to the IBA Guidelines that provide recommendations in this regard. They suggested that the code of conduct could include a provision equivalent to General Standard 7 of the IBA Guidelines, which requires disclosure to the Tribunal, the other parties to the arbitration and the arbitral institution of any relationship between the arbitrator

and a party or persons or entities with a "*direct economic interest*" in the outcome of the proceedings.⁹

Comments from Respondents who opposed the recommendation

6.29 The primary reasons given by the four Respondents who opposed Preliminary Recommendation 3(2)(b) are as follows:

- (1) The issue of conflicts can be dealt with by way of agreement between a Third Party Funder and a Funded Party; and
- (2) Concerns over conflicts may be of limited relevance in the context of international commercial arbitration.

Preliminary Recommendation 3(2)(c) – Confidentiality and privilege

Comments from Respondents who supported the recommendation

6.30 As to the issue of confidentiality, a number of Respondents proposed that section 18(2)(c) of the Arbitration Ordinance should be amended to allow an exception enabling disclosure of information relating to arbitral proceedings and awards by a Funded Party to its funder. Section 18(2)(c) contains an exception for instances where a disclosure or communication is made to a professional or adviser of one of the parties. An amendment could be made to include Third Party Funders within this exception. They suggested that the code of conduct could also address the issue of confidentiality by requiring funders to undertake in their funding agreements to maintain the confidentiality of arbitral proceedings, arbitral awards and any

⁹ *IBA Guidelines on Conflicts of Interest in International Arbitration*, adopted by resolution of the IBA Council on Thursday 23 October 2014.

information obtained by the funders in connection with those proceedings or awards. A number of Respondents referred to section 7 of the ALF Code that provides that a funder will observe the confidentiality of all information and documentation relating to the dispute to the extent that the law permits, and subject to the terms of any confidentiality or non-disclosure agreement between the funder and the Funded Party. One funder said that it asks all claimants to sign a common interest confidentiality agreement once it begins to interact with it.

6.31 As to the issue of privilege, one international law firm suggested that it is not necessary to promulgate any further legislation to extend privilege to communications between a Funded Party and a funder - doctrines of litigation privilege and common interest privilege are likely to cover Third Party Funding arrangements such that disclosure of privileged information to funders is unlikely to waive privilege over such communications. Case law may be needed to confirm this and it is better for the courts to establish this principle on a case-by-case basis, rather than legislation being introduced. However, the issue of privilege will no doubt be included in the review of ethical standards of arbitration counsel, and they said that they recognized that legislation relating to privilege may result.

6.32 One funder suggested that Hong Kong legislation, regulations or rules of court be amended to explicitly provide that:

- (1) A litigant does not waive any privilege the litigant has in any communication or document merely by disclosing that communication or document to the funder on a confidential basis;
- (2) All confidential communications between the funder, the litigant and/or their lawyers in relation to actual or proposed funded litigation or arbitration be privileged; and

- (3) These rules apply to communication both pre- and post- the commencement of the actual or proposed funded litigation or arbitration.

6.33 An international arbitration institution suggested that the issue of common law privilege should be addressed in a voluntary code of conduct whereby the Third Party Funder would acknowledge that common interest privilege attaches to communication between it and the Funded Party and state that it would observe the doctrine of legal privilege accordingly (subject to any applicable waivers in Hong Kong law).

Comments from Respondents who opposed the recommendation

6.34 The primary reasons given by the four Respondents who opposed Preliminary Recommendation 3(2)(c) were as follows:

- (1) Lawyer-client privilege creates a dilemma for the Funded Party as disclosure of confidential information regarding the claim may result in leakage of information to the opposing party while non-disclosure may result in withdrawal of funds by the Third Party Funder. Accordingly, confidentiality obligations will limit the confidential information that can be provided to the Third Party Funder to obtain or maintain funding without breach.
- (2) As lawyers from other jurisdictions often represent their clients in Hong Kong international arbitration, the terms of engagement between those lawyers and their clients (including both Funded Party and funder) are best left to the parties concerned.

Preliminary Recommendation 3(2)(d) – Extra-territoriality

6.35 Respondents generally proposed that the amendments to the Arbitration Ordinance and the provisions of any code of conduct should apply where an arbitration is taking place in Hong Kong, ie where Hong Kong is the seat of the arbitration. One international firm said that this means that even where funders are not incorporated in Hong Kong and/or do not have a physical presence in Hong Kong, their involvement in Hong Kong-based arbitration will be regulated by the Hong Kong code. They noted that section 3 of the ALF Code provides that the ALF Code applies where the resolution of a dispute takes place within England and Wales.

6.36 As referred to in Chapter 3, some Respondents proposed that Third Party Funding of litigation proceedings associated with arbitration should be permitted. Such litigation would include setting aside and enforcement proceedings and interim relief in aid of arbitration (whether taking place in or outside Hong Kong). One legal professional body suggested that exception to the scope of the amendments being restricted to applying to arbitration taking place in Hong Kong should be court proceedings in aid of foreign-seated arbitration.

6.37 An international law firm suggested that consideration be given to Third Party Funding for Hong Kong court proceedings in aid of foreign-seated arbitrations. They suggested that this would also be consistent with the scope of the Arbitration Ordinance that currently provides the power for the Hong Kong courts to grant interim measures in aid of foreign arbitrations and to recognise and enforce foreign awards.

6.38 One funder said that that it assumed that the application of the envisaged regulatory scheme will be restricted to arbitrations seated in Hong Kong, and that the issue of extra-territoriality is raised in relation only to the question of compliance with that scheme by Third Party Funders funding such cases who do not have a physical presence in Hong Kong (rather than the

application of the scheme to arbitrations with their seats elsewhere which are nevertheless taking place in Hong Kong). They suggested that difference will lie in whether the scheme introduced is self-regulatory or is statute based, overseen by a state or governmental body. Membership of any self-regulatory body will be voluntary and there will be no way to ensure funders without a presence in Hong Kong (or even with a presence for that matter) become members and adhere to its tenets. Adherence to a statutory scheme on the other hand could be made a prerequisite for the funding of arbitrations seated in Hong Kong. They suggested inclusion of a requirement for the disclosure of the involvement and identity of any funder; a concomitant requirement could be imposed that the funder also confirm its registration or licencing in accordance with the regulatory scheme.

6.39 One accounting firm commented that:

"Complex issues given the nature of international arbitrations involving parties from different jurisdictions, different governing law, different places of hearing, and different arbitration seats, even if the arbitration is partly taking place in Hong Kong.

Potential problems for lawyers working on an international arbitration in Hong Kong that is seated in another jurisdiction where Third Party Funding is permitted."

Preliminary Recommendation 3(2)(e) – Control of the arbitration by the Third Party Funder

Comments from Respondents who supported the recommendation

6.40 Most Respondents who commented upon Preliminary Recommendation 3(2)(e) submitted that it should be clearly provided in Hong Kong, for example in a code of conduct, that Third Party Funders may not

control funded proceedings, although they may monitor them. One international law firm commented that the Hong Kong courts have considered it significant in permitting third party litigation funding arrangements that, pursuant to the funding agreement: (a) parties retain control over funded litigation; and (b) there is a limited risk of a funder pressuring the Funded Party or its legal advisors to conduct the litigation improperly. See *Re Co A*.¹⁰ They suggested that any Hong Kong code should include the following provisions to limit the ability of funders to control funded arbitral proceedings (based on Article 9 of the ALF Code of Conduct):

- "(a) prior to the execution of the funding agreement, the Funder must take reasonable steps to ensure that the Funded Party has received independent legal advice on the terms of the funding agreement;*
- (b) the Funder must not take any steps that cause or are likely to cause the Funded Party's legal advisor(s) to act in breach of their professional duties; and*
- (c) the Funder must not influence the Funded Party's legal advisor(s) to cede control or conduct of the dispute to the Funder."*

6.41 The same international law firm suggested that counterpart ethical duties be specified for arbitration counsel in Hong Kong. They noted that these are requirements contained in section 9 of the ALF Code. They also drew attention to the fact that Third Party Funders in Australia, are permitted to exercise a degree of control over litigation proceedings. See, for example: *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd*.¹¹

6.42 An accounting firm commented that *"control of the arbitration is an arrangement between the Funded Party and the Third Party Funder and*

¹⁰ [2015] HKEC 2089.
¹¹ [2006] 229 CLR 386.

should be guided by the terms of the funding agreement between the Funded Party and the Third Party Funder, to the extent permitted by the applicable law." They said that a primary concern is that if the Third Party Funder has too much control or is too influential in the arbitration it will not be in the best interests of the Funded Party. They suggested that the Court or the Tribunal should sanction funding arrangements, including to review each funding arrangement and determine whether the funding arrangement gives the Third Party Funder too much influence in the arbitration. If so, the Tribunal or the Court should either not approve the funding arrangement, or order that such arrangement be amended or revised before it is approved. As to what is meant by "*too influential*", they suggested that this should be considered on a case-by-case basis and with careful consideration to both commercial and legal aspects of the funding arrangement.

6.43 A funder commented that, the approach to control is a contractual issue, save for fiduciary duties of lawyer to client. They proposed that the Funded Party should have the right to freely choose the level of control over the dispute they cede to a funder, provided there is no prejudice to the court or Tribunal's process. To the extent the Law Reform Commission is unwilling to accept the general proposition concerning control as outlined above, the Funder proposed that as a minimum, the code of conduct should provide that (subject to the terms of the funding agreement itself) there be no restrictions on funders having an input into decisions affecting the funded litigation and its resolution, provided the lawyers' fiduciary duties to the client are preserved. They suggested that the Funding Agreement does, however, need to contain a means by which disputes over settlement between the Third Party Funder and Funded Party can be fairly, expertly, promptly and reasonably resolved. This can be achieved by both parties agreeing to be bound by the decision of the most senior counsel retained by the claimant's lawyers in the proceedings. The independent ethical obligations owed by counsel towards the Funded Party provide a further protection for that party against being "*forced*" into a disadvantageous settlement by the Third Party Funder.

Comments from Respondents who opposed the recommendation

6.44 The primary reasons given by the six Respondents who opposed Preliminary Recommendation 3(2)(e) were as follows:

- (1) The degree of control the Third Party Funder may exercise over the conduct of proceedings should be agreed upon by and between the Funded Party and the Third Party Funder.
- (2) The Third Party Funder should have a say as to how the arbitration is to proceed.
- (3) The Court or the Tribunal should review the funding agreement on a case-by-case basis and determine whether it gives the Third Party Funder too much influence in the arbitration.
- (4) The concern over the control of the arbitration by the Third Party Funder is whether the involvement by specialised funders (ie international law firms and barristers' chambers) would compromise the integrity of arbitrations.
- (5) No restrictions should be imposed on Third Party Funders' input into decisions affecting the funded proceedings and its resolution provided the lawyers' fiduciary duties to the client are preserved, since funders have a direct interest in the outcome of the proceedings and their interests are closely aligned with those of the Funded Party.

Preliminary Recommendation 3(2)(f) – Disclosure of Third Party Funding to the Tribunal and to the other party/parties to the arbitration

Comments from Respondents who supported the recommendation

6.45 Of the Respondents who commented on Preliminary Recommendation 3(2)(f), 85% submitted that disclosure of Third Party Funding should be provided by the Funded Party to the Tribunal and to the other party/parties. One international law firm suggested that this should be included in a code of conduct *"as it is necessary to ensure the integrity of arbitral proceedings, in particular to safeguard the independence and impartiality of arbitrators"*. They suggested that the Hong Kong code specifies the following disclosure requirements:

- "(a) The Funded Party must disclose the name of the funder to the arbitrator(s), the other parties to the arbitration and the arbitral institution administering the arbitration (if the parties have agreed to institutional arbitration);*
- (b) The arbitrator(s) must separately disclose, on an on-going basis, to the institution administering the arbitration, the arbitration proceedings they were involved in over the past 24 months (including the names of parties appointing them, whether those parties were funded and the relevant funder). An arbitrator's record must be provided by the institution to the parties on request where one party to the arbitration has nominated the arbitrator to determine the dispute. Where parties are involved in ad hoc arbitration, the arbitrator should provide these details to parties on request; and*

- (c) *Parties may challenge the independence and impartiality of the arbitrator in accordance with the agreed institutional rules (if applicable) and/or sections 25 and 26 of the Arbitration Ordinance (Grounds for challenge and Challenge procedure, respectively)."*

6.46 An international law firm observed that counsel are under no positive disclosure obligations in Australia or in England and Wales. However, the IBA Guidelines provide that a party shall inform the arbitrators, the other parties and the arbitral institution of any relationship (direct or indirect) between the arbitrator and the party or the arbitrator and an entity with a direct economic interest in, or duty to indemnify a party for, the award to be rendered (see General Standard 7).

6.47 The same international law firm also observed that arbitrators are under no positive disclosure obligations in Australia or England and Wales. However, the 2014 IBA Guidelines provide that an arbitrator shall disclose such facts and circumstances that may give rise to doubts as to his impartiality or independence. This relates to the facts and circumstances in the past as well as the future (see General Standards 3(a) and (b)).

6.48 An accounting firm commented that:

"Mandatory disclosure by a party that it is receiving Third Party Funding is required in certain jurisdictions and is recommended by the IBA Guidelines on Conflicts of Interest in International Arbitration. In Australia, the obligation to disclose funding agreements applies equally to lawyers charging damages-based fees and litigation funders. In England and Wales, the power to order disclosure of the identity and address of a Third Party Funder was recognised in order to facilitate an application for Security for Costs under Rule 24.14 of the CPR. However, disclosure of the funding agreement itself was not part of the order."

The accounting firm proposed that, "*all information regarding the funding arrangements, including the identity of the Third Party Funder, should be kept confidential and subject to legal privilege.*" They said that this information is irrelevant.

6.49 A funder proposed that there should be no disclosure of Third Party Funding, save in costs shifting jurisdictions. In the latter jurisdictions, disclosure should be limited to existence of the funder's name and address and whether the Funding Agreement contains an adverse costs indemnity, and it should be made as soon as possible. There should be reciprocal obligation on Respondents (eg where the insured funded by insurance company).

6.50 A barrister noted that it is for the benefit of the Tribunal and the other party/parties to the arbitral proceedings to enforce costs orders to disclose the funders' identities and relevant contact information, and that the disclosure of such information shall nevertheless enhance better case management and thus foster the enforcement of such costs orders against the Third Party Funders.

Comments from Respondents who opposed the recommendation

6.51 The primary reasons given by the four Respondents who opposed Preliminary Recommendation 3(2)(f) were as follows:

- (1) A party to an arbitration should not be obliged to disclose any funding arrangement it may have with a Third Party Funder except where security of costs is concerned.
- (2) All information regarding the funding arrangements should be kept confidential and subject to legal privilege unless disclosure is required by law, applicable governmental or other regulatory authorities.

- (3) There should not be any greater obligation of disclosure for litigation funders than insurers. Such obligation should be imposed on the Funded Party but not the funder.

Preliminary Recommendation 3(2)(g) – Termination

Comments from Respondents who supported the recommendation

6.52 Of the Respondents who commented on Preliminary Recommendation 3(2)(g), 76% agreed that the issue of termination of a funding agreement by Third Party Funder should be addressed and that such circumstances should be limited. A number of Respondents suggested that Article 11 of the ALF Code should be adopted, which states that a Third Party Funder may terminate where it:

- (1) Reasonably ceases to be satisfied about the merits of the dispute;
- (2) Reasonably believes that the dispute is no longer commercially viable; and
- (3) Reasonably believes that there has been a material breach of the funding agreement by the Funded Party.

6.53 One international law firm suggested that a Hong Kong code could also include provisions modelled on Article 13 of the ALF Code to ensure that funding agreements:

- (1) Provide for the resolution of any dispute between the Funder and the Funded Party in relation to the termination of the funding agreement; and

- (2) Delineate the residual responsibilities of the Funder after the termination of the funding agreement.

Comments from Respondents who opposed the recommendation

6.54 The primary reasons given by the four Respondents who opposed Preliminary Recommendation 3(2)(g) were as follows:

- (1) The grounds for termination of funding should be left to be agreed upon by and between the Funded Party and the Third Party Funder.
- (2) The grounds for termination of funding may be relevant to Security for Costs.
- (3) There should be no restrictions on a funder's right to terminate a Third Party Funding agreement, provided the funder is obliged to pay all costs it has agreed to pay up to the time its termination takes effect and on the basis that the agreement extends to all adverse costs involved.

Preliminary Recommendation 3(2)(h) – Complaints

Comments from Respondents who supported the recommendation

6.55 One international law firm suggested that any Hong Kong code of conduct could also include provisions for a consumer complaints procedure, with the regulatory body having the power to:

- (1) Investigate complaints by Funded Parties;

- (2) Make assessment of the complaints and investigate further; and
- (3) Discipline funders as necessary.¹²

It would remain open to Funded Parties to bring civil proceedings in Hong Kong courts in respect of any contractual or other causes of action available to them. The complaints procedure could be modelled on the *HKMA bank complaints handling mechanism*.¹³

Comments from Respondents who opposed the recommendation

6.56 The two Respondents who opposed Preliminary Recommendation 3(2)(h) did not give any specific reasons for their opposition.

Other comments

6.57 There are other comments regarding this recommendation. The main "*other*" areas commented upon concerned:

- (1) Whether a Third Party Funder should have an address for service in Hong Kong and assets in Hong Kong;
- (2) Review of the initial regulatory regime for Third Party Funding; and

¹² Requirements (1) to (3) are replicated from Section 13 of the ALF Code. We note that in Australia, there are no similar provisions in relation to the termination of funding agreements.

¹³ In England and Wales, section 15 of the ALF Code also provides for a complaints procedure which applies automatically to all funders who are members of the ALF. This complaints procedure also includes sanctions which the ALF may impose on its members if they are found in breach of the ALF Code. See sections 25 – 27 of "*A procedure to govern complaints made against Funder Members by Funded Litigants*" published by the ALF.

- (3) Whether the code should regulate the "*maximum uplift*" or recovery available under the Third Party funding agreement.

Address for service and assets

6.58 A number of Respondents suggested that Third Party Funders should have an address for service and registered office in Hong Kong, with one suggesting they should have assets in Hong Kong. For example, one Respondent proposed that if one of the parties to a dispute is a Hong Kong resident or Hong Kong company, the funder must have a registered office in Hong Kong or own assets in Hong Kong so that the interests of Hong Kong, including the operating rights of Hong Kong funders and the interests of any one of the parties to the dispute, can be better protected.

Trial period and review

6.59 Further to the general comments that the form of regulation should be reviewed after some years as discussed in Chapter 5, one Respondent suggested that the applicable ethical and financial standards having been developed should be reviewed comprehensively by a self-regulatory body after it has been implemented on a trial basis for a period of "2+3" years. The review shall include the issue as to whether the supervision should be conducted by a statutory or governmental body. Under the principle of a free economy, the Government should give a free hand to the private sector for any matter that the latter can do. Only those matters that cannot be dealt with by the private sector should be taken over by the Government.

Our analysis and response

6.60 The majority of Respondents in the Consultation agreed with the financial and ethical standards that the Sub-committee had identified and discussed in the Consultation Paper. Many Respondents submitted that the standards in the Code should draw from the ALF Code and the Australian regulatory provisions for conflicts of interest, as well from the recommendations in the 2014 Australian Productivity Commission Final Report.

6.61 After considering (a) the relevant discussion in the Consultation Paper, (b) all the responses received in the Consultation, including those summarised in this Report, and (c) Hong Kong's current legal framework and regulatory culture, and also having borne in mind the public interest in access to justice and the preservation of the integrity of litigation, arbitration, and dispute resolution generally, we are of the view that the ALF Code and the Australian approach to conflicts and capital adequacy (both currently in the Australian regulations as to conflicts, and as proposed in the 2014 Australian Productivity Commission Final Report) are very useful resources for a Code. Our recommendations as to the contents of the Code have drawn on them, and have also been amended to meet Hong Kong's legal and regulatory culture and needs.

6.62 Accordingly we consider that the Code should address the following topics:

Application and Purpose of Code

1. Introduction

- (1) Scope of application
- (2) Consequences of breach of the Code
- (3) General principles

(4) Interpretation

2. Standards in the Third Party Funding for Arbitration Code of Practice

- (1) Introduction
- (2) Promotional literature
- (3) The Funding Agreement¹⁴
- (4) Capital adequacy requirements
- (5) Conflicts of interest
- (6) Confidentiality
- (7) Control
- (8) Disclosure
- (9) Liability for Adverse Costs
- (10) Grounds for termination
- (11) Complaints procedure
- (12) Annual return to the Advisory Body of any complaints and findings of breach of the Code or any of the provisions of the Proposed AO Amendment
- (13) Requirement that Third Party Funders should provide to the Advisory Body any other information it reasonably requires.

Capital adequacy

6.63 In terms of capital adequacy requirements, we recommend that the Code should provide that a Third Party Funder must at all times maintain access to adequate financial resources to meet its obligations, and the obligations of subsidiaries or associated entities, to fund all the arbitrations that they have agreed to fund. In particular, we recommend that a Third Party Funder must ensure that it maintains the capacity to pay all debts when they

¹⁴ Funding Agreement should set out the details of the Advisory Body.

become due and payable and cover aggregate funding liabilities under all of its Funding Agreements for a minimum period of 36 months. The Code should also provide that a Third Party Funder must maintain access to a minimum of HK\$20 million¹⁵ of capital.

Control

6.64 As referred to in paragraph 5.29 of the Consultation Paper, the permissible extent of control exercised by a Third Party Funder varies in other common law jurisdictions. On the one hand, the applicable Australian law appears to permit quite a high degree of control of the conduct of a funded case by a Third Party Funder; on the other hand, the English courts have made it clear that the Funded Party should retain control.

6.65 Based on our review of recent Hong Kong insolvency cases, Hong Kong courts appear to be more inclined to adopt the approach that allows the Funded Party to retain control of the legal proceedings, as is the case in England, as opposed to the Australian approach. For example, in *Akai Holdings Ltd v Ho Wing On Christopher*.¹⁶ Stone J criticised the exercise of excessive control over proceedings by certain litigation funders. Similarly, in *Re Co A*¹⁷, Harris J expressed his view that there should be limits on the control exerted by litigation funders. He was satisfied that the liquidators in that case remained in control of the intended litigation and there is limited risk of the funder being able to pressure the liquidators or the lawyers to conduct the litigation improperly.

6.66 We recommend adopting in the Code the approach to control of the Hong Kong courts in the insolvency context.

¹⁵ ALF provides for BP2 million.

¹⁶ [2009] 5 HKLRD K1 and K2 (CFI).

¹⁷ [2015] HKEC 2089.

Further information and clarification arising from a Third Party Funder's annual return

6.67 Having reviewed the annual return, the Advisory Body may wish to request further information or clarification from the Third Party Funder as to any matter disclosed in it. We recommend that the Advisory Body should be entitled to request, and the Third Party Funder should have a duty to provide such further information and clarification of any matter.

Our Final Recommendation 3(9) and (10)

6.68 We recommend that:

- (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:
 - (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;¹⁸

(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.

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

(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

¹⁸ *Code of Conduct for Litigation Funders*, ALF (2014), paras 9.1 to 9.3.

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.

Chapter 7

Recommendation: Adverse Costs Orders against Third Party Funders

Number of responses to the Sub-committee's Preliminary Recommendation 4(a) and (b)

7.1 We set out below is a summary of the responses regarding Preliminary Recommendation 4(a) and (b) in the Consultation Paper: *(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 New York Convention.*¹

Preliminary Recommendation 4(a)

7.2 Of those who agreed with or opposed Preliminary Recommendation 4(a), 76% agreed with it.

	Number	Percentage (%)
Agree	25	35%
Oppose	8	11%
Neutral/No comment	31	42%
Other comments	9	12%
<u>Total</u>	<u>73</u>	<u>100%</u>

(Note: Percentages are rounded to the nearest whole number.)

¹ See paragraphs 6.12 to 6.13 of the Consultation Paper.

Comments from Respondents who supported the recommendation

7.3 The Sub-Committee did not reach a firm view in the Consultation Paper as to whether or not a Tribunal should be granted the power to make Adverse Costs Orders against a Third Party Funder in Hong Kong arbitrations. It invited submissions as to whether the Arbitration Ordinance should be amended to allow Adverse Costs Orders against Third Party Funders, and the legal and jurisdictional basis for an amendment.

7.4 A substantial majority of the submissions received by the Sub-Committee in response to the Consultation Paper that commented on this issue supported a Tribunal being given the power to make Third Party Funders directly liable for adverse costs awards in appropriate circumstances. There was, however, no consensus as to whether this should be done by amending the Arbitration Ordinance or by other means (as discussed below at paras 7.21 to 7.27).

7.5 In its Consultation Paper, the Sub-committee stated that it saw little reason why Third Party Funders should be permitted to enjoy the proceeds of a successful claim, but avoid liability for costs where they have funded an unmeritorious claim or breached ethical and financial standards.² This view was endorsed in a number of submissions, with several Respondents endorsing the statement of Jackson LJ referred to in the Consultation Paper, that *"it is 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 of defeat."*³

7.6 One law firm pointed towards the commercial nature of Third Party Funding, emphasising that:

² Law Reform Commission of Hong Kong, *Consultation Paper on Third Party Funding for Arbitration* (October 2015), at para 6.13.

³ Law Reform Commission of Hong Kong, *Consultation Paper on Third Party Funding for Arbitration* (October 2015), at para 5.38.

"The funders in [Third] Party Funding aim at profit. They are commercially driven. As a result, they should bear the adverse consequence if they abuse Court procedure or they facilitated the wrong claims."

7.7 There was a general consensus amongst the Respondents that imposing direct liability on Third Party Funders for adverse costs awards is a fair approach. One professional body commented that otherwise it is *"unfair to Defendants who may not be able to recover costs; and it is only unfair to the other party in the arbitration"*. In its view, there was no reason to treat a Third Party Funder any differently from the Funded Party in this regard. Whilst it is commonplace for Third Party Funders to submit to contractual liability for adverse costs in their funding agreements, one professional body emphasised that the ability of a Court or Tribunal to make direct orders against a Third Party Funder would provide counterparties in arbitration with certainty that any Adverse Costs Orders will be paid by either the Funded Party or the Third Party. A law firm similarly noted in its submission that liability for adverse costs could *"protect the defendants from empty judgment if they succeed in defending cases or counterclaiming the claimants."*

7.8 A litigation funder commented that:

"A funding agreement is a commercial contract entered into freely by its parties. The agreement should set out everything that is agreed between Third Party Funder and claimant. So, if for example it has been agreed that the funder will be responsible for adverse costs and Security for Costs, this should be made clear in the agreement and any limits on the funder's liability in this regard set out."

7.9 The funder's submission did not, however, oppose giving Tribunals the power to make Adverse Costs Orders directly on Third Party Funders. After acknowledging that parties to Funding Agreements want certainty as to their potential costs exposure, it commented that the solution

appears to lie in the Tribunal requiring the Third Party Funder to adhere to the arbitration agreement for the purposes of costs only.

7.10 As put by another firm:

"Allowing Adverse Costs Orders, where appropriate, to be made against Third Party Funders will result in funders being allocated greater risks than just the costs incurred in making an unsuccessful claim. The practical effect of this would be to encourage commercial funders to carry out a rigorous analysis of the merits of the claim and would also serve as a deterrent to the pursuance of vexatious claims."

This view was shared by a number of Respondents. One professional body commented that the possibility of imposing direct liability for adverse costs on Third Party Funders *"would prevent undue influence or extraneous considerations being used for initiating arbitration proceedings."* A responding litigation funder described the potential adverse costs consequences as *"an important incentive against funders seeking to commence unmeritorious proceedings or 'strike suits'."* Another Respondent took the view that if a Third Party Funder has confidence in the matter it is funding, it will not be concerned with its potential liability.

7.11 A Government department drew attention to section 61(1) of the UK Arbitration Act 1996 which provides that a tribunal may make an award allocating the costs of the arbitration *"as between the parties, subject to any agreement between the parties"*. They suggested that an amendment to the Arbitration Ordinance along these lines may put the legal position beyond doubt. Provided that the Arbitration Ordinance is amended to allow an Tribunal to make cost orders against Third Party Funders, costs orders made in Hong Kong arbitrations against Third Party Funders may be enforced under the terms of the New York Convention.

Comments from Respondents who opposed the recommendation

7.12 Several Respondents raised concerns that adverse costs consequences could undermine the preservation and promotion of Hong Kong's competitiveness as an arbitration centre. One law firm submitted that the imposition of liability for adverse costs orders on Third Party Funders would likely make it *"too onerous for Hong Kong to be an attractive market for arbitration"*. Another firm similarly submitted that placing liability for adverse costs directly on Third Party Funders could *"potentially restrict access to Third Party Funding and thus weaken Hong Kong's competitiveness as an arbitration centre"*.

7.13 Several Respondents raised concerns that allowing Tribunals to make Adverse Costs Orders against Third Party Funders may have undesirable procedural implications. One law firm submitted that allowing Adverse Costs Orders against Third Party Funders, to the extent that it gives them a right to be heard, could increase the length and costs of arbitrations and give rise to satellite disputes between the Third Party Funder and Funded Party regarding responsibility for adverse costs. Another firm raised similar concerns, submitting that allowing a Third Party Funder to be joined as a party to an arbitration could lead to the Respondent having to answer to two parties, generating additional costs and delays. This submission also predicted Third Party Funders' attempt to have adverse costs awards set aside for lack of due process, on the grounds that they did not participate in the arbitration proceeding resulting in the order.

7.14 One law firm and several practitioners shared the view that allowing Tribunals to make Third Party Funders directly liable for Adverse Costs Orders would undermine the consensual nature of arbitration. Another firm submitted that this would undermine the contractual foundations of arbitration agreements between parties. One Hong Kong chartered arbitrator submitted that liability for adverse costs *"should be a matter of contract between the Third Party Funder and its client"*. One professional body generally commented that whilst it is desirable that a Third Party Funder agree

to meet costs orders, *"this is ultimately a matter to be agreed between the Third Party Funder and the Funded Party and recorded in the funding agreement."*

Our analysis and response

7.15 We note that there is general support from the public and the profession for making Third Party Funders directly liable for Adverse Costs Orders in matters they have funded. We have carefully considered the arguments for and against this proposal, and are persuaded that the benefits of imposing direct liability on Third Party Funders outweigh the costs. We consider that there is a good case for the introduction of a measure to empower a Tribunal to make Third Party Funders directly liable for Adverse Costs Orders, where it considers it to be appropriate in the circumstances.

7.16 The most common view expressed by Respondents was that there should be an amendment to the Arbitration Ordinance to allow the court or Tribunals to make such order. We agree with those who submitted that if a Third Party Funder has confidence in the matter it is funding, it will not be concerned with its potential liability. We are further persuaded by the comments by Jackson LJ, as referred to by the Sub-committee in its Consultation Paper, that *"[t]here is no evidence that full liability for adverse costs would stifle third party funding or inhibit access to justice."*⁴

7.17 In addition, we have reviewed the terms of an equivalent power in the litigation context. As noted by the Sub-committee in the Consultation Paper,⁵ Hong Kong courts have the power to order third parties such as Third Party Funders to pay Adverse Costs Orders in litigation, by joining them as parties to the proceedings for the purposes of costs only.⁶ This is subject to

⁴ Law Reform Commission of Hong Kong, *Consultation Paper on Third Party Funding for Arbitration* (October 2015), at para 4.70.

⁵ Law Reform Commission of Hong Kong, *Consultation Paper on Third Party Funding for Arbitration* (October 2015), at para 2.11.

⁶ Order 62, Rule 6A of the Rules of the High Court (Cap 4A) and sections 52A and 52B of the High Court Ordinance (Cap 4).

the discretion of the court. There is a high threshold for the making of such an order and, generally speaking, an order will not be made against a third party who plays a purely financial role and has little control over the conduct of the proceedings.⁷ In the context of arbitrations, the oversight of the Tribunal would ensure that Adverse Costs Orders are only made where appropriate.

7.18 We consider that in principle, Tribunals should be given the power under the Arbitration Ordinance to award Costs against a Third Party Funder. Such an order would be enforceable under the Arbitration Ordinance (including as an order under its section 61). We are not persuaded by the submissions that adverse costs consequences could undermine the preservation and promotion of Hong Kong's competitiveness as an arbitration centre.

7.19 However, we have borne in mind the concerns raised by several Respondents that allowing Tribunals to make Adverse Costs Orders against Third Party Funders may have undesirable procedural implications including that:

- (1) Allowing a Third Party Funder to be joined as a party to an arbitration could lead to the Respondent having to answer to two parties, generating additional Costs and delays.
- (2) Third Party Funders' likely attempts to have adverse costs awards set aside for lack of due process.
- (3) Allowing Tribunals to make Third Party Funders directly liable for Adverse Costs Orders would undermine the consensual nature of arbitration and could undermine the contractual foundations of arbitration agreements between parties.

⁷ See *Super Speed Limited (In Liquidation) v Bank of Baroda* [2015] HKEC 2391, at para 19.

7.20 This leads us to consideration of the Respondents' submissions as to Preliminary Recommendation 4(b) in the Consultation Paper arising from the Tribunal's lack of jurisdiction to make Adverse Costs Orders against third parties (that is persons who are not parties to the applicable arbitration agreement, including a Third Party Funder). We address this further in our discussion of responses to Preliminary Recommendation 4(b) below.

Preliminary Recommendation 4(b)

Comments from Respondents who supported the recommendation

7.21 The Sub-committee considered that there may be considerable support for making Third Party Funders, which are third parties to the Arbitration Agreement, directly liable for Adverse Costs Orders. The public was invited to provide submissions on how such liability could be imposed.

7.22 As acknowledged by the Sub-committee, there are technical obstacles to giving a Tribunal the power to make third parties, including Third Party Funders, directly liable for adverse costs.⁸ A Tribunal's jurisdiction stems from the arbitration agreement. This means that adverse costs awards handed down directly in an Arbitration against a Third Party Funder will likely be unenforceable under the New York Convention unless the Third Party Funder becomes a party to the applicable arbitration agreement. A number of Respondents, both in opposition and support of the imposition of liability, voiced their concerns about this jurisdictional bar.

7.23 To overcome the jurisdictional issue, the Sub-committee suggested in the Consultation Paper that an approach could be implemented whereby Third Party Funders contractually submit to the Tribunal's jurisdiction on a case-by-case basis.⁹ This approach received support from many

⁸ Law Reform Commission of Hong Kong, *Consultation Paper on Third Party Funding for Arbitration* (October 2015), at paras 2.22-2.23 and 5.42.

⁹ Law Reform Commission of Hong Kong, *Consultation Paper on Third Party Funding for Arbitration* (October 2015), at para 6.13.

Respondents. One Respondent proposed that a simple instrument, such as a Deed of Submission (termed a "Deed of Submission") could be used which is to be executed at the outset of the funded arbitration. The Third Party Funder can execute the deed pursuant to which it agrees to submit to the Tribunal's jurisdiction in relation to any award of Costs subject to certain provisos. The Respondent will then have standing to enforce any Costs award directly against the Funder.

7.24 An alternative approach to statutory amendment suggested by some Respondents was to require major arbitration institutions such as the HKIAC to consider amending their arbitration rules to allow for the making of Adverse Costs Orders against Third Party Funders.

7.25 Another popular view expressed by Respondents is for the Third Party Funders to contractually agree to submit to the Tribunal's jurisdiction for the limited purpose of the determination of costs. One funder went one step further and suggested that a Deed of Submission be executed by the Third Party Funder at the outset of a funded arbitration, pursuant to which they agree to submit to the Tribunal's jurisdiction in relation to costs awards. This would give the Respondent the right to enforce any costs award directly against the Third Party Funder. As to the practical implications of this process, the funder said the following:

"Since funders will generally agree to provide adverse costs indemnities for disputes they are funding, in practical terms this proposal would not increase a funder's risk of exposure. Nor is it likely that funders would routinely refuse to sign up to such Deeds of Submission: if they do not underwrite the adverse costs risk, they (or the Funded Party) are likely to have to put up Security for Costs, and if security is not put up, the proceedings may be stayed."

7.26 The funder was, however, of the view that the requirement of a Third Party Funder being liable for costs be subject to two provisos, namely that:

- (1) The Funded Party should retain the right to contract with the Third Party Funder that the Funded Party remains solely liable for adverse costs; and
- (2) The Third Party Funder's potential liability for Adverse Costs Orders should relate only to costs incurred by the opposing party during the period the Third Party Funder was funding the dispute (the *Arkin-cap*).¹⁰

A number of Respondents considered that provisos of this sort would, to some extent, mitigate the issues relating to the consensual nature of arbitration and the contractual nature of arbitration agreements.

7.27 Another funder suggested that adherence of the Third Party Funder to the arbitration agreement for the purpose of costs can be included as one of the requirements of the regulatory scheme and that a failure to do so could lead to inability to fund in Hong Kong seated arbitration. The funder can also be considered to be a "*party*" insofar as Article II of the New York Convention is concerned.

Comments from Respondents who opposed the recommendation

7.28 In summary, the grounds of those opposing Preliminary Recommendation 4(b) were as set out in paragraphs 7.12 to 7.14 above. They also expressed concerns about the enforceability of such orders under the New York Convention.

¹⁰ Law Reform Commission of Hong Kong, Consultation Paper on *Third Party Funding for Arbitration* (October 2015), at para 4.60.

Our analysis and response

7.29 We consider that the provisions of the Arbitration Ordinance to enforce orders and directions of a Tribunal (including in section 61) provide an effective mechanism for enforcement of Adverse Costs Orders against funders if the Proposed AO Amendment is implemented to empower a Tribunal to make Adverse Costs Orders against third parties, including Third Party Funders.

7.30 While a number of Respondents' submissions addressed the issue of the enforceability of such orders under the New York Convention, this is a complex area. We consider that further consideration should be given to how to address the substantive legal and procedural issues arising.

Our Final Recommendation 4(1) and 4(2)

7.31 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.

- (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,¹¹ 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 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.

¹¹ 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.

Chapter 8

Recommendation : Security for Costs Orders against Third Party Funders

Number of responses to the Sub-committee's Preliminary Recommendation 4(c) and (d)

8.1 We set out below a summary of the responses regarding Preliminary Recommendation 4 (c) and (d) of the Consultation Paper: *(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 New York Convention.*¹

8.2 Of the Respondents who agreed with or opposed Preliminary Recommendation 4(c), 74% agreed with it.

	Number	Percentage (%)
Agree	23	32%
Oppose	8	11%
Neutral/No comment	30	41%
Other comments	12	16%
<u>Total</u>	<u>73</u>	<u>100%</u>

(Note: Percentages are rounded to the nearest whole number.)

¹ See paragraph 6.14 of the Consultation Paper.

Summary of responses to Preliminary Recommendation 4(c)

8.3 Whilst a substantial majority of the submissions received in public consultation supported amendments to the law to require the Tribunal to order Security for Costs or other monetary guarantee against Third Party Funders at the beginning of the arbitration, the reasons advanced to justify this approach were largely confined to general considerations of *"fairness"*.

8.4 One law firm commented that *"it is only fair, and a necessary part of Third Party Funding, that a Tribunal has the power to order a Third Party Funder to pay Security for Costs in appropriate circumstances."* Similarly, one professional body submitted that it was necessary to amend the Arbitration Ordinance to give the Tribunal power to order Third Party Funders to provide Security for Costs, and that there was no reason to treat a Third Party Funder any differently from the Funded Party – *"[o]therwise it is only unfair to the other party in the arbitration"*. Another professional body described measures of this kind as a necessary *"balance to deter abuse of the funding mechanism"*.

8.5 Other Respondents did not view any amendments as being necessary in the Security for Costs context. For example, a specialist restructuring, insolvency and forensic accounting firm submitted that where a Court or Tribunal orders Security for Costs from the Funded Party, it will be sufficient for the Funded Party to seek the necessary funding from the Third Party Funder. The firm further submitted that Security for Costs will generally be sought at the early stages of arbitration, meaning that the Third Party Funder's interest in the outcome of the arbitration will provide them with sufficient incentive to meet the Security for Costs.

8.6 Further, one funder submitted that there would be no need to amend the Arbitration Ordinance to provide a power to make orders for Security for Costs if its Deed of Submission mechanism is implemented (as

discussed above at paragraph 7.23). It stated that "[t]he provision of an adverse costs indemnity from a solvent funder ... ought normally to militate against an award of security."

8.7 As an alternative measure, a submission from several legal practitioners suggested that mandatory disclosure be required under the Arbitration Ordinance where a party is obtaining Third Party Funding in Hong Kong arbitration. This would allow the other parties to the arbitration to seek advice as to whether the application should be made. The submission went on to state that, in the experience of the Respondents, the Third Party Funder could provide funds to the Funded Party if security is ordered. A similar suggestion was made by one litigation funder:

"The solution, so far as funded cases is concerned ... seems to lie in the tribunal requiring the funder ... to adhere to the arbitration agreement for the purposes of costs only. This would place each party with a financial interest in the outcome on a level playing field. It would be a matter for claimant and the Third Party Funder to resolve between themselves as to how to address the potential liability, and to the extent necessary, any award of costs made by the tribunal could be enforced against the funder.

This does, of course, require the involvement of a Third Party Funder to be disclosed, consistent with the IBA Guidelines on Conflicts of Interest in International Arbitration ..."

Summary of responses to Preliminary Recommendation 4(d)

8.8 There are limited responses to the question of whether an order of a Tribunal directing a Third Party Funder to provide Security for Costs would be enforceable under the New York Convention.

8.9 Two institutions suggested that there should be amendments to arbitral institutional rules specifically allowing the Tribunal to consider Third Party Funding when making Security for Costs, and in allocating costs. It was also suggested that this can be achieved by requiring the funding agreement to state that indemnification is given for the benefit of any Respondents to claim and that the Contracts (Rights of Third Parties) Ordinance (Cap 623) applies such that the indemnity clause may be directly enforceable by any Respondent against the Third Party Funder.

Our analysis and response

8.10 In the Consultation Paper, the Sub-committee did not perceive there to be a need to legislate to provide for the Tribunal's power to order Third Party Funders to provide Security for Costs, as such an order could be made by the Tribunal against the Funded Party, and the Funded Party should be able to seek funding from the Third Party Funder for this purpose. If the security ordered to be made was not provided, the case would not proceed.

8.11 There appears to be a level of general support from the public and the legal profession to amend the Arbitration Ordinance to provide for the Tribunal's power to order Third Party Funders to provide Security for Costs.

8.12 However, having reviewed the competing submissions, we are not persuaded that adopting a *"one-size-fits-all"* mandatory approach to the ordering of Security for Costs is necessary or appropriate. We are persuaded by the view that:

"Adopting a blanket approach, whereby Security for Costs was systematically ordered in the presence of third-party funding, would unfairly penalise claimants with meritorious claims, but who had relied upon third-party funding rather than alternative forms of financing a claim. It would also unfairly reward Respondents

*who had no realistic chance of being awarded costs at the end of the arbitration, but were requesting Security for Costs on a purely tactical basis."*²

8.13 We also agree with the submissions of one funder that:

"... there should be no presumption that simply because a Third Party Funder is involved, Security for Costs should be ordered. The posting of Security for Costs as a default in funded cases would be a step too far, not least in light of the increasing use of funding, of all types, by perfectly solvent commercial parties. This would penalise the claimant in so far as it would necessarily increase the cost of funding to claimants."

8.14 We have concluded that there is no need to legislate to empower the Tribunal to make Third Party Funders liable for Security for Costs. Should Preliminary Recommendation 4(a) to provide for the power of a tribunal to award costs against a Third Party Funder be implemented, there would be no need to legislate in relation to Security for Costs. The Tribunal already has power to order Security for Costs against a party and the Arbitration Ordinance sets out the relevant criteria. It is our view that such orders should be dealt with by the Third Party Funder and Funded Party in their funding agreement.

² Kirtley and Wietrzykowski, "Should an Arbitral Tribunal Order Security for Costs when an Impecunious Claimant is Relying upon Third-Party Funding" (2013) *Journal of International Arbitration* 17, 30.

Our Final Recommendation 4(3)

8.15 We recommend that:

- (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.

Chapter 9

Summary of our Final Recommendations

(The recommendations below are to be found in Chapters 3 to 8 of this Report.)

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")¹ (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).²

(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 Arbitration should apply to MO Mediation.³

(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).⁴

(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

¹ See discussion in Chapter 3, above, at paras 3.26 to 3.44 and 3.48(1).

² See discussion in Chapter 3, above, at paras 3.26 to 3.32 and 3.48(1).

³ See discussion in Chapter 3, above, at paras 3.38 to 3.39 and 3.48(2).

⁴ See discussion in Chapter 3, above, at paras 3.45 and 3.48(3).

relation to the Arbitration, as if the place of Arbitration were in Hong Kong (see section 98K of the Proposed AO Amendment).⁵

(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).⁶

(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.⁷

(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).⁸

(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. 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).⁹

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.¹⁰

⁵ See discussion in Chapter 3, above, at paras 3.33 to 3.34 and 3.48(4).

⁶ See discussion in Chapter 3, above, at paras 3.35 to 3.36 and 3.48(5).

⁷ See discussion in Chapter 3, above, at paras 3.37 and 3.48(6).

⁸ See discussion in Chapter 3, above, at paras 3.46 and 3.48(7).

⁹ See discussion in Chapter 3, above, at paras 3.47 and 3.48(8).

¹⁰ See discussion in Chapter 4, above, at paras 4.13 to 4.19.

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.¹¹

(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.¹²

(3) Third Party Funders funding Arbitration should be required to comply with a *Third Party Funding for Arbitration Code of Practice* (defined earlier as the "Code") issued by a body authorized under the Arbitration Ordinance (defined earlier 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).¹³

(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).¹⁴

(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 being decided by that court or Tribunal (see section 98O of the Proposed AO Amendment).¹⁵

(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).¹⁶

¹¹ See discussion in Chapter 5, above, at paras 5.13 to 5.26 and 5.29(1).

¹² See discussion in Chapter 5, above, at paras 5.19 to 5.22 and 5.29(2).

¹³ See discussion in Chapter 5, above, at paras 5.20 to 5.24 and 5.29(3).

¹⁴ See discussion in Chapter 5, above, at paras 5.21 and 5.29(4).

¹⁵ See discussion in Chapter 5, above, at paras 5.23 and 5.29(5).

¹⁶ See discussion in Chapter 5, above, at paras 5.24 and 5.29(6).

(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.¹⁷

(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.¹⁸

(9) The Code should include provisions as set out below,¹⁹ and Third Party Funders should be required to include these terms in any third party funding agreement:

- (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**

¹⁷ See discussion in Chapter 5, above, at paras 5.25 and 5.29(7).

¹⁸ See discussion in Chapter 5, above, at paras 5.26 and 5.29(8).

¹⁹ See discussion in Chapter 6, above, at paras 6.60 to 6.68.

or barrister instructed in the dispute;²⁰

- (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.

(10) The following measures should be implemented to facilitate the monitoring of Third Party Funding of Arbitration by the Advisory Body:²¹

- (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.

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

²⁰

Code of Conduct for Litigation Funders, ALF (2014), at paras 9.1 to 9.3.

²¹

See discussion in Chapter 6, above, at paras 6.60 to 6.67 and 6.68(10).

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.²²

(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,²³ 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 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.²⁴

(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.²⁵

²² See discussion in Chapter 7, above, at paras 7.15 to 7.20, 7.29 to 7.30 and 7.31(1).

²³ 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.

²⁴ See discussion in Chapter 7, above, at paras 7.29 to 7.30 and 7.31(2).

²⁵ See discussion in Chapter 8, above, at paras 8.10 to 8.14.

Draft Provisions to amend the Arbitration Ordinance (Cap. 609)

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The following draft provisions are possible amendments of the Arbitration Ordinance (Cap. 609) and are included to assist in explaining the proposals in this report. They are not the final version for the legislative process if legislation were to be introduced to give effect to the proposals.

Part 10A

Third Party Funding of Arbitration

Division 1—Purposes

98E. Purposes

The purposes of this Part are to—

- (a) ensure that third party funding of arbitration is not prohibited by particular common law doctrines; and
- (b) provide appropriate measures and safeguards in relation to third party funding of arbitration.

Division 2—Interpretation of Part 10A

98F. Interpretation

In this Part—

advisory body means the person appointed by the Secretary for Justice under section 98T(1);

arbitration includes—

- (a) proceedings before an emergency arbitrator;
- (b) mediation proceedings referred to in this Ordinance; and
- (c) court proceedings under this Ordinance;

arbitration body—

- (a) in relation to an arbitration (other than mediation proceedings referred to in this Ordinance)—means the emergency arbitrator, arbitral tribunal or court, as the case may be; or
- (b) in relation to mediation proceedings referred to in this Ordinance—means the mediator appointed under section 32 or referred to in section 33;

arbitration funding—see section 98G;

authorized body means the person appointed by the Secretary for Justice under section 98T(2);

code of practice means the code of practice issued by the authorized body under Division 4 and as amended from time to time;

costs, in relation to an arbitration, means the costs and expenses of the arbitration and includes—

- (a) pre-arbitration costs and expenses; and
- (b) the fees and expenses of the arbitration body;

emergency arbitrator has the meaning given by section 22A;

funded party—see section 98G;

funding agreement—see section 98G;

potential third party funder means a person who carries on any activity with a view to becoming a third party funder;

third party funder—

- (a) means a third party funder within the meaning of section 98G; and
- (b) in Division 4, includes a potential third party funder;

third party funding of arbitration—see section 98G.

98G. Meaning of *third party funding of arbitration* and related terms

- (1) ***Third party funding of arbitration*** is the provision, under a funding agreement, of arbitration funding to a funded party by a third party funder in return for the third party funder receiving a financial benefit only if the arbitration is successful within the meaning of the funding agreement.
- (2) However, ***third party funding of arbitration*** does not include the provision of arbitration funding directly or indirectly by a person practising law, or providing legal services, whether in Hong Kong or elsewhere.
- (3) ***Arbitration funding*** is money, or any other financial assistance, in relation to any costs of an arbitration.
- (4) A ***funding agreement*** is a written agreement for third party funding of arbitration that is made between a funded party and a third party funder on or after the commencement date of this Part.
- (5) A ***funded party*** is a person who—
 - (a) is provided arbitration funding by a third party funder under a funding agreement; and
 - (b) is, or will be, a party to the arbitration.
- (6) A ***third party funder*** is a person who—
 - (a) provides arbitration funding to a funded party under a funding agreement; and
 - (b) does not, or will not, have an interest recognized by law in the arbitration other than under the funding agreement.
- (7) For this section—
 - (a) arbitration funding is taken to be provided to a funded party despite it being provided to another person (for example, to the funded party's legal representative), if it is provided at the funded party's request; and
 - (b) arbitration funding is taken to be provided by a third party funder despite it being provided by another person, if it is arranged by the third party funder.

Division 3—Third Party Funding of Arbitration Not Prohibited by Particular Common Law Offences or Tort

98H. Particular common law offences do not apply

The common law offences of maintenance (including the common law offence of champerty) and of being a common barrator do not apply in relation to third party funding of arbitration.

98I. Particular tort does not apply

The tort of maintenance (including the tort of champerty) does not apply in relation to third party funding of arbitration.

98J. Other illegality not affected

Sections 98H and 98I do 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.

98K. Extension in relation to Hong Kong services despite place of arbitration being outside Hong Kong

(1) If the place of arbitration is outside Hong Kong, then, despite section 5, this Part applies in relation to the funding of related Hong Kong services, as if the place of arbitration were in Hong Kong.

(2) In this section—

funding of related Hong Kong services, in relation to an arbitration, means the provision of money, or any other financial assistance, in relation to any costs or expenses of services that are provided in Hong Kong in relation to the arbitration.

Division 4—Code of Practice

98L. Code of practice may be issued

(1) The authorized body may issue a code of practice (whether prepared by the authorized body or not) setting out 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.

(2) The authorized body may amend or revoke a code of practice. Section 98N applies in relation to an amendment or revocation of the code of practice in the same way as it applies in relation to the code of practice.

98M. Content of code of practice

(1) Without limiting section 98L, the code of practice may, in setting out practices and standards, require third party funders to ensure that—

(a) any promotional material in connection with third party funding of arbitration is clear and not misleading;

(b) funding agreements set out their key features, risks and terms, including—

(i) the degree of control that third party funders will have in relation to an arbitration;

(ii) whether, and to what extent, third party funders (or persons associated with the third party funders) will be liable to funded parties for adverse costs, insurance premiums, security for costs and other financial liabilities; and

(iii) when, and on what basis, parties to funding agreements may terminate the funding agreements or third party funders may withhold arbitration funding;

(c) funded parties receive independent legal advice on funding agreements before entering into them;

(d) third party funders provide to funded parties the name and contact details of the advisory body;

- (e) third party funders have a sufficient minimum amount of capital;
 - (f) third party funders have effective procedures for addressing potential, actual or perceived conflicts of interest and the procedures enhance the protection of funded parties;
 - (g) third party funders have effective procedures for addressing complaints against them by funded parties and the procedures allow funded parties to obtain and enforce meaningful remedies for legitimate complaints;
 - (h) third party funders follow the procedures mentioned in paragraphs (f) and (g);
 - (i) third party funders submit annual returns to the advisory body on—
 - (i) any complaints against them by funded parties received during the reporting periods; and
 - (ii) any findings by a court or arbitral tribunal of their failure to comply with the code of practice or Division 5; and
 - (j) third party funders provide to the advisory body any other information it reasonably requires.
- (2) Without limiting subsection (1), the code of practice may—
 - (a) specify terms to be included, or not to be included, in funding agreements; and
 - (b) specify what is to be included, or not to be included, in order to have effective procedures.
 - (3) The code of practice—
 - (a) may be of general or special application; and
 - (b) may make different provisions for different circumstances and provide for different cases or classes of cases.

98N. Process for issuing code of practice

- (1) Before issuing a code of practice, the authorized body must—
 - (a) consult the public about the proposed code of practice; and
 - (b) publish a notice to inform the public of the proposed code of practice.
- (2) In preparing the proposed code of practice for public consultation, the authorized body, or another body that is preparing the proposed code of practice at the authorized body's request, may consult a person with knowledge or experience of arbitration or third party funding of arbitration.
- (3) The notice must state the following information—
 - (a) the purpose and general effect of the proposed code of practice;
 - (b) how a copy of the proposed code of practice may be inspected;
 - (c) that written submissions by any person about the proposed code of practice may be made and given to the authorized body before a specified time.
- (4) After considering all written submissions made before the specified time, the authorized body may issue the code of practice (with or without revision) by publishing it in the Gazette.
- (5) The code of practice comes into operation on the date it is published in the Gazette under subsection (4).
- (6) The code of practice is not subsidiary legislation.

98O. Non-compliance with code of practice

- (1) A failure to comply with a provision of the code of practice does not, of itself, render any person liable to any judicial or other proceedings.
- (2) However—
 - (a) the code of practice is admissible in evidence in proceedings before any court or arbitral tribunal; and
 - (b) any compliance, or failure to comply, with a provision of the code of practice may be taken into account by any court or arbitral tribunal if it is relevant to a question being decided by the court or arbitral tribunal.

Division 5—Other Measures and Safeguards

98P. Confidentiality

- (1) This section applies if a party has, or seeks, third party funding of arbitration from a person.
- (2) Despite section 18, information referred to in section 18(1) may be communicated by the party to the person for the purpose of having, or seeking, the third party funding of arbitration from the person.
- (3) However, the person may not further communicate any information communicated under subsection (2), unless—
 - (a) the further communication is made—
 - (i) to protect or pursue a legal right or interest of the person; or
 - (ii) to enforce or challenge an award made in the arbitration, in legal proceedings before a court or other judicial authority in or outside Hong Kong;
 - (b) the further communication is made to any government body, regulatory body, court or tribunal and the person is obliged by law to make the communication; or
 - (c) the further communication is made to a professional adviser of the person for the purpose of obtaining advice in connection with the third party funding of arbitration.
- (4) If a further communication is made by a person to a professional adviser under subsection (3)(c), subsection (3) applies to the professional adviser as if the professional adviser were the person.
- (5) In this section—
communicate includes publish or disclose.

98Q. Disclosures about third party funding of arbitration

- (1) If a funding agreement is made, the funded party must give written notice of—
 - (a) the fact that a funding agreement has been made; and
 - (b) the name of the third party funder.
- (2) The notice must be given—
 - (a) for a funding agreement made on or before the commencement of the arbitration—on the commencement of the arbitration; or
 - (b) for a funding agreement made after the commencement of the arbitration—within 15 days after the funding agreement is made.

- (3) The notice must be given to—
 - (a) each other party to the arbitration; and
 - (b) the arbitration body.
- (4) For subsection (3)(b), if there is no arbitration body for the arbitration at the time, or end of the period, specified in subsection (2) for giving the notice, the notice must instead be given to the arbitration body immediately after there is an arbitration body for the arbitration.

98R. Disclosure about end of third party funding of arbitration

- (1) If a funding agreement ends (other than because of the end of the arbitration), the funded party must give written notice of—
 - (a) the fact that the funding agreement has ended; and
 - (b) the date the funding agreement ended.
- (2) The notice must be given within 15 days after the funding agreement ends.
- (3) The notice must be given to—
 - (a) each other party to the arbitration; and
 - (b) the arbitration body.

98S. Non-compliance with Division 5

- (1) A failure to comply with this Division does not, of itself, render any person liable to any judicial or other proceedings.
- (2) However, any compliance, or failure to comply, with this Division may be taken into account by any court or arbitral tribunal if it is relevant to a question being decided by the court or arbitral tribunal.

Division 6—Miscellaneous

98T. Appointment of advisory body and authorized body

- (1) The Secretary for Justice may, by notice published in the Gazette, appoint as the advisory body a person the Secretary for Justice considers appropriate to monitor and review the operation of this Part.
- (2) The Secretary for Justice may, by notice published in the Gazette, appoint as the authorized body a person the Secretary for Justice considers appropriate to exercise the powers under section 98L.

List of Respondents to the Consultation

Responses were received from the following Respondents, arranged in alphabetical order:

1. Jonathan Acton-Bond
2. Ashurst Hong Kong
3. Best Surveying & Recovering Services Co.
4. Bodnar Horvath
5. Borrelli Walsh Limited
6. John Budge
7. Burford Capital
8. Peter Scott Caldwell
9. Paul Carolan of Prince's Chambers
10. Chartered Institute of Arbitration (East Asia Branch)
11. China International Economic And Trade Arbitration Commission, Hong Kong Arbitration Centre
12. Colin Cohen
13. Commerce and Economic Development Bureau
14. Constitutional and Mainland Affairs Bureau
15. Construction Industry Council
16. Consumer Council
17. Department of Justice, Civil Division
18. Department of Justice, International Law Division
19. Department of Justice, Legal Policy Division
20. Robinson, Dundas
21. Duty Lawyer Service

22. Financial Services and the Treasury Bureau
23. Food & Health Bureau
24. Freshfields Bruckhaus Deringer
25. Clive Grossman SC
26. Harbour Litigation Funding
27. Hogan Lovells
28. The Hong Kong Association of Banks
29. Hong Kong Bar Association
30. Hong Kong Corporate Counsel Association
31. The Hong Kong Federation of Insurers
32. The Hong Kong Federation of Trade Unions
33. Hong Kong General Chamber of Commerce
34. Hong Kong Institute of Arbitrators
35. Hong Kong International Arbitration Centre
36. Hong Kong Mediation and Arbitration Centre
37. Hong Kong Police Force, Headquarters
38. The Hong Kong University of Science and Technology,
Department of Accounting
39. Housing Department
40. IMF Bentham International Litigation Funding
41. International Chamber of Commerce - Hong Kong
42. Judiciary
43. Nigel Kat SC
44. Kennedys
45. KPMG
46. Phyllis K Y Kwong & Associates
47. Labour and Welfare Bureau

48. LAI Yiu Kuen Dominic
49. M C A LAI & Co Solicitors
50. Damien Laracy, Laracy & Co.
51. Julia Lau
52. The Law Society of Hong Kong
53. LEUNG Hing Fung, Department of Real Estate and Construction,
University of Hong Kong
54. Mr Paul Li Mang Wah, K M Lai & Li
55. Lipman Karas
56. Nasirs
57. Kevin Ng & Co, Solicitors
58. Pinsent Masons
59. Public Interest Law and Advocacy Society of Hong Kong
60. Registrar of Companies
61. Shearman & Sterling
62. Devin C I SIO
63. Smyth & Co in association with RPC
64. Society of Construction Law Hong Kong
65. Gary Soo's Chambers
66. Stefanie Wilkins
67. Transport and Housing Bureau
68. Institute for Legal Reform, U S Chamber of Commerce
69. Ching Y Wong QC
70. Ms Cleresa Wong
71. Man Sing YEUNG
72. Dr Noam Zamir and Paul Barker
73. (Anonymous)