

THE LAW REFORM COMMISSION OF HONG KONG

**OUTCOME RELATED FEE STRUCTURES
FOR ARBITRATION
SUB-COMMITTEE**

CONSULTATION PAPER

**OUTCOME RELATED FEE STRUCTURES
FOR ARBITRATION**

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This Consultation Paper has been prepared by the Outcome Related Fee Structures for Arbitration Sub-committee of the Law Reform Commission. It does not represent the final views of either the Sub-committee or the Law Reform Commission, and is circulated for comment and discussion only.

The Sub-committee would be grateful for comments on this Consultation Paper by 16 March 2021. All correspondence should be addressed to:

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It may be helpful for the Commission and the Sub-committee, either in discussion with others or in any subsequent report, to be able to refer to and attribute comments submitted in response to this Consultation Paper. Any request to treat all or part of a response in confidence will, of course, be respected, but if no such request is made, the Commission will assume that the response is not intended to be confidential.

It is the Commission's usual practice to acknowledge by name in the final report anyone who responds to a consultation paper. If you do not wish such an acknowledgment, please say so in your response.

THE LAW REFORM COMMISSION OF HONG KONG

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Defined Terms

Abbreviation	Definition
2005 LRC Consultation Paper	Consultation paper published by the Conditional Fees Sub-committee of the LRC in September 2005.
2007 LRC Report	Report published by the Conditional Fees Sub-committee of the LRC in July 2007.
2016 TPF Report	Report published by the TPF Sub-committee in October 2016.
2019 DBA Reform Project	An independent review of the 2013 DBA Regulations (as defined in paragraph 3.42 below) in England and Wales by Professor Rachael Mulheron and Mr Nicholas Bacon, QC in 2019.
Arbitration	Any arbitration, whether or not administered by a permanent arbitral institution, in or outside Hong Kong, including the following proceedings under the Arbitration Ordinance: (i) court proceedings; (ii) proceedings before an emergency arbitrator; and (iii) mediation proceedings.
Arbitration Ordinance	Arbitration Ordinance (Cap 609) of Hong Kong.
ATE Insurance	After-the-Event Insurance. A contract of insurance between client and insurer, taken out after the event giving rise to the Proceedings, that provides reimbursement for a proportion of the client's fees, adverse costs, and disbursements in the event that the client's case is unsuccessful.
CFA	Conditional Fee Agreement. An agreement pursuant to which a Lawyer agrees with client to be paid a success fee in the event of the client's claim succeeding, where the success fee is not calculated as a proportion

Abbreviation

Definition

of the amount awarded to or recovered by the client.

CFAs include arrangements where:

- (a) the Lawyer charges no fee during the course of the Proceedings, and is paid only the success fee if the client's case succeeds (also known as a "**no win, no fee**" agreement); or
- (b) the Lawyer charges a fee during the course of the Proceedings, either at the usual rate or at a discounted rate, plus the success fee if the client's case succeeds (also known as a "**no win, low fee**" agreement).

CJC Report

The Damages-Based Agreements Reform Project: Drafting and Policy Issues, published in 2015 by the Civil Justice Council of England and Wales.

Consultation Paper

The Consultation Paper on Outcome Related Fee Structures for Arbitration issued by the Sub-committee.

DBA

Damages-based Agreement.

An agreement between a Lawyer and client whereby the Lawyer receives payment only if the client is successful, and where the payment **is calculated by reference to the outcome of the Proceedings**, for example as a percentage of the sum awarded or recovered.

Also known as a "**contingency fee**", "**percentage fee**", or "**no win, no fee**" arrangement.

DBA Payment

Damages-based Agreement Payment.

The part of the financial benefit obtained in respect of the outcome of the claim or Proceedings that the client agrees to pay the Lawyer in accordance with a DBA or a Hybrid DBA.

Abbreviation	Definition
	Also known as a " damages-based fee ".
Hong Kong	Hong Kong Special Administrative Region of the PRC.
Hybrid DBA	Hybrid Damages-based Agreement. An agreement between a Lawyer and client whereby the Lawyer receives both fees for legal services rendered (typically at a discounted hourly rate) and a payment that is calculated by reference to the outcome of the Proceedings, for example as a percentage of the sum awarded or recovered if the client is successful. Also known as a " no win, low fee " arrangement.
Jackson Report	<i>Review of Civil Litigation Costs: Final Report</i> by the Right Honourable Lord Justice Jackson dated December 2009.
Lawyer	A person who is qualified to practise the law of any jurisdiction, including Hong Kong. For the purposes of this paper, "Lawyer" includes (but is not limited to) Hong Kong barristers, solicitors and Registered foreign lawyers.
LASPO	Legal Aid, Sentencing and Punishment of Offenders Act 2012 of the United Kingdom.
Legal Practitioners Ordinance	Legal Practitioners Ordinance (Cap 159) of Hong Kong.
Lord Justice Jackson	Sir Rupert Jackson, Lord Justice of Appeal of England and Wales from 2008 to 2018.
LRC	The Law Reform Commission of Hong Kong.
Mainland China	The PRC (for the purposes of this Consultation Paper) excluding Hong Kong, Macao Special Administrative Region and Taiwan.

Abbreviation

Definition

Ontario model

The damages-based fee regime which operates in Ontario, Canada, as described in paragraph 3.45 of the Consultation Paper.

ORFS

"Outcome Related Fee Structure", an agreement between a Lawyer and client, whereby the Lawyer advises on contentious Proceedings and the Lawyer receives a financial benefit if those Proceedings are successful within the meaning of that agreement.

Also known as a "**success fee agreement**".

For the purposes of this Consultation Paper, "ORFS" includes:

- (a) CFAs;
- (b) DBAs; and
- (c) Hybrid DBAs.

PRC

The People's Republic of China.

Proceedings

Litigation or arbitration proceedings.

Registered foreign lawyer

A person registered as a foreign lawyer under Part IIIA of the Legal Practitioners Ordinance.

Sub-committee

Outcome Related Fee Structures for Arbitration Sub-committee of the LRC.

Success Fee

Additional fee in respect of the claim or Proceedings that the client agrees to pay the Lawyer in accordance with a CFA.

The Success Fee can be an agreed flat fee, or calculated as a percentage "uplift" on the fee charged during the course of the Proceedings.

Success fee model

The damages-based fee regime proposed in the 2019 DBA Reform Project in England and Wales, as described in paragraph 4.86 of the Consultation Paper.

Abbreviation**Definition**

Third Party Funder

A provider of Third Party Funding.

Third Party Funder Hybrid DBA

An agreement between a Lawyer and a Third Party Funder, by which the Lawyer agrees to share his DBA Payment with the Third Party Funder in return for the Third Party Funder paying part of the time and other costs of the claim to the Lawyer as the claim progresses.

Third Party Funding

The provision of funding for an Arbitration within the meaning of section 98G of the Arbitration Ordinance, ie:

- (a) under a funding agreement;
- (b) to a funded party;
- (c) by a Third Party Funder; and
- (d) in return for the Third Party Funder receiving a financial benefit only if the Arbitration is successful within the meaning of the funding agreement in circumstances where the Third Party Funder has no other interest in the Arbitration.

TPF Sub-committee

Third Party Funding for Arbitration Sub-committee of the LRC.

Tribunal

An arbitral tribunal, consisting of one or three arbitrator(s), established by the agreement of the parties to finally resolve disputes or differences by arbitration.

Preface

Terms of reference

1. At present, lawyers in the Hong Kong Special Administrative Region of the PRC ("Hong Kong") are prohibited from charging outcome related fees for their work on contentious matters, including litigation before the Hong Kong courts and Arbitration.¹ Lawyers in many other jurisdictions can offer Outcome Related Fee Structures ("ORFSs")² to their clients.

2. In view of Hong Kong's status as a leading centre for arbitration services, The Law Reform Commission of Hong Kong ("LRC") sees the value in studying this topic in respect of Arbitration.

3. In October 2019, the LRC established the Outcome Related Fee Structures for Arbitration Sub-committee ("Sub-committee"). The terms of reference are:

"To review the current position relating to outcome related fee structures for arbitration, to consider whether reform is needed to the relevant law and regulatory framework and, if so, to make such recommendations for reform as appropriate."

Membership of the Sub-committee

Ms Kathryn Sanger (Co-chair)	Partner Herbert Smith Freehills
Ms Briana Young (Co-chair)	Foreign Legal Consultant (England and Wales)/ Professional Support Consultant Herbert Smith Freehills
Mr C.M. Chan	Consultant Anthony Siu & Co.
Mr Matthew Gearing, QC	Partner Allen & Overy (Hong Kong)

¹ Any arbitration, whether or not administered by a permanent arbitral institution, in or outside Hong Kong, including the following proceedings under the Arbitration Ordinance: (i) court proceedings; (ii) proceedings before an emergency arbitrator; and (iii) mediation proceedings.

² An agreement between a Lawyer and client, whereby the Lawyer advises on contentious Proceedings and the Lawyer receives a financial benefit if those Proceedings are successful within the meaning of that agreement.

Dr Benny Lo

Barrister and Chartered Arbitrator
Des Voeux Chambers

Mr José-Antonio Maurellet, SC

Barrister
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4. Ms Kitty Fung, Senior Government Counsel in the Law Reform Commission Secretariat, is the secretary to the Sub-committee.

5. The Sub-committee members wish to thank Ms Wingy Ha, Government Counsel, for her valuable research assistance.

6. Since its formation, the Sub-committee has met on a regular basis to discuss and consider the matters within the terms of reference. The recommendations in this Consultation Paper are the result of those discussions. They represent the Sub-committee's preliminary views, which are presented for consideration by the community, including the general public, Arbitration users, Arbitration service providers (including legal professionals), and those with an interest in the subject generally.

7. After conducting a review of Hong Kong law and practice and analysing the legal regime for outcome related fees in a number of other jurisdictions, the Sub-committee seeks the public's comments on:

- (1) Whether ORFSs should be permitted for Arbitration in Hong Kong;
- (2) If so, which types of ORFSs should be permitted:
 - (a) Conditional Fee Agreements ("CFAs");
 - (b) Damages-based Agreements ("DBAs"); and/or
 - (c) Hybrid Damages-based Agreements ("Hybrid DBAs"); and
- (3) What changes to Hong Kong law and regulations are required to enable any such reform.

Format of this paper

8. This Consultation Paper consists of the following chapters:

- | | |
|-----------|---|
| Chapter 1 | Introduces ORFSs and their current status under Hong Kong law and regulations. |
| Chapter 2 | Describes earlier LRC consultations on whether to introduce CFAs for contentious proceedings and Third Party Funding for Arbitration, respectively, in Hong Kong. |
| Chapter 3 | Considers the position on ORFSs in other jurisdictions that, in the Sub-committee's view, are relevant for the purposes of considering such structures in the context of Hong Kong. |

- Chapter 4 Considers the principal arguments in support of, and against, introducing ORFSs for Arbitration in Hong Kong.
- Chapter 5 Sets out the Sub-committee's recommendations.
- Chapter 6 Sets out a summary of the Sub-committee's recommendations.

9. The Sub-committee welcomes any views, comments or suggestions on the issues presented in this Consultation Paper. These will greatly assist the Sub-committee to reach its final conclusions.

10. The consultation period will end on 16 March 2021.

Chapter 1

Introduction

What are Outcome Related Fee Structures?

1.1 The term "Outcome Related Fee Structures" ("ORFSs") is used in this Consultation Paper rather than the more commonly used terms "conditional fees"¹ and "contingency fees",² to avoid the different interpretations (and resulting potential for confusion) associated with those terms.

1.2 An "ORFS" is an agreement between a Lawyer³ and client, whereby the Lawyer advises on contentious litigation and arbitration proceedings ("Proceedings") and the Lawyer receives a financial benefit if those Proceedings are successful within the meaning of that agreement.

1.3 For the purposes of this Consultation Paper, ORFSs include CFAs, DBAs and Hybrid DBAs.

Are ORFSs permitted in Hong Kong?

1.4 Historically, the following laws and regulations have prohibited lawyers in Hong Kong from entering into ORFSs for work on contentious Proceedings:

- (a) The common law torts and offences of champerty and maintenance;
- (b) Section 64 of the Legal Practitioners Ordinance (Cap 159) ("Legal Practitioners Ordinance");
- (c) Principle 3.01 of The Hong Kong Solicitors' Guide to Professional Conduct;
- (d) Principle 4.17 of The Hong Kong Solicitors' Guide to Professional Conduct;

¹ ie a CFA, as defined above.

² In some literature, "contingency fee" is given a wide meaning and includes any type of calculation on a "no win, no fee" basis. However, in other contexts, "contingency fee" is taken to mean "percentage fee", whereby the lawyer's fee is calculated as a percentage of the amount awarded by the court (also known as a DBA).

³ A person who is qualified to practise the law of any jurisdiction, including Hong Kong. For the purposes of this paper, "Lawyer" includes (but is not limited to) Hong Kong barristers, solicitors and Registered foreign lawyers.

- (e) Paragraph 6.3(a) of the Hong Kong Bar Association ("HKBA") Code of Conduct;
- (f) Paragraph 9.9 of the HKBA Code of Conduct;⁴
- (g) Other relevant provisions in the HKBA Code of Conduct and The Hong Kong Solicitors' Guide to Professional Conduct; and
- (h) Section 98O of the Arbitration Ordinance (Cap 609) ("Arbitration Ordinance").

Maintenance and champerty

1.5 Outcome related fees for contentious Proceedings are generally prohibited in Hong Kong at common law, by the doctrines of champerty and maintenance.

1.6 Maintenance occurs where a party's costs are paid by a stranger who has no interest in the action.

1.7 The criminal offence and tort of maintenance are defined in Hong Kong as:

*"the giving of assistance or encouragement to one of the parties to an action by a person who has neither an interest in the action nor any other motive recognised by the law as justifying his interference."*⁵

1.8 A Lawyer acting on an ORFS may not have an "interest in the action" nor any other motive recognised by the law as justifying his interference, and by acting under its terms may thereby give "assistance" to one of the parties, amounting to maintenance.

1.9 Champerty is a form of maintenance where the funder, in return for funding the action, is entitled to receive a share of the proceeds if the litigation is successful.

1.10 Champerty is defined in Hong Kong as:

"a particular kind of maintenance, namely maintenance of an action in consideration of a promise to give to the maintainer a share of the subject matter or proceeds thereof, if the action succeeds".⁶

⁴ There is an exception for work done outside Hong Kong in jurisdictions where conditional or contingency fees are permitted (para 13.1(g) of the HKBA Code of Conduct).

⁵ *Winnie Lo v HKSAR* [2012] 15 HKCFAR 16, at para 10, adopting the same definition as the Privy Council in *Massai Aviation Services & Anor v The Attorney General & Anor (The Bahamas)* [2007] UKPC 12, at para 12.

⁶ *Winnie Lo v HKSAR* [2012] 15 HKCFAR 16, at para 10.

1.11 A Lawyer acting on a DBA or a Hybrid DBA may be guilty of champerty.

1.12 Hong Kong case law confirms that the doctrines do not apply to an ORFS for Arbitration to be performed outside Hong Kong, in a place where no equivalent public policy doctrines to maintenance or champerty apply.⁷

1.13 However, until recently, it was unclear whether the doctrines of maintenance and champerty applied to Arbitrations taking place in Hong Kong.

1.14 In *Cannonway Consultants Ltd v Kenworth Engineering Ltd*,⁸ Kaplan J held that the doctrine of champerty did not extend to arbitrations. However, in *Unruh v Seeberger*, the Court of Final Appeal in Hong Kong expressly left open the question of whether maintenance and champerty apply to arbitrations taking place in Hong Kong.⁹

1.15 When the LRC consulted on this issue (in the context of Third Party Funding¹⁰ for Arbitration) in 2015, most respondents considered that Hong Kong law was unclear as to whether the doctrines of maintenance and champerty applied to Arbitration.¹¹ For example, an arbitral institution observed that, in its view:

*"Cannonway is good law. However, we accept that Ribeiro PJ's obiter comments in Unruh have created significant uncertainty as to whether Hong Kong law permits Third Party Funding for Arbitrations seated in Hong Kong. Consequently, parties and advisors generally err on the side of caution and assume that it is not permitted. [The Respondent] also agrees that this uncertainty is 'damaging to Hong Kong's competitiveness internationally as an arbitration centre', particularly since other major seats, including England, the US and most civil law jurisdictions, do permit such funding."*¹²

1.16 Clarity in the context of Arbitration is particularly important because maintenance and champerty are indictable offences, for which the maximum penalty is seven years' imprisonment and a fine under section 101I of the Criminal Procedure Ordinance (Cap 221).

⁷ *Unruh v Seeberger* [2007] 10 HKCFAR 31, at para 122.

⁸ [1995] 1 HKC 179, at 192-193.

⁹ [2007] 10 HKCFAR 31, at para 123.

¹⁰ The provision of funding for an Arbitration within the meaning of s 98G of the Arbitration Ordinance, ie:

(a) under a funding agreement;
(b) to a funded party;
(c) by a Third Party Funder; and

(d) in return for the Third Party Funder receiving a financial benefit only if the Arbitration is successful within the meaning of the funding agreement in circumstances where the Third Party Funder has no other interest in the Arbitration.

¹¹ 2016 TPF Report, at para 3.6.

¹² Same as above.

1.17 A Hong Kong lawyer was convicted of champerty in 2013.¹³ The convicted barrister was sentenced to 3.5 years' imprisonment and ordered to pay compensation in a total amount of HK\$1,509,750. The Court of Appeal in Hong Kong noted that:

*"any member of either profession who enters into the kind of arrangements with which we have been concerned in this case must realise that he or she will, if convicted of a similar offence, inevitably go to prison for a substantial period of time, with the inevitable consequences on their professional careers."*¹⁴

1.18 Since the key provisions of the Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Ordinance 2017 came into force on 1 February 2019, it has been put beyond doubt that the doctrines of champerty and maintenance no longer apply to Third Party Funding for Arbitration taking place in Hong Kong, or to work done by Lawyers in Hong Kong on arbitrations seated elsewhere.

1.19 However, the newly added section 98O of the Arbitration Ordinance prohibits any Lawyer from providing "arbitration funding" to a party where the Lawyer or his legal practice is acting for any party in relation to the relevant Arbitration. "Arbitration funding" is defined in section 98F of the Arbitration Ordinance as "... money, or any other financial assistance, in relation to any costs of the arbitration".

1.20 In the view of the Sub-committee, this definition is broad enough to include the majority of ORFSs for Arbitration, on the basis that a Lawyer funds the Arbitration using his working capital.

1.21 Given the serious consequences of a Lawyer committing the offences of maintenance and champerty, for which the maximum penalty is seven years' imprisonment and a fine under section 101I of the Criminal Procedure Ordinance, it is important that any change of the law in the context of Arbitration be clear and unequivocal.

Section 64 of the Legal Practitioners Ordinance

1.22 Sections 58 to 62 of the Legal Practitioners Ordinance allow solicitors to enter fee agreements with their clients in respect of contentious business. However, section 64(1)(b) of the Legal Practitioners Ordinance provides that, despite the power of a solicitor to make agreements as to remuneration and the provisions for the enforcement of these agreements, nothing shall give validity to:

"any agreement by which a solicitor retained or employed to prosecute any action, suit or other contentious proceeding

¹³ *HKSAR v Mui Kwok Keung* [2014] 1 HKLRD 116.

¹⁴ Same as above, at para 81.

stipulates for payment only in the event of success in that action, suit or proceeding."

Principle 3.01 of The Hong Kong Solicitors' Guide to Professional Conduct

1.23 Principle 3.01 of The Hong Kong Solicitors' Guide to Professional Conduct, which applies to Hong Kong solicitors and a person registered as a foreign lawyer under Part IIIA of the Legal Practitioners Ordinance ("Registered foreign lawyers"), provides that:

"It is fundamental to the relationship which exists between a solicitor and his client that a solicitor is able to give impartial and frank advice to his client, free from any external or adverse pressures or interests which would destroy or weaken his professional independence or the fiduciary relationship with his client."

1.24 The accompanying commentary 5 provides that "[a] solicitor must avoid being placed in the position where his interests or ... conflict with the interests of a client". Lawyers acting on the basis of an ORFS and having a direct interest in the outcome of the Proceedings, may possibly affect their ability to give impartial and frank advice to their clients and may behave in a way that is contradictory to the interests of their clients.

Principle 4.17 of The Hong Kong Solicitors' Guide to Professional Conduct

1.25 Principle 4.17 of The Hong Kong Solicitors' Guide to Professional Conduct also confirms that "[a] solicitor may not enter into a contingency fee arrangement for acting in contentious proceedings".

1.26 The accompanying commentary 1 provides:

"A contingency fee arrangement is any arrangement whereby a solicitor is to be rewarded only in the event of success in litigation by the payment of any sum (whether fixed, or calculated either as a percentage of the proceeds or otherwise). This is so, even if the agreement further stipulates a minimum fee in any case, win or lose."

1.27 Solicitors are allowed to act on contingency fee arrangement in the above context provided the agreement does not extend to the institution of proceedings (for example advisory work).

Paragraph 6.3(a) of the HKBA Code of Conduct

1.28 Paragraph 6.3(a) of the HKBA Code of Conduct states that: "[a] practising barrister must not appear as [c]ounsel: (a) in a matter in which he himself is a party or has a material personal (whether pecuniary or otherwise) interest".

Paragraph 9.9 of the HKBA Code of Conduct

1.29 Paragraph 9.9 of the HKBA Code of Conduct prohibits practising barristers from accepting a brief or instructions on terms that payment of fees shall depend upon or be related to a contingency, including in relation to arbitration.

1.30 However, paragraph 13.1 of the HKBA Code of Conduct expressly allows a practising barrister to accept, in relation to legal services provided outside Hong Kong (including in relation to arbitration outside of Hong Kong), damages-based or fee-uplift agreements, in jurisdictions where such fee structures are permitted. This reflects the position that the doctrines of maintenance and champerty do not apply to an ORFS in relation to an arbitration seated in a place where no equivalent public policy doctrines apply.¹⁵

Other relevant provisions in the HKBA Code of Conduct and The Hong Kong Solicitors' Guide to Professional Conduct

1.31 The introduction of ORFSs for Arbitration would necessitate the amendment of the "cab-rank" rule. At present, this rule generally requires a barrister to "accept any brief to appear before a court or instruction to provide any other legal services in a field in which the barrister practises or professes to practise".¹⁶ Yet it has been observed that such a rule is plainly inconsistent with CFAs given that the latter "will require barristers to decide whether to take risks in the hope of reward", which would depend "precisely upon their views of their clients' prospects of success".¹⁷ Moreover, a barrister is also forbidden to appear as counsel in a matter in which he himself has a material personal pecuniary interest.¹⁸

1.32 In England and Wales, The Bar Standards Board Handbook expressly provides that a barrister may decline instructions if such "*instructions are on the basis that [they would] do the work under a conditional fee agreement or damages based agreement*".¹⁹ If ORFSs for Arbitration is introduced in Hong Kong, in the absence of a similar provision into the HKBA Code of Conduct, a

¹⁵ *Unruh v Seeberger* [2007] 10 HKCFAR 31, at para 122.

¹⁶ HKBA, *Code of Conduct*, at para 6.1.

¹⁷ Peter Kunzlik, "Conditional Fees: The Ethical and Organisational Impact on the Bar" (1999) 62 MLR 850, at 862.

¹⁸ HKBA, *Code of Conduct*, at para 6.3 (though the latter part of the same rule permits exceptions to be authorised by The Bar Council).

¹⁹ Bar Standards Board of England and Wales, *The Bar Standards Board Handbook* (2020), version 4.5, at Guidance gC91.

barrister, based on the "cab-rank" rule, may not be able to decline instructions involving ORFSs.

1.33 On the other hand, we do not believe that those provisions in the HKBA Code of Conduct and The Hong Kong Solicitors' Guide to Professional Conduct relating to conflicts of interests²⁰ ("No-Conflict Provisions") would need to be adjusted. It is trite that a lawyer's duty not to place himself or herself in a position where their duties and interests may conflict is a core duty of loyalty. The fiduciary nature of this relationship does not, and should not, change by mere reason of the fact that the Lawyer is being remunerated under an ORFS.

1.34 Equally, we do not believe that the No-Conflict Provisions, at least in their current form, necessarily prohibit a Hong Kong barrister or solicitor from entering into ORFSs. Insofar as all relevant persons (the client in particular) consent, there is no reason why a barrister would be professionally embarrassed for entering into such fee arrangements. This is especially so if the possibility of doing so has been expressly permitted by statute and regulated by a code of conduct as aforesaid.

Section 98O of the Arbitration Ordinance

1.35 As noted in paragraphs 1.19 and 1.20 above, section 98O of the Arbitration Ordinance prohibits any Lawyer from providing "arbitration funding" to a party where the Lawyer or his legal practice is acting for any party in relation to the relevant Arbitration. "Arbitration funding" is defined as " ... *money, or any other financial assistance, in relation to any costs of the arbitration*". In the view of the Sub-committee, this definition is broad enough to include the majority of ORFSs for Arbitration, on the basis that the Lawyer funds the Arbitration from his working capital.

²⁰ The Law Society of Hong Kong, *The Hong Kong Solicitors' Guide to Professional Conduct*, Vol 1 (3 ed, 2013), Principle 3.01; HKBA, *Code of Conduct*, at para 6.3(a).

Chapter 2

Previous LRC consideration of CFAs and Third Party Funding

2.1 The LRC has not previously considered ORFSs for Arbitration in Hong Kong. However, it considered the introduction of CFAs for Proceedings, not limited to Arbitration, between 2003 and 2007. It also considered Third Party Funding for Arbitration (outside of the lawyer-client relationship) between 2013 and 2016. This latter consultation led to the introduction of Third Party Funding for Arbitration in Hong Kong via amendments to the Arbitration Ordinance that took effect on 1 February 2019.

Conditional fees for Hong Kong Proceedings

2.2 In May 2003, the LRC established a Conditional Fees Sub-committee, with the following terms of reference:

"To consider whether in the circumstances of Hong Kong conditional fee arrangements are feasible and should be permitted for civil cases and, if so, to what extent (including for what types of cases and the features and limitations of any such arrangements) and to recommend such changes in the law as may be thought appropriate."

2.3 For the purposes of the consultation, "conditional fee" was defined as:

*"an arrangement whereby, in the event of success, the lawyer charges his usual fee plus an agreed flat amount or percentage 'uplift' on the usual fee."*¹

2.4 "Contingency fee" was defined as:

*"percentage fee', whereby the lawyer's fee is calculated as a percentage of the amount awarded by the court."*²

2.5 The consultation paper was published by the Conditional Fees Sub-committee of the LRC in September 2005 ("2005 LRC Consultation Paper") to seek the views of the public on 13 recommendations, including:

¹ 2005 LRC Consultation Paper, at 3.

² Same as above.

"Prohibitions against the use of conditional fees in certain types of civil litigation by legal practitioners should be lifted, so that legal practitioners may choose to charge conditional fees in appropriate cases." (Recommendation 1)³

"To avoid unnecessary litigation on whether a particular type of event-triggered fee is or is not valid, or against professional conduct rules or public policy, the proposed legislation should spell out the specific types of conditional fee arrangements allowed under the proposed conditional fee regime. These should be:

- (a) No win, no fee; if win, success fees;*
- (b) No win, no fee; if win, normal fees;*
- (c) No win, reduced fee; if win, normal fees; and*
- (d) No win, reduced fee; if win, success fees.*

Other forms of event triggered fees, including contingency fee arrangements, should continue to remain unlawful as being contrary to public policy." (Recommendation 10)⁴

2.6 In the report published by the LRC in July 2007 ("2007 LRC Report"), it was stated that the proposed regime had received little support from professional bodies (both legal and non-legal) and there was *"very little support"* from the insurance sector.⁵ The response from individual lawyers and firms was more mixed, but the majority rejected the proposals.⁶ The 2007 LRC Report noted:

"The arguments advanced locally by those against the introduction of conditional fees were similar to grounds raised in other jurisdictions, namely conflict of interest, lawyers' malpractice and the increase of frivolous claims. To these can be added the two major disadvantages of introducing conditional fees experienced in England: first, the generation of satellite litigation; and second, the proliferation of claims intermediaries, which was the market reaction to the change."⁷

2.7 As a result, the 2007 LRC Report concluded that the LRC *"... believe that conditions at this time are not appropriate for the introduction of conditional fees"*.⁸

³ Same as above, at 141.

⁴ Same as above, at 153.

⁵ 2007 LRC Report, at para 7.5.

⁶ Same as above.

⁷ Same as above, at para 7.7.

⁸ Same as above, at 154.

Third Party Funding

2.8 In June 2013, the LRC established a sub-committee on Third Party Funding for Arbitration to fulfil a mandate from the then Secretary for Justice and the Chief Justice:

"To review the current position relating to Third Party Funding for arbitration for the purposes of considering whether reform is needed, and if so, to make such recommendations for reform as appropriate."

2.9 In October 2015, the Third Party Funding for Arbitration Sub-committee of the LRC ("TPF Sub-committee") published the consultation paper on Third Party Funding for Arbitration, followed by the report on Third Party Funding for Arbitration in October 2016 ("2016 TPF Report"), recommending amendments to the then legislation to allow for Third Party Funding for Arbitration. The 2016 TPF Report noted that:

*"An overwhelming majority of the submissions that commented ... supported the Sub-committee's recommendation that the Arbitration Ordinance should be amended to provide that Third Party Funding for arbitration taking place in Hong Kong is permitted under Hong Kong law (approximately 97%)."*⁹

2.10 Although ORFSs for Arbitration did not fall within the terms of reference of the TPF Sub-committee, some of the submissions received might be relevant to the current consultation. For example, the 2016 TPF Report noted that an international law firm had responded:

*"The common law doctrines of maintenance and champerty do not necessarily suit the needs of modern commercial dispute resolution, in particular international arbitrations. We consider that access to justice outweighs concerns about people bringing unnecessary arbitration, as business entities in the international community are in the best position to make sound judgment as to whether particular commercial claims should be pursued."*¹⁰

2.11 The consequent legislative amendments were published in the Gazette in 2017 and entered fully into force (as Part 10A of the Arbitration Ordinance ("Part 10A")) on 1 February 2019.

2.12 Part 10A includes section 98O of the Arbitration Ordinance. As noted above, section 98O prohibits a Lawyer from providing arbitration funding to a party to Arbitration in circumstances where that Lawyer or his legal practice acts for any party in relation to the relevant Arbitration. As mentioned in Chapter 1 above, the Sub-committee is of the opinion that this definition is broad enough

⁹ 2016 TPF Report, at para 3.3.

¹⁰ Same as above, at para 3.4.

to include the majority of ORFSs for Arbitration, on the basis that a Lawyer who funds an Arbitration does so using his working capital.

2.13 Moreover, the legislative history of Part 10A confirms that the Hong Kong Government considered that allowing a Lawyer to provide Third Party Funding to his client, for a matter on which he was acting, would amount to permitting ORFSs for Arbitration.¹¹ In the view of the Hong Kong Government, it was not appropriate to change Hong Kong's longstanding position on ORFSs without fully consulting the public.¹²

2.14 The original Bill had included clause 98G(2), which prohibited all Lawyers (whether or not they practised or were qualified in Hong Kong) from providing Third Party Funding for Arbitration in Hong Kong.

2.15 During the legislative process, the Bills Committee on Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Bill 2016 ("Bills Committee") suggested deleting clause 98G(2) in its entirety, to permit all lawyers and legal services providers to participate in Third Party Funding for Arbitration in Hong Kong.¹³ Members of the Bills Committee considered, among other things, that excluding Lawyers from providing Third Party Funding would be unfair to the legal profession, and was unnecessary because existing statutory provisions and relevant professional conduct rules had already provided substantial safeguards to avoid conflicts of interest concerning the legal profession.¹⁴

2.16 The Hong Kong Government considered that it was in the public interest that Lawyers should focus on their provision of professional services to their clients and should not place themselves in a conflict of interest position by engaging in the business of Third Party Funding.¹⁵ Moreover, it noted that Hong Kong law did not permit ORFSs. In the Hong Kong Government's view, a review on the ban on such fees went beyond the terms of reference of the LRC's study on Third Party Funding for Arbitration, nor did it come within the scope of the legislative exercise in relation to Third Party Funding for Arbitration.¹⁶ It also pointed out that such a review, if initiated prior to the implementation of the LRC's recommendations on Third Party Funding for Arbitration, would generate debates over a separate but controversial subject,

¹¹ Bills Committee on Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Bill 2016, *Minutes of the second meeting held on 28 February 2017*, LC Paper No. CB(4)1111/16-17, at the Annex, available at <https://www.legco.gov.hk/yr16-17/english/bc/bc102/minutes/bc10220170228.pdf>.

¹² Same as above, at 2 of the Annex.

¹³ Same as above, at 5 of the Annex.

¹⁴ Same as above, at 1, 2 and 5 of the Annex.

¹⁵ Bills Committee on Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Bill 2016, *Minutes of the first meeting held on 14 February 2017*, LC Paper No. CB(4)1110/16-17, at 5 of the Annex, available at <https://www.legco.gov.hk/yr16-17/english/bc/bc102/minutes/bc10220170214.pdf>.

¹⁶ Department of Justice, *Government's Response to the Issues Raised by the Bills Committee at the Meeting of 14 February 2017* (February 2017), LC Paper No. CB(4)620/16-17(02), at para 11, available at <https://www.legco.gov.hk/yr16-17/english/bc/bc102/papers/bc10220170228cb4-620-2-e.pdf>.

and risk impeding the expeditious implementation of the 2016 TPF Report recommendations.¹⁷

2.17 In the Hong Kong Government's view, a review of ORFSs for Arbitration would need to be a comprehensive consultation exercise involving different organisations and stakeholders.¹⁸

2.18 Upon considering the views of members of the Bills Committee, the then Secretary for Justice stated that:

*"... a proper balance should be struck by ensuring that legitimate concerns over potential conflicts of interest are sufficiently addressed. Safeguards ought to be put in place to ensure that a lawyer should not be allowed to provide arbitration or mediation funding, if the lawyer concerned acts for any party in the relevant proceedings."*¹⁹

2.19 Ultimately, it was agreed to delete clause 98G(2), and to insert a new clause 98NA (which was subsequently enacted as section 98O of the Arbitration Ordinance), so that only Lawyers acting for a party in the relevant Arbitration or whose legal practice is acting for a party in the relevant Arbitration would be prohibited from providing Third Party Funding for that Arbitration.

2.20 In the Sub-committee's opinion, as supported by the legislative history of Part 10A, the section 98O prohibition operates to prevent Lawyers from offering ORFSs for Arbitration.

¹⁷ Department of Justice, *Government's Response to the Issues Raised by the Bills Committee at the Meeting of 28 February 2017* (March 2017), LC Paper No. CB(4)667/16-17(02), at para 5, available at <https://www.legco.gov.hk/yr16-17/english/bc/bc102/papers/bc10220170314cb4-667-2-e.pdf>.

¹⁸ Bills Committee on Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Bill 2016, *Minutes of the second meeting held on 28 February 2017*, LC Paper No. CB(4)1111/16-17, at 2 of the Annex, available at <https://www.legco.gov.hk/yr16-17/english/bc/bc102/minutes/bc10220170228.pdf>.

¹⁹ Rimsky Yuen, SC, *Speech by Secretary for Justice on resumption of Second Reading debate on Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Bill 2016* (June 2017), available at https://www.doj.gov.hk/en/community_engagement/speeches/pdf/sj20170614e3.pdf.

Chapter 3

Overview of the position in other jurisdictions

Introduction

3.1 The Sub-committee is of the view that one of the key factors in favour of permitting ORFSs for Arbitration is to enable Hong Kong to maintain its status as one of the world's top arbitral seats. With the exception of Singapore, all of the other leading seats in the world permit lawyers to offer some or all forms of ORFSs to their clients for contentious Proceedings, including Arbitration. As described elsewhere in the Consultation Paper, such fee arrangements are attractive to clients for many reasons, including financial risk management, access to justice, and a general desire that their lawyers share the risks inherent in litigating or arbitrating a claim.

3.2 Particularly in the context of international arbitration, clients have a broad choice of arbitral seats. Popular choices include London, Singapore, Paris, Geneva, New York and Mainland China.¹ Increasingly, Seoul and Kuala Lumpur are positioning themselves as alternative seats as well. Hong Kong competes with all of these jurisdictions for arbitration work, and the competition is stiff. All of its key competitors - like Hong Kong - offer strong legal and judicial support, a New York Convention enforcement regime, and good arbitration infrastructure. All - except Hong Kong and Singapore - also permit ORFSs for Arbitration. Singapore, which is widely seen as one of Hong Kong's principal competitors for Arbitration work, has already conducted a public consultation on whether to introduce CFAs. If Singapore does introduce CFAs, Hong Kong will be the only leading seat that does not permit ORFSs for Arbitration.

3.3 The position in each of these seats is set out below.

Singapore

General position relating to champerty and maintenance

3.4 Singapore adopted the early English position on the doctrines of champerty and maintenance through the commencement of the Application of English Law Act (Cap 7A) in November 1993.² Section 3 of the Application of

¹ The term "Mainland China" is used in this Consultation Paper to mean the PRC excluding Hong Kong, Macao Special Administrative Region and Taiwan.

² Section 3(1) of the Application of English Law Act (Cap 7A) provides: "*The common law of England (including the principles and rules of equity), so far as it was part of the law of Singapore immediately before 12th November 1993, shall continue to be part of the law of Singapore*".

English Law Act provides that the English common law, which was already part of the law of Singapore immediately before 12 November 1993, would continue to be part of the Singapore law. This was the common law received in 1826 via the Second Charter of Justice as modified according to the rules of *stare decisis* in Singapore.³ It included the common law doctrines on champerty and maintenance.⁴ While the criminal offences of champerty and maintenance were abolished when Singapore codified its criminal law,⁵ it was not until recently that champerty and maintenance as torts were put under the spotlight.

3.5 In 1996, in the judgment of *Jane Rebecca Ong v Lim Lie Hoa*, Chao Hick Tin J (as he then was) stated that:

*"[B]y virtue of the English Criminal Law Act 1967 neither maintenance nor champerty is a crime or tort in England. However, champerty and/or unlawful maintenance will still be struck down as being against public policy. That is also the law in Singapore."*⁶

Third party funding for arbitration

3.6 The Singapore Courts have always acknowledged that, "*where the third-party funder has a genuine commercial interest in enforcing proceedings, the funding may not be champertous*".⁷ In *Lim Lie Hoa and another v Ong Jane Rebecca*, the Singapore Court held that the arrangement was not champertous as the third-party funder (as defined below) had an interest in financing the litigation in the hope that the respondent would recover funds from the estate to enable her to discharge her liabilities.⁸

3.7 The Singapore Courts also took the view that the doctrine of champerty should apply to all dispute resolution Proceedings. In 2006, the Singapore Court of Appeal in *Otech Pakistan Pvt Ltd v Clough Engineering Ltd and Anor* confirmed that the doctrine of champerty applied to both public litigation as well as private arbitration. The Court took the view that all dispute resolution procedures should be subject to the same public policy rules.⁹

³ Law Reform Committee of the Singapore Academy of Law, *Report of the Law Reform Committee on Litigation Funding in Insolvency Cases* (2014), at para 12.

⁴ Same as above.

⁵ Same as above.

⁶ [1996] SGHC 140, at para 16, as quoted in Law Reform Committee of the Singapore Academy of Law, *Report of the Law Reform Committee on Litigation Funding in Insolvency Cases* (2014), at para 14.

⁷ Alvin Yeo SC and Swee Yen Koh, "Singapore" in Susanna Khouri and Kate Hurford (eds), *Third-party funding: snapshots from around the globe*, *Global Arbitration Review* (2012), available at <https://globalarbitrationreview.com/article/1031170/third-party-funding-snapshots-from-around-the-globe>.

⁸ [1997] 1 SLR(R) 775, at para 51, as cited in Law Reform Committee of the Singapore Academy of Law, *Report of the Law Reform Committee on Litigation Funding in Insolvency Cases* (2014), at para 15.

⁹ [2006] SGCA 46, at para 38.

3.8 In March 2017, the Civil Law Act (Cap 43) in Singapore was amended to abolish civil liability for the torts of maintenance and champerty.¹⁰ For the first time, third party funding was made expressly lawful for arbitration in Singapore. At the same time, the Civil Law Act provides that third party funding agreements are not contrary to public policy or otherwise illegal by reason that it is a contract for maintenance or champerty.¹¹ Under the new framework, the legality of third party funding agreements turns on whether they are contracts "*under which a qualifying [t]hird-[p]arty [f]under provides funds to any party for the purpose of funding all or part of the costs of that party in prescribed dispute resolution proceedings*".¹²

3.9 "Prescribed dispute resolution proceedings" are defined in Regulation 3 of the Civil Law (Third-Party Funding) Regulations 2017 to include:

- (a) international arbitration proceedings;
- (b) court proceedings arising from or out of or in any way connected with international arbitration proceedings;
- (c) mediation proceedings arising out of or in any way connected with international arbitration proceedings;
- (d) an application for a stay of proceedings referred to in section 6 of the International Arbitration Act (Cap 143A) and any other application for the enforcement of an arbitration agreement; and
- (e) proceedings for or in connection with the enforcement of an award or a foreign award under the International Arbitration Act.

3.10 Dispute resolution proceedings are defined broadly to include the "*entire process of resolving or attempting to resolve a dispute*", including through "*any civil, mediation, conciliation, arbitration or insolvency proceedings*".¹³

3.11 Under Singapore law, a "third-party funder" is "*a person who carries on the business of funding all or part of the costs of dispute resolution proceedings to which the person is not a party*".¹⁴ In order to qualify as a "third-party funder" under the Civil Law Act, the third-party funder must carry on the principal business, in Singapore or elsewhere, of the funding of the costs of dispute resolution proceedings to which the third-party funder is not a party and have at least S\$5 million in paid-up share capital or managed assets.¹⁵

3.12 A failure to comply with the requirements set out above is not actionable under Singapore law, but the third party funding agreement may not

¹⁰ Civil Law Act, s 5A(1).

¹¹ Same as above, s 5B(2).

¹² Same as above.

¹³ Same as above, s 5B(10).

¹⁴ Same as above.

¹⁵ Civil Law (Third-Party Funding) Regulations 2017, Regulation 4.

be enforceable by the relevant funder(s).¹⁶ Nevertheless, this does not prejudice the rights of any party as against the third party-funder under the third party funding agreement.¹⁷ Besides, the new framework also permits the non-compliant funder to apply to a court or arbitral tribunal to enforce its third party funding agreement on the ground that the non-compliance was "*accidental*" or due to "*inadvertence or some other sufficient cause*" or that it is otherwise "*just and equitable*" for the third party funding agreement to be enforced.¹⁸

CFAs

3.13 In August 2006, the Singapore Government established the Committee to Develop the Singapore Legal Sector ("CDSLS"), a committee to undertake a comprehensive review of the entire legal services sector. The CDSLS published a final report in 2007 and recommended reform to allow CFAs, which addressed the disadvantages often associated with ORFSs, to enhance access to justice.¹⁹ It also recommended the following measures in relation to the implementation of CFAs:

- (a) the parties' definition of what would be deemed a "successful outcome" in each case should be included in the CFAs;
- (b) a non-waivable requirement that control of the litigation in terms of whether or not to settle should remain with the client alone should be included in the CFAs;
- (c) legislative caps on the maximum uplift fee should be put in place; and
- (d) aggrieved clients should be permitted to petition to court for the CFAs to be taxed.²⁰

3.14 Notwithstanding the recommendations provided by the CDSLS in 2007 and the recent amendments to the Civil Law Act to permit third party funding in arbitration, both Singapore-based local and foreign lawyers continue to be prohibited from entering into ORFSs under prevailing professional conduct rules. Section 107(1)(b) of the Legal Profession Act (Cap 161) expressly provides that a solicitor is not allowed to enter into any agreement for contentious proceedings which "*stipulates for or contemplates payment only in the event of success*". Rule 18 of the Legal Profession (Professional Conduct) Rules 2015 also prohibits an advocate and solicitor from entering into any negotiations with a client for either an interest in the subject matter of litigation or of any other contentious proceedings, or remuneration proportionate to the amount which may be recovered by the client in the proceedings.²¹

¹⁶ Civil Law Act, s 5B(4).

¹⁷ Same as above, s 5B(7).

¹⁸ Same as above, s 5B(6).

¹⁹ CDSLS, *Report of the Committee to Develop the Singapore Legal Sector* (2007), at para 3.23.

²⁰ Same as above, at para 3.24.

²¹ Legal Profession (Professional Conduct) Rules 2015, Rule 18.

3.15 In *Law Society of Singapore v Kurubalan s/o Manickam Rengaraju*,²² a Singaporean lawyer was sentenced to six months' suspension from practice in 2013 for entering into a champertous litigation funding agreement with a client, in breach of the Singapore Legal Profession Act. In that case, the Court noted that there was an emerging trend in some jurisdictions towards recognising that champertous fee agreements which were properly regulated can help litigants gain access to justice and commented that:

*"So too, in Singapore, has there been some push to reform the law in this direction. But we reiterate two points: first, it is for Parliament, rather than the courts, to decide whether and when such a reform is to be undertaken; and second, any such reform would almost certainly feature carefully drawn parameters that regulate the extent to which such fee arrangements would be permitted and this makes it a subject more suited for the legislature rather than for the courts to develop."*²³

3.16 In August 2019, the Singapore Ministry of Law issued its *Consultation Paper on Conditional Fee Agreements in Singapore*, which proposed to introduce a framework for CFAs in relation to international and domestic arbitration proceedings, certain prescribed proceedings in the Singapore International Commercial Court, and mediation proceedings arising out of or in any way connected with such proceedings.²⁴ The purpose of the proposed amendments is to align the prospective CFA framework with the third party funding framework (once expanded), to better serve the needs of commercial parties and their counsel.²⁵

3.17 The consultation ended in October 2019. The Singapore Ministry of Law proposed the following:

(a) Professional conduct rules

- solicitors would be obliged to disclose the existence of the CFA to the Singapore Court or tribunal (as relevant), and to every other party to those proceedings;²⁶
- the lawyer's duty to act in the best interests of his client would be reinforced and the client would retain control over the conduct of the litigation, including the decision whether to settle.²⁷

(b) Costs orders considerations

An order for costs made in the proceedings against the losing party (where relevant) would not include any part of the success

²² [2013] SGHC 135.

²³ Same as above, at para 46.

²⁴ Singapore Ministry of Law, *Public Consultation on Conditional Fee Agreements in Singapore* (2019), at para 7.

²⁵ Same as above.

²⁶ Same as above, at para 15.

²⁷ Same as above.

or uplift fee which the successful party might have to pay to its solicitor under the CFA, in the event that a successful party in the proceedings has in place a CFA with its solicitor.²⁸

(c) The Singapore Ministry of Law is also considering implementing the following safeguards:

(1) *General formalities*

- CFAs must be in writing and signed by the client;
- the client must be fully informed of the nature and operation of the CFA and must confirm that it has been informed of its right to seek independent legal advice before entering into the CFA;

(2) *Inclusion of mandatory terms in CFAs*

- a "cooling off period" during which the client may terminate the CFA by written notice;
- parties to agree the definition of a "successful outcome";
- if there is an uplift or success fee, parties to agree the basis of calculation of the fee and provide an estimate or a range of such fee; and
- the client must acknowledge its continued liability for any costs orders that may be made by the Singapore court or arbitral tribunal (where relevant).²⁹

3.18 Under the proposed framework, a CFA will become void for non-compliance with the proposed safeguards.³⁰ In the event the client is successful in the proceedings, the solicitors' fees payable by the client will also be subject to taxation by the Singapore court.³¹ However, in these cases, the solicitor will not be entitled to recover any amount in excess of the amount that he would have been entitled to recover, if the CFA had not been void.³²

3.19 A separate study will also be conducted on whether CFAs will promote access to justice for categories of proceedings that are presently not being considered under the proposed framework.³³

3.20 As at the date of this Consultation Paper, the results of the Singapore consultation have not been released to the public.

²⁸ Same as above, at para 17.

²⁹ Same as above, at para 12.

³⁰ Same as above, at para 13.

³¹ Same as above.

³² Same as above.

³³ Same as above, at para 9.

England and Wales

General position relating to champerty and maintenance

3.21 The doctrines of champerty and maintenance originated in mediaeval England, and remained both crimes and torts under English law until the mid-20th century.

3.22 England and Wales abolished the torts and offences of champerty and maintenance by section 13 of the Criminal Law Act 1967. However, section 14 of the same Act provides that contracts giving effect to champerty and maintenance may be considered contrary to public policy or otherwise illegal and continue to be unenforceable. As a result, outcome related fees were not permitted.

3.23 In addition, section 59 of the Solicitors Act 1974 prohibited solicitors from entering into any fee arrangement for contentious proceedings which "*stipulates for payment only in the event of success*" in those proceedings.³⁴ The Solicitors' Code of Conduct 2007 reinforced this prohibition.³⁵

3.24 In 1998, the English courts confirmed that champerty and maintenance applied to arbitration, and that the ban on outcome related fees therefore extended to arbitration.³⁶

3.25 However, legislative developments since the 1990s have significantly altered the legal landscape in respect of ORFSs, which are now (with the exception of Hybrid DBAs) permitted in England and Wales for both litigation and arbitration proceedings.

CFAs

3.26 The ban on CFAs was initially relaxed, to a certain extent, by the introduction of the Courts and Legal Services Act 1990 ("CLSA"). The CLSA introduced CFAs into the English market, allowing their use in a limited range of "permitted proceedings". The then section 58(3) of the CLSA acted as a statutory bar to prevent a CFA from being unenforceable on the grounds of public policy. The then section 58(8) of the CLSA specifically prohibited recovery of the additional fee in respect of the claim or Proceedings that the

³⁴ Lord Justice Jackson, *Review of Civil Litigation Costs: Preliminary Report* (2009), Vol 1, at 189.

³⁵ Rule 2.04 of the Solicitors' Code of Conduct 2007: Contingency fees states:

"(1) *You must not enter into an arrangement to receive a contingency fee for work done in prosecuting or defending any contentious proceedings before a court of England and Wales, a British court martial or an arbitrator where the seat of the arbitration is in England and Wales, except as permitted by statute or the common law.*

(2) *You must not enter into an arrangement to receive a contingency fee for work done in prosecuting or defending any contentious proceedings before a court of an overseas jurisdiction or an arbitrator where the seat of the arbitration is overseas except to the extent that a lawyer of that jurisdiction would be permitted to do so."*

³⁶ *Bevan Ashford v Geoff Yeandle* [1998] 3 WLR 172.

client agrees to pay the Lawyer in accordance with a CFA ("Success Fee") from the losing party.

3.27 The CFA scheme was activated by the Conditional Fee Agreements Order 1995, which specified three types of "permitted proceedings": personal injury claims, insolvency cases, and certain proceedings before the European Court of Human Rights.³⁷ It also allowed lawyers to claim Success Fees of up to 100% of their normal fees.³⁸

3.28 The introduction of CFAs led to the development of an After-the-Event Insurance ("ATE Insurance") market in England and Wales. ATE Insurance offers protection for claimants against orders to pay the respondent's costs where their cases are unsuccessful. Frequently, ATE Insurance also provides cover for the client's liability to pay its own disbursements if the case is unsuccessful.

3.29 CFAs proved to be extremely popular: by the end of 1997, approximately 34,000 CFAs were in place.³⁹ Nevertheless, the then section 58(8) of the CLSA ban on recovering Success Fees or ATE Insurance premiums from the losing party remained in force, and was seen as a significant barrier to claimants accessing the courts.

3.30 Following a consultation, the Access to Justice Act 1999 ("AJA") came into force. Section 27 of the AJA replaced then section 58 of the CLSA,⁴⁰ broadening the scope of CFAs, and removing the ban on recovery of Success Fees and ATE Insurance premiums. The AJA provided that:

- (a) the use of CFAs was extended to cover all civil cases except family matters, while criminal work continued to be excluded;
- (b) the successful party could recover from the losing party the premium payable for the ATE Insurance; and
- (c) the successful party could recover from the losing party the Success Fees, subject to taxing down by the court.⁴¹

3.31 Although the new regime proved successful in encouraging the use of CFAs, and made available CFAs in cases where damages were unlikely to be substantially more than the Success Fees,⁴² there were some undesirable side-effects. In particular, the English courts saw a rise in satellite litigation, in which parties who had lost an earlier case challenged the enforceability of the CFA in that case, or the quantum of recoverable costs, to avoid paying the Success Fee element of the winning party's costs.

³⁷ The Conditional Fee Agreements Order 1995, Article 2.

³⁸ Same as above, Article 3.

³⁹ UK Lord Chancellor's Department, *Consultation Paper on Access to Justice with Conditional Fees* (1998), at para 2.5, as cited in the 2007 LRC Report, at para 3.30.

⁴⁰ S 27 of the AJA introduced new ss 58 and 58A to the CLSA, replacing the then s 58 of the CLSA.

⁴¹ The AJA, ss 27, 29 and 30.

⁴² UK Ministry of Justice, *Regulating Damages Based Agreements Consultation Paper* (2009), CP 10/09, at 9-10.

3.32 Ultimately, the AJA provoked criticism for allowing claimants to bring claims without any financial risk, encouraging unmeritorious claims and leading to satellite proceedings. In *Callery v Gray*, Lord Nicholls of Birkenhead gave his views as follows:

"The underlying problem, it was said, is that claimants now operate in a costs-free and risk-free zone.

... By entering into a conditional fee agreement at the outset, a claimant achieves the position that his solicitor's charges will never be payable by him or at his expense. If his claim is successful the fees, including the amount of the uplift, will be payable by the defendant's liability insurers. If his claim is unsuccessful, nothing will be due from him to his solicitor under the agreement. Likewise with the premium payable for after the event insurance: if the claim is successful, the premium will be payable by the other side's liability insurers. If the claim is unsuccessful, nothing will be payable by the claimant when, as frequently happens, the policy provides that no premium will be payable in that event.

The consequence, it was said, of these arrangements, hugely attractive to claimants, is that claimants are entering into conditional fee agreements, and after the event insurance, at an inappropriately early stage. They have every incentive to do so, and no financial interest in doing otherwise. Moreover, in entering into conditional fee agreements and insurance arrangements they have no financial interest in keeping down their solicitors' fees or the amount of the uplift or the amount of the policy premiums. Further, they have no financial incentive to accept reasonable offers or payments into court: come what may, their solicitors' bills will be met by others. So will the other side's legal costs.

As a result, it was said, the new arrangements, as they are currently working, are unbalanced and unfairly prejudicial to liability insurers and the general body of motorists whose insurance policy premiums provide the money with which liability insurers meet these personal injuries claims and costs."⁴³

3.33 In November 2008, Sir Rupert Jackson, Lord Justice of Appeal of England and Wales from 2008 to 2018 ("Lord Justice Jackson"), was appointed to review the rules and principles governing the costs of civil litigation "*in order to promote access to justice at proportionate cost*".⁴⁴ He identified a number of flaws under the then existing framework in his final report, the *Review of Civil Litigation Costs: Final Report* dated December 2009 ("Jackson Report"), which was released in 2010, including:

⁴³ [2002] UKHL 28, at paras 12-15.

⁴⁴ The Jackson Report, at xvi.

- (a) the then existing framework was open to all litigants, and therefore was not restricted to those who merited financial support with their litigations;
- (b) the parties with the benefit of the arrangement generally had little or no interest in the level of costs being incurred in their names, and therefore exerted little or no control over those costs; and
- (c) the framework placed an excessive costs burden on opposing parties, whose costs liability might become grossly disproportionate if they contested the case to trial and lost, while the cost liability of the claimants could be up to five times those incurred by the defendants.⁴⁵

3.34 The Jackson Report recommended amendments to the regime for ORFSs in England and Wales, which were then subject to a public consultation. Following the consultation, England enacted the Legal Aid, Sentencing and Punishment of Offenders Act 2012 ("LASPO"), and the statutory reform in Part 2 of the LASPO came into force in April 2013.

3.35 Part 2 of the LASPO includes various reforms to the costs and litigation funding rules in England and Wales, designed "*to reduce the costs of civil litigation and to rebalance the costs liabilities between claimants and defendants while ensuring that parties with a valid case can still bring or defend a claim*".⁴⁶

3.36 Section 44 of the LASPO provides that Success Fees are no longer recoverable from the losing party in contentious proceedings.⁴⁷ Lawyer and client can continue to enter into ORFSs, but the winning party will now have to bear the Success Fee element of its own costs, while the losing party will no longer face an increased costs liability.

3.37 Similarly, section 46 of the LASPO provides that ATE Insurance premiums are no longer recoverable. Claimants may take out ATE Insurance if they wish, but they are responsible for paying their own premiums, to encourage them to take responsibility for the costs of their case.⁴⁸

3.38 These two reforms were implemented by the Conditional Fee Agreements Order 2013.

3.39 In February 2019, the UK Ministry of Justice issued a report on *Post – Implementation Review of Part 2 of the Legal Aid, Sentencing and Punishment of Offenders Act 2012* ("2019 Review"), which concluded that the reforms introduced by Part 2 of the LASPO have succeeded in achieving the principal aim of reducing the costs of civil litigation.⁴⁹ An overall decline in

⁴⁵ Same as above, at 22, 87, 109-111.

⁴⁶ 2019 Review, at 8.

⁴⁷ CLSA, ss 58 and 58A as amended by s 44 of the LASPO.

⁴⁸ UK Ministry of Justice, *Legal Aid, Sentencing and Punishment of Offenders Act 2012: Post-Legislative Memorandum* (2017), Cm 9486, at 89.

⁴⁹ 2019 Review, at para 18.

unmeritorious claims has also been observed.⁵⁰ The 2019 Review also recommends a number of improvements to the ORFS regime in England and Wales (see below). These have not yet been implemented.

DBAs

3.40 DBAs were not permitted in England and Wales until 2013,⁵¹ except in employment matters.⁵²

Jackson Report

3.41 The Jackson Report recommended introducing DBAs to balance the impact of abolishing recoverability of the Success Fee element of CFAs.⁵³ Lord Justice Jackson considered DBAs an important funding option for parties wishing to pursue or defend a claim. He also saw particular force in the freedom of contract argument: if the client wishes to enter into a DBA with its lawyer, it should be free to do so.⁵⁴ He recommended that DBAs be subject to a requirement for independent advice, while the losing party should pay costs on a conventional basis.⁵⁵

3.42 This recommendation to introduce DBAs (with the exception of the requirement for independent advice) was accepted and given legal force by section 45 of the LASPO and The Damages-Based Agreements Regulations 2013 ("2013 DBA Regulations"), which permit lawyers to conduct both litigation and arbitration (in addition to employment and other tribunal work) in return for a share of any damages awarded.

3.43 To be enforceable, a DBA must set out:

- (a) the claim or proceedings or parts of them to which the agreement relates;
- (b) the circumstances in which the representative's⁵⁶ payment, expenses and costs, or part of them, are payable; and
- (c) the reason for setting the amount of the payment at the level agreed.⁵⁷

3.44 DBAs are available only to claimants (or counterclaimants), but not respondents, as "payment" is defined to include "*part of the sum recovered*

⁵⁰ Same as above.

⁵¹ 2013 DBA Regulations.

⁵² The Damages-Based Agreements Regulations 2010, Regulation 1.

⁵³ The Jackson Report, at 131.

⁵⁴ Same as above.

⁵⁵ Same as above.

⁵⁶ Under 2013 DBA Regulations, "representative" means "*the person providing the advocacy services, litigation services or claims management services to which the damages-based agreement relates*".

⁵⁷ 2013 DBA Regulations, Regulation 3.

*in respect of the claim or damages awarded that the client agrees to pay the representative".*⁵⁸

3.45 In the event the claim is successful, the claimant currently recovers its costs under the "Ontario model".⁵⁹ The Ontario model is based on the damages-based fee regime that operates in Ontario, Canada, whereby:

- (a) the recoverable costs of the claimants will be assessed in the conventional way, and
- (b) if the Damages-based Agreement Payment ("DBA Payment") agreed between the lawyer and the claimant is higher than the figure assessed in the conventional way, the claimant must pay the shortfall out of the damages awarded.

3.46 Under the Ontario model as it applies in England and Wales, and as a result of the "indemnity principle", the unsuccessful party pays the lower of (a) the DBA Payment agreed between the claimant and its lawyers; or (b) the claimant's costs as assessed in the conventional way.

3.47 DBA Payments in civil proceedings are subject to a cap of 50% (including Value Added Tax) of the sums ultimately recovered by the client.⁶⁰

2015 Damages-based Agreements Reform Project

3.48 In practice, DBAs have been used very sparingly by the legal profession since the LASPO took effect in 2013.⁶¹ In November 2014, the UK Government asked the Civil Justice Council ("CJC") to consider how the regulatory framework applying to DBAs could be improved (Hybrid DBAs were expressly excluded from the review, on grounds that "*such arrangements could encourage litigation behaviour based on a low risk/high returns approach*").⁶²

3.49 In September 2015, the CJC published the CJC Report,⁶³ making recommendations on a draft version of the Damages-Based Agreements Regulations 2015 ("Draft 2015 DBA Regulations") and the policy governing the operation and utility of DBAs.⁶⁴ The CJC Working Group for the Damages-

⁵⁸ Same as above, Regulation 1.

⁵⁹ Under s 6 of the Ontario Regulation 195/04, "[a] contingency fee agreement that provides that the fee is determined as a percentage of the amount recovered shall exclude any amount awarded or agreed to that is separately specified as being in respect of costs and disbursements". See also Herbert Smith Freehills, "Contingency fees or damages-based agreements (DBAs)", available at <https://hsfnnotes.com/litigation/jackson-reforms/contingency-fees-or-damages-based-agreements-dbas/>, accessed on 2 November 2020.

⁶⁰ 2013 DBA Regulations, Regulation 4(3).

⁶¹ Civil Justice Council, *Damages-based Agreements (DBAs) Publication of CJC Recommendations* (September 2015), available at <https://www.judiciary.uk/wp-content/uploads/2015/09/dba-report-news-release2-sep-2015-1.pdf>.

⁶² Judiciary of England and Wales, *CJC to look at Damages Based Agreements revisions* (November 2014), available at <https://www.judiciary.uk/related-offices-and-bodies/advisory-bodies/cjc/working-parties/civil-justice-council-cjc-to-look-at-damages-based-agreements-revisions/>.

⁶³ *The Damages-Based Agreements Reform Project: Drafting and Policy Issues*, published in 2015 by the CJC of England and Wales.

⁶⁴ The CJC Report, at v.

Based Agreements Reform Project ("Working Group") proposed 45 recommendations, including:

- (a) barrister's fees should be excluded from the DBA Payment cap;⁶⁵
- (b) the Draft 2015 DBA Regulations should clarify whether the DBA Payment can be calculated on the basis of the financial benefit obtained at first instance or whether it will always be conditional on the outcome of an appeal (if any);⁶⁶ and
- (c) in the event the client enters into separate DBAs with its solicitor and barrister, their combined DBA Payment cannot exceed the usual DBA Payment caps.⁶⁷

3.50 As at the date of this Consultation Paper, the Working Group's recommendations have not been progressed by the UK Government.

Redrafted 2019 DBA Regulations

3.51 In December 2018, subsequent to the Working Group's recommendations, the UK Government invited Professor Rachael Mulheron and Mr Nicholas Bacon, QC to conduct an independent review of the 2013 DBA Regulations.⁶⁸ Professor Mulheron and Mr Bacon, QC have proposed the redrafted Damages-Based Agreements Regulations 2019 ("Redrafted 2019 DBA Regulations") with significant changes including:

- (a) moving the 2013 DBA Regulations from the Ontario model to the Success fee model,⁶⁹ so that the DBA Payment no longer represents a ceiling on the recoverable costs to which the client is entitled;
- (b) reducing the maximum caps for recovery from 50% to 40% for claims or proceedings which are neither employment matters nor personal injury matters, and 25% to 20% for personal injury cases, in order to avoid over-compensating the legal team as a result of the introduction of the Success fee model;
- (c) permitting Hybrid DBAs;
- (d) clarifying that termination clauses may be included in DBAs; and

⁶⁵ Same as above, at 6.

⁶⁶ Same as above, at 49.

⁶⁷ Same as above, at 53.

⁶⁸ Queen Mary University of London, "The Damages-Based Agreements Reform Project", available at <https://www.qmul.ac.uk/law/research/impact/dbarp/>, accessed on 2 November 2020.

⁶⁹ The costs recovered from the opponent are outside of, and additional to, the DBA Payment.

- (e) addressing cases in which the result will not involve monetary damages by providing a definition for money or money's worth that includes consideration reducible to a monetary value.⁷⁰

3.52 As at the date of this Consultation Paper, the consultation period for the Redrafted 2019 DBA Regulations has ended, and a report is being collated by Professor Mulheron and Mr Bacon, QC for the information of the UK Ministry of Justice. It remains to be seen whether the UK Government will adopt the Redrafted 2019 DBA Regulations.

Australia

General position relating to champerty and maintenance

3.53 Historically, the doctrines of champerty and maintenance applied in Australia and can be traced back to the English Statute of Westminster, The First (1275).⁷¹ The significance of third party funding in providing access to justice began to emerge in the late 18th century,⁷² while the legitimacy of third party funding was only established at a later stage in *Re Movitor Pty Ltd (in liq)*⁷³ in 1996, which permitted third party funding in insolvency proceedings.

3.54 Subsequently, different States began to implement legislation to expressly abolish maintenance and champerty as a crime and as a tort. Victoria was the first State to do so,⁷⁴ followed by South Australia in 1992,⁷⁵ New South Wales in 1995⁷⁶ and the Australian Capital Territory in 2002.⁷⁷ Queensland and Western Australia abolished champerty and maintenance as crimes (but not torts) in 1899⁷⁸ and 1913,⁷⁹ respectively, while Tasmania abolished champerty and maintenance as torts (but not crime) in 2015.⁸⁰ Notwithstanding the statutory provisions to expressly abolish the doctrines of maintenance and champerty as a crime and as a tort, a number of the legislation in Australia assume that considerations of public policy and illegality can still arise in

⁷⁰ Professor Rachael Mulheron and Nicholas Bacon, QC, *Explanatory Memorandum - The 2019 DBA Reform Project* (2019).

⁷¹ The Honourable Justice Sarah Derrington, *Litigation Funding: Access and Ethics* (October 2018), available at <https://www.alrc.gov.au/wp-content/uploads/2019/08/AAL-Lecture-2018.pdf>.

⁷² *Findon v Parker* (1843) 11 M & W 675, at 682-683; 152 ER 976, at 979.

⁷³ (1996) 64 FCR 380.

⁷⁴ Abolition of Obsolete Offences Act 1969 (Vic); Crimes Act 1958 (Vic), s 322A; Wrongs Act 1958 (Vic), s 32(1).

⁷⁵ Criminal Law Consolidation Act 1935 (SA), Sch 11, clauses 1(3) and 3.

⁷⁶ Maintenance, Champerty and Barratry Abolition Act 1993, subsequently repealed by the Statute Law (Miscellaneous Provisions) Act 2011 (NSW); The abolition of the tort is preserved by Schedule 2 of the Civil Liability Act 2002 (NSW) and of the crime by Schedule 3 of the Crimes Act 1900 (NSW).

⁷⁷ Civil Law (Wrongs) Act 2002 (ACT), s 221; Law Reform (Miscellaneous Provisions) Act 1955 (ACT), s 68 (repealed), Civil Law (Property) Act 2006 (ACT), s 507(2) (repealed by Legislation Act 2001 (ACT), s 89(3)), Legislation Act 2001 (ACT), s 88.

⁷⁸ Criminal Code Act 1899 (Qld); *Murphy Operator Pty Ltd v Gladstone Ports Corporation Ltd (No 4)* [2019] QSC 228, at paras 105, 123 and 131.

⁷⁹ Criminal Code Act Compilation Act 1913 (WA); The Law Reform Commission of Western Australia, *Maintenance and Champerty in Western Australia* (2019), Project 110, at 21.

⁸⁰ Justice and Related Legislation (Miscellaneous Amendments) Act 2015 (Tas); Civil Liability Act 2002 (Tas), s 28E.

connection with contracts providing for or dealing with maintenance and champerty.⁸¹ Therefore, even after the statutory abolition of maintenance and champerty, the Australian courts could still intervene third party funding arrangement if the contracts giving effect to such arrangements were considered to be contrary to public policy.

3.55 In *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd*, High Court of Australia held that proceedings funded by litigation funders were neither an abuse of process nor, *per se*, contrary to public policy.⁸² The High Court confirmed that, at least in those Australian jurisdictions in which the crimes and torts of maintenance and champerty had been abolished, litigation funding could proceed.⁸³ Therefore, Pitkowitz has pointed out that:

"[i]t is unclear whether champerty, maintenance ... remain torts and crimes in the Australian [s]tates where legislation abolishing them has not been passed (ie Queensland [with respect to torts], Western Australia [with respect to torts], Tasmania (with respect to crimes) and the Northern Territory)".⁸⁴

3.56 In September 2019, The Law Reform Commission of Western Australia issued a discussion paper to consult the public on, among other things, whether the torts of maintenance and champerty should be abolished in Western Australia.⁸⁵ At around the same time, the Queensland Supreme Court in *Murphy Operator Pty Ltd v Gladstone Ports Corporation Ltd (No 4)* confirmed the legality of third party funding agreements in class actions, while found it unnecessary to decide whether maintenance and champerty remained torts actionable in Queensland.⁸⁶ Hence, it remains to be seen how the doctrines of maintenance and champerty will be developed in Queensland, Western Australia, Tasmania and the Northern Territory.

3.57 From 23 August 2020, third party funders will no longer be exempted from holding an Australian Financial Service Licence and being categorised as a management investment scheme.⁸⁷ As a result, they will be obliged to:

- (a) act honestly, efficiently and fairly;
- (b) maintain an appropriate level of competence to provide financial services; and

⁸¹ The Honourable Justice Sarah Derrington, *Litigation Funding: Access and Ethics* (October 2018), available at <https://www.alrc.gov.au/wp-content/uploads/2019/08/AAL-Lecture-2018.pdf>.

⁸² (2006) 229 CLR 386, at para 88.

⁸³ Nikolaus Pitkowitz (eds), *Handbook on Third-Party Funding in International Arbitration* (JurisNet LLC, 2018), at 103-104.

⁸⁴ Same as above, at 105.

⁸⁵ The Law Reform Commission of Western Australia, *Maintenance and Champerty in Western Australia* (2019), Project 110, at 5.

⁸⁶ [2019] QSC 228.

⁸⁷ Treasurer of the Commonwealth of Australia, *Litigation funders to be regulated under the Corporations Act* (2020), available at <https://ministers.treasury.gov.au/ministers/josh-frydenberg-2018/media-releases/litigation-funders-be-regulated-under-corporations>.

- (c) have adequate organisational resources to provide the financial services covered by the licence.⁸⁸

CFAs

3.58 CFAs are allowed in all Australian jurisdictions for most civil (excluding family) matters. They are prohibited for criminal matters, with further restrictions in Western Australia, South Australia and Tasmania for matters related to children and migration.⁸⁹ Such restrictions reflect the view that, while conditional fees are appropriate to tackle financial matters, they may not be suitable to resolve cases related to the assertion of rights, as the litigants do not make a monetary recovery from such cases, and therefore, lack the financial resources to pay their lawyers.⁹⁰ Moreover, for family matters, lawyers working under CFAs may prioritise the success of the case over reconciliation/settling the matter, which is undesirable in resolving family disputes.⁹¹

3.59 For contentious Proceedings, the uplift fee is subject to a cap of 25% over the regular legal costs payable (excluding disbursements).⁹² Moreover, the relevant Acts in New South Wales, Victoria, Western Australia, Tasmania and the Australian Capital Territory require lawyers to be reasonably confident of a successful outcome before charging uplift fees:

*"... the agreement must not provide for the payment of an uplift fee unless the law practice has a reasonable belief that a successful outcome of the matter is reasonably likely ..."*⁹³

3.60 On the other hand, an opposing requirement has been implemented in South Australia as part of recent refinements to regulation of its legal profession:

*"... the agreement must not provide for the payment of an uplift fee unless the risk of the claim failing, and of the client having to meet his or her own costs, is significant..."*⁹⁴

⁸⁸ Same as above.

⁸⁹ Legal Profession Uniform Law No 16a (NSW), Legal Profession Uniform Law Application Act 2014 (Vic), Legal Profession Act 2007 and Legal Profession Regulation 2007 (Qld), Legal Profession Act 2008 (WA), Legal Practitioners Amendment Act 2013 (SA), Legal Profession Act 2007 (Tas), Legal Profession Act 2006 (ACT), Legal Profession Act 2006 (NT), as cited in Productivity Commission, *Access to Justice Arrangements*, Volume 2 (2014), Inquiry Report No 72, at 603.

⁹⁰ Productivity Commission, *Access to Justice Arrangements*, Volume 2 (2014), Inquiry Report No 72, at 603.

⁹¹ Same as above.

⁹² "Law practices in NSW were previously prohibited from charging an uplift fee in relation to damages claims, however amendments under the Legal Profession Uniform Law No 16a have brought legislation in line with other jurisdictions", as mentioned in Productivity Commission, *Access to Justice Arrangements*, Volume 2 (2014), Inquiry Report No 72, at 603.

⁹³ Legal Profession Uniform Law No 16a (NSW), s 182(2)(a).

⁹⁴ Legal Practitioners (Miscellaneous) Amendment Act 2013 (SA), s 5.26.4(a).

3.61 The Productivity Commission, the Australian Government's independent research and advisory body on a range of economic, social and environmental issues affecting the welfare of Australians, was of the view that:

*"... the South Australian rule appears to be more appropriate as it only provides for uplift fees in cases where the risk to the lawyer of not being paid is relatively high. The contrasting rule in other jurisdictions provides for an uplift fee where the risk of not being paid is relatively low. This is likely intended to encourage lawyers to offer conditional fees for cases with higher 'merit'."*⁹⁵

3.62 Leaving aside the merits mentioned above, the Productivity Commission considered that restrictions on charging uplift fees based on subjective views of the lawyers (ie lawyer's beliefs about the likelihood of success) are not appropriate as judgments are hard to observe.⁹⁶ More importantly, such regulations will make it difficult to enforce in practice.⁹⁷

3.63 The Productivity Commission considered that the limit on uplift fees should not be increased from 25% at the time of the report, while better oversight should be in place to ensure that lawyers do not charge the full 25% when it is not warranted.⁹⁸

DBAs

3.64 In *Smits v Roach*, a lawyer entered into a DBA with his client, where the lawyer would receive 10% of any amount recovered if this was less than A\$10 million; and 5% of any amount recovered over A\$10 million.⁹⁹ The court ruled that the DBA was not enforceable. At the time of the research, lawyers in Australia remain prohibited from entering into DBAs with their clients (with the exception of class actions in Victoria).

3.65 In 2000, the Australian Law Reform Commission ("ALRC") published a report on the adversarial system of litigation to consider the procedural and ethical issues arising in class actions. The report signalled that the ALRC did not support lifting the ban on lawyers entering into DBAs.¹⁰⁰ In 2008, the Victorian Law Reform Commission conducted a review of the civil justice system. One of its recommendations was a call to reconsider the prohibition on lawyers entering into DBAs.¹⁰¹

3.66 In May 2014, a working group of the Law Council of Australia ("LCA Working Group") issued the *Percentage Based Contingency Fee*

⁹⁵ Productivity Commission, *Access to Justice Arrangements*, Volume 2 (2014), Inquiry Report No 72, at 604.

⁹⁶ Same as above.

⁹⁷ Same as above.

⁹⁸ Same as above, at 625.

⁹⁹ [2002] NSWSC 241.

¹⁰⁰ ALRC, *Managing Justice: A Review of the Federal Civil Justice System* (2000), Report No 89, at para 5.26.

¹⁰¹ Victorian Law Reform Commission, *Civil Justice Review* (2008), Report No 14, at 44.

Agreements – Final Report. The LCA Working Group recommended the introduction of percentage-based DBAs as "an additional option" for clients to finance their legal proceedings.¹⁰² Nonetheless, in April 2016, the Law Council of Australia rejected these recommendations due to mixed reactions within the legal profession.¹⁰³

3.67 While considering the introduction of DBAs in Australia in September 2014, the Productivity Commission took the view that:

- (a) DBAs will not promote unmeritorious claims, as the arrangements themselves provide sufficient incentives to prevent both lawyers and litigants from bringing frivolous claims;
- (b) the potential conflicts for lawyers can be managed by explicitly outlining the "win" outcome upfront and providing adequate disclosure to ensure the client has understood before the execution of the DBA; and
- (c) the allegedly excessive profits can be avoided by implementing caps on damages-based fees on a "sliding scale".¹⁰⁴

3.68 The Productivity Commission recommended the introduction of DBAs on the grounds that:

- (a) they increase access to legal advice, where lawyers take on claims they would not have accepted under other form of billing;
- (b) they benefit claimants by providing an upfront assurance that legal fees will be commensurate to the value of taking legal actions; and
- (c) they may constitute one of the billing options that best reflects the value of services provided and the circumstances of the client.¹⁰⁵

3.69 The Productivity Commission also recommended that, among other things,

- (a) where DBAs are permitted, sliding scales should apply to the DBA Payment for retail clients with no percentage restrictions for sophisticated clients;
- (b) comprehensive disclosure requirements should be implemented to ensure that clients understand the payment;

¹⁰² Michael Wheelahan, "Not just a business: the debate around contingency fees" (2016) PrecedentAULA 81.

¹⁰³ Same as above.

¹⁰⁴ Productivity Commission, *Access to Justice Arrangements*, Volume 2 (2014), Inquiry Report No 72, at 613 and 616.

¹⁰⁵ Same as above, at 625-626.

- (c) DBA Payment should be used on its own with no additional fees (for example, lawyers should not be able to charge DBA Payment in addition to their usual rate); and
- (d) there should be no upfront requirement for the lawyers to indemnify for adverse costs.¹⁰⁶

3.70 In 2016, the Australian Federal Government released its formal policy response to the Productivity Commission's report but did not address the recommendations from the Productivity Commission on DBAs. It remains to be seen whether the Australian Federal Government, or any other jurisdictions within Australia will adopt the suggested legislative reform.

3.71 In December 2018, the ALRC also issued a report *Integrity, Fairness and Efficiency – An Inquiry into Class Action Proceedings and Third-Party Litigation Funders* ("ALRC Report"), and one of the recommendations was to lift the ban on DBAs in limited circumstances, subject to leave and oversight of the Federal Court of Australia.¹⁰⁷ Such lift will be made in favour of class actions with an objective of providing greater return to class members, and removing economic disincentives to medium-sized class actions.¹⁰⁸ The ALRC was also of the view that DBAs should be allowed because class actions were strictly supervised by the courts and under the proposal, lawyers would be required to obtain leave from the courts, which would ensure DBAs are reasonable and proportionate.¹⁰⁹

3.72 In January 2019, the Attorney-General of Australia tabled the ALRC Report in the Federal Parliament. At the time of this research, the recommendations made in the ALRC Report had not been approved by the Federal Parliament, and the directors of the Law Council in Australia had resolved to oppose DBAs as a matter of principle in early 2020.¹¹⁰

3.73 From 1 July 2020, DBAs have been permitted for class actions in Victoria, and the claimant law firms are able to receive a percentage of "the amount of any award or settlement that may be recovered" where the Supreme Court in Victoria is satisfied that it is "*appropriate or necessary to ensure that justice is done*".¹¹¹ No limit has been set on the percentage of "the amount of any award or settlement that may be recovered".

¹⁰⁶ Same as above, at 629 and 636.

¹⁰⁷ ALRC, *Integrity, Fairness and Efficiency – An Inquiry into Class Action Proceedings and Third-Party Litigation Funders* (2018), Report 134, at 11.

¹⁰⁸ Same as above, at 18.

¹⁰⁹ Same as above.

¹¹⁰ Law Council of Australia, *Contingency fees opposed by Law Council* (2020), available at <https://www.lawcouncil.asn.au/media/media-releases/contingency-fees-opposed-by-law-council>.

¹¹¹ Supreme Court Act 1986 (Vic), s 33ZDA.

Mainland China

3.74 This section sets out the position in Mainland China in relation to ORFSs for litigation. In the opinion of the Sub-committee, it is likely that most of the laws and rules relating to such arrangements also apply to arbitrations seated in Mainland China, as well as to court proceedings in Mainland China.¹¹²

Before 2006

3.75 Mainland China is a civil law jurisdiction, with no doctrine equivalent to champerty and maintenance, and no other express provision on charging outcome related fees for contentious Proceedings or on third party funding.

3.76 ORFSs are not mentioned in the *Lawyers Law of the People's Republic of China*¹¹³ nor the *Provisional Procedures for the Administration of Lawyers' Service Charges*¹¹⁴ ("1997 Procedures"), which were promulgated in 1996 and 1997, respectively.¹¹⁵

3.77 In 2000, in consideration of the fact that the economy and legal profession were developing at different stages in different parts of Mainland China, the National Planning Committee and The People's Republic of China ("PRC") Ministry of Justice issued a *Notice on the Establishment of Provisional Fee Charging Standards for Lawyers by Various Localities*¹¹⁶ ("2000 Notice") to allow different localities provisionally to establish their own fee charging standards for lawyers in accordance with the 1997 Procedures. Although the 2000 Notice did not explicitly refer to ORFSs, "*many localities have since then expressly permitted such fee charging arrangements - some with clear regulations, and some without*".¹¹⁷

3.78 In March 2004, the *Code of Conduct for Lawyers (for Trial Implementation)*¹¹⁸ was promulgated. It was the first time that ORFSs were regulated in the laws and regulations in Mainland China:

- (a) Article 96 - Where lawyers' fees are charged based on the outcome of litigation or other legal services, the amount and method of payment of such fee should be confirmed by way of an agreement, which should specify the legal services included, the standard and method for calculating the payment (including the effect of trial/settlement/conciliation on the fees payable), and

¹¹² Lisa Bench Nieuwveld and Victoria Shannon Sahani, *Third-Party Funding in International Arbitration* (Volters Kluwer, 2017), at para 12.02.

¹¹³ 《中華人民共和國律師法》。

¹¹⁴ 《律師服務收費管理暫行辦法》。

¹¹⁵ 丁小娟，李貴雨，"淺議律師風險代理收費制度"(2009)。

¹¹⁶ 《國家計委、司法部關於暫由各地制定律師服務收費臨時標準的通知》。

¹¹⁷ 2007 LRC Report, at para 5.46.

¹¹⁸ 《律師執業行為規範（試行）》。

whether disbursements have been included in the outcome related fees.

- (b) Article 97 - Outcome related fees are prohibited for criminal cases, or civil claims in the areas of alimony/maintenance (贍養費), costs of support (扶養費) and costs of upbringing of a child (撫養費), save with instructions from the client.¹¹⁹

3.79 The outcome related fees charged generally ranged from 10% to 40% of the recovery.¹²⁰ In the event that lawyers faced substantial risk of non-recovery, they might charge a fee as high as 50%.¹²¹ On the other hand, some lawyers charged a fee much less than they would have charged under the terms of the retainer agreement.¹²²

Implementation of the Measures for the Administration of Lawyers' Fees in 2006

3.80 The National Development and Reform Commission and the PRC Ministry of Justice jointly issued the *Measures for the Administration of Lawyers' Fees*¹²³ on 13 April 2006 ("2006 Measures"), which came into effect on 1 December 2006 and explicitly affirmed ORFSs.

3.81 Pursuant to Article 4 of the 2006 Measures, government guiding price¹²⁴ and market-regulated price shall apply to the service fees charged by lawyers.¹²⁵ In the event that the client insists on using ORFSs after being informed of the government guiding price, the relevant law firm may collect outcome related fees in civil cases involving property relationships, with the exception of:

- (a) marriage and inheritance cases;
- (b) requests for social insurances or subsistence allowances;
- (c) requests for alimony, maintenance, pension, relief fund and compensation for work injury; and

¹¹⁹ 徐家力, "淺議律師風險代理收費問題" (2007)。

¹²⁰ Yao Ying, "Legal 'Saviour' Fighting for His Fees", China Daily, 5 July 2004, as cited in Michael Palmer and Chao Xi, "The People's Republic of China" in Christopher Hodges, Stefan Vogenauer and Magdalena Tulibacka (eds), *The Costs and Funding of Civil Litigation: A Comparative Perspective* (Hart Publishing, 2010), at 264.

¹²¹ Michael Palmer and Chao Xi, "The People's Republic of China" in Christopher Hodges, Stefan Vogenauer and Magdalena Tulibacka (eds), *The Costs and Funding of Civil Litigation: A Comparative Perspective* (Hart Publishing, 2010), at 264.

¹²² See Fn 120 above.

¹²³ 《律師服務收費管理辦法》。

¹²⁴ Pursuant to Article 6 of the 2006 Measures, the benchmark price and the floating range of the government guiding price shall be determined by the competent department of price of the people's government of each province, autonomous region or municipality directly under the Central Government together with the judicial administrative department at the same level.

¹²⁵ 2006 Measures, Article 4.

(d) requests for labour remuneration and so forth.¹²⁶

3.82 ORFSs are also prohibited in criminal litigation, administrative litigation, State compensation cases, and class actions.¹²⁷ Should ORFSs be adopted, the agreement entered into between the lawyer and his client must set out the risks and liabilities to be undertaken by both parties, the method of charging, and whether the fee amount is fixed or calculated as a portion of the claim.¹²⁸ The maximum fee chargeable under an ORFS shall be no more than 30% of "*the claim amount in a dispute stated in a contract for legal service*".¹²⁹ There are a number of different interpretations of the maximum cap of outcome related fees. For example, some may adopt the literal meaning, taking the limit to be 30% of the amount stipulated in the retainer agreement,¹³⁰ while others treat it as 30% of the amount recovered,¹³¹ or 30% of the disputed amount.¹³²

United States of America

DBAs

3.83 The use of ORFSs is common in the United States of America ("USA"). The validity of DBAs was recognised by the USA Supreme Court in 1853 and the use of DBAs has been widespread.¹³³ The use of CFAs seems to be less common.

3.84 There is no uniform application of DBAs; the rules vary from state to state. Some states (such as California, Delaware and Indiana) operate specific DBA models for specific types of matter (such as medical malpractice).¹³⁴ Some states provide for a single cap on the recoverable fee, while others (such as California, Delaware and Massachusetts) work on a sliding scale model (where the percentage recovered by the lawyer decreases as the amount recovered increases).¹³⁵

¹²⁶ Same as above, Article 11.

¹²⁷ Same as above, Article 12.

¹²⁸ Same as above, Article 13.

¹²⁹ Same as above; 收費合同約定標的額的30%。

¹³⁰ Wen Qin and Lei Yang, "China" in Greg Lascelles, *Litigation & Dispute Resolution Laws and Regulations 2020* (2020), at para 1.6, available at <https://iclg.com/practice-areas/litigation-and-dispute-resolution-laws-and-regulations/china>.

¹³¹ Michael Palmer and Chao Xi, "The People's Republic of China" in Christopher Hodge, Stefan Vogenauer and Magdalena Tulibacka (eds), *The Costs and Funding of Civil Litigation: A Comparative Perspective* (Hart Publishing, 2010), at 264.

¹³² Zhang Shouzhi, *Litigation and enforcement in China: overview* (2020), available at [https://uk.practicallaw.thomsonreuters.com/8-502-1965?transitionType=Default&contextData=\(sc.Default\)&firstPage=true](https://uk.practicallaw.thomsonreuters.com/8-502-1965?transitionType=Default&contextData=(sc.Default)&firstPage=true).

¹³³ *Wyllie v Cox* (1853) 56 US 415; Eric M Rhein, "Judicial Regulation of Contingent Fee Contracts" (1983) 48 J. Air L. & Com. 151, at 155 and 157.

¹³⁴ Centre for Justice Democracy at New York Law School, *Courthouse Cornerstone: Contingency Fees and Their Importance for Everyday Americans* (2013), at Appendix, see <https://www.centerjd.org/system/files/contingencyWPFfull.pdf>.

¹³⁵ The Law Society of Upper Canada, *Professional Regulation Committee Report* (2017), at 268, available at <https://lawsocietyontario.azureedge.net/media/iso/media/legacy/pdf/c/convocation-june2017-professional-regulation-committee-report.pdf>.

3.85 There is, however, some overarching guidance. The American Bar Association's *Model Rules of Professional Conduct* ("ABA Rules") impose certain formal requirements when entering into a DBA (eg a signed written agreement setting out a percentage fee) and provide that DBAs are not allowed in criminal cases and in domestic relations matters. The use of DBAs must comply with the requirements in the ABA Rules that a lawyer should not "*charge or collect*" an "*unreasonable fee*" and should make proper disclosures to the client.¹³⁶

3.86 Typical damages-based fees are calculated as "*one-third of damages obtained by settlement (net of expenses), and 40-50 per cent of damages obtained by trial*".¹³⁷ Lawyers can arrange non-recourse loans that accrue interest to mitigate the financial pressure, and the non-recourse loans are generally secured by the contingent interests of the law firm in ongoing cases.¹³⁸

Criticisms

3.87 A number of legal scholars and observers have put forward theories and empirical data criticising ORFSs, in particular DBAs, in the USA on the basis that they "*encourage litigation and unethical practices, overcompensate lawyers, inflate damages as well as raise insurance premiums*".¹³⁹

3.88 Notwithstanding these criticisms, DBAs are still widely used in the USA. They have also not prevented ORFSs being adopted in most other major common law jurisdictions, as discussed above. This is in part due to the fact that many people consider that other legal systems, with their unique characteristics, would not be susceptible to the same problems as the USA. Indeed, in its 1989 Green Paper on *Contingency Fees*, the English Lord Chancellor's Department argued that:

"[t]he differences between the jurisdictions are, however, such that the worst excesses of US contingency fee arrangements should not develop in England and Wales. It is the combination

¹³⁶ The American Bar Association, *Model Rules of Professional Conduct*, Rule 1.5.

¹³⁷ Christopher Hodges, Stefan Vogenauer and Magdalena Tulibacka (eds), *The Costs and Funding of Civil Litigation* (Hart Publishing, 2010), at 535, 540, as quoted in Jonas Von Goeler, *Third-Party Funding in International Arbitration and Its Impact on Procedure* (Wolters Kluwer, 2016), at 52.

¹³⁸ Jonathan T. Molot, "Litigation Finance: A Market Solution to a Procedural Problem" (2010) 99 Geo. L.J. 65, at 98; Jonathan T. Molot, "The Feasibility of Litigation Markets" (2014) 89 Indiana L.J. 171, at 185; American Bar Association Commission on Ethics, *White Paper on Alternative Litigation Finance*(draft), at 9-10, as cited in Jonas Von Goeler, *Third-Party Funding in International Arbitration and Its Impact on Procedure* (Wolters Kluwer, 2016), at 52.

¹³⁹ See, eg, Stewart Jay, "The Dilemmas of Attorney Contingent Fees" (1989) 2 Geo J Legal Ethics 813; Lester Brickman, "Contingent Fees without Contingencies: Hamlet without the Prince of Denmark?" (1989) 37 UCLA L Rev 29; Lester Brickman *et al*, *Rethinking Contingency Fees* (1994); Walter K Olson, *The Litigation Explosion* (1991); Victor E Schwartz, "White House Action on Civil Justice Reform: A Menu for the New Millennium" (2001) 24 Harv J L & Pub Policy 393; *Contingency Fee Abuses: Hearings on Contingency Fee Abuses Before the Senate Committee on Judiciary*, 104th Congress (1995), as cited in in Adrian Yeo, "Access to Justice: A Case for Contingency Fees in Singapore" (2004) 16 SAcLJ 76, at 76.

of such factors as a jury's ability to award damages, the absence of any rule that the loser pays the winner's costs, the possibility of punitive damages and the use of class actions, none of which is present in England and Wales, which, taken together with the ability to use contingency fees, gives rise to the worries about the US system".¹⁴⁰

3.89 The Ontario section of the Canadian Bar Association concluded in 1988 that:

"[t]here are a number of aspects of the Canadian judicial system, most importantly party and party costs awards, a maximum general damage award level and legal aid, that distinguish the way in which contingency fees operate in other Canadian jurisdictions and would likely operate in Ontario as opposed to the United States".¹⁴¹

Unique features of the legal system in the USA

3.90 The unique features of the legal system in the USA have therefore created an ORFS regime that sets the USA apart from the rest of the world.

3.91 While England and Wales, Canada, Hong Kong and most European countries adopt the "costs indemnity rule", the USA does not. The legal systems in the USA typically apply the general rule that each party must pay its own costs, unless the litigation is vexatious or an abuse of process.¹⁴²

3.92 In addition, juries in the USA have power to award damages including, in a number of states, punitive damages.¹⁴³ Since juries generally receive no legal training and are prone to influence by lawyers in ways that judges are not,¹⁴⁴ the level of damages in the USA is reportedly higher than that in England and Wales.¹⁴⁵ This enables lawyers in the USA to subsidise lower value claims using recoveries obtained from higher value claims to a much greater degree.¹⁴⁶

¹⁴⁰ UK Lord Chancellor's Department, *Contingency Fees* (1989: Cmnd 571), at para 3.20.

¹⁴¹ Canadian Bar Association – Ontario, *Opening Doors to Stirring Up Strife: The Implementation of Contingent Fees in Ontario* (1988), as quoted in Adrian Yeo, "Access to Justice: A Case for Contingency Fees in Singapore" (2004) 16 SAclJ 76, at 95.

¹⁴² ALRC, *Costs shifting – who pays for litigation* (1995), Report No 75, at para 4.3, as cited in 2005 LRC Consultation Paper, at para 1.9.

¹⁴³ 2007 LRC Report, at paras 2.26-2.27.

¹⁴⁴ David Debusschere and Jimmy L Hom, "United States" in Dennis Campbell (eds), *International Product Liability* (1993), at 564, as cited in LRC, *Report on Civil Liability for Unsafe Products* (1998), at para 6.10.

¹⁴⁵ Professor Richard Moorhead and Peter Hurst, "'Improving Access to Justice' Contingency Fees – A Study of their operation in the United States of America" (2008), at 11.

¹⁴⁶ Same as above.

3.93 Lastly, only a small amount of legal aid is available in the USA. It is available for the severely disadvantaged and not for cases which could normally be dealt with using the ORFS regime.¹⁴⁷ Therefore, DBAs are one of the principal sources of litigation finance in the USA.

3.94 In light of the above, the Sub-committee considers that the criticisms of the ORFS regime in the USA flow from the interplay of multiple factors, many of which are specific to that jurisdiction. Many of these criticisms are also specific to litigation in the courts in the USA, and to the powers those courts grant to juries when it comes to awarding damages.

3.95 Given the fundamental differences between the legal systems in Hong Kong and the USA, and the fact that any ORFS regime in Hong Kong would be limited to Arbitration, we consider it unlikely that Hong Kong would experience the same difficulties the USA has faced.

Other relevant jurisdictions

3.96 The Sub-committee considers that the jurisdictions mentioned above are the most relevant for the purposes of this Consultation Paper, either because of their common law heritage, or because they are the jurisdictions with which Hong Kong competes as an arbitral seat and hub, or both. Furthermore, with the exception of Mainland China, the above jurisdictions all share with Hong Kong a common law legal tradition, and therefore a history of prohibitions on ORFSs, derived from the common law doctrines of champerty and maintenance and reflected in local lawyers' codes of conduct.

3.97 The Sub-committee has also considered a number of other jurisdictions with which Hong Kong competes as an arbitral seat. These include France (Paris), Sweden (Stockholm), Switzerland (Geneva) and South Korea (Seoul). All these are civil law jurisdictions, and do not – so far as the Sub-committee is aware – have doctrines equivalent to champerty and maintenance. The position in respect of ORFSs for Arbitration varies across these jurisdictions, largely as a result of their respective professional conduct rules.

3.98 The position in each jurisdiction is set out below, in a summary form.

Jurisdiction	CFA	DBA	Hybrid DBA
France ¹⁴⁸	Permitted (Success Fee must be reasonable)	Permitted for arbitration ¹⁴⁹	Permitted

¹⁴⁷ David A. Root, "Attorney Fee-shifting in America: Comparing, Contrasting, and Combining the 'American Rule' and 'English Rule'" (2005) Ind. Int'l & Comp. L. Rev 583, at 602.

¹⁴⁸ Law No. 2015-990 of 6 August 2015.

¹⁴⁹ Decision of the Cour d'appel de Paris 1re ch. B 10-07-1992 N° [XP100792X], 10 July 1992.

Jurisdiction	CFA	DBA	Hybrid DBA
		Not permitted for litigation ¹⁵⁰	
Sweden ¹⁵¹	Permitted (lawyer's interest must not be disproportionate or otherwise likely to impact lawyer's performance negatively, eg by advising client to enter an unfavourable settlement)	Not permitted (exceptions for cross-border cases handled outside Sweden, and "access to justice" reasons)	Not permitted (exceptions for cross-border cases handled outside Sweden, and "access to justice" reasons)
Switzerland ¹⁵²	Permitted	Not permitted	Permitted (Switzerland permits "success bonuses" for Swiss lawyers)
South Korea ¹⁵³	Permitted (Success Fee must not be excessive)	Permitted (DBA Payment must not be excessive)	Not permitted

¹⁵⁰ Loi du 31 décembre 1971 portant réforme de certaines professions judiciaires et juridique, Article 10, and Reglement Interieur National de la Profession d'avocat, Article 11.3.

¹⁵¹ Code of Professional Conduct for Members of the Swedish Bar Association, Article 4.2.

¹⁵² Federal Act on the Freedom to Practise in Switzerland (Bundesgesetz über die Freizügigkeit der Anwältinnen und Anwälte), 1 June 2002, Article 12.

¹⁵³ Civil Act, Article 686; Supreme Court of Korea, Decision 2015Da200111, 23 July 2015.

Chapter 4

Arguments for and against ORFSs for Arbitration

4.1 This chapter considers the arguments for introducing ORFSs for Arbitration in Hong Kong, as well as the arguments against.

4.2 After careful analysis, the Sub-committee has concluded that the arguments for introducing ORFSs for Arbitration clearly outweigh the arguments against. Moreover, many of the perceived risks associated with ORFSs are historic or of no relevance to the current consultation, which is limited in scope to Arbitration.

4.3 To the extent that certain risks remain, they can be managed by implementing appropriate safeguards in the relevant laws and regulations. This is demonstrated by the fact that numerous other jurisdictions permit ORFSs for both arbitration and litigation, without adverse impact on parties, lawyers or the wider legal justice system.

4.4 In the Sub-committee's view, permitting ORFSs for Arbitration would significantly benefit Hong Kong in a number of ways, as detailed below. Indeed, we would go further, and assert that permitting ORFSs is essential to Hong Kong's continued status as one of the world's leading arbitral seats. With the notable exception of Singapore (which seems likely to introduce such fees in the near future), all major arbitral seats permit some form of ORFSs. There is significant demand for such arrangements. Clients increasingly want their lawyers to share the (often considerable) risk of bringing a claim in arbitration, and actively select lawyers who are able to offer ORFSs. These clients are generally free to seat their arbitrations anywhere in the world. If Hong Kong continues to prevent its Lawyers from sharing that risk through ORFSs, it is likely that clients will simply choose to arbitrate elsewhere.

4.5 The conclusions in this chapter inform the Sub-committee's Recommendations in Chapters 5 and 6 of this Consultation Paper.

Summary table of arguments for and against ORFSs for Arbitration

4.6 The Sub-committee has identified the following as the principal arguments for and against ORFSs for Arbitration:

Arguments for ORFSs for Arbitration	
1	Preserve and promote Hong Kong's competitiveness as a leading arbitration centre.
2	Access to justice.
3	Respond to client demand and provide pricing flexibility.
4	Support freedom of contract.
5	Weed out weak claims.
6	Enable Lawyers in Hong Kong to compete on an even playing field.

Arguments against ORFSs for Arbitration	
1	Risk of conflict of interest and unprofessional conduct.
2	Increase in opportunistic and frivolous litigation.
3	Excessive legal fees.
4	Reliance on ATE Insurance / litigation insurance.
5	Increase in satellite litigation.

Other considerations	
1	Impact on barristers.
2	Proliferation of claims intermediaries.
3	Increase in financial burden on small and medium-sized law firms.
4	Adverse costs orders.

4.7 These arguments and considerations are discussed in more detail below. As noted above, the Sub-committee considers that the arguments for permitting ORFSs for Arbitration outweigh the arguments against, and that the risks associated with outcome related fees can be managed by appropriate safeguards, as discussed in Chapter 5.

Arguments for introducing ORFSs for Arbitration in Hong Kong

Preserve and promote Hong Kong's competitiveness as a leading arbitration centre

4.8 It is the Sub-committee's view that allowing ORFSs for Arbitration is essential to Hong Kong's continued status as one of the world's leading arbitral seats and to maintaining its competitiveness.

4.9 Arbitration is expensive, and parties increasingly want their lawyers to share some of the upfront cost, and to be paid depending on the outcome of the work done. When considering the place where the arbitration should be conducted, a party may well consider whether local practitioners are permitted to charge fees on an outcome related basis. At the very least, this is a topic that often arises in the early stages of an instruction when clients select their counsel and agree on the scope of work and related payment.

4.10 As discussed in Chapter 3 above, each of these seats (with the exception of Singapore) permits some form of ORFS for Arbitration. All permit CFAs. Some of them also permit either DBAs or Hybrid DBAs. In the Sub-committee's view, this lends support to the argument that Hong Kong must permit ORFSs for Arbitration if it is to remain competitive as an arbitral seat and a hub of arbitral services, notably legal services. If it does not, parties can, and will, elect to seat their arbitrations and instruct lawyers in one of the numerous other jurisdictions that do permit such fees.

Access to justice

4.11 In most jurisdictions, a core reason for introducing fees based on outcome has been access to justice considerations. In England and Wales for example, the first incarnation of CFAs was intended to plug a legal aid/access to justice eligibility gap, and both the courts of Australia and England and Wales have emphasised the importance of this consideration when relaxing their respective approaches to maintenance and champerty.

4.12 Promoting access to justice equally underpinned the LRC Conditional Fees Sub-committee's initial recommendation to permit CFAs in 2005 LRC Consultation Paper.

4.13 Permitting ORFSs will allow clients to pursue a good claim that they may be unable to bring without some form of funding. Although Third Party Funding is now allowed in Hong Kong, not every case is suitable and Third Party Funding is difficult to obtain. Many claimants may not be able to attract providers of Third Party Funding ("Third Party Funders") even where the merits of their claims are strong.

4.14 Permitting Lawyers to charge ORFSs would help to fill this gap, just as it does in other major jurisdictions.

Respond to client demand and provide pricing flexibility

4.15 There is rising client demand for alternative pricing and funding options, not only from impecunious clients seeking to fund meritorious claims, but also from clients looking to take some of the costs of Arbitration off their balance sheet.

4.16 This is borne out by the fact that, when clients approach Lawyers to represent them in Arbitration, they frequently enquire whether they can enter into some form of ORFSs. The ability to offer funding options is increasingly a factor that clients take into account when determining which Lawyers to engage, and on what basis.

4.17 This is supported by the fact that ORFSs are used - in one form or another - in nearly all other major jurisdictions, suggesting strong client demand for such fee structures.

4.18 In the course of reviewing and considering English costs reform in 2009, Lord Justice Jackson emphasised that he had "*encountered no tenable arguments for returning to the position which existed before style 1 CFAs¹ were permitted.*"² His view was that:

*"there can be no objection in principle to lawyers agreeing to forego or reduce their fees if a case is lost. Nor can there be any objection to clients paying something extra in successful cases as compensation for the risks undertaken by their lawyers, provided that the extra payment is reasonable."*³

In short, Lord Justice Jackson was adamant that the clock should not be put back, so as to prohibit "no win, no fee" agreements.

4.19 The Sub-committee agrees. In many cases, no other forms of funding (including Third Party Funding) will be available. In those circumstances, permitting Lawyers to use ORFSs will not only provide access to justice, but will give clients much greater flexibility in how they pursue claims and structure their disputes portfolios. The Sub-committee sees no reason to deny clients that flexibility.

¹ "Style 1 CFAs" refers to the first incarnation of CFAs in England and Wales, as introduced by the then s 58 of the CLSA.

² The Jackson Report, at para 1.8 of Ch 10.

³ Same as above.

Support freedom of contract

4.20 Permitting Lawyers to enter into ORFSs with their clients also reflects support for freedom of contract, which is a fundamental principle of Hong Kong law. If a client wishes to enter into an ORFS with its Lawyer, the Sub-committee considers that the client should be free to do so.

4.21 This is particularly relevant to Arbitration where users are, on the whole, commercial parties that have elected to arbitrate their disputes in a specific jurisdiction. Such parties are typically sophisticated enough to determine whether and, if so how, to fund their claims. In general, parties to Arbitration are not subject to the same vulnerabilities (eg to exploitation by unscrupulous claims intermediaries or Lawyers) as individual parties.

4.22 The use of ORFSs in other jurisdictions is commonplace, and it is well established that Lawyers can have a financial stake in the outcome of the litigation (or Arbitration) if their clients agree that they can do so.

4.23 The Sub-committee therefore considers that ORFSs should be permitted in Hong Kong if that is what Lawyers and their clients want.

Weed out weak claims

4.24 ORFSs discourage Lawyers from pursuing weak cases.

4.25 This was cited in England and Wales as one of the factors relevant to extending CFAs to all civil cases in the late 1990s. The English Government's 1998 consultation paper *Access to Justice with Conditional Fees* described the then current system as follows:

"The current system does not encourage lawyers - who are paid the same, win, lose or draw, to weed out weak cases. This means that too many people undergo the strain of lengthy legal disputes for nothing".⁴

4.26 This principle is a natural corollary to the proposition above, that ORFSs provide clear incentives for Lawyers in respect of the cases which they do pursue, and discourage them from acting in weak or frivolous claims. If the Lawyer's remuneration depends on success in the case, it is clearly in his interests to select cases whose merits are strong (and therefore worth pursuing).

⁴ UK Lord Chancellor's Department, *Consultation Paper on Access to Justice with Conditional Fees* (1998), as quoted in Lord Justice Jackson, *Review of Civil Litigation Costs: Preliminary Report* (2009), Vol 1, at 169.

Enable Lawyers in Hong Kong to compete on an even playing field

4.27 Another argument in favour of permitting ORFSs is that it would allow Lawyers in Hong Kong to compete with lawyers from other jurisdictions on an even playing field when it comes to fees for Arbitrations taking place both in and outside Hong Kong.

4.28 Hong Kong is one of the world's leading arbitral seats. Parties from all over the world choose to arbitrate in Hong Kong, whether or not they are based in, or have any other connection to, the territory. Indeed, like all arbitral seats, parties frequently select Hong Kong specifically because they have no other connection to it and it is therefore a neutral seat.

4.29 In addition, it is a unique feature of international arbitration that the parties' representatives need not be qualified in the law of the seat. As a result, lawyers from jurisdictions other than Hong Kong routinely act for clients in Hong Kong Arbitrations. The vast majority of those jurisdictions, including the USA, England and Wales, and Australia, already permit some form of ORFSs.

4.30 Although, in the Sub-committee's view, section 98O of the Arbitration Ordinance operates to prevent any Lawyer (regardless of where he is qualified) to offer ORFSs for Arbitration in Hong Kong, there is anecdotal evidence that many routinely do so.

4.31 Given the continuing rise in Arbitrations seated in Hong Kong involving Mainland Chinese parties, including claims arising out of the Belt and Road Initiative, it is more important than ever for Lawyers in Hong Kong to be able to fund cases on the same, or similar, bases to lawyers from other jurisdictions where DBAs are permitted.

4.32 In addition to the issues identified above, if Hong Kong continues to prohibit ORFSs where many other jurisdictions do not, problems may arise if the Hong Kong courts are asked to consider the enforceability of ORFSs entered into outside Hong Kong.

4.33 If Hong Kong does not permit Lawyers to offer ORFSs for Arbitration in Hong Kong, but the arbitral seats with which Hong Kong competes do permit such fees, it is likely that parties will increasingly opt to seat their arbitrations in those competing seats. For Hong Kong to remain competitive as a leading global seat, its Arbitration fee regime must be brought into line with those of its competitors and to enable Lawyers to compete on an even playing field.

Arguments against introducing ORFSs for Arbitration in Hong Kong

4.34 In the 2007 LRC Report, the LRC identified the following arguments against the introduction of CFAs:

- (a) risk of conflict of interest and unprofessional conduct;
- (b) increase in opportunistic and frivolous claims;
- (c) excessive legal fees;
- (d) reliance on ATE Insurance; and
- (e) increase in satellite litigation.

4.35 We discuss each of these arguments below. They were raised in the context of CFAs, but in the Sub-committee's view, apply to ORFSs generally.

4.36 We discuss arguments raised specifically in connection with DBAs (and Hybrid DBAs) in a separate section below.

Risk of conflict of interest and unprofessional conduct

4.37 Historically, the risk of conflict of interest arising has been one of the main objections to ORFSs.

4.38 Stakeholders argue that a lawyer acting on the basis of an ORFS has a direct interest in the outcome of the Proceedings. Consequently, the lawyer may not be able to give impartial advice and may behave in a way that is unprofessional and contradictory to the interests of their clients.

4.39 A related objection, raised by the HKBA in 2006, was that lawyers might be tempted to settle clients' cases quickly in order to secure their fees, even if the settlement offer is less favourable than the merits of the case suggest. The HKBA said that the risk of there being a "*wedge between the lawyer and client (and possibly the insurer involved)*" is likely where there is disparity between how the lawyers and their clients view the case and the settlement offer before them.⁵

4.40 The risk of a conflict of interest was, therefore, the first objection to "conditional fees" set out in the 2007 LRC Report. Although the 2007 LRC Report noted that the potential for CFAs to create a conflict of interest did raise a significant concern, it concluded that this was not sufficient to reject the proposal altogether: "*this inherent danger of conditional fees is in our view*

⁵ HKBA, *The Hong Kong Bar Association's Position Paper on Conditional Fees: A Response to the Law Reform Commission's Consultation Paper* (2006), at para 34.

*insufficient, by itself, to justify the rejection of conditional fee arrangements".*⁶ [emphasis added] Rather, sufficient safeguards can and should be built into any system to minimise disadvantages in the system and to guard against abuse.⁷ The 2007 LRC Report cited improper trial preparation as an example where a lawyer's conduct could be controlled and penalised as appropriate through professional codes of conduct and the power of the court.⁸

4.41 More recently, the concern about conflict of interest has been described as out of date. For example, the Northern Ireland 2015 *Report of Access to Justice Part Two* ("2015 NI Access to Justice Report"), noted that a key objection to ORFSs was *"the whole principle of lawyers being paid according to results"*.⁹ The author's view, however, was that this objection:

*"is outmoded and proceeds on a false premise, namely the assumption that there is no problem with more traditional forms of retainer. Lawyers who get paid simply according to the work they do, win or lose, have a direct conflict of interest with their clients (who want to achieve a result at minimum cost). ... CFAs do give lawyers a financial interest in the outcome of a case but in light of all the experience of them elsewhere in the United Kingdom, I do not see why it is thought that the introduction of CFAs would somehow undermine the integrity of lawyers in Northern Ireland."*¹⁰ [emphasis added]

4.42 Similar concerns were raised and dismissed in the 2018 Victorian Law Reform Commission Report on *Access to Justice – Litigation Funding and Group Proceedings*. The Victorian Law Reform Commission noted that it was *"not persuaded that there would be a fundamental change to the lawyer/client relationship if the ban were lifted"*.¹¹ A position paper prepared by the Law Institute of Victoria ("LIV Position Paper") also found that *"[t]here is no evidence to suggest that lawyers and law practices will not continue to manage potential conflicts of interest well if contingency fee arrangements are permitted"*.¹²

4.43 The Sub-committee has considered these arguments carefully, and agrees that the introduction of ORFSs should not increase the risk of a conflict of interest significantly, if at all. Certainly, we agree with the findings in the 2007 LRC Report that this concern, to the extent it exists, is not sufficient to justify the rejection of ORFSs.

4.44 Indeed, as noted in the 2015 NI Access to Justice Report, the potential for a conflict of interest to arise exists even now, and in fact could be said to be even more of a concern in a system where lawyers charge by the hour, and may thus be incentivised to bill more hours in order to increase profits,

⁶ 2007 LRC Report, at para 6.7.

⁷ Same as above.

⁸ Same as above, at para 6.8.

⁹ 2015 NI Access to Justice Report, at para 22.27.

¹⁰ Same as above, at paras 22.27-22.28.

¹¹ Victorian Law Reform Commission, *Access to Justice – Litigation Funding and Group Proceedings* (2018), at para 3.51.

¹² Law Institute of Victoria, *Percentage-Based Contingency Fees: Position Paper* (2016), at 11.

regardless of the outcome of the case. This of course was the point made by Sir Thomas Bingham in 1994 (see paragraph 4.47 below).

4.45 By contrast, where a lawyer's remuneration is contingent in some way on the outcome of the matter, such that he has "skin in the game", the lawyer's interests are arguably *more* aligned with the client's, thus reducing (not increasing) any conflict of interest.

4.46 In 1993, the English Law Society carried out a survey into the use of CFAs and found that a substantial proportion of potential clients saw the assimilation of interest between lawyers and clients as a benefit.¹³ *"He's putting his money where his mouth is"* was one argument in support.¹⁴ Although this comment was made in the context of personal injury litigation, it does, in the Sub-committee's view, apply to Arbitration, in that permitting ORFSs provides clear incentives for Lawyers in respect of cases which they do pursue.

4.47 In a speech in 1994 the then English Master of the Rolls, Sir Thomas Bingham, made the following statement in support of ORFSs, which was not yet allowed in England and Wales by then:

*"suppose in litigation conducted under a conditional fee regime, a substantial offer is made at an early stage; the offer is rejected and the case goes to trial years later and the client loses. In the United States both client and lawyer are better off if the offer is accepted; so would the client be in England; but the lawyer is much better off in England if the offer is rejected (because he will be paid for the extra work, win or lose)."*¹⁵

4.48 The best evidence, again, is the experience of jurisdictions where ORFSs have been in place for some time. In this regard, Lord Justice Jackson concluded in 2009 that he had *"encountered no tenable arguments"* for abolishing CFAs and returning to the position before CFAs were permitted.¹⁶ Likewise, the 2015 NI Access to Justice Report found no suggestion of the integrity of lawyers being undermined in England and Wales following the introduction of "conditional fee arrangements".

4.49 There is no reason to think that the same would not be true in Hong Kong, particularly if sufficient safeguards are built into the system. The Sub-committee believes there is real force in these arguments. They provide a convincing counter-argument to the conflict of interest concerns that are considered below. In short, where the Lawyer only gets paid, or only gets paid an uplift on reduced fees, if the case is successful, the interests of Lawyers and clients are more aligned, not less.

¹³ Lord Justice Jackson, *Review of Civil Litigation Costs: Preliminary Report* (2009), Vol 1, at 166.

¹⁴ Same as above.

¹⁵ Same as above.

¹⁶ The Jackson Report, at 96.

Increase in opportunistic and frivolous litigation

4.50 Another objection, often cited, is that ORFSs would encourage Lawyers to pursue frivolous (low merit) cases for nuisance value against organisations with sizeable assets, in the hope that these organisations feel pressure to settle to avoid legal costs and bad publicity.¹⁷ Even if the large organisation wins the litigation, it may not be able to recover its costs from the other side. It has been said that the increased costs and insurance premiums borne by these organisations may also be passed on to consumers.¹⁸ Further, an increase in frivolous litigation would likely result in an increase in the cost of obtaining professional indemnity insurance.¹⁹

4.51 Again, however, this approach seems overly pessimistic, if not unrealistic. As noted in the 2007 LRC Report, it is not realistic to suppose that lawyers, who are professional people running commercial businesses, would willingly take on cases where there was little prospect of success.²⁰ On the contrary, having some form of ORFSs in place should prompt lawyers to undertake an even more rigorous assessment of the likely chances of success, more so than when fees are being charged under the current system on a time basis and the lawyers do not share the risk of an unsuccessful outcome. Hence, it is unlikely that the existence of ORFSs would lead to a significant upsurge in frivolous or "nuisance value" litigation.

4.52 In fact, as again the 2007 LRC Report highlighted, if Hong Kong retains the "costs indemnity rule" (the basic costs allocation rule for civil proceedings, including Arbitration, in Hong Kong), this already acts as a deterrent to vexatious, frivolous or unmeritorious claims.²¹

4.53 As with the perceived risk of "conflict of interest", perhaps the best test is looking at what has happened in other jurisdictions. We have already considered the position in England and Wales (see paragraphs 3.21-3.52 above). In addition, the LIV Position Paper expressly reported that "[e]vidence from Australia suggests that allowing third party litigation funders to charge a proportion of damages has not led to an increase in unmeritorious litigation" [emphasis added].²² This statement was made in the context of Third Party Funding but, in the Sub-committee's view, applies equally to ORFSs for Arbitration.

4.54 Again, there is no reason to suppose that the position would be any different in Hong Kong. In fact, given the shift of risk from client to lawyer where an outcome related fee arrangement is in place, the opposite is more likely to be true.

¹⁷ 2005 LRC Consultation Paper, at 114.

¹⁸ Same as above.

¹⁹ 2007 LRC Report, at para 7.6.

²⁰ Same as above, at para 6.10.

²¹ Same as above, at para 6.11.

²² Law Institute of Victoria, *Percentage-Based Contingency Fees: Position Paper* (2016), at 12.

Excessive legal fees

4.55 The risk of lawyers receiving excessive fees has also been raised as a concern.

4.56 Although this concern is usually raised in connection with DBAs rather than CFAs, some argue that even certain CFAs can be excessive, for example where a lawyer charges a high percentage uplift for taking a low risk.²³ It is argued that there is an intrinsic conflict of interest in the method of calculating the Success Fee, because it is in the lawyer's interest to over-estimate the risk of the case to justify a higher Success Fee.²⁴

4.57 However, as the 2007 LRC Report noted, others²⁵ have observed that the CFA system does not lead to excessive fees because CFAs take into account the number of hours worked and the lawyer's hourly rate to calculate the Success Fee. This, in turn, operates as a check on the amount of legal fees payable. The Sub-committee agrees.

4.58 In the context of DBAs, the fees payable to the lawyer (being a percentage of the "financial benefit" received) are both proportionate and entirely transparent from the outset, such that clients can predict with greater certainty the amount likely to be payable to their lawyers, and can assess whether that amount represents value for the legal services received.

4.59 Overall, in the Sub-committee's view, the concerns that ORFSs can result in excessive fees being payable to lawyers are, in general, overstated.

4.60 The risk of excessive fees is even lower in the context of Arbitration, where users are typically sophisticated commercial parties who have expressly considered and agreed where and how to resolve their disputes. Such risk as remains can be mitigated by the introduction of appropriate safeguards, including percentage caps on uplifts, transparency in respect of fees and hours charged, and judicial scrutiny on legal costs. The "costs indemnity rule", which in general requires costs to be "reasonable", will also deter excessive fees being charged.²⁶

Reliance on ATE Insurance / litigation insurance

4.61 The availability of stable and affordable ATE Insurance has also been identified as an important element of a successful ORFS regime. An ATE Insurance policy is a contract of insurance between the client and the insurer, taken after the event giving rise to the Proceedings, that provides

²³ South African Law Commission, *Report on Speculative and Contingency Fees* (1996), Project 93, at paras 3.13-3.14, as cited in 2007 LRC Report, at 117.

²⁴ Michael Zander, "Will the revolution in the Funding of Civil Litigation in England Eventually Lead to Contingency Fees?" (2002) 52 DePaul L. Rev. 259, as cited in 2007 LRC Report, at 117.

²⁵ For example, Allison F Aranson, "The United States Percentage Contingent Fee System: Ridicule and Reform from an International Perspective" (1992) 27 Tex Int'l LJ 755.

²⁶ 2007 LRC Report, at 118.

reimbursement for a proportion of the client's own fees, adverse costs and/or disbursements in the event the case is unsuccessful.

4.62 In 2005-2007, the Hong Kong insurance industry raised concerns over the commercial viability of the litigation insurance market in Hong Kong and thus did not, at that time, favour the introduction of CFAs.²⁷

4.63 Relevantly, the uncertainty around the availability of ATE Insurance in Hong Kong was a significant factor in the LRC revising its recommendation on conditional fees when it published the 2007 LRC Report.²⁸ The LRC contrasted the position of a wealthy corporate client, which might choose to use CFAs without ATE Insurance as an additional means of litigation funding, with the "average citizen", who has limited assets, where the risk of having to pay the other side's legal costs in the event of losing would likely render a CFA without ATE Insurance unattractive.²⁹

4.64 As the LRC put it:

"They [the 'average citizen'] are not rich enough to be able to absorb the other side's costs, and would face financial ruin if required to pay the other side's costs. It is, however, precisely this group of potential claimants that a conditional fee arrangement is supposed to assist. This fact, together with the problems associated with a conditional fee regime, has led us to revise our tentative recommendation on conditional fees."³⁰

4.65 The Sub-committee has considered and understands these concerns. There are, however, two key differences between what was being proposed in 2005-2007, and the consultation today.

4.66 First, in 2005-2007 the LRC was considering the broader ORFSs landscape, not limited to Arbitration. Now, however, the LRC has been tasked with considering ORFSs specifically for Arbitration in Hong Kong. The "average citizen" concern identified above is much less relevant in these circumstances.

4.67 Second, ATE Insurance is now much more available globally. It is particularly common in England and Wales, but is also available in a number of other jurisdictions, including Singapore. ATE Insurance policies are increasingly sophisticated and can be tailored to fit around the Lawyer's pricing arrangements to significantly reduce the client's exposure. The premium may be deferred until the conclusion of the case and contingent upon success, which makes this an attractive option to many clients.

4.68 It is the Sub-committee's understanding that ATE Insurance products may also be attractive to insurers, particularly in respect of arbitration proceedings in an established seat such as Hong Kong, and where the dispute

²⁷ Same as above, at 153.

²⁸ Same as above, at 153-154.

²⁹ Same as above.

³⁰ Same as above, at 154.

is governed by established legal systems such as Hong Kong, New York or English law.

4.69 In any event, it seems clear that the concerns relating to the availability of ATE Insurance are historic and should no longer be a bar to permitting ORFSs for Arbitration in Hong Kong. Insurers and brokers are encouraged to participate in the consultation to provide information about their positions and views on ORFSs for Arbitration.

Increase in satellite litigation

4.70 Another concern relates to the perceived risk of an increase in satellite litigation with the introduction of ORFSs for Arbitration. This concern arises largely in connection with, and as a criticism of, the English regime for CFAs. However, as the LRC noted in the 2007 LRC Report, a large part of this satellite litigation stemmed from the fact that, at that time, Success Fees and ATE Insurance premiums were recoverable by the successful party from the losing party.³¹ If, therefore, this is *not* a feature of the legal regime for ORFSs for Arbitration in Hong Kong (as we recommend), this will automatically reduce the potential for similar satellite proceedings in Hong Kong.

4.71 For completeness, the 2007 LRC Report noted that some satellite litigation had been caused by the "*complexity of the regulations governing conditional fees*", driven by the "*'unknown' nature of conditional fees and perhaps an over-zealous desire to provide comprehensive protection for the consumer*".³²

4.72 It is of course impossible to eliminate entirely the risk of satellite litigation, but this does not, in our view, justify rejecting ORFSs for Arbitration. The risk of satellite litigation can also be mitigated by restricting ORFSs to Arbitration (which will limit to a large extent the "over-zealous desire" to protect consumers), and by ensuring that the legislative framework governing ORFSs for Arbitration is clear and comprehensive.

Specific considerations in relation to DBAs and Hybrid DBAs

4.73 The arguments canvassed above were originally raised in relation to CFAs, not DBAs (or Hybrid DBAs). For completeness, however, the Sub-committee wishes to make it clear that the arguments in favour of CFAs apply to ORFSs generally, which is why the scope of the reform in Hong Kong should, in the Sub-committee's opinion, cover all three types of ORFSs: CFAs, DBAs and Hybrid DBAs.

³¹ Same as above, at para 6.19.

³² UK Department for Constitutional Affairs, *Conditional Fees in context – Notes on the English Experience* (September 2004), at 3, as cited in 2007 LRC Report, at para 6.20.

4.74 In fact, once it is determined to permit some form of ORFSs for Arbitration, and in that sense Hong Kong has "crossed the Rubicon", it is the Sub-committee's view that there is no real basis to permit one form of ORFSs (for example, CFAs) and not the other (for example, DBAs). We note that the UK Government has openly emphasised the "*similarities in substance between DBAs and CFAs*", such that it does not see DBAs as filling an access to justice gap; "*rather, they are intended to be an alternative form of funding*".³³

4.75 Nevertheless, the Sub-committee recognises that this view is not universal. It is therefore worth considering the core arguments which were specifically made for and against DBAs and summarised by Lord Justice Jackson in the Jackson Report before they were first introduced in England and Wales in 2013.

DBAs

Arguments in favour of DBAs

4.76 The key arguments in favour of DBAs were:

- (a) The principle of "no win, no fee" had already been established by CFAs, so there could be no principled objection to DBAs.
- (b) DBAs are simpler than CFAs and easier to understand.
- (c) DBAs offer less scope for conflicts of interest than CFAs.
- (d) Many clients prefer DBAs to CFAs.
- (e) Permitting DBAs as well as CFAs, only increases access to justice.
- (f) Under a DBA, the fees payable to lawyers are always, and by definition, proportionate.³⁴
- (g) DBAs give the lawyer a direct incentive to maximise recovery for his client.
- (h) There is no danger of DBAs creating a "USA type situation" where juries do not assess damages and judges are not elected.
- (i) There can be no possible objection to sophisticated clients entering into DBAs, if that is what both they and their lawyers want to do.³⁵

³³ Letter from Lord Faulks QC to Lord Dyson, the then Master of the Rolls of England and Wales, dated 30 October 2014, as quoted in the CJC Report, at vi.

³⁴ This argument is also discussed in paragraph 4.58 of the Consultation Paper.

³⁵ Lord Justice Jackson, *Review of Civil Litigation Costs: Preliminary Report* (2009), Vol 1, at 192-193.

Arguments against DBAs

4.77 The key arguments against DBAs were:

- (a) DBAs are liable to give rise to greater conflict of interest between lawyer and client than in the case of CFAs.
- (b) It is wrong in principle for lawyers to have an interest in the level of damages.
- (c) DBAs create an incentive to settle a case early.
- (d) DBAs are only acceptable in the USA because damages are extremely high and include non-compensatory elements.
- (e) The introduction of DBAs would be damaging to the legal profession, and contrary to the (then) existing professional culture.³⁶

4.78 These competing arguments were considered in the Jackson Report. Lord Justice Jackson noted that DBAs³⁷ were permitted in a number of overseas jurisdictions, including the USA, Canada, Hungary, Italy, Spain, Taiwan and Japan. He was particularly interested in Canada, and the contingency fee regime which operated in Ontario, referring to that as the so-called Ontario model.

4.79 Having weighed up the conflicting arguments, Lord Justice Jackson concluded that both solicitors and barristers should be permitted to enter into contingency fees with their clients on the Ontario model. The differences between the Ontario model and the Success fee model (which is currently being proposed in England) are discussed further below.

4.80 Lord Justice Jackson said:

"In my view the arguments in favour of contingency fees ... outweigh the arguments against ... Furthermore, it is desirable that as many funding methods as possible should be available to litigants. This will be particularly important if my earlier recommendations are accepted, that CFA success fees and ATE [l]nsurance premiums should become irrecoverable. I also see particular force in the freedom of contract argument ... It seems to me that this is self-evident in the case of commercial litigants. In the case of private litigants, such as personal injury claimants, in my view a requirement for independent advice together with

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Same as above, at 193-194.

³⁷

The Sub-committee notes that "DBA" and "DBA Payment" are not terms used in the Jackson Report. Lord Justice Jackson refers instead to "contingency fee", being "[a] lawyer's fee calculated as a percentage of monies recovered". While this is narrower than the definition of DBA adopted in this Consultation Paper, the Sub-committee considers that the analysis at paras 4.76-4.77 applies to DBAs as defined.

effective regulation will provide sufficient safeguards. If the client wishes to enter into a contingency fee agreement, after having received independent advice, he should be free to do so".³⁸

4.81 The Sub-committee agrees that the arguments in favour of DBAs outweigh the arguments against, such that DBAs should also be permitted in Hong Kong. The Sub-committee's view is reinforced by the fact that: (i) we have also recommended that Success Fees and ATE Insurance premiums not be recoverable from the losing opponent (which was a factor relevant to Lord Justice Jackson's conclusion above); and (ii) the scope of the proposed reform in Hong Kong is currently limited to Arbitration, which is primarily the arena of commercial, not private, parties.

4.82 The Sub-committee also considers that the arguments against DBAs are no different in substance from the arguments raised in the 2007 LRC Report, which have been addressed above.

4.83 In short, the Sub-committee agrees with Lord Justice Jackson that, as with CFAs, the arguments in favour of DBAs (and Hybrid DBAs) manifestly outweigh the arguments against. Therefore, the Sub-committee recommends that DBAs and Hybrid DBAs should be permitted in Hong Kong for Arbitration.

The Ontario model vs the Success fee model

4.84 In 2009, Lord Justice Jackson recommended that DBAs be permitted on the basis of the Ontario model. This was the model which was ultimately implemented in the 2013 DBA Regulations.

4.85 Under the Ontario model, the client cannot recover the full DBA Payment from the losing opponent, if it is higher than the costs that would otherwise be recoverable. The client must pay any shortfall between recoverable costs and the DBA Payment. Conversely, as a result of the indemnity principle, if the DBA Payment is lower than the costs that would otherwise be recoverable, only that lower amount can be recovered. This means that the most that the lawyer can retain, in the event of the claimant's success, is the DBA Payment. In other words, under the Ontario model, the lawyer cannot treat the DBA Payment as a true success fee,³⁹ on top of the recoverable costs incurred to successfully pursue the claim.

4.86 One of the recommendations of the 2019 DBA Reform Project⁴⁰ is to switch to the Success fee model. Under the Success fee model, the calculation is different, in that costs recovered from the opponent are outside of, and additional to, the DBA Payment.

³⁸ The Jackson Report, at 131.

³⁹ Under the Ontario model, lawyers receive (i) the recoverable costs and (ii) any difference between the recoverable costs and the full DBA Payment. Under the Success fee model, lawyers retain the recoverable costs, and can also receive the full DBA Payment.

⁴⁰ An independent review of the 2013 DBA Regulations in England and Wales by Professor Rachael Mulheron and Mr Nicholas Bacon, QC in 2019.

4.87 The DBA Payment is thus treated as the success fee, which can be retained by the lawyer *on top of* the recoverable costs awarded.

4.88 Four key reasons are cited for moving to a Success fee model.

- (a) As a concept, it is far easier to explain to clients.
- (b) It avoids the consequences of the indemnity principle. Under the Ontario model, if the DBA Payment is less than the amount of recoverable costs, then the opponent is not obliged to pay those recoverable costs, and the DBA Payment represents a ceiling on the recoverable costs to which the client is entitled. This in turn can represent a significant windfall to the losing opponent, by enabling that losing opponent to escape the consequences of an award of recoverable costs. By contrast, under the Success fee model, this scenario does not arise as recoverable costs are paid in addition to the DBA Payment.
- (c) As recoverable costs are payable in any event without reference to the DBA, an opponent has less motivation to challenge the enforceability of a DBA. This will reduce the prospect of satellite litigation.
- (d) The Success fee model is likely to enhance access to justice in low-value claims. Under the Ontario model, the DBA Payment can be "eaten up" by recoverable costs. Under the Success fee model, the lawyer is not punished by pursuing, and winning, a low-value claim.⁴¹

4.89 Under the Success fee model, the DBA Payment therefore includes only irrecoverable representative's⁴² costs (ie costs incurred by the representative which are not payable by any other party) and barristers' fees (whether recoverable or irrecoverable, where those fees are incurred by the solicitor and the barrister is not engaged directly by the client). The *Explanatory Memorandum* to the 2019 DBA Reform Project notes that the larger the barrister's fee, the lower the solicitor's recovery under the DBA, but that will be for the solicitor and barrister to resolve between them. It is not an issue that affects the client.

4.90 If DBAs are permitted for Arbitration in Hong Kong, the Sub-committee invites submissions on whether the Ontario model or the Success fee model should be adopted.

⁴¹ Professor Rachael Mulheron and Nicholas Bacon, QC, *Explanatory Memorandum – The 2019 DBA Reform Project* (2019), at 11-12.

⁴² Under the Redrafted 2019 DBA Regulations, "representative" means "*the person providing the advocacy services, litigation services or claims management services to which the damages-based agreement relates*".

Hybrid DBAs

4.91 In his keynote speech delivered to the Law Society of England and Wales on 20 October 2014, entitled "*Commercial Litigation: The Post-Jackson World*" ("2014 Keynote"), Lord Justice Jackson described a "Hybrid DBA" as "*an agreement under which the client pays its lawyers a low fee if the action is lost and a percentage of the winnings if the action is won.*"⁴³ These are typically referred to as "no win, low fee" DBA agreements, and are not currently permitted in England and Wales under the 2013 DBA Regulations.

4.92 The CJC Report noted that the UK Government's opposition to Hybrid DBAs⁴⁴ was based on the following:

- (a) if a client can afford to pay base costs as the action proceeds, then the client can use alternative funding arrangements to DBAs (even if the action ultimately loses);
- (b) Hybrid DBAs offer lucrative opportunities for lawyers to increase their earnings greatly, without a commensurate increase in risk;
- (c) there is a distinction between a Hybrid DBA and a "no win, low fee" CFA (which are permitted), in that the fee under a CFA is generally in proportion to the work actually done, as the Success Fee is benchmarked against fees and the work done. By contrast, the DBA Payment relates only to the compensation recovered, which may be substantial;
- (d) DBAs are not intended to fill any "access to justice" gap. Rather, they are intended to constitute an alternative form of funding; and
- (e) DBAs are a new form of funding, and the UK Government is concerned to ensure that they develop carefully and cautiously.⁴⁵

4.93 Relevantly, in relation to the last point, the UK Government's preference was that Hybrid DBAs should be considered as part of the scheduled LASPO post-implementation review in 2016-2018.

4.94 That review has now taken place and the 2019 DBA Reform Project in England and Wales has recommended that Hybrid DBAs should be permitted, and that it should be possible for a lawyer to charge the client as he goes, under a discounted retainer.

4.95 The reason for permitting Hybrid DBAs is two-fold:

- (a) to aid cash flow, and to ensure that, for long-running matters, a solicitor can keep some money coming in; and

⁴³ 2014 Keynote, at 3.

⁴⁴ Also referred to as *concurrent* hybrid DBAs (*cf sequential* hybrid DBAs).

⁴⁵ The CJC Report, at 74-75.

- (b) to avoid the need for solicitors to enter into "side agreements" with Third Party Funders who pay the law firm's work in progress ("WIP") as the case progresses under their own hybrid damages-based agreements, but who then may take percentage cuts from both solicitor and client (the so-called "Third Party Funder Hybrid DBA").^{46 47}

4.96 Lord Justice Jackson has also expressly advocated for permitting Hybrid DBAs. In his 2014 Keynote, he put forward compelling arguments for the use of Hybrid DBAs (in addition to DBAs), including:

- (a) DBA funding is particularly suited to long-running, high-risk commercial litigation, where some funding as the case proceeds would make the case more viable to take on;
- (b) the respondent is not affected whether the claimant's case is funded by a sole DBA, a Hybrid DBA or via a CFA. Hence, how the claimant chooses to fund his litigation is his own concern;
- (c) Hybrid DBAs are permitted in other jurisdictions, including in Canada, and have not caused any problems. On the contrary, the effect of the Canadian regime has been to increase access to justice;
- (d) permitting Hybrid DBAs in England and Wales would similarly enhance access to justice. In short, the more funding options open to the claimant, the better; and
- (e) Hybrid DBAs are very unlikely to encourage frivolous and speculative litigation, because a lawyer is unlikely to "invest" in a case that he considers weak.⁴⁸

4.97 Lord Justice Jackson also emphasised the illogicality of not allowing Hybrid DBAs, when CFAs could be used in hybrid form and Third Party Funders are permitted to fund cases on a hybrid basis under Third Party Funder Hybrid DBA.⁴⁹

4.98 The Sub-committee has considered these arguments, and are strongly of the view that if DBAs are permitted, Hybrid DBAs should be permitted too. In reaching this conclusion, we are mindful of the fact that, as noted above, it would be possible: (i) (assuming CFAs are permitted) to have a hybrid CFA where the client pays a reduced hourly rate as the case proceeds and a Success Fee if the case is won; and (ii) to replicate the financial effects

⁴⁶ An agreement between a Lawyer and a Third Party Funder, by which the Lawyer agrees to share his DBA Payment with the Third Party Funder in return for the Third Party Funder paying part of the time and other costs of the claim to the Lawyer as the claim progresses.

⁴⁷ Professor Rachael Mulheron and Nicholas Bacon, QC, *Explanatory Memorandum – The 2019 DBA Reform Project* (2019), at 15.

⁴⁸ 2014 Keynote, at 3-5.

⁴⁹ Same as above, at 4.

of a Hybrid DBA (at least from the Lawyer's perspective) using a Third Party Funder Hybrid DBA.

4.99 In fact, the key differences between a Hybrid DBA and a Third Party Funder Hybrid DBA are from the client's perspective. In particular, under a Third Party Funder Hybrid DBA structure, the Lawyer effectively trades part of the contingent DBA Payment for a guaranteed ongoing fee from the Third Party Funder. The Lawyer will be paid a (lower) fee if the action is lost, and a percentage of winnings if the action is won. The only difference between a Third Party Funder Hybrid DBA and a Hybrid DBA is that the client is not given the same flexibility. If Hybrid DBAs are not permitted, the client cannot negotiate a lower DBA Payment in return for paying a (reduced) ongoing fee to the Lawyer, even if it considers that to be in its commercial interests.

4.100 The cost of a Third Party Funder Hybrid DBA is therefore likely to be significantly higher to the client than a Hybrid DBA would be without the involvement of a funder.

4.101 In other words, banning Hybrid DBAs restricts the client's flexibility, and potentially increases its costs, without preventing the Lawyer from entering into an economically equivalent arrangement by involving a Third Party Funder.

4.102 It is for all these reasons that we have included Hybrid DBAs (as well as DBAs) within the scope of the recommended reform.

Other considerations

Impact on barristers

4.103 The LRC suggested in the 2007 LRC Report that barristers might have to be subject to a higher maximum uplift than solicitors "*to mitigate the difficulty of finding a competent barrister to represent clients who have a worthy cause but require conditional fee financing*".⁵⁰ It was observed in England and Wales that the combined effect of the advent of CFAs, the loss of legal aid funding and the success of the pre-action protocol had led to the fact that barristers were increasingly involved in riskier cases, and as a consequence, reluctant to accept "conditional fee arrangements".⁵¹ On the other hand, solicitors were unwilling to instruct barristers privately because a number of litigation insurance companies were not willing to insure the client's own costs, including barristers' fees (which, in the litigation context, are typically treated as disbursements), and solicitors would be responsible for the barristers' fees if their clients lost their cases.⁵² In the Sub-committee's view, this is unlikely to be a problem in the context of the proposed reform, in part because insurance for clients' own costs is now more readily available, and in part because it is

⁵⁰ 2007 LRC Report, at para 6.85.

⁵¹ Mark Harvey, *Guide to Conditional Fee Agreements* (Jordans, 2002), as quoted in 2007 LRC Report, at 142-143.

⁵² Same as above, at 143.

possible to instruct barristers directly to act for clients in Arbitration proceedings, and thus to pay barristers' fees directly.

4.104 The Sub-committee also agrees that most barristers are, in principle, less likely than solicitors to accept ORFSs. As the 2007 LRC Report noted in the context of CFAs, this is most likely attributable to the fact that barristers tend to be instructed later in a claim, where the defences have crystallised and where the odds of successfully pursuing the claim are lower.⁵³ Accordingly, barristers "*are not building up the fees on successful claims in the same way as solicitors and when they are instructed ... it is later in the case and with considerably greater risk*".⁵⁴ Where, on the other hand, a barrister is instructed at the outset of a case, unless there is an enforceable mechanism to ensure the barrister's involvement in each subsequent step of the proceedings, it could be risky or indeed impracticable for a barrister to agree to an outcome related fee where he does not have full conduct of the matter. Another possible reason is that barristers do not generally have the same volume of cases as solicitors, especially those from international firms, upon which the risk of receiving a reduced or no fee for an unsuccessful case may be leveraged.

4.105 That being so, the Sub-committee's tentative view is that it is probably unnecessary to allow different maximum uplifts for barristers and solicitors. First, the possibility of charging higher fees in the event of a successful claim does not mitigate the risk that a barrister would be left out of pocket if unsuccessful. For such concerns, a better solution might be for the barrister to negotiate a "no win, reduced fee" arrangement. Second, given that each barrister's risk appetite is inherently subjective and context-dependent, it is a matter of party autonomy how such fees are negotiated in each case. Third, there is no evidence from comparable jurisdictions that a higher maximum cap would encourage barristers to accept a CFA. To the contrary, it appears that most common law jurisdictions apply the same maximum uplifts for both barristers and solicitors.⁵⁵ Fourth, to permit differential maximum uplifts invariably begs further questions as to how such differences ought to be quantified.

4.106 In general, the Sub-committee feels that the barrister profession would be less impacted than solicitors if ORFSs for Arbitration were introduced. Nevertheless, the Sub-committee acknowledges that this is an issue that is likely to attract attention and debate. We therefore believe that this issue requires consultation with both branches of the legal profession and the public at large.

Proliferation of claims intermediaries

4.107 It was contemplated in the 2005 LRC Consultation Paper that the introduction of CFAs would allow lawyers to be more price-competitive, and

⁵³ Same as above.

⁵⁴ Same as above.

⁵⁵ 2005 LRC Consultation Paper. See also Legal Profession Act 2006 (ACT), s 284; Conditional Fee Agreements Order 2013 (England and Wales); Legal Profession Act 2007 (Tas), s 308.

might drive business away from unregulated claims intermediaries to lawyers, who are properly regulated.⁵⁶

4.108 However, the LRC acknowledged in its 2007 LRC Report that the 1995 abolition of the common law offences of maintenance and champerty in England and Wales had led first to the proliferation, and then to the sudden collapse, of claims intermediaries in 2003 and 2004.⁵⁷

4.109 The 2007 LRC Report noted that it was therefore difficult to predict what impact, if any, allowing lawyers to charge "conditional fees" would have on claims intermediaries.⁵⁸

4.110 The 2007 LRC Report expressed concerns over the operation of claims intermediaries (also known as recovery agents) in Hong Kong.⁵⁹

4.111 Claims intermediaries most commonly act for victims of accidents (including industrial and traffic accidents) and work-related injuries, as well as employees in employment disputes. According to a survey conducted in 2013, more than 60% of survey respondents who suffered from work injuries indicated that they had been approached by claims intermediaries or law firm representatives touting at public areas such as public hospitals or the Labour Department.⁶⁰ Claims intermediaries introduce lawyers to the victims, pay their legal fees, and may even provide loans to the victims to cover their medical, travel and living expenses. Claims intermediaries use phrases such as "no win, no fee", "risk-free guarantee", "no charge" and "huge sums of compensation" to attract clients.

4.112 In reality, claims intermediaries operate purely for profit, aim to minimise their expenses and do not always protect the rights and interests of their clients. If the claim results in no recovery, the claimant is not required to pay any legal costs. If it succeeds, claimants usually have to pay the claims intermediary 20% to 30% of any recovery, in return for the claims intermediary assisting in pursuing the claim. As accident compensation is assessed on the basis of actual loss, a victim using a claims intermediary will not be adequately compensated, as part of his compensation will be paid to the claims intermediary.

4.113 In recent years, certain insurance companies have complained that, due to rampant activities by claims intermediaries, the compensation amounts relating to traffic accident claims have significantly increased.⁶¹

⁵⁶ 2005 LRC Consultation Paper, at para 6.60.

⁵⁷ 2007 LRC Report, at paras 6.31 and 6.34.

⁵⁸ Same as above, at para 6.54.

⁵⁹ Same as above, at paras 6.38 to 6.39.

⁶⁰ Hong Kong Government, *LCQ16: Recovery agents for injured workers* (2014), available at <https://www.info.gov.hk/gia/general/201404/30/P201404300457.htm>.

⁶¹ Transport and Housing Bureau, *LCQ8: Insurance premiums for taxis* (2020), available at <https://www.thb.gov.hk/eng/legislative/transport/replies/land/2020/20200226b.htm>.

4.114 The Sub-committee notes these concerns, as well as the additional concerns set out in paragraphs 6.38 to 6.39 of the 2007 LRC Report, including that:

- (a) claims intermediaries are unregulated;
- (b) there is no minimum education or qualification requirement;
- (c) clients who receive substantial damages may pay more to a claims intermediary than they would have paid to a solicitor on a traditional time basis; and
- (d) clients are exposed to financial risk if they lose the case and the claims intermediary is unwilling or unable to pay the opponent's costs.

4.115 However, in the Sub-committee's view, the concerns about claims intermediaries relate principally to personal injury and employment litigation. They are of limited relevance to Arbitration because claims intermediaries do not, so far as the Sub-committee is aware, generally pursue Arbitration claims in Hong Kong (or elsewhere).

4.116 The present consultation seeks views on introducing ORFSs for Arbitration only. In circumstances where ORFSs would be limited to Arbitration, it seems unlikely that introducing such fees would lead to any significant increase in claims intermediary activity. To the extent that concerns remain in Hong Kong, they can be managed by appropriate limitations⁶² in law and regulations on claims intermediary activity with respect to Arbitration.

4.117 In the view of the Sub-committee, permitting ORFSs for Arbitration would not lead to an increase in the number of claims intermediaries operating in Hong Kong. Nor would it lead to increased activity by existing claims intermediaries, who are unlikely to pursue commercial claims of the type that are typically arbitrated in Hong Kong.

4.118 Consequently, the Sub-committee is not persuaded that concerns about claims intermediaries have a bearing on introducing ORFSs for Arbitration in Hong Kong.

⁶² Some of the practices and standards contained in the Code of Practice for Third Party Funding of Arbitration (which Third Party Funders of Arbitration are expected to comply in carrying on activities in connection with Third Party Funding of Arbitration in Hong Kong) could be specifically applied on claims intermediaries. For example, the claims intermediary has to (1) ensure its promotional materials are clear and not misleading; (2) ensure its client is made aware of the right to seek independent legal advice before entering into the claims handling agreement; and (3) set out and explain clearly in the claims handling agreement all the key features and terms of the proposed claims management services. Further, the claims intermediary should not influence its client or its legal representative to give control or conduct of the Arbitration to the client except permitted by law.

Increase in financial burden on small and medium-sized law firms

4.119 The Working Party on Conditional Fees of The Law Society of Hong Kong ("Working Party") contemplated in 2006 that small and medium-sized ("SME") law firms would struggle to secure a sufficient number of cases to spread the risks inherent in offering ORFSs.⁶³ Lay clients might be reluctant to use SME firms because of their lack (or perceived lack) of capability or the necessary skills to provide the type of comprehensive service that is required to manage a large or complex arbitration. It follows that such SME firms in Hong Kong may not have large number of arbitration cases. Even if SME firms manage to secure a sufficient number of cases, they would have to incur additional costs to handle the administrative work as well as manage the financial risks involved.⁶⁴ The HKBA also queried whether financial institutions in Hong Kong were willing to provide finance to the legal profession, especially to junior barristers or SME law firms, given that they might not be able to provide any assets as security.⁶⁵

4.120 As a result, the Sub-committee recognises that Hong Kong SME law firms might not be significantly affected were Hong Kong to introduce ORFSs for Arbitration. Such firms are encouraged to participate in the consultation in order to provide information about their positions and views on ORFSs for Arbitration.

Adverse costs orders

4.121 Finally, the Working Party suggested that, unless ATE Insurance were available, solicitors might be exposed to potential liability to an adverse costs order against them if the case is lost.⁶⁶

4.122 This consideration would be irrelevant if, as the Sub-committee anticipates, ATE Insurance becomes available in Hong Kong following the introduction of ORFSs for Arbitration.

4.123 In addition, this concern is considerably less relevant in the context of Arbitration, because an arbitral tribunal, consisting of one or three arbitrator(s), established by the agreement of the parties to finally resolve disputes or differences by arbitration ("Tribunals") have no jurisdiction over the parties' representatives and therefore cannot make adverse costs orders against them. To the extent that Lawyers appear in Arbitration-related proceedings in the Hong Kong courts, judges can make such orders. However, the Sub-committee submits that this situation would arise only rarely, such that it should not be a significant factor in deciding whether to permit ORFSs for Arbitration in Hong Kong.

⁶³ Working Party on Conditional Fees of The Law Society of Hong Kong, *Response to the Consultation Paper of the Law Reform Commission on Conditional Fees* (2006), at para 15.12.

⁶⁴ Same as above, at paras 15.12 and 15.13.

⁶⁵ HKBA, *The Hong Kong Bar Association's Position Paper on Conditional Fees: A Response to the Law Reform Commission's Consultation Paper* (2006), at para 37.

⁶⁶ *Arkin v Borchard Lines Ltd* [2005] EWCA Civ 655.

Chapter 5

Recommendations

Conditional Fee Agreements (CFAs)

Should CFAs be allowed?

5.1 We consider that Lawyers should be permitted to use CFAs in arbitrations seated both in and outside Hong Kong. The reference to "arbitration" should also have the meaning given to it in section 98F of the Arbitration Ordinance, and include the following proceedings under that Ordinance: (i) court proceedings; (ii) emergency arbitrator proceedings; and (iii) mediation proceedings.

5.2 In making this recommendation, we have considered carefully the arguments for and against the introduction of CFAs. We have also considered the position in other major dispute resolution and international arbitration centres, including England and Wales and Singapore (where a framework to introduce CFAs is currently being proposed).

5.3 Taking into account Hong Kong's status as a major arbitration centre and the need to maintain its competitiveness, we have concluded that Hong Kong's competitiveness will almost certainly be reduced unless the law is amended to permit the use of CFAs in Hong Kong. We also consider that there are a number of other obvious benefits to the key stakeholders in Arbitration. As discussed in Chapter 4, these include greater access to justice, increased flexibility in pricing and the alignment of interests between Lawyers and clients.

5.4 In our view, these benefits clearly outweigh the problems and risks identified with CFAs. These risks are further mitigated by limiting the scope of their use to Arbitration and ensuring that the CFA regime is properly structured.

5.5 Accordingly, we are of the unanimous view that the law in Hong Kong should be amended to permit the use of CFAs in Arbitration.

Recommendation 1

The Sub-committee recommends that prohibitions on the use of CFAs in Arbitration by Lawyers should be lifted, so that Lawyers may choose to enter into CFAs for Arbitration.

Non-recoverability of ATE Insurance premiums and Success Fees from the unsuccessful party

5.6 Although the losing respondent should continue to bear the (reasonable) costs of the claimant in accordance with the costs indemnity rule, we consider that the losing respondent should not be liable for the claimant's ATE Insurance premium (if any) or the Success Fee.

5.7 It is relevant to note that, based on recommendations made in the Jackson Report, England and Wales reverted to the above position in April 2013 when it introduced Part 2 of the LASPO. The reform was considered necessary because the ability of a successful claimant to recover its ATE Insurance premium and the Success Fee from the respondent had led to an explosion of litigation and this feature had become one of the major criticisms of the conditional fee regime in England and Wales.¹ As noted in the 2005 LRC Consultation Paper, the then Senior Costs Judge of England and Wales, Peter Hurst, had also specifically "*voiced the view that serious consideration should be given to ending the recoverability of success fee and insurance premiums in conditional fee cases*".²

5.8 Consistent with this, two of the recommendations made by Lord Justice Jackson in the Jackson Report were that the Success Fee and the ATE Insurance premium should no longer be recoverable from the respondent. These recommendations in turn constituted two of the five statutory reforms implemented by Part 2 of the LASPO. Its overall objectives were "*to reduce the costs of civil litigation and to rebalance the costs liabilities between claimants and defendants while ensuring that parties with a valid case could still bring or defend a claim*".³

5.9 We agree with these reforms, and they underpin the basis of this recommendation. Indeed, in 2019 Review, the UK Ministry of Justice concluded that the reforms implemented by Part 2 of the LASPO had been successful in achieving their objectives that: costs had been reduced, fewer unmeritorious cases had been taken forward and access to justice at proportionate cost was generally being achieved.⁴

5.10 We also agree with the statement in the 2005 LRC Consultation Paper that it would be "*inequitable, irrational and unfair to make insurance premiums and success fee recoverable from the losing party*".⁵

5.11 As a starting point, the amount of the ATE Insurance premium and the Success Fee is a matter between the successful claimant and the claimant's lawyers. It would be unfair if the losing respondent were responsible for these costs in circumstances where the respondent is not party to these contracts and

¹ The Jackson Report, at Ch 4.

² 2005 LRC Consultation Paper, at para 7.11.

³ 2019 Review, at 8.

⁴ Same as above, at 6.

⁵ 2005 LRC Consultation Paper, at para 7.11.

has no control over the pricing which is agreed. In that sense, we agree with the LRC Conditional Fees Sub-committee that there is a clear inequity where the quantum of costs depends on the claimant's choice of fee arrangement with its lawyers, and not on the objectively ascertained value of the work done.

5.12 Further, if the respondent is responsible for paying the Success Fee, this would almost certainly lead to an increase in satellite proceedings of one form or another, not least because the respondent would be entitled to scrutinise the CFA and the rationale for setting the Success Fee at the level agreed. The same analysis would apply to the ATE Insurance premium, over which the losing respondent would also have no visibility or control.

5.13 For all these reasons, we consider that Hong Kong should follow the current English provisions on recoverability of Success Fees and ATE Insurance premiums, namely that neither should be recoverable by the claimant from the losing respondent.

Recommendation 2

Where a CFA is in place, the Sub-committee recommends that any Success Fee and ATE Insurance premium agreed by the claimant with its Lawyers and insurers respectively should not be recoverable from the respondent.

Capping the Success Fee

5.14 Consistent with the position in other jurisdictions, we consider that there should be a cap on the Success Fee recoverable. In England and Wales, the Success Fee is capped at 100% of normal costs.⁶ In Australia, for contentious proceedings the Success Fee is subject to a lower cap of 25% (excluding disbursements) of the legal fees otherwise payable.⁷

5.15 Noting that in many cases the Success Fee will be pure profit, our view is that there is scope for capping it at less than the 100% cap currently adopted in England and Wales. The Sub-committee recommends that there should be a cap on the Success Fee which is expressed as a percentage of normal or "benchmark" costs.⁸

5.16 The Sub-committee invites consultation on what that cap should be, and why.

⁶ The Conditional Fee Agreements Order 2013, Article 3.

⁷ Legal Profession Act 2006 (ACT), s 284(4)(b); Legal Profession Act 2004 (NSW), s 324(5); Legal Profession Act (Qld), s 324(4); Legal Profession Act 2007 (Tas), s 308(4)(b); Legal Profession Act 2004 (Vic), s 3.4.28(4)(b); Legal Profession Act 2008 (WA), s 284(4)(b), as cited in Law Council of Australia, *Percentage Based Contingency Fee Agreements* (2014), at 13-14.

⁸ "Benchmark" costs refers to the standard fee scale determined by individual firms, which is expected to be updated annually.

5.17 The Sub-committee also invites consultation on whether barristers should be subject to a different cap and, if so, what that cap should be and why.

Recommendation 3

Where a CFA is in place, the Sub-committee recommends that there should be a cap on the Success Fee which is expressed as a percentage of normal or "benchmark" costs. The Sub-committee invites proposals on what an appropriate cap should be, up to a maximum of 100%.

The Sub-committee also invites proposals on whether barristers should be subject to the same, or a different, cap and, if different, what that cap should be, up to a maximum of 100%.

Damages-based Agreements (DBAs)

Should DBAs be allowed?

5.18 We consider that Lawyers should be permitted to use DBAs in Arbitration.

5.19 England and Wales introduced DBAs for contentious work in April 2013, as one of the statutory reforms implemented by Part 2 of the LASPO. Lord Justice Jackson recommended the introduction of DBAs, in part because he considered it desirable that as many funding methods as possible should be available to litigants, particularly once Success Fees and ATE Insurance premiums would no longer be recoverable from the losing party. Notably, he also saw great force in the freedom of contract argument: if the client wishes to enter into a DBA with its lawyer, it should be free to do so.

5.20 The UK Government has since openly emphasised the "*similarities in substance between DBAs and CFAs*".⁹ The UK Government does not see DBAs as filling an access to justice gap, "*rather, they are intended to be an alternative form of funding*".¹⁰

5.21 In the Sub-committee's view, there is merit in these propositions, and the recommendations made by Lord Justice Jackson. This is particularly so in the context of Arbitration, where parties are, on the whole, commercial

⁹ Letter from Lord Faulks, QC to Lord Dyson, the then Master of the Rolls of England and Wales, dated 30 October 2014, as quoted in the CJC Report, at vi.

¹⁰ Same as above.

entities or business people familiar with negotiating commercial terms, and related pricing for those services.

5.22 The importance of flexible pricing arrangements, and the ability to use DBAs, are further underscored by the fact that DBAs are permitted, and frequently used, in Mainland China and by the PRC clients. A large portion of Arbitration work in Hong Kong is related to the PRC in some way, and this is only likely to increase in the future, given factors such as the Belt and Road Initiative and the Arrangement Concerning Mutual Assistance in Court-ordered Interim Measures in Aid of Arbitral Proceedings by the Courts of the Mainland China and of the HKSAR.¹¹

5.23 The ability to offer DBAs will not only protect Hong Kong's status as a major arbitration centre, but allows Lawyers in Hong Kong to compete for Mainland China-related work on a more level playing field. This is critical for Hong Kong's future success as a dispute resolution hub.

5.24 As with CFAs, we are of the unanimous view that the law in Hong Kong should be amended to permit the use of DBAs in Arbitration.

Recommendation 4

The Sub-committee recommends that prohibitions on the use by Lawyers of DBAs in Arbitration should be lifted, so that Lawyers may use DBAs for Arbitration.

Non-recoverability of ATE Insurance premiums

5.25 For the same reasons given in relation to Recommendation 2 above, we consider that ATE Insurance premiums should not be recoverable from the losing respondent where a DBA is in place.

Recommendation 5

Where a DBA is in place, the Sub-committee recommends that any ATE Insurance premium agreed by the claimant with its insurers should not be recoverable from the respondent.

¹¹ A party to arbitral proceedings in Hong Kong may, in accordance with the relevant Mainland China laws and regulations, apply for interim measures from the relevant Mainland Chinese courts.

Fee model and treatment of recoverable costs

5.26 In England and Wales, the recovery of costs in a DBA context is currently based on the so-called "Ontario model". This was the model which was ultimately implemented in the 2013 DBA Regulations.

5.27 Under the Ontario model, clients cannot recover the full DBA Payment from the losing opponent, if it is higher than the costs that would otherwise be recoverable. The client must pay any shortfall between recoverable costs and the DBA Payment. Conversely, as a result of the indemnity principle, if the DBA Payment is lower than the costs that would otherwise be recoverable, only that lower amount can be recovered.¹² This means that the most that the Lawyer can retain, in the event of the claimant's success, is the DBA Payment. In other words, under the Ontario model, the lawyer cannot treat the DBA Payment as a true success fee, on top of the recoverable costs incurred to successfully pursue the claim.

5.28 One of the recommendations of the 2019 DBA Reform Project is to switch to the Success fee model. Under the Success fee model, the calculation is quite different, in that costs recovered from the respondent are outside of, and additional to, the DBA Payment. The DBA Payment is thus treated as the success fee, which can be retained by the Lawyer *on top of* the recoverable costs awarded.

5.29 Under the Success fee model, the DBA Payment includes only irrecoverable representative's costs (ie costs incurred by the representative which are not payable by any other party) and barrister's fees (whether recoverable or irrecoverable, where those fees are incurred by the solicitor and barrister is not engaged directly by the client). The *Explanatory Memorandum* to the 2019 DBA Reform Project notes that the larger the barrister's fee, the lower the solicitor's recovery under the DBA, but that will be for the solicitor and barrister to resolve between them. It is not an issue that affects the client.

5.30 In England and Wales, if a barrister is directly engaged by the client, the barrister's fee would also be outside the DBA Payment cap. In these circumstances, barristers' fee could be treated as an expense or, possibly, subject to a separate DBA. If subject to a separate DBA, we recommend that a solicitor's DBA Payment plus a barrister's DBA Payment should not exceed the statutory cap (see below).

¹² Professor Rachael Mulheron and Nicholas Bacon, QC, *Explanatory Memorandum – The 2019 DBA Reform Project* (2019), at 11.

Recommendation 6

The Sub-committee invites submissions on whether the Ontario model or the Success fee model should apply to DBAs.

It is the Sub-committee's preliminary view that the 2019 DBA Reform Project's recommendation to move to a Success fee model should be followed.

Capping the DBA Payment

5.31 Again, consistent with the position in other jurisdictions, we consider that there should be a cap on the DBA Payment payable by the client to its lawyer.

5.32 For commercial claims, the current cap in England and Wales is 50% of the "financial benefit" or "compensation" received by the client. This was introduced in 2013 by the 2013 DBA Regulations.

5.33 The 2019 DBA Reform Project has recommended that this percentage be reduced to 40% of the financial benefit obtained by the client, on the basis that the Success fee model is adopted. The reduction is described as being appropriate given that under the Success fee model, the client must pay recoverable costs in addition to the DBA Payment. In other words, the reduction is recommended to prevent a lawyer being over-compensated. The 40% suggested cap is subject to consultation.

5.34 Similar caps apply in other jurisdictions. For example, a 30% cap applies in Mainland China.¹³

5.35 We are of the view that a cap should also be applied in Hong Kong. We invite consultation on what that cap should be, and why.

Recommendation 7

The Sub-committee recommends that there should be a cap on the DBA Payment, which should be expressed as a percentage of the "financial benefit" or "compensation" received by the client. The cap should be fixed after consultation.

¹³ 2006 Measures, Article 13.

The Sub-committee is of the view that there is scope for capping the maximum DBA Payment at less than the 50% cap currently adopted in England and Wales for commercial claims, particularly if the Success fee model is adopted, and that an appropriate range for consultation is 30% to 50%.

Termination

5.36 One of the criticisms of the 2013 DBA Regulations is that they do not contain any provisions regarding the grounds or manner of termination of a DBA, at least for general civil litigation matters.

5.37 This issue was specifically considered in the CJC Report of 2015. At that time, the Working Group concluded that the grounds and manner of termination of a DBA, and the consequences of termination, were best left to negotiation between the lawyers and the client in the DBA itself.¹⁴ The Working Group noted that the professional obligations to which each solicitor and barrister was subject should be sufficient protection for the client against inappropriate termination by the lawyer.¹⁵ Further, the ability to draft a suitable DBA was sufficient protection for the lawyer against inappropriate termination by the client.¹⁶ Relevantly, however, this latter view assumed that a clause dealing with any such termination by the client would not invalidate the DBA.

5.38 In England and Wales, there was a significant degree of uncertainty on this point, and it had been the subject of litigation on at least one occasion.¹⁷ It is therefore important to make it clear that DBAs will not be void if they include sensible commercial provisions to protect the Lawyer's position in the event of termination by the client where the Lawyer is not at fault.

5.39 This issue has been addressed by the 2019 DBA Reform Project, Regulation 6 of the Redrafted 2019 DBA Regulations.

Regulation 6 of the Redrafted 2019 DBA Regulations

5.40 Regulation 6(1) of the Redrafted 2019 DBA Regulations applies where it is the lawyer who terminates the DBA. Under any DBA, and legislatively, the lawyer can terminate the DBA if the client has conducted itself, or is conducting itself, unreasonably. If that is the case, then the lawyer may charge costs, according to the circumstances and methodology stipulated in the DBA. However, both the grounds of termination of the DBA and the amount chargeable to the client in the event of such termination are subject to a different contractual agreement if that has been negotiated between the lawyer and client.

¹⁴ The CJC Report, at 107.

¹⁵ Same as above.

¹⁶ Same as above.

¹⁷ *Lexlaw Ltd v Zuberi* [2020] EWHC 1855 (Ch).

5.41 Regulation 6(2) of the Redrafted 2019 DBA Regulations applies where it is the client who terminates the DBA. In that event, the lawyer may charge the client the legal costs incurred to the point of termination, plus expenses and barristers' fees incurred to that point (if any). The *Explanatory Memorandum* to the 2019 DBA Reform Project notes that in a long-running matter, it is conceivable that this sum may exceed the amount payable as the DBA Payment. In any event, it is open to the lawyer and client to agree on an alternative agreement when the DBA is drafted, given the opening words of Regulation 6.¹⁸

5.42 Given the debate and uncertainty around termination in England and Wales, we consider that the amendments recommended by the 2019 DBA Reform Project in relation to termination are sensible, and provide appropriate protection to both client and lawyer. This seems particularly important from the lawyer's perspective, when he is faced with termination by a client towards the end of a matter in order to avoid the DBA Payment.

5.43 In addition, the Sub-committee sees no reason to differentiate between DBAs and CFAs in this respect. We consider that any ORFS for Arbitration should be subject to regulation providing for the circumstances in which the Lawyer is entitled to terminate the agreement.

Recommendation 8

The Sub-committee recommends that a CFA, DBA, or Hybrid DBA should specify whether, and if so in what circumstances:

- (a) a Lawyer or client is entitled to terminate the fee agreement prior to the conclusion of Arbitration; and if so**
- (b) any alternative basis (for example, hourly rates) on which the client shall pay the Lawyer in the event of such termination.**

¹⁸ Regulation 6 of the Redrafted 2019 DBA Regulations:
"6. Subject to the parties agreeing otherwise –
(1) the representative may not terminate the agreement and charge costs, expenses and counsel's fees unless the client has behaved or is behaving unreasonably, and
(2) in the event that the client terminates the agreement for any reason –
(a) paragraph 4(1) does not apply; and
(b) the representative may charge the client no more than the representative's costs and expenses, and counsel's fees, for the work undertaken in respect of the claim or proceedings to which the agreement relates as specified in paragraph 3(a)."

Treatment of barristers' fees

5.44 The 2013 DBA Regulations provide that the DBA Payment must include any disbursement incurred by the solicitor in respect of counsel's (ie barristers') fees.¹⁹ This means that, if a firm of solicitors incurs barristers' fees as a disbursement, the firm not only loses any entitlement to those fees in the event of an unsuccessful claim, but it is also liable for the payment of the barristers' fees. Many firms will not be prepared to take this risk.

5.45 One way to avoid this risk is for a barrister to take on the case under a separate DBA. If the barrister is to be paid by the client via a direct DBA, it is the Sub-committee's view that the solicitor's DBA Payment plus the barrister's DBA Payment in relation to the same claim or Proceedings should not exceed the DBA Payment cap. For example, it should not be possible for a solicitor to charge a 30% DBA Payment and for a barrister to charge another 30% DBA Payment in respect of the same claim. In this sense, we agree with the 2019 DBA Reform Project that there is a "*public policy imperative in making sure that the legal representatives acting for the client cannot, in combination, recover more than the statutorily-set caps for DBA payments*".²⁰

5.46 Another way to avoid this risk is for a client to be able to engage the barrister *directly*, thus cutting out the solicitor. This is possible in Arbitration. In those circumstances, the barrister's fee would not fall within the DBA Payment and the solicitor would not be responsible for the barrister's fee out of his DBA Payment. For the same reasons, the barrister's fee would be outside the DBA Payment cap, because it would be an expense payable separately by the client.

5.47 The Redrafted 2019 DBA Regulations contemplate a client being able to choose whether to engage barristers through its solicitors (in which case the barrister's fees would lie *within* the DBA Payment) or directly (in which case the barrister's fee would lie *outside* the DBA Payment).

5.48 We agree with this, and see no reason why a solicitor should be required, regardless of what is agreed between solicitor and client, to take on the risk of paying the barrister if the claim fails, or of the DBA Payment being "consumed" by barrister's fee. In short, where a DBA is contemplated, the client should be able to choose (i) how to structure its legal representation and (ii) whether, and if so on what basis, to engage barristers.

¹⁹ The Damages-Based Agreements Regulations 2013, Regulation 4(1)(a)(ii).

²⁰ Professor Rachael Mulheron and Nicholas Bacon, QC, *Explanatory Memorandum – The 2019 DBA Reform Project* (2019), at 20.

Recommendation 9

- (1) The Sub-committee recommends that clients should be able to agree, on a case by case basis, whether:**
 - (a) the DBA Payment (and thus the DBA Payment cap) includes barristers' fees; or**
 - (b) barristers' fees would be charged as a separate disbursement outside the DBA Payment.**
- (2) To the extent that barristers can be, and are, engaged directly, this could also be arranged via a separate DBA between client and barrister. In such circumstances, a solicitor's DBA Payment plus a barrister's DBA Payment in relation to the same claim or Proceedings should not exceed the prescribed DBA Payment cap.**

Should Hybrid DBAs be allowed?

5.49 The 2019 DBA Reform Project has recommended that Hybrid DBAs should be permitted, and that it should be possible for a lawyer to charge the client as the case proceeds, under a discounted retainer.²¹ The reasons for permitting Hybrid DBAs are two-fold: (i) to aid cash flow, and to ensure that, for long-running matters, a solicitor can keep some money coming in; and (ii) to avoid the need for solicitors to enter into "side agreements" with Third Party Funders, who pay the solicitor's WIP as the case progresses under the Third Party Funder Hybrid DBAs, but who then may take percentage cuts from both solicitor and client.²²

5.50 Lord Justice Jackson has also expressly advocated for permitting Hybrid DBAs. In his 2014 Keynote, he put forward compelling arguments for the use of Hybrid DBAs, including:

- (a) DBA funding is particularly suited to long-running, high-risk commercial litigation, where some funding as the case proceeds would make the case more viable to take on;
- (b) the defendant/respondent is not affected whether the claimant's case is funded by a sole DBA, a Hybrid DBA or via a CFA. Hence, how the claimant chooses to fund its litigation is its own concern;
- (c) Hybrid DBAs are permitted in other jurisdictions, including in Canada and have not caused any problems. On the contrary, the

²¹ Same as above, at 14-15.

²² Same as above, at 15.

effect of the Canadian regime has been to increase access to justice;

- (d) permitting Hybrid DBAs in England and Wales would similarly enhance access to justice. In short, the more funding options open to the claimant, the better; and
- (e) Hybrid DBAs are very unlikely to encourage frivolous and speculative litigation, because the lawyer is unlikely to "invest" in the case if he considers the case to be weak.²³

5.51 Lord Justice Jackson also emphasised the illogicality of not allowing Hybrid DBAs, when CFAs could be used in hybrid form and Third Party Funders are permitted to fund cases on a hybrid basis under the Third Party Funder Hybrid DBA.²⁴

5.52 Having considered these arguments carefully, the Sub-committee is unanimously of the view that Hybrid DBAs should also be permitted.

5.53 We invite consultation on this, and seek submissions on whether there should be a cap on the portion of costs which the Lawyer is entitled to retain in the event that the claim loses, and, if so, what that cap should be.

5.54 For completeness, we note that the 2019 DBA Reform Project has recommended that any such payment should not exceed 30% of the costs incurred in pursuing the unsuccessful claim.²⁵ In other words, the Lawyer could charge the client fees as he goes, under a discounted retainer. However, in the event that no "financial benefit" or "compensation" is obtained, there will normally be no recoverable representative's costs. There will only be irrecoverable representative's costs, and the Lawyer can retain only 30% of those costs. The Sub-committee notes that this could lead to an anomalous situation, whereby a Lawyer might recover more of his fees if the client received no financial benefit from its claim, than if the client received only a low amount of financial benefit. Specifically, if the client received only a low financial benefit, and did not recover its costs or recovered only a small proportion of its costs, the Lawyer would likely recover less than the 30% he would be entitled to receive if the client lost the case outright.

5.55 In the Sub-committee's view, it is important that any Hybrid DBA regime in Hong Kong be structured to avoid this situation. For example, the relevant regulations could provide that, if the DBA Payment is less than the capped amount of irrecoverable costs, the Lawyer is entitled to retain the capped amount of irrecoverable costs instead of the DBA Payment.

²³ 2014 Keynote, at 3-5.

²⁴ Same as above, at 4.

²⁵ See Fn 20 above, at 15.

Recommendation 10

The Sub-committee recommends that Hybrid DBAs be permitted.

In the event that the claim is unsuccessful (such that no financial benefit is obtained), the Sub-committee invites submissions as to:

- (a) whether the Lawyer should be permitted to retain only a proportion of the costs incurred in pursuing the unsuccessful claim;**
- (b) if the answer to sub-paragraph (a) is "yes", what an appropriate cap should be in these circumstances; and**
- (c) if the answer to sub-paragraph (a) is "yes", whether the relevant regulations should provide that, if the DBA Payment is less than the capped amount of irrecoverable costs, the Lawyer is entitled to retain the capped amount of irrecoverable costs instead of the DBA Payment.**

Legislation

Simple and clear legislation

5.56 This recommendation should be read in conjunction with Recommendations 1 and 4. Amendments should be made to the applicable legislation, regulations and codes of conduct to remove the prohibitions (as necessary) on the use of CFAs, DBAs and Hybrid DBAs for Arbitration.

5.57 In order to avoid the ORFSs for Arbitration regime being plagued by satellite litigation, any amendments to the legal framework should be simple, clear and user-friendly.

Recommendation 11

The Sub-committee recommends that appropriate amendments in clear and simple terms be made to:

- (a) the Arbitration Ordinance;**
- (b) the Legal Practitioners Ordinance;**

- (c) **The Hong Kong Solicitors' Guide to Professional Conduct;**
 - (d) **the HKBA Code of Conduct; and**
 - (e) **any other applicable legislation or regulation**
- to provide (as applicable) that CFAs and/or DBAs and/or Hybrid DBAs are permitted under Hong Kong law for Arbitration.**

Detailed provisions in subsidiary legislation

5.58 In terms of the more detailed provisions required to implement the legal regime, we are of the view that this should be by way of stand-alone subsidiary legislation, and not by way of further amendments to the relevant Ordinances.

5.59 We consider that this will assist the overriding objective of creating a simple, user-friendly regime, that can be navigated easily by key stakeholders. It should also shorten (and simplify) the amendment process.

5.60 When drawing up relevant regulations for Hong Kong, reference could be made to the Conditional Fee Agreements Order 2013 and the Redrafted 2019 DBA Regulations in England and Wales.

5.61 Client-care provisions should be set out in professional codes of conduct so that trivial breaches can be dealt with simply and expeditiously by the professional bodies.

Recommendation 12

The Sub-committee recommends that the more detailed regulatory framework should be set out in subsidiary legislation which, like the legislative amendments referred to in Recommendation 11, should be simple and clear to avoid frivolous technical challenges. Client-care provisions should also be set out in professional codes of conduct so that trivial breaches can be dealt with expeditiously by the professional bodies.

Further consultation

5.62 There are a number of other areas where further consultation is desired.

5.63 We therefore invite submissions on:

- (a) what specific safeguards should be addressed in the professional codes of conduct and subsidiary legislation;
- (b) whether personal injury claims should be treated differently from other claims in Arbitration, by either (i) imposing a lower cap on any Success Fee or DBA Payment in respect of a personal injury claim that is submitted to Arbitration, or (ii) prohibiting Lawyers from entering into ORFSs in respect of personal injury claims that are submitted to Arbitration;
- (c) whether any other category of claim should be treated differently from other claims in Arbitration; and
- (d) whether a DBA Payment may be payable (depending on the terms agreed between Lawyer and client) wherever a financial benefit is received by the client, based on the value of that financial benefit.

Safeguards

5.64 As to the specific safeguards, these might include the following requirements:

- (a) that the CFA or DBA or Hybrid DBA (as the case may be) be in writing and signed by the client;
- (b) that the client be fully informed of the nature and operation of the CFA or DBA or Hybrid DBA (as the case may be) and confirm that it has been told of the right to seek independent legal advice;
- (c) the provision of a "cooling off" period during which the client may terminate the agreement by written notice;
- (d) (for CFAs) a definition of what constitutes a "successful outcome" (for example, judgment in the client's favour, or a concluded settlement agreement providing some or all of the relief sought by the client);
- (e) (for DBAs) the "financial benefit" to which the agreement relates;
- (f) the reasons for setting the amount of the payment or uplift at the level agreed;

- (g) the claim or proceedings, or parts of them (including any appeal or counterclaim) to which the agreement relates; and
- (h) the circumstances in which the lawyer's uplift/payment, expenses and costs, or part of them, are payable by the client, in the event that the agreement is terminated by the lawyer or by the client.

5.65 In addition, professional obligations might impose the following:

- (a) disclosure obligations on Lawyers to disclose the existence of a CFA or DBA or Hybrid DBA (as the case may be) to every other party to the Arbitration and the Tribunal (or court as relevant); and
- (b) a requirement that the client is to retain control over the conduct of the Arbitration, including the decision whether to settle.

Personal injury and other non-commercial claims

5.66 For the purpose of this Consultation Paper, "Arbitration" includes *"any arbitration, whether or not administered by a permanent arbitral institution"*,²⁶ together with related court, mediation or emergency arbitration proceedings under the Arbitration Ordinance. This definition is taken from Part 10A, which governs Third Party Funding of Arbitration in Hong Kong.

5.67 In the Sub-committee's view, personal injury claims are very unlikely to be arbitrated.

5.68 Where an injury occurs in the workplace, it will typically give rise to a claim for statutory compensation under the Employees' Compensation Ordinance (Cap 282). This is a statutory process that does not involve arbitration. Any claim for common law damages beyond the statutory compensation can, in principle, be arbitrated. In practice, arbitration of such claims is extremely rare.

5.69 Where an injury occurs outside the workplace, it is again more likely to be brought before the Hong Kong courts, eg as a claim in negligence or breach of statutory duty, than arbitrated. Unless there were an existing arbitration agreement in place between the perpetrator and the victim, the scope of which included personal injury, the parties would have to agree to arbitrate after the injury occurred. To the best of the Sub-committee's knowledge, this rarely occurs.

²⁶ Arbitration Ordinance, s 2.

5.70 Nevertheless it is, in principle, possible to refer a personal injury claim to arbitration in Hong Kong. In jurisdictions where ORFSs are permitted for personal injury claims, some lawyers engage in unscrupulous practices, eg by offering to represent accident victims in return for significant outcome related fees that benefit the lawyer to the detriment of the client. This is commonly known as "ambulance chasing". Such practices are obviously undesirable, not least because they target vulnerable individuals and undermine public confidence in the legal profession.

5.71 In light of this, the Sub-committee invites submissions on whether personal injury claims should be treated differently from other claims in Arbitration and, if so, whether this should be achieved by:

- (a) imposing a lower cap on any Success Fee or DBA Payment in respect of a personal injury claim that is submitted to Arbitration;²⁷ or
- (b) prohibiting Lawyers from entering into ORFSs in respect of personal injury claims that are submitted to Arbitration.

5.72 The Sub-committee also invites submissions on whether there are additional categories of claim that should be treated differently from other claims in Arbitration if ORFSs are introduced.

DBAs – meaning of "financial benefit"

5.73 In relation to DBAs and the meaning of "financial benefit", there is no reason, in our view, to restrict the DBA Payment to damages actually received by the client, so that the Lawyer must take on the enforcement risk regardless of what is agreed by the client. In this regard, we note that under a CFA, the Lawyer and client can agree on a definition of "success" that triggers payment of the Success Fee, with no requirement that "success" must include actual payment of damages. We see no reason for the position to be any different under a DBA.

5.74 If, therefore, DBAs are permitted, we consider that it should be clear that a DBA Payment may be payable (depending on the terms agreed between Lawyer and client):

- (a) wherever a "financial benefit" is received by the client, and based on the value of that financial benefit; and
- (b) where the term "financial benefit" could include:
 - (i) "money or money's worth", where this includes money, assets, security, tangible or intangible property, services

²⁷ English law imposes a lower cap on ORFSs for personal injury claims than for other claims. Specifically, personal injury claims at first instance are subject to a cap of 25% of the DBA Payment. See s 58 of the CLSA and Article 4 of the Conditional Fee Agreements Order 2013.

- and any other consideration reducible to a monetary value;
- (ii) a debt owed to a client, eg under a judgment or settlement, rather than money or property actually received; and/or
 - (iii) liability on the part of the client for a lesser sum than claimed, or a lesser sum than an agreed threshold, so that DBAs may be used by the respondents.

Recommendation 13

The Sub-committee invites submissions on:

- (a) Whether and how the professional codes of conduct and/or regulations should address what other safeguards are needed. For example to:**
 - (i) be clear in what circumstances a Lawyer's fees and expenses, or part of them, will be payable;**
 - (ii) include a requirement under professional conduct obligations to give the client all relevant information relating to the ORFS that is being entered into, and to provide that information in a clear and accessible form;**
 - (iii) require a claimant using CFAs or DBAs or Hybrid DBAs to notify the respondent and Tribunal of this fact;**
 - (iv) inform clients of their right to take independent legal advice; and**
 - (v) be subject to a "cooling-off" period.**
- (b) What should be the relevant method and criteria for fixing "Success Fees" in CFAs.**
- (c) Whether personal injury claims should be treated differently from other claims in Arbitration, by:**
 - (i) imposing a lower cap on any Success Fee or DBA Payment in respect of a personal injury claim that is submitted to Arbitration; or**
 - (ii) prohibiting Lawyers from entering into ORFSs in respect of personal injury claims that are submitted to Arbitration.**

- (d) Whether any additional category/ies of claim should be treated differently from other claims that are submitted to Arbitration if ORFSs are introduced.**
- (e) Whether a DBA Payment may be payable (depending on the terms agreed between Lawyer and client) wherever a financial benefit is received by the client, based on the value of that financial benefit.**
- (f) Whether the relevant financial benefit may be a debt owed to a client, eg under a judgment or settlement, rather than money or property actually received.**
- (g) Whether provision should be made for cases in which the result will not involve monetary damages by providing a definition of money or money's worth that includes consideration reducible to a monetary value.**
- (h) Whether respondents should be permitted to use DBAs, eg to provide for a DBA Payment in the event the respondent is held liable for less than the amount claimed or less than an agreed threshold.**

5.75 For similar reasons, we consider that the legal regime for ORFSs for Arbitration should make it clear that Lawyers and legal practices should be permitted to charge separately for work done in relation to separate but related aspects of the Arbitration – eg counterclaims, enforcement actions, or appeals. By way of illustration, in the context of a DBA, it should be up to the client and the representative to negotiate whether one DBA is entered into in respect of the relevant claim, and a separate DBA for the counterclaim. In circumstances where a DBA Payment relies on the client receiving a "financial benefit" and not "damages recovered", this allows considerable flexibility for the client and the Lawyer to negotiate and agree what constitutes a financial benefit in the context of the particular case in which the DBA is being used.

Recommendation 14

The Sub-committee recommends that Lawyers and legal practices should be permitted to charge separately for work done in relation to separate but related aspects of the Arbitration, such as counterclaims, enforcement actions and appeals.

Chapter 6

Summary of recommendations

CFAs

Recommendation 1

The Sub-committee recommends that prohibitions on the use of CFAs in Arbitration by Lawyers should be lifted, so that Lawyers may choose to enter into CFAs for Arbitration. (Paras 5.1-5.5)

Recommendation 2

Where a CFA is in place, the Sub-committee recommends that any Success Fee and ATE Insurance premium agreed by the claimant with its Lawyers and insurers respectively should not be recoverable from the respondent. (Paras 5.6-5.13)

Recommendation 3

Where a CFA is in place, the Sub-committee recommends that there should be a cap on the Success Fee which is expressed as a percentage of normal or "benchmark" costs. The Sub-committee invites proposals on what an appropriate cap should be, up to a maximum of 100%.

The Sub-committee also invites proposals on whether barristers should be subject to the same, or a different, cap and, if different, what that cap should be, up to a maximum of 100%. (Paras 5.14-5.17)

DBAs

Recommendation 4

The Sub-committee recommends that prohibitions on the use by Lawyers of DBAs in Arbitration should be lifted, so that Lawyers may use DBAs for Arbitration. (Paras 5.18-5.24)

Recommendation 5

Where a DBA is in place, the Sub-committee recommends that any ATE Insurance premium agreed by the claimant with its insurers should not be recoverable from the respondent. (Para 5.25)

Recommendation 6

The Sub-committee invites submissions on whether the Ontario model or the Success fee model should apply to DBAs.

It is the Sub-committee's preliminary view that the 2019 DBA Reform Project's recommendation to move to a Success fee model should be followed. (Paras 5.26-5.30)

Recommendation 7

The Sub-committee recommends that there should be a cap on the DBA Payment, which should be expressed as a percentage of the "financial benefit" or "compensation" received by the client. The cap should be fixed after consultation.

The Sub-committee is of the view that there is scope for capping the maximum DBA Payment at less than the 50% cap currently adopted in England and Wales for commercial claims, particularly if the Success fee model is adopted, and that an appropriate range for consultation is 30% to 50%. (Paras 5.31-5.35)

Recommendation 8

The Sub-committee recommends that a CFA, DBA, or Hybrid DBA should specify whether, and if so in what circumstances:

- (a) a Lawyer or client is entitled to terminate the fee agreement prior to the conclusion of Arbitration; and if so
- (b) any alternative basis (for example, hourly rates) on which the client shall pay the Lawyer in the event of such termination. (Paras 5.36-5.43)

Recommendation 9

- (1) The Sub-committee recommends that clients should be able to agree, on a case by case basis, whether:
 - (a) the DBA Payment (and thus the DBA Payment cap) includes

barristers' fees; or

- (b) barristers' fees would be charged as a separate disbursement outside the DBA Payment.
- (2) To the extent that barristers can be, and are, engaged directly, this could also be arranged via a separate DBA between client and barrister. In such circumstances, a solicitor's DBA Payment plus a barrister's DBA Payment in relation to the same claim or Proceedings should not exceed the prescribed DBA Payment cap. (Paras 5.44-5.48)

Hybrid DBAs

Recommendation 10

The Sub-committee recommends that Hybrid DBAs be permitted.

In the event that the claim is unsuccessful (such that no financial benefit is obtained), the Sub-committee invites submissions as to:

- (a) whether the Lawyer should be permitted to retain only a proportion of the costs incurred in pursuing the unsuccessful claim;
- (b) if the answer to sub-paragraph (a) is "yes", what an appropriate cap should be in these circumstances; and
- (c) if the answer to sub-paragraph (a) is "yes", whether the relevant regulations should provide that, if the DBA Payment is less than the capped amount of irrecoverable costs, the Lawyer is entitled to retain the capped amount of irrecoverable costs instead of the DBA Payment. (Paras 5.49-5.55)

Legislation

Recommendation 11

The Sub-committee recommends that appropriate amendments in clear and simple terms be made to:

- (a) the Arbitration Ordinance;
- (b) the Legal Practitioners Ordinance;
- (c) The Hong Kong Solicitors' Guide to Professional Conduct;
- (d) the HKBA Code of Conduct; and

- (e) any other applicable legislation or regulation

to provide (as applicable) that CFAs and/or DBAs and/or Hybrid DBAs are permitted under Hong Kong law for Arbitration. (Paras 5.56-5.57)

Recommendation 12

The Sub-committee recommends that the more detailed regulatory framework should be set out in subsidiary legislation which, like the legislative amendments referred to in Recommendation 11, should be simple and clear to avoid frivolous technical challenges. Client-care provisions should also be set out in professional codes of conduct so that trivial breaches can be dealt with expeditiously by the professional bodies. (Paras 5.58-5.61)

Further consultation

Recommendation 13

The Sub-committee invites submissions on:

- (a) Whether and how the professional codes of conduct and/or regulations should address what other safeguards are needed. For example to:
 - (i) be clear in what circumstances a Lawyer's fees and expenses, or part of them, will be payable;
 - (ii) include a requirement under professional conduct obligations to give the client all relevant information relating to the ORFS that is being entered into, and to provide that information in a clear and accessible form;
 - (iii) require a claimant using CFAs or DBAs or Hybrid DBAs to notify the respondent and Tribunal of this fact;
 - (iv) inform clients of their right to take independent legal advice; and
 - (v) be subject to a "cooling-off" period.
- (b) What should be the relevant method and criteria for fixing "Success Fees" in CFAs.
- (c) Whether personal injury claims should be treated differently from other claims in Arbitration, by:
 - (i) imposing a lower cap on any Success Fee or DBA Payment in respect of a personal injury claim that is submitted to Arbitration; or

- (ii) prohibiting Lawyers from entering into ORFSs in respect of personal injury claims that are submitted to Arbitration.
- (d) Whether any additional category/ies of claim should be treated differently from other claims that are submitted to Arbitration if ORFSs are introduced.
- (e) Whether a DBA Payment may be payable (depending on the terms agreed between Lawyer and client) wherever a financial benefit is received by the client, based on the value of that financial benefit.
- (f) Whether the relevant financial benefit may be a debt owed to a client, eg under a judgment or settlement, rather than money or property actually received.
- (g) Whether provision should be made for cases in which the result will not involve monetary damages by providing a definition of money or money's worth that includes consideration reducible to a monetary value.
- (h) Whether respondents should be permitted to use DBAs, eg to provide for a DBA Payment in the event the respondent is held liable for less than the amount claimed or less than an agreed threshold.
(Paras 5.62-5.74)

Recommendation 14

The Sub-committee recommends that Lawyers and legal practices should be permitted to charge separately for work done in relation to separate but related aspects of the Arbitration, such as counterclaims, enforcement actions and appeals. (Para 5.75)