Litigation Funding for Liquidators in Hong Kong: Exemption Applied with a PRC Twist

Summary
In the recent decision of Re Po Yuen (To’s) Machine Factory Limited [2012] HKCU 816, the Honourable Mr. Justice Harris confirmed that the liquidators of a company in liquidation may enter into a litigation funding arrangement with a third party and that the funding may come in the form of a contingency fee arrangement with the third party. This endorsement and application of an exemption in Hong Kong to champerty and maintenance adds an interesting PRC dimension to the developing body of case law in Hong Kong allowing litigation funding for liquidators.

The common law torts and offences of maintenance and champerty
Maintenance refers to the improper encouragement of litigation by giving aid or assistance to a party in litigation to bring or defend a claim without just cause or excuse. Champerty is a form of maintenance where the maintainer receives a share of the proceeds of successful litigation. Imposition of criminal liability stemmed from a concern that interference from wealthy third parties might affect the integrity of the judicial process, and addressed a public policy fear of third party ‘gambling’ and trafficking in the outcome of litigation. While many common law jurisdictions have long abolished both civil and criminal liability for maintenance and champerty, in Hong Kong maintenance and champerty have been held to remain applicable, subject to certain exceptions.

Current status of litigation funding for liquidators in Hong Kong
Nevertheless, there is a developing body of case law in Hong Kong that demonstrates a liberal approach, recognising litigation funding for liquidators as a lawful exception:

- In the landmark case of Re Cyberworks Audio Video Technology Limited [2010] HKCU 974, the assignment of a cause of action to a litigation funding company (who had no financial interest in the liquidation and would be pursuing the claims for its own commercial gain) by liquidators under s.199(2)(a) of the Companies Ordinance was held to be a lawful exception to the prohibition on maintenance and champerty. This appears to have been the first time a Hong Kong court had made this endorsement in express terms and by way of a written judgment, in the context of claims by insolvent companies.

- Similarly, in the case of Berman v SPF CDO I Ltd [2011] HKCU 522, it was held that a proposed assignment by a US Chapter 11 bankruptcy trustee to a litigation funder of (i) debts owed to the company by two Hong Kong incorporated companies and (ii) the right to commence proceedings against the companies, with the trustee sharing in any proceeds of such litigation, did not infringe the prohibition on maintenance and champerty. The court took into account the fact that the company would not be able to recover the debts without funding - a consideration based on ‘access to justice’ grounds.

Whilst the Re Cyberworks and Berman cases indicate the development of litigation funding for liquidators in Hong Kong, it is to be noted that they are both decisions of a single judge in the Court of First Instance, and previously other members of the Hong Kong judiciary have expressed disapproval of certain aspects of litigation funding (see, for example, the case of Akai Holdings Ltd v Ho Wing On Christopher [2009] HKCU 172, in which the Honourable Mr. Justice Stone criticised aspects of the litigation funding industry, in particular the exercise of excessive control over proceedings by certain litigation funders). It remains to be seen what
boundaries of litigation funding are acceptable to a higher court.

That said, reform may be forthcoming as suggested by the Court of Final Appeal in Winnie Lo v HKSAR [2012] 1 HKC 537. Taken together with the recent case law developments as highlighted above, one may expect a more flexible approach to be widely adopted in the future.

The case of Re Po Yuen (To’s) Machine Factory Limited

Re Po Yuen (To’s) Machine Factory Limited adds an interesting PRC factual element to the existing body of case law in holding that there was nothing objectionable with the engagement by the liquidators of a “PRC legal consultant”, who was not a qualified lawyer, as agent in litigation in the PRC, or the contingency fee arrangement. On a simple level, this can be seen as an endorsement and application of the holdings in the Re Cyberworks and Berman cases that a liquidator may enter into a funding arrangement with a third party, with such funding coming in the form of a contingency fee arrangement in a jurisdiction in which contingency fees are permitted.

More helpfully, in making such ruling, the Honourable Mr. Justice Harris clarified the court’s expectations as to the standards and professionalism of the third party. In particular:

- The engagement of the “PRC legal consultant” was not objectionable even though he was not legally qualified as this was permissible under Article 58 of the PRC Civil Procedure Law.
- The court’s main concern was whether the liquidators had taken an informed view as to what was the best way to advance the creditors’ best interests. The judge appreciated the liquidators’ submissions that such PRC legal consultants may in practice prove more effective in conducting litigation in the PRC than qualified lawyers.

- However, the judge also commented, in obiter, that although PRC processes might be “...more chaotic than those with which the Hong Kong courts are familiar, and practices therefore may be adopted which would not be countenanced in Hong Kong”, the overriding principle was that liquidators were officers of the court and had a duty to ensure that the creditors’ interests were advanced by proper means. In sanctioning the arrangement, the judge was wary that he “...should not be taken as approving standards which are lower than that which [he] would expect professionals in Hong Kong to adopt.”

As the PRC legal consultant was not legally qualified and would also be performing other functions of a commercial nature relating to the subject matter in dispute, the judge further approved of a contingency fee of 40% instead of the normal PRC cap of 30% applicable only to lawyers.

Conclusion

The cases referred to above have confirmed the position in Hong Kong with regard to the exemption for insolvency litigation funding (and indeed Berman was not based on the statutory power of sale for liquidators in s.199(2)(a) of the Companies Ordinance, but rather on the importance of ‘access to justice’ allowing for pursuit of misfeasors where the insolvent estate would otherwise lack funds to enforce punishment).

However, the law on litigation funding remains underdeveloped and funders are likely to confine themselves to supporting clearly exempted insolvency litigation funding, given that champerty in Hong Kong continues to attach criminal liability.

Advice should be sought where litigation funding is contemplated with a view to reducing the risk of challenge and invalidity.
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