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LAW TAKES ITS COURSE

THE IMPACT OF THIRD PARTY FUNDING ON HONG KONG AS CENTRE FOR INTERNATIONAL ARBITRATION

Third-party funding of arbitration has just been permitted in Hong Kong. Amendments to the Arbitration Ordinance (Cap.609) abolishes the doctrines of champerty and maintenance for arbitration, clearing the way for parties with no legitimate interest in the proceedings to fund them, in return for a share in any award or settlement. Third parties can include lawyers and law firms, although not if they act for any party to the proceedings. The amendment is expected to take effect later this year, to allow time for development of an appropriate funder code of conduct. Why the change? And what does this mean for lawyers and their clients?

Charlie Morris

ON 14 JUNE 2017, HONG KONG'S LEGISLATURE PASSED AN AMENDMENT TO THE ARBITRATION ORDINANCE (CAP. 609) BECOMING THE LATEST jurisdiction to permit third party funding in international arbitration. While there will be some delay to allow for the development of a code of conduct for funders, the change swiftly follows a similar liberalisation of regional rival Singapore's funding regime earlier in the year.

Previously, funding was only permitted in insolvency cases, but Hong Kong possibly found itself at a significant competitive disadvantage when measured against rival arbitral seats – not just Singapore but London, Paris, New York and Geneva too.

Litigation and arbitration funding is no longer exotic or novel and is now an established and unremarkable feature in many jurisdictions. The ever-increasing utilisation and understanding of both the mechanics and benefits of funding has seen it move into the legal mainstream while attracting growing interest from investors drawn by the potentially high returns uncorrelated to capital markets or the broader market or economy.

Implications for Hong Kong and beyond

As the litigation funding industry has matured and developed over the last 10 years or so, lawyers, their clients and other key stakeholders have developed a real appreciation of its benefits together with a realisation that many of the fears around funding are overblown.

Providing access to justice will always be a key benefit of commercial litigation funding. In scenarios where an under-resourced claimant with a good claim is pitted against a much larger defendant, funding can level the playing field, ensuring the claimant has the means to see the claim through to conclusion. Just as importantly, knowing that a dispassionate, objective third-party has assessed the case and is willing to invest significant sums, where they will only see a return if the case wins, will often encourage the defendant to seriously consider settling the dispute.

Increasingly, litigation funding is seen as a potentially useful tool for both law firms and well-resourced claimants. A law-firm portfolio funding arrangement can allow firms that wish to offer clients contingent fee structures by sharing their risk to a level that they are comfortable with, to take on more of this type of work and to maintain cash flow. And well-resourced corporate claimants are starting to see funding as a highly effective risk-management tool that can reduce the need to have working capital tied-up for several years and has significant advantages from an accounting perspective.

The key charge levelled at litigation funding is that it will lead to an increase in frivolous or unmeritorious litigation, but this illustrates a fundamental misunderstanding of how the industry works. Funding is typically 'non-recourse' meaning that a funder invests in a case on the basis that it only receives a return if the case wins. Indeed, in some jurisdictions, funders may be liable for at least some of a defendant's costs if the funded case fails. In these circumstances, clearly funders have little incentive to back 'frivolous' claims.

Leading global firm Freshfields Bruckhaus Deringer in 2016 stated: 'Funding is here to stay… Already this year we have seen news of an arrangement to provide litigation funding to a FTSE 20 company. This reflects our own experience of handling funded claims – even large corporations are looking to third-party funding as a form of cash flow management…

'To our ears, the concern sometimes expressed that funding breathes life into unmeritorious claims rings false. On the contrary, the involvement of a funder adds an additional layer of diligence at an early stage of the process, leading to greater rigour in risk and cost-benefit assessments'.

Seat at the table

Both Hong Kong and Singapore have, initially at least, only opened up international arbitration to third party funding (funding for insolvency proceedings was already permitted in both jurisdictions). However, the clear indication is that as and when the funding of arbitrations has become established, and assuming no significant issues are encountered, funding of domestic disputes will, in time, be permitted too. The higher value disputes of the type that appeal to funders tend to be subject to arbitration rather than domestic litigation in any event.

Hong Kong was in real danger of becoming the 'odd one out', as the only major arbitral seat that did not permit third-party funding. Now this is no longer the case, Hong Kong is well-placed to continue its growth as a leading centre for international arbitration. While we anticipate that the take-up of funding will be slow and steady (as it has been in other jurisdictions when they have opened up to funding), it has the potential to be transformative both for claimants who would otherwise lack the resources to pursue a claim and sophisticated deep-pocketed law-firms. This will also aid claimants looking to manage and mitigate risk.

Until now, an Asian-based corporate may have opted to have its arbitration heard in a venue where funding has long been permitted, such as London or Paris. Now, thanks to the reforms in Asia, that same corporate may prefer to select Hong Kong or Singapore as its venue of choice. ●

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