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Hong Kong Continues To Cultivate Int'l Arbitration Praise

By **Caroline Simson**

Law360, New York (July 12, 2017, 8:42 PM EDT) -- A recent decision by a Hong Kong judge that provides more certainty to parties contracting with Chinese state-owned entities and the recent legalization of third-party funding in arbitration are being hailed for contributing to the territory's already excellent reputation in international arbitration.

Hong Kong has already been recognized as a top venue for international arbitration, having been named in a 2015 survey released by Queen Mary University of London in partnership with White & Case LLP as the third most preferred arbitral seat in the world behind London and Paris. But far from resting on its laurels, the territory has continued to evolve. Part of the impetus behind that evolution may be the neighboring rival jurisdiction of Singapore nipping at its heels.

Singapore — which enacted its own legislation legalizing third-party funding in international commercial arbitration in January — was just behind Hong Kong in terms of popularity in the Queen Mary survey.

“The challenge for Hong Kong in maintaining this position will be to continue to effectively market itself as an arbitral venue in the face of increasing competition from other jurisdictions such as Singapore,” said James Comber, a partner in Ashurst’s dispute resolution practice in Hong Kong.

Still, Hong Kong was only a few months behind Singapore on the third-party funding front. It enacted legislation in June clarifying that third-party funding of arbitration is permitted and that the arbitration of intellectual property disputes is allowed.

Meanwhile, earlier in the month the Hong Kong Court of First Instance concluded that a Malaysian company could enforce an arbitral award against a Chinese state-owned entity. The decision clarifies the Hong Kong judiciary's position on so-called crown immunity, a holdover doctrine from the days before Hong Kong was handed back to China in 1997 by the U.K., under which the Crown is immune from the processes of its own courts. Post-1997, crown immunity has meant that the Chinese government can't be sued in Hong Kong.

"The latest developments show that Hong Kong is committed to maintaining and growing that reputation," said Mayer Brown JSM partner Menachem Hasofer, who is the co-leader of the firm's international arbitration practice, and Mayer Brown JSM senior associate James Lewis in an email to Law360, referring to Hong Kong’s status in the Queen Mary survey as the third most preferred arbitral seat in the world.

Here, Law360 takes a closer look at these recent developments and what they mean for the territory.

Third-Party Funding Legislation

The legislation on third-party funding, which amends the special administrative region's law dealing with international arbitration — the Arbitration Ordinance (Cap. 609) — comes months after the Hong Kong Law Reform Commission issued a report stating that third-party funding should be permitted there as long as financial and ethical safeguards are in place. The bill also officially legalizes third-party funding in mediations.

Burford Capital Managing Director Craig Arnott told Law360 that the Hong Kong legal community had long sought to reform the territory's stance on third-party funding to provide access to legal finance.

"The legal and business community overwhelmingly supported the LRC's recommendations, and the reasons for this are plenty," he said. "Legal finance for arbitration in Hong Kong is of great benefit to law firms and their clients alike."

Not only does third-party funding allow companies to pursue claims that might otherwise be cost-prohibitive, but allowing those companies access to third-party funding can also help them avoid the negative effects on share price that can be the result of spending post-tax earnings on legal fees, he said.

He added that law firms may benefit as well since their business model depends on a regular cash flow.

Hong Kong is slightly late to the party when it comes to the legalization of third-party funding, given that Singapore legalized third-party funding earlier this year, and other leading common law jurisdictions such as England, Australia and the U.S. did so years or even decades ago. But there are still holdouts, like Ireland. Earlier this year, that country's top court found that third-party funding is illegal due to ethical concerns over parties with no interest in litigation profiting from its outcome.

And, despite the new law in Hong Kong, there is continuing concern surrounding third-party funding there. In its report last year, the LRC recommended that third-party funders to an arbitration should be required to comply with a code of practice that would set out certain standards and practices.

Those could include requirements that a third-party funder's promotional literature be clear and not misleading; that their funding agreements set out and explain clearly the key features, risks and terms of the agreement; and that the third-party funder take reasonable steps to ensure that the funded party receives independent legal advice on the terms of the funding agreement before signing it.

Such requirements would likely be welcomed by the legal community.

"In the context of third-party funding there is ... both a need and a desire for industry engagement in developing a code of practice to regulate this area," said Hasofer and Lewis, adding that such a code would likely reflect the key recommendations in the LRC's report, at least in broad strokes.

Crown Immunity Decision

The decision on crown immunity came in a case in the Hong Kong Court of First Instance brought by a Malaysian company called TNB Fuel Services Sdn Bhd, which was looking to enforce a $5.27 million arbitral award against China National Coal Group Corp, a state-owned entity. In the decision, Judge Mimmie Chan

determined that China National could not assert crown immunity — the doctrine under which the Chinese government is immune from suit in Hong Kong — to escape enforcement of the award because it is neither part of nor controlled by the Chinese government to the extent required to assert such a defense.

The situation addressed in the suit — a party seeking to enforce an international arbitration award against the assets of a mainland Chinese state-owned entity in Hong Kong, which is a sovereign territory of China — is a classic Belt and Road scenario, Hasofer and Lewis told Law360. They are referring to a Chinese initiative that focuses on improving trade infrastructure on land from China to other countries in Asia, securing efficient sea trade routes, and establishing a network of free trade zones and cultural exchanges, among other things. Or, as China's state news agency put it in April: "a Chinese solution to global economic blues."

The Hong Kong judiciary had first addressed the issue of crown immunity in 2010, when it held that crown immunity still existed in Hong Kong. In that case, known as The Hua Tian Long No. 2, the court held that the Chinese government is entitled to absolute crown immunity in Hong Kong, meaning that it is not subject to suit in Hong Kong unless it explicitly waives its immunity. The court concluded that the state-owned entity there was entitled to assert crown immunity since it was not a separate legal entity, but instead formed part of the Chinese communications ministry.

But the TNB case has now resolved considerable uncertainty in the area of crown immunity when it came to enforcing arbitral awards against Chinese state-owned entities in a commercial context, according to Comber. Judge Chan's decision makes clear that it will only be in extremely exceptional circumstances that Chinese state-owned entities will be able to assert immunity in Hong Kong in relation to their commercial dealings.

"The judgment is a welcome development and will enable parties entering into agreements with Chinese SOEs to have confidence that their dealings will be treated on a purely commercial footing by the Hong Kong courts," he said.

Nevertheless, Comber added, it's still important for contracting parties to ensure that the state-owned contracting entity is dealing on a commercial basis and that it has a separate legal identity and powers of governance that are independent of the Chinese government.

And despite the fact that the decision came from the Court of First Instance and may be subject to appeal, Hasofer says it is still quite important. He noted that the decision is consistent with the position put forward by the Hong Kong Secretary for Justice, which intervened in the case. That, in turn, supports Hong Kong's status as an important commercial and financial hub for the region.

"For these reasons, the decision of the Court of First Instance should be taken seriously, as representing the law in Hong Kong for the time being," he said.

--Editing by Pamela Wilkinson and Kelly Duncan.
