

# Small firms tap deep pockets for big disputes

Cash-short companies that run into a dispute can gain access to funding partners - such as publicly listed firms and high-net worth individuals in China - who are willing to foot the bill but also split the rewards.

With the introduction of arbitration funding on February 1, Hong Kong's small businesses can now access deep pocketed partners to help finance their contract disputes. How will this work and who will benefit? *Hong Kong Business* reached out to top lawyers who assessed the implications of the regulation.

### Q: Who is likely to use arbitration funding ?

The construction industry for one, where often there are a myriad of small sub-contractors who can be affected when a dispute arises between the main contractor and developer. Without deep pockets to fight their claims themselves, many of these sub-contractors are put under severe financial strain. Under the new laws, they can find funding partners who will foot the bill and split the rewards. King & Wood Mallesons Partner Paul Starr notes that accessibility to third party funding is likely to free up otherwise encumbered cash flow for these industry participants and has the potential to increase the number of claims brought in arbitration, allowing meritorious claims to be brought that might not have been able to without the support of such funding. Third party funders

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can also assist impecunious contractors or sub-contractors in managing resources during a project. With such assistance, the contractor or sub-contractor can avoid having to allocate or find funds to deal with the claim.

Simmons & Simmons consultant for dispute resolution Eric Chan said third party funding is equally relevant to businesses with sufficient funding, but would like to invest the funds in other projects, as opposed to funding an arbitration – recognising that legal costs could escalate quickly. “There is certainly a potential that the availability of third party funding could lead to an increased number of arbitration claims, although based on our experience in Europe and Asia, third party funders tend to be quite selective about the cases they wish to fund,” he explained.

### Q: Who are arbitration funders and what do they need?

Starr notes some funders are publicly listed, some are backed by high net worth individuals whilst others have lines of credit available to them. The nature of a funder's financing structure can affect not only its ability to maintain necessary funds but may influence its approach to management of claims. A funder must maintain capacity to pay all its debts and cover its aggregate funding liabilities for a minimum of 36 months, as well as maintain access to at least \$20m of capital. Simmons & Simmons' Chan added that there are not many local funders in Hong



The construction industry is likely to benefit greatly from this bill



Paul Teo



Eric Chan

Kong and he envisages that some third party funders which operate in the Mainland will also target Hong Kong, given the expectation of increased interactions in the Greater Bay Area. “Based on our experience, it is very important for the prospective funded party to provide all the key information to the funder, to increase the likelihood that the funder will accept the case,” he added.

### Q: What should companies do to prepare for third party arbitration funding?

Baker McKenzie Arbitration Partner Paul Teo said that companies must get a firm understanding of how third party funding works, what funding options there are and in what jurisdictions they are available. In particular, companies need to understand what types of commercial claims are particularly suitable for third party funding and how the cost of self-financing such claims compare to the benefits of obtaining outside funding such as increasing cash-flow and shifting some or all of the financial risks associated with pursuing a claim to the funder. In addition, companies need a proper understanding of the typical risks such as conflicts of interest, unfair terms.

Companies also need to familiarise themselves with the implications of defending claims against funded claimants. This is because before a funder has reached the conclusion that the prospects of the claim are sufficiently strong to fund it, it has made a careful assessment of the merits of the case and whether the claimed amount is realistic. Hence, the fact that a claimant is funded can increase the pressure on a respondent to settle.

When choosing a seat of arbitration, it is important for companies to take into account the legal framework governing third party funding. For example, Hong Kong permits third party funding but has imposed various safeguards to manage the risks typically associated with third party funding such as protection of legal privilege and confidentiality, ensuring that funded parties retain control over the arbitration.