

## Can't Pay, Won't Pay — Hong Kong Introduces Third-Party Funding of Arbitration

***New provisions allowing third-party funding of arbitration come into force on 1 February 2019.***

### **Key Points:**

- The key provisions of the Arbitration and Mediation Legislation (Third-Party Funding) (Amendment) Ordinance 2017 allowing third-party funding of arbitration come into force on 1 February 2019.
- The Amendment Ordinance confirms that the laws of maintenance and champerty do not apply in relation to third-party funding of arbitration.
- The sought-after reform might allow parties to shift the financial risk of arbitration, as well as remove arbitration costs from their profit and loss statements and balance sheets. More broadly, the reform could potentially increase access to justice.
- The Amendment Ordinance will “*add to the attractiveness of Hong Kong as an international arbitration centre,*” says the Department of Justice.

### **Recap: The Arbitration and Mediation Legislation (Third-Party Funding) (Amendment) Ordinance 2017**

The Arbitration and Mediation Legislation (Third-Party Funding) (Amendment) Ordinance 2017 (the Amendment Ordinance) was enacted in June 2017, with key provisions to come into operation later (at a date set by the Secretary for Justice).

The purpose of the Amendment Ordinance is to:

- Amend the Arbitration Ordinance (Cap. 609) to ensure that third-party funding of arbitration is not prohibited by the common law doctrines of maintenance and champerty
- Provide for measures and safeguards to regulate the provision of third-party funding for arbitration

In particular, the Amendment Ordinance:

- Provides that a “third-party funder” may provide “arbitration funding” to a “funded party” under a “funding agreement” in return for a financial benefit only if the arbitration is successful within the meaning of the funding agreement

- Applies to arbitrations outside Hong Kong in relation to costs and expenses of services provided in Hong Kong in relation to the arbitration
- Makes provision for a code of practice to regulate the practices and standards expected of third-party funders
- Regulates the provision of third-party funding by way of measures and safeguards, e.g., the communication of information for third-party funding and the requirements for disclosure of funding agreements
- Provides for an amendment to the Mediation Ordinance to allow third-party funding of mediation (this amendment has not yet come into force)

### **Reminder: What Are Maintenance and Champerty?**

Maintenance is a historic common law doctrine (dating back to medieval English law) that, in essence, seeks to prohibit a person from supporting (or maintaining) litigation in which he or she has no legitimate interest or concern. Maintenance is based on a public policy concern regarding illegitimate financing of litigation by intermediaries who may “sully the purity of justice.”

Champerty is an “aggravated” form of maintenance. Champerty occurs when a person without a legitimate concern in the outcome of litigation agrees to support the action financially in consideration of a promise to receive a share in the proceeds of the action.

Interested parties have doubted whether the doctrines of maintenance and champerty should apply at all to arbitrations since they are — unlike litigation — generally private, voluntary, and consensual in nature. However, this issue has not previously been settled as a matter of Hong Kong law.<sup>1</sup> Parties have generally accepted that third-party funding for arbitration was not permitted in Hong Kong, therefore third-party funding of arbitration has not been a common practice in Hong Kong.

### **What Is the Significance of the Amendment Ordinance?**

The Amendment Ordinance clarifies beyond doubt that the doctrines of maintenance and champerty do not apply to third-party funding of arbitration, thereby increasing the attractiveness of arbitration in Hong Kong.

In this regard, the Department of Justice hopes that “*clarifying the uncertainty as to whether the doctrines of maintenance and champerty apply to third party funding of arbitrations can enable Hong Kong to stay abreast of latest international developments.*”<sup>2</sup>

### **Key Provisions Now in Operation**

On 7 December 2018, the Secretary of Justice gazetted a notice appointing 1 February 2019 as the date upon which the key provisions of the Amendment Ordinance regarding third-party funding of arbitration would come into operation.

Now that these provisions have come into operation, parties can start entering into funding arrangements to fund their arbitrations.

Institutional funders likely will waste no time in making use of the new law. Indeed, institutional funders have been arguing for some years now that Hong Kong has been losing arbitration volume and falling behind the likes of London and New York because of its failure to allow third-party funding.

The arbitration community in Hong Kong has hailed the reform, with commentators noting the value of maintaining and promoting Hong Kong's position as a leading arbitration center.

## Parallel Developments

### Code of Practice

Pursuant to Division 4 of the Amendment Ordinance, the Secretary of Justice has issued a Code of Practice for Third-Party Funding of Arbitration (the Code) on 7 December 2018.

The Code sets 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.

The main purpose of the Code is to provide protection for funded parties. It sets out minimum standards of good practice expected of funders and covers, for example, capital adequacy requirements, disclosure obligations, requirements of what the funding agreement must include, and complaint procedures. For example, *"a third-party funder must ensure its promotional materials are clear and not misleading"* (paragraph 2.2) and *"must remind the funded party of its obligation to disclose information about the third-party funding of arbitration"* per the Amendment Ordinance (paragraph 2.10).

### New HKIAC Rules

Hong Kong's flagship arbitration institution, the Hong Kong International Arbitration Centre (HKIAC), recently released an updated set of administered arbitration rules (the 2018 Rules) containing, for the first time, specific rules regarding third-party funding. Consistent with the Amendment Ordinance, the 2018 Rules require a funded party to disclose the existence of a funding agreement. An exception to a party's obligation of confidentiality is now included for the purposes of having or seeking third-party funding of arbitration. The 2018 Rules also expressly allow an arbitral tribunal to take into account any third-party funding arrangement in fixing and apportioning arbitration costs. For a more in-depth look at the new rules, please see [Latham's previous Client Alert](#). HKIAC is already aware of one Hong Kong-seated arbitration in which a party is seeking funding.

## Commentary

The use of third-party funding in international arbitration has increased markedly in recent years. Many jurisdictions — such as the US and England — already allow the practice. As a global center of international arbitration and a favored seat of arbitration worldwide, Hong Kong is now well-placed to take advantage of this trend. Users of arbitration in Hong Kong can now choose whether they wish to fund their arbitrations themselves or whether to seek external funding.

Proponents of third-party funding point out that as well as increasing access to justice (for those who could not afford to arbitrate without this funding), it can also provide significant advantages to those for whom third-party funding is a pure business choice. Users are able to free-up capital for core business purposes, remove arbitration costs from the P&L and balance sheet, and manage risks more effectively. Whilst management traditionally views business disputes as an unwelcome distraction, the growth of a marketplace for the funding of arbitrations can contribute to a change of perspective: seeing arbitration claims as potentially valuable assets that can be put to efficient use — similar to other contingent assets.

Moreover, institutional funders argue that they have a lot more to offer than just cold hard cash (welcome as that is). They see themselves as also adding value in the form of the expertise that they can bring to bear: a seasoned and unbiased second pair eyes. Some third-party funders have an investment advisory committee

of retired legal practitioners who are well placed to provide a preliminary assessment of the strength of the case. Other indirect benefits of third-party funding may include the possibility of facilitating earlier settlement.

Following this reform, parties likely will want to consider whether third-party funding is right for their arbitration claims. In doing so, parties involved in an arbitration should consider:

- **Whether the particular case is right for funding.** Relevant factors may include (i) the nature of the claim (e.g., is the claim monetary or non-monetary); (ii) the value and complexity of the claim; (iii) the amount of funding needed; and (iv) the likelihood of success of the claim. Obtaining funding will involve some time and costs, likely will involve giving away some control of the conduct of the arbitration, and will mean giving up some share of the proceeds.
- **Which funder is right for parties and for the claim.** Parties seeking funding are likely to enjoy greater choice as the market for funding of arbitration in Hong Kong develops. Each funder is different and parties should approach selecting an institutional funder in the same way they would for any other professional service provider.

Parties must consider the extent to which the funder may be inclined to seek an active role in the arbitration. In England, funders are expected not to take an active role in proceedings and the party itself must retain ultimate control. However in other jurisdictions, such as Australia, funders typically exercise much greater levels of control. In Hong Kong, the Code provides that the funding agreement must outline clearly “*that the third-party funder will not seek to influence the funded party or the funded part’s legal representative to give control or conduct of the arbitration to the third party funder except to the extent permitted by law*” (paragraph 2.9(1)).

- **The terms upon which funding is available.** Parties must review the terms carefully and obtain external legal advice before entering into a funding agreement.

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**Endnotes**

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<sup>1</sup> The issue of whether maintenance and champerty apply to agreements concerning arbitrations taking place in Hong Kong was expressly left open by the CFA in the case of *Unruh v. Seeberger* [2007] HKCFA 10, see paragraph 123.

<sup>2</sup> Department of Justice, Legislative Council Brief "Commencement of Section 3 of Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Ordinance 2017", December 2018. [https://www.legco.gov.hk/yr18-19/english/subleg/brief/2018ln260\\_brf.pdf](https://www.legco.gov.hk/yr18-19/english/subleg/brief/2018ln260_brf.pdf)