

THE LAW REFORM COMMISSION OF HONG KONG

**THIRD PARTY FUNDING FOR ARBITRATION
SUB-COMMITTEE**

CONSULTATION PAPER

THIRD PARTY FUNDING FOR ARBITRATION

This consultation paper can be found on the Internet at:
<<http://www.hkreform.gov.hk>>

OCTOBER 2015

This Consultation Paper has been prepared by the Third Party Funding Sub-committee of the Law Reform Commission. It does not represent the final views of either the Sub-committee or the Law Reform Commission, and is circulated for comment and discussion only.

The Sub-committee would be grateful for comments on this Consultation Paper by 18 January 2016. All correspondence should be addressed to:

*The Secretary
The Third Party Funding for Arbitration Sub-committee
The Law Reform Commission
4th Floor, East Wing, Justice Place
18 Lower Albert Road
Central
Hong Kong*

Telephone: (852) 3918 4097

Fax: (852) 3918 4096

E-mail: hklrc@hkreform.gov.hk

It may be helpful for the Commission and the Sub-committee, either in discussion with others or in any subsequent report, to be able to refer to and attribute comments submitted in response to this Consultation Paper. Any request to treat all or part of a response in confidence will, of course, be respected, but if no such request is made, the Commission will assume that the response is not intended to be confidential.

It is the Commission's usual practice to acknowledge by name in the final report anyone who responds to a consultation paper. If you do not wish such an acknowledgment, please say so in your response.

THE LAW REFORM COMMISSION OF HONG KONG

THIRD PARTY FUNDING FOR ARBITRATION SUB-COMMITTEE

CONSULTATION PAPER

THIRD PARTY FUNDING FOR ARBITRATION

CONTENTS

<i>Chapter</i>	<i>Page</i>
Defined Terms	1
Preface	4
Terms of Reference	4
Membership of the Sub-committee	5
Format of this paper	6
1. Introduction	7
What is Third Party Funding?	8
How is Third Party Funding relevant to arbitration?	9
How is Third Party Funding relevant to arbitration in Hong Kong?	9
What are the doctrines of maintenance and champerty under Hong Kong law?	10
How does Third Party Funding fall under the doctrines of maintenance and champerty?	11
Is Third Party Funding of litigation permitted in Hong Kong?	11
Is Third Party Funding for arbitration permitted in Hong Kong?	11
What is the issue that this Sub-committee is addressing and what is its role?	12
Scope of the Sub-committee's review	13
Recommendations	13

Chapter	Page
2. Overview of litigation and arbitration in Hong Kong	16
Hong Kong's sovereignty with regard to dispute resolution	16
<i>Litigation in Hong Kong</i>	17
<i>Arbitration in Hong Kong</i>	18
<i>Sources of Hong Kong's arbitration law</i>	19
<i>Relevance in Hong Kong of the distinction between foreign and domestic arbitrations</i>	19
<i>The Tribunal's jurisdiction</i>	20
<i>Arbitrability</i>	20
<i>Arbitral jurisdiction under investment protection and promotion agreements</i>	21
<i>Parties' powers in arbitration</i>	22
<i>The role of courts in arbitration</i>	23
<i>Role of arbitrators</i>	24
<i>Enforcement of Tribunal's orders and Awards</i>	24
<i>Enforcement of Awards</i>	25
<i>Parties' arbitration in Hong Kong</i>	26
<i>Costs of arbitration</i>	26
<i>Stakeholders in arbitration</i>	27
3. Outline of Third Party Funding and current Hong Kong law	29
A. Third Party Funding	30
<i>The main methods of Third Party Funding</i>	30
(1) <i>Investment by payment of Funds</i>	31
(2) <i>Brokers</i>	31
(3) <i>Lawyer funding</i>	31
<i>What are conditional fees?</i>	32
<i>Contingency fee, percentage fee, "no win, no fee"</i>	32
<i>Conditional fee, uplift fee, success fee</i>	32
<i>Speculative fee</i>	33
<i>Conditional fees in relation to Third Party Funding</i>	33
(4) <i>ATE insurance</i>	33
<i>Typical structures of Third Party Funders of the Proceedings and Sources of Funds</i>	34
<i>Sources of funds of Third Party Funders</i>	35
<i>Types of cases attracting Third Party Funding</i>	35
<i>Criteria for funding</i>	36
<i>Likelihood of success</i>	37
<i>Quantum of the claim</i>	38
<i>The Third Party Funding compensation structure</i>	38
<i>Typical terms of agreement</i>	39
<i>Order of payments</i>	40
<i>Liability for costs, including Adverse Costs Orders and Security for Costs</i>	41

Chapter	Page
<i>ATE insurance and Third Party Funding</i>	41
<i>Termination and withdrawal of funding</i>	41
<i>Control over the conduct of proceedings</i>	42
<i>Party conflict management and dispute resolution</i>	42
<i>Confidentiality and provision of documents</i>	43
B. The current Hong Kong law on maintenance and champerty and Third Party Funding in Hong Kong	43
<i>Exceptions to the rule against maintenance and champerty</i>	43
<i>Sanctions for breach of the rule against maintenance and champerty</i>	44
<i>Tortious claims</i>	44
<i>Criminal offences</i>	44
<i>Do maintenance and champerty apply to arbitration under Hong Kong law?</i>	45
<i>Third Party Funding in Hong Kong and its regulation</i>	45
<i>Relevant regulation of the Hong Kong legal profession</i>	47
4. The current law and regulation of Third Party Funding for arbitration in various common law and civil law jurisdictions and under the Washington Convention	49
Australia	51
<i>Overview of Third Party Funding in Australia</i>	51
<i>Judicial approval of litigation funding</i>	52
<i>Orders for costs and Security for Costs</i>	57
<i>Government regulation of Third Party Funding in Australia</i>	61
England and Wales	66
<i>Overview of Third Party Funding</i>	66
<i>Judicial approval of litigation funding</i>	67
<i>Law reform recommendations regarding litigation funding</i>	70
<i>Orders for costs and Security for Costs</i>	72
<i>Court's powers to make costs orders against third parties</i>	72
<i>Third party funder's liability for costs orders</i>	73
<i>Court's powers to make Security for Costs orders against Third Party Funders</i>	74
<i>Costs and Security for Costs in arbitration in the UK</i>	75
<i>Industry regulation</i>	75
France	78
<i>Third Party Funding generally</i>	78
<i>Ethical considerations</i>	79
Germany	80
<i>Third Party Funding generally</i>	80
<i>Third Party Funding in arbitration</i>	84
<i>Ethical considerations</i>	85
The Netherlands	87
<i>Third Party Funding generally</i>	87

Chapter	Page
<i>Third Party Funding in arbitration</i>	87
<i>Ethical considerations</i>	87
Sweden	88
<i>Third Party Funding generally</i>	88
<i>Third Party Funding in arbitration</i>	88
<i>Ethical considerations</i>	88
Switzerland	89
<i>Third Party Funding generally</i>	89
<i>Third Party Funding in arbitration</i>	90
European Union	90
Korea	91
<i>Third Party Funding generally</i>	91
PRC	92
<i>Third Party Funding generally</i>	92
Singapore	93
<i>Third Party Funding generally</i>	93
<i>Third Party Funding in arbitration</i>	94
United States of America	98
<i>Third Party Funding generally</i>	98
<i>Maintenance, champerty and barratry</i>	99
<i>Usury</i>	101
<i>Privilege</i>	102
<i>Ethical considerations</i>	102
<i>The ABA model rules of professional conduct</i>	102
<i>Third Party Funding in arbitration</i>	107
<i>Treaty cases under the Washington Convention</i>	109
5. The benefits and risks of Third Party Funding for arbitration	112
Introduction	112
Summary table of benefits and risks of Third Party Funding	112
Potential benefits of Third Party Funding for arbitration	114
<i>Maintaining and promoting Hong Kong's competitiveness as an arbitration centre</i>	114
<i>Benefits to Hong Kong public</i>	114
<i>Benefit to the Funded Party and public interest considerations</i>	115
<i>Access of participants to proceedings</i>	115
<i>Risk management and financial support</i>	115
<i>Experience and thorough due diligence before the commencement of hearing</i>	115
<i>Increasing the chances of a beneficial settlement for the claimant</i>	116
<i>Effective case management monitored by the Funder and reduction of legal costs</i>	116
<i>Availability of funding for respondents</i>	117

Chapter	Page
<i>Enforcement of costs awards by respondents</i>	118
<i>Screening of claims</i>	118
<i>Promotion of arbitration as an alternative dispute resolution method</i>	119
Potential risks of Third Party Funding for arbitration	120
<i>Introduction</i>	120
<i>Is there a risk of promoting unnecessary arbitration proceedings?</i>	120
<i>Degree of control over arbitration by Third Party Funders</i>	121
<i>Costs of Third Party Funding</i>	122
<i>Structure of the funding agreement</i>	122
<i>Security</i>	122
<i>Liability for adverse costs awards or orders</i>	122
<i>Potential for breaches of legal professional privilege</i>	124
<i>Confidentiality issues</i>	125
<i>Disclosure of Third Party Funding agreement</i>	126
<i>Conflicts of interest</i>	126
<i>Disclosure of funding may unduly influence Tribunal / may prevent the proper settlement of a case</i>	127
<i>Risk of arbitrary termination of the Third Party Funding agreement in Third Party Funding</i>	127
<i>Risk of insufficient Third Party Funder capital adequacy</i>	127
<i>Inadequate complaints procedures</i>	128
<i>Money laundering</i>	128
6. Recommendations	129
7. Summary of Recommendations	136
Annex 1	138
Relevant legislative and regulatory regime	

Defined Terms

Abbreviation

Definition

Adverse Costs Order	A court order requiring a party to court proceedings to pay all or some of the costs of the other party or parties involved.
AFS Licence	Australian Financial Services Licence.
ALF	The Association of Litigation Funders of England and Wales.
ALF Code	Code of Conduct for Litigation Funders issued by the ALF.
ALFA	American Legal Finance Association.
Arbitrability	Whether the subject matter of the dispute is capable of being resolved by arbitration or must be resolved by the courts or some decision making body other than an arbitral tribunal.
Arbitration Ordinance	Arbitration Ordinance (Cap 609) of the HKSAR.
ATE Insurance	After-the-Event Insurance.
Award	A decision of an arbitral tribunal that finally determines a substantive issue.
Basic Law	The Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China, promulgated on 4 April 1990 by the Seventh National People's Congress pursuant to the Joint Declaration of the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the People's Republic of China.
BO	Banking Ordinance (Cap 155).
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.

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

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.
CPR	Civil Procedure Rules 1998 of the UK commenced on 26 April 1999.
Funded Party	A party to legal proceedings that is being funded by Third Party Funder.
Funds	Monies paid by a Third Party Funder to a Funded Party.
HKIAC	Hong Kong International Arbitration Centre.
HKSAR	Hong Kong Special Administrative Region of the People's Republic of China.
ICC	International Chamber of Commerce.
ICSID	International Centre for Settlement of Investment Disputes.
Jackson Report	<i>Review of Civil Litigation Costs: Final Report</i> by the Right Honourable Lord Justice Jackson dated December 2009.
Jackson Review	<i>Review of Civil Litigation Costs: Preliminary Report</i> by the Right Honourable Lord Justice Jackson dated May 2009.
MLO	Money Lenders Ordinance (Cap 163).
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.
PRC	The People's Republic of China.
Proceedings	Arbitration or litigation proceedings.
Security for Costs	An order made by an arbitral 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 the claims/counterclaims are unsuccessful.
SFC	Securities and Futures Commission of the Hong Kong Special Administrative Region.
SFO	Securities and Futures Ordinance (Cap 571).
Speculative Fee	An arrangement where a lawyer is entitled to charge

his/her normal fee only in the event of successful litigation. A lawyer will not be entitled to a fee if the action does not succeed.²

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 provider of Third Party Funding to a party to an arbitration or litigation that does not otherwise have an interest in those Proceedings.
Third Party Funding	The funding of claims in arbitration or litigation by commercial bodies in return for a share of the proceeds recovered in such Proceedings, or some other financial benefit.
Tribunal	The arbitral tribunal, consisting of one or three arbitrator(s), established by the agreement of the parties to finally resolve disputes or differences by arbitration.
Washington Convention	Convention on the Settlement of Investment Disputes between States and Nationals of Other States of 1965.

² The Law Reform Commission of Hong Kong, *Consultation Paper on Conditional Fees* (2005), at para 8.

Preface

Terms of reference

1. Third Party Funding has become increasingly common over the last decade in numerous jurisdictions including Australia, England and Wales, various European jurisdictions and the United States. Third Party Funding arrangements are usually motivated by a party's lack of financial resources to pursue its own claims in arbitration or litigation. A Third Party Funding contract commonly provides that the Third Party Funder will pay for the Funded Party's costs of arbitration or litigation proceedings in return for a percentage of the judgment or Award or some other financial benefit from any proceeds recovered by the Funded Party from such funded proceedings. If there is no recovery from the proceedings, the Third Party Funder will not receive any repayment or return on the Funds it has advanced to the Funded Party.

2. 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.

3. 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) in a miscellaneous category of proceedings including insolvency proceedings.

4. It is 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 decision in *Unruh v Seeberger*¹ where the Court expressly left open this question.

5. In June 2013, the Chief Justice and the Secretary for 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."

¹ (2007) 10 HKCFAR 31, at para 123.

Membership of the Sub-committee

6. In June 2013, a sub-committee was appointed to review the subject. The members of the Sub-committee are:

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 Dispute Resolution Practice Herbert Smith Freehills
Mr Victor Dawes, SC	Barrister Temple Chambers
Mr Jason Karas	Principal and Solicitor Advocate Lipman Karas
Mr Robert Y H Pang, SC	Senior Counsel Bernacchi Chambers

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

8. Since its formation, the Sub-committee has met on a regular basis to discuss and consider the matters within the Terms of Reference. The recommendations in this paper are the result of those discussions. They represent the Sub-committee's preliminary views, presented for consideration by the community including the general public, arbitration users, arbitration service providers, Third Party Funders' regulators and those with an interest in this subject generally.

9. After conducting a review of current Hong Kong law and practice and analysing the legal regime for Third Party Funding for arbitration in a number of overseas jurisdictions, including whether or not it is permitted, and if so, on what terms, the Sub-committee is issuing this Consultation Paper to seek the public's view and comments on (a) whether reform is needed of the current position relating to Third Party Funding for arbitration in Hong Kong and, (b) if so, what kind of reform is appropriate. The consultation period will end on Monday, 18 January 2016. The Sub-committee welcomes any views, comments and suggestions on the issues presented in this Consultation Paper. These will greatly assist the Sub-committee to reach its final conclusions.

10. The Sub-committee members wish to thank the following for their valuable research assistance: Mark Giddings, James MacKinnon, Eric Ng, Suraj Sajnani, Winnie Wat and Briana Young.

Format of this paper

11. This Consultation Paper consists to the following chapters:
- (1) Chapter 1 is the introduction of the Consultation Paper.
 - (2) Chapter 2 provides an overview of litigation and arbitration in Hong Kong.
 - (3) Chapter 3 provides an overview of Third Party Funding and sets out the current Hong Kong law on the application of the doctrines of maintenance and champerty to Third Party Funding of arbitrations taking place.
 - (4) Chapter 4 examines the current law and regulation of Third Party Funding for arbitration in various common law and civil law jurisdictions and under the Washington Convention.
 - (5) Chapter 5 analyses the benefits and risks of Third Party Funding for arbitration.
 - (6) Chapter 6 sets out the recommendations of the Sub-committee.
 - (7) Chapter 7 is a summary of the Sub-committee's recommendations.

Chapter 1

Introduction

1.1 Hong Kong is one of Asia's major commercial, financial and arbitration centres. It was one of the first jurisdictions in the world (and the first in Asia) to adopt the UNCITRAL Model Law on International Commercial Arbitration of 21 June 1985 into its arbitration law. Hong Kong has regularly reviewed and reformed its law to maintain a pro-arbitration regime, incorporating best international standards while accommodating the needs of Hong Kong arbitration users and incorporating provisions arising from its constitutional status.

1.2 Hong Kong's common law system has continued to apply the doctrines of maintenance and champerty which originated in England in medieval times with the intention of preventing unnecessary litigation proceedings being promoted or financed by powerful individuals for the sole purpose of furthering their own interests. However, over the past 700 years the courts have evolved and there are far greater protections against the potential abuses that maintenance and champerty were intended to prevent, and a greater focus on access to justice issues.

1.3 International arbitration is increasingly used to resolve investment and commercial disputes involving parties and assets from different countries and jurisdictions. Separately, around the world a specialised source of Third Party Funding for arbitration and litigation is developing, to enable parties involved in dispute resolution to pay for the cost of their Proceedings in exchange for a portion of any amounts that they recover in such Proceedings. As we discuss in Chapter 4, all but one of the major international arbitration centres that we have researched allows third party funding of arbitration.

1.4 In *Winnie Lo v HKSAR*¹ and *Unruh v Seeberger*, the Court of Final Appeal observed that the scope of what constitutes maintenance and champerty in Hong Kong has been narrowed over the years reflecting the changed public policy considerations to allow recognised exceptions in litigation (with the leave of the court) where third party funding of litigation will be permitted, such as cases involving third parties with a legitimate interest in the outcome of the litigation, or where "*access to justice considerations*" apply, or in a miscellaneous category including insolvency litigation. As the Court of Final Appeal observed in *Unruh v Seeberger*, such developments demonstrate that the Hong Kong courts have been prepared to adapt a law with ancient origins to cope with modern requirements and conditions.²

¹ (2012) 15 HKCFAR 15.

² *Unruh v Seeberger* (2007) 10 HKCFAR 31, at para 77 (*per* Ribeiro PJ).

1.5 Accordingly, in Hong Kong, notwithstanding that the doctrines of maintenance and champerty continue to apply to litigation, it has been held that "*they must be substantially qualified by other considerations...*" and the scope of the exceptions has expanded to clearly allow third party funding of litigation in the excepted areas outlined in paragraph 1.4 above.³ These include access to justice considerations and the increased ability of the Hong Kong courts to protect against potential abuses. We discuss the three main exceptions further in Chapter 3. Hong Kong courts have balanced the need to protect individuals from the risk of unnecessary litigation proceedings being promoted or financed by powerful entities for the sole purpose of furthering their own interests, with the benefits of permitting such third party funding of litigation where there is good reason to do so.

1.6 The current position as to third party funding of arbitration in Hong Kong, however, is not clear. While the Hong Kong courts do not object, in principle, to Third Party Funding for arbitration, as may be seen from the Hong Kong Court of Final Appeal decision in *Unruh v Seeberger*,⁴ the Court of Final Appeal has left open the question of whether or not Third Party Funding for arbitration is permitted,⁵ as described later in this chapter.

1.7 As both a major international financial and arbitration centre, parties considering whether to resolve their disputes in Hong Kong by international arbitration are starting to take into account not only the features of the Hong Kong arbitration regime, but the potential financing options available to them for conducting such an arbitration. The uncertainty in Hong Kong law as to whether Third Party Funding for arbitration taking place in Hong Kong is permitted, is leading to the general view that it is not permitted, potentially making Hong Kong less attractive as a place to conduct arbitration and damaging its competitiveness as an arbitration centre whether for international, Mainland Chinese or Hong Kong disputes.

1.8 This Consultation Paper reviews and discusses whether Hong Kong law should be amended to expressly state and clarify that the doctrines of maintenance and champerty do not prohibit Third Party Funding for arbitrations taking place in Hong Kong, and if so, whether ethical and financial safeguards are needed, in what areas and in what form.

What is Third Party Funding?

1.9 Third Party Funding has been described as "*the funding of claims by commercial bodies in return for a share of the proceeds.*"⁶ It involves a

³ See *Unruh v Seeberger* (2007) 10 HKCFAR 31, at para 100 (*per* Ribeiro PJ).

⁴ *Unruh v Seeberger* (2007) 10 HKCFAR 31.

⁵ *Unruh v Seeberger* (2007) 10 HKCFAR 31, at para 123 (*per* Ribeiro PJ).

⁶ Lord Justice Jackson, "Third Party Funding or Litigation Funding" (Speech delivered at the Sixth Lecture in the Civil Litigation Costs Review Implementation Programme, The Royal Courts of Justice, 2011).

"third person" to the Proceedings providing financial "assistance or support to a party to" the Proceedings.⁷

1.10 A Third Party Funding arrangement for arbitration commonly provides that the Third Party Funder will pay the Funded Party's legal and other costs of the arbitration in return for a percentage of the Award or some other financial benefit from any financial recoveries in the arbitration.

1.11 A feature of Third Party Funding that distinguishes it from other forms of financing of Proceedings is that the Third Party Funder will be compensated only from the Funded Party's net recoveries from the Proceedings (after deduction of agreed costs and expenses). A Funded Party will not have to pay any amount to the Third Party Funder if the Proceedings are unsuccessful (as determined by the definition of "success" or similar expression in the relevant Third Party Funding agreement).

1.12 While Third Party Funding arrangements are usually motivated by a party's lack of financial resources to pursue its own claims, Third Party Funding may also be used by a party to manage the risks of litigation or arbitration by sharing the risk of non-recovery with the Third Party Funder in return for sharing the funds recovered out of such Proceedings by the Funded Party, if any.

How is Third Party Funding relevant to arbitration?

1.13 A party conducting an arbitration must pay upfront the costs and expenses associated with it including the costs of the arbitrators, any arbitral institution, their lawyers, expert witnesses, translators, court reporters, hearing venues and similar expenses. These can be high. The party may not have the financial resources itself to pay these costs and expenses and so may want to obtain Third Party Funding.

How is Third Party Funding relevant to arbitration in Hong Kong?

1.14 Hong Kong is an international arbitration centre with a growing number of arbitrations. A party conducting an arbitration in Hong Kong may wish to obtain Third Party Funding to enable it to pay upfront for costs and expenses of conducting the Proceedings. The party in question either may not have the funds itself to pay for these costs, or may wish to obtain Third Party Funding as a form of financing for the efficient allocation and management of their financial resources.

⁷ <<http://associationoflitigationfunders.com/wp-content/uploads/2014/02/Sixth-Lecture-by-Lord-Justice-Jackson-in-the-Civil-Litigation-Costs-Review-.pdf>>, at para 2.1.

Unruh v Seeberger (2007) 10 HKCFAR 31, at para 118 (*per* Ribeiro PJ).

1.15 The users of arbitrations taking place in Hong Kong are overwhelmingly corporations, partnerships, government departments and similar entities. This is reflected in the types of disputes that are commonly resolved by arbitration taking place in Hong Kong, whether international disputes or disputes that have arisen in Mainland China or Hong Kong. The parties to arbitrations taking place in Hong Kong are usually corporations, partnerships and government bodies, and concern commercial, construction, corporate and shareholders, maritime, finance, joint venture, partnership, trade and commodities, and restraint of trade and restrictive covenant disputes, among others. Sovereign countries may also participate in international arbitration, generally either as a party to an arbitration brought under an investment treaty by an investor in that country, or in an arbitration brought by another sovereign country under a treaty or trade agreement between those two countries. Hearings for such arbitrations may take place in Hong Kong.

1.16 Individuals are rarely parties to arbitrations taking place in Hong Kong. Where individuals are involved in arbitrations, the dispute also generally involves commercial, contractual or similar issues. This is because Hong Kong courts and specialist tribunals already provide dispute resolution services for members of the public involved in matters in the nature of consumer, employment and personal injury disputes. Also, some disputes are not permitted to be arbitrated, such as those involving matrimonial, probate and taxation issues. Criminal matters cannot be arbitrated in Hong Kong.

What are the doctrines of maintenance and champerty under Hong Kong law?

1.17 As we mentioned in the Introduction to this Chapter, the doctrines of maintenance and champerty originated in England in medieval times and were intended to prevent unnecessary litigation proceedings being promoted or financed by powerful individuals for the sole purpose of furthering their own interests.⁸

1.18 "Maintenance" has been defined as:

*"the giving of assistance or encouragement to one of the parties to an action by a person who has neither an interest in the action nor any other motive recognised by the law as justifying his interference."*⁹

⁸ *Unruh v Seeberger* [2007] 10 HKCFAR 31.

⁹ *Massai Aviation Services v Attorney General* [2007] UKPC 12, quoted in *Winnie Lo v HKSAR* (2012) 15 HKCFAR 16, at para 10 (*per* Bokhary PJ). Champerty has also been defined as "the procurement, by direct or indirect financial assistance, of another person to institute, or carry on or defend civil proceedings without lawful justification" by the Law Commission for England and Wales, *Proposals for the Reform of the Law Relating to Maintenance and Champerty*, Report No 7 (1966), at para 4; see *Hill v Archbold* [1968] 1 QB 686 (CA).

1.19 "Champerty" has been defined as:

"a particular kind of maintenance, namely maintenance of an action in consideration of a promise to give to the maintainer a share of the subject matter or proceeds thereof, if the action succeeds".¹⁰

How does Third Party Funding fall under the doctrines of maintenance and champerty?

1.20 Third Party Funding falls within the scope of maintenance and champerty because the Third Party Funder does not have an interest in the funded arbitration, save for its commercial interest arising from the Third Party Funding it provides to the Funded Party. Thus Third Party Funding falls within the scope of the expression "*giving of assistance*" referred to in the definition of "*Maintenance*" above.

1.21 As the Third Party Funder may receive a share of the proceeds, or some other financial benefit from the Proceedings it funds, if there is a recovery, its share of the proceeds from the arbitration falls within the scope of the expression "*share of the subject matter or proceeds thereof*", referred to in the definition of "*Champerty*" above.

Is Third Party Funding of litigation permitted in Hong Kong?

1.22 As discussed earlier, Third Party Funding of litigation is only permitted in Hong Kong in limited circumstances, where the three exceptional areas apply: (a) in cases involving third parties with a legitimate interest in the outcome of the litigation; (b) where "*access to justice considerations*" apply; or (c) in a miscellaneous category including insolvency litigation, as we discuss in Chapter 3.¹¹

Is Third Party Funding for arbitration permitted in Hong Kong?

1.23 As discussed in the Preface and the introduction to this chapter, it is undecided in Hong Kong whether or not the application of the doctrines of maintenance and champerty prohibit Third Party Funding for arbitration. In *Unruh v Seeberger*,¹² the Court of Final Appeal upheld the validity of a Third Party Funding agreement for an arbitration conducted in a foreign jurisdiction. The Court expressly left open the question of whether the doctrines of

¹⁰ Quoted in *Winnie Lo v HKSAR* (2012) 15 HKCFAR 16, at para 10 (*per* Bokhary PJ).

¹¹ (1) Where a third party can prove that it has a legitimate interest in the outcome of the litigation; (2) where a party can persuade the court that it should be permitted to obtain Third Party Funding to enable it to have access to justice; and (3) in insolvency and a miscellaneous category of proceedings.

¹² (2007) 10 HKCFAR 31.

maintenance and champerty apply to Third Party Funding agreements concerning arbitrations taking place in Hong Kong, as the issue did not arise in that case. As Ribeiro PJ stated in that case:

"The Hong Kong court should not strike down an agreement on the grounds of maintenance or champerty where it is to be performed in relation to judicial or arbitral proceedings in a jurisdiction where no such public policy objections exist"¹³ ... I leave open the question whether maintenance and champerty apply to agreements concerning arbitrations taking place in Hong Kong since it does not arise in the present case."¹⁴

What is the issue that this Sub-committee is addressing and what is its role?

1.24 The question of whether Third Party Funding is permitted for arbitration taking place in Hong Kong has been the subject of Hong Kong judicial review in recent years and has also been increasingly discussed among arbitration users, legal practitioners and academics.

1.25 As we commented upon earlier, in *Winnie Lo v HKSAR*¹⁵ and *Unruh v Seeberger*, the Court of Final Appeal observed that the scope of what constitutes maintenance and champerty in Hong Kong has been narrowed over the years to allow recognised exceptions (with the leave of the court) reflecting the changed public policy considerations, such as cases involving third parties with a legitimate interest in the outcome of the litigation, or where "access to justice considerations" apply, or in insolvency litigation.¹⁶ However, the Hong Kong courts have not recognized any similar exception applicable to third party funding of arbitration taking place in Hong Kong.

1.26 As the application of the doctrines of maintenance and champerty to funding for arbitration is unclear and as this issue is relevant to maintaining and further promoting the competitiveness of Hong Kong as an international arbitration centre, the Secretary for Justice and the Chief Justice asked the Law Reform Commission of Hong Kong to establish this Sub-committee. The Terms of Reference of this Sub-committee 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."

¹³ *Unruh v Seeberger* (2007) 10 HKCFAR 31, at para 122 (per Ribeiro PJ).

¹⁴ *Unruh v Seeberger* (2007) 10 HKCFAR 31, at para 123 (per Ribeiro PJ).

¹⁵ (2012) 15 HKCFAR 15.

¹⁶ *Unruh v Seeberger* (2007) 10 HKCFAR 31, at paras 77 and 100 (per Ribeiro PJ).

Scope of the Sub-committee's review

1.27 Taking into account the profile of typical arbitration users in Hong Kong and the nature of the disputes arbitrated described in the introduction to this chapter, we have focused in our review on the issues raised by Third Party Funders of commercial, commodities, contractual, construction, financial, investment, trade and similar disputes.

1.28 Hong Kong law does not permit Conditional Fee, Contingency Fee, or Success Fee agreements, nor does it provide for class actions. This is by contrast to various other jurisdictions where Third Party Funding is permitted (discussed in Chapter 4). As these areas have been reviewed by other Sub-committees of the Law Reform Commission of Hong Kong, we have excluded them from our recommendations.¹⁷

1.29 Litigation associated with arbitration is also outside the scope of our review as it is not referred to in our terms of reference.

1.30 Mediation and other alternative forms of dispute resolution, such as adjudication, are also outside the scope of our review referred to in our terms of reference. In any event, we consider that such forms of alternative dispute resolution are not contentious proceedings to which the doctrines of maintenance and champerty apply although legal professional conduct rules do apply.

Recommendations

1.31 The Sub-committee has unanimously concluded that reform of Hong Kong law is needed to make it clear that Third Party Funding for arbitrations taking place in Hong Kong is permitted under Hong Kong law provided that appropriate financial and ethical safeguards are complied with. We consider that this reform is necessary to enhance Hong Kong's competitive position as an international arbitration centre and to avoid Hong Kong being overtaken by its competitors. Our research shows that nearly all major international arbitration centres now allow Third Party Funding.

1.32 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. As we had observed earlier, in *Unruh v Seeberger* the Court of Final Appeal upheld the validity and enforceability of an agreement for Third Party Funding for arbitration where the arbitration takes place in a jurisdiction outside Hong Kong that allows Third Party Funding. It also confirmed the existence of three categories of exceptions to the doctrines of maintenance and champerty, namely, common interest, access to justice and a "miscellaneous" category which includes

¹⁷ The Law Reform Commission of Hong Kong has released (1) *Report on Conditional Fees* (2007) and (2) *Report on Class Actions* (2012).

insolvency proceedings. As to litigation, the Hong Kong courts have provided a framework within which litigation is permitted to be funded by third parties if it falls within one of the three exceptions.

1.33 Bearing in mind Hong Kong's status as a major international arbitration centre, the current Hong Kong law of maintenance and champerty as it applies to arbitration, and the nature of the exceptions to doctrines of maintenance and champerty, we consider that Hong Kong law may prudently and fairly be reformed to clearly permit Third Party Funding for arbitration, subject to compliance by Third Party Funders with the appropriate ethical and financial safeguards to be prescribed under Hong Kong law. As we have said, our research shows that nearly all major arbitration centres now allow Third Party Funding.

1.34 We also consider that a party with a good case in law should not be deprived of the financial support it needs to pursue that case via arbitration. Without the ability to obtain Third Party Funding, a party with a good case may be deprived of its right to pursue its claim or counterclaim if it cannot afford to do so.

1.35 We consider that ethical and financial safeguards can be placed on Third Party Funding in Hong Kong to protect against potential abuse. Compliance with these safeguards should enable Third Party Funding of arbitrations to take place in Hong Kong with all the benefits such funding can provide, while minimising the risk of possible adverse consequences. We have formed this view, having reviewed the framework for Third Party Funding of Proceedings in many of the major arbitration centres as summarised in Chapter 4, and the benefits and risks of Third Party Funding of arbitration as summarised in Chapter 5.

1.36 As outlined in this chapter and elsewhere in this Consultation Paper, Hong Kong law already permits third party funding of litigation where the litigation falls within one of the three exceptions to the prohibition on Maintenance and Champerty. It is permitted for appropriate cases even though litigation is widely used by private individuals in Hong Kong (as well as corporations) and legal aid is available for various types of cases (where individuals satisfy the criteria as to merits and means).

1.37 By contrast, as we outline in this Consultation Paper, third party funding of arbitration taking place in Hong Kong is not clearly permitted under Hong Kong law. In our view, Third Party Funding of arbitration raises rather different issues to those raised by litigation. For example, as we address further in Chapter 2, a fundamental difference between litigation and arbitration is that the source of the power of the judiciary is from the Basic Law; and a judgment of a superior court has effect as a precedent and is a source of law which binds all in Hong Kong. By contrast, Hong Kong arbitration is a voluntary and consensual process conducted under a specialised regime provided under the Arbitration Ordinance that is based on the Model Law. Arbitration awards made by Tribunals do not bind non-Parties to the arbitration and do not create a precedent that must be followed in later cases involving

the same principles. Also by contrast to Hong Kong litigation, Hong Kong users of arbitration are overwhelmingly corporations engaged in commercial, financial, investment and trading disputes who must self fund their disputes. We consider that any reform of the Hong Kong law of Maintenance and Champerty as it relates to arbitration should take these differences into account.

1.38 For the reasons we explain in this Consultation Paper, the fact that Hong Kong law does not clearly permit third party funding of arbitration in any circumstances, is, in the Sub-committee's view, a situation that is damaging to Hong Kong's competitiveness internationally as an arbitration centre.

1.39 Reform of the Hong Kong law to clearly permit Third Party Funding for arbitration within the appropriate ethical and regulatory framework should not adversely affect members of the public and indeed could benefit the general public in a number of ways, including by:

- (1) supporting the competitiveness of Hong Kong as an international arbitration centre, which can bring more arbitration related employment, skills enhancement and financial benefits, among other benefits; and
- (2) diverting more commercial, construction, finance, trade and similar disputes from the Hong Kong courts to arbitration, relieving the pressure on the Hong Kong courts' resources and thereby providing more resources for litigation of issues and disputes involving the public.

The specific reforms of the current position relating to Third Party Funding for arbitration that we consider necessary are set out in Chapter 6.

Chapter 2

Overview of litigation and arbitration in Hong Kong

2.1 The two primary ways of finally determining civil (ie, non-criminal) disputes in Hong Kong are by:

- (1) litigation in the Hong Kong courts; and
- (2) arbitration before one or three arbitrator(s).

In Hong Kong, there are also specialist tribunals and other bodies that resolve specific types of disputes, such as consumer disputes, employment disputes and tax disputes.

2.2 This Chapter outlines the nature of litigation and arbitration in Hong Kong. As to arbitration, it briefly describes the Hong Kong legal framework for arbitration and enforcement of final arbitration decisions (known as "Awards"), the types of arbitration disputes that commonly arise in Hong Kong, the range of stakeholders in arbitration, and the types of disputes or differences that may be finally determined by arbitration known as "Arbitrability."

Hong Kong's sovereignty with regard to dispute resolution

2.3 On 1 July 1997, the Government of the People's Republic of China resumed the exercise of sovereignty over Hong Kong from the Government of the United Kingdom of Great Britain and Northern Ireland. Hong Kong's common law system has been maintained as a separate system from the PRC's under the "*one country, two systems*" principle.¹ Under the Basic Law (which is Hong Kong's constitutional document)² and the Arbitration Ordinance for the purposes of arbitration, Mainland China and Hong Kong treat each other as separate jurisdictions.

¹ Article 8 of the Basic Law provides that, "*The laws previously in force in Hong Kong, that is, the common law, rules of equity, ordinances, subordinate legislation and customary law shall be maintained, except for any that contravenes this Law, and subject to any amendment by the Legislature of the Hong Kong Special Administrative Region.*"

² Article 19 of the Basic Law provides that the HKSAR, "*shall be vested with independent judicial power*". In addition, section 2 of the Arbitration Ordinance defines the "*the Mainland*" as "*any part of China other than Hong Kong, Macao and Taiwan*".

Litigation in Hong Kong

2.4 The majority of civil (including commercial) disputes in Hong Kong are litigated either in the District Court or the High Court. Litigation in Hong Kong concerns a very broad range of disputes including, among others, administrative law, commercial, contractual, corporate, environmental, financial, intellectual property, land, sale of goods and tortious disputes. Individuals as well as corporations and government departments (among others) are often parties to such proceedings.

2.5 Many types of disputes that may be litigated may also be arbitrated. However, some categories of disputes may only be litigated as they are non-arbitrable as outlined further below.

2.6 The Hong Kong courts exercise judicial power.³ Their jurisdiction, which is the power and authority to finally determine cases, comes from legislation including the Basic Law, the High Court Ordinance (Cap 4) and the District Court Ordinance (Cap 336), and from their inherent powers, which is also known as "*inherent jurisdiction*."⁴ The Hong Kong courts are independent of the Hong Kong Government's executive and legislative branches.⁵

2.7 In litigation, the judge hearing a case is assigned by the Court administration. He or she is not agreed upon by the parties.

2.8 An unsuccessful party to litigation has the right to appeal against the first court's decision to a higher court and ask the appeal court to review and reconsider the earlier decision.

2.9 Litigation proceedings are held in public, except for specific types of proceedings that are held in private in judges' or other court officials' chambers, including proceedings relating to arbitration (where certain exceptions apply).⁶

2.10 Litigation proceedings follow the rules of the particular court in which they are held (for instance, the Rules of the High Court (Cap 4A)).

2.11 The Hong Kong courts have power to order third parties to pay costs, known as Adverse Costs Orders.⁷ They do not have power to order third parties to provide Security for Costs.⁸

³ Articles 2, 19, 80 and 81 of the Basic Law; *Stock Exchange of Hong Kong Ltd v New World Development Co Ltd* (2006) 9 HKCFAR 234, at 45 (*per* Ribeiro PJ).

⁴ *Ng Yat Chi v Max Share Ltd* [2005] 1 HKLRD 473.

⁵ Article 85 of the Basic Law.

⁶ Section 16 of the Arbitration Ordinance.

⁷ 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).

⁸ In Hong Kong, Order 23, Rule 1 of the Rules of the High Court (Cap 4A) provides that the court can order security for costs against the plaintiff only. The rule also provides: "*The references in the foregoing paragraphs to a plaintiff and a defendant shall be construed as references to*

2.12 Judges are generally bound by rules of evidence.⁹

2.13 As Hong Kong is a common law jurisdiction, the doctrine of precedent applies. This means that the *ratio decidendi* (being the essential principle or statement of law on which the decision of a superior court is based) is binding on a lower court. The doctrine of *stare decisis* also applies, which involves a superior court being bound by its own previous decision.¹⁰

Arbitration in Hong Kong

2.14 Arbitration is the process by which the parties voluntarily agree¹¹ to submit a dispute or difference that they have (or may have in the future) as to their legal rights and liabilities arising from a legal relationship between them, to a Tribunal. The tribunal will consist of a private individual or multiple individuals, usually one or three in number, who will issue a final and binding determination of the disputes referred to it.¹² There is no right to appeal against the Tribunal's Award (save where transitional provisions for domestic arbitrations apply,¹³ or where the parties have agreed to opt in to greater court supervision).¹⁴

2.15 An arbitration may be administered by an arbitral institution, such as HKIAC, the China International Economic and Trade Arbitration Commission ("CIETAC") or the ICC, all of which have offices in Hong Kong. This form of administered arbitration is known as "*institutional arbitration*."

2.16 The parties may agree to an arbitration that is not administered by any arbitral institution, in which case they will make the administrative and financial arrangements for the arbitration themselves – this is known as "*ad hoc arbitration*." Pursuant to the Arbitration Ordinance, the HKIAC provides support to *ad hoc* arbitrations, such as by appointing arbitrators where the parties cannot agree and another default appointing authority has not been chosen.

the person (howsoever described on the record) who is in the position of plaintiff or defendant, as the case may be, in the proceeding in question, including a proceeding on a counterclaim."

⁹ Evidence Ordinance (Cap 8); *Halsbury's Laws of Hong Kong*, Vol 27, at [175.001].

¹⁰ *A Solicitor v the Law Society of Hong Kong* (2008) 11 HKCFAR 117. As to *stare decisis* the Court referred to Cross and Harris, *Precedent in English Law* (4th ed. 1991) at 72, where it was stated: "*The ratio decidendi of a case is any rule of law expressly or impliedly treated by the judge as a necessary step in reaching his conclusion, having regard to the line of reasoning adopted by him, ...*". See Sir Anthony Mason, "The Use and Abuse of Precedent" (1988) 4 *Australian Bar Review* 93, at 95 and 98. In "The Use and Abuse of Precedent" at 103, Sir Anthony Mason referred to the *ratio* as: "*the principle or statement of law on which the previous decision is based to the extent to which it is essential to the decision, it being recognised that there may be more than one ratio when the court assigns more than one ground for its decision.*"

¹¹ In Hong Kong, the arbitration agreement must be in writing. Section 19 of the Arbitration Ordinance adopting Article 7 of the UNICTRAL Model Law on International Commercial Arbitration 1985 – option 1.

¹² Section 73(1) of the Arbitration Ordinance.

¹³ Section 99 and Schedule 2 of the Arbitration Ordinance.

¹⁴ Section 100 and Schedule 2 of the Arbitration Ordinance.

Sources of Hong Kong's arbitration law

2.17 The sources of Hong Kong's arbitration law are:

- (1) Hong Kong legislation (statutes) including the Arbitration Ordinance and the High Court Ordinance (Cap 4);
- (2) principles of common law, constituted by Hong Kong's laws as of 30 June 1997 immediately before the PRC resumed the exercise of sovereignty over Hong Kong, as modified since 1 July 1997; and
- (3) international law which is incorporated into its law either by statute or case law, or as a consequence of Hong Kong's accession to various treaties and international conventions, including the New York Convention and the rules of customary international law.¹⁵

2.18 The Arbitration Ordinance, which came into force on 1 June 2011, is the main statute providing the legal framework for arbitration in Hong Kong. It is based on the Model Law as amended on 7 July 2005.¹⁶

2.19 The Arbitration Ordinance governs all arbitrations conducted in Hong Kong under a unified system that consolidates provisions for domestic and international arbitrations.¹⁷ It applies to all arbitrations under an arbitration agreement (wherever it was made) provided that Hong Kong is the place of arbitration. Only some of the Arbitration Ordinance's provisions are stated to apply to arbitrations where Hong Kong is not the place of arbitration.¹⁸

Relevance in Hong Kong of the distinction between foreign and domestic arbitrations

2.20 While the Arbitration Ordinance has created a unitary regime, the distinction between domestic and foreign arbitration is still relevant in two key areas:

- (1) the enforcement of Awards; and
- (2) the operation of provisions providing for greater supervision by the Hong Kong courts of domestic arbitration for a transitional period following the coming into force of the Arbitration Ordinance in 2011.

¹⁵ *Halsbury's Laws of Hong Kong*, Vol 2, 2nd Ed, at para 25.005.

¹⁶ The full text of the Model Law is set out in Schedule 1 of the Arbitration Ordinance. UNCITRAL is the United Nations Commission on International Trade Law.

¹⁷ The Arbitration Ordinance replaced the former arbitration framework, which consisted of separate regimes for domestic and international arbitration.

¹⁸ Section 5(2), referring to sections 20, 21, 45, 60, 61 and Part 1, Part 3A as well as Part 10 of the Arbitration Ordinance.

Foreign parties may also choose to "*opt in*" to greater supervision by the Hong Kong courts, and to various other provisions.¹⁹

2.21 Under the Arbitration Ordinance, the parties must be treated with equality and fairness.²⁰ Some provisions of the Model Law have been amended so that they can also apply to domestic arbitrations to enhance the speed and efficiency of arbitration, to address some issues on which the Model Law is silent, and to accommodate the different categories of Awards that may be enforced in Hong Kong.²¹ Among other things, the Arbitration Ordinance includes additional provisions for confidentiality, time limitation periods, interest and costs, limited scope for court intervention, powers provided to the Tribunal to award interim measures, provisions for the use of other alternative dispute resolution techniques, and provisions for enforcement of various categories of Awards.

The Tribunal's jurisdiction

2.22 By contrast to the Hong Kong courts (who derive their jurisdiction from legislation and their inherent powers), the jurisdiction of a Tribunal generally comes from the parties' written agreement to arbitrate. The Tribunal can only determine the disputes that the parties submit to it in writing and which are arbitrable.

2.23 This arbitration agreement is usually found as a term in the contract between the parties and is commonly called the "*dispute resolution clause*" or "*arbitration agreement*." It may also be contained in related documents, or communicated in an exchange of documents, including electronic communications.²²

Arbitrability

2.24 In addition, for the Tribunal to have power to finally determine a dispute by arbitration, the dispute must concern a matter that Hong Kong law allows to be arbitrated. Section 81 of the Arbitration Ordinance provides that an Award can be set aside by the Court on the ground that the subject-matter of the disputes is "*not capable of settlement by arbitration under the law of this state*."²³ Examples of categories of disputes that may not be referred to arbitration in Hong Kong are:²⁴

¹⁹ Sections 99-102 and Schedule 2 of the Arbitration Ordinance.

²⁰ Section 46 of the Arbitration Ordinance.

²¹ For example, non-New York Convention, non-Mainland, non-Macao awards (which may be domestic or foreign), New York Convention awards, PRC awards and Macao awards.

²² Section 19 of the Arbitration Ordinance.

²³ Section 81 of the Arbitration Ordinance incorporates Article 34(2)(b)(i) of the Model Law.

²⁴ *Halsbury's Laws of Hong Kong*, Vol 2, 2nd Ed, at para 25.003.

- (1) criminal charges;
- (2) disputes relating to intellectual property (except where enforcement rights are sought against a particular person);
- (3) competition and anti-trust;
- (4) marriage and divorce;
- (5) relations between parents and children;
- (6) personal status;
- (7) actions *in rem* against vessels; and
- (8) matters reserved for resolution by state agencies and tribunals, such as taxation, development control, immigration, nationality and social welfare entitlements.

Arbitral jurisdiction under investment protection and promotion agreements

2.25 The Tribunal's jurisdiction may also come from an investment treaty such as a bilateral investment treaty or multi-lateral investment treaties or an Investment Protection and Promotion Agreement (IPPA), which are international agreements between two or more governments for the promotion and protection of investments made by investors of one contracting party in the area of the other contracting party. For example, such an investment treaty or IPPA may include a dispute resolution provision that provides for the arbitration of a dispute between an investor from one contracting party to the treaty or IPPA with the other contracting party, in its capacity as the host state or jurisdiction. Such an agreement attempts to give additional assurance to foreign investors that their investments in the host jurisdiction are adequately protected, and to enable investors of the other state or jurisdiction to enjoy similar treatment and protection in respect of their investments. As of the date of this Consultation Paper, Hong Kong has signed treaties or IPPAs with 17 economies.²⁵

²⁵ Trade and Industry Department, Government of HKSAR, "Investment Promotion and Protection Agreement (IPPA)", (2014), <http://www.tid.gov.hk/english/trade_relations/ippa/index.html>. Under Article 13 of the Basic Law, the Central People's Government is responsible for foreign affairs relating to the HKSAR, but it authorises the HKSAR to conduct the relevant external affairs in accordance with the Basic Law. Article 151 of the Basic Law provides that the HKSAR, using the name "*Hong Kong, China*" may maintain and develop relations and conclude and implement agreements on its own, with foreign states and regions and international organisations in such matters as economic affairs, trade, finance and monetary affairs, shipping, communications, tourism, culture and sports. Under Article 152(2) of the Basic Law, the HKSAR may, using the name "*Hong Kong, China*", participate in international organisations and conferences not limited to states.

Parties' powers in arbitration

2.26 Parties to an arbitration generally have a great deal of choice as to the way in which their arbitration will be conducted including:

- (1) the number of arbitrators;²⁶
- (2) the procedure of appointing the arbitrator(s);²⁷
- (3) the procedural rules to be followed by the Tribunal in conducting the arbitration, subject to provisions of the Arbitration Ordinance;²⁸
- (4) the legal place (the "seat") of their arbitration;²⁹
- (5) the law applicable to the arbitration;
- (6) the geographical place where hearings may be heard (which may be different from the seat of their arbitration);³⁰ and
- (7) the language in which the arbitration should be conducted.

2.27 The Tribunal must apply the law agreed upon by the parties (or failing such agreement, the law which it determines applies) to determine the case.³¹

2.28 Unless otherwise agreed by the parties, the Tribunal is not bound by strict rules of evidence.³²

2.29 In Hong Kong, unless otherwise agreed by the parties, arbitral proceedings (and court proceedings related to arbitration) are held in private.³³ The content of an arbitration (and in some cases even its existence) is confidential, except for a limited set of circumstances under which disclosure is allowed.³⁴

2.30 Unless otherwise agreed by the parties, a Tribunal's Award is final and binding on the parties to the agreement, and upon others claiming through them.³⁵ As we discussed in paragraph 2.14 above, in Hong Kong, unless the parties agree otherwise, there is no right of appeal against an arbitral award. An exception is where Schedule 2 of the Arbitration Ordinance applies (either by express agreement of the parties, or automatically pursuant to Section 100 of the Arbitration Ordinance).³⁶ As outlined further below, the

²⁶ Section 23 of the Arbitration Ordinance.
²⁷ Section 24 of the Arbitration Ordinance.
²⁸ Section 47 of the Arbitration Ordinance.
²⁹ Section 20 of the Arbitration Ordinance.
³⁰ Section 48(2) of the Arbitration Ordinance.
³¹ Section 64 of the Arbitration Ordinance.
³² Section 47(3) of the Arbitration Ordinance.
³³ Section 16 of the Arbitration Ordinance.
³⁴ Sections 16-18 of the Arbitration Ordinance.
³⁵ Section 73 of the Arbitration Ordinance.
³⁶ Sections 99-103 and Schedule 2 of the Arbitration Ordinance.

Hong Kong courts have supervisory jurisdiction over an arbitration seated in Hong Kong.

2.31 In contrast to a judgment of a court, an Award is not binding on third parties. Correspondingly, there is not an authority or precedent that binds courts in later cases as it binds only the parties to the Award or their successors.³⁷

2.32 Under the Arbitration Ordinance, a Tribunal only has power to award costs against the parties to the Arbitration.³⁸ Similarly it only has the power to order Security for Costs against a party to proceedings under the Arbitration Ordinance.³⁹

2.33 Awards that are made in Hong Kong are eligible to be enforced in more than 150 states around the world that have ratified and implemented the terms of the New York Convention. This is an international treaty which binds Hong Kong.⁴⁰ Similarly, Awards made in any other New York Convention state may be enforced in Hong Kong pursuant to the New York Convention as implemented by the Arbitration Ordinance (also see paragraph 2.42 below in relation to enforcement of Hong Kong awards in Mainland China).⁴¹

The role of courts in arbitration

2.34 Pursuant to the Arbitration Ordinance, the Hong Kong courts only have supervisory powers in aid of arbitration.⁴² The Hong Kong courts' powers are generally limited to proceedings which determine substantive rights to promote the efficient conduct of arbitrations such as:

- (1) the jurisdiction of a Tribunal;⁴³
- (2) stays of litigation proceedings in favour of arbitration where the parties have agreed to arbitrate and their dispute is arbitrable;⁴⁴
- (3) the appointment of arbitrators;⁴⁵
- (4) the procedure to challenge an arbitrator;⁴⁶

³⁷ Section 73 of the Arbitration Ordinance.

³⁸ Section 74 of the Arbitration Ordinance.

³⁹ Sections 40 and 56 of the Arbitration Ordinance.

⁴⁰ Upon resumption of the exercise of sovereignty over Hong Kong on 1 July 1997, the PRC Government extended the territorial application of the *New York Convention* to Hong Kong, subject to the statement originally made by China upon accession to the *New York Convention*.

⁴¹ Note that the PRC has made a "*commercial reservation*" and a "*reciprocity reservation*" to the New York Convention. By reason of the commercial reservation Hong Kong will only apply the New York Convention to contractual or non-contractual commercial legal relationships. By reason of the reciprocity reservation Hong Kong will only apply the New York Convention to awards made in other contracting States (States that are parties to the New York Convention).

⁴² Section 3 of the Arbitration Ordinance.

⁴³ Section 34 of the Arbitration Ordinance.

⁴⁴ Section 20 of the Arbitration Ordinance.

⁴⁵ Section 24 of the Arbitration Ordinance.

⁴⁶ Section 26 of the Arbitration Ordinance.

- (5) decisions that terminate the mandate of an arbitrator;⁴⁷
- (6) granting of interim measures of relief such as injunctions in aid of arbitration;⁴⁸
- (7) applications for setting aside an Award.⁴⁹ If a party to an arbitration objects to the Award of a Tribunal made in Hong Kong, it may apply to set aside the Award within a limited time period, on exhaustive grounds that largely reflect those set out in Article V of the New York Convention;⁵⁰ and
- (8) applications for recognition and enforcement of a Tribunal's order, direction or Award,⁵¹ as discussed further below.

Role of arbitrators

2.35 The Hong Kong courts have described arbitrators as exercising quasi-judicial functions that are similar to the functions of a judge,⁵² in that arbitrators have the power and duty to finally determine disputes or differences in a judicial manner.⁵³

2.36 Even though the parties to an arbitration pay the fees and expenses of the arbitrators (and generally must make a deposit on account of the arbitrators' fees and expenses at the beginning of an arbitration, either to the arbitrators directly, or by a deposit to an arbitral institution), arbitrators are required to remain independent, impartial and unbiased.

2.37 Section 104 of the Arbitration Ordinance limits the liability of arbitrators in the exercise of their arbitral functions for an act done or omitted, "*only if it is proved that the act was done or omitted to be done dishonestly.*"

Enforcement of Tribunal's orders and Awards

2.38 A Tribunal's Award, order or direction is enforceable in the same way as a judgment, order or direction of the court, but only with the leave of the Court following an application for such enforcement.⁵⁴

⁴⁷ Section 27 of the Arbitration Ordinance.

⁴⁸ Section 45 of the Arbitration Ordinance.

⁴⁹ Section 81 of the Arbitration Ordinance.

⁵⁰ John Choong and J Romesh Weeramantry, *The Hong Kong Arbitration Ordinance – Commentary and Annotations*, Thomson Reuters, 2011, at 423.

⁵¹ Sections 82-98 of the Arbitration Ordinance.

⁵² *Lendon v Keen* [1916] 1 KB 994, at 999 (*per* Sankey J); *Arenson v Casson Beckman Rutley & Co* [1977] AC 405 (HL).

⁵³ Sharma C & Stirastava D K, *Halbury's Laws of Hong Kong*, Vol 2, 2nd Ed, Butterworth Asia, Hong Kong 2012, at para 25.001.

⁵⁴ Section 61 of the Arbitration Ordinance.

Enforcement of Awards

2.39 The enforcement of an Award, where a party does not voluntarily comply with the orders set out in an Award, is through the Hong Kong courts. If a party to an arbitration agreement fails to comply with the Award, the successful party may bring an action to enforce the Award in the Court of First Instance of the High Court of Hong Kong.⁵⁵ The plaintiff in a court action to enforce the Award may claim the following relief:

- (1) judgment for the amount of the Award;
- (2) a declaration that the Award is binding;
- (3) in appropriate cases, specific performance of the Award;
- (4) damages for failure to perform the Award; and
- (5) an injunction restraining the unsuccessful party from failing to comply with the Award. Judgment may be granted on an Award in a foreign currency.⁵⁶

2.40 The Court will grant leave to enforce the Award as a judgment⁵⁷ unless there is either a real ground for doubting the validity of the Award or the Award is not in a form in which it can be enforced as a judgment.⁵⁸

2.41 There are four main types of Awards that may be enforced in Hong Kong:

- (1) Awards which are not New York Convention, Mainland or Macao Awards (division 1 of part 10 of the Arbitration Ordinance), whether made in Hong Kong or outside Hong Kong;
- (2) New York Convention Awards (division 2 of Part 10 of the Arbitration Ordinance) which are Awards made in states or territories that have ratified or acceded to the New York Convention, other than China or territories of China;
- (3) Mainland China Awards (division 3 of Part 10 of the Arbitration Ordinance), which are awards made in the Mainland by a recognised Mainland arbitral authority in accordance with the PRC Arbitration Law;⁵⁹ and
- (4) Macao Awards (division 4 of Part 10 of the Arbitration Ordinance).

2.42 The New York Convention does not apply to the enforcement of Awards between Hong Kong, Macao and the Mainland as they are not separate contracting states. To address these issues, the governments of

⁵⁵ Sections 2 and 84 of the Arbitration Ordinance.

⁵⁶ *Halsbury's Laws of Hong Kong*, Vol 2, 2nd Ed, at para 25.173.

⁵⁷ Section 84 of the Arbitration Ordinance.

⁵⁸ *Halsbury's Laws of Hong Kong*, Vol 2, 2nd Ed, at para 25.174.

⁵⁹ Section 2 of the Arbitration Ordinance defines the "the Mainland" as "any part of China other than Hong Kong, Macao and Taiwan."

Hong Kong and the Mainland signed the "*Arrangement Concerning Mutual Enforcement of Arbitral Awards between the Mainland and the Hong Kong Special Administrative Region*" in 1999, an arrangement to recognise and enforce Awards in their respective jurisdictions. The "*Arrangement Concerning Reciprocal Recognition and Enforcement of Arbitral Awards between the Hong Kong Special Administrative Region and the Macao Special Administrative Region*" was signed on 7 January 2013 between the governments of Hong Kong and Macao. These Arrangements are largely based upon the provisions of the New York Convention.⁶⁰

Parties' arbitration in Hong Kong

2.43 Section 63 of the Arbitration Ordinance expressly permits anyone to appear on behalf of a party in arbitral proceedings in Hong Kong to give advice, prepare documents for the purposes of arbitral proceedings, and to do any other thing in relation to arbitral proceedings (except where it is done in connection with court proceedings (i) arising out of an arbitration agreement, or (ii) arising in the course of, or resulting from, arbitral proceedings).⁶¹ Examples of such arbitration related litigation include representing a party in litigation proceedings where interim measures in aid of arbitration (such as injunctive relief) are sought and proceedings concerning the recognition and enforcement of Awards.

2.44 However, parties are usually represented by lawyers in arbitration proceedings in Hong Kong. Hence, the regulatory framework for lawyers is relevant to our review. This issue is discussed further in Chapter 4.

Costs of arbitration

2.45 In preparing for and conducting arbitration proceedings, parties must expend funds to ensure that not only do the proceedings take place (and potentially proceed to an Award), but that their claims/defences are presented by their lawyers and that, as needed, for expert witnesses to give evidence.

2.46 The amount of the costs that parties must incur to conduct arbitration varies from case to case. There is no set guidance as to the amount each arbitration will cost each party. The costs of arbitration are

⁶⁰ *Halsbury's Laws of Hong Kong*, Vol 2, 2nd Ed, at paras 25.177, 25.179-25.180.

⁶¹ Section 63 of the Arbitration Ordinance provides:
"section 44 (*Penalty for unlawfully practising as a barrister or notary public*), section 45 (*Unqualified person not to act as solicitor*) and section 47 (*Unqualified person not to prepare certain instruments, etc.*) of the *Legal Practitioners Ordinance (Cap 159)* do not apply to –
(a) *arbitral proceedings*;
(b) *the giving of advice and the preparation of documents for the purposes of arbitral proceedings*; or
(c) *any other thing done in relation to arbitral proceedings, except where it is done in connection with court proceedings –*
(i) *arising out of an arbitration agreement*; or
(ii) *arising in the course of, or resulting from, arbitral proceedings.*"

dependent on a number of variable factors, including but not limited to the following:

- (1) the amount in dispute;
- (2) the fees of the solicitors and barristers whom the party instructs;
- (3) the length and complexity of the procedural timetable set by the Tribunal;
- (4) the complexity and number of the legal and factual issues in dispute, which will require commensurate work by the parties' counsel to put forward in legal submissions;
- (5) whether experts are required (and the fees that they charge);
- (6) the fees of the Tribunal (which vary either due to the set fees charged by each arbitral institution, or the fees of each arbitrator as agreed to be paid by the parties, ie, not against a set scale);
- (7) the administrative and registration fees of an arbitral institution if it is an institutional arbitration;
- (8) the amount of documentation that is required to be reviewed and produced in the arbitration, and the cost of the solicitor's fees and/or the technical tools (ie, specialised document review IT programs) to review that documentation;
- (9) the costs of holding a hearing, including the cost of hiring facilities in which to hold the hearing, the cost of accommodation and transport for the Tribunal as well as counsel. A hearing is also a cost intensive phase in relation to legal representation fees incurred by the parties; and
- (10) the costs of enforcing an Award, or applying to a court to challenge or set aside the Award.

Stakeholders in arbitration

2.47 A number of entities may be described as having an interest or stake in an arbitration taking place in Hong Kong (depending upon the nature of the issues concerned and the impact of the outcome of the Award on a party), whether direct or indirect, including:

- (1) the parties to the arbitration;
- (2) the parties' representatives (including lawyers);
- (3) the parties' creditors;
- (4) the parties' shareholders;
- (5) the arbitrators;
- (6) an Arbitral Institution administering an arbitration, such as the HKIAC, CIETAC or ICC; and

- (7) the service providers to an arbitration such as transcription services and translators.

2.48 The list of stakeholders in paragraph 2.47 above is not exhaustive but illustrates the range of individuals and entities that may have a direct interest in an arbitration.

2.49 In Hong Kong, as discussed earlier, arbitration is primarily engaged in by commercial entities and governmental and quasi-governmental agencies. Private individuals are rarely a party to arbitral proceedings. However, by reason of the quasi-judicial nature of a Tribunal's role, the public has an interest in the fair, impartial and efficient conduct of arbitrations by arbitrators. The Arbitration Ordinance expressly refers to the "*public interest*" in its section 3 when outlining the "*object and principles of this Ordinance*". In the discussion in this Consultation Paper we have borne in mind the public interest in the fair and efficient conduct of arbitration and access to justice, among other considerations.

Chapter 3

Outline of Third Party Funding and current Hong Kong law

3.1 Third Party Funding has been described as "*the funding of claims by commercial bodies in return for a share of the proceeds.*"¹ It involves a "*third person*" to Proceedings providing "*[financial] assistance or support to a party to*" the Proceedings.²

3.2 A feature of Third Party Funding that distinguishes it from other forms of financing of the Proceedings is that a Funded Party will not have to pay any amount to the Third Party Funder if the Proceedings are unsuccessful (as determined by the definition of "*success*" or similar expression in the relevant Third Party Funding agreement). A Third Party Funder will usually be compensated from the Funded Party's net recoveries from the Proceedings (after deduction of agreed costs and expenses).

3.3 Third Party Funding is now permitted in England and Wales, Australia and many other jurisdictions. It has been described as being "*a late arrival on the litigation scene*" because "*outside interference of this type was long regarded as morally reprehensible (since it stirred up litigation) and unlawful (because of the doctrines of maintenance and champerty).*"³ However, the scope of the doctrines of maintenance and champerty in England and Wales has been progressively narrowed.⁴ The current position in England and Wales is that "*properly structured litigation funding*" does not infringe the rules against maintenance and champerty primarily because it is considered to be a means of providing access to justice.⁵ A similar approach has been adopted in Australia, among other jurisdictions.⁶ It appears from our review that, to-date, most Third Party Funding has been of litigation.

¹ Lord Justice Jackson, "Third Party Funding or Litigation Funding" (Speech delivered at the Sixth Lecture in the Civil Litigation Costs Review Implementation Programme, The Royal Courts of Justice, 2011),

<<http://associationoflitigationfunders.com/wp-content/uploads/2014/02/Sixth-Lecture-by-Lord-Justice-Jackson-in-the-Civil-Litigation-Costs-Review-.pdf>>, at para 2.1.

² *Unruh v Seeberger* (2007) 10 HKCFAR 31, at para 118 (*per* Ribeiro PJ).

³ Lord Justice Jackson, "Third Party Funding or Litigation Funding" (Speech delivered at the Sixth Lecture in the Civil Litigation Costs Review Implementation Programme, The Royal Courts of Justice, 2011), at para 2.1.

⁴ *Sibthorpe v Southwark London Borough Council* [2011] 1 WLR 2111.

⁵ *Arkin v Borchard Lines Ltd* [2005] 1 WLR 3055.

⁶ *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd* (2006) 229 CLR 386.

3.4 This Chapter first gives an overview of the nature of Third Party Funding, discussing:

- (1) the main methods of Third Party Funding of the parties to Proceedings internationally;
- (2) typical structures of Third Party Funders of Proceedings and sources of Third Party Funds;
- (3) the main types of cases funded by Third Party Funders;
- (4) the criteria for Third Party Funding;
- (5) the costs of Third Party Funding; and
- (6) the typical terms of a Third Party Funding agreement.

3.5 This Chapter then considers the legal framework in Hong Kong with respect to:

- (1) the main types of cases funded by Third Party Funders;
- (2) the exceptions to the doctrines of maintenance and champerty under which Third Party Funding is permissible;
- (3) and regulation of the Hong Kong legal profession that is relevant to Third Party Funding.

A. Third Party Funding

The main methods of Third Party Funding

3.6 Third Party Funding consists of "*a group of funding methods*", not a single method.⁷ The availability of a particular method of funding within a jurisdiction depends upon the operation of its laws and regulations, market forces, customs and trade practices. Internationally, the main methods of funding for a party retaining a direct legal interest in the Proceedings are:⁸

- (1) payment of Funds by a Third Party Funder to the Funded Party, or at its direction, to lawyers and others, typically to fund all the Funded Party's costs and expenses of the Proceedings. The Third Party Funder may appear to underwrite any orders against the Funded Party to pay costs to the other party/parties, which is known as Adverse Costs Orders, or to provide Security for Costs;
- (2) the arrangement by a broker of a loan from a lender other than a Third Party Funder to fund the Funded Party's costs and

⁷ Maya Steinitz, *Whose Claim is This Anyway? Third-Party Litigation Funding* (Legal Studies Research Paper No 11-31, University of Iowa, 2011), 95 *Minn L Rev* 1268, at 1275-1276.

⁸ Subrogation and assignment of claims are outside the scope of this Consultation Paper.

expenses of the Proceedings (for example, from a bank or other type of financial institution);

- (3) funding by the Funded Party's lawyer of its costs and expenses of the Proceedings; and
- (4) ATE Insurance.

(1) *Investment by payment of Funds*

3.7 A Third Party Funder who advances Funds may be generally described as making either: (1) an arm's length investment, with little or no day-to-day involvement in the conduct of the case;⁹ or (2) an investment with its active participation,¹⁰ depending on the degree of control that it is given over the Funded Party's conduct of the Proceedings. A Third Party Funder will generally undertake its own independent investigation into the nature and merits of a funded case. The Third Party Funder may have some involvement in how the case is run, such as requiring that additional evidentiary material is obtained or that a certain strategic direction is taken. In addition to investing in the legal action, the Third Party Funder may meet costs associated with investigating the claim or engaging expert witnesses. In some jurisdictions, doctrines of maintenance and champerty limit the extent to which a Third Party Funder can take an active role in a case.

(2) *Brokers*

3.8 A broker assists a party to source funding, obtain insurance or arrange fee structures between the Funded Party and their lawyer in return for payment of a commission or other form of compensation. A broker will typically put together packages of such arrangements and present several options to the Funded Party. Funding options include funding from Third Party Funders, from banks and financial institutions and from individuals/corporations whose primary business is not Third Party Funding. As the broker will be paid a fee out of the Third Party Funder's compensation, the broker will have an interest in the outcome of the Proceedings even though the broker does not take an active role in its conduct.¹¹

(3) *Lawyer funding*

3.9 Lawyer funding of a party's participation in the Proceedings may occur through the use of fee arrangements under which a lawyer agrees to

⁹ "Arm's Length Investment" refers to situations where a Funder is approached to invest in a case for which the client has already engaged a lawyer. The lawyer will have conducted a preliminary investigation into the case and an assessment of the merits. See Christopher Hodges, John Peysner and Angus Nurse, *Litigation Funding: Status and Issues* (Research Report, University of Oxford, 2012), at 85-86.

¹⁰ "Investment with Funder Active Participation" may be sought either by a lawyer who has undertaken initial investigation of the case or by a client directly. See Christopher Hodges, John Peysner and Angus Nurse, *Litigation Funding: Status and Issues* (Research Report, University of Oxford, 2012), at 86-87.

¹¹ Christopher Hodges, John Peysner and Angus Nurse, *Litigation Funding: Status and Issues* (Research Report, University of Oxford, 2012), at 87.

represent a party at a discount or for no fee, but with a success fee payable in the event of a favourable outcome.¹² The case will therefore be fully or partly funded out of the working capital of the lawyer's firm. Hong Kong law prohibits such lawyer funding of a party to Proceedings as discussed in Chapter 4. In some other jurisdictions, such as the US, it is a common funding method.¹³ Depending on the jurisdiction, as also discussed in Chapter 4, fee arrangements may take the form of Speculative or no win/no fee agreements and Conditional or Contingency Fee agreements. Damages based agreements may also apply, where a success fee is charged as a percentage of any recovery in proceedings.¹⁴

What are conditional fees?

3.10 A Conditional or Contingency Fee agreement in summary is an agreement between a legal practitioner and his or her client to the effect that the legal practitioner will charge no fees if the client's case is conducted unsuccessfully. This type of fee arrangement is usually allowed only in civil litigation cases, although the scope of application differs amongst jurisdictions.¹⁵ Solicitors and registered foreign lawyers in Hong Kong are prohibited from entering into all forms of Conditional and Contingency Fee arrangements.¹⁶

Contingency fee, percentage fee, "no win, no fee"

3.11 A "*Contingency Fee*" has been defined as meaning a "*percentage fee*", whereby the lawyer's fee is calculated as a percentage of the amount awarded by the court. For the purposes of this Consultation Paper, we use the term "*Contingency Fee*" to mean only "*percentage fee*", whereas the term "*event-triggered fee*" covers all the different "*no win, no fee*" bases of calculation.¹⁷

Conditional fee, uplift fee, success fee

3.12 For the purposes of this Consultation Paper, "*Conditional Fee*" means an arrangement whereby, in the event of success, the lawyer charges his usual fee plus an agreed flat amount or percentage "*uplift*" on the usual fee.

¹² Australian Productivity Commission, *Access to Justice Arrangements*, Draft Report (2014), at 524.

¹³ Christopher Hodges, John Peysner and Angus Nurse, *Litigation Funding: Status and Issues* (Research Report, University of Oxford, 2012), at 43-44.

¹⁴ Australian Productivity Commission, *Access to Justice Arrangements*, Draft Report (2014), at 524-532.

¹⁵ The Law Reform Commission of Hong Kong, *Consultation Paper on Conditional Fees* (2005), at para 4.

¹⁶ Section 64, Legal Practitioners Ordinance (Cap 159); Principle 4.17, *The Hong Kong Solicitors' Guide to Professional Conduct* Vol 1 (3 Ed, 2013).

¹⁷ The Law Reform Commission of Hong Kong, *Consultation Paper on Conditional Fees* (2005), at para 6.

The additional fee is often referred to as an "*Uplift Fee*" or a "*Success Fee*".¹⁸ Conditional Fee agreements have been allowed in the UK since 1995, and also in the Australian jurisdictions of Victoria, South Australia, New South Wales and Queensland.

Speculative fee

3.13 Where a "*Speculative Fee*" is charged, the lawyer is entitled to charge only his or her normal fee in the event of successful litigation. Where the action does not succeed, the lawyer is not entitled to a fee.¹⁹ Speculative fees have been used in Scotland for a long time.

Conditional fees in relation to Third Party Funding

3.14 Jurisdictions that allow for success fees often place a cap on the maximum amount of success fee that can be claimed. The following table sets out caps on success fees or recommended caps in the jurisdictions identified in it.²⁰

Table 3.14 – Caps on Success Fees

Jurisdiction	Fees
Australia	Capped at 25% Funders fees are typically 25-40%
Canada	6% on recovery of C\$10M found reasonable but not the same if it were C\$3M
USA	Typically one-third but substantial variation
European (various)	25-40%
Poland	Capped at 20%
Jackson Review, the UK recommendation	Capped at 25%

(4) *ATE insurance*

3.15 Insurance for legal expenses in the form of ATE Insurance also protects a party against Adverse Costs Orders. ATE Insurance allows potential Funded Parties to pursue claims that might otherwise be too risky; as

¹⁸ The Law Reform Commission of Hong Kong, *Consultation Paper on Conditional Fees* (2005), at para 7.

¹⁹ The Law Reform Commission of Hong Kong, *Consultation Paper on Conditional Fees* (2005), at para 8.

²⁰ Christopher Hodges, John Peysner and Angus Nurse, *Litigation Funding: Status and Issues* (Research Report, University of Oxford, 2012).

such, it may be seen as a method of Third Party Funding. The attractiveness of this insurance is reported to have been reduced by recent legislative changes in England and Wales, which no longer permit the insurance premium to be recoverable from the opposing party.²¹

Typical structures of Third Party Funders of the Proceedings and Sources of Funds

3.16 Third Party Funders typically adopt a variety of publicly listed and private corporate organisational structures. This is illustrated by the structure of ALF members. ALF is an independent body designated by the UK Ministry of Justice with delivering self-regulation of litigation funding in England and Wales.²²

3.17 The ALF currently consists of seven Third Party Funder members,²³ of which:

- (1) one is a publicly listed investment company regulated by the AIM Market of the London Stock Exchange;
- (2) five are private companies operating as private investment funds, generally regulated by the UK Financial Conduct Authority; and
- (3) one is a group consisting of a Financial Conduct Authority-regulated corporate investment adviser and privately owned Financial Conduct Authority-regulated investment funds.

3.18 The ALF has seven associate members, of which:

- (1) one is an overseas Funder member;
- (2) four are litigation funding broker members;
- (3) one is a law firm member; and
- (4) one is an academic member.

3.19 As to the activities undertaken by the ALF members (both Third Party Funders' members and associate members):

- (1) eight state that they act directly as Funders; and
- (2) six state that they act as brokers or advisers that assist private funders wishing to invest in litigation or arbitration disputes.

²¹ Section 58C of the Courts and Legal Services Act (1990) (UK), as amended by the Legal Aid, Sentencing and Punishment of Offenders Act (2012) (UK).

²² "About Us", Association of Litigation Funders (2014), <<http://associationoflitigationfunders.com/about-us/>>.

²³ "Membership Directory", Association of Litigation Funders (2014), <<http://associationoflitigationfunders.com/membership/membership-directory/>>.

Sources of Funds of Third Party Funders

3.20 The sources of funds for Third Party Funders are varied and depended upon its structure and its business model. Potential sources of Funds include:

- (1) issuing shares in a publicly listed company to members of the public;
- (2) investment by private equity investors in a fund;
- (3) investment by members of the public in a Third Party Funder;
- (4) inviting investors to subscribe to mutual funds;
- (5) borrowing from banks and financial institutions; and
- (6) building-up working capital through funding successful cases.

3.21 Potential providers of capital to Third Party Funds include high-net-worth individuals, corporate investors, university endowment funds and pension funds investing as part of the higher-risk end of their investment activities.

Types of cases attracting Third Party Funding

3.22 Third Party Funders have stated that they are most attracted to high value cases with a high chance of success as these provide the greatest chance of profit. Third Party Funding is mainly available to plaintiffs/claimants in the Proceedings, but may also be available to fund a defendant's/respondent's counter-claim. It is rarely available to defend a claim (given the difficulties in agreeing upon the formulation of the success fee).

3.23 Proceedings that may be considered to be suitable for Third Party Funding are predominantly commercial cases, including those involving shareholder disputes, contractual interpretation and general commercial disputes. Third Party Funding is also often sought in insolvency proceedings.

3.24 Commercial disputes are usually deemed to be more suitable for Third Party Funding, as the relevant investment criteria can be more easily applied to commercial disputes and assessed. Such criteria may include as follows:

- (1) the amount claimed, and potentially available to be recovered, can usually be estimated;
- (2) the prospects of success can be predicted with some confidence;
- (3) the procedure of the Proceedings is usually limited in time and scope; and

- (4) there are usually assets against which an Award can be enforced (thereby increasing certainty of recovery of the Third Party Funding).²⁴

3.25 Third Party Funding is also utilized in arbitration cases involving states or state owned enterprises, although this appears to represent a small segment of the funding market. Third Party Funding in these cases is usually sought by investors against the host state or territory against which a claim is brought. Such cases often concern expropriation of the assets of that investor, where the investor is therefore left with limited (if any) resources with which it can pursue its claims against the country under an appropriate investment treaty. It appears that sovereign countries rarely seek Third Party Funding as (a) they usually have sufficient resources to conduct the proceedings, or (b) if they do not have sufficient resources, they can often find far cheaper (and less complex) financing options by issuing sovereign debt.

3.26 Exactly which types of cases are able to attract Third Party Funding appears to depend on a variety of factors including:

- (1) the dynamics of the particular funding market;
- (2) the laws of the jurisdiction where the Proceedings are being conducted; and
- (3) the particular funding model used by the potential Third Party Funder.

3.27 For example, one UK litigation funder states that it will fund "*any case, in any industry sector, which has a potential damages or money outcome*" including "*breach of contract; breach of statute, insolvency, misrepresentation, intellectual property, competition, breach of fiduciary duty, breach of trust; and professional negligence.*"²⁵

Criteria for funding

3.28 For Third Party Funders, as commercial entities, the decision to fund arbitration is an investment decision. Factors relevant to a decision to invest are addressed in both academic discussions and publicly available statements of litigation funders. Criteria typically include:²⁶

- (1) the likelihood of a claim being successful;

²⁴ Eric De Brabandere and Julia Lepeltak, *Third Party Funding in International Investment Arbitration* (Working Paper No 1, Grotius Centre for International Legal Studies, 2012), at 5-6; Christopher Hodges, John Peysner and Angus Nurse, *Litigation Funding: Status and Issues* (Research Report, University of Oxford, 2012), at 71.

²⁵ Harbour Litigation Funding Ltd, "Types of Cases We Fund" (2014), <<http://www.harbourlitigationfunding.com/types-of-cases-we-fund>>.

²⁶ Eric De Brabandere and Julia Lepeltak, *Third Party Funding in International Investment Arbitration* (Working Paper No 1, Grotius Centre for International Legal Studies, 2012), at 5-6. Christopher Hodges, John Peysner and Angus Nurse, *Litigation Funding: Status and Issues* (Research Report, University of Oxford, 2012), at 74.

- (2) the likely quantum of a successful claim and potential return on investment;
- (3) the complexity of a claim and time needed to reach an outcome;
- (4) the costs involved in pursuing a claim;
- (5) the likely cost of failure, including possible Adverse Costs Orders;
- (6) the capacity of the opposing party to pay all or part of a judgment or an Award (and the assets against which any Award would be enforced);
- (7) the quality of the legal representation;
- (8) the nature of any existing relationship between the Third Party Funder and the legal representation;
- (9) the legal expertise of the Third Party Funder in a particular area;
- (10) other risks inherent in the Proceedings, such as the jurisdiction in which the case is being pursued, the complexity of enforcing a decision against a defendant with assets in foreign jurisdictions and the possibility of counter-claims; and
- (11) the level of risk and outlay required for a potential case relative to the portfolio of ongoing cases that the Third Party Funder has invested in at the time.

3.29 The manner in which the above criteria are applied is part of the commercial model of each Third Party Funder and, accordingly, this information is often not widely publicised. There is publicly available evidence that gives some indication, however.

Likelihood of success

3.30 As to the likelihood of success of a case funded by Third Party Funders, an estimation in a 2012 report into the UK market states, "*funders would want to see chances of success of at least 60%.*"²⁷ An alternative estimation in the *Review of Civil Litigation Costs: Preliminary Report* (2009), known as the Jackson Review, suggests that litigation funders in the UK generally require a 70% prospect of success of the Proceedings before they will invest.²⁸ Anecdotal evidence provided by an unnamed litigation funder to the Jackson Review indicated that from 53 cases, there was a success rate of 78%.²⁹ One Australian Funder has stated that:

²⁷ Christopher Hodges, John Peysner and Angus Nurse, *Litigation Funding: Status and Issues* (Research Report, University of Oxford, 2012), at 69.

²⁸ Lord Justice Jackson, *Review of Civil Litigation Costs*, Preliminary Report (2009), Vol 1, at 161, at para 2.3.

²⁹ Lord Justice Jackson, *Review of Civil Litigation Costs*, Preliminary Report (2009), Vol 1, at 161, at para 2.4.

*"Case selection is made on the basis of 'virtual certainty of success' – expressed as a percentage, no case should be taken unless it is thought that it has at least an 85% chance of success or there are special reasons that the committee thinks justify a deviation from this approach."*³⁰

Quantum of the claim

3.31 With respect to the quantum of the claim, the UK Third Party Funders interviewed for a 2012 report indicated that, "*The threshold of viability for a claim value is currently not less than £100,000.*"³¹ The report also considered funding in Australia, the USA, Canada, Ireland, Germany, Austria and the Netherlands and found nothing to indicate any lower minimum values in these jurisdictions, with the exception of Germany, "*where [litigation] costs are lower (and more predictable).*"³²

3.32 In the February 2015 issue of "*Litigation Funding*", a bi-monthly magazine published by the Council of the Law Society of England and Wales,³³ 20 Third Party Funders indicated the minimum claim value that they would consider funding. The table below summarises the number of Third Party Funders that stated a minimum claim value equal to or less than each of the listed amounts.

Claim amount	Number of funders
Less than £100,000	5 Funders
£100,000	8 Funders
£3 million	15 Funders
£25 million	20 Funders

The Third Party Funding compensation structure

3.33 It appears that the typical basis of compensation for the Third Party Funder is to receive a percentage of net recoveries in successful Proceedings, as illustrated by a review of nine reported cases involving litigation funding in Australia, the US and the UK, which was conducted for this Consultation Paper. This identified entitlements for Third Party Funders of

³⁰ Christopher Hodges, John Peysner and Angus Nurse, *Litigation Funding: Status and Issues* (Research Report, University of Oxford, 2012), at 54.

³¹ Equivalent to approximately HK\$1.25 million; Christopher Hodges, John Peysner and Angus Nurse, *Litigation Funding: Status and Issues* (Research Report, University of Oxford, 2012), at 53.

³² Christopher Hodges, John Peysner and Angus Nurse, *Litigation Funding: Status and Issues* (Research Report, University of Oxford, 2012), at 104, 153.

³³ Council of the Law Society of England and Wales, *Litigation Funding*, Issue 95 (Feb 2015).

between 8% and 55% of the proceeds of a case.³⁴ In a 2014 comparative table of the Third Party Funders in the *Litigation Funding* publication, the range most commonly stated by the Third Party Funders was 20% to 45%.³⁵ In international arbitration claims, a range of 15% to 50% of an Award has been suggested as typical, with a median figure of around 33%.³⁶

3.34 A feature of some Third Party Funding agreements is that the Third Party Funder's fee may increase over time to reflect the additional costs of prolonged litigation or arbitration. For example, a Third Party Funder may be entitled to 35% of net proceeds in the first six months following the signing of an agreement, and then 45% between six and 12 months.³⁷

3.35 An alternative basis for calculation of the Third Party Funder's success fee is as a multiple of the amount it has invested. For example, where a Third Party Funder has provided a sum of \$1,000,000, the success fee could be agreed as twice this sum: \$2,000,000.

3.36 Third Party Funding agreements may provide for the Third Party Funder to be reimbursed by some combination of a multiple of committed funding or a percentage of the Award.³⁸ An example of this would be an agreement that specified that the Third Party Funders' fees are to be the larger of these two alternatives.

3.37 Some Third Party Funding agreements may set a maximum fee recoverable by the Funder. One source suggests that the percentage of the proceeds recoverable by the Funder would typically be capped "*at three to four times the legal costs advanced by the funder.*"³⁹

³⁴ *Stoczina Gdanska SA v Latreefers Inc* [2001] CLC 1267 (CA) (55% entitlement); *Hall v Poolman* [2007] NSWSC 1330 (50% entitlement); *Groewood Holdings plc v James Capel & Co Ltd* [1995] Ch 80 (50% entitlement); *Farmer v Mosely (Holdings) Ltd* [2001] 2 BCLC 572 (40% and 50% entitlements); *ANC Ltd v Clark Goldring & Page Ltd* [2001] BCC 479(CA) (50% entitlement); *Clairs Keeley (a firm) v Treacy* (2003) 28 WAR 139 (35% on success at trial, 45% on successful settlement); *Arkin v Bochart Lines Ltd* [2005] 1 WLR 3055 (CA) (25% entitlement for first £5m damages and 23% thereafter); *QPSX Ltd v Ericsson Australia Pty Ltd* (2005) 219 ALR 1 (17% entitlement on resolution pretrial, 24% on resolution after trial begins); *Regina (Factortame Ltd) v Secretary of State for Transport, Local Government and the Regions (No 8)* [2003] QB 381 (CA) (8% entitlement).

³⁵ Council of the Law Society of England and Wales, *Litigation Funding*, Issue 93 (2014). See also Lord Justice Jackson, *Review of Civil Litigation Costs*, Final Report (2009), Vol 1, at 24-25.

³⁶ Susanna Khouri, Kate Hurford and Clive Bowman, "Third Party Funding in International Commercial and Treaty Arbitration – A Panacea or a Plague? A Discussion of the Risks and Benefits of Third Party Funding" 8(4) *Transnational Dispute Management* (2011), at 3; Eric De Brabandere and Julia Lepeltak, *Third Party Funding in International Investment Arbitration* (Working Paper No 1, Grotius Centre for International Legal Studies, 2012), at 5.

³⁷ Eric De Brabandere and Julia Lepeltak, *Third Party Funding in International Investment Arbitration* (Working Paper No 1, Grotius Centre for International Legal Studies, 2012), at 3. This addresses the added costs and risks associated with prolonged litigation.

³⁸ Eric De Brabandere and Julia Lepeltak, *Third Party Funding in International Investment Arbitration* (Working Paper No 1, Grotius Centre for International Legal Studies, 2012), at 5.

³⁹ Maya Steinitz, *Whose Claim is This Anyway? Third-Party Litigation Funding* (Legal Studies Research Paper No 11-31, University of Iowa, 2011), at 1276.

Typical terms of agreement

3.38 The terms of a Third Party Funding agreement will usually be the result of negotiations between the Funded Party and the Third Party Funder and will be drafted to reflect the specific circumstances of each set of Proceedings. However, there are several subjects that a Third Party Funding agreement would typically include, such as:

- (1) the Third Party Funder's fee or other compensation, including the circumstances in which the Third Party Funder is entitled to be paid/benefitted, and the calculation of such fee or benefit (discussed generally above);
- (2) the order of payments from the proceeds of a successful case;
- (3) the Third Party Funder's liability for costs, including Adverse Costs Orders and Security for Costs;
- (4) the termination and withdrawal of Third Party Funding;
- (5) the Third Party Funder's control over the conduct of Proceedings;
- (6) conflict Management and Dispute Resolution; and
- (7) confidentiality.

3.39 A number of the above issues will arise from the regulatory requirements of the jurisdiction in which the funded Proceedings are being heard, as discussed further in Chapter 4.

Order of payments

3.40 A Third Party Funding agreement will generally set out the order of payments among the Third Party Funder, the Funded Party and others, in the event of a successful recovery in the Proceedings, where the Third Party Funder is to be compensated by a payment of funds. The following order of payment from the net proceeds of a case (after costs, such as those of the legal team and experts have been paid) would likely be:

- (1) the Third Party Funder is reimbursed for its investment or expenses to date;
- (2) the Third Party Funder is paid its return (or profit) on its investment;
- (3) any other potential stakeholders who are entitled to share in the payment including insurers and lawyers acting on a deferred, contingent or conditional basis are paid; and
- (4) the balance of the proceeds obtained from the Proceedings is paid to the Funded Party.⁴⁰

⁴⁰ Susanna Khouri and Kate Hurford, *Third Party Funding for International Arbitration Claims: Practical Tips* (Practice Note, Practical Law Company Arbitration, 2012), at 21-22.

Liability for costs, including Adverse Costs Orders and Security for Costs

3.41 The terms of a Third Party Funding agreement will generally address whether the Third Party Funder bears responsibility for an Adverse Costs Order. In litigation proceedings Adverse Cost Orders may be made against Third Party Funders directly in certain circumstances, as the Hong Kong courts are generally given wide powers to make costs orders.⁴¹

3.42 The position in arbitration is less clear as a Tribunal will not generally have the power to award costs against a third party under the applicable statute.⁴² The jurisdiction of a Tribunal comes from the arbitration agreement between the parties. As a Third Party Funder is not party to the arbitration agreement, the Tribunal will not have jurisdiction over the Third Party Funder. The updated *IBA Guidelines on Conflicts of Interest in International Arbitration 2014* have stated that a Third Party Funder "bears the identity" of the party to an arbitration. It is unclear whether this development represents a revision of the arbitral theory regarding the scope of the Tribunal's jurisdiction over third parties.⁴³

ATE insurance and Third Party Funding

3.43 In some jurisdictions such as England and Wales, ATE Insurance may be available to cover the eventuality of adverse costs. Agreements between a Third Party Funder and a Funded Party may provide that the Third Party Funder will pay for an insurance premium. In England, it is often a condition of funding that ATE Insurance is taken out.⁴⁴

Termination and withdrawal of funding

3.44 Third Party Funding agreements will generally provide for the circumstances in which termination of an agreement and withdrawal of Third Party Funding will occur. Grounds for termination may include the Funded Party's material breach of a contractual term and a material change of prospects of the Funded Party's success in the Proceedings. Dispute resolution clauses may be included to resolve situations potentially leading to

⁴¹ See *Arkin v Borchard Lines Ltd* [2005] 1 WLR 3055 (CA).

⁴² William Kirtley and Koralie Wietrzykowski, "Should a Tribunal Order Security for Costs When an Impecunious Claimant Is Relying upon Third Party Funding?" (2013) 30(1) *Journal of International Arbitration* 17.

⁴³ General Standard 6(b), *IBA Guidelines on Conflicts of Interests in International Arbitration* (2014).

⁴⁴ Lord Justice Jackson, *Review of Civil Litigation Costs*, Preliminary Report (2009), Vol 1, at 161, para 2.2.

or giving grounds for termination,⁴⁵ see for example Rule 11 of the ALF Code.⁴⁶

Control over the conduct of proceedings

3.45 Third Party Funding agreements typically address the extent to which a Third Party Funder may exercise control over the conduct of Proceedings.⁴⁷ In jurisdictions such as England and Wales, where, in the litigation context at least, third party control gives rise to a real risk of stays or dismissal on grounds of abuse of process, parties may be concerned to make provision in the Third Party Funding agreements for the Funded Party to retain full control of the conduct of the Proceedings.⁴⁸ By contrast, in Australia it is permitted, and more common, for Third Party Funders to exercise a degree of control over the Funded Party, as discussed further in Chapter 5.

Party conflict management and dispute resolution

3.46 Third Party Funding agreements generally specify what is to happen when there is a conflict of interest between the Third Party Funder and the Funded Party. Conflicts that can arise include whether to accept a settlement offer, disclosure of documents (such as the Third Party Funding agreement itself) and decisions to prolong the Proceedings.⁴⁹

3.47 To protect a Funded Party, the Third Party Funding agreements may provide terms such as that: (1) the lawyer representing the Funded Party owes his or her professional and fiduciary duties solely to the Funded Party; and (2) in the event of conflict of interest between the Third Party Funder and the Funded Party, the lawyer may continue to act for the Funded Party.⁵⁰

⁴⁵ Susanna Khouri and Kate Hurford, *Third Party Funding for International Arbitration Claims: Practical Tips* (Practice Note, Practical Law Company Arbitration, 2012), at 24-25.

⁴⁶ Rule 11 of the ALF Code specifies that a funding agreement shall state the conditions under which a funder may terminate the agreement in the event that the funder "*reasonably ceases to be satisfied about the merits of the dispute; reasonably believes the dispute is no longer commercially viable; or believes that there has been a material breach of the [litigation funding agreement] by the Funded Party.*" Rule 2.4 states that the ALF Code applies to "*litigation, arbitration or other dispute resolution procedures.*"

⁴⁷ Susanna Khouri and Kate Hurford, *Third Party Funding for International Arbitration Claims: Practical Tips* (Practice Note, Practical Law Company Arbitration, 2012), at 25.

⁴⁸ Rule 9.2 of the ALF Code specifies that a funder will "*not take any steps that cause or are likely to cause the Funded Party's solicitor or barrister to act in breach of their professional duties.*" Rule 9.3 of the ALF Code states that a funder will "*not seek to influence the Funded Party's solicitor or barrister to cede control or conduct of the dispute to the Funder.*"

⁴⁹ In a recent arbitration between S&T Machinery Ltd and Romania, disagreement between S&T and their funder Juridica over alleged misrepresentations and disclosure of information led to proceedings being discontinued after Juridica declined to pay procedural fees: *S&T Oil Equipment and Machinery Ltd v Romania, Order of Discontinuance of the Proceedings* (ICISD Case No ARB/07/13).

⁵⁰ Susanna Khouri and Kate Hurford, *Third Party Funding for International Arbitration Claims: Practical Tips* (Practice Note, Practical Law Company Arbitration, 2012), at 23. See generally Eric De Brabandere and Julia Lepeltak, *Third Party Funding in International Investment Arbitration* (Working Paper No 1, Grotius Centre for International Legal Studies, 2012), at 9.

3.48 Specific dispute resolution mechanisms may be included in a Third Party Funding agreement, including provisions to refer particular disputes to a nominated senior counsel, to enter into mediation, or to arbitrate the dispute between the Funded Party and the Third Party Funder. The conditions triggering these dispute resolution mechanisms will be stated.⁵¹

Confidentiality and provision of documents

3.49 Generally, a Third Party Funding agreement will state that documents provided to the Third Party Funder that are not already in the public domain remain confidential and privileged.

B. The current Hong Kong law on maintenance and champerty and Third Party Funding in Hong Kong

3.50 As discussed in Chapter 1, while the doctrines of maintenance and champerty still apply to Hong Kong litigation (with three main exceptions), it has become clear that the Hong Kong courts do not object, in principle, to Third Party Funding for arbitration where the Third Party Funded arbitration is conducted in a jurisdiction that permits such funding: see *Unruh v Seeberger*. However, the Court of Final Appeal has made it clear that it is for the legislature to change the Hong Kong law to clearly allow Third Party Funding for arbitrations taking place in Hong Kong, if it considers it to be appropriate to do so.⁵²

Exceptions to the rule against maintenance and champerty

3.51 In *Unruh v Seeberger*, the Court of Final Appeal held that the doctrines of maintenance and champerty continued to have effect in Hong Kong, but identified three categories where liability for engaging in maintenance or champerty could be excluded:

- (1) the "*common interest*" category, whereby persons with a legitimate interest in the outcome of the litigation are justified in supporting the litigation;
- (2) cases involving "*access to justice*" considerations; and

⁵¹ Rules in the ALF Code address some of these issues. For example, Rule 9.2 of the ALF Code provides that a funder will refrain from actions that "*cause or are likely to cause the Funded Party's solicitor or barrister to act in breach of their professional duties.*" Rule 9.3 of the ALF Code provides that a funder will "*not seek to influence the Funded Party solicitor or barrister to cede control or conduct of the dispute to the Funder.*" Rule 11.1 of the ALF Code requires that funding agreements "*shall state whether (and if so how) the Funder... may ... provide input to the Funder Party's decisions in relation to settlements.*"

⁵² *Unruh v Seeberger* (2007), at para 123 and the *Winnie Lo* case (2012) at paras 177-179.

- (3) a miscellaneous category of practices accepted as lawful such as the sale and assignment by a trustee in bankruptcy of an action commenced in the bankruptcy to a purchaser for value.

Sanctions for breach of the rule against maintenance and champerty

3.52 In Hong Kong, breach of the rule against maintenance and champerty could potentially give rise to both civil and criminal liability.

Tortious claims

3.53 As stated in *Unruh v Seeberger*, under Hong Kong law, maintenance and champerty can be a tort (which is a civil wrong).⁵³ Thus where a party has proved that an agreement is champertous or constitutes maintenance, the agreement may be held to be void and unenforceable between the parties,⁵⁴ and the successful party can also claim damages for any losses caused (although these may be difficult to establish).⁵⁵ For example, a solicitor who has actively participated in a champertous agreement may be unable to recover his or her own costs, as well as being personally liable for the costs of the defendant.⁵⁶ He or she may also be subject to a disciplinary hearing for professional misconduct by the professional regulators. He or she may also be criminally prosecuted, as outlined below.

Criminal offences

3.54 Engaging in maintenance and champerty can constitute criminal offences in Hong Kong. The penalty for such offences is provided under section 101I of the Criminal Procedure Ordinance (Cap 221), a general catch-all provision for indictable offences. Section 101I provides as follows:

"Subject to subsections (2) and (5), where a person is convicted of an offence which is an indictable offence and for which no penalty is otherwise provided by any Ordinance, he shall be liable to imprisonment for 7 years and a fine."

3.55 In *Winnie Lo v HKSAR*,⁵⁷ it was asserted that the offence of conspiracy to commit maintenance was "*punishable under section 101I of the Criminal Procedure Ordinance, Cap 221.*"⁵⁸

⁵³ *Unruh v Seeberger* (2007) 10 HKCFAR 31, at 62 (per Ribeiro PJ).

⁵⁴ *Hutley v Hutley* (1873) LR 8 QB 112; *Cole v Booker* (1913) 29 TLR 295, at 296.

⁵⁵ *Neville v London Express Newspaper Ltd* [1919] 1 AC 368 (HL).

⁵⁶ *Danzey v Metropolitan Bank of England and Wales* (1912) 28 TLR 327; see also *Grassmoor Colliery Co v Workmen's Legal Friendly Society Connell* (1912) 1 LJNCCR 92.

⁵⁷ *Winnie Lo v HKSAR* (2012) 15 HKCFAR 16.

⁵⁸ The background to *Winnie Lo v HKSAR* (2012) 15 HKCFAR 16 was that in 2009, the District Court had found that a solicitor had conspired with a recovery agent to unlawfully maintain a personal injury action. The recovery agent had entered into an agreement with the plaintiff family to bring a claim on a "no win, no fee" basis. The District Court convicted the appellant

3.56 Ribeiro PJ said in *Winnie Lo v HKSAR* that:

"As a postscript, I wish to raise for consideration the question whether and to what extent criminal liability for maintenance should be retained in Hong Kong. In England and Wales, criminal and tortious liability for both maintenance and champerty were abolished by the Criminal Law Act 1966. As pointed out in 1997 in Magic Menu Systems Pty Ltd v AFA Facilitation Pty Ltd, such liability was abolished in Victoria in 1969, in South Australia in 1992 and in New South Wales in 1995 by the Maintenance and Champerty Abolition Act 1993 (NSW).

*The issues are, however, of some complexity and may involve taking a different view in respect of maintenance as opposed to champerty; and of criminal as opposed to tortious liability. It is in my view a fit topic to be referred to the Law Reform Commission.*⁵⁹

Do maintenance and champerty apply to arbitration under Hong Kong law?

3.57 As discussed in *Unruh v Seeberger*⁶⁰, the Court of Final Appeal expressly left open the question whether maintenance and champerty applied to agreements concerning arbitrations taking place in Hong Kong, as it did not arise in the case.

3.58 Notwithstanding the comments of Ribeiro PJ in *Unruh v Seeberger*, there has been no express abolition of the offences of maintenance and champerty in Hong Kong.

Third Party Funding in Hong Kong and its regulation

3.59 Third Party Funding in Hong Kong is at a relatively early stage of development, with external funding largely confined to the insolvency context, as this is one of the clear exceptions to application of the doctrines of maintenance and champerty in Hong Kong.

3.60 The Hong Kong Companies Court, which supervises the winding-up of companies in Hong Kong and the liquidators of those companies,

solicitor of one count of conspiracy to commit maintenance and sentenced her to 15 months' imprisonment. The recovery agent was also convicted of conspiracy to commit maintenance as well as a further charge of champerty and was sentenced to 16 months' imprisonment. The solicitor's conviction and sentence were affirmed by the Court of Appeal but leave was granted to appeal to the Court of Final Appeal.

⁵⁹ *Winnie Lo v HKSAR* (2012) 15 HKCFAR 16, at 71 (per Ribeiro PJ).

⁶⁰ *Unruh v Seeberger* (2007) 10 HKCFAR 31.

has sanctioned the use of funding by company liquidators in a number of reported cases. Three of these cases are discussed briefly below.

3.61 In *Re Cyber Works Audio Video Technology Limited*⁶¹ and *Berman v SPF CDO I Ltd*,⁶² the court approved arrangements entered into by the liquidators under which Third Party Funders would investigate potential claims and would fund viable cases in exchange for an assignment of the causes of action. In both cases, the court considered that, because the companies seeking funding were in insolvent liquidation without resources of their own, there were access to justice grounds justifying the arrangements.

3.62 In *Po Yuen (To's) Machine Factory Limited*,⁶³ the Court held that the liquidators were permitted to enter into a Third Party Funding arrangement in the Mainland and that the funding could come in the form of a Contingency Fee arrangement with the Third Party Funder, as this was permitted in the Mainland. The court emphasised the need for the liquidators to "*bear in mind that it is their duty to ensure that the creditors' interests are advanced by proper means*".⁶⁴

3.63 To date, Third Party Funding arrangements that have been considered acceptable by the Hong Kong courts have generally involved the Third Party Funder providing Funds at arm's length to the Funded Party in exchange for a share of the net proceeds in the event that the plaintiff is successful in its pursuit of the litigation and in obtaining financial recovery. The Funded Party retains control of the Proceedings, which is a requirement established by English case law and followed in Hong Kong. The Third Party Funder assumes liability for the costs and disbursements of the plaintiff (including costs of solicitors, counsel and experts), Adverse Costs Orders and Security for Costs Orders, if so ordered by the court.⁶⁵

3.64 There are a number of Hong Kong-based Third Party Funders who are involved in funding cases before the Hong Kong courts. The funding

⁶¹ [2010] 2 HKLRD 1137.

⁶² [2011] 2 HKLRD 815.

⁶³ [2012] 2 HKLRD 752.

⁶⁴ *Po Yuen (To's) Machine Factory Ltd* [2012] 2 HKLRD 752, at 756 (*per* Harris J).

⁶⁵ We have considered whether Third Party Funders might be regulated under the current legislative framework in Hong Kong, as the potential for regulatory oversight of Third Party Funders arises in two distinct phases: (1) Phase 1, ie, the Third Party Funders raising of capital; and (2) Phase 2, ie, a Third Party Funders' use of capital to fund a party to an arbitration. As to Phase 1, we consider that a Third Party Funder's fundraising activities could fall within the regulatory framework of the SFC if the sources of funds are a collective investment scheme as defined in the SFO and if a Third Party Funder's activities fall within the scope of sections 103 and 114 of the SFO. As to Phase 2, it seems unlikely to us that the activities of the Third Party Funders will fall within the scope of the BO or within the regulated activities of the SFO. However, depending on the terms of the Third Party Funders' funding to a party to an arbitration, it may fall within the category of a "*money lender*" under the MLO and may therefore be required to possess a licence to conduct business with the parties it is funding, if the Funds provided by a Third Party Funder are properly to be characterized as a "*loan*". Based on the information available regarding the Third Party Funders' structures, most funding does not appear to fall within this category. In any event, the extent of the Registrar's control and regulation under the MLO is fairly narrow. We have not considered these issues further as it is beyond the scope of our review.

of cases before the Hong Kong courts has also attracted the interest of a number of overseas-based Third Party Funders, principally from England and Australia. Their familiarity with the Hong Kong legal system and the reliability of the Hong Kong judiciary are factors that appear to have attracted these overseas-based Third Party Funders to funding litigation in Hong Kong. They have not formed any industry body or other organised structure in Hong Kong.

3.65 It seems likely that cases are also being externally funded outside of the insolvency context on the access to justice ground. However, as there is usually no judicial mechanism for a litigant to obtain an advance sanction of a Third Party Funding arrangement from the Hong Kong courts, reported cases are few and the reported cases which do exist usually arise as a result of an adverse party seeking to challenge the propriety of the funding arrangement or the conduct of one of the parties or their legal advisers.

3.66 We have briefly considered the possible regulatory regime for Third Party Funders under the current legislative framework in Hong Kong, as the potential for regulatory oversight of Third Party Funders arises in two distinct phases. Phase 1 relates to the raising of capital by Third Party Funders. Phase 2 relates to the use of capital by Third Party Funders to fund a party to an arbitration.⁶⁶

Relevant regulation of the Hong Kong legal profession

3.67 The primary branches of the legal profession qualified to practise Hong Kong law are barristers and solicitors.⁶⁷ In addition, foreign lawyers may be registered and regulated by the Hong Kong Law Society. All are regulated as providers of services to the public. Solicitors undertake both transactional and dispute resolution work (including arbitration) and are regulated by the Hong Kong Law Society. Barristers focus on provision of specialist advisory as well as advocacy services and are mainly involved in litigation, arbitration or dispute resolution (including mediation). The Hong Kong Bar Association is the regulating body of barristers in Hong Kong.

3.68 In Hong Kong, neither a barrister nor a solicitor may enter into a Conditional or Contingency Fee arrangement to act in contentious business. These restrictions stem from legislation, professional conduct rules, and the common law. For example, the Legal Practitioners Ordinance (Cap 159) provides that a solicitor's power to make agreements as to remuneration and the provisions for the enforcement of these agreements do not give validity to:

"any agreement by which a solicitor retained or employed to prosecute any action, suit or other contentious proceeding

⁶⁶ Same as above.

⁶⁷ Suitably qualified solicitors may also be granted higher rights of audience enabling them to appear as "*Solicitor-Advocates*" in the Hong Kong Courts.

*stipulates for payment only in the event of success in that action, suit or proceeding.*⁶⁸

3.69 Annex 1 to this Consultation Paper sets out a summary of the main statutory provisions and applicable professional conduct rules of the Hong Kong Law Society, being "*The Hong Kong Solicitors' Guide to Professional Conduct*" (3rd Edition) and the Hong Kong Bar Association's "*Code of Conduct*" relevant to Third Party Funders and lawyers, including the duties of lawyers:

- (1) to avoid conflicts of interest;
- (2) not to act on the basis of contingency or success fees; and
- (3) to observe their duty of confidentiality to the client.

3.70 As at the date of this Consultation Paper, the High Court of Hong Kong is currently considering a case where it is alleged that a solicitor agreed to a Contingency Fee arrangement: *Angela Ho & Associates (a firm) v Kwong Ka Yin trading as Phyllis K Y Kwong & Associates (unreported)*.⁶⁹

⁶⁸ Legal Practitioners Ordinance (Cap 159) section 64(1)(b).

⁶⁹ HCMP 1794/2014, 2 December 2014 (CFI).

Chapter 4

The current law and regulation of Third Party Funding for arbitration in various common law and civil law jurisdictions and under the Washington Convention

4.1 The development of the law as to Third Party Funding in other international arbitration centres is relevant to Hong Kong. Like Hong Kong, many of these have adopted the Model Law to varying degrees. The international origin of the Arbitration Ordinance, by its adoption of Article 2A of the Model Law, indicates that regard should be had to the international origin of that law, "*and the need to promote uniformity in its application and the observance of good faith.*"¹

4.2 As appears from the following discussion, to date, the relevant cases, statutes and practices regarding Third Party Funding in overseas jurisdictions have focused on litigation. There is relatively little material considering the application of Third Party Funding to arbitrations.

4.3 We consider that understanding modern attitudes to public policy considerations underpinning the doctrines of maintenance and champerty in other major international arbitration jurisdictions is essential to understanding:

- (1) the reasons for the emergence of Third Party Funding for Proceedings in Australia, England and other jurisdictions;
- (2) how Third Party Funding arrangements are structured in jurisdictions where they are permitted; and
- (3) how law-makers have sought to regulate the emerging Third Party Funding sector, as the doctrines of maintenance and champerty have been interpreted so as to allow Third Party Funding, primarily relying on the principle of access to justice.

4.4 The history of Third Party Funding internationally suggests that the Third Party Funders who fund litigation are also the main Third Party Funders of arbitration. Internationally, it appears that Third Party Funding arrangements for arbitrations are generally regulated on the same, or a similar, basis as for litigation, at least in the context of governmental (by statute) or industry body regulation (by self-regulation); also, that Third Party Funding of

¹ Section 9 of the Arbitration Ordinance.

litigations is also regulated by the rules and practices of the relevant courts. In the arbitration context, it should be borne in mind that detailed procedural rules, of the nature that many courts have, generally do not apply.

4.5 In recent years, there has been a great deal of debate internationally, including in England and Australia, on the question of how to regulate Third Party Funding. In the jurisdictions that we have reviewed, there has been no general acceptance of the proposition that Third Party Funding should be wholly unregulated. Little or no distinction has been made between litigation and arbitration for the purposes of the industry body regulatory regimes established in England, and the government regulation in Australia, respectively.

4.6 To date, a "*light touch*" approach to regulation has been generally adopted in the jurisdictions where Third Party Funding is permitted. In Australia, the focus has been on avoiding conflicts of interest. In England, minimum capital requirements, among other issues, have received greater attention. In Germany, the distinction between the Funder and the lawyer, and the prohibition on the Third Party Funder providing legal advice, has been emphasised. It is clear, however, that such "*light touch*" regulation has not been accepted as the only approach. In a number of jurisdictions, the discussion as to the extent of regulation needed continues, with calls for further regulation from politicians, law reform bodies and from within the Third Party Funding industry itself.

4.7 This Chapter considers these issues in relation to Third Party Funding in jurisdictions other than Hong Kong and under the 1965 Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the "Washington Convention")² as follows:

- (1) Australia [paragraphs 4.11 to 4.50 below];
- (2) England and Wales [paragraphs 4.51 to 4.89 below];
- (3) France [paragraphs 4.90 to 4.95 below];
- (4) Germany [paragraphs 4.96 to 4.111 below];
- (5) The Netherlands [paragraphs 4.112 to 4.114 below];
- (6) Sweden [paragraphs 4.115 to 4.117 below];
- (7) Switzerland [paragraphs 4.118 to 4.121 below];
- (8) The European Union [paragraphs 4.122 to 4.123 below];
- (9) Korea [paragraphs 4.124 to 4.125 below];
- (10) Mainland China [paragraphs 4.126 to 4.127 below];
- (11) Singapore [paragraphs 4.128 to 4.143 below];
- (12) The United States [paragraphs 4.144 to 4.172 below]; and

² The Washington Convention opened for signature on 18 March 1965, 575 UNTS 159 (entered into force 14 October 1966).

- (13) Treaty Cases under the Washington Convention [paragraphs 4.173 to 4.181 below].

4.8 In discussing specific jurisdictions, particular attention is given to Australia and England, which provide case studies on the emergence and evolution of Third Party Funding in common law jurisdictions. The discussion canvasses the development of law relating to Third Party Funding of contentious proceedings, possible differences in considerations relevant to Third Party Funding for arbitration as contrasted with litigation, and the contrasting approach of government regulation and industry self-regulation of the Third Party Funding sector.

4.9 Discussion of other jurisdictions takes a thematic approach. To the extent relevant to each jurisdiction, the discussion deals with:

- (1) Third Party Funding generally;
- (2) Third Party Funding in relation to arbitration;
- (3) the application, if any, of the doctrines of maintenance and champerty; and
- (4) limitations on Third Party Funding arising from the professional and ethical obligations of potential Third Party Funders.

4.10 Our discussion in this Chapter concludes by referring to some relevant cases under the Washington Convention concerning state disputes under investment treaties.

Australia

Overview of Third Party Funding in Australia

4.11 The crimes and torts of maintenance and champerty are of decreasing relevance, and have been abolished in some state jurisdictions.³ Regulation of litigation funding in Australia has evolved piecemeal through the decisions of the courts. The involvement of the Government has been limited to the introduction of legislation to deal with specific issues arising from particular court decisions. As a result, while there is some general regulation provided by consumer protection laws, there is little specific statutory regulations aimed at Third Party Funders of litigation. However, there are ongoing calls for reform, such as the recommendations recently published in

³ Both torts have been abolished in the Australian Capital Territory, New South Wales, South Australia and Victoria, and both crimes have been abolished in New South Wales, South Australia and Victoria. However, their abolition in the latter jurisdictions is expressed to not affect any rule of law where a contract is treated to be contrary to public policy or otherwise illegal.

the Australian Productivity Commission's *Access to Justice Arrangements Report*.⁴

4.12 The current position in Australia is that Third Party Funding of litigation is not prohibited by the common law doctrines of maintenance and champerty. Court rules and procedures are considered sufficiently robust to protect against potential abuses of process arising from such funding arrangements.⁵ Litigation Third Party Funders are not required to provide indemnity for Adverse Costs Orders.⁶ Third Party Funding of litigation schemes are exempted from regulations imposed on "*managed investment schemes*" and "*credit facilities*" and Third Party Funders are not required to hold an AFS Licence.⁷ However, Third Party Funders of both litigation and arbitration must ensure that they have in place adequate processes to manage conflicts of interest.⁸

Judicial approval of litigation funding

4.13 The leading case on Third Party Funding for litigation in Australia is the decision of the High Court in *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd* ("*Fostif*").⁹ The High Court upheld the litigation funding arrangement, by a five to two majority, in a decision that has gained international attention. This decision illustrates the strong divergence of views on the subject expressed in the three separate judgments delivered by the Court.

4.14 *Fostif* involved a class action to recover amounts paid by retailers of tobacco products to wholesalers, representing licence fees that the wholesalers did not pass on to the relevant taxing authority because the High Court held the licence fees to be unconstitutional. A third party, Firmstones, wrote to retailers who may have been eligible to recover the fees, seeking permission to start proceedings on their behalf against the wholesalers. Firmstones proposed to take principal control of the litigation and was to receive 33.3% of the proceeds.¹⁰

4.15 The joint majority judgment of Gummow, Hayne and Crennan JJ (Gleeson CJ agreeing) in *Fostif* confirmed that there was no broad public policy against litigation funding agreements in Australia:

"[89] As Mason P rightly pointed out in the Court of Appeal, many people seek profit from assisting the processes of litigation. That a person who hazards funds in litigation

⁴ Australian Productivity Commission, *Access to Justice Arrangements* (Final Report, 2014), at section 18.2.

⁵ *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd* (2006) 229 CLR 386, at paras 89-93 (*per* Gummow, Hayne and Crennan JJ).

⁶ *Jeffery and Katauskas Pty Ltd v SST Consulting Pty Ltd* (2009) 239 CLR 75, at para 43 (*per* Heydon J).

⁷ Regulations 5C.11.01, 7.1.04N, 7.1.06 and 7.6.01 of the Corporations Regulations 2001 (Cth).

⁸ Regulation 7.6.01AB of the Corporations Regulations 2001 (Cth).

⁹ (2006) 229 CLR 386.

¹⁰ *Fostif* (2006) 229 CLR 386, at para 26 (*per* Gummow, Hayne and Crennan JJ).

wishes to control the litigation is hardly surprising. That someone seeks out those who may have a claim and excites litigation where otherwise there would be none could be condemned as contrary to public policy only if a general rule against the maintenance of actions were to be adopted. But that approach has long since been abandoned and the qualification of that rule (by reference to criteria of common interest) proved unsuccessful. And if the conduct is neither criminal nor tortious, what would be the ultimate foundation for a conclusion not only that maintaining an action (or maintaining an action in return for a share of the proceeds) should be considered as contrary to public policy, but also that the claim that is maintained should not be determined by the court whose jurisdiction otherwise is regularly invoked?

[90] Two kinds of consideration are proffered as founding a rule of public policy – fears about adverse effects on the processes of litigation and fears about the 'fairness' of the bargain struck between funder and intended litigant. In Giles v Thompson, Lord Mustill said that the law of maintenance and champerty could best 'be kept in forward motion' by looking to its origins: these his Lordship saw as reflecting 'a principle of public policy designed to protect the purity of justice and the interests of vulnerable litigants.'

[91] Neither of these considerations, whatever may be their specific application in a particular case, warrants formulation of an overarching rule of public policy that either would, in effect, bar the prosecution of an action where any agreement has been made to provide money to a party to institute or prosecute the litigation in return for a share of the proceeds of the litigation, or would bar the prosecution of some actions according to whether the funding agreement met some standards fixing the nature or degree of control or reward the funder may have under the agreement. To meet these fears by adopting a rule in either form would take too broad an axe to the problems that may be seen to lie behind the fears."

4.16 The majority in *Fostif* also affirmed that the doctrine of abuse of process, coupled with the rules regulating the duties of lawyers to the court, provided sufficient protections against the fears which had historically concerned the common law:

"[93] As for the fears that 'the funder's intervention will be inimical to the due administration of justice', whether because 'the greater the share of the spoils ... the greater the temptation to stray from the path of rectitude' or for

some other reason, it is necessary first to identify what exactly is feared. In particular what exactly is the corruption of the process of the Court that is feared? It was said, in In re Trepca Mines Ltd [No 2], that the common law fears that the champertous maintainer might be tempted, for his own personal gain, to inflame the damages, to suppress the evidence, or even to suborn witnesses. Why is that fear not sufficiently addressed by existing doctrines of abuse of process and other procedural and substantive elements of the court's processes? And if lawyers undertake obligations that may give rise to conflicting duties there is no reason proffered for concluding that present rules regulating lawyers' duties to the court and to clients are insufficient to meet the difficulties that are suggested might arise."

4.17 In a separate concurring judgment in *Fostif*, Kirby J emphasised the importance of ensuring access to justice as a fundamental human right, stating:

"[145] The importance of access to justice, as a fundamental human right which ought to be readily available to all, is clearly a new consideration that stimulates fresh thinking about representative or 'grouped' proceedings. It is this consideration that has informed the decisions of other Australian appellate courts on such questions and also a decision of the Supreme Court of Appeal of South Africa."

4.18 Callinan and Heydon JJ, in a joint dissenting judgment in *Fostif*, were of the view that the following factors, in combination, pointed to the proceedings being an abuse of process, namely that:

- (1) Firmstones' motivation was purely to make a profit;¹¹
- (2) Firmstones sought out and encouraged people to sue who would not otherwise have done so;¹²
- (3) the plaintiff's losses were small,¹³ but Firmstones' potential gain was enormous;¹⁴
- (4) Firmstones had too much control of the litigation;¹⁵
- (5) the litigation was being pursued in such a way that the plaintiffs' interests were subservient to Firmstones';¹⁶

¹¹ *Fostif* (2006) 229 CLR 386, at para 269.

¹² *Fostif* (2006) 229 CLR 386, at paras 270-271.

¹³ *Fostif* (2006) 229 CLR 386, at paras 272-274.

¹⁴ *Fostif* (2006) 229 CLR 386, at paras 275-276.

¹⁵ *Fostif* (2006) 229 CLR 386, at paras 277-280.

¹⁶ *Fostif* (2006) 229 CLR 386, at para 281.

- (6) the plaintiffs' solicitors had only a limited role;¹⁷ and
- (7) Firmstones had a monopoly position, in that any plaintiff who wished to make a claim had to do so on Firmstones' terms.¹⁸

4.19 The minority in *Fostif* considered that the facilitation of access to justice needed to be viewed in light of established principle and ought not to be unduly elevated:

"[256] The importance of not preventing 'humble men' from receiving 'contributions to meet a powerful adversary' has been long recognised, and underlies the exceptions to the common law doctrines of maintenance and champerty. The facilitation of access to justice, however, is not to be treated as having absolute priority over traditional principle."

4.20 The *Fostif* decision confirmed that in Australia, even outside the insolvency context, the funding of litigation by a Third Party Funder is permissible and appropriate, provided that the involvement of the Third Party Funder does not give rise to any material risk of abuse of the court's process. It is also notable that *Fostif* goes further than any other decision to date in recognising, if not giving its implicit approval to, a significant degree of control over the legal proceedings by the Third Party Funder, at least in the context of representative proceedings.

4.21 The Australian courts have also recognised the benefits of external litigation funding in the context of costs and efficiency, even in circumstances where the claimant is not impecunious such that the policy considerations in favour of access to justice are not invoked. Although decided before *Fostif*, such that there was a greater emphasis on the question of control than there may have been post *Fostif*, in *QPSX Ltd v Ericsson Australia Pty Ltd (No 3) ("QPSX Limited")*,¹⁹ French J (then of the Federal Court, now Chief Justice of the High Court of Australia) upheld a Third Party Funding agreement entered into by a plaintiff who was alleging breaches of a licensing agreement and misleading conduct relating to the licensing and use of patent rights in technology used in telecommunications. French J described the plaintiffs as "*substantial commercial enterprises experienced in entering into co-funding arrangements around the world*",²⁰ such that they were unlikely to tolerate any compromise of their interests by the Third Party Funder in pursuit of its own.

4.22 In the following passages in *QPSX Limited*, French J identified additional policy considerations in favour of external litigation funding and recognised that the involvement of external funders "*may inject a welcome element of commercial objectivity into the way in which budgets are framed*

¹⁷ *Fostif* (2006) 229 CLR 386, at para 282.

¹⁸ *Fostif* (2006) 229 CLR 386, at para 283.

¹⁹ (2005) 219 ALR 1.

²⁰ *QPSX Limited* (2005) 219 ALR 1, at 3.

and the efficiency with which the litigation is conducted",²¹ provided there is no risk of abuse of process:

"[54] The considerations relevant to the range of acceptable litigation funding arrangements today go beyond questions of access to justice for the ordinary litigant. The present proceedings do not involve ordinary litigants. The parties are sophisticated, well resourced commercial actors operating in domestic and international markets for the sale of complex and potentially very lucrative technologies. Their capacities to exploit those technologies and to enjoy intellectual property rights associated with them, whether as the creators of those rights or as their collectors under assignment or license, are important elements of their participation in the relevant markets. There is no doubt that the cost of litigation in relation to such rights can be very high. Even when conducted as efficiently as it can be with the aid of skilled advisers and technical experts, it is time consuming and expensive. The development of arrangements under which the cost risk of complex commercial litigation can be spread is at least arguably an economic benefit if it supports the enforcement of legitimate claims. Where such arrangements involve the creation of budgets by funders knowledgeable in the costs of litigation it may inject a welcome element of commercial objectivity into the way in which such budgets are framed and the efficiency with which the litigation is conducted. The formulation of a budget limiting the amount of funding provided is, of course, different from the assumption by the funder of control of the conduct of the litigation. The Court is in no position to pass definitive judgments on questions of the overall economic benefits to be derived from legitimate litigation funding arrangements. But the development of modern funding services in commercial litigation may be seen as indicative of a need in the market place to which those developments are legitimate responses. It is not for the Court to judge them as contrary to the public interest unless it can be shown that a particular arrangement threatens to compromise the integrity of the Court's processes in some way.

[55] The public policy concerns associated with handing over the conduct of litigation to a non-party, whether by assignment or other means, remain. For the assumption of control by a non-party raises the possibility that decisions may be made affecting the conduct of the

²¹ QPSX Limited (2005) 219 ALR 1, at 14.

litigation which serve the interests of the funder in a way that is incompatible with the interests of the funded party and the legitimate purposes for which the litigation is to be prosecuted or defended."

Orders for costs and Security for Costs

4.23 The Australian courts have recognised that Third Party Funding gives rise to questions as to orders for:

- (1) Security for Costs against Third Party Funders; and
- (2) the payment by Third Party Funders of Adverse Costs Orders made against Funded Parties.

4.24 On the question of Security for Costs, two out of the three judges sitting on a New South Wales Court of Appeal bench in *Green (as liquidator of Arimco Mining Pty Ltd) v CGU Insurance Ltd*²² expressed the view that the involvement of a non-party who stands to benefit from the litigation "*is a matter that favours an order for security.*"²³ However, the majority of the Court of Appeal accepted that the exercise of the court's discretion to order security in such circumstances would depend very much on the facts of the case.

4.25 In *The Australian Derivatives Exchange Ltd v Doubell*,²⁴ it was said of the purpose of security for costs in this context that:

"[13] The main purpose of the power to order security for costs is to ensure that lack of success by a plaintiff does not visit injustice upon a defendant who would, in that event, expect to have an order that the plaintiff pay the defendant's costs. The power is discretionary. Security, if granted, serves the purpose of providing to the defendant a measure of assurance that, having been brought to court by the plaintiff and having successfully resisted the plaintiff's claim, the defendant will have some means of recovering costs awarded to the defendant.

[14] Central to any decision to award security for costs, therefore, is a conclusion reached by the court that the prospects that the defendant, if successful, will enjoy the fruits of a costs order against the plaintiff are somehow in jeopardy.

²² (2008) 67 ACSR 105.

²³ *Green (as liquidator of Arimco Mining Pty Ltd) v CGU Insurance Ltd* [2008] NSWCA 148, at para 53 (*per* Hodgson JA), para 86 (*per* Campbell JA), para 76-81 (*per* Basten JA, who expressed the view that the fact a litigation funder expects to profit from the litigation may be of limited relevance).

²⁴ [2008] NSWSC 1174.

[15] *If, in the present case, those prospects centred on the personal financial capacity of the liquidator, the court would reach such a conclusion.... But an added dimension comes from the litigation funding agreement.*²⁵

4.26 In *The Australian Derivatives Exchange Ltd v Doubell*, the litigation funding agreement provided the liquidator with a full indemnity against any Adverse Costs Order. The Court was satisfied that, subject to the liquidator providing appropriate undertakings to: (1) inform the defendants if the funding agreement was terminated (so that they may renew their application for Security for Costs); and (2) pursue the recovery from the funder in the event that the funder did not willingly pay any Adverse Costs Order, Security for Costs would not be ordered at that point in the proceedings, relying on the nature and terms of the indemnity contained in the funding agreement.²⁶

4.27 The question whether the absence of an indemnity from a litigation funder to pay adverse costs constituted an abuse of process was considered by the High Court of Australia in *Jeffery and Katauskas Pty Ltd v SST Consulting Pty Ltd*.²⁷ The relevant court procedural rules then in effect provided that the court could not, in the exercise of its statutory power to make costs orders in its discretion, make any order for costs against a person who is not a party, subject to an exception where the non-party had committed an abuse of process.²⁸ In a joint majority judgment, French CJ, Gummow, Hayne and Crennan JJ concluded that there was no such abuse of process of the court and held that there is no general proposition that those who fund another's litigation must place the party funded in a position to meet any adverse order for costs:

"[43] The proposition that those who fund another's litigation must put the party funded in a position to meet any adverse costs order is too broad a proposition to be accepted. As stated, the proposition would apply to shareholders who support a company's claim, relatives who support an individual plaintiff's claim and banks who extend overdraft accommodation to a corporate plaintiff. But not only is the proposition too broad, it has a more fundamental difficulty. It has no doctrinal root. It seeks to take general principles about abuse of process (and in particular the notion of 'unfairness'), fasten upon a particular characteristic of the funding arrangement now in question, and describe the consequence of that arrangement as 'unfair' to the defendant because provisions and principles about security for costs have

²⁵ *The Australian Derivatives Exchange Ltd v Doubell* [2008] NSWSC 1174, at paras 13-15 (per Barrett J).

²⁶ *The Australian Derivatives Exchange Ltd v Doubell* [2008] NSWSC 1174, at para 23-25 (per Barrett J).

²⁷ (2009) 239 CLR 75.

²⁸ Rule 42.3 of the Uniform Civil Procedure Rules 2005 (NSW) (since repealed).

been engaged in the case in a particular way and the rules will not permit the ordering of costs against the funder unless the principles of abuse of process are engaged. For the reasons stated earlier, that proposition is circular. And to point to the particular feature of a funding arrangement that the funder is to receive a benefit in the form of a success fee or otherwise, adds nothing to the proposition that would break that circularity of reasoning or otherwise support the conclusion that there is an abuse of process."

4.28 In *Jeffery and Katauskas Pty Ltd v SST Consulting Pty Ltd*, Heydon J (who was also in dissent in *Fostif*) delivered another dissenting judgment in which he expressed the view that a Third Party Funder who does not provide an indemnity to the plaintiff for Adverse Costs Order commits an abuse of process. Although the judgment of Heydon J does not represent the law of Australia, it is cited below to demonstrate the range of senior judicial opinions on the subject of third party litigation funding and its practical implementation:

"[111] The court's procedure exists primarily to serve the function of enabling rights to be vindicated rather than profits to be made. Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd recognised that it was legitimate for third parties having no prior concern with the subject of the litigation to fund that litigation in return for profit, but it dealt only with circumstances where the funder had indemnified the plaintiffs against their liability for costs to defendants in a manner that would be practically effective. Those circumstances do not exist here. The authorities, scattered and directed to other questions though they generally are, evince a repugnance for third party litigation funding of the type which leaves defendants at risk of not being able to enforce costs orders in their favour. As a matter of fairness and justice, the successful party to litigation is ordinarily entitled to an order for costs in its favour. To the extent that that order is not complied with, the successful party will have been treated unfairly and unjustly.

[112] It is true that not every unfair and unjust outcome signifies an abuse of process. But the unfair and unjust outcome of these proceedings for the defendant was generated by an abuse of process: the maintaining of litigation a primary purpose of which was the gaining of a very large 'success fee' for the funder without any effective indemnity from the funder for the plaintiff's liability to the defendant.

[113] The funder's 'success fee' was on one view more than double the sum advanced and on another more than treble

that sum. If viewed as interest on a loan to support proceedings conducted with proper expedition, it would be extortionate to a degree, beyond the dreams of the greediest usurer. If charged by a lawyer, it would cause that lawyer to be barred from practice. It is an abuse of process, in several senses, for a non-party funder to fund the plaintiff's prosecution of proceedings in which the funder has that kind of financial interest without giving a practically effective indemnity to the plaintiff against its liability to the defendant for costs in the event that the plaintiff loses. It is manifestly and grossly unfair and unjust to the defendant. It is seriously burdensome, prejudicial and damaging to the defendant. It is productive of serious and unjustified trouble and harassment: for it caused the defendant to be vexed by baseless proceedings without being indemnified against the costs of demonstrating their baselessness. It is 'unjustifiably oppressive' to the defendant. If the funder's conduct in this case became an institutionalised practice in the administration of justice, it would be an institutionalised practice by which injustice is constantly and inevitably caused. An institutionalised practice of that kind would bring the administration of justice into disrepute. Bringing the administration of justice into disrepute is a touchstone of abuse of process. The funder was telling the defendant:

'[Y]ou have no choice about whether to play this game; we are going to provide the means to start and continue it; if our side wins, you pay us; but if you win we will not pay you.'

The funder wished to take the chance of financial gain by backing a horse to win without being responsible for paying a component of the sum wagered if the horse lost. The funder wanted to obtain insurance monies without paying a key part of the premium. The funder wanted the palm without much of the dust. A funder who funds litigation instituted by an impecunious plaintiff for the purpose of large personal profit without giving an indemnity to that plaintiff against its liability for the defendant's costs in a manner which will protect the defendant is, in the light of our forensic mores and standards, a funder who commits an abuse of process."

4.29 The relevant court procedural rules considered in effect when *Jeffery and Katauskas Pty Ltd v SST Consulting Pty Ltd* was decided limiting the award of costs against non-parties to cases of abuse of process (or contempt), have since been repealed as a result of the majority decision. However, the majority judgment led to other proposals for reform directed at

making specific provisions for security for costs to be ordered against third party litigation funders.

4.30 In its December 2012 report,²⁹ the New South Wales Law Reform Commission recommended amendments to the Uniform Civil Procedure Rules 2005 (NSW) applicable in New South Wales, to provide courts with the power to make security for costs orders against litigation funders in terms similar to Rule 25.14 of the Civil Procedure Rules 1998 (UK), known as the "CPR". It appears that this suggested reform has yet to be adopted.³⁰

4.31 Similarly, there is no express power in the Federal Court Rules 2011 (Cth) of the Federal Court of Australia to order security for costs against Third Party Funders of litigation. Among the arguments against such a reform were:

- (1) the absence of evidence of any practical problem requiring legislation;³¹
- (2) the fact that standard litigation funding agreements cover adverse costs orders so that there may be no good reason in most cases to apply for or make orders for security;³² and
- (3) the view that requirements for litigation funders to take responsibility for adverse costs was a matter for industry regulation.³³

4.32 Legislation governing international and domestic arbitrations in Australia makes no specific provision for (1) awards of costs, or (2) orders for security for costs against Third Party Funders.

Government regulation of Third Party Funding in Australia

4.33 Since the Australian High Court's decision in *Fostif*, there have been many calls for regulation of third party litigation funding in Australia, including in the September 2014 Australian Productivity Commission Final Report on *Access to Justice Arrangements*. The Commission's Final Report

²⁹ New South Wales Law Reform Commission, *Security for Costs and Associated Orders*, Report No 137 (2012).

³⁰ Certain other of the Commission's recommendations in their December 2012 report were adopted by the New South Wales Uniform Civil Procedure Rules (Amendment No 61) 2013 (NSW), but the adoption of an equivalent to Rule 25.14 of the CPR was not among the amendments.

³¹ New South Wales Law Reform Commission, *Security for Costs and Associated Orders*, Report No 137, (2012), at para 3.27.

³² New South Wales Law Reform Commission, *Security for Costs and Associated Orders*, Report No 137, (2012), at para 3.27; Australian Productivity Commission, *Access to Justice Arrangements*, Draft Report (2014).

³³ New South Wales Law Reform Commission, *Security for Costs and Associated Orders*, Report No 137, (2012), at para 3.28.

included recommendations on Third Party Funding which are currently under consideration, as we discuss below.

4.34 However, at present there is only limited regulation of Third Party Funding under the federal legislation governing the financial services industry. This legislation requires that Third Party Funders have in place adequate procedures and practices for managing conflict of interest. This position of limited regulation has been adopted in response to particular decisions of the courts.

4.35 In 2009, in *Brookfield Multiplex Ltd v International Litigation Partners Pte Ltd*,³⁴ the Full Court of the Federal Court of Australia held that a litigation funding arrangement in a class action constituted a "*managed investment scheme*" for the purposes of the Corporations Act 2001 (Cth) ("Corporations Act").³⁵ This had the effect, under the Corporations Act, of imposing on Third Party Funders significant disclosure and registration requirements.³⁶

4.36 In *International Litigation Partners Pte Ltd v Chameleon Mining NL*,³⁷ the New South Wales Court of Appeal held that a litigation funding agreement constituted a "*financial product*" for the purposes of the Corporations Act.³⁸ A consequence of this judgment was that litigation funders would have been required to hold an AFS Licence and be subject to regulation by and disclosure obligations to the Australian Securities and Investments Commission.³⁹ Among other things, the Corporations Act provides for rights of rescission in respect of contracts entered into with non-licensees.⁴⁰ As discussed below this judgment was overturned on appeal to the High Court of Australia.

4.37 However, as an immediate reaction to the judgments in *Brookfield Multiplex* and *International Litigation Partners Pte Ltd v Chameleon Mining NL*, pending action by the Federal Parliament, the Australian Securities and Investments Commission made orders, known as "*class orders*", exempting funders from obligations relating to managed investment schemes and from the requirement to hold an AFS Licence.⁴¹ The Federal Parliament followed this by enacting the Corporations Amendment Regulation 2012 (No 6) (Cth) which expressly excludes litigation funding schemes from the definition of "*managed investment scheme*" under the Corporations Act and exempts the

³⁴ (2009) 180 FCR 11.

³⁵ As defined under section 9 of the Corporations Act 2001 (Cth).

³⁶ See Chapter 5C of the Corporations Act 2001 (Cth).

³⁷ (2011) 276 ALR 138.

³⁸ As defined under Section 763A(1)(b) of the Corporations Act 2001 (Cth).

³⁹ See generally Parts 7.6–7.9 of the Corporations Act 2001 (Cth).

⁴⁰ See sections 924A and 925A of the Corporations Act 2001 (Cth).

⁴¹ See Australian Securities and Investments Commission, *ASIC Class Order – Funded representative proceedings and funded proof of debt arrangements*, CO 10/333, 11 January 2013; Australian Securities and Investments Commission, *ASIC Class Order – Variation*, CO 11/555, 23 June 2011.

Third Party Funders from the requirement to hold an AFS Licence.⁴² Instead, Third Party Funders were simply required to establish adequate processes and procedures to manage conflict of interest.⁴³

4.38 In the *Explanatory Statement to the Amendment Regulation* which explained the Corporations Amendment Regulation 2012 (No 6) (Cth), it was observed that the effect of the *Brookfield Multiplex* decision was to impose a wide range of requirements, on Third Party Funders and arrangements, which the Government considered were "*not appropriate*" for litigation funding schemes.⁴⁴ It was said that the Government "*supports*" litigation funding as it can:

"provide access to justice for a large number of consumers who may otherwise have difficulties in resolving disputes" and

"[t]he Government's main objective is therefore to ensure that consumers do not lose this important means of obtaining access to the justice system."⁴⁵

4.39 Subsequently, the *International Litigation Partners Pte Ltd v Chameleon Mining NL* case was overturned by the High Court on appeal⁴⁶ on the ground that the litigation funding arrangements were held to constitute a "*credit facility*" as opposed to a "*financial product*", and as such were covered by Australia's regime for consumer credit regulation.⁴⁷

4.40 The High Court's decision in *International Litigation Partners Pte Ltd v Chameleon Mining NL* led to a further class order from the Australian Securities and Investments Commission,⁴⁸ and to the Federal Parliament enacting the Corporations Amendment Regulation 2012 (No 6) (Cth), which expressly classified litigation funding schemes and arrangements as exempted "*financial products*", and not "*credit facilities*" (but maintained the requirements that litigation funders have in place adequate practices for managing conflict of interest).⁴⁹ Regulation 5C.11.01 of the Corporations Regulations 2001 (Cth) defines a "*litigation funding arrangement*" broadly so that regulations would apply to Third Party Funding for arbitrations as well as court litigation.

⁴² See Corporations Amendment Regulation 2012 (No 6) (Cth), which amended Regulations 5C.11.01, 7.6.01 and 7.6.01AB of the Corporations Regulations 2001 (Cth).

⁴³ See Regulation 7.6.01AB of the Corporations Regulations 2001 (Cth).

⁴⁴ Explanatory Statement, Corporations Amendment Regulation 2012 (No 6) (Cth).

⁴⁵ Explanatory Statement, Corporations Amendment Regulation 2012 (No 6) (Cth).

⁴⁶ *International Litigation Partners Pte Ltd v Chameleon Mining NL* (Receivers and Managers Appointed) (2012) 246 CLR 455.

⁴⁷ Section 765A(1)(h)(i) of the Corporations Act 2001 (Cth) provided that a "*credit facility*", as defined by Regulation 7.1.06(3) of the Corporations Regulations 2001 (Cth), is excluded from the definition of "*financial product*".

⁴⁸ See Australian Securities and Investment Commission, ASIC Class Order – Funded representative proceedings and funded proof of debt arrangements exclusion from the National Consumer Credit Protection Act 2009, CO 13/18, 10 July 2014 whereby it was declared that a litigation funding arrangement was excluded from the application of the National Credit Code.

⁴⁹ Regulations 7.1.04N, 7.1.06, 7.6.01AB of the Corporations Regulations 2001 (Cth).

4.41 Calls for further reform continued, and are supported by one of the executive directors of a major Australian listed Third Party Funder, who recently nominated four priority areas for reform, namely, "*capital adequacy, strict separation of funders from clients' lawyers, transparency in court, and full disclosure to clients*".⁵⁰

4.42 In April 2014, the Australian Productivity Commission published a Draft Report on *Access to Justice Arrangements*. The Draft Report followed an extensive public consultation process whereby the Productivity Commission undertook a 15-month inquiry into Australia's system of civil dispute resolution.⁵¹ The Productivity Commission's terms of reference included examining alternative mechanisms to improve access to justice, including private funding for litigation.

4.43 In September 2014, the Productivity Commission published a Final Report on *Access to Justice Arrangements*. The Productivity Commission recognised that "*overall funding provides benefits*"⁵² and recommended that Third Party Funders should be licenced to ensure capital adequacy:

"The Australian Government should establish a licence for third party litigation funding companies designed to ensure they hold adequate capital relative to their financial obligations and systems for managing risks and conflicts of interest.

- *Regulation of the ethical conduct of litigation funders should remain a function of the courts.*
- *The licence should require litigation funders to be members of the Financial Ombudsman Scheme.*
- *Where there are any remaining concerns relating to categories of funded actions, such as securities class actions, these should be addressed directly, through amendments to underlying laws, rather than through any further restrictions on litigation funding.*⁵³

4.44 The Productivity Commission considered a number of issues that had been raised in submissions from the public, one of which concerned whether Third Party Funding promotes unmeritorious claims. The Productivity Commission concluded that "*given the small proportion of additional actions (less than one per cent) and the relatively low number of*

⁵⁰ Jennifer Ball, "Clear regulation needed for litigation funding", *Australian Financial Review* (25 October 2013), <http://www.afr.com/p/national/legal_affairs/clear_regulation_needed_for_litigation_phBISxTNE CIUD1L1IVB7DK>.

⁵¹ The Productivity Commission received more than 300 public submissions.

⁵² Australian Productivity Commission, *Access to Justice Arrangements*, Final Report (2014), at 623.

⁵³ Australian Productivity Commission, *Access to Justice Arrangements*, Final Report (2014), at 633.

securities class actions in Australia, there is a risk that the spectre of actions, rather than evidence, is driving policy debate."⁵⁴

4.45 In response to submissions that Third Party Funders could potentially take advantage of clients, the Productivity Commission observed that "*court oversight provides some assurance to clients of litigation funders*". Specifically, courts have the power to order that funding agreements be rewritten and tend to make more frequent and higher security for costs orders when Third Party Funders are involved in litigation.⁵⁵

4.46 A related recommendation made by the Productivity Commission was that restrictions on Contingency Fees by lawyers in the form of damages-based billing should be removed, but that such fees should be subject to disclosure requirements and a cap based on a sliding scale.⁵⁶ It was also recommended that court rules be amended to ensure that the power to award costs against non-parties in the interests of justice and obligations to disclose funding agreements apply equally to lawyers charging damages-based fees and litigation funders.⁵⁷

4.47 In addition to receiving the attention of the Productivity Commission, Third Party Funding for litigation has been flagged for review by the current Attorney-General, George Brandis. This has caused at least one Third Party Funder in Australia to reconsider its approach. In February 2014, Claims Funding Australia withdrew an application to the Federal Court for approval of a funding agreement. The lawyers involved in the case, Maurice Blackburn, commented that:

*"The new Commonwealth Attorney-General [George Brandis] has plainly stated he is proposing to introduce further regulation of litigation funding and that he is strongly opposed to litigation funding companies, that are owned by the principals of law firms, funding lawsuits in which the firm represents the claimants. In these circumstances it seems likely that even if Court approval were obtained the co-funding arrangement will be prohibited by regulation."*⁵⁸

4.48 Had the funding agreement been approved, it would have allowed Claims Funding Australia to fund a class action run by Maurice Blackburn. Claims Funding Australia is a related entity of Maurice Blackburn; the firm's principals are all beneficiaries of the discretionary trust formed to set up Claims Funding Australia. Approval of the funding agreement would have,

⁵⁴ Australian Productivity Commission, *Access to Justice Arrangements*, Final Report (2014), at 621.

⁵⁵ Australian Productivity Commission, *Access to Justice Arrangements*, Final Report (2014), at 630.

⁵⁶ Australian Productivity Commission, *Access to Justice Arrangements*, Final Report (2014), at 629.

⁵⁷ Australian Productivity Commission, *Access to Justice Arrangements*, Final Report (2014), at 637.

⁵⁸ Australian Productivity Commission, *Access to Justice Arrangements*, Draft Report (2014), at 543.

in effect, circumvented the current prohibition on Australian lawyers charging contingency fees, since the principals of Maurice Blackburn would have been in a position to benefit from any success fee received by Claims Funding Australia.⁵⁹

4.49 In May 2014, Attorney-General George Brandis announced that he was convening an advisory panel to examine the litigation funding industry, amidst concerns over opportunistic litigation. The Attorney-General indicated that the panel was to focus on plaintiff law firms running class actions and financing those claims through their own funding vehicles. However, the work of this panel has apparently been put on hold pending the release of the Productivity Commission's *Final Report into Access to Justice Arrangements*.⁶⁰

4.50 On 26 November 2014, Ferguson JA held in *Bolitho v Banksia Securities Ltd (No 4)*⁶¹ (a judgment of the Victorian Supreme Court) that the solicitor and senior counsel for the plaintiff should be restrained from acting as each had a significant connection with the company funding the litigation. The plaintiff's solicitor controlled a self-managed superannuation fund and another company with a 45% interest in the litigation funder, and was also secretary of the litigation funder. The wife of the senior counsel controlled a company that held a 45% interest in the company. Hence, each lawyer stood to gain from any success fee received by the litigation funder. The situation impermissibly circumvented the ban on lawyers charging Contingency Fees and affected "*the proper administration of justice, including the appearance of justice.*"

England and Wales

Overview of Third Party Funding

4.51 The current position in England and Wales is that the litigation funding industry is self-regulated through the Association of Litigation Funders, known as the ALF. As in Australia, courts consider that Third Party Funding is not contrary to the doctrines of maintenance and champerty, and that the judicial system is strong enough to withstand the potential for abuse of process posed by funding arrangements.⁶² Litigation funding has attracted significant attention from law reform bodies as a means of improving access to justice. So far the Parliament has refrained from introducing statutory regulation, over concern that regulations might inhibit growth of the nascent funding industry.

⁵⁹ Australian Productivity Commission, *Access to Justice Arrangements*, Draft Report (2014), at 542-543.

⁶⁰ Marianna Papadakis, "Class action advisory panel on hold", *The Financial Review* (29 August 2014), <http://www.afr.com/p/national/legal_affairs/class_action_advisory_panel_on_hold_uhP4lqEmDq6NvzFQCDZzIL>. The Productivity Commission's Final Report into Access to Justice Arrangements was released on 3 December 2014.

⁶¹ [2014] VSC 582.

⁶² See, for example, *Giles v Thompson* [1994] 1 AC 142, at 153 (*per* Lord Mustil).

However, the Parliament has indicated that statutory regulations will be revisited, if and when, Third Party Funding of litigation expands.⁶³

4.52 The ALF system of regulation is set out in the ALF Code. Some of the main features of the ALF Code are capital adequacy requirements, limitations on the withdrawal of funding during litigation, and limitations on the Third Party Funder's ability to influence litigation. The ALF has complaint procedures in place, under which sanctions can be imposed. However, the main force of industry self-regulation is intended to come from the market credibility to be gained by Third Party Funders who comply with the code.

Judicial approval of litigation funding

4.53 Notwithstanding that the doctrines of maintenance and champerty developed in England and Wales some 700 hundred years ago and were regularly applied, as early as 1886, the Privy Council in *Ram Coomar Coondoo v Chunder Canto Mookerjee*⁶⁴ recognised that champertous agreements which were fair and promoted access to justice ought not to be regarded as being *per se* contrary to public policy, subject to the important proviso:

"that agreements of this kind ought to be carefully watched, and when found to be extortionate and unconscionable, so as to be inequitable against the party; or to be made not with the bona fide object of assisting a claim believed to be just, and of obtaining a reasonable recompense therefore, but for improper objects, as for the purpose of gambling in litigation, or of injuring or oppressing others by abetting and encouraging unrighteous suits, so as to be contrary to public policy – effect ought not to be given to them."

4.54 Maintenance and champerty were abolished as crimes and torts in England and Wales in 1967. These changes, introduced by section 13 of the Criminal Law Act 1967 (UK), followed recommendations made by the Law Commission for England and Wales in its 1966 report on *Proposals for Reform of the Law relating to Maintenance and Champerty*.⁶⁵ In recommending the abolition of maintenance and champerty as torts, the Law Commission considered how litigants often rely on the financial assistance of a wide variety of third parties, including trade unions, insurance agencies and legal aid. The Law Commission concluded that:

⁶³ *Parliamentary Debates*, United Kingdom House of Lords, 1 February 2012, Column 1596 (Lord Davies of Stamford).

⁶⁴ [1876] 2 App Cas 186, at 210.

⁶⁵ Law Commission for England and Wales, *Proposals for the Reform of the Law Relating to Maintenance and Champerty*, Report No 7 (1966). Maintenance and champerty were also abolished as crimes and torts in Northern Ireland pursuant to the Criminal Justice (Miscellaneous Provisions) Act (Northern Ireland) 1968.

*"[t]he truth is that today the great bulk of litigation which engages our courts is maintained from the sources of others, including the state, who have no direct interest in its outcome but who are regarded by society as being fully justified in maintaining it."*⁶⁶

4.55 The Law Commission considered that there remained a role for these doctrines in protecting against certain types of agreements. By section 14 of the Criminal Law Act 1967 (UK), the Parliament preserved the law as it related to "*cases in which a contract is to be treated as contrary to public policy or otherwise illegal.*" The effect of this is that an arrangement under which a third party agrees to fund litigation in return for a share in any award of damages may still be found invalid if it offends the prohibition on champerty.

4.56 However, changing public policy means that the scope of champerty has been progressively narrowed. There has been an increasing concern with overcoming barriers preventing access to justice, including the prohibitive costs of litigation.⁶⁷ Legislation has been implemented in England and Wales to permit Conditional Fee agreements⁶⁸ and damages-based agreements between lawyers and their clients as a means of expanding access to the courts.⁶⁹ In the circumstances, the approach of older English cases to the application of the doctrines of maintenance and champerty need to be treated with caution.⁷⁰

4.57 Increasingly, English courts have inclined to the view that the modern judicial system is strong enough to withstand the risk of abuse of process against which the doctrines of maintenance and champerty were designed to protect. In 1994, in the judgment handed down in *Giles v Thompson*,⁷¹ Lord Mustill (with whom the other Law Lords agreed in a House of Lords judgment) explained this shift as follows:

*"As the centuries passed the courts became stronger, their mechanisms more consistent and their participants more self-reliant. Abuses could be more easily detected and forestalled, and litigation more easily determined in accordance with the demands of justice, without recourse to separate proceedings against those who trafficked in litigation."*⁷²

4.58 In 2003, the English Court of Appeal in *R (Factortame) Ltd v Secretary of State for Transport, Local Government and the Regions (No 8)*⁷³ ("*Factortame*") held that an agreement pursuant to which a third party agreed to fund litigation would not be automatically struck down as offending public

⁶⁶ Law Commission for England and Wales, *Proposals for the Reform of the Law Relating to Maintenance and Champerty*, Report No 7 (1966), at 5.

⁶⁷ Lord Woolf, *Access to Justice*, Interim Report (1995); Lord Wolf, *Access to Justice*, Final Report (1996).

⁶⁸ Section 58 of the Courts and Legal Services Act 1990 (UK).

⁶⁹ Damages-Based Agreements Regulations 2013 (UK).

⁷⁰ *Trendtex Trading Corporation v Credit Suisse* [1982] AC 679 (HL), at 702-703 (*per* Lord Roskill).
⁷¹ [1994] 1 AC 142.

⁷² *Giles v Thompson* [1994] 1 AC 142, at 153.

⁷³ [2003] QB 381 (CA).

policy. The Court stated that whether such an agreement was champertous would depend upon the particular circumstances. The Court confirmed that maintenance and champerty must be kept under review as public policy changes. Phillips LJ, delivering the judgment for the Court (Robert Walker and Clarke LJJ agreeing) said:

*"Where the law expressly restricts the circumstances in which agreements in support of litigation are lawful, this provides a powerful indication of the limits of public policy in analogous situations. Where this is not the case, then we believe one must today look at the facts of the particular case and consider whether those facts suggest that the agreement in question might tempt the allegedly champertous maintainer for his personal gain to inflame the damages, to suppress evidence, to suborn witnesses or otherwise to undermine the ends of justice."*⁷⁴

Thus the Court of Appeal in *Factortame* confirmed that, in each case, it is necessary to look at the agreement under attack to see whether it conflicts with existing public policy that is directed to protecting the due administration of justice with particular regard to the interests of the defendant.⁷⁵

4.59 In 2004, Lord Phillips MR in *Gulf Azov Shipping Co Ltd v Idisi*⁷⁶ stated that:

*"Public policy now recognises that it is desirable, in order to facilitate access to justice, that third parties should provide assistance designed to ensure that those who are involved in litigation have the benefit of legal representation."*⁷⁷

4.60 In 2005, in *Arkin v Borchard Lines Ltd* ("*Arkin*"),⁷⁸ the English Court of Appeal confirmed that maintenance and champerty would no longer prevent litigants in the non-insolvency context from obtaining funding to pursue litigation.⁷⁹ The factual background concerned a plaintiff without his own funds to pay for his case. He was, however, able to pursue his litigation claims because of the financial support provided by a Third Party Funder. The Third Party Funding agreement provided that the Third Party Funder would receive 25% of the first £5million awarded, and 23% of any additional amount. The plaintiff's claims failed and the defendants incurred substantial costs in their successful defence of the claims. The issue was whether the Third Party Funder was liable to pay those costs. The Court of Appeal

⁷⁴ *R (Factortame) Ltd v Secretary of State for Transport, Local Government and the Regions* (No 8) [2003] QB 381 (CA), at para 36.

⁷⁵ *R (Factortame) Ltd v Secretary of State for Transport, Local Government and the Regions* (No 8) [2003] QB 381 (CA), at para 44.

⁷⁶ [2004] EWCA Civ 292 (CA).

⁷⁷ [2005] 1 WLR 3055 (CA), at para 34 (*per* Lord Phillips MR).

⁷⁸ *Arkin v Borchard Lines Ltd* [2005] 1 WLR 3055 (CA).

⁷⁹ *Per* Lord Phillips MR Brooke and Dyson LJJ.

accepted that Third Party Funding of litigation was permissible in the interests of ensuring access to justice. However, the Court held that:

*"a professional funder, who finances part of a claimant's costs of litigation, should be potentially liable for the costs of the opposing party to the extent of the funding provided."*⁸⁰

4.61 In 2008, Coulson J provided a summary of the current state of the English law regarding Third Party Funding, in *London & Regional (St George's Court) Ltd v Ministry of Defence*:⁸¹

- "(a) the mere fact that litigation services have been provided in return for a promise in the share of the proceeds is not by itself sufficient to justify that promise being held to be unenforceable: see R (Factortame) Ltd v Secretary of State for Transport (No. 8) [2003] QB 381;*
- (b) in considering whether an agreement is unlawful on grounds of maintenance and champerty, the question is whether the agreement has a tendency to corrupt public justice and that such a question requires the closest attention to the nature and surrounding circumstance of a particular agreement: see Giles v Thompson;*
- (c) the modern authorities demonstrated a flexible approach where courts have generally declined to hold that an agreement under which a party provided assistance with litigation in return for a share of the proceeds was unenforceable; see, for example, Papera Traders Co Ltd v Hyundai (Merchant) Marine Co Ltd (No 2) [2002] 2 Lloyd's Rep 692;*
- (d) the rules against champerty, so far as they have survived, are primarily concerned with the protection of the integrity of the litigation process in this jurisdiction: see Papera."*

Law reform recommendations regarding litigation funding

4.62 Throughout the 1990s, the issue of the prohibitive costs of litigation and its impact on access to justice was of considerable concern to the United Kingdom Parliament and law reform bodies. One commentator observed that:

"... the transaction costs associated with the legal system exceed the merits of the dispute by a factor of two to one. This absolutely extraordinary level of expenditures means that the legal system is simply too expensive, too inefficient and too

⁸⁰ *Arkin v Borchard Lines Ltd* [2005] 1 WLR 3055 (CA), at para 41 (per Lord Phillips MR).

⁸¹ [2008] EWHC 526 (TCC), at para 103, following Underhill J in *Mansell v Robinson* [2007] EWHC 101 (QB).

sclerotic to provide a meaningful forum for dispute resolution in the commonplace social interactions that fall within the confines of tort, contract and property."⁸²

4.63 Concern over the increasing expense and inefficiency of the England and Wales justice system lead to a series of reports being produced by the Lord Chancellor's Department,⁸³ under the direction of Lord Woolf MR, addressing factors such as the lack of judicial control of proceedings, excessive use of adversarial tactics and the inadequacy of the legal aid system. These led to the establishment of the Civil Justice Council (charged with keeping civil justice under review), the introduction of the CPR, and the passing of the Access to Justice Act 1999 (UK), which reformed the legal aid system in England and Wales.

4.64 In 2005, the Civil Justice Council (established as part of the access to justice reforms in the late 1990s) published a report entitled *Improved Access to Justice – Funding Options and Proportionate Costs*. It was recommended that:

"Building on the judgment of the Court of Appeal in 'Arkin' further consideration should be given to the use of third party funding as a last resort means of providing access to justice."⁸⁴

4.65 Following consultations and discussions, the Civil Justice Council published another report in 2007, entitled *The Future Funding of Litigation – Alternative Funding Structures*, where it was recommended that:

"Properly regulated Third Party Funding should be recognised as an acceptable option for mainstream litigation. Rules of Court should also be developed to ensure effective controls over the conduct of litigation where third parties provide the funding."⁸⁵

4.66 In 2008, a further separate review from those undertaken by the Civil Justice Council was begun by Lord Justice Jackson. In the Jackson Report published in 2010, Jackson LJ considered what the appropriate form of regulation should be for the emerging litigation funding industry in the UK:

⁸² Samuel Issacharoff, "Too Much Lawyering, Too Little Law" in Zuckerman and Cranston (eds), *Reform of Civil Procedure - Essays on Access to Justice* (Oxford University Press, 1995), at 245-246.

⁸³ Lord Woolf, *Access to Justice*, Interim Report (1995); Lord Wolf, *Access to Justice*, Final Report (1996); Lord Chancellor's Department, *Modernising Justice: The Government's Plans for Reforming Legal Services and Courts* (Command Paper No 4155, 1998). For current and past reforms of the civil litigation system and costs of litigation see "Civil Justice Council Advisory Bodies", *Courts and Tribunals Judiciary UK*, <<http://www.judiciary.gov.uk/about-the-judiciary/advisory-bodies/cjc>>.

⁸⁴ Michael Napier CBE QC et al, *Improved Access to Justice – Funding Options & Proportionate Costs, Report & Recommendations* (Civil Justice Council, Aug 2005), Recommendation 13, at 12.

⁸⁵ Michael Napier CBE QC et al, *Improved Access to Justice – Funding Options & Proportionate Costs, The Future Funding of Litigation – Alternative Funding Structures* (Civil Justice Council, June 2007), Recommendation 3, at 12.

"I accept that [Third Party Funding] is still nascent in England and Wales and that in the first instance what is required is a satisfactory voluntary code, to which all litigation funders subscribe. At the present time, parties who use TPF are generally commercial or similar enterprises with access to full legal advice. In the future, however, if the use of TPF expands, then full statutory regulation may well be required, as envisaged by the law society."⁸⁶

4.67 Jackson LJ went on to make three recommendations with respect to any voluntary code:

"A satisfactory voluntary code, to which all litigation funders subscribe, should be drawn up. This code should contain effective capital adequacy requirements and should place appropriate restrictions upon funder's ability to withdraw support for ongoing litigation.

The question of whether there should be statutory regulation of third party funders by the FSA ought to be re-visited if and when the TPF market expands.

Third party funders should potentially be liable for the full amount of adverse costs, subject to the discretion of the judge."⁸⁷

Orders for costs and Security for Costs

Court's powers to make costs orders against third parties

4.68 The power of the UK Courts to make non-party cost orders in England under the Senior Courts Act 1981 (UK) and Rule 45.2 of the CPR is clear.⁸⁸

4.69 Whilst such a costs order by a court against third parties has been described as "exceptional",⁸⁹ as explained by the Privy Council in *Dymocks Franchise Systems (NSW) Pty Ltd v Todd*:⁹⁰

"exceptional in this context means no more than outside the ordinary run of cases where parties pursue or defend claims for their own benefit and at their own expense. The ultimate question in any such 'exceptional case' is whether in all the circumstances it is just to make the order."

⁸⁶ Lord Justice Jackson, *Review of Civil Litigation Costs*, Final Report (2009), at 119, para 2.4.

⁸⁷ Lord Justice Jackson, *Review of Civil Litigation Costs*, Final Report (2009), at 124, para 6.1.

⁸⁸ Formerly Rule 48.2 of the CPR.

⁸⁹ See *Symphony Group Plc v Hodgson* [1994] QB 179 (CA).

⁹⁰ [2004] 1 WLR 2807.

Third party funder's liability for costs orders

4.70 Of the recommendations as to costs in the Jackson Report, the third departed from the approach to costs advocated by the court in *Arkin* described above. This departure was a response to submissions made by the London Law Society's Litigation Committee and the Commercial Litigation Association that were critical of the decision in *Arkin*. Accepting these submissions, Jackson LJ stated that, contrary to *Arkin*:

*"[t]here is no evidence that full liability for adverse costs would stifle Third Party Funding or inhibit access to justice."*⁹¹

4.71 Jackson LJ referred to the Australian position on Third Party Funding to support the above proposition and further stated 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."*⁹²

4.72 On 23 October 2014, Clarke LJ handed down a judgment in *Excalibur Ventures LLC v Texas Keystone Inc*⁹³ ("*Excalibur 2014*") in which he dealt with applications made by the defendants (Texas Keystone Inc and Gulf Keystone Petroleum Ltd) that the Third Party Funders to Excalibur Ventures should be jointly and severally liable for the indemnity costs order made against Excalibur Ventures in 2013 (discussed below). The background is that the Court had dismissed a US\$1.6 billion claim brought by Excalibur Ventures funded by several Third Party Funders. Excalibur Ventures had brought claims of US\$1.6 billion against Texas Keystone Inc and Gulf Keystone Petroleum Ltd as the defendants concerning rights to exploit and develop petroleum fields in Kurdistan. The High Court dismissed the claim, and found that Excalibur Ventures and its counsel had acted inappropriately by (among other ways): bringing claims without a sound foundation in fact or law; running an unnecessarily long trial; grossly exaggerating the amount of the claim; and acting in an aggressive way towards the other side by sending an unnecessarily large quantity of correspondence to it.

4.73 In *Excalibur 2014*, Clarke LJ held that the Third Party Funders should be liable for the indemnity costs order, but only in accordance with the principle laid down in *Arkin* - that the Third Party Funders should only be liable for adverse/indemnity costs up to the amount of the funding they had provided:

"In short, in a case of this kind, justice requires that, when the case fails so comprehensively, not merely on the facts but because it was wholly bad in law, the funder should, subject to the Arkin cap, bear the costs ordered to be paid by the person

⁹¹ Lord Justice Jackson, *Review of Civil Litigation Costs*, Final Report (2009), at 123, para 4.5.

⁹² Lord Justice Jackson, *Review of Civil Litigation Costs*, Final Report (2009), at 123, para 4.6.

⁹³ [2014] EWHC 3436 (Comm).

whom or which he has unsuccessfully supported, assessed on the scale which the court thinks it just for that person to pay in light of all the circumstances, including but not limited to that person's behaviour and that of those whom that person engaged. In short, he should, absent special circumstances, follow the fortunes of those from whom he himself hoped to derive a small fortune."⁹⁴

4.74 This judgment reinforces the acceptance of the *Arkin* cap on Third Party Funder costs by the English courts. However, in an interesting development, Clarke LJ held that it was not necessary to prove "control" or "influence" of the Third Party Funders on the party being funded for the Third Party Funder to also be liable for the Funded Party's adverse costs. Instead, the provision of funding itself satisfied the requirement of "causation"⁹⁵ for an order to be made against a Third Party Funder:

*"Each tranche of funding was something but for which the action would not have continued and an effective cause of that continuance, which caused the Defendants to continue to incur costs. It is not necessary to show that the funder was personally responsible for the circumstances that led to indemnity costs in the sense of knowing the claim was bad, authorising disproportionate expenditure and the like."*⁹⁶

Court's powers to make Security for Costs orders against Third Party Funders

4.75 In 2013, the CPR were amended by Rule 24.14 to allow for security for costs orders against Third Party Funders. A review of the case law suggests that this rule had been infrequently invoked.

4.76 In *Reeves v Sprecher*,⁹⁷ Sir Donald Rattee recognised the Court's power to order disclosure of the identity and address of a Third Party Funder to facilitate an application for security for costs under Rule 24.14 of the CPR. His Lordship was not, however, prepared to order disclosure of the funding agreement itself.⁹⁸

⁹⁴ *Excalibur Ventures LLC v Texas Keystone Inc* [2014] EWHC 3426 (Comm), at para 110 (per Clarke LJ).

⁹⁵ *Excalibur Ventures LLC v Texas Keystone Inc* [2014] EWHC 3426 (Comm), at para 141 (per Clarke LJ), referring to Simon Brown LJ's judgment in *Hamilton v Al Fayed* [2003] QB 1175, at para 54 ("... proof of causation is a necessary pre-condition of the making of section 51 order against a non-party ...").

⁹⁶ *Excalibur Ventures LLC v Texas Keystone Inc* [2014] EWHC 3426 (Comm), at para 148 (per Clarke LJ).

⁹⁷ [2009] 1 Costs LR 1.

⁹⁸ Law reform debate directed at the question whether there should be transparency of funding arrangements in litigation and arbitration is not addressed in this paper. Any consideration of the topic should, however, take account of a line of Australian authority to the effect that funding agreements, or parts thereof, may be subject to valid claims for legal professional privilege. See, for example, *Green in his capacity as liquidator of Arimco Mining Pty Ltd (in liq) v CGU Insurance Ltd* [2008] NSWSC 390; *Re Global Medical Imaging Management Ltd (in liq)* [2001] NSWSC 476; *Rickard Constructions Pty Ltd v Rickard Hails Moretti Pty Ltd* [2006] NSWSC 234; *Fiduciary Ltd v Morningstar Research Pty Ltd* (2004) 208 ALR 564.

4.77 In 2013, in *Excalibur Ventures LLC v Texas Keystone Inc*⁹⁹ ("*Excalibur 2013*"), Clarke LJ considered an application for Security for Costs against the unsuccessful plaintiff who had received Third Party Funding, and also the power of the Court to join Third Party Funders to such proceedings.

4.78 In *Excalibur 2013* the Court awarded significant costs against Excalibur Ventures on an indemnity basis (meaning that the costs awarded do not have to be proportionate to the matters in issue). The defendants sought Security for Costs against Excalibur Ventures and sought a further order that if Excalibur Ventures failed to provide Security for Costs within 14 days, the defendants should be allowed to seek costs against the Third Party Funders directly.¹⁰⁰ The Court agreed that the defendants were entitled to protection against inability to recover costs. The Court ordered that if security was not paid within 14 days, the defendants could join the Third Party Funders to the proceedings and, if necessary, serve the proceedings out of the jurisdiction. The effect of these orders was that if Excalibur Ventures had assets, then the defendants could seek Security for Costs against these. However, if Excalibur Ventures did not have assets, then the Third Party Funders would face a claim that they should have to pay costs. The additional costs were not paid into court, and Clarke LJ later gave leave to join the Third Party Funders to the proceedings in respect of the costs' issues.¹⁰¹

Costs and Security for Costs in arbitration in the UK

4.79 With respect to the UK position on costs and Security for Costs in arbitration, the Arbitration Act 1996 (UK) provides in section 61(1) that a Tribunal may make an Award allocating the costs of the arbitration "*as between the parties, subject to any agreement between the parties.*" Similarly, a Tribunal's statutory power to order Security for Costs under section 38 appears to restrict its power to order Security for Costs of the arbitration (in the absence of contrary agreement between the parties) to orders against a "*claimant*" which would extend to counterclaimant.¹⁰²

Industry regulation

4.80 The result of the reform program in England is that there is no governmental regulation of litigation and arbitration funders by the Financial Services Authority or otherwise. At present, a regime of industry self-regulation is being developed.

⁹⁹ [2013] EWHC 2767 (Comm).

¹⁰⁰ Clarke LJ said in *Excalibur Ventures LLC v Texas Keystone Inc* [2013] EWHC 4278 (Comm), at paras 73-74, that the defendant sought "*an order that Excalibur [the plaintiff] should provide further security for its costs in that amount within 14 days. It also seeks an order that, unless security for that sum is put up within that time limit, leave should be given to join the Funders to the proceedings for the purpose of seeking a non-party costs order against them.*"

¹⁰¹ *Excalibur Ventures LLC v Texas Keystone Inc* [2014] EWHC 3436 (Comm).

¹⁰² This is consistent with the current position under Section 56 of the Arbitration Ordinance.

4.81 The ALF has been formed and is intended to provide industry body regulation, although membership is not compulsory. The ALF subscribes to the ALF Code developed by the Civil Justice Council and launched in November 2011, which made clear at paragraph 2 that it is intended to apply to funding for arbitration as well as litigation. In January 2014 a revised version of the ALF Code was published on the ALF website.

4.82 The main features of the ALF Code are:

- (1) capital adequacy requirements;
- (2) limitations on the withdrawal of funding during litigation; and
- (3) limitations on the funder's ability to influence litigation.

The capital adequacy provisions require, among other things, that a litigation funder maintain adequate financial resources to allow it to cover aggregate funding liabilities for a minimum period of 36 months.¹⁰³

4.83 According to the ALF website, the ALF is established:

*"... to oversee the adherence by its members to the provisions of the Code of Conduct. It aims to ensure that the legal and ethical standards set out in the Code of Conduct are respected by all of its members and a funder will only be approved as a member of the ALF if they can demonstrate they comply with the Code of Conduct."*¹⁰⁴

4.84 Membership in the ALF is contingent upon the adoption and adherence to the ALF Code.¹⁰⁵ In 2013, the ALF adopted a complaints procedure under which sanctions on its members for breach of the ALF Code can be imposed. However, the ALF considers that the main regulatory effect of the ALF Code concerns the reputational impact of compliance and non-compliance upon Third Party Funders, as suggested by the following statement on the ALF website:

*"The members of the ALF will have to abide by the Code of Conduct if they want to have credibility in this industry and maintain their membership of the ALF. Claimants and practitioners alike are urged to work only with those funders who are approved members of the ALF."*¹⁰⁶

4.85 As referred to above, in January 2014, the ALF published a revised ALF Code. It has retained the main features of the 2011 ALF Code,

¹⁰³ Rule 9.4.1.2 of the ALF Code.

¹⁰⁴ "About us", Association of Litigation Funders (2014), <<http://associationoflitigationfunders.com/about-us/>>.

¹⁰⁵ Rule 1 of the ALF Code as well as Rule 6.1 of the Rules of the Association of Litigation Funders of England and Wales.

¹⁰⁶ "About Us", Association of Litigation Funders (2014), <<http://associationoflitigationfunders.com/about-us/>>.

although there have been some changes to the numbering of regulations. The 2014 ALF Code has introduced several significant additional regulations:

- (1) extension of the 2011 ALF Code to cover Subsidiaries and Associated Entities of ALF Members (Rules 2.1, 2.2, 14);
- (2) a regulation explicitly stating that ALF members undertake to be responsible to the ALF for compliance with the ALF Code (Rule 4);
- (3) a regulation explicitly stating that the ALF maintains a complaints procedure for breaches of the ALF Code (Rule 15);
- (4) requirement for ALF Members to have access to a minimum of £2m capital (Rule 9.4.2);
- (5) continuous disclosure obligations in respect of capital adequacy (Rule 9.4.3); and
- (6) annual auditing requirements for ALF members (Rule 9.4.4).

4.86 In mid February 2014, allegations emerged that Centaur Litigation SPC, an entity associated with then ALF member, Argentum Capital Limited, was an offshore Ponzi scheme.¹⁰⁷ Following investigations by the Board of the ALF, Argentum offered to withdraw from ALF membership, which the Board accepted. In a statement released on its website, the ALF emphasised that since Argentum was no longer a member of the ALF:

*"... the important protections that are available to counterparties who deal with ALF members are no longer available to those who deal with Argentum in the future."*¹⁰⁸

4.87 In the UK, industry self-regulation through the voluntary ALF Code by Third Party Funders has come under some criticism. In February 2012, during the House of Lords debate on the Legal Aid, Sentencing and Punishment of Offenders Bill 2012 (by which the Jackson reforms were to be introduced), an amendment was moved to introduce provisions for statutory regulation of litigation funders to replace the then three months old voluntary ALF Code (the "Proposed TPF Amendment").¹⁰⁹ The Proposed TPF Amendment was to the effect that a litigation funding agreement would be enforceable only if it complied with the terms of the proposed provision, which included "*such requirements as shall be prescribed by the Lord Chancellor.*" The amendment also provided that such regulations may:

¹⁰⁷ Ben Butler, "Ponzi scheme claims against litigation funder of equine class action", *Sydney Morning Herald* (2014), <<http://www.smh.com.au/business/ponzi-scheme-claims-against-litigation-funder-of-equine-class-action-20140221-337my.html>>.

¹⁰⁸ "Notice Regarding Argentum Capital Limited", Association of Litigation Funders (2014), <<http://associationoflitigationfunders.com/2014/04/notice-regarding-argentum-capital-limited/>>.

¹⁰⁹ United Kingdom, *Parliamentary Debates*, House of Lords, 1 February 2012, Columns 1585-1586 (Lord Thomas of Gresford).

"require any person which enters into a TPF agreement with a litigant to first obtain a license from a licensing body to be designated by the Lord Chancellor, and set out conditions to be satisfied in order to obtain such a license."

4.88 The Proposed TPF Amendment was withdrawn at the request of Lord McNally who repeated the sentiments expressed in the Jackson Report that statutory regulation would need to be revisited *"if and when third-party funding expanded."*¹¹⁰

4.89 The 2012 debate in the House of Lords indicates that alongside support for Third Party Funding as a means of improving access to justice, there remains a degree of concern about the extent of regulation, which may lead in the future to the introduction of statutory regulation of Third Party Funding in England and Wales.

France

Third Party Funding generally

4.90 Despite the development in Third Party Funded litigation in France, no legislation governs it, nor is there case law that directly deals with the subject. Third Party Funders of litigation also provide funding for arbitrations.¹¹¹ Professional funders for international arbitration proceedings are said to be increasingly active in France, with two French Third Party Funders recently established.¹¹² Practitioners in the jurisdiction have opined that the relatively low uptake of Third Party Funding in France in the past might be due to several factors. First, French litigation is relatively inexpensive. Second, punitive damages are not allowed, presumably rendering the investment less attractive to Third Party Funders. Third, from the point of ethical professional restrictions, pure Contingency Fees (discussed in greater detail below) are not allowed. Fourth, either the state provides sufficiently comprehensive legal aid assistance, or litigants might have their legal costs covered by insurance.¹¹³

4.91 The validity of Third Party Funding under French law can be inferred from one case of *Foris AG v SA Veolia Propreté (formerly SA Onyx)* [2006]; at this point it appears that mainly ethical concerns for lawyers are raised by Third Party Funders.¹¹⁴ In *Foris AG*, the French courts were asked to enforce an agreement for Third Party Funding by a German fund. A lower

¹¹⁰ United Kingdom, *Parliamentary Debates*, House of Lords, 1 February 2012, Column 1596 (Lord Davies of Stamford).

¹¹¹ See, for example, *Cases we fund*, Alter Litigation <<http://www.alterlitigation.com/#cases-we-fund>>.

¹¹² "France - International Arbitration 2014", *International comparative Legal Guides* (2014), <<http://www.iclg.co.uk/practice-areas/international-arbitration-/international-arbitration-2014/france>>.

¹¹³ Antoine Adeline and Laure Perrin, Third-party funding of arbitration in France', *Lexology* (2013), <<http://www.lexology.com/library/detail.aspx?g=b1bdb7c6-82fc-4423-aaa3-a3c76720ccc9>>.

¹¹⁴ "Country Summary: France", *Harbour Litigation Funding* (2014), <<http://www.harbourlitigationfunding.com/funding-map/FR>>.

French court enforced the agreement but the decision was quashed by the Versailles Court of Appeal for lack of jurisdiction. The Court of Appeal noted that such agreements are "*sui generis and unknown in the European Union except in countries with a Germanic legal culture*".¹¹⁵ For this reason, the question of validity was not addressed by the Court. However, there did not seem to be any question of the validity of the agreement put before the lower court, the Court of Appeal is dealt only with the jurisdictions issue.

Ethical considerations

4.92 The following ethical rules that may become of concern in France appear to only be applicable to French lawyers. It has been observed that foreign lawyers representing a client in international arbitration proceedings in France would not be subject to such rules and regulations.¹¹⁶

4.93 While there is no ethical rule that forbids French lawyers from acting in funded litigation two main ethical concerns arise. First, French lawyers are required to be independent and loyal to their clients rather than a Third Party Funder. Second, French lawyers must either abstain from giving legal advice, or withdraw from a case, if they are unable to identify the client or if a conflict of interest occurs. It is conceivable that Third Party Funding agreements could require a French lawyer to act in accordance with such duties.¹¹⁷

4.94 Furthermore, two particular ethical rules must be complied with in France. First, is a prohibition on pure Contingency Fee arrangements where a French lawyer provides funding, pursuant to Article 10 of the Act No. 71-1130 of Dec 31 1971. The second is pursuant to Article 11.3 of the French National Bar Regulation that provides that "*the lawyer can receive payment of his fees only from his client or someone granted power of attorney by the latter*".¹¹⁸ It has been suggested that provided these two ethical rules are complied with, then no issue should arise with Third Party Funding agreements. Thus, one article by practitioners in France summarising the French position concluded that there were no restrictions, legislative or otherwise, suggesting Third Party Funding arrangements were invalid, and noted that it did not seem the validity of such arrangements to fund international arbitrations would be at issue.¹¹⁹

¹¹⁵ "Third-party funding: snapshots from around the globe", *Global Arbitration Review* (2011), <http://www.imf.com.au/docs/default-source/site-documents/gar_vol7_iss1>, at 28.

¹¹⁶ Antoine Adeline and Laure Perrin, "Third-party funding of arbitration in France", *Lexology* (2014), <<http://www.lexology.com/library/detail.aspx?g=b1bdb7c6-82fc-4423-aaa3-a3c76720ccc9>>.

¹¹⁷ "Third-party funding: snapshots from around the globe", *Global Arbitration Review* (2011), <http://www.imf.com.au/docs/default-source/site-documents/gar_vol7_iss1>, at 28.

¹¹⁸ "Third-party funding: snapshots from around the globe", *Global Arbitration Review* (2011), <http://www.imf.com.au/docs/default-source/site-documents/gar_vol7_iss1>, at 28.

¹¹⁹ Philip Dunham and Samantha Nataf, "Case Notes on Third-Party Funding" (2008) 3(1) *Global Arbitration Review* 36 http://www.lalive.ch/data/publications/Third_Party_Funding.pdf, at 36.

4.95 It seems likely that ethical rules are more flexible in international arbitrations on the basis of a 1992 decision of the Paris Court of Appeal concerning a member of the Paris bar who attempted to enforce a pure contingency arrangement. The Court noted that while such arrangements are unenforceable in France, they would be enforceable in an international arbitration to which parties had consented, as:

*"this form of retribution of a lawyer by his client is recognised by the international trade usages ... [and] admitted in many countries with different legal systems."*¹²⁰

Germany

Third Party Funding generally

4.96 It appears in Germany that Third Party Funding is an unregulated market that has been active since the late 1990s (primarily in litigation).¹²¹ On the whole, there are no restrictions on Third Party Funders,¹²² save that a Third Party Funder may not offer legal advice to their client, arising from the general restriction on Contingency Fees found in section 49b(2) of the Federal Lawyer's Act (*Bundesrechtsanwaltsordnung, BGBl. I, 565, 1959*).¹²³

4.97 Contingency agreements are only permitted in Germany on a limited basis under the term of "*speculative funding*", or "*Erfolgshonorar*", although such agreements are uncommon.¹²⁴ The permission for these speculative funding agreements was brought about by a decision of the German Constitutional Court,¹²⁵ triggering amendments to the Lawyers' Fees Act ("*Rechtsanwaltsvergütungsgesetz*"),¹²⁶ to relieve claimants who, on the one hand have financial limitations in pursuing claims, yet on the other hand do not meet the requisite threshold for legal aid.¹²⁷ Counterbalancing this change, the Germany Federal Lawyers' Act was revised so that lawyers were explicitly banned from "*comprehensive funding agreements*" in respect of the lawyers' own fees (although the ban is limited in that it does not cover costs of

¹²⁰ "Third-party funding: snapshots from around the globe", *Global Arbitration Review* (2011), <http://www.imf.com.au/docs/default-source/site-documents/gar_vol7_iss1>, at 28.

¹²¹ "Third-party funding: snapshots from around the globe", *Global Arbitration Review* (2011) <http://www.imf.com.au/docs/default-source/site-documents/gar_vol7_iss1>, at 29.

¹²² Eckart Brödermann, Tina Denso and York Zieren, "Lexology Navigator Q&A: Arbitration – Germany" (2014)

<<http://www.lexology.com/library/detail.aspx?g=162711b2-03b9-49b4-801a-a866fff89346>>

¹²³ Translation and analysis of the German statute by Cornelia Emmert, "Contingency Fees in Germany" *German American Law Journal* <<http://www.amlaw.us/emmert1.shtml>>.

¹²⁴ Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 7.02 at 163.

¹²⁵ *Bundesverfassungsgericht*, judgment dated Dec. 12, 2006 (1 BvR 2576/04).

¹²⁶ Being the introduction of section 4a to the Lawyers' Fees Act.

¹²⁷ Lord Justice Jackson, *Review of Civil Litigation Costs*, Preliminary Report (2009), 558 and 559 para 2.9; "Germany – International Arbitration 2014", *International Comparative Legal Guides* (2014), <http://www.iclg.co.uk/practice-areas/international-arbitration-international-arbitration-2014/germany>>

the opposing side nor court costs).¹²⁸ Agreements for "*uplifts*" of lawyers' fees were also allowed, with the caveat that such agreements still adhere to the statutory fees mandated in legislation.¹²⁹

4.98 Germany has, since the 1990s, developed significant case law regarding Third Party Funding. German courts have developed Third Party Funding practice by reference to:

- (1) the concept of usury, which prohibits loans at abusive interest rates; and
- (2) existing ethical rules, in particular the principle according to which only attorneys are authorised to give legal advice.

The court-imposed limitations caused Third Party Funders to reduce their interest in the Award and limit their involvement in the litigation being funded.¹³⁰

4.99 A 2011 study by the Soldan Institut of Third Party Funding commenced by the German Bar Association and published in its monthly journal *Anwaltsblatt* in March 2012, illustrates the nature of the German Third Party Funding market. Based on empirical findings from its survey, the Institut found that:

*"82% of lawyers had not submitted one single matter to a litigation funder for potential funding. Of the minority who had dealt with funders, 8% had submitted one matter during the two year period, 6% had submitted two matters, and only 4% has submitted three or more. The survey further revealed that about 25% of claims submitted for evaluation did get funding. Lawyers who classified themselves as specialized had a higher ratio of proposals to litigation funders, namely 19%, whereas only 13% of general practitioners had made such proposals."*¹³¹

4.100 It seems from the German Bar Association research that there has been a low level of utilisation of Third Party Funding in Germany.¹³² Notwithstanding this, there are estimated to be approximately ten Third Party

¹²⁸ General Federal Lawyers' Act section 49b(2); see Lord Justice Jackson, *Review of Civil Litigation Costs*, Preliminary Report (2009), 558 and 559 para 2.9.

¹²⁹ Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 7.02 at 163.

¹³⁰ Maxi Scherer and Aren Goldsmith, "Third Party Funding in International Arbitration Proceedings – A View from Europe: Part II: The Legal Debate" (2012) 6 *International Business Law Journal* 649, at 649 and 661.

¹³¹ Peter Bert, "Litigation Funding — Some Empirical Findings", *Dispute Resolution in Germany* (2012), <http://www.disputeresolutiongermany.com/2012/04/litigation-funding-some-empirical-findings/>.

¹³² German Bar Association, "Anwaltsblatt" (March 2012), at 244; see also Lord Justice Jackson, *Review of Civil Litigation Costs*, Preliminary Report (2009), 559 para 2.11 and 564 Table 55.2 which makes a comparison between the statistics for Third Party Funding arrangements for Germany and England & Wales.

Funders offering Third Party Funding in Germany, with UK and United States funders also seeking to offer Funding.¹³³

4.101 It seems that the prevailing view of the nature of the Third Party Funding agreements in Germany is that they are a form of partnership ("*Gesellschaft*") between the Funded Party and the Third Party Funder. It has been noted that as a result of the capacity for accurate prediction of costs, risk is lowered, making the market attractive for Third Party Funding.¹³⁴

4.102 Practically speaking, Third Party Funding agreements are normally entered into by the claimant (as opposed to the defendant, given that there is no profit for the Third Party Funder in a pure defence, although the defendant might enter into such agreement if it is to finance a counterclaim), and is usually used to fund actions for performance.¹³⁵ To a lesser extent, such agreements might be entered into in actions for declaratory judgment, but only where such declarations would result in something of monetary value, such as declaring regular maintenance or a state of ownership.¹³⁶ Further, depending on the individual case, the Third Party Funder in a Third Party Funding agreement normally assumes the risk for the first hearing of the case, excluding the possibility of financing an appeal.¹³⁷ Termination rights are usually specifically addressed in the Third Party Funding agreement. The contractual provisions will allow termination in certain circumstances – they might provide for termination rights to arise, for example, where fresh developments in the factual circumstances have drastically reduced the viability of the claim.¹³⁸ The exercise of termination rights is not necessarily the end of the relationship, as various obligations might arise depending on the progress of the claim post-termination. The claimant might continue the claim with his own money. If so, and if he is both successful and awarded the costs of pursuing his claim, having previously been a Funded Party, he will have to compensate the Third Party Funder for the costs incurred by the Third Party Funder prior to termination of the Third Party Funding agreement. This prevents a windfall situation of the claimant benefitting from the Third Party Funder's Funds and at the same time reaping the costs paid by the defendant on the costs order.¹³⁹

¹³³ Peter Bert, "Third-Party Litigation Funding: Movements in the German Marketplace", *Dispute Resolution in Germany* (2011) <<http://www.disputeresolutiongermany.com/2011/12/third-party-litigation-funding-movements-in-the-german-marketplace/>>.

¹³⁴ Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 7.02 at 163.

¹³⁵ Michael Coester and Dagobert Nitzsche, "Alternative Ways to Finance a Lawsuit in Germany" (2005) 24 (Jan) *Civil Justice Quarterly*, at 88.

¹³⁶ Michael Coester and Dagobert Nitzsche, "Alternative Ways to Finance a Lawsuit in Germany" (2005) 24 (Jan) *Civil Justice Quarterly*, at 88.

¹³⁷ Michael Coester and Dagobert Nitzsche, "Alternative Ways to Finance a Lawsuit in Germany" (2005) 24 (Jan) *Civil Justice Quarterly*, at 88.

¹³⁸ Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 7.03 at 166, citing "Alternative Ways to Finance a Lawsuit in Germany", 49, 91, noting also that it is rare for a funder to terminate the agreement. *Litigation Funding: Status and Issues: Research Report*, 42.

¹³⁹ Michael Coester and Dagobert Nitzsche, "Alternative Ways to Finance a Lawsuit in Germany" (2005) 24 (Jan) *Civil Justice Quarterly*, at 91.

4.103 The Third Party Funding agreement might have contractual terms obliging the Funded Party to accept a settlement which the Third Party Funder is amenable to.¹⁴⁰ Since the Funded Party is the party to the claim, the Third Party Funder cannot, technically, "make" or "force" the Funded Party into settlement with the opposition. However, where there is a contractual provision as aforesaid, the Third Party Funder achieves the same result practically speaking, as the Funded Party has no alternative but to terminate the Third Party Funding agreement if he wishes to pursue the claim without settling.¹⁴¹ On the other end of the spectrum, the Funded Party could be contractually prohibited from: (1) entering into a settlement which does not provide for recovery; (2) settling without the approval of the Third Party Funder; and/or (3) waiving the claim, unless the Funded Party will fully compensate the Third Party Funder on the quantum basis of there being a successful claim.¹⁴²

4.104 Academics have discussed the legal character of a Third Party Funding agreement and the precise legal relationship between the Funded Party and the Third Party Funder. The "*prevailing opinion*"¹⁴³ is that it gives rise to a "*silent partnership*" pursuant to the German Civil Code ("*Stille Gesellschaft bü rgerlichen Rechts*"), which states at section 705, "*By a partnership agreement, the partners mutually put themselves under a duty to promote the achievement of a common purpose in the manner stipulated by the contract, in particular, without limitation, to make the agreed contributions.*"¹⁴⁴ This is categorisation of some importance because it means the personal liability of the partners (ie, the Funded Party and the Third Party) is unlimited.¹⁴⁵

4.105 The rationale is that such a partnership arises out of the pursuit of a joint aim (ie, various litigation goals).¹⁴⁶ The "*silent*" factor of the partnership results partly from the undisclosed nature of the Third Party Funder (in that the claim continues to be asserted, in the claim papers, in the

¹⁴⁰ Michael Coester and Dagobert Nitzsche, "Alternative Ways to Finance a Lawsuit in Germany" (2005) 24 (Jan) *Civil Justice Quarterly*, at 92.

¹⁴¹ See, for example, the contractual conditions ss 6.4, 8.2 and 8.3 of the financing contract provided by FORIS AG (available in German at <www.foris.de>), cited by way of example in Michael Coester and Dagobert Nitzsche, "Alternative Ways to Finance a Lawsuit in Germany" (2005) 24 (Jan) *Civil Justice Quarterly*, at 92. The same article describes the financial consequences in terms of repaying the Third Party Funder.

¹⁴² Michael Coester and Dagobert Nitzsche, "Alternative Ways to Finance a Lawsuit in Germany" (2005) 24 (Jan) *Civil Justice Quarterly*, at 92.

¹⁴³ Dethloff, "Verträge zur Prozessfinanzierung gegen Erfolgsbeteiligung" (2000) NJW (Neue Juristische Wochenschrift) 2227; Creutz, "Rosinenpicker oder Regenmacher--ein Bericht über die Prozessfinanzierung und ihre Anbieter", *Anwaltsreport* 2002, at 10, and Bräuer, "Rechtsanwalt und Prozessfinanzierer" (2001) *AnwBl.* at 112, being the prevailing opinions in German legal literature cited by Michael Coester and Dagobert Nitzsche, "Alternative Ways to Finance a Lawsuit in Germany" (2005) 24 (Jan) *Civil Justice Quarterly*, at 94 and 95.

¹⁴⁴ Paras 705 the *German Civil Code* (BGB), English translation provided at <http://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.html#p0682> accessed 10 Jan 2015.

¹⁴⁵ Michael Coester and Dagobert Nitzsche, "Alternative Ways to Finance a Lawsuit in Germany" (2005) 24 (Jan) *Civil Justice Quarterly*, at 94.

¹⁴⁶ See paras of the *German Civil Code* (BGB), English translation provided at <http://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.html#p0682> accessed 10 January 2015, see also Michael Coester and Dagobert Nitzsche, "Alternative Ways to Finance a Lawsuit in Germany" (2005) 24 (Jan) *Civil Justice Quarterly*, at 94.

name of the Funded Party); partly from fact that there are no jointly owned assets.¹⁴⁷

4.106 There is no obligation in Germany to disclose the existence of a Third Party Funding agreement.¹⁴⁸ There is no provision in German law entitling a party to know that his opponent is a Funded Party, and the lack of disclosure of a Third Party Agreement has not, so far, been considered inconsistent with general duties of litigation, such as the requirements of disclosure under regular litigation and of cooperating with the court.¹⁴⁹

4.107 Additionally, it has been observed that Third Party Funding neither comes within the German regulatory ambit of insurance services, nor that of legal services, nor of financial services (in particular, the funding is not considered a loan), and as such is free from the demands posed by those respective regulators and the restrictions prescribed in the legislative regimes for those services.¹⁵⁰

Third Party Funding in arbitration

4.108 To a limited extent, the costs of legal representation in arbitral proceedings are regulated under German law. Some items on cost scales apply in arbitrations as well as court proceedings. Further, a Tribunal, when fixing the costs of the proceedings, shall take into account the costs accruing to the parties that were necessary in order to appropriately file a request for arbitration proceedings, or to defend against such a request.¹⁵¹

4.109 It was reported that in a roundtable discussion with representatives from Funds active in international arbitration, all of the participants spoke favourably of using German law. German law was seen as protective of funding agreements, in particular against challenges based on the champerty principle. One other funder added that Germany has developed what the funder believed to be an extensive collection of case law

¹⁴⁷ Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 7.03 at 167, citing "Alternative Ways to Finance a Lawsuit in Germany", 49, 95, Michael Coester and Dagobert Nitzsche, "Alternative Ways to Finance a Lawsuit in Germany" (2005) 24 (Jan) *Civil Justice Quarterly*, at 95.

¹⁴⁸ Cornelia Emmert, "Contingency Fees in Germany", *German American Law Journal*, <<http://www.amlaw.us/emmert1.shtml>>.

¹⁴⁹ Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 7.06 at 172, citing Jurgen Veith and Jurgen Grafe, *Der Versicherungsprozess*, (Muchen: Beck 2010) 1538.

¹⁵⁰ Peter Bert, "Third-Party Litigation Funding: Movements in the German Marketplace", <<http://www.disputeresolutiongermany.com/2011/12/third-party-litigation-funding-movements-in-the-german-marketplace/>>; Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 7.06 at 171; Michael Coester and Dagobert Nitzsche, "Alternative Ways to Finance a Lawsuit in Germany" (2005) 24 (Jan) *Civil Justice Quarterly*, at 94 and 95.

¹⁵¹ "Germany – International Arbitration 2014", *International Comparative Legal Guides* (2014), <<http://www.iclg.co.uk/practice-areas/international-arbitration-/international-arbitration-2014/germany/>>.

on Third Party Funding over the years, making its legal regime more predictable.¹⁵²

4.110 Although Third Party Funding in German litigation has been the subject of some discourse in German legal literature,¹⁵³ the same cannot be said of Third Party Funding in the arbitration context, and there are no statistics or figures on this area.¹⁵⁴ Academics, whilst acknowledging the lack of data, have opined that the permissibility of Third Party Funding in litigation renders it apparent that the same is probably equally allowed in arbitration.¹⁵⁵

Ethical considerations

4.111 Ethical considerations are set out in the German Act on the Ethics of the Profession of Lawyers ("*Bundesrechtsanwaltsordnung*") (the "Ethics Act"). The following ethical issues have been described as arising under German law in Third Party Funding arrangements:¹⁵⁶

"(1) A Third Party Funder is not in the same regulatory and legal position as a lawyer, which means that, obviously, the professional constraints of the Ethics Act cannot be expected to govern the conduct of the Third Party Funder. A specific example of the repercussions is that, as already mentioned above, a lawyer (as opposed to a Third Party Funder) is banned from entering into a contingency fee arrangement according to Section 49b(2) of the Ethics Act.¹⁵⁷ The rationale behind this distinction, is that rather than serving as a legal advisor acting (a) in the claimant's best interests as a lawyer does for his client and (b) under the professional expectation of independence of legal services, the Third Party Funder is simply carrying out a commercial assessment as to the viability of the claim, with its own ultimate aim of financial profit to the Third Party Funder.¹⁵⁸

(2) Situations may arise where a lawyer also participates as a profit-sharer in a Third Party Funding enterprise. This arises in the context of partnership or shareholding. The lawyer might

¹⁵² Maxi Scherer and Aren Goldsmith, "Third Party Funding in International Arbitration in Europe: Part 1 – Funders' Perspectives" (2012) (2) 2012 *International Business Law Journal* 207, at 216.

¹⁵³ See for example the numerous articles cited in "Alternative Ways to Finance a Lawsuit in Germany", 49, 91; Michael Coester and Dagobert Nitzsche, "Alternative Ways to Finance a Lawsuit in Germany" (2005) 24 (Jan) *Civil Justice Quarterly*.

¹⁵⁴ Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 7.03 at 168.

¹⁵⁵ Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 7.03 at 168.

¹⁵⁶ For an in-depth discussion on the ethical considerations listed below, see Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 7.06 at 170-172.

¹⁵⁷ Save for the exceptions discussed above.

¹⁵⁸ For an in-depth discussion on the ethical considerations listed below, see Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 7.06 at 170.

have the Third Party Funder finance his clients. The propriety of this sort of situation is highly questionable, as the lawyer has a conflict interest, on the one hand to act in the best interests of the client, and on the other hand, to receive the largest monetary outcome for payment to the Third Party Funder, and therefore to himself.¹⁵⁹ Furthermore, a German lawyer's obligation to maintain his independence and avoid conflicts of interest with that of his client covers not only actual conflicts, but also the perception of such a conflict.¹⁶⁰ Nonetheless, in the normal course of Third Party Funding agreements, the aforesaid issue should not arise, because the Third Party Funder and the lawyer act separately – there is no relationship of authority/subordination between the two. The fact that a referral system is prohibited – the Third Party Funders cannot require the Funded Party to hand over the claim to designated lawyers¹⁶¹ – further avoids an association between the Third Party Funders and the lawyers, whether actual or apparent.

(3) Furthermore, whilst having clearly outlined the distinction between Third Party Funders and lawyers, in reality a blurred line will sometimes exist where it appears unclear whether the Third Party Funders have overstepped into the realm of providing legal advice to the Funded Party or to the intended Funded Party. Clearly this is at odds with the objectives of the regulatory regime for lawyers, which painstakingly seeks to safeguard the propriety of all legal advice given. These concerns were addressed in 2007, by way of a statutory licensing regime under the Legal Services Law open to Third Party Funders if those Third Party Funders were providing legal services. Nonetheless, this does not aid the arbitral context, as the legislation for the regime explicitly does not apply to arbitrations.¹⁶² Still, so long as the Third Party Funder's role is limited to, as described above, carrying out a commercial assessment as to the viability of the claim based on the available evidence, with its own ultimate aim of financial profit to the Third Party Funder, this is not considered stepping beyond their boundary into that of legal services.¹⁶³

¹⁵⁹ Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 7.06 at 170-171, citing "Alternative Ways to Finance a Lawsuit in Germany", 49, 96-99.

¹⁶⁰ "Alternative Ways to Finance a Lawsuit in Germany", 49, 100.

¹⁶¹ Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 7.06 at 172.

¹⁶² Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 7.06 at 171, citing "Gesetz über außergerichtliche Rechtsdienstleistungen" para 1(1) & (3) (12.12.2007).

¹⁶³ Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 7.06 at 171, citing "Alternative Ways to Finance a Lawsuit in Germany", 49, 97-99.

The Netherlands

Third Party Funding generally

4.112 Most commentators state that claim funding is allowed under Dutch law and Contingency Fees are legal under Dutch law,¹⁶⁴ although it appears to be a very low uptake of the concept, with few claimants opting for Third Party Funding.¹⁶⁵ Third Party Funding has been described by some as a "*growing field*", although statistical data was not cited in support of this contention.¹⁶⁶

Third Party Funding in arbitration

4.113 With respect to arbitration, as with litigation, there is also no publicly available statistical data to gauge the popularity of Third Party Funding in that area, but commentators have opined that it being a legitimate source of Funds in litigation should render it equally legitimate in arbitration.¹⁶⁷ Third Party Funders of litigation in the Netherlands also offer arbitration funding.¹⁶⁸ A new Dutch arbitration law was approved by the Dutch Senate in 2014, but does not entail changes to the position of Third Party Funding in arbitration.¹⁶⁹

Ethical considerations

4.114 In the Netherlands, a fixed scale is imposed in terms of the fees that an unsuccessful party can be ordered to pay to the successful party.¹⁷⁰ Whilst Dutch lawyers are not allowed to appear on strict "*no win, no fee*", there are caveats. First, Dutch lawyers can enter into agreements that charge a lower rate on the condition that the lawyer is paid a fair additional fee should the case be successful, alongside a reasonable success fee should the case

¹⁶⁴ "Netherlands - International Arbitration 2014", *International Comparative Legal Guides* (2014), <<http://www.iclg.co.uk/practice-areas/international-arbitration-/international-arbitration-2014/netherlands>>; Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 8.01 at 177; although a different view is espoused in Peter Taylor, Sara Bradstock and Graham Huntley, "At what cost? A Lovells multi jurisdictional guide to litigation costs" (2010), at 127, para 3.1, to the effect that Third Party Funding for claims is not permitted, but the existence of Third Party Funders operating in the Netherlands such as *Omni Bridgeway*, <<http://omnibridgeway.com/litigation-arbitration-funding-and-management/>> suggests otherwise.

¹⁶⁵ Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 8.01 at 177. Note however, that statistical data was not cited in support of this view.

¹⁶⁶ Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 8.01 at 177.

¹⁶⁷ Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 8.01 at 177.

¹⁶⁸ "Litigation and Arbitration Funding and Management", *Omni Bridgeway*, <<http://omnibridgeway.com/litigation-arbitration-funding-and-management/>>.

¹⁶⁹ "The New Dutch Arbitration Law" *Linklaters* <<http://www.linklaters.com/Insights/Pages/New-Dutch-Arbitration-Law.aspx>>.

¹⁷⁰ Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 8.01 at 177.

succeed. Second, and with particular significance for international arbitrations, foreign lawyers appearing in arbitrations will not be bound by the "no win, no fee" prohibition, as the prohibition is in the regulations of the Dutch Bar Association and therefore only applies to local lawyers.¹⁷¹

Sweden

Third Party Funding generally

4.115 Third Party Funding is not prohibited by Swedish law,¹⁷² although it is extremely uncommon¹⁷³ and there are said to be no professional Third Party Funders in Sweden.¹⁷⁴ Contingency fees are not allowed under the regulations of the Swedish Bar Association.¹⁷⁵

Third Party Funding in arbitration

4.116 It has been suggested by academics that by extension of the fact that Third Party Funding is not explicitly prohibited in litigation in Sweden, it would also be allowed in an international arbitration with a connection with Sweden, ie, where such arbitration chooses Sweden as its seat, or where a party seeks to enforce the Award in Sweden.¹⁷⁶

Ethical considerations

4.117 Professional limitations on the lawyers' involvement in Third Party Funding in Sweden include the risk for a conflict of interest to arise between the Funded Party and the Third Party Funder. The Swedish Bar Association will intervene *via* professional ethics regulations where the risk of conflict to arise. As noted above, Swedish lawyers may not enter into

¹⁷¹ Peter Taylor, Sara Bradstock and Graham Huntley, "At what cost? A Lovells multi jurisdictional guide to litigation costs" (2010), at 127, para 3.1; "Netherlands - International Arbitration 2014", *International Comparative Legal Guides* (2014), <<http://www.iclg.co.uk/practice-areas/international-arbitration-/international-arbitration-2014/netherlands>>.

¹⁷² Hans Dahlberg Kolga, Jesper Grünbaum and Johan Strömbäck "Arbitration in Sweden - Lexology Navigator Q&A" (2014) and Peter Eriksson, "*Bird & Bird Commentary*", (Sweden: Oct. 13, 2008), available at <<http://www.lexology.com/library/detail.aspx?g=81f7dd58-9738-46f6-858f-89c04425fd83>>.

¹⁷³ Peter Taylor, Sara Bradstock, Graham Huntley, "At what cost? A Lovells multi jurisdictional guide to litigation costs" (2010), at 164, para 6.3 which describes it as rare, "*if at all existing*". See also "Sweden- International Arbitration 2014".

¹⁷⁴ "Sweden - International Arbitration 2014", *International Comparative Legal Guides* (2014), <<http://www.iclg.co.uk/practice-areas/international-arbitration-/international-arbitration-2014/sweden>>.

¹⁷⁵ "Sweden - International Arbitration 2014", *International Comparative Legal Guides* (2014), <<http://www.iclg.co.uk/practice-areas/international-arbitration-/international-arbitration-2014/sweden>>; and Peter Taylor, Sara Bradstock and Graham Huntley, "At what cost? A Lovells multi jurisdictional guide to litigation costs" (2010), at 163, para 3.1.

¹⁷⁶ Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 11.02 [AA] at 222.

Contingency Fee arrangements. The same ethical regulations mandate that lawyers cannot involve themselves financially in client affairs – examples of such involvement include lending money or charging referral fees, although it is equally obvious that a lawyer is thereby prohibited from providing Third Party Funding to his client.¹⁷⁷ This consideration should not arise in the classic case of Third Party Funding whereby the Third Party Funder is separate from the lawyer.

Switzerland

Third Party Funding generally

4.118 The Swiss Attorneys-at-Law Act and the Professional Rules of the Swiss Bar Association prohibit pure "*no win, no fee*", but a modified version of such agreements to "*no win, less fee*" (ie, charging a fixed legal fee on the outset with the promise of an additional fee should the claim succeed) is allowed.¹⁷⁸ The lawyers are also restricted in terms of the discount they give when arriving at the base fee – they are not allowed to charge a fee that does not even cover the lawyer's own costs.¹⁷⁹

4.119 Switzerland has been described as providing a favourable environment for Third Party Funding. Its use is said to have increased following the Federal Supreme Court's rejection in 2004 of a draft law, proposed by the Cantonal Council of Zurich, which prohibited Third Party Funding. The rejection was based on an argument of disproportionality; specifically, that the legislation would unduly restrict freedom of commerce of litigation funders (who were not, in the first place, affected by the prohibition on Contingency Fees of lawyers).¹⁸⁰

4.120 However, it appears that some common provisions in Third Party Funding agreements have been controversial. These include a Third Party Funder's discretion to refuse to agree to the Funded Party settling, compelling such a party to continue proceedings, and a Third Party Funder's control over the Funded Party's legal representation.¹⁸¹

¹⁷⁷ Peter Eriksson, "Bird & Bird Commentary", (Sweden: Oct 13, 2008), available at <<http://www.lexology.com/library/detail.aspx?g=81f7dd58-9738-46f6-858f-89c04425fd83>>.

¹⁷⁸ "Switzerland - International Arbitration 2014", *International Comparative Legal Guides* (2014) <<http://www.iclg.co.uk/practice-areas/international-arbitration/international-arbitration-2014/switzerland>>.

¹⁷⁹ Peter Taylor, Sara Bradstock and Graham Huntley, "At what cost? A Lovells multi jurisdictional guide to litigation costs" (2010), at 165, para 3.1.

¹⁸⁰ Noradèle Radjai, "Third Party Funding: Snapshots from around the globe" *Global Arbitration Review* (2012) 7(1) at 31. <http://www.imf.com.au/docs/default-source/site-documents/gar_vol7_iss1>; Noradèle Radjai, "Case Notes on Third-Party Funding" (2008) 3(1) *Global Arbitration Review* 36 <http://www.lalive.ch/data/publications/Third_Party_Funding.pdf>, at 37; "Switzerland - International Arbitration 2014" *International Comparative Legal Guides* (2014) <<http://www.iclg.co.uk/practice-areas/international-arbitration/international-arbitration-2014/switzerland>>.

¹⁸¹ *Global Arbitration Review*, "Third-party Funding: Snapshots from Around the Globe" (2011), at 31.

Third Party Funding in arbitration

4.121 Third Party Funding has been successfully utilized in a number of international arbitrations in Switzerland. One such Third Party Funded arbitration particularly demonstrates the multi-jurisdictional nature of these arrangements, being an international arbitration for a dispute between a French party and a Swiss party, administered under the ICC, in which the Funded Party was given the backing of a German Third Party Funder.¹⁸²

European Union

4.122 Given the sometimes multi-jurisdictional nature of these arrangements as demonstrated above, the relevance of regulations pertaining to cross-border litigation activities is of relevance. At the level of the European Union, commentators have stated that "*it appears that the European Commission is developing an interest in the use of [Third Party Funding] for litigation proceedings*".¹⁸³ A recent European Parliamentary Research Service Briefing in 2014 on Investor-State Dispute Settlement, however, commented that:

*"The high costs of arbitration explain to some extent the growing phenomenon of 'third-party funding of claims' By reducing the financial risk for companies, such 'third-party funding' contributes to an increase in 'frivolous cases' for which states still bear full legal costs."*¹⁸⁴

4.123 The Council of Bars and Law Societies of Europe has a Code of Conduct for Lawyers in the European Union which binds all Member States of the Council of Bars and Law Societies of Europe in the conduct of cross-border activities within, *inter alia*, the European Union, the European Economic Area and the Swiss Confederation.¹⁸⁵ Article 3.3 of the Code does not allow "*no win, no fee*" arrangements, the rationale of which is based on the common position that unregulated Contingency Fees are undesirable as they encourage speculative litigation and are open to abuse.¹⁸⁶ However, the

¹⁸² Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 11.02 [BB] at 223.

¹⁸³ Maxi Scherer and Aren Goldsmith, "Third Party Funding in International Arbitration Proceedings – A View from Europe: Part II: The Legal Debate" (2012) 6 *International Business Law Journal* 649, at 649, 654.

¹⁸⁴ Marta Latek, "Investor- State Dispute Settlement (ISDS) State of play and prospects for reform", *European Parliamentary Research Service* (2014), <[http://www.europarl.europa.eu/RegData/bibliotheque/briefing/2014/130710/LDM_BRI\(2014\)130710_REV2_EN.pdf](http://www.europarl.europa.eu/RegData/bibliotheque/briefing/2014/130710/LDM_BRI(2014)130710_REV2_EN.pdf)>.

¹⁸⁵ "Charter of Core Principles of the European Legal Profession and Code of Conduct for European Lawyers" (2013 ed), at 1, available at <http://www.ccbe.eu/fileadmin/user_upload/NTCdocument/EN_CCBE_CoCpdf1_1382973057.pdf>.

¹⁸⁶ Article 3.3.1 provides "*A lawyer shall not be entitled to make a pactum de quota litis*". See the commentary to Article 3.3 in "Charter of Core Principles of the European Legal Profession and Code of Conduct for European Lawyers" (2013 ed), 28, available at

commentary on the Article goes on to state that Conditional Fees which are properly regulated to protect the lawyers' clients are allowed.¹⁸⁷ Article 3.6 of the Code prohibits fee-sharing with non-lawyers, although this provision does not prevent fee sharing which is within an approved form of association.¹⁸⁸ This clearly rules out referral arrangements with Third Party Funders and also prohibits lawyers from participating as profit-sharing stakeholders in Third Party Funding in respect of cases for their own clients. Article 5.4 prohibits referral fees that allow lawyers to make a secret profit.¹⁸⁹

Korea

Third Party Funding generally

4.124 Third Party Funding in arbitration appears to be a new concept in Korea. At a 2013 conference on arbitration held by the International Association of Korean Lawyers, there was reportedly a discussion on the "*possibility of introducing TPF into Korea.*"¹⁹⁰

4.125 Whilst there are no prohibitions against Contingency Fees on the outset in Korean law and regulation,¹⁹¹ a Contingency Fee of an excessive amount can be reduced by the court to a reasonable level, if the amount is found to violate public policy.¹⁹² It has been reported that there is no express

¹⁸⁷ <http://www.ccbe.eu/fileadmin/user_upload/NTCdocument/EN_CCBE_CoCpdf1_1382973057.pdf>; see further Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 7.02, footnote 9 at 163.

See the commentary to Article 3.3 in "Charter of Core Principles of the European Legal Profession and Code of Conduct for European Lawyers" (2013 ed), 28, available at <http://www.ccbe.eu/fileadmin/user_upload/NTCdocument/EN_CCBE_CoCpdf1_1382973057.pdf>; see further Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 7.02, footnote 9 at 163.

¹⁸⁸ Article 3.6.1 provides "A lawyer may not share his or her fees with a person who is not a lawyer except where an association between the lawyer and the other person is permitted by the laws and the professional rules to which the lawyer is subject." See the commentary to Article 3.6 in "Charter of Core Principles of the European Legal Profession and Code of Conduct for European Lawyers" (2013 ed), 29, available at

<http://www.ccbe.eu/fileadmin/user_upload/NTCdocument/EN_CCBE_CoCpdf1_1382973057.pdf>.

¹⁸⁹ Article 5.4.1 provides "A lawyer may not demand or accept from another lawyer or any other person a fee, commission or any other compensation for referring or recommending the lawyer to a client"; and Article 5.4.2 provides "A lawyer may not pay anyone a fee, commission or any other compensation as a consideration for referring a client to him- or herself." See the commentary to Article 5.4 in "Charter of Core Principles of the European Legal Profession and Code of Conduct for European Lawyers" (2013 ed), 31, available at

<http://www.ccbe.eu/fileadmin/user_upload/NTCdocument/EN_CCBE_CoCpdf1_1382973057.pdf>.

¹⁹⁰ "Strategic Considerations and Recent Development in International Arbitration", *2013 IAKL Conference* (2013), <[http://2013iakl.net/mobile/pdf/\[3B_All\]%20ADR_Strategic_Considerations_and_Recent_Developments_in_International_Arbitration.pdf](http://2013iakl.net/mobile/pdf/[3B_All]%20ADR_Strategic_Considerations_and_Recent_Developments_in_International_Arbitration.pdf)>.

¹⁹¹ Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration*, at 234, para 12.02 [H] citing Jae Won Kim, "The Ideal and the Reality of the Korean Legal Profession" (2001) 2 *Asian-Pacific Law & Policy Journal* 45, at para 63.

¹⁹² Yong Suk Yoon, Moon Sung Lee and Sean Sungwoo Lim, "South Korea - Law & Practice", *Legal Practice Guide* (2014), <<http://www.chambersandpartners.com/guide/practice-guides/location/241/6626/1415-200>>.

prohibition against the use of Third Party Funding in Korea¹⁹³; nor is there any prohibition generally against the sharing of proceeds of litigation, save for the one restriction contained in the Attorney At Law Act providing that a lawyer may not be assigned any rights being contested in the litigation.¹⁹⁴

PRC

Third Party Funding generally

4.126 There are no laws or regulations specifically banning Third Party Funding in Mainland China.¹⁹⁵ However, Third Party Funding, whether in litigation or arbitration, appears to be unheard of or extremely rare.¹⁹⁶

4.127 Contingency Fees came under regulation in the 2006 Measures on Lawyers' Fees, although such arrangements had also been used (without being regulated) in some cases before the regulations were put in place. The 2006 Measures on Lawyers' Fees outright prohibited Contingency Fees in certain cases, and also put a ceiling percentage on the amount to be charged for all other cases. Pursuant to this legislation, Contingency Fees are no longer permitted in the following specified categories of cases: collective actions, criminal proceedings, administrative litigation, state compensation, estate, divorce, and social insurance or minimum allowance. As for cases falling out of those four categories, Contingency Fees may be charged, but only up to a maximum of 30% of the proceeds.¹⁹⁷

¹⁹³ Benjamin Hughes, Seungmin Lee and Suh-Young Claire Shin, Shin & Kim, "Litigation and enforcement in South Korea: Overview" *Practical Law* (2012) <<http://us.practicallaw.com/8-381-3681>>.

¹⁹⁴ Benjamin Hughes, Seungmin Lee and Suh-Young Claire Shin, Shin & Kim, "Litigation and enforcement in South Korea: Overview" *Practical Law* (2012) <<http://us.practicallaw.com/8-381-3681>>.

¹⁹⁵ Peter Taylor, Sara Bradstock and Graham Huntley, "At what cost? A Lovells multi jurisdictional guide to litigation costs" (2010), at 53, para 3.1; Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 12.02 [B] at 227.

¹⁹⁶ Nicholas Song and John G Zadkovich, "Arbitration in China – Lexology Navigator Q & A" (2014), <<http://www.lexology.com/library/detail.aspx?g=3b643fc4-dcfc-4558-bf04-6a47cbad4228>>; 'China - International Arbitration 2014', *International Comparative Legal Guides* (2014), <<http://www.iclg.co.uk/practice-areas/international-arbitration-/international-arbitration-2014/china>> which states that "[there] are no 'professional funders' active in the market, either for litigation or arbitration." See also Peter Taylor, Sara Bradstock and Graham Huntley, "At what cost? A Lovells multi jurisdictional guide to litigation costs" (2010), at 54, para 6.3.

¹⁹⁷ Nicholas Song and John G. Zadkovich, "Arbitration in China – Lexology Navigator Q & A" (2014), <http://www.lexology.com/library/detail.aspx?g=3b643fc4-dcfc-4558-bf04-6a47cbad4228>; Christopher Hodges, John Peysner & Angus Nurse, *Litigation Funding: Status and Issues Research Report*, 115, <<http://www.csls.ox.ac.uk/documents/ReportonLitigationFunding.pdf>>. See also Peter Taylor, Sara Bradstock and Graham Huntley, "At what cost? A Lovells multi jurisdictional guide to litigation costs" (2010), at 53 para 3.1, reiterating the 30% cap.

Singapore

Third Party Funding generally

4.128 Singapore law is reported to generally prohibit Third Party Funding.¹⁹⁸ The doctrines of maintenance and champerty are applicable and can give rise to both tortious and criminal liability.

4.129 However, it has been observed that a Singapore Court's foremost concern, when considering the validity of funding agreements, is whether the Third Party Funder has a genuine commercial interest in the litigation. It has been said that where a funding agreement can be shown to come from a party with a genuine commercial interest, rather than the mere sale of a cause of action, and where on the facts there is little risk that the Third Party Funder will influence the action, suppress evidence or inflate damages, the Singapore courts will be more prepared to allow it.¹⁹⁹

4.130 In the 2013 case of *Law Society of Singapore v Kurubalan s/o Manickam Rengaraju*,²⁰⁰ however, the Singapore Court of Appeal imposed a six month suspension from practice on a Singaporean lawyer who had entered into a champertous litigation funding agreement with a client, in breach of the Singapore Legal Profession Act 2009. The defendant was a solicitor who had entered into two agreements with a client, who had suffered a personal injury in an accident in Australia. The client signed an engagement letter with the solicitor's law firm, and concurrently entered into a litigation funding agreement with the solicitor personally. The litigation funding agreement was drafted by the solicitor and provided that the solicitor would pay for the legal fees of the claim in return for a certain percentage of the proceeds depending on the sum obtained. It was stated in the agreement that the solicitor was acting in his own personal capacity and not as an advocate or solicitor of Singapore.

4.131 A Law Society of Singapore Inquiry Committee was convened to hear the matter and found that the solicitor had concurrently acted as a solicitor advocate and as a litigation funder and had therefore breached the Legal Profession Act and the Legal Profession (Professional Conduct) Rules by carrying out legal work pursuant to a champertous agreement. This was found to warrant disciplinary action, the appropriate sanction for which was decided by the Court of Appeal. The court in *The Law Society of Singapore v Kurubalan s/o Manickam Rengaraju*²⁰¹ commented generally (as the point was not necessary to determine the case) that:

"it would be permissible and even honourable for an Advocate and Solicitor to act for an impecunious client in the knowledge

¹⁹⁸ Ministry of Law, Review of the International Arbitration Act: Proposals for Public Consultation, (2011) 5 para 29, <<https://www.mlaw.gov.sg/content/dam/minlaw/corp/assets/documents/linkclickf651.pdf>>.

¹⁹⁹ "Third-party funding: snapshots from around the globe" *Global Arbitration Review* (2011) <http://www.imf.com.au/docs/default-source/site-documents/gar_vol7_iss1> at 30.

²⁰⁰ [2013] SGHC 135.

²⁰¹ [2013] SGHC 135.

*that he would likely only be able to recover his appropriate fees or disbursements if the client were successful in the claim and could pay him out of those proceeds or if there was a costs order obtained against the other side*²⁰² (emphasis in original).

4.132 In *Law Society of Singapore v Kurubalan s/o Manickam Rengaraju*, the court also considered that any reform in this area was the task of the legislature rather than the courts, because any reform would feature carefully drawn parameters that regulated the extent to which such fee arrangements would be permitted, making the task more suited for the legislature rather than the judiciary.²⁰³

Third Party Funding in arbitration

4.133 The Singapore Court of Appeal in the case of *Otech Pakistan Pvt Ltd v Clough Engineering Ltd*²⁰⁴ ("*Otech Pakistan*") ruled that the doctrine of champerty applies to any procedure chosen for the resolution of a claim, including international arbitration. This reasoning comes from the Court's perception that all dispute resolution procedures should be subject to the same public policy rules:

*"In our judgment, it would be artificial to differentiate between litigation and arbitration proceedings and say that champerty applies to the one because it is conducted in a public forum and not to the other because it is conducted in private."*²⁰⁵

4.134 In *Otech Pakistan*, the Court made reference to the Hong Kong case of *Cannonway Consultants Limited v Kenworth Engineering Ltd*²⁰⁶ where Kaplan J observed that the law of champerty did not extend to arbitration. The Court further analysed the reference in *Cannonway* to the *obiter* of Steyn LJ in *Giles v Thompson*, which noted that "*the boundaries of the doctrine might exclude arbitration and were drawn rather narrowly and possibly even anomalously.*" When *Giles* went on appeal to the House of Lords, Lord Mustill stated that "*the law on maintenance and champerty can best be kept in forward motion by looking to its origins as a principle of public policy designed to protect the purity of justice and the interests of vulnerable litigants*",²⁰⁷ but

²⁰² *The Law Society of Singapore v Kurubalan s/o Manickam Rengaraju* [2013] SGHC 135 at para 82; see also commentary of the case by Reynard Chua, "The Future of Champerty in Singapore", *Singapore Law Review* (2013), <<http://www.singaporelawreview.org/2013/10/the-future-of-champerty-in-singapore>>.

²⁰³ The doctrine of part performance, prohibition against champertous agreements and the contextual approach of interpretation of contractual terms - see "Singapore High Court clarifies the application of the doctrine of part performance", *Dispute Resolution Singapore* (2014), at 3. <http://www.bakermckenzie.com/files/Uploads/Documents/Asia%20Pacific/ASEAN/al_singapore_applicationdoctrine_oct13.pdf>.

²⁰⁴ [2007] 1 SLR (R) 989.

²⁰⁵ [2007] 1 SLR (R) 989 at para 38 (*per* Parkash J). See generally, Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 12.02 [K] at 236.

²⁰⁶ [1995] 2 HKLR 475.

²⁰⁷ [1994] 1 AC 142 (HL), at 164 (*per* Lord Mustill).

made no observations as to the doctrine's place in arbitral proceedings as that issue was not before him.

4.135 In *Otech Pakistan*, the Court, adopting Lord Mustill's statement in *Giles v Thompson*, rejected Kaplan J's observation in *Cannonway* that there was a strong inclination amongst English judges not to apply the doctrine of champerty to arbitration, reasoning that "*the purity of justice and the interests of vulnerable litigants are as important in such proceedings as they are in litigation.*"²⁰⁸

4.136 Giving effect to this view, in *Otech Pakistan* the Court adopted the reasoning of Scott VC in *Bevan Ashford v Geoff Yeandle (Contractors) Ltd.*²⁰⁹

*"Arbitration proceedings are a form of litigation. The lis prosecuted in an arbitration will be a lis that could, had the parties preferred, have been prosecuted in court. The law of champerty has its origins in, and must still be based upon, perceptions of the requirements of public policy. I find it quite impossible to discern any difference between court proceedings on the one hand and arbitration proceedings on the other that would cause contingency fee agreements to offend public policy in the former case but not in the latter. In principle and on authority, the law of champerty ought to apply, in my judgment, to arbitration proceedings as it applies to proceedings in court."*²¹⁰

4.137 Accordingly, the Court held in *Otech Pakistan* that it is clear that in Singapore the position is that the "*the principles behind the doctrine of champerty are general principles and must apply to whatever mode of proceedings is chosen for the resolution of a claim.*"²¹¹

4.138 In terms of reform, the Singapore Ministry of Law in its 2011 Review of the International Arbitration Act, sought "*views on whether TPF would be appropriate in the context of international arbitration.*"²¹² It appears that this request for views was prompted by the Jackson Report in the United Kingdom²¹³ which advocated the use of Third Party Funding. The suggested parameters of an exception for TPF in international arbitration (as set out in the Singapore Ministry of Law's *Review of the International Arbitration Act: Proposals for Public Consultation*²¹⁴) are set out below, alongside the rationale for those parameters:

²⁰⁸ [2007] 1 SLR (R) 989, at para 36 (*per* Prakash J).

²⁰⁹ [1999] Ch 239.

²¹⁰ *Bevan Ashford v Geoff Yeandle (Contractors) Ltd (In Liquidation)* [1999] Ch 239, at 249 (*per* Scott VC).

²¹¹ [2007] 1 SLR (R) 989, at para 38 (*per* Prakash J).

²¹² Ministry of Law, *Review of the International Arbitration Act Proposals for Public Consultation* (2011), at 32.

²¹³ Lord Justice Jackson, *Review of Civil Litigation Costs Final Report*, December 2009.

²¹⁴ Ministry of Law, *Review of the International Arbitration Act Proposals for Public Consultation* (2011), at 6-7, para 33.

- "(a) *Restricting TPF by category, value of claim and eligibility of sponsor - These restrictions intend a policy to limit TPF to high value commercial arbitrations:*
- (i) *Exclusion of domestic practice areas: We recommend exclusion of family law, constitutional and administrative law, criminal law, professional negligence and personal injury work;*
 - (ii) *A threshold value of claim, of S\$1 million (subject to change by gazetting) which would prevent third party funders from 'farming' claims ie providing funds indiscriminately to low value claims and seeking profits by way of recovery from as many sources as possible. The imposition of a minimum claim sum will help to ensure that funders assess the merits of each case carefully before agreeing to provide funding.*
 - (iii) *Limiting eligibility to third party fund. Third party funders should be entities with at least S\$5 million in paid up capital (or equivalent sum in another currency, depending on whether the funder is based locally or overseas). Law firms will be excluded.*
- (b) *Allowing adverse costs/security for costs orders against funders - This will ensure that defendants are not prejudiced by a lack of recourse in claims brought by funded parties. This may also be coupled with a requirement that third party funders maintain a minimum capital requirement, so that they are able to pay costs awarded against them.*
- (c) *Requiring parties to disclose funding agreements - This will enable transparency and ensure that the court is aware of any potential policy issues which may arise from the circumstances of each individual case. It will also enable the court to make the appropriate orders against funders where necessary."*

4.139 Responses to the Ministry of Law's proposals were due 21 November 2011. The document setting out the feedback from the public consultation did not mention the responses to Third Party Funding.²¹⁵ The International Arbitration (Amendment) Bill,²¹⁶ and the subsequent legislation

²¹⁵ Singapore Ministry of Law, "Responses from feedback received from 'The Public Consultation on Proposed Amendments to the International Arbitration Act and the New Foreign Limitation Periods Act'" (2011),

²¹⁶ Singapore Ministry of Law, International Arbitration (Amendment) Bill.
<<http://www.mlaw.gov.sg/content/dam/minlaw/corp/assets/documents/linkclick34ed.pdf>>.
<<https://www.mlaw.gov.sg/content/dam/minlaw/corp/assets/documents/linkclick5d8a.pdf>>

ultimately enacted as the International Arbitration (Amendment) Act 2012 in Singapore did not contain the amendment on Third Party Funding outlined in the Singapore Ministry of Law's 2011 Review as extracted above.

4.140 Nonetheless, Third Party Funding in arbitration is now considered an important issue in Singapore. In a keynote address in 2013, the Chief Justice of Singapore, Sundaresh Menon SC, discussed Third Party Funding in arbitration as a growing area, noting that in the arbitration context "*there is a virtual absence of any form of regulation.*"²¹⁷

4.141 Specific issues highlighted by Chief Justice Menon SC included: the need for "*meaningful guidance*" where conflicts of interest may arise out of Third Party Funding in arbitration; the extent of influence the Third Party Funder may have over the arbitration proceedings; whether the existence of a Third Party Funder ought to be disclosable; the impact of Third Party Funding on cases against the State; and the emergence of Third Party Funding in arbitration as a market with practices reminiscent of vulture funds.²¹⁸ The same keynote address stated that a concerted effort was necessary to table recommendations in Third Party Funding in arbitration, so that the industry could respond with due care to the new challenges it could expect to face.²¹⁹

4.142 Third Party Funding was also discussed at a panel session in the 2014 Singapore International Arbitration Centre Congress.²²⁰

4.143 In February 2014 the Law Reform Committee of the Singapore Academy of Law published a report entitled *Report of the Law Reform Committee on Litigation Funding in Insolvency Cases*.²²¹ It recommended "*reform to allow litigation funding in cases of formal insolvency within a regulated framework that strikes a balance between the competing policies of access to justice and purity of justice in Singapore.*"²²²

²¹⁷ The Honourable Chief Justice of Singapore Sundaresh Menon, "Some Cautionary Notes for an Age of Opportunity" (Speech delivered at the Chartered Institute of Arbitrators, International Arbitration Conference, Penang, 2013), at para 9.

²¹⁸ The Honourable Chief Justice of Singapore Sundaresh Menon, "Some Cautionary Notes for an Age of Opportunity" (Speech delivered at the Chartered Institute of Arbitrators, International Arbitration Conference, Penang, 2013), at paras 9, 10, 12 and 13.

²¹⁹ The Honourable Chief Justice of Singapore Sundaresh Menon, "Some Cautionary Notes for an Age of Opportunity" (Speech delivered at the Chartered Institute of Arbitrators, International Arbitration Conference, Penang, 2013), at para 47.

²²⁰ "Highlights - India Conference". *Singapore International Arbitration Conference* (2014). <<http://www.siac.org.sg/>>.

²²¹ Law Reform Committee of the Singapore Academy of Law, *Litigation Funding in Insolvency Cases*, Report (2014).

²²² Law Reform Committee of the Singapore Academy of Law, *Litigation Funding in Insolvency Cases*, Report (2014), at 2.

United States of America

Third Party Funding generally

4.144 It has been observed that the practice of Third Party Funding in the US began with small lenders providing cash advances to plaintiffs involved in Contingency Fee litigation in the 1990s.²²³ The US market for Third Party Funding for litigation and arbitration has expanded rapidly in the last decade and encompasses a broad range of products, including Contingency Fee arrangements, fee advances, legal insurance and traditional loan arrangements.²²⁴ It appears that the issues that face Third Party Funding for litigation and arbitration in the US have begun to diverge but, as in other jurisdictions, there is still considerable cross-over between how courts and tribunals consider the two types of dispute resolution.

4.145 The US is a federal republic, with both federal laws and the laws of the 50 states and the District of Columbia governing arbitration. It has been reported that the various state arbitration laws do not refer to Third Party Funding, and that accordingly, reference must be made to the laws relating to Third Party Funding of litigation for guidance. Litigation funding is generally governed by the statutes and case law of the individual states and the District of Columbia.²²⁵

4.146 Considering the issues that have arisen from Third Party Funding of litigation, the different states have taken widely differing stances on questions of maintenance and champerty, usury and ethical issues. Academics surveying these issues have found that traditional Third Party Funding agreements are considered valid in about two-thirds of the courts in the United States, noting at the same time that the prime considerations for those courts in upholding validity include: whether the proceedings were frivolous; and whether there was any improper motive in pursuing the suit; and whether the Third Party Funder was inappropriately involved, either by way of controlling the legal representation, or by forcing the Funded Party to accept or refuse settlement.²²⁶

4.147 Third Party Funding of litigation is allowed in a number of states including Arizona, California, Colorado, Connecticut, Florida, Illinois, Massachusetts, Missouri, New Hampshire, New Jersey, New Mexico, New York, South Carolina and Texas.²²⁷ In the 2014 case of *Miller UK Ltd v Caterpillar Inc*,²²⁸ the US District Court for the Northern District of Illinois

²²³ New York City Bar, *Formal Opinion 2011-2: Third Party Litigation Financing* (Opinion, The Association of the Bar of the City of New York Committee of Professional Ethics, 2011).

²²⁴ "Third-party funding: snapshots from around the globe" *Global Arbitration Review* (2011) <http://www.imf.com.au/docs/default-source/site-documents/gar_vol7_iss1> at 31.

²²⁵ Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 6.05 at 130.

²²⁶ Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 6.10 at 145.

²²⁷ Harbour Litigation Funding, "Country Summary: United States of America", (2014), <<http://www.harbourlitigationfunding.com/funding-map/US>>.

²²⁸ 17 F. Supp. 3d 711.

rejected the respondent's submission that litigation funding was unlawful in Illinois. The judge referred to the 2012 White Paper on *Alternative Litigation Financing* from the American Bar Association's (ABA) Commission on Ethics 20/20, which recognised that third party litigation funding looks set to grow, given the shift away from the doctrine of champerty.²²⁹

Maintenance, champerty and barratry

4.148 In the US, there are three broad stances towards maintenance and champerty: liberal, conservative and regulatory.

4.149 The first "*liberal*" stance is reflected in the case of *Saladini v Righellis*,²³⁰ where the Massachusetts Supreme Court abolished the doctrines of maintenance and champerty. The Court was no longer persuaded that the:

*"champerty doctrine is needed to protect against the evils once feared: speculation in lawsuits, the bringing of frivolous lawsuits, or financial overreaching by a party of superior bargaining position. There are now other devices that more effectively accomplish these ends."*²³¹

It has been observed that such modern rules include rules for the regulation of misconduct and frivolous lawsuits, and the doctrines of public policy, duress and good faith.²³²

4.150 The Massachusetts' approach has been followed by South Carolina in *Osprey Inc v Cabana Ltd Partnership*²³³ and is also generally applied by the states of New Jersey and Arizona.

4.151 The second "*conservative*" stance can be seen in the ruling of the Ohio Supreme Court in 2003 in *Rancman v Interim Settlement Funding Corporation*,²³⁴ where a litigation funding agreement was found to be champertous on the grounds that: (1) the funders had dissuaded Rancman from settling her case; and (2) that cash advances amounted to maintenance as the funder, Interim, had purchased a share in a lawsuit in which they did not have an independent interest. The Court stated that "*a lawsuit is not an investment vehicle An intermeddler is not permitted to gorge upon the fruits of litigation.*"²³⁵ The strong language of the Court suggests the ruling

²²⁹ 17 F. Supp. 3d 711, Ssating at 727 that "[the] ABA Commission on Ethics 20/20's white paper of February, 2012 concluded that 'shifts away from older legal doctrines such as champerty, and society's embracing of credit as a financial tool have paved the way for a litigation financing industry that appears poised to continue to grow ...'".

²³⁰ 687 NE 2d 1224 (Mass, 1997).

²³¹ 687 NE 2d 1224 (Mass, 1997), at Part II (*per* Marshall J).

²³² Nicholas Dietsch, "Litigation Financing in the US, the UK and Australia: How the Industry has Evolved in Three Countries" (2011) 38 *Northern Kentucky Law Review* 687, at 694.

²³³ 532 SE 2d 269 (SC 2000), at 277.

²³⁴ 789 NE 2d 217 (Ohio 2003).

²³⁵ 789 NE 2d 217 (Ohio 2003), at 221 (*per* O'Connor J).

reflects the attitudes of courts wary of predatory lending practices and of investors profiting from speculating on litigation.²³⁶

4.152 The third "regulatory" stance can be seen in the District Court of Appeals of Florida judgment in *Fausone v US Claims, Inc.*²³⁷ The common law doctrine of champerty was held not to apply here as Florida state law required as a central element of champerty some degree of "officious meddling", defined as "offering unnecessary and unwanted advice or services; meddlesome, [especially] in a highhanded or overbearing way."²³⁸ The court found that this had not occurred as the Funded Party contacted the Third Party Funder first. The judgment canvassed the advantages and disadvantages of Third Party Funding of litigation and highlighted that if such agreements continued to be allowed, "the legislature might wish to examine this industry to determine whether Florida's citizens are in need of any statutory protection"²³⁹ to limit the potential for predatory lending.²⁴⁰ Another distinctive stance put forward by the District Court of Appeals of Florida was in the case of *Abu-Ghazaleh v Chaul*,²⁴¹ which decided that the Third Party Funder itself could be, and was in that case, a party to the litigation. This holding was made in the context of liability for Florida's statute on lawyers' fees (as to liability for being ordered to pay costs of the successful party). Note, however, that in *Abu-Ghazaleh*, the Third Party Lender had a large degree of control over the conduct of the case, including that to remove the representing lawyer, as to the manner and time of filing, and exclusive authority as to whether to settle.²⁴² These elements are not necessarily present in other Third Party Funding agreements.

4.153 In the US, barratry adds "frequency" to the string of elements: multiple instances of champerty by a single person could constitute barratry in some jurisdictions. Barratry is the most obscure of the three related doctrines of maintenance, champerty and barratry, and a review of case law suggests that it has been invoked least often with respect to Third Party Funding. More often, the doctrines of maintenance and champerty are used to weigh the propriety or impropriety of a funding arrangement.²⁴³

4.154 In 2014, Tennessee became the latest in a series of states to have passed legislation specifically targeting Third Party Funders of litigation, though the legislation applies primarily to loans in personal injury cases, rather than commercial cases. States with such legislation include Ohio (2008),

²³⁶ Nicholas Dietsch, "Litigation Financing in the US, the UK and Australia: How the Industry has Evolved in Three Countries" (2011) 38 *Northern Kentucky Law Review* 687, at 696.

²³⁷ 915 So 2d 626 (Fla Dist Ct App 2005), at 627 (*per* Altenbernd J).

²³⁸ Lauren J Grous, "Causes of Action For Sale: The New Trend of Legal Gambling" (2006) 61 *U Miami L Rev* 203, at 214.

²³⁹ Nicholas Dietsch, "Litigation Financing in the US, the UK and Australia: How the Industry has Evolved in Three Countries" (2011) 38 *Northern Kentucky Law Review* 687, at Part 5.

²⁴⁰ Nicholas Dietsch, "Litigation Financing in the US, the UK and Australia: How the Industry has Evolved in Three Countries" (2011) 38 *Northern Kentucky Law Review* 687, at 697.

²⁴¹ 36 So. 3d 691, at 694 (Fla. App. Dist. 2009).

²⁴² Jason Lyon, "Revolution in Progress: Third-Party Funding of American Litigation" (2010) 58 *UCLA Law Review* 571 at 604.

²⁴³ Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 6.06 at 131.

Maine (2009), Nebraska (2010), Oklahoma (2013) and Tennessee (2014).²⁴⁴ State laws typically contain provisions requiring mandatory disclosure of specified information to clients, cooling-off periods and non-interference by the Third Party Funders with the professional judgment of the attorney handling the claim. Some states also require Third Party Funders to hold a licence.²⁴⁵

Usury

4.155 There have been challenges to Third Party Funding agreements under US state usury laws. Due to the sometimes extremely high percentages of award demanded by Third Party Funders, some agreements have been challenged in some states as constituting usury, that is, "*Usury is the exacting, taking or receiving of a greater rate than is allowed by law, for the use or loan of money.*"²⁴⁶ If an agreement is found to be usurious the illegal interest term is invalidated and the lender can only recover the debt and legal interest.

4.156 It appears that the issue of usury is not particularly widespread, with only a small number of US courts having ruled on the issue and its relevance to Third Party Funders, but it remains a potential hurdle for Third Party Funders.²⁴⁷ An example of judicial reasoning where usury was rejected is the case of *Kelly, Grossman & Flanagan, LLP v Quick Cash Inc*²⁴⁸ in the New York Supreme Court. Here the Court held that a funding agreement which stipulated that the Third Party Funder was entitled to share 40% of the award was not usurious. To determine "*whether a particular transaction qualifies as a loan subject to criminal usury prohibitions, courts look to the purpose of the transaction.*"²⁴⁹ Utilising this criteria, the transaction was characterised by the Court as "*a non-recourse agreement ... not a loan.*"²⁵⁰ Further, the Court held that the funding could not be held as a loan, as "*had respondents been unsuccessful in negotiating a settlement or winning a judgment, petitioner would have no contractual right to payment.*"²⁵¹

4.157 In November 2014, the South Carolina Department of Consumer Affairs ruled that Third Party Funders must comply with state laws governing loans. This ruling places restrictions on the interest rates that can be charged.

²⁴⁴ *Non-Recourse Civil Litigation Advances*, Ohio Rev. Code Ann. 13 section 1349.55 (West 2008); *Maine Consumer Credit Code Legal Funding Practices*, Me. Rev. Stat. Ann. 9-A section 12 (2009); *Nebraska Nonrecourse Civil Litigation Act*, Neb. Rev. Stat. Ann. section 25-3303 (West 2010); *Consumer Credit Code Consumer Litigation Funding Agreements* 14A Okla. Stat. section 3-801 (2013); *Tennessee Litigation Financing Consumer Protection Act*, Tenn. Code Ann. section 47-16-101 (2014).

²⁴⁵ See for example *Consumer Credit Code*, 14A Okla. Stat. section 3-809 (2013).

²⁴⁶ *O'Connor v Televideo System, Inc* (1990) No. H004798, Court of Appeals of California, Sixth Appellate District. Mar 7, 1990; *Ross v Wheeler* (1934) 140 Cal App. 217, 222 [35 P.2d 220].

²⁴⁷ Julia H McLaughlin, "Litigation Funding: Charting a Legal and Ethical Course" (2007) 31 *Vermont Law Review* 615, at 635.

²⁴⁸ 950 NYS 2d 723 (NY Sup Ct 2012).

²⁴⁹ 950 NYS 2d 723 (NY Sup Ct 2012), at para 4 (*per Pines J.*).

²⁵⁰ 950 NYS 2d 723 (NY Sup Ct 2012), at para 5 (*per Pines J.*).

²⁵¹ 950 NYS 2d 723 (NY Sup Ct 2012), at para 6 (*per Pines J.*).

A similar ruling was made in Kansas in 2009, where the Kansas Office of the State Bank Commissioner ruled that funding agreements constitute loans.²⁵²

Privilege

4.158 In recent years various district courts in the US have handed down different rulings on the question of whether litigation funding agreements are privileged documents, with rulings ranging from requiring full disclosure to permitting full privilege. The latest such decision is *Miller UK Ltd v Caterpillar Inc*,²⁵³ which was handed down in June 2014. The defendant, which was accused of stealing trade secrets, brought a motion to get discovery of the plaintiff's litigation funding financing documents and documents relating to the dispute that had been shared with the Third Party Funder (and/or prospective Third Party Funders). The Court held that the funding agreement was not relevant to the proceedings and so the Court did not have to decide whether the work product or attorney-client privilege doctrines applied. But the Court did find that documents which were provided to the Third Party Funder and which revealed litigation strategy were protected by the work product doctrine.

Ethical considerations

4.159 Ethical considerations are significant in the US with state courts in Arizona, Florida, New York, Ohio, South Carolina, Utah and Virginia all having handed down judgments on the issue and state bar associations also having issued opinions and guidance.²⁵⁴

4.160 In 2011, the American Bar Association Commission on Ethics released a draft *White Paper on Alternative Litigation Finance* which canvassed the major issues and generally recommends that attorneys must approach funding with care and be mindful of professional obligations.²⁵⁵

The ABA model rules of professional conduct

4.161 In February 2012, ABA's Commission on Ethics issued an informational report on "*alternative litigation finance*" detailing how attorneys should handle the professional ethical concerns they encounter when alternative litigation finance is involved in their clients' cases, making reference to the *ABA Model Rules of Professional Conduct* then applicable (it is again noted that it appears these will generally only apply to US lawyers). The main

²⁵² John O'Brien, "South Carolina agency rules lawsuit loans are traditional loans subject to state law", *Washington Examiner* (2014), <<http://www.washingtonexaminer.com/south-carolina-agency-rules-lawsuit-loans-are-traditional-loans-subject-to-state-law/article/feed/2175138>>.

²⁵³ (ND Ill, No 1:10-cv-03770, 1 June 2014).

²⁵⁴ Mariel Rodak, "It's About time: A Systems Thinking Analysis of the Litigation Finance Industry and its Effect on Settlement" (2006) 155 *University of Pennsylvania Law Review* 503, at 509.

²⁵⁵ American Bar Association Commission on Ethics 20/20, *White Paper on Alternative Litigation Finance* (Draft Paper, 2011).

rules and guidance identified in the informational report with respect to Third Party Funding are:²⁵⁶

(1) Conflicts of interest

(a) Material Limitation Conflicts: Model Rule 1.7(a)(2). A conflict of interest might arise in two situations: first, where the lawyer has a direct professional relationship with the Third Party Funder, for example, by way of a referral relationship; second, where the lawyer is a profit-sharing stakeholder in the Third Party Funder, for example, by way of shareholding or partnership in the Third Party Funder. This is relevant to arbitration because it is a relatively small circle, resulting in frequent reappearance of the same practitioners and funders. Model Rule 1.7(b) guides that if an attorney does have a connection with the Third Party Funder and thereby possibly have a conflict, the lawyer should obtain informed consent from the client / Funded Party. The informed consent must be confirmed in writing, and in obtaining such consent, the lawyer should have explained to the Funded Party as to the risks to the Funded Party's interest in that situation. Referral fees without informed consent are also caught by this rule, as a concurrent conflict of interest is defined as existing where there is a risk that the legal representation will be limited by the lawyer's personal interest.²⁵⁷

(b) Business transactions with clients: Model Rule 1.8(a). This rule that a lawyer should not enter into a business transaction with a client or obtain a pecuniary interest adverse to a client comes into play if the lawyer acts on behalf of the client to negotiate the entering into an agreement with the Third Party Funder. The lawyer has a financial interest in the result of the negotiations, an interest which is in competition with, and could be adverse to, the client's interest. Model Rule 1.8(a)(1) however, provides that the lawyer can conduct such negotiations if he has fully disclosed his interest to the client in writing, and if the terms for him to enter into the negotiations are fair and reasonable.²⁵⁸

²⁵⁶ See the analysis in Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 6.09[B] at 134-143.

²⁵⁷ The Rule states inter alia, "... a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if ... there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer"; Further commentary in Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 6.09[B][2][a] at 136.

²⁵⁸ The Rule states inter alia "A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a

(c) Prohibition on providing financial assistance to client and obtaining a financial interest in client's case: Model Rules 1.8(e) and 1.8(i). This rule, that a lawyer shall not provide financial assistance to a client for litigation, unless it is a contingency fee or the client is an indigent client, is a longstanding rule that is enshrined in state law. However, this rule would not be breached in the course of a regular Third Party Funding agreement where the Third Party Funder, and not the lawyer, is providing the financial assistance.²⁵⁹

(2) Reasonableness of fees and expenses charged to client

Model Rule 1.5(a): This rule relating to the reasonableness of lawyers' bills is only peripherally applicable, insofar as it dictates that the lawyer cannot charge exorbitant fees via a Third Party Funding arrangement and thereby circumvent the prohibition on unreasonable fees.²⁶⁰

(3) Withdrawal and substitution of counsel

Model Rules 1.16(a)(3) and 1.16(c): Whilst clients can, generally speaking, terminate representation by the lawyer at will, the reverse is not the case. The Model Rules guide when a lawyer can terminate representation. However, the Model Rules do not intervene to govern the conduct of the parties if the Third Party Funding agreement provides for the Third Party Funder to control the dismissal or changing of legal representation, because the lawyer is not a party to the Third Party Funding agreement and it is a contractual matter between the Third Party Funder and the Funded Party. An alternative possibility, depending on state law, is that such a contractual term might be invalid under the state law rather than under the Model Rules.²⁶¹

client..."; Further commentary in Lisa Bench Nieuwald and Victoria Shannon, Third Party Funding in International Arbitration (Aspen Publishers, 2012), para 6.09[B][2][b] at 136-137.

²⁵⁹ The Rules state inter alia, "A lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation" and "A lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting for a client..."; Further commentary in Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 6.09[B][2][c] at 137.

²⁶⁰ The Rule states inter alia, "A lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses. ..." Further commentary in Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 6.09[B][3] at 137.

²⁶¹ The Rules state inter alia, "... a lawyer shall not represent a client or, where representation has commenced, shall withdraw from the representation of a client if: ... the lawyer is discharged." and "A lawyer must comply with applicable law requiring notice to or permission of a tribunal when terminating a representation. When ordered to do so by a tribunal, a lawyer shall continue representation notwithstanding good cause for terminating the representation." Further commentary in Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 6.09[B][3][a] at 138.

(4) Independent professional judgment

Model Rules 2.1 and 5.4(c): These rules impress upon the lawyer's need to assert independence in giving legal advice to the litigant, even when paid by a third party such as a Third Party Funder. Excessive involvement of the Third Party Funder (whether based on contractual provisions or otherwise), to the extent that it infringes the lawyer's independence and professional judgment, will mean that the lawyer might have to withdraw representation to avoid breaching these Rules.²⁶²

(5) Referring clients to Third Party Funders

Model Rule 7.2: Whilst referrals are, under the conditions of non-exclusivity and informed consent, allowed by this Rule, as discussed above, there are further restrictions which apply when the lawyer would receive a financial interest in making referrals (to Third Party Funders) and thus has a conflict of interest. See the analysis above on Model Rules 1.7 and 1.8, which details the need to disclose and to obtain the client's informed consent in writing.²⁶³

(6) Settlement

Model Rule 1.2(a): This Rule maintains that the lawyer may only act on the client's instructions, putting primacy on the client's decision over the Third Party Funder's decision. This is particularly relevant in the context of the decision to settle. Since the Funded Party, and not the lawyer, would have entered into the contractual provision which gives the Third Party Funder the right to approve or veto a potential settlement, this Rule does not affect the validity of such a contractual provision. Regardless of a Third Party Funder having such a contractual right, a lawyer must still adhere to his independence and duty to act in his clients' interests in the course of negotiating a settlement.²⁶⁴

²⁶² The Rules state, "*In representing a client, a lawyer shall exercise independent professional judgment and render candid advice. In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social and political factors, that may be relevant to the client's situation.*" and "*A lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services.*" Further commentary in Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 6.09[B][4] at 138.

²⁶³ The Rule states, "... a lawyer may ... refer clients to another lawyer or a nonlawyer professional pursuant to an agreement not otherwise prohibited under these Rules that provides for the other person to refer clients or customers to the lawyer, if (i) the reciprocal referral agreement is not exclusive, and (ii) the client is informed of the existence and nature of the agreement." Further commentary in Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 6.09[B][4][a] at 139.

²⁶⁴ The Rule states, "... a lawyer shall abide by a client's decisions concerning the objectives of representation and ... shall consult with the client as to the means by which they are to be

(7) Duty of confidentiality

Model Rule 1.6: Under this Rule, a lawyer generally should not disclose information on the client's case, although there are exceptions to this Rule, two of which become particularly pertinent in Third Party Funding arrangements. First, the client may give informed consent to disclose. Secondly, the disclosure is impliedly authorized in order to carry out the representation. If the Third Party Funder requires the disclosure of information in order to ascertain the commercial viability of the case and therefore the prospect of returns on its funding, a lawyer must be particularly aware that the "*informed consent*" requirements are met. The lawyer must take care to explain the risks, for example, whether this would give rise to waivers and the consequences of the same under the relevant laws of evidence.²⁶⁵

4.162 As noted above, the most significant ethical issue relating to Third Party Funding in the US appears to concern the potential impact on the attorney-client relationship of Third Party Funding agreements. Where such agreements require attorneys to give Third Party Funders access to their case file, privilege is almost certainly waived.²⁶⁶ Such disclosure may make it possible for a defence attorney, through obtaining discovery against the Third Party Funder, to gain access to that file. However, this appears not to be a settled position. In 2012, the US District Court Eastern District of Pennsylvania ruled in *Devon IT Inc v IBM Corp* [2012]²⁶⁷ that documents produced in anticipation of or during US litigation are protected by the work-product doctrine, and that even if shown to a Third Party Funder, the documents cannot be disclosed to the opposing party.²⁶⁸

4.163 An issue also discussed in the US is related to the attorney-client relationship, that the influence of a Third Party Funder may affect the attorney's ability to terminate an attorney-client relationship. It has been commented that many Third Party Funding agreements stipulate that should the attorney-client relationship end then the entire balance of the advance and any interest accrued must be returned to the Third Party Funder. Under such

pursued. A lawyer may take such action on behalf of the client as is impliedly authorized to carry out the representation ..." Further commentary in Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 6.09[B][4][a] at 139.

²⁶⁵ The Rules state, "A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b)" Further commentary in Lisa Bench Nieuwald and Victoria Shannon, *Third Party Funding in International Arbitration* (Aspen Publishers, 2012), para 6.09[B][6] at 143.

²⁶⁶ Meriam N Alrashid, Jane Wessel and John Laird, "Impact of Third Party Funding on Privilege in Litigation and International Arbitration" (2012) *Dispute Resolution International* 101, at 108.

²⁶⁷ 2012 US Dist LEXIS 166749 (ED Pa, 21 September 27, 2012).

²⁶⁸ "Privilege in the US - an Update", *Harbour Litigation Funding* (2014), <<http://www.harbourlitigationfunding.com/articles/privilege-in-the-us-an-update>>.

agreements an attorney may not be able to terminate the relationship without incurring malpractice claims.

4.164 It has been recognised in the US that the potential exists also for a Third Party Funder, using their economic influence, to control or direct a claimant's decision-making. The New York City Bar Association in a Formal Opinion has stated that:

*"a lawyer may not permit the company to influence his or her professional judgment in determining the course or strategy of the litigation, including the decisions of whether to settle or the amount to accept in any settlement."*²⁶⁹

Despite this, in cases where the Third Party Funder's advice and the attorney's advice differ, should the claimant follow the attorney's advice to their detriment, it may expose the attorney to liability for malpractice or breach of fiduciary duty.²⁷⁰

4.165 In terms of industry bodies, the US lacks equivalents to the UK ALF Code and the ALF. Since 2004, the only relevant body has been the American Legal Finance Association, known as the ALFA, a not-for-profit corporation based in New York whose members are obliged to adhere to a Code of Conduct.

4.166 It appears that the ALFA has some influence in the US market in terms of promoting best practice but is far from being an industry standard. Furthermore, as an organisation, it has no presence in commercial cases, only claims for personal injury. Recently, a group of litigation funders have considered forming an organisation similar to ALFA, but specifically for commercial cases. This was partly in response to negative comments that had been made by the US Chamber of Commerce.²⁷¹

Third Party Funding in arbitration

4.167 The market for Third Party Funding for arbitration has existed for a sufficiently long period of time in the US that two broad types of disputes have arisen.

4.168 The first category has concerned disputes between the Third Party Funder and the Funded Party arising after the final award or settlement, often concerning private settlements in which the Third Party Funder was not involved or as to the manner in which the amount paid should be calculated. An example is the 2008 IP-related case *Altitude Nines v DeepNines*, where the

²⁶⁹ New York City Bar, *Formal Opinion 2011-2: Third Party Litigation Financing* (Opinion, The Association of the Bar of the City of New York Committee of Professional Ethics, 2011).

²⁷⁰ Nicholas Dietsch, "Litigation Financing in the US, the UK and Australia: How the Industry has Evolved in Three Countries" (2011) 38 *Northern Kentucky Law Review* 687, at 693.

²⁷¹ Harbour Litigation Funding, "Country Summary: United States of America" (2014) <<http://www.harbourlitigationfunding.com/funding-map/US>>.

Third Party Funder sued the Funded Party for \$5 million it was allegedly owed, in addition to the amounts it had already received. The Third Party Funder's claim was based on a contention that the Funded Party should not have deducted legal expenses before disbursing the contingent fee share. The merits of the argument were not litigated as the dispute was settled, but the case illustrates the importance of clarity and precision in the Third Party Funding agreement to avoid costly future disputes.²⁷²

4.169 The second category of disputes arising from Third Party Funding in the US concerns cases that are terminated prematurely, an issue referred to in the earlier section on ethical considerations. An example of such a dispute is in the dispute between S&T Oil (the Funded Party) and Juridica Investments (the Third Party Funder). The dispute, in the form of a Racketeer Influenced and Corrupt Organisations Act suit brought by S&T Oil and an arbitration of the London Court of International Arbitration brought by Juridica, pursuant to the disputes clause found in the original funding agreement, was over issues arising from Juridica's funding of S&T Oil's arbitral proceedings brought against Romania in the International Centre for Settlement of Investment Disputes ("ICSID"). The complaint arose when S&T Oil's legal counsel withdrew from the case citing the company's failure to produce a critical piece of evidence. S&T Oil alleged that legal counsel had violated ethical and legal obligations by persuading S&T Oil to allow Juridica's counsel access to case documents that were now being used against S&T Oil in the dispute proceedings. The District Court found S&T Oil's arguments unpersuasive and a subsequent appeal was dismissed.²⁷³

4.170 The S&T Oil case is a useful example of issues that may arise from Third Party Funding for arbitration and the possible benefits of provisions clarifying by statute or other regulation the obligations of the Third Party Funder and the Funded Party as well as their legal representatives in such arrangements.

4.171 It was reported that in a roundtable discussion with representatives from Third Party Funders active in international arbitration that the funder's access to legal analysis prepared by counsel in the US was a concern due to US privilege and discovery rules. Third Party Funders noted that the US is one of the most challenging jurisdictions in this respect.²⁷⁴ Some Third Party Funders were said to have expressed the view that they do not operate in the US specifically in order to avoid difficulties relating to the discovery mechanism.²⁷⁵

²⁷² "Third-party funding: snapshots from around the globe" *Global Arbitration Review* (2011) <http://www.imf.com.au/docs/default-source/site-documents/gar_vol7_iss1>.

²⁷³ "Third-party funding: snapshots from around the globe" *Global Arbitration Review* (2011) <http://www.imf.com.au/docs/default-source/site-documents/gar_vol7_iss1>.

²⁷⁴ Maxi Scherer and Aren Goldsmith, "Third Party Funding in International Arbitration in Europe: Part 1 – Funders' Perspectives" (2012) 2 *International Business Law Journal* 207, at 216.

²⁷⁵ Maxi Scherer and Aren Goldsmith, "Third Party Funding in International Arbitration Proceedings – A View from Europe: Part II: The Legal Debate" (2012) 6 *International Business Law Journal* 649, at 664.

4.172 The same roundtable discussion also raised the concern that the disclosure of funding agreements can lead to frivolous defences that raise the cost of the proceedings. The example of *Fuchs and Kardassopoulos v Georgia* was mentioned, where the claimant's claim was funded by a Third Party Funder whose existence was disclosed to the Tribunal. The defendant argued that it should not be liable for the claimant's costs on the basis that those legal fees had allegedly been met by an undisclosed third party, although the Tribunal ultimately held that the existence of a Third Party Funder did not affect the recoverability of costs from the losing defendant.²⁷⁶

Treaty cases under the Washington Convention

4.173 The Washington Convention²⁷⁷ provides for a dispute resolution framework for disputes between contracting states and investors of other states. Among other things, it establishes the ICSID.

4.174 As to whether, in investment treaty cases under the Washington Convention, security for costs may be ordered against a Claimant that is being supported by a Third Party Funder, we note that an ICSID tribunal has for the first time issued a security for costs order against a Third Party Funded claimant in the case of *RSM Production Corporation v Saint Lucia*.²⁷⁸ In its "*Decision on Saint Lucia's Request for Security for Costs*", issued on 13 August 2014, the Tribunal, for the first time in ICSID's history, ordered the Claimant to pay security for costs in the amount of US\$750,000 pursuant to its powers under Article 47 of the Washington Convention and ICSID Arbitration Rule 39.

4.175 Article 47 of the Washington Convention states:

"Except as the parties otherwise agree, the Tribunal may, if it considers that the circumstances so require, recommend any provisional measures which should be taken to preserve the respective rights of either party."

4.176 Additionally, ICSID Arbitration Rules, Rule 39 provides:

"(1) At any time after the institution of the proceeding, a party may request that provisional measures for the preservation of its rights be recommended by the Tribunal. The request shall specify the rights to be preserved, the measures the recommendation of which is requested, and the circumstances that require such measures."

²⁷⁶ Maxi Scherer and Aren Goldsmith, "Third Party Funding in International Arbitration in Europe: Part 1 – Funders' Perspectives" (2012) 2 *International Business Law Journal* 207, at 218.

²⁷⁷ The Washington Convention opened for signature on 18 March 1965, 575 UNTS 159 (entered into force 14 October 1966).

²⁷⁸ *RSM Production Corporation v Saint Lucia*, Decision on Saint Lucia's Request for Security for Costs (ICSID Case No ARB/12/10).

4.177 Prior to the Tribunal's decision in *RSM v St Lucia*, other ICSID tribunals had considered whether Article 47 of the Washington Convention and ICSID *Arbitration* Rule 39 could empower tribunals to order security for costs against a claimant, in particular given ICSID's unique role as a facilitative dispute resolution mechanism for investors in foreign states. The discussion as to whether Article 47 can extend to security for costs orders stems back to *Maffezini v Spain* in 1999.²⁷⁹ Since then, multiple tribunals have determined that a measure recommending security for costs does fall within the powers prescribed by Article 47 of the Washington Convention and ICSID Arbitration Rules, Rule 39.²⁸⁰

4.178 However, despite a multitude of arbitrators determining that an ICSID tribunal would have powers to order security for costs, no tribunal until *RSM v St Lucia* had ordered such security, as each tribunal agreed that in order to issue an order for security for costs, there must be exceptional circumstances, which in each previous case had been found to be absent.

4.179 The Tribunal (by majority) in *RSM v Saint Lucia* found that on the specific facts of that case, exceptional circumstances were present. The claimant had previously been involved in two separate ICSID arbitrations against the State of Grenada. In the first, which consisted of annulment proceedings, the claimant was slow in meeting an initial request for an advance payment, and had not complied with an additional call for funds, the result of which led to the proceedings being stayed. Further, when asked to advance further funds to recover the costs of ICSID, the claimant had not complied. In the second arbitration, the claimant was ordered to reimburse the State of Grenada for the cost advances that Grenada had made to ICSID. The claimant again did not comply.

4.180 The Tribunal in *RSM v Saint Lucia* took into account the claimant's previous conduct in the two earlier arbitrations, and based on that conduct, found that there was a material risk that the claimant would not reimburse Saint Lucia for its costs incurred in the present arbitration should such a costs award be issued. The Tribunal found sufficient evidence that the claimant did not have sufficient financial resources to satisfy any costs award, and that, together with the claimant's consistent procedural history in other ICSID and non-ICSID proceedings, there were compelling grounds for ordering security for costs.²⁸¹

²⁷⁹ *Emilio Agustin Maffezini v Kingdom of Spain*, Procedural Order No 2 (ICSID Case No ARB/97/7).

²⁸⁰ See *Libananco Holdings Co Limited v Republic of Turkey*, Decision on Preliminary Issues (ICSID Case No ARB/06/08), at para 57; *Commerce Group Corp and San Sebastian Gold Mines Inc v The Republic of El Salvador* (ICSID Case No ARB/09/17), Decision on El Salvador's Application for Security for Costs, at para 45; *Victor Pey Casado and Foundation Presidente Allende v Republic of Chile*, Decision on Provisional Measures (ICSID Case No ARB/98/2), at para 88; Rachel S Grynberg, *Stephen M Grynberg, Miriam Z Grynberg and RSM Production Corporation v Grenada*, Decision on Respondent's Application for Security for Costs (ICSID Case No ARB/10/6), at para. 5.16. See also William Kirtley and Koralie Wietrzykowski, "Should A Tribunal Order Security for Costs When An Impecunious Claimant Is Relying upon Third Party Funding?" (2013) 30(1) *Journal of International Arbitration* 17.

²⁸¹ *RSM Production Corporation v Saint Lucia*, Decision on Saint Lucia's Request for Security for Costs (ICSID Case No ARB/12/10), at para 82.

4.181 The claimant in *RSM v Saint Lucia* had also received Third Party Funding and had admitted to being funded in the present proceedings. The Tribunal held that the fact that the claimant was being supported by a Third Party Funder further supported the Tribunal's concern that the claimant would be unable to comply with a costs award rendered against it, as it was doubtful whether the Third Party Funder would assume responsibility for honouring such an award.²⁸²

²⁸² *RSM Production Corporation v Saint Lucia*, Decision on Saint Lucia's Request for Security for Costs (ICSID Case No ARB/12/10), at para 83.

Chapter 5

The benefits and risks of Third Party Funding for arbitration

Introduction

5.1 This Chapter discusses the potential benefits of Third Party Funding for arbitration as well the potential risks. Such benefits and risks have been widely debated by academics, lawyers and by the courts of several jurisdictions. To inform public debate in relation to whether Third Party Funding for arbitration should be allowed in Hong Kong, it is necessary to identify and explain the principal benefits, as well as the potential risks, of Third Party Funding. This review has informed the recommendations that we have made.

5.2 In surveying and identifying the benefits and risks of Third Party Funding, this Sub-committee has drawn upon helpful academic commentary, anecdotal evidence from lawyers and Funders, the publicly available judgments of the courts in Hong Kong and other jurisdictions, and reports issued by the judiciary or government commissions of other countries.

Summary table of benefits and risks of Third Party Funding

5.3 The Sub-committee has identified the following to be the principal benefits and risks of Third Party Funding for Arbitration:

Benefits of Third Party Funding for Arbitration	
1	<p><u>Preserving and promoting Hong Kong's competitiveness as an arbitration centre</u></p> <p>As discussed in Chapter 4, all but one of the major international arbitration centres allow Third Party Funding. Hong Kong's competitiveness as an arbitration centre will be maintained and promoted if it is clear that Hong Kong law permits Third Party Funding for arbitration.</p>
2	<p><u>Benefit to the court system and use of public resources</u></p> <p>By increasing the availability and use of arbitration services, Third Party Funding will assist in reducing the large number of commercial cases that the Hong Kong courts currently handle. This will not only save the taxpayer money by reducing the burden on the Hong Kong courts, but will also allow those</p>

Benefits of Third Party Funding for Arbitration	
	resources to be deployed more effectively for disputes that are of greater concern to the public (eg, criminal offences, points of public interest).
3	<p><u>Promotion of use of arbitration</u></p> <p>(A) Enables parties who may not have sufficient financial means to pursue their legal rights and valid claims through arbitration, which is a form of access to justice.</p> <p>(B) Allows a greater range of persons and commercial entities to use arbitration as a dispute resolution method.</p>
4	Allows the Funded Party to mitigate the risks of conducting arbitration proceedings.
5	The due diligence conducted by Third Party Funders against their own investment criteria helps to give parties an objective view of the merits of their own claim.
6	Knowledge that a party has received Third Party Funding (and therefore can pay for the arbitration until an Award is handed down) can help to precipitate a resolution of a dispute by the other side offering to settle it, thereby saving considerable time and expense.
7	Promotion of effective case management, as the Third Party Funder will ensure the arbitration procedure is cost-efficient and focuses on key issues.
8	Can assist resource-poor respondents facing several claims.
9	As Third Party Funders will only fund cases which meet their investment criteria, and in particular having a reasonable to high chance of success, Third Party Funding helps to screen against unmeritorious claims.

Potential risks of Third Party Funding for Arbitration	
1	Potential for Third Party Funding to promote unnecessary arbitration proceedings.
2	Potential for Third Party Funders to exercise too great a level of control over arbitration proceedings.
3	Costs of Third Party Funding (ie, proportion of awarded amounts which Third Party Funder is entitled to) could be excessive.
4	Potential for breaches of legal professional privilege.

Potential risks of Third Party Funding for Arbitration	
5	Potential for breach of the confidentiality of the arbitration.
6	Scope for conflicts of interest.
7	Disclosure of Third Party Funding may unduly influence the Tribunal / may prevent the proper settlement of a case.
8	Risk of arbitrary termination of the Third Party Funding agreement by Third Party Funders.
9	Risk of insufficient Third Party Funder's capital adequacy.
10	An inadequate complaints procedure may give limited recourse to aggrieved funded parties.
11	Risk of money laundering.

5.4 Having considered the benefits and risks of Third Party Funding, we consider that the benefits clearly outweigh the risks, and that the risks be managed by appropriate safeguards as discussed in Chapter 6.

Potential benefits of Third Party Funding for arbitration

Maintaining and promoting Hong Kong's competitiveness as an arbitration centre

5.5 Allowing Third Party Funding for Arbitration in Hong Kong will enable Hong Kong to maintain its competitiveness as an arbitration centre.

5.6 Arbitration is becoming increasingly expensive and parties to an arbitration may need access to Third Party Funding to bring a claim or counterclaim. When considering the place where an arbitration should be conducted a party may well consider it to be relevant whether Third Party Funding is permitted.

Benefits to Hong Kong public

5.7 The availability of Third Party Funding could enhance the efficiency of the legal system in terms of case management, reduction of legal costs and promotion of arbitration as an alternative to litigation, reducing the commercial case-load of the Hong Kong courts and freeing their resources for other cases involving the public.

5.8 Third Party Funding could also reduce the difference in position between an inexperienced claimant and *an experienced* respondent in arbitration proceedings. At the moment, there are great disparities in

experience and resources between a claimant that is pursuing its first and possibly only claim, as contrasted with a respondent who is accustomed to defending claims. Third Party Funding would assist to facilitate the inexperienced claimant in bringing meritorious claims against a respondent with greater experience and resources, thereby promoting access to justice.¹

Benefit to the Funded Party and public interest considerations

Access of participants to proceedings

5.9 Where Third Party Funding has been permitted, it is primarily on the ground that it enables a Funded Party access to justice by being able to pursue a good claim that it may be unable to bring without such funding. For example, the courts of Australia and of England and Wales, have emphasised the importance of this consideration when relaxing their respective approaches to maintenance and champerty; see for example the High Court of Australia's judgment in *Campbells Cash and Carry Pty Limited v Fostif Pty Limited*² and the English decision of *Gulf Azov Shipping Co Ltd v Idisi*,³ both discussed in Chapter 4.

Risk management and financial support

5.10 Third Party Funding not only provides a party with a good case with the financial resources to pursue a claim, but also an opportunity to mitigate the financial risks associated with the pursuit of a claim through arbitration. If a Funded Party transfers some or all of the arbitration risks to the Third Party Funder, the Funded Party may be able to achieve a successful recovery in an arbitration without having to pay legal fees and other costs as the claim progresses, or having to obtain or allocate funds to deal with the consequences should the claim fail,⁴ which will generally assist its cash flow.

Experience and thorough due diligence before the commencement of hearing

5.11 Experienced Third Party Funders may be managed by experienced former dispute resolution lawyers who are focused on the timely, efficient and successful resolution of funded claims for the maximum achievable value. Access by a Funded Party to these specialist skills and experience may assist a Funded Party to more successfully prepare and conduct their arbitration.

¹ Maya Steinitz, *Whose Claim is This Anyway? Third-Party Litigation Funding* (Legal Studies Research Paper No 11-31, University of Iowa, 2011), at 1303-1318.

² (2006) 229 CLR 386.

³ [2004] EWCA Civ 292 (CA).

⁴ Susanna Khouri and Kate Hurford, *Third Party Funding for International Arbitration Claims: Practical Tips* (Practice Note, Practical Law Company Arbitration, 2012).

5.12 A reputable Third Party Funder should carefully and thoroughly analyse and assess all relevant aspects of the claim or counterclaim that it may fund. A Third Party Funder can bring an independent, commercial and objective perspective when assessing the merits of a claim or counterclaim. This can be of assistance to the Funded Party and can help to shape, in practical and strategic ways, how a claim is pursued.⁵ The Funded Party also gets the benefit of an additional professional opinion on the prospect of success of his claim. For example, in *Excalibur Ventures Ltd v Texas Keystone Inc*,⁶ Clarke LJ stated in relation to his decision to award indemnity costs against Third Party Funders:

*"If it serves to cause funders and their advisors to take rigorous steps short of champerty, ie behaviour likely to interfere with the due administration of justice, – particularly in the form of rigorous analysis of law, facts and witnesses, consideration of proportionality and review at appropriate intervals – to reduce the occurrence of the sort of circumstances that caused me to order indemnity costs in this case, that is an advantage and in the public interest."*⁷

Increasing the chances of a beneficial settlement for the claimant

5.13 If a defendant or respondent to an arbitration knows that a party is funded, that knowledge may facilitate settlement as defendants will be more likely to try to avoid prolonged proceedings that they know the Funded Party can afford to participate in.⁸ A Third Party Funder's willingness to fund an arbitration, if known to the opposing party, may function as a signal to the opposing party regarding the strength of the claim. Such a signal can further strengthen the Funded Party's bargaining position and enhance the chances of an early and high settlement.⁹

Effective case management monitored by the Funder and reduction of legal costs

5.14 It appears that the Funded Party's lawyer will usually be asked to provide regular reports to enable the Third Party Funder to monitor the claim's progress, chances of success and compliance with the funding agreement. The Third Party Funder's active monitoring may help enhance case management in arbitration and, as a result, reduces the costs of arbitration

⁵ Susanna Khouri and Kate Hurford, *Third Party Funding for International Arbitration Claims: Practical Tips* (Practice Note, Practical Law Company Arbitration, 2012).

⁶ [2014] EWHC 3436, at para 129.

⁷ *Excalibur Ventures LLC v Texas Keystone Inc* [2014] EWHC 3436 (Comm), at para 129 (*per* Clark LJ)

⁸ Marco de Morpurgo, "A Comparative Legal and Economic Approach to Third-party Litigation Funding" (2011) 19 *Cardozo Journal of International and Comparative Law* 343, at 382.

⁹ Maya Steinitz, *Whose Claim is This Anyway? Third-Party Litigation Funding*, (Legal Studies Research Paper No 11-31, University of Iowa, 2011), at 1305.

(the provision of information by the Funded Party's lawyers to the Funder is, however, subject to the issue of confidentiality and privilege between lawyers and claimants).¹⁰

5.15 The involvement of a Third Party Funder may deter or undermine defensive forensic posturing (eg, extensive document production requests) by a respondent designed to cause delay and exhaust a claimant's financial resources.¹¹

Availability of funding for respondents

5.16 Third Party Funding may also be available for respondents, either when they have a meritorious counterclaim, or to act as a form of insurance against the costs of defending a claim. The respondents will still need to meet the investment criteria of the Third Party Funders in order to receive funding.

5.17 In the UK, there is a developing industry in funding respondents without a counterclaim.¹² In this situation, a Third Party Funder may be reimbursed for its direct outlays and paid a fee if there is a successful outcome for the respondent in the arbitration.¹³ A successful outcome for a respondent in these circumstances could include an Award in its favour, including one in which no damages are awarded against it, a settlement of the claim on favourable terms, or an Award requiring the respondent to pay less than its potential liability or the amount originally claimed.

5.18 It has been said that while Third Party Funding may be used by both claimants *and* respondents in arbitrations to improve their ability to bargain, it may be analysed differently because claim funding functions as a form of "*finance*", whereas defence funding functions as a form of "*insurance*".¹⁴

5.19 Defence funding is the functional equivalent of after-the-event insurance, since it takes the form of allowing a company to pay the expected

¹⁰ Susanna Khouri and Kate Hurford, *Third Party Funding for International Arbitration Claims: Practical Tips* (Practice Note, Practical Law Company Arbitration, 2012).

¹¹ Jasminka Kalajdzic, Peter Cashman and Alana Longmoore, "Justice for Profit: A Comparative Analysis of Australian, Canadian and U.S. Third Party Litigation Funding" (2013) 61(1) *American Journal of Comparative Law* 93, at 101. For a more detailed discussion on how arbitration funding can level the playing field by transforming "*One-Shotter*" to "*Modified One-Shotter*", and "*Repeat Player*" to "*Modified Repeat Player*", see Maya Steinitz, *Whose Claim is This Anyway? Third-Party Litigation Funding* (Legal Studies Research Paper No 11-31, University of Iowa, 2011), at 1303-1318.

¹² Jasminka Kalajdzic, Peter Cashman and Alana Longmoore, "Justice for Profit: A Comparative Analysis of Australian, Canadian and U.S. Third Party Litigation Funding" (2013) 61(1) *American Journal of Comparative Law* 93, at 101; see also Maxi Scherer and Aren Goldsmith, "Third Party Funding in International Arbitration in Europe: Part 1 – Funders' Perspectives" (2012) 2 *International Business Law Journal* 207, at 211.

¹³ "Sources of Funding: The Sinews of Business", *Games Investor Consulting* (2014), <<http://www.gamesinvestor.com/content/Research/Industry-Reports/Sources-of-Funding>>.

¹⁴ Maya Steinitz, *Whose Claim is This Anyway? Third-Party Litigation Funding* (Legal Studies Research Paper No 11-31, University of Iowa, 2011), at 1302.

value of a lawsuit plus a premium to protect it against a higher-than-expected loss. Such "insurance" allows companies to:

- (1) hedge against the loss involved in an unfavourable Award;
- (2) minimize and predict arbitration costs; and therefore
- (3) eliminate the effects of having uncertain litigation or arbitration on the company's books in respect of the company's ability to engage in major transactions.¹⁵

Enforcement of costs awards by respondents

5.20 In a litigation, the Third Party Funding of a claimant may enable a successful respondent to enforce a favourable costs order or order for security for costs against the Third Party Funder (in those jurisdictions where it is permitted). This is not the case in arbitration, as generally only parties to an agreement are within the scope of the Tribunal's jurisdiction, as discussed in Chapter 2.

Screening of claims

5.21 A Third Party Funder also provides preliminary screening against unmeritorious claims, provided the Third Party Funder undertakes a competent assessment of the merits of the claims prior to the funding.¹⁶ Third Party Funders only recover their investment if funded claims are successful. Experience in other jurisdictions suggests that Third Party Funders, rather than encouraging meritless claims, have an economic incentive to be selective in funding cases.¹⁷ Such assessment by the Third Party Funders of the strengths and weaknesses of a potential case is essential. In assessing the merits of the claims, a Third Party Funder should carefully and thoroughly analyse and assess all aspects of the claim against its investment criteria. This process should eliminate many unmeritorious arbitrations against the respondent. These factors include:

- (1) the prospects of success of the claims based on an analysis of the legal and factual arguments known to the claimant;

¹⁵ Maya Steinitz, *Whose Claim is This Anyway? Third-Party Litigation Funding* (Legal Studies Research Paper No 11-31, University of Iowa, 2011), at 1311.

¹⁶ Jasminka Kalajdzic, Peter Cashman and Alana Longmoore, "Justice for Profit: A Comparative Analysis of Australian, Canadian and U.S. Third Party Litigation Funding" (2013) 61(1) *American Journal of Comparative Law* 93, at 101.

¹⁷ The experience with TPF in Australia shows that the legal experience, expertise and risk aversion of commercial litigation funders in Australia has served to prevent unmeritorious claims rather than facilitate them: see Jasminka Kalajdzic, Peter Cashman and Alana Longmoore, "Justice for Profit: A Comparative Analysis of Australian, Canadian and US Third Party Litigation Funding" (2013) 61(1) *American Journal of Comparative Law* 93, at 142; see also Marco de Morpurgo, "A Comparative Legal and Economic Approach to Third-party Litigation Funding" (2011) 19 *Cardozo Journal of International and Comparative Law* 343, at 383-384; Eric De Brabandere and Julia Lepeltak, *Third Party Funding in International Investment Arbitration* (Working Paper No 1, Grotius Centre for International Legal Studies, 2012), at 7.

- (2) the quantum of the claims in comparison with the likely costs and risks of pursuing the claims. The Third Party Funders will not expect that the claim carries no risk, but will be looking to ensure that they have the right balance of risk versus reward and that the costs are not disproportionate to the likely recovery;
- (3) the terms of the arbitration agreement or applicable treaty;
- (4) the arbitral institution and composition of the Tribunal (if it has been appointed);
- (5) the seat of the arbitration, and the law of the arbitration agreement;
- (6) the substantive law of the dispute;
- (7) whether there are any potential jurisdictional issues. For example, any grounds for the respondent to challenge the Tribunal's jurisdiction or for the Tribunal to determine that it does not have jurisdiction;
- (8) possible counterclaims;
- (9) the likely timing of resolution of the claims; and
- (10) the risks associated with enforcing and obtaining payment under an Award. In international commercial arbitrations, one of the most important factors is whether the respondent has assets of sufficient value in a state that is a signatory to the New York Convention.¹⁸

Promotion of arbitration as an alternative dispute resolution method

5.22 Permitting Third Party Funding for arbitration should promote the access to arbitration as an alternative dispute resolution method to using the Hong Kong courts. This will free up the Hong Kong courts' resources, enabling the court to deploy its tax-payer funded resources to deal with cases that are of a greater public interest.

5.23 There are several benefits to arbitration as an alternative dispute resolution method, including the flexibility and party-controlled nature of any procedure, the capacity for greater choice over who decides a claim (rather than a court appointed judge), the confidentiality of such proceedings, the potential for a quick and cost-efficient resolution of disputes, and the potential to enforce any decisions in multiple jurisdictions.

5.24 An increase in the availability of Third Party Funding for arbitration makes it easier for parties unfamiliar with alternative dispute resolution to have access to the benefits of arbitration. It will also increase Hong Kong's reputation as an international arbitration centre, promoting Hong

¹⁸ Susanna Khouri and Kate Hurford, *Third Party Funding for International Arbitration Claims: Practical Tips* (Practice Note, Practical Law Company Arbitration, 2012).

Kong's commitment to the rule of law, and attracting further investment and jobs.

Potential risks of Third Party Funding for arbitration

Introduction

5.25 Whilst Third Party Funding has several benefits as explored above, there are potential risks that arise which need to be considered and addressed from the perspectives of the parties, their representatives and in the public interest. Third Party Funders are commercial entities that need to ensure a return on their investment, and as such, will not only conduct a thorough due diligence of a claim or defence before providing funding (giving rise to confidentiality and risk issues), but are also likely to attempt to negotiate the most favourable terms for any funding agreement in order to maximise their potential returns.

Is there a risk of promoting unnecessary arbitration proceedings?

5.26 The analogy in modern dispute resolution proceedings, including arbitration, to the medieval rationale for the development of the doctrines of champerty and maintenance (discussed in Chapters 1 and 3) is that the Third Party Funding of arbitral proceedings may enable the commencement or continuation of unnecessary arbitration. In our view, the publicly available information does not evidence that this is a substantial issue. As Third Party Funders are commercial entities who need a funded case to succeed to recover their investment and to make a profit, the available evidence suggests that they are unlikely to invest in claims or defences that have little chance of success, as we have discussed in Chapter 3.

5.27 Whilst the principles of market economics should ensure that Third Party Funders fund only cases that have a high chance of success, the recent *Excalibur Ventures v Gulf Keystone Inc*¹⁹ case before the English Commercial Court shows that not only is it possible for Funders to get their initial assessment of the merits of a case wrong and invest in unnecessarily high quantum claims, but also to condone and finance the conduct of counsel which unnecessarily increases the costs of a dispute for both parties. In *Excalibur 2013*, this resulted in the Third Party Funder having to finance an Adverse Costs Order handed down in recognition of that conduct. This is a rare case, however.

5.28 As the recent English case law of *Harcus Sinclair v Buttonwood Legal Capital Ltd*²⁰ shows, the prospects of success can change after a Third

¹⁹ *Excalibur Ventures LLC v Texas Keystone Inc* [2013] EWHC 2767. Discussed in Chapter 4.

²⁰ *Harcus Sinclair v Buttonwood Legal Capital Ltd and others* [2013] EWHC 1193. In this case, it was a condition of the Third Party Funder's funding that the chances of success of the claim were above 60%. As the case progressed, the Third Party Funder considered that the Funded

Party Funder has agreed to invest. Whilst it is likely that the Third Party Funders will attempt to avoid "*unnecessary*" arbitration claims (however that may be defined) in order to safeguard their own commercial interests, the processes they undertake to do so are not infallible and Third Party Funders may inadvertently fund what instead may become a weak case. However, this is a risk in any arbitration irrespective of whether or not it is being funded by a Third Party Funder.

Degree of control over arbitration by Third Party Funders

5.29 Given that the Third Party Funder is bearing the financial risk of the arbitration and is the entity incurring the costs of legal representation, there is a chance that a Third Party Funder will want to exercise control over any arbitration it funds, whether overall or day to day. While 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, the English courts have made it clear that the Funded Party should retain control, as discussed in Chapter 4.

5.30 Whilst the resources of the Third Party Funders generally mean that they are unable to manage arbitrations on a day-to-day basis,²¹ it is likely that the Third Party Funders will want to express a view on the "*big picture*" strategic decisions, given the potential effect such decisions may have on their return on investment. This may include the choice of counsel, as well as decisions on legal strategy.

5.31 The nature of the control a Third Party Funder will have over the arbitration will be governed by the terms of the funding agreement to the extent permitted by the applicable law. Despite those terms, in the jurisdictions reviewed (as in Hong Kong), the Funded Party's legal representatives have professional and ethical duties and responsibilities solely to the Funded Party and not to the Third Party Funder, and should therefore not act in the commercial interests of the Third Party Funder if they conflict with their duties to their clients.

Party counsel's initial legal opinion as to the chances of success was inadequate. The Third Party Funder sought a legal opinion from independent legal counsel, which put the chances of success of the Funder Party's claim at below 60%. The Third Party Funder subsequently terminated the funding agreement, which prompted the action before the court. The Court held that the Third Party Funder had valid grounds to terminate the funding agreement.

²¹

"The Dynamics of Third-Party Funding", *Global Arbitration Review* (2012), <<http://globalarbitrationreview.com/journal/article/30372/the-dynamics-third-party-funding-in-full>>, Mick Smith of Calunius Capital UK said, "*We're not a law firm ... we have a lot of interesting things to say about some of the economic risks around the case. But we're not set up to run it. Calunius is just four partners and two support staff.*"

Costs of Third Party Funding

Structure of the funding agreement

5.32 From the information available, there do not appear to be any standard terms for Third Party Funding regarding:

- (1) how Third Party Funding is provided and on what terms; and
- (2) how the Third Party Funder obtains a return on its investment and at what percentage.

5.33 The terms and costs of Third Party Funding are therefore variable, and where permitted (absent regulation), depend on the relative negotiating strengths of the Third Party Funder and the Funded Party. There is a risk that an unsophisticated Funded Party may agree to onerous and unreasonable terms in the agreement, thereby denying the Funded Party a fair entitlement to a majority of the sums it is claiming for.

Security

5.34 Third Party Funders may ask for security from a Funded Party as a condition for providing funding. Providing a Third Party Funder with security could lead to significant risks to the Funded Party, for example, it may affect or restrict the Funded Party's ability to conduct its normal business operations.

Liability for adverse costs awards or orders

5.35 At the end of arbitration proceedings, the Tribunal will render an Award on how the costs incurred by the parties should be apportioned between them. The costs Award is used by the Tribunal not only to reward or punish parties for their respective conduct throughout the arbitration, but also to recognise whether the claimant had a meritorious claim that justified commencing the arbitration. Adverse costs awards may also be made where the claim is either legally unsound or without merit, or its quantum claim is wildly overstated, meaning that the cost the respondent has incurred in dealing with the claim was unnecessary. In such situations, the Tribunal may sanction the claimant by ordering it to pay all of the costs that the respondent has incurred.

5.36 It is therefore a key consideration for both Third Party Funders and Funded Parties, as well as for successful respondents, whether the Funded Party or the Third Party Funder is ultimately liable for adverse costs awards.²² Such liability should be governed by the terms of the funding agreement.

²² Generally, a Tribunal cannot make an adverse costs order against a Third Party Funder directly, as the Third Party Funder is not a party to the arbitration agreement.

5.37 As we have discussed in Chapter 4, the issue of whether or not adverse costs awards or orders are made against Third Party Funders has been considered by various courts.

5.38 In England and Wales, the extent of a Third Party Funder's liability for adverse costs (in litigation) remains unsettled. In *Arkin v Borchard Lines Ltd*,²³ the English Court of Appeal held that a professional Third Party Funder, who finances part of a claimant's costs of litigation, should be potentially liable for the costs of the opposing party "to the extent of the funding provided."²⁴ The Court of Appeal reasoned that if a Third Party Funder that was contemplating funding a limited part of an impecunious claimant's expenses were potentially liable for the entirety of the defendant's costs should the claim fail, then no Third Party Funder would be prepared to provide the necessary funding. This would have the effect of denying access to justice for claimants.²⁵ However, the approach in *Arkin* has been criticised. Lord Justice Jackson, for example, has argued that there is no evidence indicating that imposing full liability for adverse costs on Funders would stifle Third Party Funding or inhibit access to justice.²⁶ As a matter of principle, he considered it wrong that a Third Party Funder, which stood 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.

5.39 The Court of Appeal in *Arkin* did recognise, albeit on an *obiter* basis, that there might be a possibility for its limitation on the extent of the Third Party Funder's liability for an Adverse Costs Order to be waived, if the Third Party Funder had "*motives other than profit*" in funding an unsuccessful claim.²⁷ An example of a motive "*other than profit*" may be drawn from the *Akai Holdings* case before the Hong Kong court, where Stone J aired a concern about the liquidators of Akai Holdings disclosing confidential information received in that litigation to the Third Party Funders, and made an order prohibiting such disclosure.²⁸

5.40 In *Excalibur 2013*, however, the English High Court did limit the amount of costs that the Third Party Funders were liable for to the amount of their funding, in accordance with the "*cap*" principle developed in *Arkin*. As discussed in Chapter 4, such an order was given regardless of the level of influence or control the Third Party Funder may have exercised over the proceedings – the very funding itself was found by the English High Court to be justification enough in *Excalibur 2013* for the liability of the Third Party Funders.

²³ [2005] 1 WLR 3055 (CA).

²⁴ *Arkin v Borchard Lines Ltd* [2005] 1 WLR 3055 (CA), at para 41 (*per* Lord Phillips).

²⁵ *Arkin v Borchard Lines Ltd* [2005] 1 WLR 3055 (CA), at para 39 (*per* Lord Phillips).

²⁶ Lord Justice Jackson, *Review of Civil Litigation Costs*, Final Report (2009), Vol 1, at 123.

²⁷ *Arkin v Borchard Lines Ltd* [2005] 1 WLR 3055 (CA), at para 44 (*per* Lord Phillips).

²⁸ See *Akai Holdings Ltd v Ho Wing On Christopher* [2009] HKEC 1437, at para 82 where Stone J revised the terms of a receivership order which gave "*carte blanche*" rights to the liquidators to investigate the assets of a valuable family trust, to prohibit information from this being provided to the Liquidators' Third Party Funders.

5.41 If the position in England and Wales is applied and extended to arbitration proceedings, Third Party Funders may need to develop, and indeed many litigation funders in fact have developed, business models that cover potential liability for adverse costs.²⁹ As part of their standard funding package, many Funders do agree to fund the costs of insurance for adverse costs.³⁰ Furthermore, the decision in *Excalibur 2013* is likely to increase the scope and thoroughness of the due diligence a Third Party Funder will conduct before it agrees to provide funding to a party.

5.42 Whilst these cases dealt with Adverse Costs Orders issued by courts against Third Party Funders, it is unclear on what legal basis a Tribunal could make similar orders. As stated at paragraph 2.23 above, a Tribunal's jurisdiction stems from the arbitration agreement, and the Tribunal can only issue Awards against those who are party to the arbitration agreement and have thereby consented to the Tribunal's jurisdiction. Unless the Third Party Funder becomes a party to the arbitration agreement, any adverse costs award handed down directly against a Third Party Funder by a Tribunal will very likely be unenforceable for lack of jurisdiction.

5.43 A Tribunal can issue awards against third parties in certain very limited circumstances when the arbitration agreement "*is construed to have been extended*" to involve those third parties on certain grounds (and even then the legal basis for such extension is a matter of debate).³¹ It is doubtful whether such grounds can be extended to provide a sound legal basis for Tribunals to issue adverse costs awards against Third Party Funders. As noted in Chapter 3, the recently revised *IBA Guidelines on Conflicts of Interest in International Arbitration 2014* state that a Third Party Funder "*bears the identity*" of the Funded Party to the arbitration. It is unclear, though, whether this concept extends the jurisdiction of the Tribunal to include Third Party Funders, as it does not account for the necessity of the Third Party Funder's consent either to such an extension, or to being a party to the arbitration agreement (as required by Article II 1 of the New York Convention).

Potential for breaches of legal professional privilege

5.44 A funding agreement is usually between the Third Party Funder and the Funded Party. The Funded Party's legal counsel is not usually party

²⁹ Lord Justice Jackson, *Review of Civil Litigation Costs*, Final Report (2009), Vol 1, at 123.

³⁰ "International Arbitrations: is there an Arkin risk equivalent?", *Harbour Litigation Funding* <<http://www.harbourlitigationfunding.com/articles/international-arbitrations-is-there-an-arkin-risk-equivalent>>.

³¹ These grounds include the *alter ego* principle, or implied consent. Maxi Scherer, "Third-party funding in international arbitration: Towards mandatory disclosure of funding agreements?", ICC Institute of World Business Law Dossiers, *Third Party Funding in International Arbitration* (2013, ed Bernardo Cremades, Antonias Dimolitsa). These grounds are discussed in detail in section 10.02 to "Legal Bases for Binding Non Signatories to International Arbitration Agreements"; and section 10.03 "Future Directions: Legal Bases for Binding Non Signatories to International Arbitration Agreements"; Gary B Born *International Commercial Arbitration* (2014; Second Edition), Chapter 10.

to it. As such, there is no client or lawyer relationship between the Funded Party's legal counsel and the Third Party Funder, with the potential result that the following types of communication may not be protected by legal professional privilege:

- (1) communications by counsel to both the Third Party Funder and the Funded Party regarding the arbitration (though it is likely that these communications will be covered by litigation privilege); and
- (2) communications by counsel to the Funded Party, which are subsequently forwarded to the Third Party Funder by the Funded Party (this action may constitute an implied waiver of legal professional privilege by the Funded Party).

5.45 If the two types of communications identified above are not legally privileged, then confidentiality terms of the funding agreement may still restrain a Third Party Funder from disclosing a document, if the Third Party Funder finds itself the subject of a disclosure application by the other side in the arbitration. The risk of such advice being subject to a disclosure application brought by the other side on the basis that legal professional privilege was waived, has led to a consensus amongst certain Third Party Funders that due diligence on a claim should focus on facts available, rather than legal opinions being transferred.³²

Confidentiality issues

5.46 As illustrated by the *Harcus Sinclair* case before the English courts, and as discussed earlier, Third Party Funders require regular updates during the arbitration.³³ This leads to the necessity of disclosure of key facts to the Third Party Funder to maintain its commercial confidence in its investment, and it may be the case that such information is confidential. The Funded Party therefore faces a conflict of interest – to disclose confidential information to the Third Party Funder in order to maintain funding, or to risk the loss of the Third Party Funder's continued involvement by not disclosing the information. Such disclosure of information may breach the provisions of section 18 of the Arbitration Ordinance which prohibit disclosure of information relating to arbitrations without the consent of all parties involved.

5.47 The possibility of confidential information being provided to the Third Party Funder is not limited to information regarding the Funded Party. As the *Akai Holdings* case in Hong Kong shows, the Hong Kong courts have expressed a concern about the provision of confidential information to Third Party Funders and have made an Order prohibiting this.³⁴

³² Maxi Scherer and Aren Goldsmith, "Third Party Funding in International Arbitration in Europe: Part 1 – Funders' Perspectives" (2012) (2) 2012 *International Business Law Journal* 207, at 216.

³³ *Harcus Sinclair v Buttonwood Legal Capital Ltd* [2013] EWHC 1193.

³⁴ *Akai Holdings Ltd v Ho Wing On Christopher* [2009] 5 HKLRD K2.

Disclosure of Third Party Funding agreement

5.48 It will be of great interest to the opposing party in an arbitration to know whether the party bringing the claim is being funded by a Third Party Funder. As discussed earlier, knowledge of the existence of a funding agreement may significantly affect the other side's willingness to settle the claim.

5.49 Knowledge of the existence of the Third Party Funding agreement may also be used by the opposing party as part of its strategy to deal with the claim. For example, as explained in this chapter, the opposing party may make certain allegations or take actions to undermine the relationship between the Third Party Funder and the Funded Party, thereby jeopardising the resources with which a claim has been brought against it.

Conflicts of interest

5.50 The development of Third Party Funding has given rise to a new source of conflict of interest for legal professionals participating in the arbitration process, ie, counsel, as well as arbitrators. Examples of the potential conflicts of interest that could arise for both sets of professionals discussed have included the following:

(1) Counsel

- (a) A conflict of interest may arise if a Third Party Funder frequently funds the same law firm, albeit for different clients. In this situation, there becomes a potential conflict between the professional duties that a law firm owes to its clients, and the economic reliance that law firm has on the Third Party Funder. This may give rise to the risk, from the Funded Party's perspective, that the law firm may side with the Third Party Funder in certain issues.
- (b) A conflict of interest may arise during settlement negotiations. It may be in the financial interest of the Third Party Funder, and the law firm, for the case to settle or not settle, depending on the facts of the matter. This financial interest may conflict with the best interests of the client.

(2) Arbitrators

- (a) A conflict of interest may arise if the same arbitrator is appointed in different arbitrations, by Funded Parties funded by the same Third Party Funder. In this situation, the arbitrator must consider whether this affects his impartiality.

- (b) The issue may be used by the opposing party in an arbitration to challenge the appointment of the arbitrator, on the basis of a lack of impartiality owing to repeat appointments by the same Third Party Funder.

Disclosure of funding may unduly influence Tribunal / may prevent the proper settlement of a case

5.51 On the theory that Third Party Funders will only fund meritorious claims, it is possible that if the fact that a Funded Party is being funded is disclosed to the Tribunal, it may influence it to form a more favourable view of the strength of the Funded Party's case.

5.52 If Third Party Funding is disclosed to the other party in the arbitration, the other party may consider that it is therefore certain to incur significant legal costs in defending the claim for the full duration of the arbitration (as the claimant is fully funded). This prospect can be very influential in a party's calculation as to whether to settle early on in the arbitration, so as to avoid incurring costs itself (as well as any adverse costs order).

Risk of arbitrary termination of the Third Party Funding agreement in Third Party Funding

5.53 One of the key issues in relation to Third Party Funding is when (and on what basis) a Third Party Funder can terminate the provision of funding to a Funded Party. In negotiating the scope of a Third Party Funder's power to withdraw funding, it is necessary to balance the competing interests of the Funded Party and the Third Party Funder.

5.54 A Funded Party needs protection from a Third Party Funder's arbitrary withdrawal of funding. If a Third Party Funder has very broad discretion to cut the financial support for the Funded Party's arbitration, this may put pressure on the Funded Party to defer to the Third Party Funder's interests. This may allow the Third Party Funder to exert indirect influence over the conduct of the arbitration and erode the Funded Party's ability to direct its own arbitration strategy.

Risk of insufficient Third Party Funder capital adequacy

5.55 The capital adequacy of a Third Party Funder refers to the ratio of a Third Party Funder's capital (cash deposits in the bank) to its assets (ie, funding arrangements). A minimum level of capital is necessary to protect Third Party Funders against unexpected losses if a Funded Party's claim does not succeed, as well as to provide confidence to the Funded Parties that the Third Party Funder has sufficient money to pay for the costs of an arbitration, which can be substantial.

5.56 Capital adequacy is particularly important as Funded Parties do not have visibility of the Third Party Funder's other investments, and therefore do not know whether a Third Party Funder has agreed to fund more claims than it can afford to fund, or has taken on risks which are beyond its financial capacity to absorb if they are realised. Capital adequacy has therefore been described as of significant importance in the context of Third Party Funding.³⁵

5.57 Given that capital adequacy is such an important form of protection for Funded Parties, some commentators have considered whether capital adequacy should be regulated by a statutory body, not just by a voluntary regulatory body within the Third Party Funding industry, as the UK has chosen to do so with ALF.³⁶

Inadequate complaints procedures

5.58 In addressing the risks of Third Party Funding that arise from the potential conduct of Third Party Funders, there are currently no formal procedures or rules in place for dealing with complaints against Third Party Funders in Hong Kong. The ability for the Funded Parties to obtain meaningful remedies for legitimate complaints made against Third Party Funders is important to protect them from exploitation by the Third Party Funders. Equally important is the need to deter Third Party Funders from engaging in inappropriate conduct.

5.59 The different approaches other jurisdictions have adopted in relation to dealing with complaints have been discussed in Chapter 4.

Money laundering

5.60 As with any activity involving money or financial services, there is a risk that Third Party Funding in arbitration may be used as a means to launder the monetary proceeds of criminal activity. This area is highly regulated in Hong Kong and accordingly we have not considered it necessary to conduct any in-depth review.

³⁵ Lord Justice Jackson, *Review of Civil Litigation Costs*, Final Report (2009), at 121.

³⁶ Lord Justice Jackson, *Review of Civil Litigation Costs*, Final Report (2009), at 121. Lord Justice Jackson approached the Financial Services Authority ("FSA") in the United Kingdom to ascertain whether that body was the appropriate body to monitor the capital adequacy of Third Party Funders. The FSA indicated that it would not be able to undertake this monitoring role alone, and the benefits of doing so would have to outweigh the costs.

Chapter 6

Recommendations

6.1 We have considered Hong Kong's status as a major arbitration centre and the need to maintain its competitiveness. We have also considered how all but one of other major international arbitration centres allow Third Party Funding of Arbitration. We have concluded that Hong Kong's competitiveness as an international arbitration centre will likely be reduced if the law is not clarified to make it clear that Third Party Funding for arbitration taking place in Hong Kong is permitted.

6.2 We have reviewed current Hong Kong law relating to Third Party Funding of arbitrations taking place in Hong Kong including the Hong Kong Court of Final Appeal's judgment in *Unruh v Seeberger*.¹

6.3 We are of the unanimous view that the current position relating to Third Party Funding for arbitration in Hong Kong needs reform to clearly permit Third Party Funding for arbitration, subject to compliance with appropriate ethical and financial standards.

6.4 We consider from our review of the law in Hong Kong (Chapters 2 and 3) and in other jurisdictions (Chapter 4) that there are obvious benefits to the stakeholders in arbitration (Chapter 5). We also consider that the potential risks arising from Third Party Funding (Chapter 5) are manageable by implementing clear ethical and financial standards which will provide safeguards.

Recommendation 1

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

6.5 Having clear ethical and financial standards for Third Party Funders providing Third Party Funding to parties to arbitration is important.

¹ In *Unruh v Seeberger* (2007) 10 HKCFAR 31, the Court of Final Appeal held that it should not strike down an agreement providing for Third Party Funding of Proceedings on the grounds of maintenance or champerty where such funded arbitral proceedings (among others) are seated in a jurisdiction in which there is no public policy objection to such funding.

Such standards are in place to varying degrees in all of the jurisdictions that permit Third Party Funding that we have reviewed.

6.6 Our survey of jurisdictions in Chapter 4 shows that while Third Party Funding for arbitration is permitted in all but one of the jurisdictions reviewed, there is little uniformity in the form of regulation of Third Party Funding. The main trend is toward a light touch approach either by including statutory regulation of financial and conflicts issues (eg, Australia) or self-regulation (eg, England and Wales).

6.7 To varying degrees, different jurisdictions (eg, Australia and some states in the United States) have statutory regulation in place, while in England and Wales there is a system of industry self-regulation. All jurisdictions that we reviewed also impose ethical and professional rules on lawyers, of varying content. We consider that Hong Kong should develop its own model of regulation to suit its culture and needs, which will be informed by the experience and approach of other relevant jurisdictions.

Recommendation 2

We recommend that clear ethical and financial standards for Third Party Funders providing Third Party Funding to parties to arbitrations taking place in Hong Kong should be developed.

6.8 As to the approach to regulation of Third Party Funding to a party to an arbitration taking place in Hong Kong, we do not have any fixed views to whether this should be by:

- (a) statute, such as a schedule to the Arbitration Ordinance (Cap 609) or by regulation. This could involve challenges, including that the implementation and any later amendment process could take too long; or,
- (b) a Code of Conduct, such as that of the ALF (albeit the Code was drafted by a Ministry of Justice Working Group consisting of representatives of various stakeholders).

6.9 We consider that potential challenges to adopting a self-regulatory approach in Hong Kong, by contrast to England and Wales, include that:

- (1) there is no critical mass of Third Party Funders in Hong Kong;
- (2) Third Party Funders are generally not incorporated in Hong Kong, nor do they generally have a place of business in Hong Kong;

- (3) Hong Kong is generally a jurisdiction that promulgates statutory codes or regulations to protect matters in the public interest.

A question may also arise as to how to ensure public confidence in a self-regulatory Code. One alternative could be for the self-regulatory approach to be implemented on a trial basis, for example for a 2 year period. However, the question would then arise as to how to monitor the effectiveness of self-regulation.

6.10 Among the questions arising, whatever approach to regulation is adopted, are whether Hong Kong would need Third Party Funders to have:

- (1) a Hong Kong registered office; and
- (2) assets in Hong Kong;

and how any ethical and financial standards for Third Party Funders should be enforced.

6.11 The areas that the regulation of Third Party Funders should address are obviously important. The following areas have been considered in other jurisdictions:

- (1) Capital adequacy requirements [see paras 5.55 to 5.57 above] – This is a key feature in the regulation of Third Party Funders in other jurisdictions. We consider 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. From our review of jurisdictions where Third Party Funding is common, it appears that Third Party Funders whose business is focused on providing such financing are usually entities with adequate financial resources. We are of the view that Third Party Funders should satisfy capital adequacy requirements. The requisite amount of capital can be considered in due course.
- (2) Conflicts of interest [see para 5.50 above] – This is an area that should be considered, as it is likely that situations will arise from time to time where the interests of a Third Party Funder may conflict with the interests of the Funded Party and other stakeholders. Different techniques have been deployed to minimise/ manage such conflicts in other jurisdictions.
- (3) Confidentiality [see paras 5.46 to 5.47 above] – The Arbitration Ordinance imposes extensive confidentiality obligations with respect to arbitral proceedings. The confidential nature of arbitration has long been considered as one of its advantages over court proceedings. A dilemma can arise where a Third Party Funder requires disclosure of key facts in the proceedings to enable it to decide whether to fund a party. However, there is a problem for the party seeking funding as to the confidential

information it can provide to the Third Party Funder in order to obtain and/or maintain funding without breach of section 18 of the Arbitration Ordinance, which prohibits disclosure of information relating to arbitrations without the consent of all parties involved, or any contractual confidentiality obligations.

- (4) Privilege [see paras 5.45 to 5.46 above] – There are uncertainties as to whether the communications between the Third Party Funder and the Funded Party (and their representatives) are privileged and may be discoverable. The operation of the rules on privilege and waiver in the context of Third Party Funding for arbitration should be considered.
- (5) Extent of extra-territorial application – This area can raise 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. Under section 5 of the Arbitration Ordinance, the Ordinance is applicable if the seat of the arbitration is Hong Kong. The main exceptions to non-extra-territoriality relate to the powers of the Hong Kong courts, and recognition and enforcement of awards.

There are also potential problems for lawyers working on an international arbitration in Hong Kong that is seated in another jurisdiction where Third Party Funding is permitted, given the lack of clarity in the Hong Kong law as to the permissibility of Third Party Funding.

- (6) Control of the arbitration by Third Party Funders [see paras 5.29 to 5.31 above] – As we discussed in Chapter 5, given that the Third Party Funder is bearing the financial risk of the arbitration and is the entity incurring the costs of legal representation, there is a chance that a Third Party Funder will want to exercise control over an arbitration it funds. The nature of the control will be governed by the terms of the funding agreement to the extent permitted by the applicable law. The extent of control allowed varies in other jurisdictions.
- (7) Disclosure of Third Party Funding to the Tribunal and to the other party/parties to the arbitration [see paras 5.48 to 5.49 and 5.51 to 5.52 above] – 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*.
- (8) Termination of funding [see paras 5.53 to 5.54 above] – Termination of funding by the Third Party Funder will have serious ramifications for the Funded Party. We consider that

the safeguards (if any) to be imposed in this regard should be explored.

- (9) Complaints and enforcement procedures [see paras 5.58 to 5.59 above] – The applicable complaints and enforcement procedure for a funded party aggrieved by the conduct of a Third Party Funder is another important issue. These are linked to the question of whether regulation should take the form of standards issued and supervised by a statutory body, or self-regulation by Third Party Funders.
- (10) Body issuing regulatory standards – If the regulatory standards applicable to Third Party Funding are to be drafted and issued by a statutory or governmental body, who should that body be? One possible approach would be for the Department of Justice to establish a working group with representatives of the main stakeholders in Hong Kong arbitration, including HKIAC, to draft a code of conduct setting out the ethical and financial standards to apply to Third Party Funding for arbitrations taking place in Hong Kong. To comply with Hong Kong law as amended, a Third Party Funder funding an arbitration taking place in Hong Kong would be required to agree in writing to comply with such Code of Conduct.

Recommendation 3

We invite submissions as to:

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

- (f) disclosure of Third Party Funding to the Tribunal and other party/parties to the arbitration;**
- (g) grounds for termination of Third Party Funding; and**
- (h) a complaint procedure and enforcement.**

6.12 We recommend that consideration be given 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.

6.13 We invite 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 (taking into account existing arbitral theory as to the limitation of a Tribunal's jurisdiction in relation to third parties). This Sub-Committee sees little reason as to why Third Party Funders should be permitted to enjoy the proceeds of a successful claim, but not be liable for costs if they have funded an unmeritorious claim or breached ethical and financial standards. One approach to overcoming the limitations on a Tribunal's jurisdiction would be for the Third Party Funder to contractually submit to the Tribunal's jurisdiction on a case by case basis.

6.14 This Sub-Committee does not consider that there is a need to legislate to provide for the Tribunal's power to order Third Party Funders to provide Security for Costs, as the parties themselves should be able to seek funding from the Third Party Funder for this purpose. However, we also invite submissions on this issue.

Recommendation 4

We invite submissions as to:

- (a) Whether or not a Third Party Funder should be directly liable for adverse costs orders in a matter it has funded;**
- (b) If the answer to sub-paragraph (a) is "yes", how such liability could be imposed as a matter of Hong Kong law, and for the purposes of recognition and enforcement under the Convention for Recognition and Enforcement of Foreign Arbitral Awards 1958;**
- (c) Whether there is a need to amend the Arbitration Ordinance to provide for the Tribunal's power to order**

**Third Party Funders to provide Security for Costs;
and**

- (d) If the answer to sub-paragraph (c) is "yes", the basis for such power as a matter of Hong Kong law, and for the purposes of recognition and enforcement under the Convention for Recognition and Enforcement of Foreign Arbitral Awards 1958.**

Chapter 7

Summary of Recommendations

Recommendation 1

We recommend that the Arbitration Ordinance should be amended to provide that Third Party Funding for arbitration taking place in Hong Kong is permitted under Hong Kong law. (Paras 6.1-6.4.)

Recommendation 2

We recommend that clear ethical and financial standards for Third Party Funders providing Third Party Funding to parties to arbitrations taking place in Hong Kong should be developed. (Paras 6.5-6.7.)

Recommendation 3

We invite submissions as to:

- (1) Whether the development and supervision of the applicable ethical and financial standards should be conducted by: (a) a statutory or governmental body, whether existing or to be established, and if so, what type of body; or (b) a self-regulatory body, whether for a trial period or permanently and how any ethical and financial standards should be enforced. (Paras 6.8-6.10.)
- (2) How the applicable ethical or financial standards should address any of the following matters or any additional matters:
 - (a) capital adequacy;
 - (b) conflicts of interest;
 - (c) confidentiality and privilege;
 - (d) extent of extra-territorial application;
 - (e) control of the arbitration by the Third Party Funder;
 - (f) disclosure of Third Party Funding to the Tribunal and other party/parties to the arbitration;
 - (g) grounds for termination of Third Party Funding; and
 - (h) a complaint procedure and enforcement. (Para 6.11.)

Recommendation 4

We invite submissions as to:

- (a) Whether or not a Third Party Funder should be directly liable for adverse costs orders in a matter it has funded;
- (b) If the answer to sub-paragraph (a) is "yes", how such liability could be imposed as a matter of Hong Kong law, and for the purposes of recognition and enforcement under the Convention for Recognition and Enforcement of Foreign Arbitral Awards 1958;
- (c) Whether there is a need to amend the Arbitration Ordinance to provide for the Tribunal's power to order Third Party Funders to provide Security for Costs; and
- (d) If the answer to sub-paragraph (c) is "yes", the basis for such power as a matter of Hong Kong law, and for the purposes of recognition and enforcement under the Convention for Recognition and Enforcement of Foreign Arbitral Awards 1958. (Paras 6.12-6.14.)

**Relevant legislative and regulatory regime
[The law as of September 2015]**

The Basic Law of the HKSAR

Article 35	<p><i>[Access to justice]</i></p> <p>Hong Kong residents shall have the right to confidential legal advice, access to the courts, choice of lawyers for timely protection of their lawful rights and interests or for representation in the courts, and to judicial remedies.</p> <p>...</p>
------------	---

Arbitration Ordinance (Cap 609)

s 63	<p><i>Representation and preparation work</i></p> <p>Section 44 (Penalty for unlawfully practising as a barrister or notary public), section 45 (Unqualified person not to act as solicitor) and section 47 (Unqualified person not to prepare certain instruments, etc.) of the Legal Practitioners Ordinance (Cap 159) do not apply to —</p> <p>(a) arbitral proceedings;</p> <p>(b) the giving of advice and the preparation of documents for the purposes of arbitral proceedings; or</p> <p>(c) any other thing done in relation to arbitral proceedings, except where it is done in connection with court proceedings —</p> <p style="padding-left: 20px;">(i) arising out of an arbitration agreement; or</p> <p style="padding-left: 20px;">(ii) arising in the course of, or resulting from, arbitral proceedings.</p>
------	--

Criminal Procedure Ordinance (Cap 221)

s 101I	<p>(1) Subject to subsections (2) and (5), where a person is convicted of an offence which is an indictable offence and for which no penalty is otherwise provided by any Ordinance, he shall be liable to imprisonment for 7 years and a fine.</p>
--------	---

Code of Conduct of the Bar of the HKSAR

92	<p><i>[Commission]</i></p> <p>A barrister may not give a commission or present to any person who introduces professional work to him.</p>
110	<p><i>[Fiduciary duty]</i></p> <p>A barrister has a duty to uphold the interests of his client without regard to his own interests or to any consequences to himself or to any other person.</p>
112	<p><i>[Conflict of interest]</i></p> <p>If a barrister forms the view that there is a conflict of interest between his lay client and the person instructing him in the matter or the company, firm or other body of which such a person is a director, partner, member or employee, he should advise that it would be in the lay client's interest to instruct another person authorised to instruct him in the matter. Such advice should be given either in writing or at a conference at which both the person instructing him in the matter and the lay client are present.</p>
116	<p><i>[Confidentiality]</i></p> <p>A barrister employed as Counsel is under a duty not to communicate to any third person information which has been entrusted to him in confidence, and not to use such information to his client's detriment or to his own or another client's advantage. This duty continues after the relation of Counsel and client has ceased. A barrister's duty not to divulge confidential information without the consent of his client, express or implied, subsists unless he is compelled or permitted to do so by law.</p>
124	<p><i>[Contingency fee]</i></p> <p>A barrister may not accept a brief or instructions on terms that payment of fees shall depend upon or be related to a contingency. For the avoidance of doubt nothing in this rule shall prevent a member from accepting payment of his fees by instalments and payment of interest on his fees either as agreed or allowed on taxation.</p>
126	<p><i>[Remuneration not to be commission]</i></p> <p>It is the duty of a barrister to remunerate his staff as may be agreed between them, provided that no barrister shall share or agree to share with any person (including his clerk) his fees by paying a commission or otherwise a percentage of the barrister's earnings.</p>

Hong Kong Solicitors' Guide to Professional Conduct

3.01	<p><i>Basic principles</i></p> <p>It is fundamental to the relationship which exists between a solicitor and his client that a solicitor is able to give impartial and frank advice to his client, free from any external or adverse pressures or interests which would destroy or weaken his professional independence or the fiduciary relationship with his client. The status of the profession is dependent upon a solicitor being in a position to advise his client independently and without any allegiance to or influence from anyone else.</p> <p><u><i>Commentary</i></u></p> <p>4. Many insurance policies contain the right for insurers to act in the name of the insured in the defence, prosecution or settlement of any claim falling within the policy cover and to nominate a solicitor to carry out legal services on behalf of the insured in relation to the claim. A solicitor is permitted to act on the instructions of an insurer who offers this form of policy, without being in breach of rule 2 of the <i>Solicitors' Practice Rules</i> (Cap 159 sub. leg. H). It must be recognised that in these circumstances, a solicitor-client relationship is established between the solicitor and the insured (see principle 9.04, commentary 1).</p> <p>If the insurer's solicitor acts for the insured in defending criminal proceedings, the solicitor should normally act in such proceedings on the instructions of the insured alone, notwithstanding that the outcome of the prosecution may affect subsequent civil proceedings.</p> <p>5. A solicitor must avoid being placed in the position where his interests or the interests of a third party to whom the solicitor may owe a duty conflict with the interests of a client (see Chapters 7 & 9).</p>
4.16	<p><i>Sharing profit costs</i></p> <p>Subject to the exceptions set out in rule 4 of the <i>Solicitors' Practice Rules</i> (Cap 159 sub. leg. H), a solicitor shall not share or agree to share his profit costs with any person other than a practising solicitor.</p> <p><u><i>Commentary</i></u></p> <p>1. A solicitor should not factor his book debts (see also principle 8.01, commentary 33).</p> <p>2. The Council has granted a general waiver under rule 6 from rule 4 of the <i>Solicitors' Practice Rules</i> (Cap 159 sub. leg. H) to enable solicitors to accept payment of their fees by the use of a credit card facility.</p>

4.17	<p>Contingency fee arrangements</p> <p>A solicitor may not enter into a contingency fee arrangement for acting in contentious proceedings (see section 64 of the Legal Practitioners Ordinance (Cap 159)).</p> <p><u>Commentary</u></p> <ol style="list-style-type: none"> 1. A contingency fee arrangement is any arrangement whereby a solicitor is to be rewarded only in the event of success in litigation by the payment of any sum (whether fixed, or calculated either as a percentage of the proceeds or otherwise). This is so, even if the agreement further stipulates a minimum fee in any case, win or lose. 2. This principle 4.17 only extends to agreements which involve the institution of proceedings. Consequently, it would not be unlawful for a solicitor to enter into an agreement on a commission basis to recover debts due to a client, provided that the agreement is limited strictly to debts which are recovered without the institution of legal proceedings.
5.06	<p>Third party instructions</p> <p>Where instructions are received not from a client but from a third party purporting to represent that client, a solicitor should obtain written instructions from the client that he wishes him to act. In any case of doubt he should see the client or take other appropriate steps to confirm instructions.</p> <p><u>Commentary</u></p> <ol style="list-style-type: none"> 1. In such circumstances a solicitor must advise the client without regard to the interests of the source from which he was introduced. 2. This principle should particularly be borne in mind when instructions are received to commence or defend litigation; a solicitor is required by law to be properly authorised to act on behalf of a litigating client; if he is not he may become personally liable for costs if the action is struck out.
5.07	<p>Conflict of interest</p> <p>A solicitor must not act, or must decline to act further, where there is, or is a significant risk of, a conflict of interest.</p>
5.13	<p>Confidentiality</p> <p>A solicitor must observe the duty of confidentiality (see Chapter 8).</p>

5.16	<p><i>Fiduciary duty</i></p> <p>A solicitor owes a fiduciary duty to his client (see Chapter 7).</p>
5.19	<p><i>Unbiased advice</i></p> <p>A solicitor's advice must be unbiased and not be influenced by whether his employment or other work may depend upon advising in a particular way (see rule 2 of the Solicitors' Practice Rules (Cap 159 sub. leg. H) and Chapter 3).</p>
7.01	<p><i>Loyalty, Openness and Fairness</i></p> <p>In addition to the other duties implied by a retainer, a solicitor owes a fiduciary duty to his client. He must act with loyalty, openness and fairness towards his client.</p>
7.02	<p><i>Conflict of interest between solicitor and client</i></p> <p>A solicitor must act in the best interest of his client and he must not put himself in a position where his own interests conflict or are likely to conflict with his duty to his client, quasi-client or potential client.</p> <p><u><i>Commentary</i></u></p> <ol style="list-style-type: none"> 1. This principle applies not only where a solicitor is personally interested in a transaction, but equally where a partner or an employee of his firm is so interested. 2. A solicitor must also consider whether any family or other personal or emotional relationship, office, appointment or shareholding which he may inhibit his ability to advise his client properly and impartially. 3. Because of the fiduciary relationship which exists between a solicitor and his client, a solicitor must not take advantage of a client nor may he act where there is or there is a likelihood of a conflict of interest between his client and himself. For example, there will invariably be a potential conflict of interest where a solicitor leases to, sells to, or purchases from or lends to or borrows from his own client. In all such circumstances, unless the client takes independent advice, the solicitor must not proceed with the transaction. It should be understood that by independent advice is meant not only legal advice, but where appropriate, competent advice from a member of another profession, for example, chartered surveyor. 4. A solicitor must not apply any pressure on a purchaser-client to obtain finance from the solicitor's choice of lender (see Chapter 3.) 5. A solicitor should not enter into any arrangement or understanding with a client or prospective client prior to the conclusion of the matter giving rise to his retainer by

	<p>which the solicitor acquires an interest in the publication rights with respect to that matter.</p> <p>6. A solicitor who is a director or shareholder of a company for which he also acts must consider whether he is in a position of conflict when he is asked to advise the company upon steps it has taken or should take. It may be necessary for the solicitor to resign from the board or for another solicitor to advise the company in that particular matter.</p>
7.03	<p>Full disclosure</p> <p>A solicitor must disclose with complete frankness whenever he has or might obtain a personal interest or benefit in a transaction in which he is acting for a client. The disclosure should be in a manner that will be understood by the client, and preferably in writing (see Principle 2.07 Commentary 3).</p>
7.04	<p>Secret profits</p> <p>A solicitor must not make a secret profit but must disclose to his client fully the receipt of any such profit. He may only retain it if the client agrees (see Principle 2.07 Commentary 3).</p> <p><u>Commentary</u></p> <p>This principle also applies to the receipt by a solicitor of, for example, interest on client accounts, commissions received from insurance companies and agents and from stock brokers and from estate agents.</p>
8.01	<p>Duty of confidentiality</p> <p>A solicitor has a legal and professional duty to his client to hold in strict confidence all information concerning the business and affairs of his client acquired in the course of the professional relationship, and must not divulge such information unless disclosure is expressly or impliedly authorized by the client or required by law or unless the client has expressly or impliedly waived the duty.</p> <p><u>Commentary</u></p> <p>15. Confidential information may be divulged with the express authority of the client concerned and, in some situations, the authority of the client to divulge may be implied. For example, some disclosure may be necessary in a pleading or other document delivered in litigation being conducted for the client. Again, a solicitor may (unless his client directs otherwise) disclose the client's affairs to partners and associates in the firm and, to the extent necessary, to non-legal staff such as secretaries and filing clerks. This implied authority to disclose places the firm under a duty to impress upon its own lawyers and staff and those of any</p>

	<p>firm with which it may be associated the importance of non-disclosure (both during their employment and afterwards).</p> <p>19. Problems with confidentiality can arise where a solicitor or firm shares office services provided by independent contractors (such as computers, equipment or typing services) with another person or business. A solicitor should only make use of these where strict confidentiality of client matters can be ensured: see Practice Direction D.5.</p> <p>20. The Law Society has forbidden employment by a solicitor of any unqualified person who is in the regular employment of another solicitor unless approval has been given by the Council: see rule 4B of the <i>Solicitors' Practice Rules</i> (Cap 159 sub. leg. H).</p>
13.04	<p><i>A solicitor must not assist an unqualified person to act as a solicitor</i></p> <p>Section 49 of the Legal Practitioners Ordinance provides:</p> <p>"(1) No solicitor shall wilfully and knowingly:</p> <ul style="list-style-type: none"> (a) act as agent in any action or in any matter in bankruptcy for any unqualified person; or (b) permit his name to be made use of in any such action or matter upon the account or for the profit of any unqualified person; or (c) (repealed); (d) do any other act enabling any unqualified person to appear, act or practise in any respect as a solicitor in any such action or matter. <p>(2) Where it appears to a Solicitors Disciplinary Tribunal or to the Court that a solicitor has acted in contravention of this section, the Solicitors Disciplinary Tribunal or the Court shall order his name to be struck off the roll of solicitors.</p> <p>(3) Where the Court orders the name of a solicitor to be struck off the roll in respect of an offence under this section, it may further order that the unqualified person who was enabled by the conduct of the offender to act or practise as a solicitor shall be imprisoned for any period not exceeding one year."</p> <p><u><i>Commentary</i></u></p> <p>1. This section prohibits a solicitor from allowing an unadmitted person or body corporate to act as his principal or use his name in any action or in any bankruptcy matter.</p>

	<p>2. This section underlines the importance of the rules for the supervision of staff and offices prescribed by rule 4A of the Solicitors' Practice Rules (Cap 159 sub. leg. H) (see principle 2.04).</p>
--	--

Legal Practitioners Ordinance (Cap 159)

<p>s 44(1)</p>	<p><i>Penalty for unlawfully practising as a barrister or notary public</i></p> <p>(1) Any person who-</p> <p>(a) not being a qualified barrister, either directly or indirectly, practises or acts as a barrister;</p> <p>(b) not being a qualified notary public, either directly or indirectly, practises or acts as a notary public, shall be guilty of an offence and shall be liable on summary conviction to a fine of \$500,000.</p>
<p>s 45(1) & (2)</p>	<p><i>Unqualified person not to act as solicitor</i></p> <p>(1) A person who, by virtue of section 7, is not qualified to act as a solicitor shall not act as a solicitor, or as such sue out any writ or process, or commence, carry on or defend any action, suit or other proceeding, in the name of any other person or in his own name, in any court of civil or criminal jurisdiction or act as a solicitor in any cause or matter, civil or criminal, to be heard or determined before any court or magistrate.</p> <p>(2) Any person who contravenes the provisions of this section shall –</p> <p>(a) be guilty of contempt of the court in which the action, suit, cause, matter or proceeding in relation to which he so acts is brought or taken and may be punished accordingly;</p> <p>(b) be incapable of maintaining any action for any costs in respect of anything done by him in the course of so acting; and</p> <p>(c) be guilty of an offence and shall be liable on summary conviction to a fine of \$500000 and to imprisonment for 2 years;</p> <p>(d) (Repealed 60 of 1994 s 34).</p>
<p>s 49(1)</p>	<p><i>Solicitor not to act as agent for unqualified person</i></p> <p>(1) No solicitor shall wilfully and knowingly -</p> <p>(a) act as agent in any action or in any matter in bankruptcy for any unqualified person; or</p>

	<ul style="list-style-type: none"> (b) permit his name to be made use of in any such action or matter upon the account or for the profit of any unqualified person; or (c) (Repealed 60 of 1994 s 38); (d) do any other act enabling any unqualified person to appear, act or practise in any respect as a solicitor in any such action or matter.
<p>s 56(1) & (2)</p>	<p>Agreement for remuneration for non-contentious business</p> <ul style="list-style-type: none"> (1) Whether or not any rules made under section 74 are in force, a solicitor and his client may, either before or after or in the course of the transaction of any non-contentious business by the solicitor, make an agreement as to the remuneration of the solicitor in respect thereof. (2) The agreement may provide for the remuneration of the solicitor by a gross sum, or by commission or percentage or by salary, or otherwise, and it may be made on the terms that the amount of the remuneration therein stipulated for either shall or shall not include all or any disbursements made by the solicitor in respect of searches, plans, travelling, stamps, fees or other matters.
<p>s 64(1)</p>	<p>General provisions as to remuneration</p> <ul style="list-style-type: none"> (1) Nothing in section 58, 59, 60, 61 or 62 shall give validity to – <ul style="list-style-type: none"> (a) any purchase by a solicitor of the interest, or any part of the interest, of his client in any action, suit or other contentious proceeding; or (b) any agreement by which a solicitor retained or employed to prosecute any action, suit or other contentious proceeding stipulates for payment only in the event of success in that action, suit or proceeding; or (c) any disposition, contract, settlement, conveyance, delivery, dealing or transfer which is under the law relating to bankruptcy invalid against a trustee or creditor in any bankruptcy or voluntary arrangement with creditors within the meaning of the Bankruptcy Ordinance (Cap 6). (Amended 27 of 1998 s 7)

Solicitors (General) Costs Rules (Cap 159G)

Rule 5	<p><i>Costs in other non-contentious business</i></p> <p>In the case of any non-contentious business to which neither the First or Second Schedule nor any other rules apply or in the event of a solicitor making an election under rule 3(5), costs shall be such sum as may be fair and reasonable, having regard to all the circumstances of the case and, in particular, to –</p> <ul style="list-style-type: none">(a) the complexity of the matter or the difficulty or novelty of the questions raised;(b) the skill, labour, specialized knowledge and responsibility involved on the part of the solicitor;(c) the number and importance of the documents prepared or perused without regard to length;(d) the place where and circumstances in which the business or any part thereof is transacted;(e) the time expended by the solicitor;(f) where money property is involved, its amount or value; and(g) the importance of the matter to the client.
--------	--

Solicitors' Practice Rules (Cap. 159H)

Rule 2	<p><i>General conduct</i></p> <p>A solicitor shall not, in the course of practising as a solicitor, do or permit to be done on his behalf anything which compromises or impairs or is likely to compromise or impair-</p> <ul style="list-style-type: none">(a) his independence or integrity;(b) the freedom of any person to instruct a solicitor of his choice;(c) his duty to act in the best interests of his client;(d) his own reputation or the reputation of the profession;(e) a proper standard of work; or(f) his duty to the court.
Rule 3	<p><i>Fee cutting</i></p> <p>A solicitor shall not hold himself out or allow himself to be held out directly or indirectly and whether or not by name as being prepared to do professional business in contentious matters at less than the scale fixed by Rules of Court or by any other enactment or in any other matters at less than such scale as may from time to time be fixed by any enactment or by the Society.</p>
Rule 4	<p><i>Sharing with non-qualified persons</i></p> <p>A solicitor shall not share or agree to share with any person not being a solicitor practising in Hong Kong his profit costs in respect of any business whether by way of paying or agreeing to pay a</p>

	<p>commission on business introduced by any such person not being a solicitor, or otherwise:</p> <p>Provided that -</p> <ul style="list-style-type: none"><li data-bbox="405 338 1347 517">(a) a solicitor carrying on practice on his own account may agree to pay an annuity or other sum out of profits to a retired partner or predecessor or the dependants or legal personal representative of a deceased partner or predecessor; (LN 138 of 1993; LN 617 of 1994)<li data-bbox="405 521 1347 887">(b) a solicitor who has agreed in consideration of a salary to do the legal work of an employer who is not a solicitor may agree with such employer to set off his profit costs received in respect of contentious business from the opponents of such employer or the costs paid to him as the solicitor for such employer by third parties of non-contentious business, against the salary so paid or payable to him and the reasonable office expenses incurred by such employer in connection with such solicitor and to the extent of such salary and expenses; and (LN 617 of 1994)<li data-bbox="405 891 1347 992">(c) a solicitor whose firm is a party to an Association may share fees and profits with the foreign firm or firms in that Association. (LN 617 of 1994).
--	---