

Non-party costs orders: Hong Kong court grants costs order against third party funders

March 14, 2023 | Client Update | 7-minute read

The Hong Kong Court recently revisited the legal principles of costs orders against non-parties in *Hydrotech Waterproofing Solutions Limited v Shun Yuen Construction Company* [2023] HKCFI 601. This decision summarized the principles governing when such orders will be made, including against third party funders who seek to benefit from litigation.

The decision is relevant given the increasing prevalence of third-party funding in Hong Kong, especially in insolvency litigation and arbitration.

Introduction

Third party funding of litigation and arbitration is increasingly prevalent in Hong Kong, in particular for large commercial claims. Professional funders are actively seeking opportunities, focused on high-value claims against deep-pocketed defendants for which settlements or judgments can generate lucrative profits. Commercial funding of Hong Kong litigation continues to be constrained by the anachronistic common law criminal offences of maintenance and champerty, which prohibit funding where the funder does not have a legitimate interest in the litigation or where there is no public interest. Insolvency is a recognized exemption, and high-value claims by liquidators are often commercially funded. In addition, commercial funding and conditional fee agreements are now permitted in Hong Kong arbitration following recent legislation.

A defendant faced with a claim that is funded, or suspected to be funded, should always seek to ensure that the funder faces economic risk by seeking costs against the funder if the defence is successful, and where possible (e.g. in cases brought by liquidators) securing those costs in advance by a security for costs application.

The ability to obtain costs against non-party funders was recently re-affirmed in the Hong Kong High Court decision of *Hydrotech Waterproofing Solutions Limited v Shun Yuen Construction Company Limited* [2023] HKCFI 601. This decision helpfully summarized the legal principles on when such an order would be made, in particular in relation to a third party funder who seeks to benefit from litigation.

Legal principles

The power of the Court to make costs orders against a non-party is provided in section 52A of the High Court Ordinance (Cap. 4) and Order 62 rule 6A of the Rules of the High Court (Cap. 4A). The Court is empowered to award costs against a non-party to the proceedings where it is “in the interests of justice to do so”. However, the Court has recognized that appropriate cases for non-party costs orders are “rare” (*To Pui Kui v Ng Oi Che* [2014] HKEC 1082).

In the recent case of *Hydrotech Waterproofing Solutions Limited*, after the Plaintiff’s case was dismissed in an earlier judgment, the Defendant applied to join (1) the sole director of the Plaintiff, (2) a third party company who entered into

profit-sharing arrangements with the Plaintiff and funded the Plaintiff's litigation ("Third Party"), and (3) the sole director of Third Party for costs purposes.

The Court considered relevant case law in Hong Kong and England, including *Dymocks Franchise Systems (NSW) Pty Ltd v Todd & Ors* [2004] 1 WLR 2807 (PC), *The Liberty Container* [2007] 2 HKLRD 507 (CFA), and *Goknur v Organic Village* [2021] EWCA Civ 1037, and summarized the legal principles concerning non-party costs orders as follows:

1. The power to make a non-party costs order is discretionary, and is only exercised in "exceptional" circumstances.
2. However, "exceptional" in the context of non-party costs orders means no more than outside the ordinary run of costs where parties pursue or defend claims for their own benefit and at their own expense.
3. The ultimate question in any such "exceptional" case is whether in all circumstances it is just to make a non-party costs order. The touchstone is whether, despite not being a party to the litigation, the director/ third party in question can fairly be described as "the real party to the litigation".
4. The consideration of whether a third party should be liable to pay the costs of the proceedings is fact sensitive. There will often be various considerations at play.
5. Generally speaking, costs orders will not be made against "pure funders", i.e. "those with no personal interest in the litigation, who do not stand to benefit from it, are not funding it as a matter of business, and in no way control its course".
6. However, where the funder "substantially...controls or at any rate is to benefit from them, justice will ordinarily require that, if the proceedings fail, he will pay the successful party's costs". The funder is "not so much facilitating access to justice by the party funded as himself gaining access to justice for his own purposes. He "himself" is "the real party" to the litigation".
7. Where a funder is seeking to benefit personally from the litigation instead of pursuing the interest of the party of the proceedings, then "justice will normally require that a self-interested funder whom the law can reach be ordered to pay the costs of the funded litigant's successful opponent".
8. So far as directors and shareholders are concerned:
 - a. The touchstone is whether, despite not being a party to the litigation, the director or shareholder in question can fairly be described as "the real party to the litigation".
 - b. In the case of an insolvent company, if a director knew that the company had no genuine cause of action, and also knew that the company would not be able to pay the costs of the unsuccessful litigation, and still continued the proceedings for the director's personal interests, that would be a case in which a non-party costs order may be made against the director. A director should not be allowed to hide behind a corporate identity so as to engage in risk-free litigation for his own purposes.
 - c. In order to assess whether a director was the "real party to the litigation", the Court may look to see, among other things, (i) if the director controlled or funded the company's pursuit or defence of the litigation, (ii) whether the director was seeking to benefit personally from the litigation, or whether the proceedings were pursued for the benefit of the company.
 - d. While the matters noted in (c) above are helpful indicia, they remain merely elements of the guidance given by the authorities, and not a checklist that needs to be completed in every case.
 - e. If the litigation was pursued for the benefit of the company, then a party seeking a non-party costs order against the director will need to show some other reason why it is just to make such an order, for example, impropriety or bad faith on the part of the director in connection with the litigation.
 - f. The impropriety or bad faith will need to be of a serious nature and, ordinarily, have to be linked to the applicant unnecessarily incurring costs in the litigation.

The Court in *Hydrotech Waterproofing Solutions Limited* considered the application of the above principles in two contexts. As it relates to a director in control of the proceedings, the Court held that the director of the Plaintiff acted under legal advice and genuinely believed on such advice that the Plaintiff had a viable cause of action against the Defendant. The Court considered that both the director of the Plaintiff and the director of the Third Party acted in their capacities as directors of the companies, rather than in their personal capacities or for their own benefit. The Court declined to join the directors in the proceedings.

As it relates to a third party, the Court considered the profit sharing arrangement between the Plaintiff and the Third Party, under which the Third Party was entitled to \$3 million of the sum recovered from the Defendant if the litigation was successful, to be a sufficient basis for the Third Party to be considered a "real party" to the action. The Third Party was thus joined as a plaintiff and ordered to pay, jointly and severally with the Plaintiff, the Defendant's costs of the action.

Comments

Subject to the provisions of rules of court, the Court has wide discretion as to the costs orders it can make, including summary assessment of costs. See *Haller AG v Vestey International Group Limited* [2023] HKCA 274 (Date of decision:

3 March 2023). The Court has full power to determine by whom, and to what extent, the costs are to be paid.

The Court in *Hydrotech Waterproofing Solutions Limited* affirmed the position that, while the Court will not readily impose costs orders on non-parties, a litigation funder who not merely funds the proceedings but substantially controls or benefits from the proceedings can be made liable to pay the costs of the litigation.

Non-party costs orders remain uncommon in Hong Kong. As noted above, defendants who have grounds for believing that the plaintiff would be unable to pay the costs of the proceedings (e.g. companies in liquidation), or that the plaintiff is ordinarily resident out of the jurisdiction, should typically protect their costs position by applying for security of costs under Order 23 rule 1 of the Rules of the High Court, and/or section 905 of the Companies Ordinance.

Finally, we expect that third-party liability for costs will become increasingly relevant due to the increasing volume of third-party funded litigation and arbitration. The ability to seek non-party costs orders should therefore be of interest to institutional defendants, directors, shareholders, insurers and professional litigation funders.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

Martin Rogers

+852 2533 3307
martin.rogers@davispolk.com

Jonathan K. Chang

+1 650 752 2043
jonathan.chang@davispolk.com

Yuan Zheng

+852 2533 1007
yuan.zheng@davispolk.com

Leanne Chu

+852 2533 3337
leanne.chu@davispolk.com

This communication, which we believe may be of interest to our clients and friends of the firm, is for general information only. It is not a full analysis of the matters presented and should not be relied upon as legal advice. This may be considered attorney advertising in some jurisdictions. Please refer to the firm's privacy notice for further details.