

## **Draft Code of Practice for Third Party Funding of Arbitration and Mediation**

### **Preamble**

The authorized body is empowered under Part 10A of the Arbitration Ordinance (Cap. 609) and section 7A of the Mediation Ordinance (Cap. 620) to issue a code of practice setting out the practices and standards with which third party funders of arbitration (including emergency arbitrator proceedings, mediation and court proceedings) under Cap. 609 and mediation under Cap. 620, are ordinarily expected to comply in carrying on activities in connection with third party funding of arbitration and mediation in Hong Kong. The code is now issued and named the Third Party Funding of Arbitration and Mediation Code of Practice (“Code”).

### **Relationship with the Arbitration Ordinance and the Mediation Ordinance**

This Code should be read in conjunction with Cap. 609 and Cap. 620, which Ordinances shall prevail in the event of uncertainty or inconsistency with this Code. The terms used in this Code, where they are defined in Cap. 609 (including for the purposes of Part 10A of Cap. 609), are intended to carry the same meanings as for Cap. 609 or Part 10A as the case may be. The terms used in this Code, where they are defined in Cap. 620 (including for the purposes of section 7A of Cap. 620), are intended to carry the same meanings as for Cap. 620 or section 7A as the case may be.

### **Application**

Except in the circumstances specified in section 98O(1) of Cap. 609, this Code applies to all third party funders within the meaning of Division 2 of Part 10A of Cap. 609 and section 7A of Cap. 620.<sup>1</sup>

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<sup>1</sup> For the purpose of this Code, a third party funder includes each of the third party funder’s subsidiaries and associated entities and to investment advisors acting as its agents. For reference only, under the Code of Conduct for Litigation Funders issued by the Association of Litigation Funders of England & Wales in January 2018 a third party funder having access to funds immediately within its control, including within a corporate parent or subsidiary is known as

## **Purpose**

The purpose of this Code is to set out the practices and standards that third party funders are ordinarily expected to comply in carrying on activities in connection with third party funding of arbitration and mediation in Hong Kong.

## **The Code**

### 1. **Introduction**

#### *Interpretation*

- 1.1 The terms defined in Cap. 609 (in particular in its Part 10A) and in Cap. 620, are incorporated by reference into this Code.
- 1.2 References in the Code to Part 10A of Cap. 609 or individual provisions of Part 10A also include Part 10A or the relevant provisions as applied to mediation within the meaning of Cap. 620 pursuant to section 7A of Cap. 620.

#### *Scope of Code*

- 1.3 This Code applies to any funding agreement commenced or entered into on or after the date of commencement of the Code between a third party funder and a funded party (including a potential funded party) for third party funding of arbitration and/or mediation.

#### *Consequences of non-compliance with the Code*

- 1.4 Section 98S of Cap. 609 sets out the consequences of failing to comply with the Code.

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‘Funder’s Subsidiary’ and a third party funder acting as the exclusive investment advisor to an entity or entities having access to funds immediately within its or their control, including within a corporate parent or subsidiary is known as ‘Associated Entity’.

2. Standards and practices in third party funding of arbitration and mediation

*Responsibility for Subsidiaries and Associated Entities*

2.1 A third party funder shall accept responsibility for compliance with this Code by its subsidiaries and associated entities and any investment advisors acting as its agent.

*Promotional Materials*

2.2 A third party funder must ensure its promotional materials are clear and not misleading.

*The Funding Agreement*

2.3 The third party funder must:

- (1) take reasonable steps to ensure that the funded party has received independent legal advice on the funding agreement before entering into it;
- (2) provide a Hong Kong address for service in the funding agreement;
- (3) set out and explain clearly in the funding agreement all the key features, risks and terms of the proposed funding and the funding agreement including, without limitation, the matters set out in Part 10A of Cap. 609 and in this Code; and
- (4) set out the name and contact details of the advisory body responsible for monitoring and reviewing the operation of third party funding under Part 10A of Cap. 609.

2.4 The obligation under paragraph 2.3(1) is satisfied if the funded party confirms in writing to the third party funder that the funded party has taken independent legal advice on the funding agreement before entering into it.

## *Capital Adequacy Requirements*

2.5 A third party funder must:

- (1) ensure that it maintains the capacity to:
  - (a) pay all debts when they become due and payable; and
  - (b) cover all of its aggregate funding liabilities under all of its funding agreements for a minimum period of 36 months;
- (2) maintain access to a minimum of HK\$20 million of capital;
- (3) provide the advisory body with either:
  - (a) a copy of the audit opinion on the third party funder's most recent annual financial statements (but not the underlying financial statements) within 1 month of receipt of the opinion and in any case within 6 months of the end of each fiscal year; or
  - (b) reasonable evidence from a qualified third party (preferably from an auditor, but alternatively from a third party administrator or bank) that the third party funder satisfies the minimum capital requirement set out in subparagraph (2);
- (4) accept a continuous disclosure obligation under each funding agreement in respect of its capital adequacy, including:
  - (a) a specific obligation to give timely notice to the funded party if the third party funder believes that its representations to the funded party in respect of its capital adequacy as required by the Code are no longer valid because of changed circumstances; and

- (b) a specific undertaking that if an audit opinion provided for any audit period is qualified (except as to any emphasis of matters relating to the uncertainty of valuing relevant litigation funding investments) or expresses any question as to the ability of the third party funder, to continue as a going concern:
  - (i) it will promptly inform the funded party; and
  - (ii) the funded party will be entitled to enquire further into the qualification or question expressed and take any further action it deems appropriate.

### *Conflicts of Interest*

2.6 The third party funder must:

- (1) maintain, for the duration of the funding agreement, effective procedures for managing any conflict of interest that may arise in relation to activities undertaken by the third party funder in relation to the funding agreement;
- (2) follow the written procedures mentioned in paragraph 2.7 for the duration of the funding agreement; and
- (3) not take any steps that cause or may cause the funded party's legal representative to act in breach of its professional duties.

2.7 For paragraph 2.6(2), the third party funder has effective procedures for managing a conflict of interest that may arise if it can show through documentation that:

- (1) the third party funder has conducted a review of its business operations that relate to the funding

agreement to identify and assess potential conflicting interests;

- (2) the third party funder:
  - (a) has written procedures for identifying and managing conflicts of interest; and
  - (b) has implemented the procedures;
- (3) the written procedures are reviewed at intervals no greater than 12 months;
- (4) the written procedures include procedures about the following:
  - (a) monitoring the third party funder's operations to identify and assess potential conflicting interests;
  - (b) disclosing conflicts of interest to funded parties and potential funded parties;
  - (c) managing situations in which interests may conflict;
  - (d) protecting the interests of funded parties and potential funded parties;
  - (e) dealing with situations in which a lawyer acts for both the third party funder and a funded party or potential funded party;
  - (f) dealing with a situation in which there is a pre-existing relationship between any of the third party funder, a lawyer and a funded party (or potential funded party);
  - (g) reviewing the terms of a funding agreement to ensure the terms are consistent with Part 10A of Cap. 609 and this Code; and

- (h) marketing to potential funded parties;
- (5) the terms of the funding agreement are reviewed to ensure the terms are consistent with Part 10A of Cap. 609 and this Code; and
- (6) the matters mentioned in subparagraphs (1) to (5) (including those procedures mentioned in subparagraph (4)(a) to (h)) are implemented, monitored and managed by:
  - (a) if the third party funder is an entity other than an individual - the senior management or partners of the third party funder; or
  - (b) if the third party funder is an individual that represents an entity - the senior management or partners of the entity.

#### *Confidentiality and Legal Professional Privilege*

2.8 A third party funder will observe the confidentiality and privilege of all information and documentation relating to the arbitration or mediation and the subject of the funding agreement to the extent that Hong Kong law, or other applicable law, permits.

#### *Control*

- 2.9 The funding agreement shall set out clearly:
- (1) that the third party funder will not seek to influence the funded party or the funded party's legal representative to give control or conduct of the arbitration or mediation to the third party funder except to the extent permitted by law; and
  - (2) that the third party funder will not take any steps that cause or are likely to cause the funded party's legal representative to act in breach of professional duties.

### *Disclosure*

- 2.10 The third party funder must remind the funded party of its obligation to disclose information about the third party funding of arbitration and mediation under sections 98U and 98V of Cap. 609.
- 2.11 To avoid doubt, the funded party to an arbitration or mediation does not have any obligation to disclose details of the funding agreement except as required by the funding agreement, or as ordered by the arbitration body in an arbitration, or as otherwise required by law.

### *Liability for Adverse Costs*

- 2.12 The funding agreement must state whether (and if so to what extent) the third party funder is liable to the funded party to:
- (1) meet any liability for adverse costs;
  - (2) pay any premium (including insurance premium tax) to obtain costs insurance;
  - (3) provide security for costs; and
  - (4) meet any other financial liability.

### *Grounds for Termination*

- 2.13 The funding agreement must state whether (and if so, how) the third party funder may terminate the funding agreement in the event that the third party funder:
- (1) reasonably ceases to be satisfied about the merits of the arbitration or mediation;
  - (2) reasonably believes that there has been a material adverse change of prospects to the funded party's success in the arbitration;
  - (3) reasonably believes that there has been a material adverse change of prospects to the funded party's



being able to reach any agreement with the other party(ies) to the mediation to resolve in whole or in part the dispute in question; or

- (4) reasonably believes that the funded party has committed a material breach of the funding agreement.

2.14 The funding agreement must not establish a discretionary right for a third party funder to terminate the funding agreement in the absence of the circumstances described in paragraph 2.13.

2.15 The funding agreement must provide that if the third party funder terminates the funding agreement, the third party funder is to remain liable for all funding obligations accrued to the date of termination unless the termination is due to a material breach as mentioned in paragraph 2.13(4).

2.16 The funding agreement must provide that the funded party may terminate the funding agreement if it reasonably believes that the third party funder has committed a material breach of the Code or the funding agreement.

#### *Dispute regarding Funding Agreement*

2.17 The funding agreement must provide a neutral, independent and effective dispute resolution mechanism for settlement of any dispute arising under or in connection with the funding agreement between the third party funder and the funded party.

#### *Complaints Procedure*

2.18 The third party funder must maintain an effective procedure for addressing complaints against them as follows:

- (1) the third party funder must ensure that complaints from a funded party under or in connection with the funding agreement are handled in a timely and appropriate way;

- (2) steps must be taken to investigate and respond to a complaint in a timely way;
- (3) if a complaint has been received, the subject matter of the complaint must be properly reviewed;
- (4) if a complaint is not remedied promptly, the third party funder must advise the funded party of any further steps which may be available to the funded party under the funding agreement, the Code and the Ordinances; and
- (5) if the subject matter of the complaint raises issues of more general concern, the third party funder must take steps to investigate and remedy such issues, even if other funded parties may not have complained.

#### *Annual Returns*

2.19 The third party funder must:

- (1) submit annual returns to the advisory body of:
  - (a) any complaints against it by funded parties received during the reporting period; and
  - (b) any findings by a court or arbitral tribunal of its failure to comply with the Code or Division 5 of Part 10A of Cap. 609 during the reporting period; and
- (2) respond to any request from the advisory body for further information or clarification concerning any matter.