THE LAW REFORM COMMISSION OF HONG KONG

OUTCOME RELATED FEE STRUCTURES FOR ARBITRATION SUB-COMMITTEE

CONSULTATION PAPER

EXECUTIVE SUMMARY

(This executive summary is an outline of the Consultation Paper issued to elicit public response and comment on the Sub-committee's questions, and it adopts the same abbreviations and defined terms in the Consultation Paper. Those wishing to comment should refer to the full text of the Consultation Paper, which can be downloaded from the Commission's website at: http://www.hkreform.gov.hk or obtained from the Secretariat of the Law Reform Commission, 4th Floor, East Wing, Justice Place, 18 Lower Albert Road, Central, Hong Kong.

Comments should be submitted to the Outcome Related Fee Structures for Arbitration Sub-committee Secretary by 16 March 2021.)

Introduction

Terms of reference

1. The terms of reference of the Law Reform Commission of Hong Kong's Sub-committee on Outcome Related Fee Structures for Arbitration ("Sub-committee") 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."*

2. Since the formation of the Sub-committee in October 2019, it has conducted a review of the law and practice in the Hong Kong Special Administrative Region of the People's Republic of China ("Hong Kong") and analysed the legal regime for outcome related fees in a number of other jurisdictions. The Sub-committee seeks the public's comments on:

(1) Whether Outcome Related Fee Structures (as defined in paragraph 3 below) should be permitted for Arbitration[1] in Hong Kong;

(2) If so, which types of Outcome Related Fee Structures should be permitted:

[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.

(a) Conditional Fee Agreements[2] ("CFAs");
(b) Damages-based Agreements[3] ("DBAs"); and/or
(c) Hybrid Damages-based Agreements[4] ("Hybrid DBAs"); and

(3) What changes to Hong Kong law and regulations are required to enable any such reform.

Chapter 1: Background to the Sub-committee's proposal

What are Outcome Related Fee Structures?

3. An "Outcome Related Fee Structure" ("ORFS") is an agreement between a Lawyer[5] and client, whereby the Lawyer advises on litigation or arbitration proceedings ("Proceedings") which are contentious and the Lawyer receives a financial benefit if those Proceedings are successful within the meaning of that agreement. For the purposes of the Consultation Paper, ORFSs include CFAs, DBAs and Hybrid DBAs.

Are ORFSs permitted in Hong Kong?

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;

(e) Paragraph 6.3(a) of the Hong Kong Bar Association ("HKBA") Code of Conduct;

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2 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 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).

3 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.

4 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.

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

(f) Paragraph 9.9 of the HKBA Code of Conduct;[6]

(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").

Chapter 2: Previous LRC consideration of CFAs and Third Party Funding

5. The Law Reform Commission of Hong Kong ("LRC") had previously considered the introduction of CFAs for Proceedings, not limited to Arbitration, between 2003 and 2007. It also considered Third Party Funding[7] for Arbitration (outside of the lawyer-client relationship) between 2013 and 2016.

Conditional fees for Hong Kong Proceedings

6. In the report published by the LRC in July 2007 ("2007 LRC Report"), it was stated that the proposed regime for conditional fees had received little support from professional bodies (both legal and non-legal) and there was "*very little support*" from the insurance sector.[8] The response from individual lawyers and firms was more mixed, but the majority rejected the proposals.[9] 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*".[10]

Third Party Funding

7. In October 2015, the Third Party Funding for Arbitration Sub-committee of the LRC published the consultation paper on Third Party Funding for Arbitration, followed by the report on Third Party Funding for Arbitration in October 2016, recommending amendments to the then legislation to allow for Third Party Funding for Arbitration. The consequent legislative amendments entered fully into force on 1 February 2019.

8. The newly enacted section 98O of the Arbitration Ordinance 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. The Sub-committee is of the opinion that this definition is broad enough

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6 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).

7 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.

8 2007 LRC Report, at para 7.5.

9 Same as above.

10 Same as above, at 154.

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

Chapter 3: Overview of the position in other jurisdictions

9. 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. 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.

10. 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.[11] 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. This Chapter considers the position of each of these arbitral seats.

Singapore

11. Singapore-based local and foreign lawyers are prohibited from entering into ORFSs under prevailing professional conduct rules. 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.[12] As at the date of the Consultation Paper, the results of the Singapore consultation have not been released to the public.

England and Wales

CFAs

12. The ban on CFAs was initially relaxed, to a certain extent, by the introduction of the Courts and Legal Services Act 1990 ("CLSA"). The then section 58(3) of the CLSA acted as a statutory bar to prevent a CFA from being

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11 The term "Mainland China" is used in the Consultation Paper to mean the People's Republic of China excluding Hong Kong, Macao Special Administrative Region and Taiwan.

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

unenforceable on the grounds of public policy. The then section 58(8) of the CLSA specifically prohibited recovery of the Success Fee[13] from the losing party.

13. 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.[14] It also allowed lawyers to claim Success Fees of up to 100% of their normal fees.[15]

14. The introduction of CFAs led to the development of an After-the-Event Insurance[16] ("ATE Insurance") market in England and Wales. Nevertheless, the then section 58(8) of the CLSA ban on recovering Success Fees or ATE Insurance premiums from the losing party was seen as a significant barrier to claimants accessing the courts.

15. Following a consultation, the Access to Justice Act 1999 ("AJA") came into force. Section 27 of the AJA replaced the then section 58 of the CLSA,[17] broadening the scope of CFAs, and removing the ban on recovery of Success Fees and ATE Insurance premiums. The AJA provoked criticism for allowing claimants to bring claims without any financial risk, encouraging unmeritorious claims and leading to satellite proceedings.

16. 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*".[18] 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.

17. Following the consultation on the amendments recommended in the Jackson Report, England and Wales 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. Section 44 of the LASPO provides that Success Fees are no longer recoverable from the losing party in contentious proceedings.[19] Similarly, section 46 of the LASPO provides that ATE Insurance premiums are no longer recoverable. These two reforms were implemented by the Conditional Fee Agreements Order 2013.

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

14 The Conditional Fee Agreements Order 1995, Article 2.

15 Same as above, Article 3.

16 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.

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

18 The Jackson Report, at xvi.

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

DBAs

18. The Jackson Report recommended introducing DBAs to balance the impact of abolishing recoverability of the Success Fee element of CFAs.[20] This recommendation to introduce DBAs was 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 return for a share of any damages awarded. DBAs are available only to claimants (or counterclaimants), but not respondents.

19. In the event the claim is successful, the claimant currently recovers its costs under the "Ontario model".[21] 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.

20. 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. DBA Payments in civil proceedings are subject to a cap of 50% (including Value Added Tax) of the sums ultimately recovered by the client.[22]

21. In the 2019 DBA Reform Project,[23] 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;[24]

(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;

(c) permitting Hybrid DBAs;

(d) clarifying that termination clauses may be included in DBAs; and

(e) addressing cases in which the result will not involve monetary damages

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20 The Jackson Report, at 131.

21 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://hsfnotes.com/litigation/jackson-reforms/contingency-fees-or-damages-based-agreements-dbas/, accessed on 2 November 2020.

22 2013 DBA Regulations, Regulation 4(3).

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

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

by providing a definition for money or money's worth that includes consideration reducible to a monetary value.[25]

22. It remains to be seen whether the UK Government will adopt the Redrafted 2019 DBA Regulations.

Australia

23. 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.[26] For contentious Proceedings, the uplift fee is subject to a cap of 25% over the regular legal costs payable (excluding disbursements).[27] 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).

Mainland China

24. The National Development and Reform Commission and the People's Republic of China ("PRC") Ministry of Justice jointly issued the *Measures for the Administration of Lawyers' Fees*[28] on 13 April 2006 ("2006 Measures"), which came into effect on 1 December 2006 and explicitly affirmed ORFSs. Pursuant to Article 4 of the 2006 Measures, government guiding price[29] and market-regulated price shall apply to the service fees charged by lawyers.[30] 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

(d) requests for labour remuneration and so forth.[31]

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

26 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.

27 "*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.

28 《律師服務收費管理辦法》

29 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.

30 2006 Measures, Article 4.

31 Same as above, Article 11.

25. ORFSs are also prohibited in criminal litigation, administrative litigation, State compensation cases, and class actions.[32] 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.[33] 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*".[34]

United States of America

26. 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.[35] The use of CFAs seems to be less common. There is no uniform application of DBAs; the rules vary from state to state. 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*".[36]

27. 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*".[37] 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. 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.

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32 Same as above, Article 12.

33 Same as above, Article 13.

34 Same as above; 收費合同約定標的額的30%。

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

36 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.

37 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 Adrian Yeo, "Access to Justice: A Case for Contingency Fees in Singapore" (2004) 16 SAcLJ 76, at 76.

Other relevant jurisdictions

Jurisdiction	CFA	DBA	Hybrid DBA
France[38]	Permitted (Success Fee must be reasonable)	Permitted for arbitration[39] Not permitted for litigation[40]	Permitted
Sweden[41]	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[42]	Permitted	Not permitted	Permitted (Switzerland permits "success bonuses" for Swiss lawyers)
South Korea[43]	Permitted (Success Fee must not be excessive)	Permitted (DBA Payment must not be excessive)	Not permitted

38 Law No. 2015-990 of 6 August 2015.
39 Decision of the Cour d'appel de Paris 1re ch. B 10-07-1992 N° [XP100792X], 10 July 1992.
40 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.
41 Code of Professional Conduct for Members of the Swedish Bar Association, Article 4.2.
42 Federal Act on the Freedom to Practise in Switzerland (Bundesgesetz über die Freizügigkeit der Anwältinnen und Anwälte), 1 June 2002, Article 12.
43 Civil Act, Article 686; Supreme Court of Korea, Decision 2015Da200111, 23 July 2015.

Chapter 4: Arguments for and against ORFSs for Arbitration

Summary table of arguments for and against ORFSs for Arbitration

Arguments for ORFSs for Arbitration	
1	<u>Preserve and promote Hong Kong's competitiveness as a leading arbitration centre</u> Each of the arbitral seats discussed in Chapter 3 (with the exception of Singapore) permits some form of ORFSs for Arbitration. All permit CFAs. Some of them also permit either DBAs or Hybrid DBAs. 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.
2	<u>Access to justice</u> 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.
3	<u>Respond to client demand and provide pricing flexibility</u> 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. Permitting Lawyers to use ORFSs will give clients much greater flexibility in how they pursue claims and structure their disputes portfolios.
4	<u>Support freedom of contract</u> 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.
5	<u>Weed out weak claims</u> ORFSs provide clear incentives for Lawyers in respect of the cases which they do pursue, and discourage them from acting

Arguments for ORFSs for Arbitration	
	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).
6	<u>Enable Lawyers in Hong Kong to compete on an even playing field</u> 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. Moreover, 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. 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 ORFSs for Arbitration	
1	<u>Risk of conflict of interest and unprofessional conduct</u> A lawyer acting on the basis of an ORFS has a direct interest in the outcome of the Proceedings, and consequently, 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.
2	<u>Increase in opportunistic and frivolous litigation</u> 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.[44]
3	<u>Excessive legal fees</u> There is concern for the risk of lawyers receiving excessive fees, usually 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.[45]

44 The LRC, *Consultation Paper on Conditional Fees* (2005), at 114.

45 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.

Arguments against ORFSs for Arbitration	
	It is also 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.[46]
4	Reliance on ATE Insurance / litigation insurance The availability of stable and affordable ATE Insurance has also been identified as an important element of a successful ORFS regime. However, there is uncertainty about the availability of ATE Insurance in Hong Kong.
5	Increase in satellite litigation There is a 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, and can be mitigated by having a regime where any Success Fee and/or ATE Insurance premium agreed by the claimant with its Lawyers and insurers are not recoverable from the losing party, and (in the case of DBAs) by adopting the Success fee model (discussed below)[47].

Other considerations	
1	Impact on barristers 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*". [48] It was observed in England and Wales that barristers were increasingly involved in riskier cases, and as a consequence, reluctant to accept "conditional fee arrangements".[49] 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.[50]

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

47 Success fee model is discussed in paras 67 to 68 of this Executive Summary.

48 2007 LRC Report, at para 6.85.

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

50 Same as above, at 143.

Other considerations	
2	<u>Proliferation of claims intermediaries</u> The 2007 LRC Report noted that it was difficult to predict what impact, if any, allowing lawyers to charge "conditional fees" would have on claims intermediaries.[51] In the Sub-committee's view, the concerns about claims intermediaries relate principally to personal injury and employment litigation and are of limited relevance to Arbitration.
3	<u>Increase in financial burden on small and medium-sized law firms</u> 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.[52] 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.
4	<u>Adverse costs orders</u> 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.[53]

28. After careful analysis as detailed in Chapter 4 of the Consultation Paper, 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.

29. 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.

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51 2007 LRC Report, at para 6.54.

52 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.

53 *Arkin v Borchard Lines Lt*d [2005] EWCA Civ 655.

Specific considerations in relation to DBAs and Hybrid DBAs

30. 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. In fact, once it is determined to permit some form of ORFSs for Arbitration, 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).

32. 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.

Arguments in favour of DBAs

33. 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.[54]

(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.[55]

Arguments against DBAs

34. 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.

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

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

(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.[56]

35. 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

36. 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,[57] on top of the recoverable costs incurred to successfully pursue the claim.

37. 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 different, in that costs recovered from the opponent 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.

38. 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.

(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.

(d) The Success fee model is likely to enhance access to justice in low-value claims. [58]

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56 Same as above, at 193-194.

57 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.

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

Hybrid DBAs

39. *The Damages-Based Agreements Reform Project: Drafting and Policy Issues*, published in 2015 by the Civil Justice Council of England and Wales ("CJC Report") noted that the UK Government's opposition to Hybrid DBAs[59] 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; and

(e) DBAs are a new form of funding, and the UK Government is concerned to ensure that they develop carefully and cautiously.[60]

40. 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 the case goes, under a discounted retainer. 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

(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").[61] [62]

41. 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 put forward compelling arguments for the use of Hybrid DBAs (in addition to DBAs) (detailed in paragraphs 4.96-4.97 of the Consultation Paper).

42. The Sub-committee is strongly of the view that if DBAs are permitted, Hybrid DBAs should be permitted too. In reaching this conclusion, the Sub-

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

60 The CJC Report, at 74-75.

61 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.

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

committee is mindful of the fact that 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 of a Hybrid DBA (at least from the Lawyer's perspective) using a Third Party Funder Hybrid DBA.

Chapter 5: Recommendations

Conditional Fee Agreements (CFAs)

Should CFAs be allowed?

43. We consider that Lawyers should be permitted to use CFAs in Arbitration 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.

44. 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).

45. 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 above, these include greater access to justice, increased flexibility in pricing and the alignment of interests between Lawyers and clients.

46. 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.

47. 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

48. 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.

49. 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.[63]

50. 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.

51. We agree with these reforms, and they underpin the basis of this recommendation. Indeed, in its February 2019 report *Post-Implementation Review of Part 2 of the Legal Aid, Sentencing and Punishment of Offenders Act 2012*, 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.[64]

52. We also agree with the statement in the Consultation Paper published by the Conditional Fees Sub-committee of the LRC in September 2005 that it would be "*inequitable, irrational and unfair to make insurance premiums and success fee recoverable from the losing party*".[65]

53. For all of the reasons set out in paragraphs 5.6-5.12 of the Consultation Paper, 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.

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63 The Jackson Report, at Ch 4.

64 UK Ministry of Justice, *Post-Implementation Review of Part 2 of the Legal Aid, Sentencing and Punishment of Offenders Act 2012* (2019), CP 38, at 6.

65 The LRC, *Consultation Paper on Conditional Fees* (2005), at para 7.11.

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

54. 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.[66] In Australia, for contentious proceedings the Success Fee is subject to a lower cap of 25% (excluding disbursements) of the legal fees otherwise payable.[67]

55. 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.[68]

56. The Sub-committee invites proposals on what that cap should be, and why.

57. The Sub-committee also invites proposals 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%.

66 The Conditional Fee Agreements Order 2013, Article 3.

67 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.

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

Damages-based Agreements (DBAs)

Should DBAs be allowed?

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

59. 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.

60. In the Sub-committee's view, there is merit in the propositions by the UK Government, and the recommendations made by Lord Justice Jackson set out in paragraphs 5.19-5.20 of the Consultation Paper. This is particularly so in the context of Arbitration, where parties are, on the whole, commercial entities or business people familiar with negotiating commercial terms, and related pricing for those services.

61. 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.[69]

62. 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.

63. 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.

[69] 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.

Non-recoverability of ATE Insurance premiums

64. 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.

Fee model and treatment of recoverable costs

65. In England and Wales, the recovery of costs in a DBA context is currently based on the so-called "Ontario model".[70] This model was ultimately implemented by the 2013 DBA Regulations.

66. 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.[71]

67. One of the recommendations of the 2019 DBA Reform Project is to switch to the Success fee model.[72] 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.

68. Under the Success fee model, the DBA Payment includes only irrecoverable representative's[73] 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.

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70 The damages-based fee regime which operates in Ontario, Canada, as described in paragraphs 19 and 20 above.

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

72 The damages-based fee regime proposed in the 2019 DBA Reform Project in England and Wales, as described in paragraph 37 above.

73 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*".

69. In England and Wales, if a barrister is directly engaged by the client, the barrister's fee would 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).[74]

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

70. 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.

71. 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.

72. 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.

73. Similar caps apply in other jurisdictions. For example, a 30% cap applies in Mainland China.[75]

74. We are of the view that a cap should also be applied in Hong Kong. We invite proposals 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.

[74] This is discussed in paras 70 to 74 of this Executive Summary.

[75] 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

75. 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.

76. This issue was specifically considered in the CJC Report of 2015. At that time, the Civil Justice Council Working Group for the Damages-Based Agreements Reform Project concluded that the grounds and manner of termination of a DBA, and the consequences of termination, were best left to negotiation between the lawyer and the client in the DBA itself.[76] 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.[77] Further, the ability to draft a suitable DBA was sufficient protection for the lawyer against inappropriate termination by the client.[78] Relevantly, however, this latter view assumed that a clause dealing with any such termination by the client would not invalidate the DBA.

77. 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.[79] 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.

78. This issue has been addressed by the 2019 DBA Reform Project, Regulation 6 of the Redrafted 2019 DBA Regulations, as detailed in paragraphs 5.40-5.41 of the Consultation Paper.

79. 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.

80. 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

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76 The CJC Report, at 107.
77 Same as above.
78 Same as above.
79 *Lexlaw Ltd v Zuberi* [2020] EWHC 1855 (Ch).

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.

Treatment of barristers' fees

81. 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.[80] 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.

82. 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.

83. 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.

84. 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).

85. 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

[80] 2013 DBA Regulations, Regulation 4(1)(a)(ii).

choose (i) how to structure its legal representation and (ii) whether, and if so on what basis, to engage barristers.

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.

Hybrid Damages-based Agreements (Hybrid DBAs)

Should Hybrid DBAs be allowed?

86. 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.[81] 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.[82]

87. In his 2014 Keynote, Lord Justice Jackson put forward compelling arguments for the use of Hybrid DBAs as set out in paragraphs 5.50-5.51 of the Consultation Paper.

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

89. We invite public views 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.

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81 Professor Rachael Mulheron and Nicholas Bacon, QC, *Explanatory Memorandum – The 2019 DBA Reform Project* (2019), at 14-15.

82 Same as above, at 15.

90. 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.[83] 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.

91. 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.

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.

[83] Same as above.

Legislation

Simple and clear legislation

92. 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.

93. 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

94. 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.

95. 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.

96. 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.

97. 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

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

Safeguards

99. We invite submissions on what specific safeguards should be put in place in the professional codes of conduct of the two legal professional bodies and in subsidiary legislation.

100. Possible requirements for the specific safeguards (set out in paragraph 5.64 of the Consultation Paper) might include:

(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; and

(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).

101. 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[84] (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.

[84] 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.

Personal injury and other non-commercial claims

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

103. 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;[85] or

(b) prohibiting Lawyers from entering into ORFSs in respect of personal injury claims that are submitted to Arbitration.

104. 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"

105. 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.

106. 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 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

[85] 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.

(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.

107. 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. 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.