

Hong Kong's New Law on Third Party Funding for Arbitration: Opportunities and Risks

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INTRODUCTION

On 1 February 2019, Hong Kong's new law permitting third party funding ("TPF") for arbitration and related court proceedings came into force. This law creates opportunities for those previously unable to fund claims, or for those seeking to transfer risk, or minimize expenditure and legal budgets, in pursuing their claims. TPF is a highly sophisticated multi-billion dollar industry. As the new law is likely to see an increase in the number of arbitrations seated in Hong Kong, it is important that those operating in the market become familiar with how best to seize these opportunities as claimants and defend against third party funded claims as respondents.

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What is TPF?

A TPF arrangement typically involves a funder agreeing to pay a party's budgeted legal costs (including its legal fees, expert and counsel fees, and disbursements). If the party is successful, then the funder obtains the return of its investment, and an agreed premium. If the party is unsuccessful, the funder loses its investment in the case and the party bears no liability for the loss of the investment. This is why TPF is also sometimes referred to as "non-recourse lending". In essence, TPF transfers some or all of the risk of the dispute from the claimant to the funder in exchange for a portion of the potential value of the claims.

The process of applying for TPF is relatively clear. However, it can take weeks or months to get through the application process, and applications will only be successful if the funder is persuaded that the claim has a good or very good prospect of success. Typically, following the execution of a non-disclosure agreement, a party's claims will be subject to an initial review by the funder. If the funder is minded to proceed, a term sheet providing for a period of exclusivity will be agreed, followed by a further due diligence review by the funder and, if that goes well, ultimately a funding agreement. The funder will maintain an active role in monitoring the progression of the case. Funding may also be agreed for separate phases of the arbitration, including the jurisdictional, merits, or quantum phases. This is frequently the case in investor-State

arbitrations, which tend to run for several years and involve distinct phases with different legal issues being determined.

Who can fund and how?

There is wide scope for TPF of arbitration under Hong Kong's new regime. This is tempered by mandatory provisions in respect of the funding agreement itself, disclosure obligations, and confidentiality requirements, as set out below.

The funder: any party to an arbitration may seek financial assistance from any person who does not have an interest in the arbitration. This creates a large pool of potential funders, many of whom are already active in the Asian markets. The new law also permits TPF of emergency arbitrations, and court proceedings or mediations connected to an arbitration.

The funding agreement: the funding agreement must be in writing and entered into between the funder and the funded party or parties after 1 February 2019 (the day the law came into force). A TPF agreement sets out funding terms, and should include what is and is not covered; the funding premium; what happens in the event of settlement (including the funder's right to veto a proposed settlement); whether the funder is liable to cover adverse costs orders (to pay another party's costs) or a security for costs order; responsibility for satellite litigation and challenges to an award; the funder's rights to terminate funding; and whether funding is contingent on the party engaging legal counsel selected by the funder.

Disclosure: the funded party must give written notice stating that a funding agreement has been made, and provide the name of the funder to the arbitral tribunal and to each other party to the arbitration. This notice must be given before commencement of arbitration, or if funding is secured after commencement, then within 15 days of the funding agreement being made. If the funding agreement terminates, both the arbitral tribunal and each other party to the arbitration must be notified within 15 days of the agreement ending. The requirement under Hong Kong law for systematic disclosure of funding arrangements is fairly unique among jurisdictions permitting third party funding of arbitration (although this mirrors the position in Singapore). However, confidential communications between a funder and the funded party ordinarily should remain protected by legal privilege.

Confidentiality: in the process of obtaining or maintaining TPF, the funded party may provide the funder with information relating to the arbitration. The funder is subject to the same statutory confidentiality rules that apply to arbitration.

Arbitration rules: the applicable arbitration rules may also contain provisions relating to TPF. By way of example, the Hong Kong International Arbitration Centre ("HKIAC")

pre-empted the change in law, through the introduction in its 2018 HKIAC Rules of new TPF provisions (see our client update “[New Arbitration Rules of the Hong Kong International Arbitration Centre Come Into Force](#)”). The 2018 HKIAC Rules require a funded party to disclose the existence of any funding arrangements and the identity of the funder, and permit a funded party to disclose information related to the arbitration to its funder. They also allow an arbitral tribunal to take into account any TPF arrangement in fixing and apportioning the costs of the arbitration. The 2017 Investment Arbitration Rules of the China International Economic and Trade Arbitration Commission (“CIETAC”) likewise require a TPF-supported party to provide similar notifications, and they also empower the arbitral tribunal to take TPF arrangements into account in making decisions on costs.

What standards must funders meet?

The change in law has been accompanied by publication of a Code of Practice for Third Party Funding of Arbitration (the “Code of Practice”). According to Hong Kong’s Department of Justice, the Code of Practice sets out “*minimum standards of good practice by third party funders of arbitration.*” Notably, however, TPF remains unregulated in Hong Kong, and no liability attaches to funders for failing to comply with the Code of Practice’s requirements. The ethical and financial standards that the Code of Practice prescribes include the following.

The TPF relationship: funders should ensure that funded parties are aware of their right to seek independent legal advice on the funding agreement. This is particularly important given the possibility for the funder to obtain a significant proportion of the proceeds of a successful claim.

Conflicts of interest: funders should maintain procedures for managing conflicts of interest that might arise during the duration of the funding agreement. Whilst the funder is not party to the arbitration proceedings, it is a potential beneficiary of them. Hence, there is scope for an arbitrator conflict of interest with the funder to arise. As Hong Kong’s law mandates disclosure of the identity of the funder at an early stage, such conflicts should be more readily avoided.

Disputes and complaints: the funding agreement must provide a dispute resolution mechanism for any disputes arising from the funding agreement. The funder should also maintain an effective procedure for dealing with complaints.

CONCLUSION

Hong Kong has been preparing for this moment for quite some time. Whilst the TPF amendments to Hong Kong’s arbitration law had been passed back in June 2017 (see our

client update “[Hong Kong and Singapore Permit Third-Party Funding in International Arbitration](#)”), these could only come into force following the December 2018 publication of the Code of Practice. Prospective claimants will be eager to bring their funded claims at the earliest opportunity. Likewise, funders will not be sitting idly. A steady flow of funded arbitrations in Hong Kong should be expected.

Any party considering TPF for its arbitration claims should carefully consider the terms of any funding agreement and obtain professional advice. An ill-drafted funding agreement may be harmful to a party’s interests in pursuing its claims, result in unanticipated liabilities, and lead to unexpectedly low recovery in the event of success. Equally, a defending party should be prepared to adjust its litigation strategy to meet the nuances of a funded claim.

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