

**DRAFT CODE OF PRACTICE FOR
THIRD PARTY FUNDING OF ARBITRATION AND MEDIATION
SUBMISSIONS**

1. The Law Society has reviewed the Draft Code of Practice for Third Party Funding of Arbitration and Mediation (the Draft “Code”) and provides this submission. The Draft Code was issued on 30 August 2018 for public consultation.
2. Our comments in this submission are set out in two parts - In Part I, we set out our concerns on mediation funding as applied to personal injuries (“PI”) claims. For the purpose of this Submission, PI claims include employees’ compensation claims under Cap 282 and medical negligence claims. In Part II, we relay our comments on the Draft Code *insofar as non-PI litigation is concerned*.
3. In the course of our review of the Draft Code, we are made aware of the following:
 - (a) the *Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Ordinance 2017* (Ord No. 6 of 2017) (“Amendment Ordinance”) was enacted in June 2017. Among other things, it provides that common law doctrines of champerty and maintenance do not apply to third party funding of arbitration and mediation;
 - (b) Divisions 1, 2, 4 and 6 of the Amendment Ordinance have come into operation upon its gazettal on 23 June 2017; Divisions 3 (on champerty and maintenance) and 5 (on measures and safeguards) of the Amendment Ordinance will come into operation after a regulatory framework for third party funding has been put in place; such shall include the issuance of the Code for third party funders;
 - (c) the Secretary for Justice has on 18 May 2018 been appointed as the authorized body under section 98(X)(2) of the Arbitration Ordinance; and

- (d) on 24 August 2018 appointments were made for the setting up of an advisory body provided for under section 98(X)(1) of the Arbitration Ordinance. This advisory body is to monitor and review the operation of the provisions of the third party funding of arbitration and mediation, including the implementation of the Code.

Part I: Mediation Funding for Personal Injuries Claims?

- 4. PI litigation is different from commercial litigation. It has its own set of Practice Directions (viz. PD 18.1 and 18.2). Some of its legal procedures are unique (e.g. Order 80 sanction). It is, where applicable, intertwined with other jurisprudence, for example the mental health jurisdiction and personal data privacy doctrines (for non-party party discovery).
- 5. Victims of PI accidents are mostly commercially unsophisticated. This stands in contrast to commercial entities which would receive proper legal advice when they are to seek funding for arbitration / mediation for their transactional disputes. Absent any legal advice, victims of PI accidents would have tremendous difficulties to appreciate their rights and their entitlements in the aftermath of the accidents. They do not understand issues such as conflicts of interests. It is also almost impossible for them to bargain the terms of a funding agreement with recovery agents.

The above makes the victims susceptible to persuasion and exploitation, in particular at times when victims of PI accidents are emotionally vulnerable.

- 6. Touting by recovery agents in PI claims has been a worrying problem:
 - (a) The recovery agents are not professionally qualified nor are they subject to any code of professional conduct;
 - (b) There is no compulsory insurance covering any claims directed at recovery agents;
 - (c) They could be of unknown background;
 - (d) They have an interest in the damages recovered; the injured persons' best interests are not looked after. The recovery agents could disappear before the claim is disposed of/settled, when they consider that the claim is not financially worthy;

- (e) Assessment of damages is strictly to give the injured full compensation, “*no more but certainly no less*”— see *Knauer* [2016] UKSC 6. If the injured is to give away a percentage of his/her damages, he/she is under-compensated;
 - (f) The situation is exacerbated in cases when the recovery agent pushes the injured to under-settle, just to obtain early payment for themselves. Recovery agents are not interested in the requisite investigation on liability or quantum, or to render any professional assessment of damages.
7. The HKSAR Government, the Judiciary and the legal profession have in the past been devoting huge efforts to combat the problems of touts and recovery agents. The judgments e.g. on *Yeong Yun Hong Gary* DCCC 216/2013, CAAR 3/2014, *Mui Kwok Keung* HKLRD116[2014]1 speak volume on the distaste of the Judiciary on the problems of champerty and maintenance.
 8. Without realizing the above distinctiveness of the PI litigation, the “one-size-fit-all” approach taken by the Government on mediation funding for PI litigation is fundamentally flawed.
 9. At present, due to the above efforts by the Government, the Judiciary and the profession, open funding for profits for PI actions has largely been contained. However, anecdotally, recovery agents are still funding PI claims in a discreet manner, in exchange for a share of the damages. This takes place, for example, by way of a loans arrangement or “pro bono” offer with subsequent billing commitments. When the Amendment Ordinance fully comes into effect, recovery agents would readily re-emerge with open advertisements for their funding service. This is made possible because, according to the Draft Code, entities with a capital of HK\$20 million are legitimately allowed to finance mediations in PI actions. These recovery agents which used to take a 20% to 30% share of the damages in the background could now openly milk the victims in a legitimate manner, under the guise of financing mediation.
 10. We envisage what could happen *for instance* is for a third party funder to agree with a plaintiff to mediate his claim for a share of his damages. The third party funder then engages lawyers (or asks its own in-house legal clerks) to essentially prepare the entire case as if it would proceed to litigation - there could be exchange of correspondence, complete discovery, engagement of experts, provision of legal advice and negotiation of a settlement through mediation. If the time bar becomes an issue then a generally endorsed writ could be issued. In short what needs to be done

would be to load the entire litigation process into pre-action mediation. Under the funding regime, all this is legalized. The funder would escape from any champerty / maintenance offences when, for all practical purposes, it has funded litigation.

11. The pecuniary advantages to be obtained from the above are huge and are obvious; the regime encourages non-professional entities to enter the market and run the bulk of personal injury mediation claims for a substantial profit. See paragraph 6 in the above for the prejudice arising therefrom.
12. It is important to realize that mediation in PI cases is effectively “compulsory” as a matter of procedure, for failure to attend mediation attract costs sanctions from the Court. The process itself is therefore not truly consensual. Moreover, mediation could be repeated in the claim process. The above make PI litigation particularly attractive to recovery agents and, at the same time, invite exploitation.
13. We have been having correspondence and meetings with the Department of Justice (“DOJ”) to discuss the above. Notwithstanding these exchanges of views, it has not been made sufficiently clear to us (in the Amendment Ordinance or otherwise) as to whether (a) the concepts of champerty and maintenance apply to mediation after the commencement of an action and (b) what effect this has on the position of the PI practitioners involved in the litigation who are subject to champerty and maintenance in the litigation but it appears are not to be subject to champerty and maintenance in any matters arising from the mediation. With respect to (b), if it is the case it seems disingenuous to pretend that mediation which takes place in on-going litigation is a separate and stand-alone process (particularly when it is effectively a “compulsory” part of the litigation process). We note reference has been made to paragraph 1.30 of the Law Reform Third Party Funding sub-committee’s report which says

“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.” (emphasis added)

14. Similar averment has been made by the Bills Committee on Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Bill 2016. In a LegCo

paper, the Government explained their position as follows¹:-

“52. The Administration has advised that the common law doctrines of maintenance and champerty have been held by the Hong Kong courts to prohibit third party funding of litigation, save in the three exceptional areas mentioned in (paragraph 2 of the paper). On the other hand, mediation is a consensual negotiation process which parties to a dispute voluntarily resort to with a view to reaching a settlement of the dispute through the assistance of an impartial mediator. Mediation is not a legal action or legal proceedings per se. Indeed, mediation is very different from litigation (and arbitration) in that mediation does not involve any adjudication of legal rights or liabilities by a third party.

53. The Bills Committee notes the Administration’s notion that mediation encourages settlement of disputes. In principle, assisting in or facilitating the settlement of disputes does not undermine the common law doctrines of maintenance and champerty or their underlying rationale, namely, to prevent unnecessary litigation proceedings being promoted or financed by powerful individuals for the sole purpose of furthering their own interests. Hence, third party funding of mediation arguably facilitates the early resolution of dispute without resorting to litigation which is the very objective of mediation. The Bills Committee also notes the LRC’s view that, apart from arbitration, mediation and other forms of alternative dispute resolution are not considered as contentious proceedings to which the doctrines of maintenance and champerty apply.” [emphasis supplied]

15. We have revisited cases on champerty and maintenance including *Unruh v Seeberger* [2007] 2 HKLDR 414. In *Otech Pakistan Pvt Ltd v Clough Engineering Ltd* [2006] SGCA 46 (Singapore), the Singaporean court states that the doctrines should apply to not only public forum disputes in litigation but also to the private forum disputes in arbitration, as arbitration proceedings are a form of litigation. A *lis* prosecuted in an arbitration could be prosecuted in a court. Mediation deals with settlement of a dispute. It does not deal with adjudication of a dispute. It is consensual in its outcome. For there to be a resolution, the parties must agree on the result. On the face of it, and according to LRC’s view above, mediation, including those within the context of an ongoing litigation, could be seen as a separate

¹ See LC Paper No. CB(4)1161/16-17 of 5 June 2017

stand-alone process and thus is immune to champerty and maintenance offences (irrespective of whether it is arranged pre- or post-commencement of proceedings).

16. Following the above analysis, the launch of the mediation funding regime in Hong Kong would be a loud wake-up call to recovery agents.
17. Apart from the above concerns, we envisage two practical problems to arise when the Amendment Ordinance comes into full effect. These two problems relate to (i) Order 80 settlements / ECAS cases and (ii) legal aid cases.
18. Consider an Order 80 case which is settled by mediation. The settlement is to be approved by the Court as a matter of statutory requirement. As part of the agreement to settle, the funder is to take say 20% of the damages. When the matter is before the Court and the Court is aware of the share of damages, it is very likely that the Court is not going to approve that settlement, as the victim will not be able to receive what he is legally entitled to. What would happen to the “settlement” and to the victim? On the other hand, the funder is arguably entitled to its share of damages under the funding agreement, irrespective of whether the settlement is approved by the Court. When the funder is no longer committing an offence of champerty or maintenance, he could legitimately chase the victim, and could even bring civil proceedings to recover from the victims the shares of damages.
19. The above could have implications to the resources of the Judiciary as, on one hand, the settlement process would become unduly and unnecessarily complicated and, on the other, there could be satellite litigation arising therefrom.
20. Complications could arise also with cases involving Employees Compensation Assistance Fund Scheme (“ECAS”). This Scheme provides for cases when no insurance companies are available for payment of damages. Under the Scheme, before a claimant can apply to the ECAS for relief payments, he must have a liability judgment. At the initial stage of the claim process, it may not readily be apparent that ECAS would be involved, or even if the ECAS has initially responded to a claim, it may not continually be involved throughout the claim process. When a funder realizes that it could not secure pecuniary benefit from a funding arrangement (proposed or otherwise), it would be dis-incentivized to fund or to continue the funding, leaving the action to be time-barred, or rendering the further prosecution of the claim to be difficult if not impossible.

21. As to the legal aid costs, the Legal Aid Department has a First Charge on damages to be recovered (section 18A, Cap 91). How is this impacted by the fact that say 20% of the damages has been agreed to be paid to a third party funder which funds a successful mediation? How are the public funds protected?
22. In the light of all the above complications, the only prudent measure is to introduce requisite legislative amendments to the effect that *PI litigation be carved out from the third party funding regime under the Arbitration Ordinance Cap 609 and the Mediation Ordinance (as amended by Ord no. 6 of 2017)*.
23. By virtue of the above, we do not consider we should provide comments to the Draft Code for PI Claims. Additionally, any comments on the draft Code for PI Claims would only be interpreted and used by recovery agents to guide them on how to avoid pitfalls. In reality, the Code will then become a handbook by which the DOJ “teaches” the recovery agents on how to tout and run their business legally.
24. As a passing remark, we do not consider that mere public education against recovery agents, *in lieu of* the above proposed changes in paragraph 22, would be helpful to address the above concerns.

Part II: General Comments on the Draft Code for Funding for Non-PI Claims

25. This section sets out our general comments on the Draft Code for *non-PI Claims*.
26. As a caveat, we state that our comments made in this Part are without prejudice to any proposal which, as part of our on-going efforts to combat champerty and maintenance, may be made to the Judiciary on those Declarations / Undertakings routinely filed by plaintiffs in PI Claims, as required under the current Practice Directions.
27. For non-PI Claims, we have a clause-by-clause examination of the Draft Code. Our proposed amendments and comments are marked up on **Annex 1** to this Submission. We have not reviewed the Chinese translation of the Draft Code.
28. Among the various proposed amendments to the Draft Code, we invite the attention of the DOJ to the following policy issues, viz.

- (a) On capital requirement of a funder (para 25(2) of the Draft Code), we ask that the capital should be unencumbered. We also ask the DOJ to carefully consider the measurement to be adopted for measuring capital adequacy ratio, as different measurements are calibrated by different accounting concepts.
 - (b) At present there is no restriction on who can be the funder or who can run a funding business if the funder is an entity. Should the DOJ allow someone who has a criminal record e.g. a conviction involving dishonesty or on money laundering to run a funding business?
 - (c) We propose for the DOJ to consider to itself maintain a list of funders, and that a “de-listing” mechanism is introduced. When funders have become substandard, they would be removed from the list. This enhances transparency and self-regulation of funders.
29. In terms of drafting, notwithstanding the “light-touch” approach in the Amendment Ordinance, we ask whether the Code should be more robust. We have the following observations.
- (a) The Code and/or funding agreement should provide for governing law to be Hong Kong law.
 - (b) The Code of Practice should state that the contents are not exhaustive or complete and that it does not replace independent legal advice.
 - (c) If the third party funder is a company (non-listed or listed), should it be subject to applicable laws, regulations, licensing rules or approvals concerning fund raising, investment, financing or money lending services or products?
 - (d) Should the funding agreement state that:
 - (i) a third party funder is *deemed to* have adopted the Code of Practice (and any updates); and
 - (ii) the provisions will prevail over the third party funder’s internal code of conduct and any other codes of conduct (e.g. external, industry or overseas) to the extent of any inconsistency etc, if any?
 - (e) Should the funding agreement include provisions that third party funder will:
 - (i) observe the privacy of all personal data (and comply with applicable

- laws);
 - (ii) safeguard the security of all information and documentation; and
 - (iii) have effective procedures and systems in place regarding the above, including, among others, immediate notification of any loss or waiver of confidentiality, privilege, privacy and security?
- (f) Should the funding agreement include provisions for the third party funder and funded party to communicate and/or cooperate with each other (subject to non-control provisions) on any issues in the matter and for funded party to disclosures e.g. regarding meeting minutes, advice received by third party funders, AML checks?
- (g) Should the funding agreement state:
- (i) who takes decisions of the third party funder (e.g. identify the investment committee and whether any participant is an arbitrator, mediator, lawyer, expert or other professional); and
 - (ii) how any risk of conflict of interests (actual or potential) concerning the person concerned is disclosed and managed?
- (h) Should the funding agreement include further provisions on how third party funder's return (and any reimbursement) is calculated, on priority of payments (if any recovery) and on interest in the proceeds, if any (or whether to use a separate agreement)? Should there be any provisions for trust account (or separate agreement) to hold any recovery money and whether the funded party's representative should be a party to the same?
- (i) Insofar as control is concerned, should the Code clarify and identify that
- (i) the Funded Party is the "client" of the lawyer (and not the Third Party Funder or any other person) and that the lawyer's duties etc. are owed to the Funded Party only;
 - (ii) the applicable provisions of the Contracts (Rights of Third Parties) Ordinance (Cap 623) may be expressly carved out or excluded if necessary;
 - (iii) the Funded Party's choice of lawyer is freely provided;
 - (iv) if there is any inconsistency between provisions of the Funding Agreement and the law firm retainer (made between the client/the Funded Party and the solicitor), the retainer prevails (e.g. fiduciary, contractual, tortious and ethical duties of the lawyer)?

- (j) In the light of the above, the DOJ might wish to consider adding to the Draft Code those draft paragraphs on Annex II that should address some of the above issues.

OTHER COMMENTS

30. Our other specialist committees are also reviewing the Draft Code. We shall provide supplemental submissions if or when we are so advised.

The Law Society of Hong Kong
30 October 2018

[Note: amendments proposed in the following are without prejudice to the Law Society's rights to provide further amendments when so advised]

Proposed Amendments to
The 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. 620.¹

¹ 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

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.

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.

2018 a third party funder having access to funds immediately within its control, including within a corporate parent or subsidiary is known as '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'.

Promotional Materials

2.2 A third party funder must ensure its promotional materials:

- (1) are clear and true and should not be misleading;
- (2) contain a caveat that the potential funded party should seek independent legal advice before entering into any funding agreement with the third party funder.

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; and-
- (4)(5) comply with all applicable laws and rules (including any applicable regulatory or licensing regime concerning fund raising, financing, investment or money lending services or products).

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 at all times:

- (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 unencumbered capital and ensure its liquidity ratio exceeds 1;

- (3) audit its accounts for each of its financial year and 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 at least 14 days' written 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 immediately 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 avoid conflict of interest at all times (i.e. the third party funder as a fiduciary or otherwise must not put itself in a position where its own interests conflict or are likely to conflict with its duty to the funded party or intended funded party) and must:

- (1) have established systems and procedures to maintain, ~~for the duration of the funding agreement~~ at all times, 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 (including but not limited to its directors, officers, shareholders, investment committee members, investors and other

stakeholders);

- (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, practice directions and/or legal obligations.

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 and/or the arbitration or potential arbitration concerned to identify and assess potential conflicting interests and the review should be on-going as necessary;
- (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) ceasing to act or continuing to act if necessary;
 - ~~(a)~~(b) monitoring the third party funder's operations to identify and assess potential conflicting interests;
 - ~~(b)~~(c) disclosing conflicts of interest and potential conflicts to funded parties and potential funded parties;
 - ~~(c)~~(d) managing situations in which interests may conflict;
 - ~~(d)~~(e) protecting the interests of funded parties and potential funded parties;
 - ~~(e)~~(f) dealing with situations in which a ~~lawyer~~ representative acts for both the third party funder and a funded party or potential funded party;
 - ~~(f)~~(g) 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)~~(h) reviewing the terms of a funding agreement to ensure the

terms are consistent with Part 10A of Cap. 609 and this Code;
and

- ~~(h)(i)~~ 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, not disclose nor waive the confidentiality and legal professional privilege of all information and documentation relating to the arbitration or mediation and the contents subject of the funding agreement subject to to the extent that Hong Kong law, or other applicable law, permits.

As part of the funding agreement and/or the confidentiality and common interest agreement, the third party funder acknowledges and undertakes the following before the funded party makes any disclosure to the third party funder.

(1) The documents and information being provided to the third party funder are confidential and privileged and the benefit of the confidentiality belongs to the funded party (e.g. only the funded party can consent to waive the right);

(2) The documents and information have been provided to the third party funder for the sole or dominant purpose of pursuing arbitration proceedings;

(3) None of the communications with the third party funder amount to a waiver of privilege attaching to those communications or documents;

(4) The third party funder undertakes to: -

- (a) keep all documents and information relating to the matter secure, confidential and privileged (to the extent that Hong Kong law, or other applicable law, permits);
- (b) ensure effective procedures and controls for confidential, secure and proper handling of the documents and information are in place and that these are followed by its personnel, agents and suppliers; and
- (c) not to disclose the documents and information to any other person nor use them for any other purpose unless written consent of the funded party is obtained beforehand (e.g. bankers, agents of third party funder, etc.).

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, witness or expert 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, practice directions and/or legal obligations; and
- (2)(3) it will not seek to influence the arbitration body (including the arbitral tribunal and arbitral institution).

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~~ as required by the arbitration body or the arbitral tribunal in an arbitration, or as otherwise required by law.

Liability for ~~Adverse~~ Costs and Fees

2.12 The funding agreement must state whether (and if so to what extent and

when payable) the third party funder is liable to the funded party to:

- (1) meet any liability for adverse costs, wasted costs and pre-arbitration costs (e.g. due diligence, negotiation, etc.);
- (2) pay any premium (including insurance premium tax) to obtain costs insurance;
- (3) provide security for costs; and
- (4) meet any other financial liability (e.g. costs and fees relating to any counterclaim, related litigation, enforcement, taxation and any other items).

Grounds for Termination

2.13 The funding agreement must state whether (and if so, how) the third party funder may terminate the funding agreement after giving reasonable notice to the funded party 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 which is irremediable or not remedied within a reasonable time by the funded party after receipt of the third party funder's notice requiring the funded party remedying the same.

2.14 The funding agreement must not ~~establish~~ purport to confer a discretionary right for a third party funder to terminate the funding agreement in the absence of the circumstances described in paragraph 2.13. In particular, the funding agreement should require the third party funder to communicate any termination to the funded party not less than one calendar month (or other specific period agreed between them) before any hearing or other major step in the arbitration (if relevant grounds are shown).–

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) without prejudice to the rights and remedies of the third party funder at common law.

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 and/or that there may be a conflict of interest (actual or potential) which is irremediable or not remedied within a reasonable time by the third party funder after receipt of the funded party's notice requiring the third party funder remedying the same.

Dispute regarding Funding Agreement

2.17 The funding agreement must provide a fair, neutral, independent and effective dispute resolution mechanism for resolution or settlement of any dispute arising under or in connection with the funding agreement between the third party funder and the funded party (e.g. conduct, strategy, liability, amounts, settlement terms, termination, conflicts of interest and other disputes).

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—, and

(5)(6) In particular, the funding agreement should state that each of the funded party and the third party funder may terminate the funding agreement if either reasonably believes that there is a conflict of interest (e.g. anti-money laundering requirements, etc.).

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 and/or arbitration body for further information or clarification concerning any matter.

Anti-Money Laundering and Counter Terrorist Financing

2.20 The third party funder will provide information, documents and answers to the funded party or funded party's representative upon request as soon as possible (and provide updates as necessary) relating to applicable legal and regulatory compliance including:

- (1) its beneficial ownership, members and shareholders of the third party funder;
- (2) how, where and from whom it raises funds necessary to fund the matter (e.g. lenders, bankers or other sources, if any);
- (3) its organizational structure including directors and officers of the third party funder;
- (4) relevant constitutional documents;
- (5) authorized representative(s) of the third party funder; and
- (6) other details reasonably requested (e.g. declarations where incorporated overseas).

PROPOSED ADDITIONAL CLAUSES TO THE DRAFT CODE**Third Party Funding Agreement**

- I. The third party funding agreement is a contractually binding agreement entered into between a third party funder and a funded party relating to disputes seated in Hong Kong under the applicable laws. The third party funding agreement will:
- (a) be in writing;
 - (b) specify the amount of funding to be provided to the funded party;
 - (c) indicate the agreed investment return to the funder;
 - (d) be drafted in as clear and concise a manner as possible so as to aid understanding by the funded party;
 - (e) specify that the third party funder authorizes the disclosure of its identity, its address and the existence of funding to the tribunal, the mediator, the court and other parties (as set out in the third party funding agreement and as allowed by law); and
 - (f) adequately address the matters set out in the Code of Practice.

Conflicts of Interest

- II. The third party funding agreement will provide that the third party funder will not:
- (a) pay any commission, fee or share of proceeds to legal practitioners or law firms for the introduction or referral of clients or potential clients;
 - (b) knowingly allow a legal practitioner or law practice representing the funded party to directly or indirectly hold any share or other ownership interest in the third party funder;
 - (c) fund or continue to fund other parties to the same proceedings where there arises a conflict of interests between or among the funded parties. If there appears to be potential for any such conflict, the third party funder will draw this to the funded parties' attention and address, with the funded parties' agreement, how any conflict that may emerge will be resolved.

Control

III. The funding agreement will provide that:

- (a) the funded party's legal practitioner (or other representative as the Case may be) acts for the funded party only and may continue to do so notwithstanding any fall out or non-alignment of interests between the funded party and the third party funder;
- (b) the funded party's legal practitioner owes professional ethical, fiduciary and legal duties to the funded party (even though payment of fees of the legal practitioner may be made by the third party under);
- (c) the funded party's consent will be obtained before any agreement is made between the third party funder and the funded party's legal practitioner or representative; and
- (d) the third party funder recognizes the arrangement and accepts the same.