

**For discussion on
28 November 2016**

**Legislative Council Panel on
Administration of Justice and Legal Services
Response to the Law Reform Commission of Hong Kong
Report on Third Party Funding for Arbitration
and
Proposed Amendments to the Arbitration Ordinance (Cap. 609)
and the Mediation Ordinance (Cap. 620)**

This paper seeks: (a) to report to Members the Government's response to the recommendations made in the Report on *Third Party Funding for Arbitration* ("Report") published by the Law Reform Commission of Hong Kong ("LRC") in October 2016; and (b) Members' views on the Government's proposed amendments to the Arbitration Ordinance (Cap. 609) ("AO") and the Mediation Ordinance (Cap. 620) ("MO") to implement the recommendations in the Report.

PROPOSALS

2. The Government proposes to introduce legislative amendments to –
 - (a) the AO and the MO, to ensure that third party¹ funding of arbitration and associated proceedings is not prohibited by the common law doctrines of maintenance and champerty; and
 - (b) provide for related measures and safeguards,

based on the Report.

BACKGROUND

3. A third party funding contract commonly provides that the third party funder will pay for the funded party's costs (including expenses) of the arbitration or other proceedings in return for a percentage of the arbitral award

¹ In the Report, the Chinese version of "third party" is "第三方". As a third party funder is not a "party" (一方、方) as defined in section 2 of the AO, the DoJ takes the view that it is more appropriate to use "第三者" as the Chinese equivalent of "third party" in the proposed legislative amendments.

or judgment or other financial benefit from the funded party's recovery in the proceedings if successful, as defined in the funding agreement. If the proceedings are unsuccessful, the third party funder will not receive any repayment or return on the funds it has paid to, or on behalf of, the funded party, for the proceedings' costs (hence the common description of third party funding as "non-recourse" funding). Third party funding for arbitration and other dispute resolution proceedings has become increasingly common over the last decade in numerous jurisdictions, including Australia, England and Wales, various European jurisdictions and the United States. To date, third party funding arrangements have usually been motivated by a funded party's lack of financial resources to pursue its own claims in contentious proceedings. However, increasingly, parties who do have the financial resources to fund contentious proceedings may seek third party funding as a financial or risk management tool.

4. 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.

5. The legal doctrines of maintenance and champerty, developed some 700 years ago under English common law, 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) a miscellaneous category of proceedings including insolvency proceedings.

6. However, 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 judgment in *Unruh v Seeberger*² where the Court expressly left open this question.

7. In early 2013, the Chief Justice and Secretary for Justice asked the LRC to review the 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.

8. In June 2013, the Third Party Funding for Arbitration Sub-committee of the LRC (the "Sub-committee") was appointed to review the subject. On 19 October 2015, the Sub-committee published a consultation paper on *Third*

² (2007) 10 HKCFAR 31, at para 123.

Party Funding for Arbitration (the “Consultation Paper”) with a proposal to amend the relevant legislation.

9. In addition to attending two consultation forums, members of the Sub-committee attended the meeting of the Panel on Administration of Justice and Legal Services (“AJLS Panel”) of the Legislative Council (“LegCo”) on 23 November 2015, and briefed Members on its Consultation Paper. The Sub-committee also gave various interviews to the media as well as speaking at various conferences and writing articles.

10. In total, 73 submissions were received, ranging from a simple acknowledgement of the Consultation Paper to detailed submissions on the Sub-committee’s Preliminary Recommendations and associated issues. Those who submitted responses included accounting firms, arbitral institutions, arbitrators, barristers, chambers of commerce, consumer/public interest groups, the financial sector, third party funders, Government departments, insurers/insurers associations, law firms, insolvency practitioners, professional bodies, and academics.

11. Based on the submissions received, the LRC concluded that the reform of Hong Kong law is needed to state that third party funding of arbitration and associated proceedings under the AO is permitted under Hong Kong law provided that appropriate financial and ethical safeguards are complied with.

12. The LRC further recommended that third party funders funding arbitration should be required to comply with a Third Party Funding for Arbitration Code of Practice (“Code”) issued by a body authorized under the AO. The LRC takes the view that the Code should set out the standards and practices (including financial and ethical standards) with which third party funders will ordinarily be expected to comply in carrying on activities in connection with third party funding of arbitration.³

13. The LRC also recommended that consideration should be given whether to make consequential amendments to the MO to extend the proposals described in paragraphs 11 and 12 above to mediation within the scope of the MO.

RESPONSES TO THE REPORT

14. A table showing the detailed recommendations as set out in the Report and the Government responses to those recommendations is at **Annex A**. The

³ See Recommendation 3(3) of the LRC Report.

Government takes the preliminary view that, from the perspective of promoting Hong Kong's arbitration services, the proposed law reform is desirable, so that Hong Kong, as one of the leading centres for international legal and dispute resolution services in the Asia Pacific region, can keep up with the latest practice in international arbitration and hence enhance its competitive position. The Government also agrees that the Code should be issued by an authorized body in accordance with procedure to be set out in the AO and the MO. The authorized body will be required to consult relevant stakeholders on the draft Code in accordance with the procedures to be laid down in the AO and the MO respectively. A draft Code prepared by the Department of Justice ("DoJ") is at **Annex B** for Members' reference only. This draft Code focuses on the standards and practice with which third party funders will ordinarily be expected to comply in carrying on third party funding of arbitration. A draft Code in relation to third party funding for mediation will be drawn up for consultation with relevant stakeholders.

CONSULTATION

15. The LRC released the Report on 12 October 2016, following the completion of its study. In this connection, the DoJ has written to the legal and arbitration professional bodies set out at **Annex C** to consult them on the recommendations of the Report. The organisations which have responded have indicated their support for the proposed reform as outlined in paragraphs 11 to 13 above.

16. On 4 November 2016, the Steering Committee on Mediation was consulted by the DoJ and the Steering Committee supported the proposed consequential amendments to the MO.⁴

WAY FORWARD

17. Subject to Members' comments, the Government intends to implement the above legislative proposals by introducing an amendment bill into the LegCo in early 2017.

Department of Justice
November 2016

⁴ See Recommendation 1(2) of the LRC Report.

**Responses of the Government to the recommendations made by the
Law Reform Commission of Hong Kong (“LRC”)
in the Report on Third Party Funding for Arbitration (October 2016)**

LRC’s Recommendations	Government’s responses
<p><u>Recommendation 1</u></p> <p>The LRC set out the following recommendations:</p> <p>(1) The Arbitration Ordinance should be amended to state that the common law doctrines of maintenance and champerty (both as to civil and criminal liability) do not apply to arbitration to which the Arbitration Ordinance applies, to proceedings before Emergency Arbitrators as defined under the Arbitration Ordinance, and to mediation and court proceedings under the Arbitration Ordinance (“Arbitration”) (see sections 98H to 98K of the Proposed AO Amendment). The non-application of these doctrines in relation to Arbitration does not affect any rule of law as to the cases in which a contract is to be treated as contrary to public policy or otherwise illegal (see section 98J of the Proposed AO Amendment).</p> <p>(2) Consideration should be given to whether to make consequential amendments at the same time to the Mediation Ordinance to extend such non-application of the common law doctrines of maintenance and champerty (both as to civil and criminal liability) to mediation within the scope of the Mediation Ordinance (the “MO Mediation”), including whether the proposed regulatory regime for Arbitration should apply to MO Mediation.</p>	<p>We accept Recommendation 1(1). We agree that the Arbitration Ordinance (Cap. 609) (“AO”) should be amended to state that third party funding of arbitration and associated proceedings is not prohibited by the common law doctrines of maintenance and champerty.</p> <p>We accept Recommendation 1(2). We agree that consequential amendments should be introduced to the Mediation Ordinance (Cap. 620) (“MO”) at the same time. On 4 November 2016, the Steering Committee on Mediation was consulted by the Department</p>

LRC's Recommendations	Government's responses
<p>(3) The Proposed AO Amendment should apply to Funding Agreements for Third Party Funding of Arbitration made on or after the coming into effect of the Proposed AO Amendment (see section 98G(4) read with sections 98H and 98I of the Proposed AO Amendment).</p> <p>(4) If the place of Arbitration is outside Hong Kong, then, despite section 5 of the Arbitration Ordinance, the Proposed AO Amendment should apply in relation to funding of services provided in Hong Kong in relation to the Arbitration, as if the place of Arbitration were in Hong Kong (see section 98K of the Proposed AO Amendment).</p> <p>(5) The definition of “Third Party Funding” in the Proposed AO Amendment should not include any funding provided either directly or indirectly by a person practising law or providing legal services (whether in Hong Kong or elsewhere) (see section 98G(2) of the Proposed AO Amendment).</p> <p>(6) The professional conduct rules applicable to barristers, solicitors, and foreign registered lawyers should be amended to expressly state the terms and conditions upon which such lawyers may represent parties in Arbitrations and related court proceedings funded by Third Party Funder.</p>	<p>of Justice and members of the Steering Committee supported the proposed consequential amendments to the MO.</p> <p>We accept Recommendation 1(3).</p> <p>We accept Recommendation 1(4). We agree that the recommendation should be reflected in the proposed amendments to the AO.</p> <p>We accept Recommendation 1(5). We agree that the recommendation should be reflected in the proposed amendments to the AO.</p> <p>We note that, on 12 October 2016, the LRC Secretariat wrote to the Law Society of Hong Kong and Hong Kong Bar Association, the professional bodies that are responsible for making the relevant rules.</p>

LRC's Recommendations	Government's responses
<p>(7) The Arbitration Ordinance should be amended to allow the communication of information relating to arbitral proceedings and awards to a Third Party Funder or its professional adviser (see section 98P of the Proposed AO Amendment).</p> <p>(8) If a Funding Agreement is made, the Funded Party must give written notice of the fact that a Funding Agreement has been made and the identity of the Third Party Funder. The notice must be given, for a Funding Agreement made on or before the commencement of the Arbitration, on the commencement of the Arbitration; or, for a Funding Agreement made after the commencement of the Arbitration, within 15 days after the Funding Agreement is made. The notice must be given to each other party to the Arbitration and the Arbitration Body. However, if there is no Arbitration Body for the Arbitration at the time specified for giving the notice, the notice must instead be given to the Arbitration Body immediately after there is an Arbitration Body for the Arbitration (see section 98Q of the Proposed AO Amendment). There should also be disclosure about the end of third party funding (see section 98R of the Proposed AO Amendment).</p>	<p>We will follow up with the Law Society of Hong Kong and Hong Kong Bar Association on this recommendation in due course.</p> <p>We accept Recommendation 1(7). We agree that the recommendation should be reflected in the proposed amendments to the AO and take the view that the related matters should be reflected in the Code referred to in Recommendation 3(3).</p> <p>We accept Recommendation 1(8). We agree that the recommendation should be reflected in the proposed amendments to the AO and take the view that the related matters should be reflected in the Code referred to in Recommendation 3(3).</p>

LRC's Recommendations	Government's responses
<p><u>Recommendation 2</u></p> <p>The LRC recommended that clear standards (including ethical and financial standards) for Third Party Funders providing Third Party Funding to parties to Arbitration should be developed.</p>	<p>We accept Recommendation 2. We take the view that the relevant standards should be reflected in the Code referred to in Recommendation 3(3).</p>
<p><u>Recommendation 3</u></p> <p>The LRC set out the following recommendations:</p> <p>(1) At this first stage of Third Party Funding of Arbitration in Hong Kong, a “<i>light touch</i>” approach to its regulation should be adopted <i>for an initial period of 3 years</i>, in line with international practice and in accordance with Hong Kong's needs and regulatory culture.</p> <p>(2) The “<i>light touch approach</i>” to regulating Third Party Funders funding Arbitration should apply irrespective of whether they have a place of business inside or outside Hong Kong.</p>	<p>We accept Recommendation 3(1) in principle. We take the view that the details of implementing this recommendation should be subject to the comments received during the consultation on the drafting of the Code referred to in Recommendation 3(3).</p> <p>We accept Recommendation 3(2) in principle. We take the view that the details of implementing this recommendation should be subject to comments received during the consultation on the drafting of the Code referred to in Recommendation 3(3).</p>

LRC's Recommendations	Government's responses
<p>(3) Third Party Funders funding Arbitration should be required to comply with a <i>Third Party Funding for Arbitration Code of Practice</i> (defined earlier as the "Code") issued by a body authorized under the Arbitration Ordinance (defined earlier as the "Authorized Body"). The Code should set out the standards and practices (including financial and ethical standards) with which Third Party Funders will ordinarily be expected to comply in carrying on activities in connection with Third Party Funding of Arbitration (see sections 98L and 98M of the Proposed AO Amendment).</p> <p>(4) Before issuing the Code (and before making any subsequent amendment to the Code), the Authorized Body should consult the public about the proposed Code (or amendment) (see section 98N of the Proposed AO Amendment).</p> <p>(5) A failure to comply with a provision of the Code should not, of itself, render a person liable to any judicial or other proceedings. However the Code should be admissible in evidence in proceedings before any court or Tribunal; and any compliance or failure to comply with a provision of the Code may be taken into account by any court or Tribunal if it is relevant to a question being decided by that court or Tribunal (see section 98O of the Proposed AO Amendment).</p>	<p>We accept Recommendation 3(3) in principle. We take the view that the details of implementing this recommendation should be subject to the comments received during the consultation on the drafting of the Code. This should be reflected in the proposed amendments to the AO.</p> <p>We accept Recommendation 3(4). We agree that, before issuing the Code (and before making any subsequent amendment to the Code), the Authorized Body should consult the public about the proposed Code (or amendment). This should be reflected in the proposed amendments to the AO.</p> <p>We accept Recommendation 3(5). We agree that the consequence of non-compliance with a provision of the Code should be set out in the proposed amendments to the AO.</p>

LRC's Recommendations	Government's responses
<p>(6) A failure to comply with a provision of the Proposed AO Amendment should not, of itself, render a person liable to any judicial or other proceedings. However, any compliance or failure to comply with a provision of the Proposed AO Amendment may be taken into account by any court or Tribunal if it is relevant to a question being decided by that court or Tribunal (see section 98S of the Proposed AO Amendment).</p>	<p>We accept Recommendation 3(6). We agree that the effect of non-compliance with a provision in the proposed amendments to the AO should be clearly set out.</p>
<p>(7) The Advisory Committee on the Promotion of Arbitration (established by the Department of Justice in 2014, and chaired by the Secretary for Justice), should be nominated by the Secretary for Justice to be the Advisory Body to monitor the conduct of Third Party Funding for Arbitration following the coming into effect of the Proposed AO Amendment in regard to Arbitration (as defined in the Proposed AO Amendment) and the implementation of the Code, and to liaise with stakeholders. The LRC suggests that the Advisory Body (or a sub-committee that it establishes to monitor Third Party Funding for Arbitration) should arrange to meet at least twice a year with representatives of primary stakeholders or interested parties in third party funding to discuss the implementation and operation of the Code and any matters arising.</p>	<p>We will consult members of the Advisory Committee on the Promotion of Arbitration and other stakeholders, including third party funders, before taking a view on Recommendation 3(7).</p>
<p>(8) 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 as to the updating of the ethical and financial standards set out in it. At this time the Advisory Body should also make recommendations on whether a statutory or other form of body is needed, how it could be set up and as to the criteria for selecting members of such a body. In the meantime,</p>	<p>We will consult members of the Advisory Committee on the Promotion of Arbitration and other stakeholders, including third party funders, before taking a view on Recommendation 3(8).</p>

LRC's Recommendations	Government's responses
<p>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. The report should also deal with the effectiveness of the Code and make recommendations as to the way forward.</p> <p>(9) The Code should include provisions as set out below, and Third Party Funders should be required to include these terms in any third party funding agreement:</p> <ul style="list-style-type: none"> (a) A Third Party Funder shall accept responsibility for compliance with the Code on its own behalf and by its subsidiary or an associated entity. (b) The promotional literature of a Third Party Funder in connection with Third Party Funding of Arbitration must be clear and not misleading. (c) As to the Funding Agreement, the Third Party Funder must: <ul style="list-style-type: none"> (i) take reasonable steps to ensure that the Funded Party shall have received independent legal advice on the terms of the Funding Agreement prior to its execution, which obligation shall be satisfied if the Funded Party confirms in writing to the Third Party Funder that the Funded Party has taken legal advice from the solicitor or barrister instructed in the 	<p>We accept Recommendation 3(9). We will incorporate the provisions as set out in this recommendation in the draft Code and consult the stakeholders accordingly.</p>

LRC's Recommendations	Government's responses
<p>dispute;</p> <p>(ii) provide a Hong Kong address for service in the Funding Agreement;</p> <p>(iii) set out and explain clearly in the Funding Agreement the key features, risks and terms of the Funding Agreement including, without limitation, as to the matters set out in section 98M(1) of the Proposed AO Amendment, including as to:</p> <ol style="list-style-type: none"> 1. capital adequacy requirements; 2. conflicts of interest; 3. confidentiality and privilege; 4. control; 5. disclosure; 6. liability for adverse costs; 7. grounds for termination; and 8. complaints procedure. <p>(10) The following measures should be implemented to facilitate the monitoring of Third Party Funding of Arbitration by the Advisory Body:</p> <p>(a) A Third Party Funder must submit an annual return to the Advisory Body of any (a) complaints received, and (b) findings that the Third Party Funder has failed to comply with the Code or</p>	<p>We accept Recommendation 3(10). We will incorporate the provisions as set out in this recommendation in the draft Code and consult the stakeholders accordingly.</p>

LRC's Recommendations	Government's responses
<p>any of the provisions of the Proposed AO Amendment.</p> <p>(b) A Third Party Funder must provide to the Advisory Body any other information the Advisory Body reasonably requires.</p> <p>(c) A Third Party Funder must provide to the Funded Party the name and contact details of the Advisory Body.</p>	
<p><u>Recommendation 4</u></p> <p>The LRC set out the following recommendations:</p> <p>(1) While the LRC considers that, in principle, a Tribunal should be given the power under the Arbitration Ordinance to award Costs against a Third Party Funder, in appropriate circumstances, after according it due process, following any application for such Costs, the LRC considers that it is premature at this stage to amend the Arbitration Ordinance to provide for this power. The Arbitration Ordinance (based on the UNICTRAL Model Law) applies only to parties to an arbitration agreement (as set out in its section 5(1)). The LRC considers that further careful consideration of this issue is warranted bearing in mind the need to preserve the integrity of Hong Kong's regime for Arbitration, to provide due process to a third party, including a Third Party Funder, where an application for an Adverse Costs Order against it has been made, and to provide for equal treatment, fairness and efficiency for all involved.</p>	<p>We note the views expressed by the LRC under Recommendation 4(1). We agree that it is necessary to give further careful consideration of the issue of whether an arbitral tribunal should be given the power under the AO to award costs against a third party funder.</p> <p>In this connection, we will keep in view the latest development of the relevant studies being conducted by the international arbitration community, e.g., the International Council for Commercial Arbitration (ICCA) Third-Party Funding Taskforce.</p>

LRC's Recommendations	Government's responses
<p>(2) Further consideration should be given by the Advisory Body in the initial three year period following implementation of the AO Proposed Amendment as to providing for the power of a Tribunal to award Costs against a third party, including a Third Party Funder, in appropriate circumstances, including:</p> <ul style="list-style-type: none"> (a) considering whether this should be achieved by an amendment of the Arbitration Ordinance to empower a Tribunal to make Costs orders against third parties, including Third Party Funders, without joinder of such a third party to the arbitration (albeit for the sole purposes of the Costs application); (b) the formulation of the provisions for the third party's right to be heard, to equal treatment and to due process; (c) the rules of procedure to be applied; (d) the consequences of non-participation by a third party in any such Costs application following due notice and a reasonable opportunity to participate; and (e) the form of any Adverse Costs Order against a third party that a Tribunal may make including whether it may form part of a final award. 	<p>We will consult members of the Advisory Committee on the Promotion of Arbitration and other stakeholders, including third party funders, before taking a view on Recommendation 4(2).</p> <p>We will also keep in view the latest development of the relevant studies being conducted by the international arbitration community, e.g., the International Council for Commercial Arbitration (ICCA) Third-Party Funding Taskforce.</p>

LRC's Recommendations	Government's responses
<p>(3) The LRC considers that there is no need to give a Tribunal the power to order Security for Costs against a Third Party Funder, as the powers of a Tribunal under the Arbitration Ordinance to order a party to give Security for Costs afford adequate protection.</p>	<p>We note the views expressed by the LRC in Recommendation 4(3).</p>

Draft Third Party Funding of Arbitration Code of Practice

Preamble

The authorized body is empowered under Part 10A of the Arbitration Ordinance (Cap. 609) (“Ordinance”) 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 the Ordinance, are ordinarily expected to comply in carrying on activities in connection with third party funding of arbitration. The code is now issued and named the Third Party Funding of Arbitration Code of Practice (“Code”).

Relationship with Ordinance

This Code should be read in conjunction with the Ordinance. The terms used in this Code, where they are defined in the Ordinance including for the purposes of Part 10A of the Ordinance, are intended to carry the same meanings as for the Ordinance or Part 10A as the case may be.

Application

This Code applies to all third party funders within the meaning of Division 2 of Part 10A of the Ordinance.

Purpose

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

The Code

1. **Introduction**

Scope of Code

- 1.1 This Code applies to the pre-contractual negotiations, making and performance of any funding agreement between a third party funder and a funded party (including a potential funded party) for third party funding of arbitration commenced or entered into on or after date of commencement of the Code.

Consequences of non-compliance with the Code

- 1.2 Section 98O of the Ordinance sets out the consequences of failing to comply with the Code.

Interpretation

- 1.3 The terms defined in the Ordinance, in particular in its Part 10A, are incorporated by reference into this Code.

2. Standards and practices in third party funding of arbitration

Responsibility for Subsidiaries and Associated Entities

- 2.1 A third party funder must accept responsibility for compliance with this Code on its own behalf and by a subsidiary or an associated entity.

Promotional Materials

- 2.2 A third party funder must ensure its promotional materials in connection with third party funding of arbitration 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 the key features, risks and terms of the proposed funding and the funding agreement including, without limitation, the matters set out in Part10A of the Ordinance including Sections 98M, 98P, 98Q and 98R 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 Part10A of the Arbitration Ordinance.
- 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 advice from its legal representative instructed in the arbitration.

Capital Adequacy Requirements

- 2.5 A Third Party Funder must at all times maintain access to adequate financial resources to meet its obligations, and the obligations of subsidiaries or associated entities, to fund all the arbitrations that they have agreed to fund.
- 2.6 In particular, a Third Party Funder must:
- (1) ensure that it, and each of its subsidiaries and associated entities (if any), maintain the capacity to:
 - (a) pay all debts when they become due and payable; and

- (b) cover aggregate funding liabilities under all of their Funding Agreements for a minimum period of 36 months;
 - (2) maintain access to a minimum of HK\$20 million of capital;
 - (3) arrange and submit to an annual audit by a recognized local or international audit firm and provide the advisory body with:
 - (a) a copy of the audit opinion given by the audit firm on:
 - (i) the third party funder's and any subsidiary and associated entity's most recent annual financial statements (but not the underlying financial statements); or
 - (ii) in the case of a third party funder who is an investment advisor to an associated entity, the audit opinion given by the audit firm in respect of the associated entity (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; and
- (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, and each of its subsidiaries and associated entities (if any), satisfies the minimum capital requirement set out in subparagraph (2) above;
- (4) accept a continuous disclosure obligation under each funding agreement in respect of its capital adequacy, including:
 - (a) a specific obligation to notify timeously 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, or any subsidiary or associated entity, 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

2.7 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, or any subsidiary or associated entity, or an agent of any of them, in relation to the funding agreement;
- (2) follow the written procedures mentioned in paragraph 2.8 for the duration of the Funding Agreement; and
- (3) not take any steps that cause or are likely to cause the Funded Party's legal representative to act in breach of professional duties.

2.8 For paragraph 2.7(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) how to disclose 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) how to deal with situations in which a lawyer acts for both the third party funder and a funded party or potential funded party;
 - (f) how to deal 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 the Ordinance 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 the Ordinance 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 Privilege

- 2.9 A Third Party Funder will observe the confidentiality of all information and documentation relating to the arbitration to the extent that Hong Kong law (including the Ordinance) permits, and subject to the terms of any confidentiality or non-disclosure agreement agreed between the third party funder and the funded party.
- 2.10 To avoid doubt, the Third Party Funder is responsible for the purposes of this Code for preserving confidentiality on behalf of any Subsidiary or Associated Entity.

Control

- 2.11 A third party funder must undertake in each funding agreement that:
- (1) it will not seek to, and will not, control or direct the funded party as to the conduct of the arbitration, including, without limitation, as to the negotiation and conclusion of any settlement;

- (2) it will not seek to influence the funded party's legal representative to cede control or conduct of the arbitration to the third party funder; and
- (3) it 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

- 2.12 The third party funder must remind the funded party of its obligation to disclose information about the third party funding of arbitration under section 98Q of the Ordinance.
- 2.13 To avoid doubt, the funded party 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, or as otherwise required by law.

Liability for Adverse Costs

- 2.14 Subject to the provisions of the Ordinance, the funding agreement must state whether (and if so to what extent) the third party funder, a subsidiary or an associated entity 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

- 2.15 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;
 - (2) reasonably believes that there has been a material adverse change of prospects to the funded party's success in the arbitration; or
 - (3) reasonably believes that the funded party has committed a material breach of the funding agreement.

- 2.16 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 2.15 above.
- 2.17 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 2.15(3) above.
- 2.18 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.

Non-compliance by Subsidiary or Associated Entity

- 2.19 The funding agreement must provide that a failure by a subsidiary or associated entity to comply with the Code constitutes a failure to comply with the Code by the third party funder.

Dispute regarding Funding Agreement

- 2.20 The funding agreement must provide a neutral and independent 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

- 2.21 The third party funder must maintain a complaints procedure in respect of any relevant act or omission by the third party funder 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 the complaints 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 Ordinance; 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 that other funded parties may not have complained.

Annual Returns

2.22 The third party funder must:

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

Annex C

The legal and arbitration professional bodies whose responses on the Report were sought include the following:

1. Chartered Institute of Arbitrators (East Asia Branch)*
2. China International Economic And Trade Arbitration Commission, Hong Kong Arbitration Center*
3. China Maritime Arbitration Commission, Hong Kong Arbitration Center*
4. Hong Kong Bar Association*
5. Hong Kong Institute of Arbitrators
6. Hong Kong International Arbitration Centre*
7. The Law Society of Hong Kong
8. Secretariat of the International Court of Arbitration of the International Chamber of Commerce – Asia Office

*: The organisations which have provided their comments on the Report (as at 21 November 2016)