

Client Alert

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Hong Kong Law Reform Commission Recommends Third Party Funding for Arbitration

Recent developments

The Law Reform Commission of Hong Kong ("**LRC**") published a report on 12 October 2016 ("**Report**") in which it recommends amendments to the Arbitration Ordinance (Cap. 609) ("**AO**") to expressly permit third party funding ("**TPF**") for arbitrations and other proceedings under the AO, provided that appropriate financial and ethical safeguards are put in place.

The Report sets out the LRC's final recommendations on TPF and related matters, including draft provisions to amend the AO. The Report also discusses the 73 responses to a consultation paper which was published by its Third Party Funding for Arbitration Sub-committee ("**Sub-committee**") in October 2015.

Implications for parties arbitrating in Hong Kong

As noted in the Report, TPF for arbitration has become increasingly common over the last decade in numerous jurisdictions. Jurisdictions allowing TPF for arbitration include, in particular, the common law jurisdictions of Australia, England and Wales, and the USA. It is, however, currently uncertain whether TPF for arbitrations in Hong Kong is permitted or whether the common law doctrines of maintenance and champerty apply to it, making it a tort and criminal offence in Hong Kong.

The Report builds on the recommendations of the Sub-committee that TPF for arbitrations in Hong Kong should be expressly permitted because the benefits outweigh the risks which can be managed by appropriate safeguards. We discussed the benefits and risks, and the Sub-committee's recommendations in our previous client [alert](#) of October 2015. One major benefit of TPF is that it provides parties with additional financing options to pursue their claims and allows them to share the risk of non-recovery with third party funders ("**Funders**").

The LRC's final recommendation confirms that parties choosing to arbitrate in Hong Kong should be allowed to seek financial assistance from Funders without the risk of committing a tort and criminal offence in Hong Kong. According to the Report, persons practising law or providing legal services should, however, be prohibited from providing TPF directly or indirectly.

In our view, one of most important recommendations of the LRC is that Funders should be required to comply with a Code of Practice ("**Code**") setting out practices and standards which Funders are ordinarily expected to comply with.

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The Report

The key recommendations of the LRC include the following:

1. The AO should be amended to state that the doctrines of maintenance and champerty, with respect to both civil and criminal liability, shall not apply to arbitration and associated proceedings under the AO.
2. TPF in Hong Kong should also be permitted for arbitrations seated outside Hong Kong.
3. A party should be required to disclose to all other parties and the arbitral tribunal or court the fact that a funding agreement has been made and the identity of the Funder.
4. Clear ethical and financial standards for Funders should be developed. The LRC has recommended a “light touch” approach to the regulation of TPF for arbitrations in Hong Kong for an initial period of three years.
5. Funders should be required to comply with a Code to be issued by a body authorized under the AO after public consultation. The Code should set out the standards and practices which Funders are ordinarily expected to comply with, including:
 - Funder’s promotional literature must be clear and not misleading;
 - The funding agreements should clearly explain the key features, risks and terms of the agreement, which should cover, among others, capital adequacy requirements, conflicts of interest, confidentiality and privilege, and grounds for termination of the funding; and
 - Funders must take reasonable steps to ensure that the funded party receives independent legal advice on the terms of the funding agreement before signing it.
6. Notably, the LRC has concluded that it is not necessary to give arbitral tribunals the power to order security for costs against a Funder, as the existing powers to order a party to give security for costs under the AO afford adequate protection. Although the LRC considered that, in principle, arbitral tribunals should be empowered to award costs against a Funder in appropriate circumstances and after according it due process, they considered it premature at this stage to amend the AO to provide such powers.

The Report also includes a set of draft provisions to amend the AO. Apart from the AO, the LRC has recommended giving consideration to extend the permission of TPF to mediation under the Mediation Ordinance (Cap. 620).

Conclusion

We expect that the reform for the provision of TPF services would lead to an increase in the number of arbitrations brought in Hong Kong. We see a good prospect that the AO will be amended within the next six to eight months. We will continue to monitor the proposed reform and will provide updates as to its progress. Meanwhile, we are happy to discuss what impact this development may have on future arbitrations in Hong Kong.

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