

Speech by the Hon Teresa Cheng, GBS, SC, JP
Secretary for Justice
at the “Debate on Third Party Funding in Arbitration”
on 13 March 2018 (Tuesday)

Distinguished Guests, Ladies and Gentlemen,

I thank the CIETAC Hong Kong Arbitration Center for organizing and inviting me to take part in this open debate of topical issues involving third party funding (“TPF”) for arbitration.

2. International arbitration is not risk-free. Traditionally, TPF is an effective risk management tool that can assist under-resourced parties by containing the potential losses and soaring costs of international arbitration. Nevertheless, that perception of TPF has undergone a seismic change in recent years. It is no longer viewed as the preserve of smaller, cash-strapped companies in "David and Goliath" disputes. Increasingly, large and well-resourced commercial entities are opting to fund arbitral proceedings through third parties as a “tool of choice” to smooth their cash flow, to offset the cost and risk of the proceedings and as a means of obtaining an additional layer of due diligence on the merits of their case¹. However, TPF is not without its own risks and should be regulated appropriately. I would like to take this opportunity to share with you the latest development of Hong Kong’s legal framework on TPF and our approach to regulating

¹ *Arbitration Speedread: The rise and rise of third party funding in arbitration*, 19 September 2017, Bird & Bird.

TPF for arbitration and mediation.

3. It has been the steadfast policy of the Government of the Hong Kong SAR to enhance our status as a leading centre for international legal and dispute resolution services in the Asia-Pacific region and beyond. Hong Kong recently passed legislation providing express frameworks for third party funding in international arbitration proceedings, joining the global trend supporting this alternate source of funding.

4. The Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Ordinance 2017 (“the Amendment Ordinance”) was passed by the Legislative Council in June 2017 to enhance the competitiveness of Hong Kong’s regime for dispute resolution services, and help to promote the use of mediation services in Hong Kong. It is also intended to divert more commercial, construction, financial, trade and similar disputes from the local courts to arbitration and/or mediation, thus saving significant time and costs of the parties and relieving the pressure on courts’ resources.

5. Apart from the above reasons, TPF has contributed to some investment arbitration claims² and experienced accelerated growth globally with the proliferation of cross-border trade and investment disputes³.

² In 2016, anecdotal evidence suggests that at least 40% of the investment arbitration claims have either secured or explored funding from third party funders: <http://arbitrationblog.kluwerarbitration.com/2016/02/18/the-impact-of-third-party-funding-on-allocation-for-costs-and-security-for-costs-applications-the-icca-queen-mary-task-force-report/?print=print>.

³ Victoria Shannon Sahani, *Judging Third-Party Funding*, 63 UCLA L. Rev. 388 (2016)

6. To meet the anticipated growing demand for TPF in international arbitration, the Amendment Ordinance expressly stated that the common law doctrines of maintenance and champerty do not apply in relation to TPF of arbitrations, including proceedings before emergency arbitrators and ancillary court proceedings⁴. TPF is not only allowed for arbitrations seated in Hong Kong, it also covers services provided in Hong Kong for arbitrations and mediations taking place outside Hong Kong or where there is no place of arbitration⁵. The extension to arbitration where there is no place of arbitration is to cater for those arbitrations of investor-state disputes which are administered by the International Centre for Settlement of Investment Disputes (or “ICSID”). As you are all aware, there is no “legal seat of arbitration”⁶ as such for ICSID arbitration. Chapter VII of the ICSID Convention refers to the “place of proceedings”⁷ and Hong

⁴ New section 98K (read with relevant definition provisions in new sections 98F–98J), Part 10A of the Arbitration Ordinance (Cap. 609) (“the principal Ordinance”).

⁵ Pursuant to the new section 98N, Part 10A of the principal Ordinance, the new Part 10A extends to work done in Hong Kong on arbitration seated overseas, and includes a provision to expand their scope to permit TPF of work done in Hong Kong on arbitration that do not have a municipal seat. This is to facilitate the TPF of related services provided in Hong Kong in relation to non-Hong Kong arbitrations and mediations. See also the article on ‘*Hong Kong Third Party Funding – Arbitration, Mediation (and beyond?)*’ by Andrew Aglionby in the Special Release to Hong Kong Civil Procedure 2018 (White Book) published by Sweet & Maxwell.

⁶ ICSID proceedings are specialized insofar as they are limited to investment disputes. The arbitral tribunal is regulated by a body of international rules completely detached from any municipal law, including that of the situs of the arbitration. Hence, the seat of the proceedings has no legal significance whatsoever in ICSID arbitration. Moreover, ICSID Convention arbitrations are self-contained with annulment proceedings on awards. The Convention awards (as opposed to Additional Facility awards) are not subject to any review or appeal by national courts. See ‘*ICSID Arbitration Proceedings*’ by Georges R. Delaume, Berkeley Journal of International Law (Volume 4 Issue 2 Fall Article 4), available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?referer=http://www.google.com.hk/url?sa=t&ct=j&q=&esrc=s&source=web&cd=2&ved=0ahUKEwjF1K_XlbvZAhWDjJOKHQOt_A2IQFgg3MAE&url=http%3A%2F%2Fscholarship.law.berkeley.edu%2Fcgi%2Fviewcontent.cgi%3Farticle%3D1048%26context%3Dbjil&usq=AOvVaw3TKb2iFJk2oJW1SXEJlxCi&httpsredir=1&article=1048&context=bjil

⁷ Articles 62 and 63 are the relevant articles regarding the place of proceedings in the ICSID Convention.

Kong being geographically convenient with cost-effective support services is definitely well-placed to hold ICSID arbitration hearings. This is evidenced by the facilities cooperation agreement made between ICSID and the Hong Kong International Arbitration Centre⁸. No doubt, TPF services provided in Hong Kong will facilitate parties to have another viable option to fund arbitration proceedings under the auspices of ICSID.

7. The term “third party funder” under our Amendment Ordinance has a broad meaning. It refers to anyone who does not have an interest recognized by law in the arbitration other than under the funding agreement. Further, the new section 98G sets out the definition of “third party funding of arbitration”, namely the provision of arbitration funding for an arbitration under a funding agreement in return for the third party funder receiving a financial benefit only if the arbitration is successful⁹, also known as “non-recourse” funding. The new section 98H defines the meaning of funding agreement as an agreement made in writing between a funded party and a third party¹⁰.

If the parties agree, proceedings may be held at the seat of the Permanent Court of Arbitration (PCA) or anywhere in the world. If the parties are unable to reach a mutual agreement on the place of proceedings, the default location envisioned by the Convention is the seat of the Centre which shall be the principal office of the International Bank for Reconstruction and Development in Washington, DC, the United States of America under Article 2 of the ICSID Convention. See <https://icsid.worldbank.org/en/Documents/icsiddocs/ICSID%20Convention%20English.pdf>

⁸ To facilitate ICSID proceedings in Hong Kong, the HKIAC and ICSID entered into the Agreement on General Arrangements between the International Centre for Settlement of Investment Disputes and the Hong Kong International Arbitration Centre on 23 May 2011. See the article in GAR (Global Arbitration Review) Know how: Maritime & Offshore Arbitration 2017 – Hong Kong, available at <https://globalarbitrationreview.com/jurisdiction/1004569/hong-kong>. Also see the ICSID 2011 Annual Report at p.38, available at <https://icsid.worldbank.org/en/Documents/resources/2011%20-%20Annual%20Report%20-%20English.pdf>.

⁹ New section 98G(d), Part 10A of the principal Ordinance

¹⁰ New section 98H, Part 10A of the principal Ordinance

8. To avoid any potential conflicts of interest and bias issue, it is a mandatory requirement under Hong Kong's TPF framework for the funded party to disclose the identity of funder and the existence of funding agreement to each other party to the arbitration and the relevant arbitration body¹¹. This echoes the arbitrators' ongoing obligation to maintain independence and impartiality throughout the arbitral process by making assessment on the disclosure of potential conflicts with reference to, for example, the 2014 IBA Guidelines on Conflicts of Interest in International Arbitration¹².

9. Nowadays, not only does the use of TPF is growing, the forms of funding are also evolving rapidly¹³. The forms can range from portfolio funding, equity financing, to providing fund for purposes other than financing legal costs (such as providing working capital)¹⁴. Against the increasingly complicated

¹¹ Pursuant to new section 98U, Part 10A of the principal Ordinance, the funded party must give notice in writing to each other party to the arbitration and the relevant arbitration body in relation to (i) the fact that a funding agreement has been made; and (ii) the name of the third party funder.

¹² See International Bar Association (IBA) *Guidelines on Conflicts of Interest in International Arbitration* published on 28 November 2014 which includes references to third party funding as a "direct economic interest in the award to be rendered in the arbitration" in General Standards 6 and 7; the Explanations to General Standards 6 and 7; para.1.2 of the Non-Waivable Red List; para. 2.23 of the Waivable Red List and paras. 3.2.2, 3.4.3 & 3.4.4 of the Orange List, available at https://www.ibanet.org/ENews_Archive/IBA_July_2008_ENews_ArbitrationMultipleLang.aspx. However, the IBA Guidelines are soft laws. They are optional rather than mandatory.

¹³ Third party funders not only invest in single cases, but they also provide legal finance to law firms and large corporates in relation to a portfolio of their legal claims. By funding multiple cases, the third party funders can cross collateralize their returns across a portfolio and mitigate the legal risk of each case within it, with the result that the cost of providing funding is lower than it would be on a single case by case basis. See '*On & Beyond Third Party Funding – a 360° interview with a funder*' published in CIETAC Hong Kong Insight, available at <http://files.constantcontact.com/66c613c7601/d5034b37-a314-47bc-8c5d-1e07c2dfffb2d.pdf?ver=1504702747000>.

¹⁴ See pages 28-33, Draft Report for Public Discussion of the ICCA-Queen Mary Task Force on Third-party Funding in International Arbitration (http://www.arbitration-icca.org/media/10/14053115930449/submission_version_for_public_comment_

arrangements of TPF, we are mindful to set out clear standards on the conduct of third party funders to address concerns over risks stemming from the funding. These risks would include, for example, undisclosed conflicts of interest – perceived or actual, between the funder and parties involved in the proceedings.

10. Following the recommendations of the Hong Kong Law Reform Commission (“LRC”) in its Final Report of Third Party Funding For Arbitration released in October 2016, the Amendment Ordinance adopts a “light touch” approach to regulating third party funding of arbitration in Hong Kong. In line with this approach, third party funders are required to comply with the applicable financial and ethical standards in a Code of Practice (“the Code”)¹⁵ to be issued by the Authorized Body soon to be appointed¹⁶. The Code is not subsidiary legislation¹⁷. Failure to comply with the Code does not render a person liable to any judicial or other proceedings. That said, such non-compliance may be taken into account by any court or arbitral tribunal if it is relevant to a question being decided by the court or the arbitral tribunal¹⁸.

finalversion.pdf). The final report is expected to be published in April 2018.

¹⁵ New section 98P, Part 10A of the principal Ordinance

¹⁶ The Authorized Body is to be appointed by the Secretary for Justice under the new section 98X(2), Part 10A of the principal Ordinance. It has to set out practices and standards for third party funders to follow when they carry out activities in connection with TPF of arbitration, and to amend or revoke the Code. According to Andrew Aglionby in his article ‘*Hong Kong Third Party Funding – Arbitration, Mediation (and beyond?)*’ published in the Special Release to the Hong Kong Civil Procedure 2018 edition, “...consumers will be protected by a code of conduct overseen by an authorized body which would be able to respond flexibly to changing appreciation of the circumstances.”

¹⁷ New section 98R(6), Part 10A of the principal Ordinance

¹⁸ New section 98S, Part 10A of the principal Ordinance

11. The provisions of the Code may require third party funders to ensure that (a) any promotional materials are clear and not misleading; (b) they have effective procedures to deal with conflicts of interest situation and for addressing complaints against them; and (c) they have sufficient minimum amount of capital. Funders are also required to report annually on their compliance with the Code and to provide any other information that the Advisory Body reasonably requires¹⁹.

12. The preparatory work for a draft Code is under way and members of the public will be consulted before it is finalized²⁰.

13. Before the substantive provisions come into operation, an Advisory Body will be established to monitor and review the operation of the new provisions. The LRC recommended that after the conclusion of the first three years of operation of the Code, the Advisory Body should issue a report reviewing its operation and make recommendations on whether a statutory or other form of body is needed. In the meantime, the Advisory Body could at the end of each year review whether or not to speed up the process for regulation by an independent statutory or other form of body. It was further recommended that the Advisory Body should in its report deal with the effectiveness of the Code and make recommendation as to the way forward²¹. We will bear the LRC's

¹⁹ New section 98Q, Part 10A of the principal Ordinance

²⁰ New section 98R(4) & (5), Part 10A of the principal Ordinance

²¹ Recommendation 3(8) of the Final Report of Third Party Funding For Arbitration released by LRC on 12 October 2016 at p.20, available at http://www.hkreform.gov.hk/en/docs/rtpf_e.pdf.

recommendations in mind when we monitor and review the operation of the new law in the near future.

14. As the main gatekeeper of the rule of law, it is the vital role of my Department to improve access to cost-effective justice and help maintain Hong Kong's competitive edge as a leading arbitral seat globally. The new legislative framework will allow Hong Kong to put itself in a competitive position as a cost-effective seat of arbitration for future "Belt and Road" related outbound investments disputes brought by Mainland enterprises, which is seen to be a future trend in the growth of Asian arbitration²².

15. While we will continue to apply international best practices for the TPF in Hong Kong's international legal and dispute resolution services, I cannot stress enough that in contemplating the appropriate regulations on the funders, we must stay alert to the possible stifling of the innovative development of this useful tool of TPF. An open debate among seasoned practitioners on topical issues of TPF will be interesting. I am looking forward to your thoughtful discussion today which will definitely provide some insights to our formulation of policies on developing TPF in Hong Kong.

16. On this note, it remains for me to wish this event every success.

Thank you.

²² *Legal finance market focus: Asia-Pacific*, [James MacKinnon](http://www.burfordcapital.com/blog/legal-finance-market-focus-asia-pacific/), February 13, 2018, Burford (<http://www.burfordcapital.com/blog/legal-finance-market-focus-asia-pacific/>)