29 October 2018

Legal Policy Division
Department of Justice
5/F, East Wing, Justice Place
18 Lower Albert Road
Central
Hong Kong

By email: tpfcode@doj.gov.hk

Dear Secretary for Justice,

Comments on the Draft Code of Practice for Third Party Funding of Arbitration and Mediation

Burford Capital welcomes the publication of the Draft Code of Practice for Third Party Funding of Arbitration and Mediation (the "Draft Code") and the launch of the consultation process. We are grateful for the opportunity to share our views with you.

1. General comments

Burford is the largest litigation finance firm in the world, publicly listed on the London Stock Exchange with more than US$3 billion invested in litigation finance assets.

Burford has historically been supportive of Hong Kong's reforms to allow third-party funding for international arbitration. Hong Kong was a pioneer in Asia in introducing a third-party funding framework and recognising legal finance as a valuable dispute resolution tool. Burford participated in the earlier consultation process for the introduction of the Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Ordinance 2017 (the "Amendment Ordinance").[1]

We eagerly await the full implementation of the framework and are encouraged by the progress that is being made with the publication of the Draft Code.

The concept of using external legal finance for international arbitration has gained prominence in Asia with the introduction of the respective legal frameworks in Hong Kong and Singapore. In the case of Singapore, the framework was fully implemented in February 2017, complementing the existing use of

[1] A member of Burford's underwriting and investments team, James MacKinnon, also provided assistance to the Third Party Funding for Arbitration Sub-Committee of The Law Reform Commission of Hong Kong, when he was an associate at Herbert Smith Freehills in Hong Kong.

external funding in insolvency matters.

In response to the anticipated interest and demand in legal finance, Burford opened an office in Singapore in 2017. Burford has also funded the first known international arbitration case in Singapore in 2017, which is testament to its leadership in this nascent industry.

Over the past year, we have had the benefit of observing how the legal finance industry has developed in the region. Since the opening of our Singapore office, we have received a number of funding requests for arbitrations seated in Singapore (as well as from liquidators in Hong Kong and Singapore). The nature of the underlying disputes and the parties and legal advisers involved have been diverse - we have been asked to consider both institutional and ad hoc arbitrations seated in Singapore, involving claimants from within and outside the country, and represented by both local and international law firms.

Burford is the world's largest legal finance provider by a clear distance, with a market capitalisation of US$5 billion and, as a publicly listed company, unparalleled transparency of financial reporting and business operations. We have the most experienced legal finance team in the industry, with particular expertise in financing international commercial and investment treaty arbitrations. We value the opportunity to contribute our significant experience and knowledge towards the successful implementation of the framework in Hong Kong.

2. Comments on the Draft Code

We are generally in support of the content of the Draft Code which, consistent with the Amendment Ordinance, identifies the key issues which users of legal finance should be aware of when considering funding for the first time, and sets clear guidance for funders operating in Hong Kong.

We set out some specific thoughts below:

i. Capital adequacy requirements

We note that paragraph 2.5(2) of the Draft Code, which follows Section 98Q(e) of the Amendment Ordinance, provides that a third party funder must maintain access to a minimum of HK$20 million of capital. The paragraph also sets out other financial and audit requirements.

Capital adequacy is a key factor for clients: when choosing a third-party funder, an essential consideration must be its demonstrated financial capacity to meet all its ongoing funding obligations. The core of the funding business is the ability to fund.

From the perspective of assessing a funder's capacity to meet its funding obligations, a net asset position would in theory be more instructive, though we recognise that there are many difficulties with establishing net asset positions. Burford engages with its auditors to establish this (which is very time consuming and costly given this is non-traditional asset class) and currently has in excess of US$1.6 billion in assets.

It may be that replacing the net asset requirement with a capitalisation requirement is appropriate. When some capital is to be paid in the future, clients must be confident that capital will be available to them at the point when it is needed. Even when capital availability is not an issue—such as when the client is

receiving all the capital upfront—clients need to focus on the size and structure of their financial providers to assess their stability and incentives and the materiality of the investment to them. This is important because, if a transaction is material to the financier, there may be contractual provisions in the litigation funding agreement that will—if it comes under pressure—permit the financier to act in a manner that may be inconsistent with client interests. In this regard, we support the requirement in the Draft Code that a third party funder must be able to cover all of its aggregate funding liabilities for a minimum period of 36 months. This approach is also consistent with the requirement in other jurisdictions, such as the Code of Conduct for the members of the Association of Litigation Funders of England and Wales (the "ALF Code").

We would argue that having access to a minimum of HK$20m of capital may be too low a hurdle and in practice may not be sufficient to afford funded parties the financial security that they need, particularly in international arbitration proceedings.

A typical legal budget (taking into account professional fees, costs of experts, security for costs and, in some cases, premium for adverse cost insurance) for arbitration proceedings is around US$3-6 million, and certain claims may cost up to US$10 million or more to pursue. The funding process, from the point legal fees are incurred to the time when a successful recovery from the respondent is achieved, typically takes 18 months to three years. The potential costs and duration of an arbitration could result in significant demand on a funder's capital, especially when most professional funders would at any point in time be funding multiple cases. A minimum capital requirement of HK$20 million (equivalent to approximately US$2.5 million) therefore represents possibly only a fraction of actual legal expenditure required. Even assuming the claimant could ultimately be successful in the arbitration, the lack of capital may not enable the party to see the case through if it runs the full course.

We would suggest setting the capital requirement at no less than HK$40 million (equivalent to just over US$5 million); more would be safer. This better reflects the average costs of a large arbitration and the minimum amount of capital that a professional funder would need in practice. At the same time, this amount would not seem unduly burdensome and should be capable of being met by most professional funders. By way of comparison, the corresponding threshold under the ALF Code is £5 million (HK$52 million), which is already relatively paltry.

ii. Disclosure

Paragraph 2.10 of the Draft Code provides that the funded party has an obligation to disclose information about the third party funding arrangement under the Amendment Ordinance. Paragraph 2.11 clarifies that the disclosure of the details of the funding agreement is not required (except in a few specific circumstances). While we welcome the limited scope of the disclosure, one would go further and question the rationale for disclosure and that, if it is to occur, it should occur *ex parte* and *in camera*. There is no basis for disclosure of funding to a respondent, and none has ever been suggested.

As we explained in our earlier submission on the Amendment Ordinance to the Department of Justice, Burford objects, as a matter of principle, to disclosure rules being applied to legal finance over other forms of finance used by parties to arbitration (e.g. equity capital, insurance) and sees such a regulatory approach as being based on an outdated understanding of legal finance. Notwithstanding this, we understand that there is a statutory basis for the inclusion of provision relating to disclosure in the Draft Code.

Burford's view is that the requirement for the disclosure of the existence of funding, and the identity of the funder, unduly focuses on one category of finance provider, and is unfair. Accordingly, we do not stipulate in our funding agreements that we authorise the upfront disclosure of our identity and the provision of our funding. A claimant does not need to disclose its financial means at the commencement of an arbitration, the identity of its bank or its shareholders – why should this be different for a legal financier? In circumstances where we are a passive provider of finance, we do not see why the Amendment Ordinance and the Draft Code should treat legal finance differently from other sources of capital, or why we should expressly authorise the disclosure of our identity in our funding agreement.

We recognise that the Draft Code restricts the scope of the disclosure to the existence of the funding arrangement and not the terms of funding agreements. We fully support this approach. Several leading common law jurisdictions, including the U.S., U.K. and Australia, have held that the terms of funding agreements are confidential and protected by legal privilege (for example, see the English High Court decision in *In the Matter of Edwardian Group Limited* [2017] EWHC 2806 (Ch)). Over recent years, following the existence of funding being disclosed, we have noticed a trend of respondents making applications for the terms of funding agreements to also be disclosed – such applications, which often fail and have little merit, only serve to delay arbitrations and add to the overall cost of bringing a claim.

We consider that a recent case in the U.S. illustrates the right approach to disclosure regarding funding in international arbitration, if it is required. In the multi-district litigation concerning the opioid crisis, U.S. District Judge Dan Polster ordered that disclosure of the existence of funding was made to him *ex parte* and *in camera*. He clarified that the purpose of the disclosure was simply to affirm to him that there is no conflict and the funder exercises no control over the matter. In addition, Judge Polster also ordered in advance that no discovery would be permitted into the litigation finance arrangements, which he recognised were covered by legal privilege. In our view Judge Polster's order deals correctly with Burford's principal objections to disclosure – that it is misused to create expensive and time-wasting frolics and detours in litigation as a tactical device by respondents.

3. Other comments

It is important to note that whilst single case financing is an introductory product Burford offers to lawyers and clients and is often a first step into litigation finance, single case financing represents only 5% of our business, and clients tend to turn rapidly to portfolio finance. Accordingly, we do not consider ourselves a "third party funder" but a provider of legal finance. It is in this vein that we see growth in Hong Kong and the wider Asia Pacific region. We provide legal finance facilities to corporates and law firms who can use legal finance to address the accounting issues surrounding legal spend – namely the impact of it on earnings, a company's cash flow, and its P&L and potentially share price. We see a strong interest for these facilities. This is an important market dynamic for the Department of Justice to consider as the regulatory approach adopted for single case financing does not work particularly well when applied to portfolio financing, and is restrained to arbitrations only.

In the meantime, single case funding is a useful way for companies and law firms to access the legal finance industry for the first time. Burford's growth into portfolio financing in other jurisdictions shows that, in time, Hong Kong's legal finance market will develop away from a focus on single case financing for arbitrations. In crafting Hong Kong's approach to the legal finance industry, the Hong Kong arbitration community should be cognisant of this wider drive in other jurisdictions towards a more sophisticated

provision of legal finance.

Separately, as the world's leading legal finance firm, we have witnessed the strong uptake of legal finance in other key jurisdictions, such as the U.S., U.K. and Australia, for commercial arbitration, litigation and insolvency. We take the view that there is no reason why the safe-harbour in Hong Kong for funding should not be expanded to cover all forms of disputes resolution commonly used by sophisticated parties for high-value commercial disputes. To allow legal finance for such disputes only when they are resolved using international arbitration, and not litigation, creates a dissonance in the legal market that hampers Hong Kong's ability to cater to the broad requirements of international commercial parties. The availability of legal finance for the litigation of commercial disputes in Hong Kong, albeit those above a certain monetary threshold (e.g. HK$100 million), would be an innovative step that would harmonise the legal finance market, and greatly increase Hong Kong's competitiveness as a global hub for commercial dispute resolution.

Hong Kong has the benefit of being a global finance hub, with a large number of multinational corporations establishing their headquarters. It is a gateway to China as well as international commerce in the region and has already demonstrated its track record as a regional dispute resolution hub. Consistent with other common law environments and in keeping with the interest of claimants seeking access to justice, business seeking to operative efficiently, and indeed the system of justice as a whole, Hong Kong would be in a prime position to benefit from a full acceptance of litigation finance.

A wider application of legal finance, particularly in court litigation, would inevitably bring to bear other considerations of risk allocation not usually relevant in arbitration proceedings, such as adverse costs and security for costs orders. However, these issues have now been well considered by both academics and legal practitioners, so Hong Kong will have the benefit of drawing upon the experience in other jurisdictions in dealing with these issues. In this regard, Burford Capital has the benefit of having managed these issues first hand and would be in the good position to share our experience and to seek to bring best practices to Hong Kong.

We eagerly await the full implementation of the third party arbitration funding framework in Hong Kong. In the latest Queen Mary University of London International Arbitration Survey released on 9 May 2018, Hong Kong is ranked as one of the most preferred arbitration seats in the world, although its ranking within Asia has now been overtaken by Singapore since the last survey in 2015. It is therefore critically important that the new framework be given focus in its implementation.

We hope these comments are of help to the Department of Justice. If you would like to discuss any of our comments or seek further information, we would be more than happy to be of assistance.

Yours faithfully

Burford Capital