

THE LAW REFORM COMMISSION OF HONG KONG

REPORT

**OUTCOME RELATED FEE STRUCTURES
FOR ARBITRATION**

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December 2021

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The members of the Commission at present are:

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Secretary for Justice*

Members: *The Hon Chief Justice Andrew Cheung, GBM
The Hon Mr Justice Johnson Lam,
Permanent Judge of the Court of Final Appeal
Mr Michael Lam, Law Draftsman
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Ms May Chan, SBS, JP
Professor Cheng Han Tan
Professor Lutz-Christian Wolff
Professor Hualing Fu
Mr Stephen Hung
Mrs Janice Choi, BBS, MH, JP
Mr Chak Ming Chan
Mrs Margaret Leung, SBS, JP*

The Secretary of the Commission is **Mr Wesley Wong, SC, JP, Law Officer** and the Commission's offices are at:

***4/F East Wing, Justice Place
18 Lower Albert Road
Central
Hong Kong***

***Telephone: 3918 4097
Fax: 3918 4096
E-mail: hklrc@hkreform.gov.hk
Website: <http://www.hkreform.gov.hk>***

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Defined Terms

Abbreviation

Definition

2019 DBA Reform Project

An independent review of the Damages-Based Agreements Regulations 2013 in England and Wales by Professor Rachael Mulheron and Mr Nicholas Bacon, QC during 2019 to 2020.

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 only in the event of a successful outcome for the client in the matter.

CFAs include arrangements where:

- (a) the Lawyer charges no fee during the course of the Proceedings, and is paid only in the event of a successful outcome for the client in the matter (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 only in the event of a successful outcome for the client in the

matter (also known as a "no win, low fee" agreement).

Consultation Paper

The Consultation Paper on Outcome Related Fee Structures for Arbitration issued by the Subcommittee on 17 December 2020.

DBA

Damages-based Agreement.

An agreement between a Lawyer and client whereby the Lawyer receives payment only if the client obtains a Financial Benefit in the matter, and where the payment is calculated by reference to the Financial Benefit that is obtained, ie a percentage of the Financial Benefit. 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.

Also known as a "contingency fee" or a "damages-based fee".

Financial Benefit

Money or money's worth, but does not include any sum awarded in respect of recoverable Lawyer's costs or recoverable expenses.

HKBA

Hong Kong Bar Association.

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 agrees with the client to be paid a DBA Payment only in the event the client obtains a Financial Benefit in the matter and also fees (typically discounted) for legal services rendered during the course of the matter.

Also known as a "no win, low fee" arrangement.

Law Society	The Law Society of Hong Kong.
Lawyer	A person who is qualified to practise the law of any jurisdiction, including Hong Kong. For the purposes of this Report, "Lawyer" includes (but is not limited to) Hong Kong barristers, solicitors and Registered foreign lawyers.
Legal Expense Insurance	<p>A contract of insurance that provides reimbursement to a client or a lawyer for some or all of the legal fees, adverse costs or disbursements incurred in respect of a matter.</p> <p>Legal Expense Insurance includes ATE Insurance.</p>
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 Report) excluding Hong Kong, Macao Special Administrative Region and Taiwan.
Money or money's worth	Money, assets, security, tangible or intangible property, services, any amount owed under an award, settlement agreement or otherwise, and any other consideration reducible to a monetary value, including any avoidance or reduction of a potential liability.
Ontario model	<p>The damages-based fee regime which operates in Ontario, Canada, whereby:</p> <ul style="list-style-type: none"> (a) the recoverable costs of the claimants will be assessed in the conventional way, and (b) if the 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.

ORFS	<p>Outcome Related Fee Structure.</p> <p>For the purposes of this Report, "ORFS" means any of the following agreements made between a Lawyer and client:</p> <ul style="list-style-type: none"> (a) CFAs; (b) DBAs; (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.
Redrafted 2019 DBA Regulations	The redrafted Damages-Based Agreements Regulations 2019 proposed in the 2019 DBA Reform Project.
Report	The Report on Outcome Related Fee Structures for Arbitration issued by the Sub-committee.
Sub-committee	Outcome Related Fee Structures for Arbitration Sub-committee of the LRC.
Success Fee	<p>Additional fee in respect of the claim or Proceedings that the client agrees to pay the Lawyer in accordance with a CFA only in the event of a successful outcome for the client in the matter.</p> <p>The Success Fee can be an agreed flat fee, or calculated as a percentage "uplift" on the fee that the Lawyer would have charged if there were no ORFS in place during the course of the Proceedings.</p>
Success fee model	The damages-based fee regime proposed in the 2019 DBA Reform Project in England and Wales, whereby costs recovered from the opponent are outside of, and additional to, the DBA Payment.
Success Fee premium	Portion of the Success Fee which exceeds the amount of fees which would be payable to the Lawyer if there were no ORFS in place.

Third Party Funder

A provider of Third Party Funding.

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.

Tribunal

An arbitral tribunal, consisting of a sole arbitrator or a panel of arbitrator(s), and includes an umpire, established by the agreement of the parties to finally resolve disputes or differences by arbitration.

Chapter 1

Introduction

1.1 This report ("**Report**") discusses the responses received to the consultation paper issued by the Law Reform Commission's Outcome Related Fee Structures for Arbitration Sub-committee ("**Sub-committee**") in December 2020 ("**Consultation Paper**"),¹ and sets out our analysis and final recommendations on outcome related fee structures for Arbitration² and related matters.

1.2 The Report includes a set of draft provisions to amend the Legal Practitioners Ordinance (Cap 159) ("**Legal Practitioners Ordinance**") and the Arbitration Ordinance (Cap 609) ("**Arbitration Ordinance**") of Hong Kong, as well as recommended safeguards to be included in related subsidiary legislation. These are attached respectively at Annexes 1 and 2 to the Report.³

Background

What are Outcome Related Fee Structures?

1.3 For the purposes of this Report, an outcome related fee structure ("**ORFS**") means any of the following agreements made between a Lawyer⁴ and client: conditional fee agreements ("**CFAs**"), damages-based agreements ("**DBAs**") and hybrid damages-based agreements ("**Hybrid DBAs**").

1.4 A CFA is an agreement pursuant to which a Lawyer agrees with the client to be paid a Success Fee which is an additional fee to be paid only in the event of a successful outcome for the client in the matter. Relevantly, the Success Fee is not calculated as a proportion of the amount awarded to or recovered by the client. Instead, the client agrees to pay an additional fee which is an agreed flat fee or is pegged to the "benchmark" rates or fees that the Lawyer would have charged, if there were no ORFS in place during the course of the litigation or arbitration proceedings ("**Proceedings**").

¹ Apart from setting out the Sub-committee's Recommendations, the Report will not repeat the content of the Consultation Paper which is available on the LRC's website at: <https://www.hkreform.gov.hk/en/publications/orfsa.htm>. The Report should be read in conjunction with the Consultation Paper.

² 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.

³ At Annex 3 to the Report is the List of Respondents who made submissions in response to the Consultation Paper.

⁴ A person who is qualified to practise the law of any jurisdiction, including Hong Kong. For the purposes of this Report, "Lawyer" includes (but is not limited to) Hong Kong barristers, solicitors and Registered foreign lawyers.

1.5 One form of CFA is commonly known as a "no win, low fee" arrangement. This is where the Lawyer charges at "benchmark" rates or, more commonly, at a discounted rate during the course of the Proceedings, and then charges a Success Fee on top in the event of a successful outcome for the client in the matter.

1.6 Another form is commonly known as a "no win, no fee" arrangement. This is where the Lawyer charges *no fee* during the course of the Proceedings, and charges a Success Fee, namely "benchmark" fees *plus* an uplift, in the event of a successful outcome for the client in the matter.

1.7 In either scenario, the Success Fee can be an agreed flat fee, or calculated as a percentage "uplift" on "benchmark" fees or rates that the Lawyer would have charged, if there were no ORFS in place during the course of the Proceedings. In each case, the Success Fee includes a Success Fee premium⁵ paid by the client over and above "benchmark" fees. This is illustrated in the following "no win, low fee" worked example:⁶

- (a) Client and Lawyer agree that client will only pay 70% of "benchmark" hourly rates during the course of the Proceedings.
- (b) However, in the event of success, the client will pay 120% of "benchmark" hourly rates. The Success Fee therefore represents the 50% paid on top of the 70% of "benchmark" hourly rates charged during the course of the Proceedings.
- (c) The Success Fee premium in this scenario is the 20% uplift on 100% "benchmark" hourly rates. The distinction between the 50% Success Fee and the 20% premium is particularly relevant in the context of Final Recommendation 2, discussed below.

1.8 A DBA is another form of, commonly known as, "no win, no fee" arrangement. If the client does not obtain a Financial Benefit⁷ in the matter, the Lawyer charges no fee. However, in contrast with a CFA, the Lawyers' fee is calculated by reference to the Financial Benefit that is 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 ("**DBA Payment**"). For example, this could be a percentage of the amount that is obtained. It could also be calculated by reference to a respondent's success in dismissing or reducing a claim for damages. As discussed further in the context of Final Recommendation 13 below, we agree with the responses received on this issue, and have recommended that Financial Benefit be defined in broad terms, in order to give clients and Lawyers as much flexibility as possible to define success and determine when and how a DBA Payment is to be paid.

⁵ Portion of the Success Fee which exceeds the amount of fees which would be payable to the Lawyer if there were no ORFS in place.

⁶ The Sub-committee thanks the law firm that provided a worked example along these lines, in order to illustrate how CFAs work in practice.

⁷ Money or money's worth, but does not include any sum awarded in respect of recoverable Lawyer's costs or recoverable expenses.

1.9 A Hybrid DBA is commonly known as a form of "no win, low fee" arrangement. The Lawyer charges a fee for the legal services rendered (typically at a discounted rate) plus, in the event the client obtains a Financial Benefit in the matter, the DBA Payment.

The need to change the law in Hong Kong relating to ORFSs for Arbitration

1.10 Historically, Lawyers in Hong Kong have been prohibited from entering into ORFSs for work on contentious Proceedings. This includes Arbitration, noting in particular that section 98O of the Arbitration Ordinance expressly 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, where "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*".

1.11 Hong Kong is a notable outlier in this respect. With the exception of Singapore⁸, all major arbitral seats permit some form of ORFSs. There is also significant client demand for such arrangements. Clients increasingly want their lawyers to share the risk of bringing a claim in arbitration and to have "skin in the game". These are not just impecunious clients seeking funding for meritorious claims, but also sophisticated, commercial clients, looking to take some of the costs of arbitration off their balance sheets.

1.12 These clients are generally free to seat their arbitrations anywhere in the world, and it is the Sub-committee's view that allowing ORFSs for Arbitration is essential to Hong Kong's status as one of the world's leading arbitral seats and to maintaining its competitiveness.

1.13 In fact, 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 to be able to fund cases on the same, or similar, bases as lawyers from other jurisdictions where ORFSs are permitted, including Mainland China.⁹ 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.

⁸ The Ministry of Law of Singapore introduced the Legal Profession (Amendment) Bill for First Reading in the Parliament of Singapore on 1 November 2021. The proposed amendments provided a framework for conditional fee agreements only in relation to certain contentious proceedings (ie proceedings before a court of justice or an arbitrator or any other dispute resolution proceedings) that would be specified in regulations. As a start, the Ministry of Law of Singapore proposed that these proceedings included "*international and domestic arbitration proceedings, certain proceedings in the Singapore International Commercial Court, and related court and mediation proceedings*".

⁹ The People's Republic of China (for the purposes of this Report) excluding Hong Kong, Macao Special Administrative Region and Taiwan.

The LRC Sub-committee

Terms of reference

1.14 In October 2019, the Law Reform Commission of Hong Kong ("**LRC**") established the 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	Barrister (England & Wales) and Solicitor-Advocate (Hong Kong) Fountain Court Chambers
Dr Benny Lo	Barrister and Chartered Arbitrator Des Voeux Chambers
Mr José-Antonio Maurellet, SC	Barrister Des Voeux Chambers

1.15 Ms Kitty Fung, Acting Deputy Principal Government Counsel in the Law Reform Commission Secretariat, is the secretary to the Sub-committee. Miss Wingy Ha, Government Counsel in the Law Reform Commission Secretariat, has also assisted the Sub-committee.

The consultation process

1.16 In December 2020, the Sub-committee published the Consultation Paper, putting forward 14 recommendations as set out in its Chapter 6.

1.17 The Sub-committee's consultation period closed on 16 March 2021.¹⁰ In total, 23 submissions were received, ranging from a simple acknowledgement of the Consultation Paper to detailed submissions on the Sub-committee's Recommendations and associated issues. Those who submitted responses included arbitral institutions, an arbitrator/barrister, a barrister, a chamber of commerce, consumer/public interest groups, the finance sector, a Government department, law firms, a litigation funder, professional bodies and a regulator (each "**Respondent**" and collectively the "**Respondents**"). A list of the Respondents is set out in Annex 3 of this Report. We are most grateful to all those who commented on the Consultation Paper. Their submissions are summarised in the following chapters.

1.18 In addition to attending consultation briefings, including with a committee of the Hong Kong Bar Association ("**HKBA**"), members of the Sub-committee attended the meeting of the Panel on Administration of Justice and Legal Services of the Legislative Council on 27 January 2021, as well as speaking at various conferences and writing articles. The Sub-committee has also consulted the Law Draftsman. The Sub-committee is grateful for the assistance of the Law Draftsman and his colleagues for their valuable contribution to its work, and their assistance in preparing the Draft Amendments to Legal Practitioners Ordinance and Arbitration Ordinance attached at Annex 1 to this Report.

¹⁰ The Sub-committee also acceded to a number of requests for an extension of time for the submission of written responses, since the extensions requested were not unreasonable and would not give rise to undue delay to the overall progress.

Chapter 2

Lifting prohibitions on the use of CFAs by Lawyers in Arbitration

Responses to the Sub-committee's Recommendation 1

2.1 This Chapter discusses the responses regarding Recommendation 1 in the Consultation Paper which reads as follows:

"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."¹

2.2 An overwhelming majority of the Respondents supported Recommendation 1. Those in favour included an arbitral institution, an arbitrator/barrister, a chamber of commerce, consumer/public interest groups, a Government department, law firms, a litigation funder, professional bodies and a regulator.

Comments from Respondents who supported Recommendation 1

2.3 All but one of the submissions that commented on Recommendation 1 supported the recommendation.² They also supported the proposal that the reference to "Arbitration" should have the meaning given to it in section 98F of the Arbitration Ordinance, namely, to include the following proceedings under that Ordinance: (i) court proceedings; (ii) emergency arbitrator proceedings; and (iii) mediation proceedings.

2.4 The Law Society of Hong Kong ("**Law Society**") made the following general observations:

"The Law Society supports the policy direction which underlines [sic] the Sub-committee's recommendations, i.e Lawyers in Hong Kong must remain globally competitive with lawyers in other jurisdictions and that there ought to be a level playing field in arbitration. This is fundamentally essential to maintain and to continue to enhance Hong Kong's status as a leading international arbitration hub for cross-border and international commercial and investment disputes."

¹ See Consultation Paper, at paras 5.1 to 5.5.

² 17 out of 18 Respondents who expressed a view.

2.5 The Respondents generally supported allowing parties to Arbitration the freedom to select the type of ORFS that best suits their circumstances. An international law firm observed:

"... we believe that arbitrating parties should have the freedom to select the type of ORFS, whether it be CFA, DBA or Hybrid DBA, that best suits their needs. Allowing such a choice would provide parties with welcome flexibility in respect of how they fund their disputes and complement the third-party funding reforms that Hong Kong has already adopted."

2.6 A litigation funder expressed similar views in support of the recommendation:

"... the introduction of CFAs in Hong Kong arbitration will promote access to justice and risk management, as well as promoting Hong Kong as a hub for commercial dispute resolution by bringing it in line with major international dispute resolution hubs like London and New York. [Protective measures] are necessary to protect users and the integrity of the arbitral process, without unnecessarily limiting the flexibility for clients and lawyers to make arrangements which suit the particular circumstances of a case."

2.7 Many Respondents agreed with the Sub-committee that the benefits arising from the introduction of CFAs in Arbitration outweigh the problems and risks identified with CFAs, so long as appropriate safeguards are introduced. For example, a regulator observed:

"... on balance, given that the proposal is limited to arbitration, our general view is that the potential advantages may outweigh the potential concerns. However, we do view it as imperative that the safeguards outlined in the Consultation Paper (e.g. the need to have a written agreement clearly setting out the scope of ORFS between a client and the lawyer, the appropriate and reasonable limit or restriction to the fees recoverable etc.) are implemented to minimize the prospect of opportunistic and frivolous proceedings and unnecessary disputes between parties."

2.8 The Consumer Council commented:

"It is ... the Council's view that the Sub-committee's recommendations to lift prohibition against ORFS in arbitration would help achieve better accessibility to justice and provide more choice. However, this has to be based on the proviso that sufficient safeguards are to be in place for the protection of consumers."

The Council is therefore supportive of the LRC's recommendations 1[,], 4, and 6 insofar as lifting prohibitions on the use of different types of funding models for arbitration."

Comments from the Respondent who opposed Recommendation 1

2.9 Only one Respondent expressly opposed Recommendation 1. That Respondent, a local law firm, opposed the introduction of ORFSs in general, on the basis that they "*will complicate the business of running a law firm*" (particularly small and medium sized firms), could lead to conflicts of interest and "*commercialization of the legal profession*", and give rise to other concerns, including the potential to exploit clients, issues with claiming under an after-the-event insurance ("**ATE Insurance**"),³ and "*opening the floodgates*" to ORFSs for litigation in the Hong Kong courts.

Our analysis and response

2.10 We have carefully considered all the responses received in respect of Recommendation 1, including the objections to it. While we acknowledge that there was at least one dissenting view, we note that there is otherwise overwhelming support from a diverse range of Respondents for permitting the use of CFAs in Arbitration by Lawyers.

2.11 We have carefully considered the objections raised. We have also considered the position in other major dispute resolution and international arbitration centres, including the United States of America, England and Wales and Singapore (where a framework to introduce CFAs is currently proposed, but not yet implemented).

2.12 We agree with those who submitted that permitting CFAs for Arbitration would significantly benefit Hong Kong in numerous ways. In particular, we are persuaded that introducing ORFSs, including CFAs, in Arbitration is necessary to preserve and promote Hong Kong's competitiveness as a leading arbitration centre, enhance access to justice, and – importantly – respond to client demand by providing pricing flexibility. For Hong Kong to remain a leading arbitration hub, it is essential that it can offer what its competitors offer. An important element of this is the ability to compete with other jurisdictions when it comes to legal fees for arbitration work.

2.13 Permitting ORFSs, including CFAs, is also consistent with Hong Kong's overall policy of supporting freedom of contract. Additionally, the process of assessing a case with a view to offering a CFA (or other ORFSs) can help Lawyers and their clients to weed out weak claims.

2.14 We are encouraged that both regulators of the legal profession in Hong Kong (the Law Society and the HKBA) expressed support for introducing CFAs (or other ORFSs). We are further persuaded by the view of Sir Rupert Jackson, Lord Justice of Appeal of England and Wales from 2008 to 2018 ("**Lord Justice Jackson**"), that:

³ 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.

*"... 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."*⁴

2.15 Overall, we are of the view that permitting ORFSs, including CFAs, in Arbitration will benefit Hong Kong and enable it to remain one of the top arbitral seats in the world. For the avoidance of doubt, the Final Recommendations to permit ORFSs (ie Final Recommendations 1, 4 and 10) are limited to Arbitration and related court proceedings, such as applications to the Hong Kong courts to set aside or enforce an arbitral award, or for interim relief in support of an Arbitration. We emphasise that these Final Recommendations are not applicable to mediation proceedings that do not fall within the Arbitration Ordinance⁵ and private adjudication under the Pilot Scheme on Private Adjudication of Financial Disputes in Matrimonial and Family Proceedings launched by the Judiciary in Hong Kong in 2015.⁶

Response to objections

2.16 In reaching the above conclusion, we have borne in mind the concerns raised that allowing Lawyers to enter into CFAs (or other ORFSs) in Arbitration with their clients may have undesirable implications. Our response to these objections is set out below.

Risk of conflict of interest and unprofessional conduct

2.17 With respect to the risk of conflict of interest between Lawyer and client and the stated concern that CFAs may prompt a Lawyer to engage in unprofessional conduct, we agree with the Sub-committee that these concerns are outdated, and are unlikely to be significant risks in practice.⁷ As the Sub-committee remarked, where a CFA (or any ORFS) is in place, the Lawyer's interests are, if anything, more closely aligned with the client's because a significant part of the Lawyer's remuneration depends on the client's case succeeding. Under a conventional hourly fee arrangement, the Lawyer will be paid regardless of the outcome of the case. Moreover, lawyers in numerous other jurisdictions operate under ORFS arrangements without, to our knowledge, significant conflicts arising.

⁴ Lord Justice Jackson, *Review of Civil Litigation Costs: Final Report* (2009), at para 1.8 of Ch 10.

⁵ See s 98ZA of the draft amendments to the Arbitration Ordinance in Annex 1 to this Report.

⁶ In Hong Kong, the Judiciary has launched the Pilot Scheme on Private Adjudication of Financial Disputes in Matrimonial and Family Proceedings to deal with financial disputes in matrimonial and family matters by way of private adjudication since 2015. Pursuant to Practice Direction SL 9 on Pilot Scheme on Private Adjudication of Financial Disputes in Matrimonial and Family Proceedings dated 2 December 2020, the pilot scheme has now been extended to 2024.

⁷ Consultation Paper, at paras 4.37 to 4.49.

Complications in running law firms

2.18 One Respondent pointed out that law firms providing arbitration advice on an ORFS basis would need to adapt their billing and accounting practices accordingly. Working on a CFA (or other ORFSs) basis would involve the law firm receiving less than its usual (or "benchmark") hourly rate until the matter concludes, and this could impact on the law firm's overall cash-flow position.

2.19 While we accept that some law firms might be temporarily inconvenienced by the need to adopt new billing and accounting practices for ORFSs, we are confident that law firms are capable of adapting their billing and accounting practices successfully and without adverse impact in the long term. In fact, in the many jurisdictions where ORFS has - in one form or another - been in place for some time, there is no suggestion that lawyers or law firms have been unable to adapt their billing practices accordingly.

2.20 We acknowledge that the impact of ORFSs on cash flow could be more material, particularly for smaller law firms with fewer cash reserves to support their overheads pending payment of the Success Fee under a CFA, or the DBA Payment under a DBA (including a Hybrid DBA). However, we note that under the Sub-committee's proposals, law firms and Lawyers would be free to negotiate the terms of any CFA (or any other ORFSs) with their clients, and could not be compelled to enter into a CFA (or any other ORFSs) if its terms are financially unattractive - or unviable - for the firm. Law firms can also access insurance products that will cover the costs they incur in ORFS matters where the client's claim does not succeed.

Increase in opportunistic and frivolous litigation

2.21 We consider it unlikely that permitting ORFSs will increase opportunistic or frivolous claims. Where a Lawyer agrees to act on a CFA or any other ORFS, he or she bears a significant financial risk if the case does not succeed. Indeed, the Lawyer takes a much greater risk in an ORFS situation than in a conventional fee arrangement, under which he or she is entitled to payment whether the client wins or loses. Far from prompting them to drum up claims on an opportunistic basis, ORFSs should encourage Lawyers to take a cautious approach to potential instructions. In other words, Lawyers are likely to offer ORFSs only where they are persuaded that the merits of the claim are genuinely strong. We are further encouraged by the Sub-committee's review of jurisdictions in which ORFSs are already permitted, and none of these jurisdictions has seen a link between those fee structures and an increase in frivolous claims.⁸

Excessive legal fees

2.22 We agree with the Sub-committee that the risk of ORFSs encouraging Lawyers to charge excessive fees is, in general, overstated. As

⁸ Consultation paper, at paras 4.50 to 4.54.

noted in the Consultation Paper, the calculation of Success Fees in CFAs is usually based on the number of hours the Lawyer has worked, and the Lawyer's hourly rate. To the extent that there is a risk of a Lawyer inflating the rate, that same risk exists whether the client is paying on the basis of time worked, or only in the event of a successful outcome for the client in the matter.

2.23 Where a DBA is in place, the fee payable to the Lawyer is expressed as a percentage of any Financial Benefit the client obtains in the case. As such, the fee is both proportionate to the amount in dispute and entirely transparent from the outset. Furthermore, the client 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.

2.24 Perhaps most importantly, we are not aware of any evidence that permitting ORFSs in other jurisdictions has led Lawyers to charge their clients excessively. As the Sub-committee pointed out, such risk as remains was *"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"*.⁹

2.25 Finally, we agree that any remaining risk will be mitigated by Hong Kong's "costs indemnity rules", and by introducing appropriate safeguards to the ORFS regime for Arbitration.¹⁰

Reliance on after-the-event/litigation insurance

2.26 The availability of ATE Insurance was undoubtedly a concern when the LRC considered introducing conditional fees¹¹ in 2005-2007. However, for the reasons set out at paragraphs 4.66 to 4.69 of the Consultation Paper, we are persuaded that these concerns are largely historical, and should not be a bar to introducing ORFSs for Arbitration in Hong Kong now.

2.27 In reaching this conclusion, we are encouraged by the response received from a regulator in Hong Kong, which supported the introduction of ORFSs for Arbitration in Hong Kong and considered that it can give rise to a new market in ATE Insurance. In general, we note that the insurance market has developed significantly since 2007, such that ATE Insurance and other forms of litigation insurance are now readily available internationally. We are confident that, were ORFSs for Arbitration to be introduced in Hong Kong, the insurance market here would respond positively by making similar products available.

⁹ Consultation Paper, at para 4.60.

¹⁰ Consultation Paper, at paras 4.55 to 4.60.

¹¹ For the purposes of the LRC Report on Conditional Fees in 2007, "conditional fees" mean fee arrangements whereby, in the event of success, the lawyer charges his usual fees plus an agreed flat amount or percentage "uplift" on the usual fees.

Increase in satellite litigation

2.28 This objection is based on a concern that parties who lose an arbitration and are ordered to pay the winning party's costs might bring separate, or "satellite", claims challenging the validity of the winning party's ORFS arrangement with its Lawyer.

2.29 We are aware that England and Wales witnessed a spike in such "satellite" claims after the Access to Justice Act 1999 which allowed a successful party to recover from its opponent the success fee payable to its lawyer under a CFA.¹² The English courts saw a rise in satellite litigation, in which a losing party challenged the enforceability of the CFA, or the quantum of recoverable costs, in order to avoid paying the success fee element of the winning party's costs. In order to reduce the risk of such claims, England and Wales subsequently amended its laws to provide that the success fee element is no longer recoverable from the losing opponent in contentious proceedings.

2.30 In preparing its Consultation Paper, the Sub-committee has carefully reviewed the position in England and Wales on this issue. Consequently, the ORFS regime that is proposed in this Report would prohibit a winning party from recovering the Success Fee. This element of the regime is designed specifically to avoid the risk of such "satellite" claims.

2.31 Having analysed the arguments for and against Recommendation 1, we are persuaded that the benefits of permitting the use of CFAs in Arbitration outweigh any potential disadvantages. We agree with the Sub-committee that risks can be further mitigated by limiting the use of CFAs (and ORFSs generally) to Arbitration, and by ensuring that the CFA regime contains appropriate safeguards in the relevant laws and regulations. We discuss this below when we consider Recommendation 13.

2.32 The mechanism for lifting the prohibition on CFAs is also discussed in Chapters 12 and 13 where Recommendations 11 and 12 are considered respectively.

Final Recommendation 1

We recommend 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.

¹² Consultation Paper, at para 3.30(c).

Chapter 3

Recoverability of Success Fee premium and Legal Expense Insurance premium from the unsuccessful party under CFAs

Responses to the Sub-committee's Recommendation 2

3.1 This Chapter discusses the responses regarding Recommendation 2 in the Consultation Paper, namely that:

"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."¹

3.2 Almost all of the submissions that commented on Recommendation 2 supported the recommendation. Those in favour included an arbitral institution, an arbitrator/barrister, a chamber of commerce, a consumer/public interest group, a Government department, law firms and professional bodies.

Comments from Respondents who supported Recommendation 2

3.3 As noted above, an overwhelming majority of Respondents agreed with Recommendation 2. Among them, a Government department noted that:

"The relevant legislative history in England and Wales shows that allowing claimants to recover ATE insurance premium and success fee has resulted in undesirable consequences, namely (i) the rise in satellite litigation (in which the enforceability of CFA and the quantum of recoverable costs are challenged) and (ii) the inequity between the claimant who commences the proceeding costs-free and risk-free and the losing respondent who is held responsible for those costs of the CFA to which he is not a party. Statutory reforms had already been implemented in England and Wales so that ATE insurance premium and success fee are no longer recoverable from the losing respondent."

3.4 An arbitral institution commented: *"Any success fee or ATE insurance premiums agreed between a party and its lawyers or insurers for the*

¹ See Consultation Paper, at paras 5.6 to 5.13.

purposes of an ORFS arrangement should not be recoverable from the counterparty."

3.5 A chamber of commerce also agreed, noting that Recommendation 2 would not only *"avoid the possibility of additional 'satellite' litigation"* but it would also be *"unfair for the losing party to be liable for these costs: the amount of the Success Fee and ATE premium should be a matter purely between the claimant and its lawyers"*.

3.6 Another law firm agreed in principle, but expressed the view that only the portion of Success Fee which exceeds the costs recoverable from the losing party should not be recoverable. As the law firm put it:

"The justification for this approach is that it does not create a situation whereby either the claimant has a disadvantage or the respondent has a windfall in a hybrid CFA situation. In all circumstances, the respondent will be liable to pay costs under the usual costs indemnity rules, irrespective of whether any part of this formed an element of the 'Success Fee'."

3.7 A second law firm also agreed with Recommendation 2, but noted that this *"potentially gives rise to a divergence between the position under a CFA in relation [sic] a Success Fee and the position in the context of third party funding, where a premium (economically equivalent to a Success Fee) may be recoverable: see, e.g. Essar v Norscot [2016] EWHC 2361. Does this give rise to a potentially unfair playing field between Lawyers and third party funders? Might this potential lacuna incentivise fee structures intended to circumvent this prohibition, e.g. funder financed no win, low fee arrangement."*

3.8 Other Respondents, including an arbitrator/barrister and a professional body, were aligned, and confirmed their view that clients should be able to choose to enter into CFAs for Arbitration with their lawyers, *"subject to Recommendation 2 that ATE insurance premiums and success fees should not be recoverable from the unsuccessful party."*

Comments from the Respondent who opposed Recommendation 2

3.9 Amongst the responses received, only one – a litigation funder - directly opposed Recommendation 2. Referring again to *Essar v Norscot*,² this Respondent's view is that there should be:

"... no express prohibition on the recovery from the respondent of any Success Fee and ATE insurance premium. The awarding of legal 'and other costs' in an arbitration should continue to be at the discretion of the arbitral tribunal in line with international best practice. Under section 74(7) of the Arbitration Ordinance, the tribunal must only allow costs 'that are reasonable having regard

² [2016] EWHC 2361 (Comm).

to all the circumstances.' In the case of a CFA, this may, depending on the circumstances of the case, include any Success Fee and/or ATE insurance premium.

Consistent with the core arbitral principles of flexibility and party-autonomy, the tribunal should retain flexibility to do justice in the case as it sees fit, subject to any overarching agreement otherwise between the parties."

Our analysis and response

3.10 The overwhelming majority of Respondents who commented specifically on Recommendation 2 agreed with the Sub-committee's view that the losing party should not be responsible for any Success Fee or ATE Insurance premium agreed by a client with its Lawyers or insurers.

3.11 The most common view expressed by Respondents is that the ability of a successful claimant to recover any ATE Insurance premium or Success Fee from the losing opponent might lead to *"an explosion of litigation"*. We agree, and indeed this is a point highlighted in the Consultation Paper, which commented that this historic feature of English law had been one of the major criticisms of the conditional fee regime in England and Wales, before its reform in 2013.

3.12 Further, and as noted by one Respondent above, we agree that it would also, in most circumstances at least, be *"unfair for the losing party to be liable for these costs ... "*. This is consistent with the statement in the Consultation Paper published by the Conditional Fees Sub-committee of the LRC in September 2005, cited in the Consultation Paper, namely that it would be *"inequitable, irrational and unfair to make insurance premiums and success fee recoverable from the losing party"*.³ It would be unfair because the respondent is not party to the contracts between client and Lawyer and/or insurer, and accordingly has no control or say over any pricing which is ultimately agreed.

3.13 One Respondent pointed out that the definition of success fee in Recommendation 2 of the Consultation Paper was not clear. For the avoidance of doubt, in this context, success fee means the Success Fee premium, as illustrated in the worked example in paragraph 1.7 above. The question of what "reasonable" fees should be recovered from the losing party would, in general, be assessed by reference to "benchmark" costs in the usual way. This was what the Sub-committee had intended when it made Recommendation 2, and this has been clarified in Final Recommendation 2.

³ Conditional Fees Sub-committee of the LRC, *Consultation Paper on Conditional Fees* (2005), at para 7.11.

3.14 We also consider the arguments made by the litigation funder that the Tribunal⁴ should have complete discretion over whether, and on what basis, to award legal and other costs, as well as the related references made by another Respondent to the English decision of *Essar v Norscot*.⁵

3.15 We note that *Essar v Norscot* involved an International Chamber of Commerce arbitration before a sole arbitrator, in which Essar was found liable to pay damages to Norscot for repudiatory breach of an operations management agreement. The award which came before the English court was the fifth partial award, in which the arbitrator found Essar liable to Norscot for approximately US\$ 4 million in costs. The costs award included the GBP 1.94 million costs of third party funding which Norscot had obtained in order to bring the arbitration. The arbitrator's findings on Essar's conduct in the arbitration were a key consideration in the arbitrator's decision on costs.

3.16 Relevantly, the arbitrator considered that Essar had set out to cripple Norscot financially and that, as a consequence of Essar's treatment, *"Norscot had no alternative, but was forced to enter into the litigation funding ... The funding costs reflect standard market rates and terms for such facility, ..."*⁶ The arbitrator also found that:

*"It was blindingly obvious to [Essar] that the claimant ... would find it difficult if not impossible to pursue its claims by relying on its own resources. The respondent probably hoped that this financial imbalance would force the claimant to abandon its claims."*⁷

The arbitrator considered that he had wide discretion to decide which costs should be awarded in the arbitration, and held that Norscot was entitled to recover the sum of GBP 1.94 million, being the sum owed to the third party funder for advancing Norscot its legal costs to bring the claims.

3.17 The facts of that case were clearly unusual. The arbitrator found that Essar had deliberately tried to hurt Norscot financially, with the aim of preventing Norscot from being able to pursue its (legitimate) claim. Moreover, it was directly because of Essar's conduct that Norscot had no choice but to obtain third party funding to be able to protect its legal rights. This went beyond the usual tussles which feature in contentious proceedings, and beyond the needs of an impecunious party looking for financial assistance to advance a meritorious claim.

3.18 Nevertheless, we note that guerrilla tactics in commercial arbitration do happen, and that there may be some extreme situations, albeit limited, where it would be fair and equitable to pass part or all of the additional

⁴ An arbitral tribunal, consisting of a sole arbitrator or a panel of arbitrator(s), and includes an umpire, established by the agreement of the parties to finally resolve disputes or differences by arbitration.

⁵ [2016] EWHC 2361 (Comm).

⁶ Same as above, at para 22.

⁷ Same as above, at para 23.

costs of a Success Fee premium or Legal Expense Insurance⁸ (including ATE Insurance) premium onto the losing party. We have considered this carefully, and the comments made by a number of the Respondents, and agree with them.

3.19 On balance, therefore, we consider that there is merit in leaving the door open to Tribunals to order the losing party to pay the Success Fee premium and Legal Expense Insurance premium in genuinely exceptional circumstances, similar to those that existed in *Essar v Norscot*. This will also address the concern raised by a law firm who considered that the irrecoverability of Success Fee proposed under Recommendation 2 in the Consultation Paper may give rise to an unfair playing field that puts Lawyers at a disadvantage (as discussed in paragraph 3.7 above) by way of treating Lawyers and Third Party Funders⁹ equally in respect of the recoverability of the Success Fee premium and Third Party Funder premium.

3.20 For all these reasons, our final recommendation is that the position under Hong Kong law for Arbitration should be that the losing party should not, in principle, be liable to pay any Success Fee premium or Legal Expense Insurance premium agreed by the winning party respectively with its Lawyers and/or insurers. However, in exceptional circumstances, the Tribunal should have the power to apportion those fees between the parties in the Arbitration based on the exceptional circumstances of the case.

Final Recommendation 2

Where a CFA is in place, we recommend that any Success Fee premium and any Legal Expense Insurance premium agreed by a client with its Lawyers and insurers respectively shall not, in principle, be borne by the unsuccessful party. However, where in the opinion of the Tribunal there are exceptional circumstances, the Tribunal may apportion such Success Fee premium and/or Legal Expense Insurance premium between the parties if it determines that apportionment is reasonable, taking into account the exceptional circumstances of the case.

⁸ A contract of insurance that provides reimbursement to a client or a lawyer for some or all of the legal fees, adverse costs or disbursements incurred in respect of a matter.

⁹ A provider of Third Party Funding.

Chapter 4

Cap on the Success Fee

Responses to the Sub-committee's Recommendation 3

4.1 This Chapter discusses the responses to Recommendation 3 in the Consultation Paper:

"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%."*¹

4.2 A substantial majority of Respondents agreed with Recommendation 3. Where Respondents expressed a specific view on what the appropriate cap should be, the cap ranged from 30% to 100%. Nevertheless, the majority of those who commented specifically preferred the higher cap of 100%. Only two Respondents advocated for no cap at all.

4.3 Respondents, including the HKBA, agreed that where barristers entered into CFAs with clients, there was no reason for barristers to be subject to a different cap.

Comments from Respondents who supported Recommendation 3

4.4 A clear majority of the Respondents who commented on Recommendation 3 agreed that there should be a cap on the Success Fee, expressed as a percentage of normal or "benchmark" costs.

4.5 A Government department commented that there should be a cap, and that the appropriate cap should be *"decided with reference to the prevailing practice in other jurisdictions (capped at 100% of normal cost in England and Wales and at 25% (excluding disbursements) of legal fee in Australia) and any views from other stakeholders"*. This Respondent stated that it would be *"desirable for the cap to reflect a proper balance between the extent of risk assumption by lawyers and the remuneration payable to lawyers"*.

¹ See Consultation Paper, at paras 5.14 to 5.17.

4.6 Likewise, the Consumer Council also agreed with there being a cap, and would leave it to the legal profession to decide what that cap should be. It nevertheless noted that the cap should be reasonable and *"a proportionate return for the consumer who embark [sic] on such an arrangement with his/her legal counsel should be factors to be taken into account"*.

4.7 A consumer/public interest group also agreed that there should be a cap, and proposed that the cap be *"100% of normal costs"*. This Respondent noted that *"applying a cap of 100% does not mean requiring a client to pay the double of the normal costs in every case. Rather, prior negotiation will take place between the client and the lawyer and the interests of the client hence will not be prejudiced."*

4.8 A law firm that agreed on implementing a cap noted that *"[o]bviously there are good policy reason [sic] for imposing a cap, but setting this cap involves a careful balancing act between the risk of the proliferation of substantially unmeritorious cases (by setting the cap too high) and rendering CFAs unattractive by not permitting risk to be properly priced (by setting the cap too low)." This Respondent stated that, balancing these considerations, "we favour a higher cap and would suggest following the lead of England and Wales."* The same Respondent did not see any reason for differentiating between barristers and other Lawyers, and also raised an important question about who would be the ultimate arbiter on what are *"normal or 'benchmark' costs"* and what, if any, impact an assessment of recoverable costs by the Tribunal would have on this figure. We address this question below.

4.9 Two arbitral institutions also agreed that there should be an appropriate cap, consistent with the position in other jurisdictions. One institution did not comment specifically on what the cap should be, but noted that it was *"important ... that such caps and other safeguards are carefully drawn so as not to have the effect of unduly limiting the circumstances in which ORFSs can be used (e.g. by preventing parties and their lawyers from being able to appropriately share the risk and reward of a dispute..."*. The other institution's view was that the *"Success Fee should be capped at 75 per cent of normal costs"*.

4.10 Another Respondent took the view that the cap should be higher and, consistent with the position in England and Wales, stated simply that: *"The appropriate cap should be ... up to a maximum of 100%."*

4.11 The Law Society also agreed with a cap, and commented that the cap should be 100% for the following reasons: *"(a) freedom of contract; (b) [the cap] only affects claimant and their lawyers, not respondent (assuming not recoverable – see ... Recommendation 2 in the above); and (c) lower cap would penalise smaller firms and firms with lower fee scales"*. While the HKBA also agreed with a cap, it proposed that the appropriate level should be 50% of *"benchmark" costs*.

4.12 A litigation funder agreed with the 100% cap, noting that *"a cap of 100 per cent should enable some lawyers to offer no-win no-fee (or low fee) arrangements which they may not otherwise have offered (and taken the risk of non-payment or a discounted payment) if a lower cap was fixed"*. The funder added that, in its view, *"most parties in arbitrations in Hong Kong are sophisticated users and it is appropriate to permit the parties and lawyers the autonomy to negotiate the terms of the CFA, including an appropriate Success Fee up to the cap, depending on the circumstances of the case"*. The funder concluded that barristers should be subject to the same 100% cap.

4.13 Another Respondent, a law firm, also considered that the maximum Success Fee should be capped at 100% of "benchmark" costs. The reasons given were consistent with other Respondents, as follows:

"(a) On the basis that Recommendation 2 (i.e. Success Fees and ATE Insurance premium should not be recoverable from a losing respondent) is accepted, clients should be free to negotiate an appropriate level of Success Fee with their Lawyers. [and] (b) Due to the nature of international arbitration, Lawyers often work with colleagues in several jurisdictions for complex cases. London is one such key legal hub where most international firms with international arbitration practice have an office. Given that the cap for the Success Fee in England and Wales is at 100%, a lower cap for Hong Kong could lead to international law firms switching their profit centre to London and engaging the client from their London office in attempts to circumvent relevant restrictions in Hong Kong and to take advantage of the ambiguity under law regarding the applicable ORFS regime where Lawyers from multiple jurisdictions are engaged under a single retainer."

As the law firm put it: *"Setting the cap at 100% for Hong Kong will ensure a level playing field for Lawyers in Hong Kong."*

4.14 The same Respondent commented that it preferred to refer to "benchmark" costs as the reference point for any cap. The law firm considered that "normal" costs would be subject to a reasonableness assessment under the "costs indemnity rules", so removing the reference to "normal" costs might remove the propensity for unnecessary litigation in particular.

4.15 This law firm saw no reason why barristers should be subject to a different standard or cap, and accordingly proposed that *"barristers should be subject to the same cap at 100% of any agreed hourly rate"*.

4.16 Finally, a chamber of commerce agreed on there being a cap, but suggested a lower cap of 30%: *"We suggest that the cap is 30 per cent of normal legal costs (slightly higher than the 25 per cent in Australia, lower than the 100 per cent in England and Wales, and the same percentage as that which we suggest applies to DBAs"*

Comments from Respondents who opposed Recommendation 3

4.17 Amongst the responses received, two opposed Recommendation 3. The reasons given were the same, namely that *"this is entirely a matter to be agreed by the parties and the lawyers (the solicitors and barristers) involved and any capping would necessarily be arbitrary"*. In short, these Respondents (a professional body and an arbitrator/barrister) considered that a cap would be *"unnecessary and unworkable"*.

Our analysis and response

4.18 When considering the question of capping the Success Fee, we have considered in detail the submissions received from all Respondents, as well as the approach to addressing this issue in other comparable common law jurisdictions, in particular England and Wales. Like almost all Respondents who commented on this issue, and for the reasons stated, we agree that there should be a cap. Indeed, the support for a cap in some form is overwhelming. As noted in paragraph 4.14 of the Consultation Paper, this is also consistent with the legal regime in other jurisdictions, and we see no reason to depart from that position in Hong Kong.

4.19 As some Respondents noted, having a cap would not mean that the maximum uplift will be applied in every case. Clients would still be free to negotiate and agree on the Success Fee with their Lawyers, subject only to the cap, and so this would be consistent with freedom of contract, whilst ensuring at the same time that sufficient safeguards would be in place to protect clients.

Appropriate cap on the Success Fee

4.20 In terms of what specific cap should be applied, there is again overwhelming support for the same 100% cap as applies in England and Wales. As a number of Respondents noted, the question of what that cap should be is a careful balancing act, with a key concern being to ensure that clients can appropriately share – and price – risk with their Lawyers.

4.21 Only three Respondents advocated for a lower cap: one suggesting 75%, the other one suggesting 50% and the third one suggesting 30% on the basis that this was in-between England and Wales (at 100%) and Australia (at 25%) (which is also consistent with the 30% cap on recoveries for DBAs and the DBA Payment as suggested by this Respondent). We have considered these submissions carefully. We note, however, that it is at odds with the many other Respondents who supported a cap of 100%, as well as the tried and tested regime in England and Wales. There is also no reason, in our view, to align the cap on fees relevant to CFAs, to the cap on "financial success" relevant to DBAs (including Hybrid DBAs), given that the structures of CFAs and DBAs are different.

4.22 On balance, after considering all the responses received and the position in other comparable jurisdictions, and England and Wales in particular,

we recommend that there should be a cap of 100% on the Success Fee, which is expressed as a percentage of "benchmark" (rather than "normal") costs. The reference to "benchmark" costs will be calculated according to the rates agreed by the client with its Lawyer in the CFA, by reference to which any discount and uplift is calculated.

4.23 To give a worked example, a Lawyer and client may agree in the CFA that the "benchmark" rate for a partner's time is HKD 8,000 per hour, and that 70% of "benchmark" (HKD 5,600) will be charged as the case progresses, to be uplifted to 120% of "benchmark" (HKD 9,600) if the matter is successful. This will be a matter for the client and its Lawyer, noting only that if the 100% cap applied, the maximum that the Lawyer could charge per hour for the partner would be HKD 16,000. The Success Fee premium - being 20% of HKD 8,000, or HKD 1,600 per hour - could not (absent exceptional circumstances) be passed on to the losing party in the event of success (in accordance with Final Recommendation 2 above). Inter-party recoverable costs - and the question of whether these have been reasonably incurred - would be assessed against "benchmark" (without reference to the "premium") in the usual way.

Same cap for barristers

4.24 As noted in paragraph 4.103 of the Consultation Paper, it was suggested in the report published by the LRC in July 2007 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"*.²

4.25 There was, however, no support in the responses received for barristers to be subject to a different cap. We agree. As a number of Respondents commented, we have not been able to identify any reason or basis to differentiate between barristers and other Lawyers. On the contrary, there are cogent grounds to keep the playing field level across all Lawyers, and to have the same cap applicable to all.

4.26 We therefore conclude that barristers instructed on a CFA basis should be subject to the same cap as other Lawyers.

Final Recommendation 3

Where a CFA is in place, we recommend that:

- (a) there should be a cap on the Success Fee of 100% of "benchmark" costs; and**
- (b) barristers should be subject to the same cap in such circumstances.**

² LRC, *Report on Conditional Fees* (2007), at para 6.85.

Chapter 5

Lifting prohibitions on the use of DBAs by Lawyers in Arbitration

Responses to the Sub-committee's Recommendation 4

5.1 This Chapter discusses the responses regarding Recommendation 4 in the Consultation Paper:

"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."¹

5.2 Of the responses received, the vast majority of them were supportive of Recommendation 4.

Comments from Respondents who supported Recommendation 4

5.3 All but one of the submissions that commented on Recommendation 4 supported the recommendation.² Those in favour included an arbitral institution, an arbitrator/barrister, a chamber of commerce, consumer/public interest groups, a Government department, law firms, a litigation funder, professional bodies (including both the Law Society and the HKBA) and a regulator.

5.4 One Respondent, a chamber of commerce, commented:

"We see no valid reason for prohibiting DBAs while allowing CFAs. The client should have full flexibility to negotiate with its lawyers the most appropriate fee structure to suit its individual circumstances."

5.5 An international law firm expressed similar views:

"... we believe that arbitrating parties should have the freedom to select the type of ORFS, whether it be CFA, DBA or Hybrid DBA, that best suits their needs. Allowing such a choice would provide parties with welcome flexibility in respect of how they fund their disputes and complement the third-party funding reforms that Hong Kong has already adopted."

¹ See Consultation Paper, at paras 5.18 to 5.24.

² 17 of 18 Respondents who expressed a view.

Moreover, as the Sub-committee rightly noted, once the view is taken to 'cross the Rubicon' by permitting one form of ORFS in Hong Kong, there is no real basis to exclude other forms of ORFS."

5.6 Another Respondent noted that arbitration is a "particularly expensive" process, and went on to say:

"... the introduction of DBAs in Hong Kong arbitration will promote access to justice and risk management, as well as promoting Hong Kong as a hub for commercial dispute resolution by bringing it in line with major international dispute resolution hubs like London and New York. ... Permitting DBAs (as well as CFAs) for arbitration will provide parties with additional flexibility and funding options. It is again consistent with the core arbitral principles of flexibility and party-autonomy."

5.7 An arbitrator/barrister also noted the Sub-committee's observation that DBAs are used often in Mainland China, and that allowing DBAs in Hong Kong would allow Hong Kong lawyers to compete with Mainland lawyers for arbitration work on an even playing field.

Comments from the Respondent who opposed Recommendation 4

5.8 The single Respondent that objected to DBAs is a local law firm. This Respondent objected to introducing ORFSs in any form, on grounds that they would "*complicate the business of running a law firm*", create conflicts of interest and the potential to exploit clients, give rise to concerns around insurance, and "*open the floodgates*" to introducing ORFSs for litigation.

5.9 With regard to DBAs specifically, this Respondent commented that:

"The concept of damage-based agreements ... may also skew the idea of compensation. The idea of damages is compensatory to the party who had suffered as a result of the loss. By introducing DBA it would mean that part of the compensation will be used as a means to calculate the client's costs, which may ultimately be used to pay off their legal fees. This may mean that the client will be inadequately compensated."

Our analysis and response

5.10 We have carefully considered all responses, including each ground of objection raised by the above Respondent. These objections reflect historical concerns about introducing ORFSs in Hong Kong. As such, they have been comprehensively addressed by the Sub-committee in Chapter 4 of

the Consultation Paper, and earlier in this Report.³ For the reasons set out in that chapter, and repeated at paragraphs 2.16 to 2.31 of this Report, we are of the view that the objections to introducing ORFSs generally, and DBAs specifically, are largely unfounded and, in any event, outweighed by the considerable benefits.

5.11 In reaching this conclusion, we note the overwhelming support of Respondents for making Hong Kong's ORFS regime as broad as possible. Respondents have expressed a clear desire to give users of Hong Kong Arbitration access to the full range of ORFSs, so they can finance their arbitrations in the way that best suits the circumstances of each case. Like the Respondents and the Sub-committee,⁴ we do not see a basis for permitting CFAs while prohibiting other forms of ORFS, including DBAs.

5.12 In response to the specific concern that DBAs might result in a party receiving inadequate compensation for its losses, we make the following observations:

- (a) Parties frequently enter into a DBA because they do not have the resources to pay their Lawyers out-of-pocket. In these circumstances, the party could not otherwise afford to claim for damages at all. Thus, even if the DBA results in the party obtaining a Financial Benefit and paying its Lawyer more than it would have paid on an hourly rate basis, the party will receive at least some Financial Benefit for its losses. Any DBA regime will be subject to caps, thus ensuring that no Lawyer can ever receive the entire amount of the client's Financial Benefit.
- (b) If a party instructs its Lawyer on a DBA basis and does not obtain a Financial Benefit in its case, it pays the Lawyer nothing. This contrasts favourably with the traditional hourly rate arrangement, where the client must pay the same fee whether it wins or loses.
- (c) Any DBA regime that Hong Kong introduces will include protection against excessive fees, in the form of caps on the percentage of damages (or other Financial Benefit) the Lawyer can claim as a DBA Payment.
- (d) It is up to the client and Lawyer to negotiate the DBA Payment in each case; the cap is simply a maximum. These negotiations will take into account the amounts in dispute, the amount of work involved in pursuing the claim, and the likelihood of obtaining a Financial Benefit. If the client feels that the DBA Payment ultimately proposed by one Lawyer is too high, the client may decline to instruct that Lawyer, and try to negotiate a lower DBA Payment with another Lawyer.

³ See Consultation Paper, at paras 4.34 to 4.75, and Chapter 2 of this Report.

⁴ See Consultation Paper, at para 4.74.

5.13 Overall, therefore, we are confident that DBAs will offer benefits to clients who might otherwise be unable to pursue a meritorious claim, as well as to clients who can afford to bring the claim but prefer to share the risk of Arbitration with their legal advisers. DBAs are simply another option for clients to consider.

5.14 The objecting Respondent also raised a concern that allowing ORFSs for Arbitration would "*open the floodgates*", ultimately leading to an ORFS regime for "general litigation".

5.15 In light of the overwhelming levels of support for allowing ORFSs in Arbitration, we do not consider that this concern is widely shared. We emphasise that the scope of the Sub-committee's consultation, and of our Final Recommendations, is limited to Arbitration (as defined in this Report). There is no proposal to introduce an ORFS regime beyond the arena on which the public has been consulted.

5.16 Thus, having considered the arguments for and against Recommendation 4, we are persuaded that the benefits of allowing Lawyers to offer DBAs in Arbitration, with appropriate safeguards,⁵ outweigh any potential disadvantages.

5.17 The mechanism for lifting the prohibitions on DBAs is discussed in Chapters 12 and 13, where Recommendations 11 and 12 are considered.

Final Recommendation 4

We recommend that prohibitions on the use by Lawyers of DBAs in Arbitration should be lifted, so that Lawyers may use DBAs for Arbitration.

⁵ See the discussion of such safeguards in Chapter 14 of this Report.

Chapter 6

Recoverability of Legal Expense Insurance premium from the unsuccessful party under DBAs

Responses to the Sub-committee's Recommendation 5

6.1 This Chapter discusses the responses regarding Recommendation 5 in the Consultation Paper:

*"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."*¹

6.2 Consistent with the responses to Recommendation 2 (which dealt with the recoverability of Success Fee premium and Legal Expense Insurance premium in the context of CFA, and thus covered a similar issue), almost all of the submissions that commented on Recommendation 5 supported the recommendation. Those in favour included an arbitral institution, an arbitrator/barrister, a chamber of commerce, a consumer/public interest group, a Government department, law firms and professional bodies.

Comments from Respondents who supported Recommendation 5

6.3 Most Respondents who supported Recommendation 5 cited the same grounds as Recommendation 2. For example, a Government department commented: *"For the same reasons given in paragraphs 13-14 above [responding to Recommendation 2], we agree with the LRC Sub-committee's recommendation on the irrecoverability of ATE insurance premium from the losing respondent in the DBA context."* Likewise, a chamber of commerce submitted: *"We agree, for the same reasons given in our answer to Recommendation 2 above in relation to CFAs."*

6.4 An arbitral institution also agreed, noting that *"Any ... ATE insurance premiums agreed between a party and its ... insurers for the purposes of an ORFS arrangement should not be recoverable from the counterparty."*

6.5 Other Respondents, including a professional body and an arbitrator/barrister, concurred. The following response was typical: *"We agree with Recommendation 5 that ATE insurance premium should not be*

¹ See Consultation Paper, at para 5.25.

recoverable from the losing party." They went on to emphasise that, in their view, they were *"against recovery of any DBA payments from the losing party, as the structure of funding and the apportionment of the damages (the outcome) are matters for the winning party"*. This becomes relevant to Recommendation 6, and the question of which model, the Success fee model² or the Ontario model,³ should apply to DBAs (including Hybrid DBAs), discussed in Chapter 7 below.

Comments from the Respondent who opposed Recommendation 5

6.6 As with Recommendation 2, amongst the responses received, only one – a litigation funder - directly opposed Recommendation 5. The funder relied on the same reasons cited against Recommendation 2. To reiterate, and referring again to the English court decision in *Essar v Norscot*,⁴ this Respondent's view was that:

"... there should be no express prohibition on the recovery from the respondent of any Success Fee and ATE insurance premium. The awarding of legal 'and other costs' in an arbitration should continue to be at the discretion of the arbitral tribunal in line with international best practice. Under section 74(7) of the Arbitration Ordinance, the tribunal must only allow costs 'that are reasonable having regard to all the circumstances.' In the case of a CFA, this may, depending on the circumstances of the case, include any Success Fee and/or ATE insurance premium.

Consistent with the core arbitral principles of flexibility and party-autonomy, the tribunal should retain flexibility to do justice in the case as it sees fit, subject to any overarching agreement otherwise between the parties."

Our analysis and response

6.7 As with Recommendation 2, the overwhelming majority of Respondents who commented specifically on Recommendation 5 agreed with the Sub-committee's view that the losing party should not be responsible for any ATE Insurance premium agreed by a client with its insurers.

6.8 We have, however, also considered the arguments made that the Tribunal should have discretion over whether, and on what basis, to award legal

² The damages-based fee regime proposed in the 2019 DBA Reform Project in England and Wales, whereby costs recovered from the opponent are outside of, and additional to, the DBA Payment.

³ The damages-based fee regime which operates in Ontario, Canada, whereby:

- (a) the recoverable costs of the claimants will be assessed in the conventional way, and
- (b) if the 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.

⁴ [2016] EWHC 2361 (Comm).

and other costs incurred by the winning party in the Arbitration, as well as the related references made to the English decision of *Essar v Norscot*. As noted above, the facts of *Essar v Norscot* were unusual, and the Tribunal made the decision to order the losing party to bear the third party funder premium of the winning party based on the exceptional circumstances in that case. Therefore, we consider that where a DBA, or a Hybrid DBA, is in place, there is merit in giving the Tribunal discretion, in exceptional circumstances, to order the losing party to pay any ATE Insurance premium that has been incurred by the successful party.

6.9 For all these reasons, our final recommendation is similar to Final Recommendation 2, namely that the position under Hong Kong law for Arbitration should be that, where a DBA, or a Hybrid DBA, is in place, the losing party should not, in principle, be liable to pay any Legal Expense Insurance (including ATE Insurance) premium agreed by the winning party with its insurers. However, in exceptional circumstances, the Tribunal should have power to apportion those costs between the parties in the Arbitration based on the exceptional circumstances of the case.

Final Recommendation 5

Where a DBA, or a Hybrid DBA, is in place, we recommend that any Legal Expense Insurance premium agreed by a client with its insurers shall not, in principle, be borne by the unsuccessful party. However, where in the opinion of the Tribunal there are exceptional circumstances, the Tribunal may apportion such Legal Expense Insurance premium between the parties if it determines that apportionment is reasonable, taking into account the exceptional circumstances of the case.

Chapter 7

Success fee model should apply where a DBA is in place

Responses to the Sub-committee's Recommendation 6

7.1 This Chapter discusses the responses regarding Recommendation 6 in the Consultation Paper:

"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."*¹

7.2 Of the Respondents who commented specifically on Recommendation 6, almost all supported the application of the Success fee model to DBAs, as opposed to the Ontario model. A small number of Respondents did not specifically agree, but this was primarily on the basis that the position on costs should not be pre-determined by legislation and/or that the Tribunal should retain discretion over how to apportion costs between the parties depending on the circumstances and outcome of the case. Only one Respondent advocated for the Ontario model to apply, instead of the Success fee model, at least initially.

Comments from Respondents who supported the Success fee model

7.3 The Law Society agreed with the Sub-committee's tentative recommendation that, if DBAs are used in arbitration, the Success fee model should be followed. Having explained the differences between the two models, the Law Society said: "**We *strongly* feel that we ought to continue to follow the Success fee model. Otherwise, essentially, a losing party stands to benefit at the expense of the winning party, which is inherently – and fundamentally – wrong ... The Success fee model is clearly to be preferred ... to fairly allow a winning party to recover as much of its recoverable costs as possible.**" (emphasis in original).

¹ See Consultation Paper, at paras 5.26 to 5.30.

7.4 Two other Respondents, both law firms, agreed, with one noting:

"We agree with the Sub-Committee's view. In particular, we view the cap on recoverability in the Ontario model to be problematic because a losing respondent may not be responsible for paying the full recoverable costs. Our overarching view is that a losing respondent should be liable to pay the full recoverable costs on a costs indemnity basis, irrespective of which ORFS is employed between the client and lawyer (providing always of course that the claimant should not recover more than the amount of legal fees incurred)."

7.5 A professional body and a consumer/public interest group concurred, saying *"The success fee model should apply to DBAs"*, and

"The [group] agrees with the Sub-committee's preliminary view ... [that] a Success fee model should be followed. Under the Ontario model, if the claim is successful, the lawyer cannot treat the DBA Payment as a true success fee, on top of the recoverable costs incurred to successfully pursue the claim. The [group] found it unfair to Lawyers. Conversely, the Success fee model allows Lawyers to retain the DBA Payment on top of the recoverable costs awarded, whereby the lawyers will be reasonably remunerated in proportion to what they have given."

7.6 A chamber of commerce also agreed, saying that the *"question of recoverable costs should be kept separate from the question of the amount of the DBA payment"*.

7.7 A further Respondent – another law firm – also supported the adoption of the Success fee model in preference to the Ontario model, saying:

"The Ontario model is subject to the indemnity principle. In other words, if the DBA Payment is lower than the amount of recoverable costs, then the DBA [sic] acts as a ceiling on the recoverable costs to which the client is entitled from the losing party. The losing party can therefore escape the consequences of an award of recoverable costs."

7.8 The same Respondent continued:

"The Ontario model is particularly unattractive when the claimant wins on the merits but loses its quantum case. ... In these circumstances, Lawyers risk making a loss even when they have won the case (or at least part of the case) for their clients."

... this scenario does not arise under the Success fee model because recoverable costs are paid in addition to, and independent of, the DBA Payment. Adopting the Success fee model means that the successful party's recoverable costs will not

be offset against the damages awarded. Further, we are of the view that the Success fee model is more compatible with Hybrid DBAs, which we also support"

7.9 An arbitral institution also agreed that the Success fee model should apply. As did a Government department, which noted that:

"... England and Wales has been considering switching to the Success fee model from the Ontario model. We see merits in the key arguments for moving to the Success fee model (as highlighted in paragraph 4.88 of the Consultation Paper) and have no other comments on the LRC Sub-committee's recommendation to follow the trend of adopting the Success fee model."

Comments from Respondents who opposed the Success fee model

7.10 Of the Respondents who commented on Recommendation 6, only a small number objected to the application of the Success fee model to DBAs.

7.11 A litigation funder commented that:

"This recommendation principally goes to the question of cost recovery in an arbitration. As noted above, [this funder] considers that the allocation of legal and other costs (including any success-based fee due to the lawyers or a third-party funder) should remain at the discretion of the tribunal, subject to any agreement between the parties. This is in line with international best practice and the core arbitral principles of flexibility and party-autonomy. The situation in arbitration is distinct from court litigation in England and Wales and Hong Kong arbitration should adopt a lighter touch approach reflecting the nature and sophistication of its corporate users."

7.12 Two Respondents (who submitted identical responses) also disagreed with the application of Success fee model. However, these Respondents did not prefer the Ontario model. Rather, their approach was similar, and to the effect that "[g]iven the importance of 'freedom of contract' ... no pre-determined success fee model, whether the Ontario Model or any other discussed model, should be imposed to fetter the application of DBA". As these Respondents put it: *"It is for the parties to keep clear contemporaneous records of costs, to be assessed and recoverable based on indemnity principles."*

7.13 The HKBA is the only Respondent who preferred the Ontario model. It stated:

"With respect to Recommendation 6, the HKBA proposes that initially the Ontario model should generally apply which requires that the DBA payment includes recoverable costs to prevent overcompensation of Lawyers.

If the Success Fee model is applied, a reduced cap should apply, once again to prevent overcompensation of Lawyers."

Our analysis and response

7.14 We have considered carefully the responses and comments including those summarised above. This includes the comments received from the HKBA in favour of applying the Ontario model, as well as comments from Respondents who were not in favour of any specific fee model being applied, and wished to leave this to the parties – and the Tribunal – to regulate.

7.15 In our view, however, there are two key difficulties with this latter approach.

7.16 The first is that it does not address the indemnity principle, which applies to commercial arbitrations in Hong Kong, just as it does in commercial litigation. As the Sub-committee explained in the Consultation Paper,² if the Success fee model is not adopted and the DBA Payment is less than the amount of recoverable costs (including as assessed by the Tribunal), then the opponent is not obliged to pay those recoverable costs, and the DBA Payment becomes the ceiling of recoverable costs to which the client is entitled. This can be a significant windfall for the losing opponent. Although in most cases the DBA Payment is likely to be higher than recoverable costs, there will be some cases, as indicated by one law firm's response in paragraphs 7.7 and 7.8 above, where it is not.

7.17 The benefit, then, in these scenarios of using the Success fee model, is that the windfall scenario described does not arise, as recoverable costs are paid *in addition* to the DBA Payment.

7.18 The other difficulty is that if recoverable costs are payable in any way by reference to the DBA Payment – and if there is any chance that the losing opponent might be responsible for any part of that payment, beyond recoverable costs – the losing opponent has an incentive to challenge the enforceability of the DBA (including Hybrid DBA), which increases the propensity for satellite litigation.

7.19 In light of these issues, and considering the otherwise overwhelming support for the Success fee model from the Respondents, we

² Consultation Paper, at para 5.27.

agree with the Sub-committee's view that, where a DBA or a Hybrid DBA is in place, the Success fee model should be adopted. This means that costs recovered from the opponent are outside of, and additional to, the DBA Payment, and the DBA Payment is treated as true success fee on top of recoverable costs.

7.20 In reaching this conclusion, we have taken into account the fact that, Tribunals have significant discretion and flexibility in how to award and apportion costs between the parties. The Success fee model does not affect or fetter that discretion in any way. Notably, the winning party is still able to recover its costs, reasonably incurred, from the losing opponent, taking into account the circumstances of the particular case, its outcome and the conduct of the parties.

Final Recommendation 6

We recommend that the Success fee model should apply to DBAs, including Hybrid DBAs.

Chapter 8

Cap on DBA Payment

Responses to the Sub-committee's Recommendation 7

8.1 This Chapter discusses the responses regarding Recommendation 7 in the Consultation Paper:

"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%.¹

8.2 Again, a substantial majority of the Respondents, who expressed their views on Recommendation 7 agreed with the recommendation. With one exception, the Respondents who did not agree with a cap were, on the whole, the same as those who disagreed with a cap for CFAs.

Comments from Respondents who supported Recommendation 7

8.3 Among the Respondents who were in favour of a cap, a consumer/public interest group explained its view as follows: *"The [group] agrees that there should be a cap on the DBA Payment payable by the client to its lawyer ..."* In terms of what that cap should be, and acknowledging that England and Wales was proposing a reduction of the cap from 50% to 40% if the Success fee model was adopted, this body proposed that:

"... it be capped at 50%. Notwithstanding UK's reduction of the capped share of the financial benefit obtained by the client to 40% in 2019 to prevent a lawyer being over-compensated, the [group] considers that a cap of 50% does not necessarily lead to such presumption of over-compensation as it is after all a recommendation only and it is believed that the client will negotiate the payment with its lawyer according to the prevailing situation when signing the agreement."

¹ See Consultation Paper, at paras 5.31 to 5.35.

8.4 An arbitral institution agreed: *"Consistent with the position in other jurisdictions, there should be appropriate caps on the ... DBA payment by the client to its lawyer under DBAs and Hybrid DBAs."* The institution did not express a specific view on what the cap should be, but noted that it was:

"... important ... that such caps and other safeguards are carefully drawn so as not to have the effect of unduly limiting the circumstances in which ORFSs can be used (e.g. by preventing parties and their lawyers from being able to appropriately share the risk and reward of a dispute in a DBA)".

8.5 Another Respondent, a professional body, was of the view that the appropriate range for consultation was 30% to 50%, but did not express a view within that range.

8.6 Other Respondents – law firms – also agreed with the cap. One expressly stated its preference for the *"cap to be set at the higher end of the range, ie 50%"*. They noted that this *"potentially increases the number of lower value claims for which a DBA may be considered"*, and that a higher cap was preferred in particular in circumstances where a solicitor and a barrister might each be engaged via a separate DBA, where their combined DBA Payments would be subject to the prescribed cap.

8.7 Another law firm also agreed with the cap, its view being that the cap should be 40% if the Success fee model is adopted: *"On the assumption that the Success fee model were to be applied, we agree with the 2019 DBA Reform Project's proposal that the percentage should be 40% on the basis that the client must pay recoverable costs in addition to the DBA Payment and the Lawyers should not be overcompensated."*

8.8 The Law Society agreed with there being a cap, expressed as a percentage of financial benefit or compensation obtained by the client, and expressed the view that a *"lower percentage is appropriate if the Success fee model is adopted"*. The Law Society thought that *"[c]onsideration should be given to the possibility of different percentages depending on the value of the claim – e.g. a higher percentage if the claim value is lower. This cap (which could be reviewed say two years after the implementation of ORFS for arbitration) should favourably put Hong Kong in a competitive position in the international arbitration landscape."* The HKBA agreed with a cap, and expressed a similar view: *"The HKBA considers that the cap should be: (1) 40% if the Ontario Model is adopted [, and] (2) 30% if the Success Fee Model is adopted."*

8.9 The Consumer Council was also in favour of a cap, but said it would leave the precise cap to the legal profession to decide:

"Suffice to say that any cap imposed should be reasonable and should not make a mockery of taking the matter to arbitration e.g. the consumer client is left in a situation whereby despite succeeding on a case, he/she is left with an unfavourable

outcome where the legal representative retains an inequitable proportion of the award. When determining what is an appropriate cap to impose, affordability and a proportionate return for the consumer who embark [sic] on such an arrangement with his/her legal counsel should be factors to be taken into account."

Comments from Respondents who opposed Recommendation 7

8.10 Three Respondents, an arbitrator/barrister, a litigation funder and a professional body, were against the imposition of any cap.

8.11 The key reasons given were party autonomy and the ability of sophisticated, commercial parties – primary users of Arbitration in Hong Kong – to negotiate their own DBA terms with their Lawyers.

8.12 As the funder put it:

"As noted in the Consultation Paper, most parties to international arbitration are, on the whole, sophisticated commercial parties. In [the funder's] view, the DBA terms should be left to the parties to negotiate, provided there is a requirement in the ORFS regime for clients to receive independent advice. This will allow parties to have the necessary commercial autonomy to negotiate terms that are appropriate in the circumstances of the case and to maximise access to justice."

8.13 The other two Respondents gave a similar response, namely that a cap should not be necessary. The professional body stated that:

"... given the importance of party autonomy and the need for flexibility to structure arbitration financing to meet the needs of the relevant stakeholders, we are against any capping. We are of the view that the client should be in the best position to make its own commercial decisions, and to take responsibility to protect its own interests."

These two Respondents thought that although the *"cap at 30-50% is not unreasonable, we are of the view it is not necessary"*.

Our analysis and response

8.14 Again, the majority of Respondents who commented on Recommendation 7 agreed with the Sub-committee 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.

8.15 A handful of Respondents did not, as noted, agree with a cap, but they did so on the basis that they did not consider a cap to be necessary,

because clients are fully capable of negotiating their own DBA Payments with their Lawyers.

8.16 We acknowledge the views given. We also agree with the litigation funder's view that most parties to international commercial arbitration are, on the whole, sophisticated commercial parties. Despite this, we are mindful of the position in other jurisdictions, and the fact that caps on DBA Payments are applied in other jurisdictions where ORFSs are permitted.

8.17 In light of this, and even though the users of Arbitration in Hong Kong are, on the whole, commercial parties, we agree with the Sub-committee's view that the DBA Payment should be subject to a cap. This is consistent with the position in some other jurisdictions, including England and Wales, Australia and Mainland China.

8.18 One Respondent suggested that the Consultation Paper has not covered the cap on DBA Payments payable under Hybrid DBAs. The DBA Payments payable under DBAs and Hybrid DBAs should be subject to the same cap as discussed in Recommendation 7. This was what the Sub-committee had intended when it made Recommendation 7.

8.19 In terms of what that cap should be, we agree with the responses given that it should be in the range of 30% to 50%. After reflecting on the comments made, we consider that the appropriate cap is 50% for the reasons set out in the ensuing paragraphs.

8.20 First, any cap only operates as a cap on the maximum DBA Payment that can be charged. It does not require parties and their Lawyers to adopt the cap, but it does allow the parties and their legal representatives to negotiate within more flexible parameters. This addresses the concerns raised by those Respondents who considered that no cap at all should be applied. As a consumer/public interest group noted: *"... it is after all a recommendation only and it is believed that the client will negotiate the payment with its lawyer according to the prevailing situation when signing the agreement"*.

8.21 Second, we have taken into account the views expressed by a law firm, which is that a higher cap *"potentially increases the number of lower value claims for which a DBA may be considered"*. We are mindful too that co-counsel, and even barristers, may well be instructed directly by a client in international arbitration proceedings pursuant to separate DBAs. Given that the aggregate DBA Payment under two (or more) DBAs (including Hybrid DBAs) cannot exceed the overall cap, adopting a higher cap benefits all stakeholders, including clients, and provides greater access to justice.

8.22 Third, a 50% cap currently applies in England and Wales, and has been working well. The Sub-committee acknowledges that in return for a move from the Ontario model to the Success fee model, the 2019 DBA Reform

Project² has proposed reducing the cap from 50% to 40%, as a *quid pro quo* for the change. However, based on further consideration of this proposal, and canvassing the views of those who have commented on the proposed reform in England and Wales, we consider that there may be a number of circumstances where recoverable costs from the losing party are reduced or not paid, as a result of conduct on the part of the losing party or even the client, which is in no way the fault of the Lawyer. In these cases, reducing the maximum permitted DBA Payment could result in Lawyers being undercompensated, contrary to the rationale for reducing the cap in the first place.

8.23 For all these reasons, we conclude that there should be a cap on the DBA Payment, and that the appropriate cap in these circumstances should be 50% of the Financial Benefit obtained by the client.

Final Recommendation 7

We recommend that any DBA Payment be capped at 50% of the Financial Benefit obtained by the client.

² An independent review of the Damages-Based Agreements Regulations 2013 in England and Wales by Professor Rachael Mulheron and Mr Nicholas Bacon, QC during 2019 to 2020.

Chapter 9

Circumstances for termination of CFA, DBA or Hybrid DBA

Responses to the Sub-committee's Recommendation 8(a) and (b)

9.1 This Chapter discusses the responses regarding Recommendation 8(a) and (b) in the Consultation Paper:

"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."¹*

Recommendation 8(a)

Comments from Respondents who supported Recommendation 8(a)

9.2 Of the Respondents who commented on Recommendation 8(a), an overwhelming majority were in support, in particular of ORFSs for Arbitration specifying in what circumstances they can be terminated. Both the Law Society and the HKBA supported Recommendation 8 as a whole.

9.3 One Government department noted that:

"In line with the freedom of contract argument for permitting ORFSs for Arbitration in Hong Kong, we believe that parties to the ORFS agreements ... should be entitled and free to negotiate the terms of termination and address the same in the relevant ORFS agreements. Indeed, a termination clause is commonly used in ordinary contracts by parties to define the circumstances under which agreements can be terminated, for the sake of certainty.

To further enhance clarity in the local legislative framework of ORFSs regarding termination ... we tend to agree with the proposed reform in England and Wales that certain statutory

¹ See Consultation Paper, at paras 5.36 to 5.43.

parameters could be put in place as to the general principles for termination."

9.4 A law firm agreed, noting that: *"... this is an important safeguard, albeit one would expect a properly drafted CFA, DBA or Hybrid DBA to provide for this".* Similarly, another law firm confirmed its agreement that there *"should be regulation providing for the circumstances in which the lawyer is entitled to terminate the agreement"*. This Respondent further considered that: *"... the legislated grounds for termination should be in addition to any further grounds for termination in the engagement agreement" because "different arrangements may entail different risk profiles, and each engagement would be highly sensitive to its facts. As such, lawyers and clients should be free to negotiate and agree additional grounds upon which a lawyer may be able to terminate, beyond those that will eventually be provided for."*

9.5 Another professional body also agreed that the relevant ORFS *"[m]ust clearly state reasons for termination"* and that the *"client shall pay the lawyer on [sic] hourly rate basis in the event of such termination"*.

9.6 A litigation funder also agreed, noting that this was the position in relation to Third Party Funding arrangements in Hong Kong.

9.7 Two other Respondents, an arbitrator/barrister and a professional body, also agreed, noting that it should be for the parties to a CFA, DBA, or Hybrid DBA to specifically *"specify, whether, and if so, in what circumstances and upon what basis, the lawyers or client are entitled to terminate the fee agreements."* However, in the view of these Respondents, this was *"not a matter for legislation. If there has not been any prior agreement, the parties can always subsequently negotiate and arrive at a mutually agreed separation agreement, failing which, neither should be allowed to terminate."*

9.8 As to the circumstances in which a client is entitled to terminate the ORFS prior to the conclusion of the Arbitration, one Respondent - a Government department - endorsed the proposed reform in England and Wales, namely that:

"... certain statutory parameters could be put in place as to the general principles for termination. For example, as proposed in the latest draft of the Damages-Based Agreements Regulations 2019 which is still under consideration in England and Wales, subject to the parties agreeing otherwise, lawyers may not terminate the ORFS agreements unless their clients have behaved or are behaving unreasonably, and that if clients terminate the ORFS agreements, the legal fees chargeable by lawyers cannot exceed those costs and expenses incurred."

9.9 Another consumer/public interest group agreed, noting that:

"... it is expected that relevant mechanisms and standards should be established in the legislative process to stipulate that the

agreement may only be terminated ex parte by the terminating party on sufficient and reasonable grounds, in order to prevent unnecessary disputes arising upon termination".

9.10 A chamber of commerce agreed that *"at least during the initial years of the new regime, it would be advisable to put in place certain safeguards, particularly to protect the interests of SMEs. We agree with [the] recommended safeguards."*

Comments from Respondents who opposed Recommendation 8(a)

9.11 There were no specific objections to Recommendation 8(a).

Our analysis and response on Recommendation 8(a)

9.12 There is overwhelming support from the public and the professional bodies that parties should be able to specify in their CFAs, DBAs, or Hybrid DBAs the circumstances in which a Lawyer or client is entitled to terminate the fee agreement prior to the conclusion of the Arbitration. We agree, noting that this is consistent with the principles of freedom of contract and party autonomy, and also provides clarity and certainty about the circumstances when ORFS arrangements for Arbitration can be brought to an end. As one Government department noted, termination provisions are common in ordinary contracts, and they *"define the circumstances under which agreements can be terminated, for the sake of certainty"*.

9.13 In terms of what those grounds for termination are, a small number of Respondents considered that the grounds for termination were not a matter for legislation at all, and should be entirely a matter for negotiation between clients and Lawyers. As these Respondents acknowledged, however, the difficulty with this is that if the parties are unable to agree on the grounds for termination, whether in the initial arrangement or subsequently, neither party will be able to terminate.²

9.14 A more common view expressed by Respondents was that the general principles for termination should be regulated and provided for within the statutory regime, as a way of providing safeguards to stakeholders and enhancing clarity. Examples given included permitting the Lawyer to terminate when a client has behaved or is behaving unreasonably. Another Respondent stated that:

"... relevant mechanisms and standards should be established in the legislative process to stipulate that the agreement may only be terminated ex parte by the terminating party on sufficient and reasonable grounds, in order to prevent unnecessary disputes arising upon termination".

² Unless grounds exist for termination at law.

9.15 The majority of those who responded were of the firm view that the statutory grounds for termination should not be exhaustive. As one Respondent explained,

"... different arrangements may entail different risk profiles, and each engagement would be highly sensitive to its facts. As such, lawyers and clients should be free to negotiate and agree additional grounds upon which a lawyer may be able to terminate, beyond those that will eventually be provided for."

9.16 Another Respondent agreed, noting that, *"at least during the initial years of the new regime, it would be advisable to put in place certain safeguards, particularly to protect the interests of SMEs"* but that, under the principle of freedom of contract, *"businesses should generally be free to negotiate the terms of their agreement, including fees, with their lawyers, free of legislative intervention"*.

9.17 We have considered these responses, and the views expressed. We agree that the relevant legislation should specify the principal grounds upon which an ORFS can be terminated by the Lawyer. This will provide the primary safeguards highlighted by the Respondents. We also see no reason to differentiate between CFAs, DBAs and Hybrid DBAs in this respect. However, we do not consider it necessary to set out statutory grounds on which a client may terminate an ORFS arrangement for Arbitration. Consistent with the regime proposed in the English redrafted Damages-Based Agreements Regulations 2019 proposed in the 2019 DBA Reform Project ("**Redrafted 2019 DBA Regulations**"), we consider that the grounds for termination by the client should be purely a matter for agreement with the Lawyer in accordance with basic contractual principles, so as to provide maximum flexibility for the benefit of the client.

9.18 We agree with the majority of Respondents that the statutory grounds for termination by the Lawyer should not be exhaustive, and that parties should be able to negotiate and agree additional grounds on which the parties can terminate, just as they can with any contract. The non-exhaustive statutory grounds for termination by a Lawyer are put in place to provide the client with guidance on when it might be reasonable for a Lawyer to terminate, while a broader scope for when the client wants to terminate, *beyond fault*, depends on the negotiation between the Lawyer and the client. This is in line with the principles of freedom of contract and party autonomy, both cornerstones of international arbitration. We note that this is consistent too with the position in England and Wales, and in particular the Redrafted 2019 DBA Regulations, which provide that "[s]ubject to the parties agreeing otherwise ...", the Lawyer may not terminate the agreement unless the client has behaved or is behaving unreasonably.

9.19 In our view, this should be implemented in Hong Kong by subsidiary legislation stipulating that Lawyers may terminate a CFA, DBA or Hybrid DBA where they reasonably believe that the client (i) has committed a

material breach of the ORFS; or (ii) has behaved or is behaving unreasonably. These are reflected in the recommended ORFS safeguards to be included in the subsidiary legislation, ie item 1(m) set out in Annex 2 attached to this Report.

Recommendation 8(b)

Comments from Respondents who supported Recommendation 8(b)

9.20 The two Respondents who commented specifically on Recommendation 8(b) supported the recommendation. A professional body noted that if an ORFS arrangement was terminated, clients should pay the Lawyer based on hourly rates.

9.21 A litigation funder agreed that, *"in the event of termination, any alternative basis (for example, hourly rates) on which the client shall pay the lawyer should be specified in the agreement. These terms should be left to the parties to negotiate, provided there is a requirement in the ORFS regime for clients to receive independent advice ..."*

Comments from Respondents who opposed Recommendation 8(b)

9.22 There were no specific objections to Recommendation 8(b).

Our analysis and response on Recommendation 8(b)

9.23 We agree that the parties should be required to agree an alternative basis – for example hourly rates – on which the client shall pay the Lawyer, if the relevant ORFS is terminated prior to the conclusion of the Arbitration. The alternative basis should be set out in the ORFS, and should be subject to the caveat that the Lawyer may not charge more than the Lawyer's costs and expenses (including barristers' fees if charged as a disbursement) for the work undertaken.

Final Recommendation 8

We recommend that:

- (a) A CFA, DBA, or Hybrid DBA should specify whether, and if so in what circumstances, a Lawyer or client is entitled to terminate the ORFS prior to the conclusion of the Arbitration.**

- (b) Subsidiary legislation should specify, on a non-exhaustive basis, that a Lawyer is entitled to terminate an ORFS prior to the conclusion of the Arbitration if the Lawyer reasonably believes that:**

 - (i) the client has committed a material breach of the CFA, DBA or Hybrid DBA; or**
 - (ii) the client has behaved or is behaving unreasonably.**
- (c) A CFA, DBA, or Hybrid DBA should specify an alternative basis (for example, hourly rates) on which the client shall pay the Lawyer in the event of such termination, save that the Lawyer may not charge the client more than the Lawyer's costs, expenses and disbursements for the work undertaken in respect of the Proceedings to which the CFA, DBA or Hybrid DBA relates.**
- (d) The grounds on which a client may terminate a CFA, DBA or Hybrid DBA prior to the conclusion of the Arbitration should be a matter for agreement with the Lawyer in accordance with basic contractual principles, and no statutory requirements should apply.**

Chapter 10

Treatment of barristers' fees

Responses to the Sub-committee's Recommendation 9(1) and (2)

10.1 This Chapter discusses the responses regarding Recommendation 9 in the Consultation Paper:

"(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."¹

Recommendation 9(1)

Comments from Respondents who supported Recommendation 9(1)

10.2 All but one of the submissions that commented on Recommendation 9(1) supported the recommendation 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 will be charged as a separate disbursement outside the DBA Payment.

10.3 A Government department commented:

"In principle, arbitration parties are allowed to freely structure their representation. They may choose to be represented by lawyers qualified in any jurisdictions. They may also elect to engage a barrister directly without the intervention of a firm of solicitors. Taking into consideration the high degree of party autonomy in

¹ See Consultation Paper, at paras 5.44 to 5.48.

arbitration, we agree with the LRC Sub-committee's recommendations in this regard."

10.4 A regulator also agreed, noting that *"the scope of the ORFS framework should be broadly and flexibly crafted so as to encompass the diversified needs of different parties to enter into the most suitable fee arrangement(s)".*

10.5 A chamber of commerce's view was consistent: *"We agree with these recommendations. Businesses should be free to negotiate with their lawyers whether or not the DBA payment includes barristers' fees."*

10.6 The Law Society also supported the recommendation, stating that *"clients should be fully advised on and be given the choice on whether: (a) the DBA Payment includes barristers' fees; or (b) barristers' fees would be charged as a separate disbursement outside the DBA Payment".* The HKBA also agreed with Recommendation 9(1).

10.7 A litigation funder concurred: *"[The funder] agrees with the Sub-committee's recommendation for flexibility in how barristers' fees are charged. These terms should be left to the parties to negotiate and structure in the most appropriate way, depending on the circumstances of the case, provided there is a requirement in the ORFS regime for clients to receive independent advice"*

Comments from the Respondent who opposed Recommendation 9(1)

10.8 Only one Respondent appeared to oppose Recommendation 9(1). Even then this was on the basis, stated simply, that *"[s]olicitors shouldn't be liable for terms agreed between barristers and clients"*, and thus was in support of barristers being engaged directly by clients, which is possible in Arbitration.

Our analysis and response

10.9 As discussed in paragraph 5.47 of the Consultation Paper, the Redrafted 2019 DBA Regulations contemplate a client being able to choose whether to engage barristers through its solicitors (in which case the barristers' fees would be paid out of the DBA Payment) or directly (in which case the barristers' fees would lie outside the DBA Payment).

10.10 In light of this, and considering the overwhelming support for Recommendation 9(1), we fully agree that parties should be able to choose (i) how to structure the client's legal representation and (ii) whether barristers' fees (or any other disbursements incurred by the solicitor) will be absorbed as part of the DBA Payment, or whether they are to be treated as *expenses* which the client is required to pay in addition to the DBA Payment.

10.11 In fact, this is something that the parties could be required to specify (as relevant) in their DBA, or Hybrid DBA.

Recommendation 9(2)

Comments from Respondents who supported Recommendation 9(2)

10.12 Of the Respondents that commented specifically, a slight majority agreed with Recommendation 9(2), namely that 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.

10.13 A chamber of commerce commented: *"Where there is a separate DBA between a client and a barrister, we agree that the solicitor's DBA payment plus the barrister's DBA payment should not exceed the prescribed DBA payment cap"* The rationale given was that it would be *"invidious for a successful claimant, under a DBA payment structure, to have to pay most, if not all, of the sum recovered in the arbitration on legal fees"*.

10.14 The Law Society agreed: *"In the event that barristers' fees are charged as a separate disbursement outside the DBA Payment, the Law Society considers that 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."*

10.15 Another Respondent – a law firm – was also of the same view, but noted that where a solicitor's and barrister's combined DBA Payments were subject to the prescribed DBA Payment cap, its preference would be for the *"DBA Payment cap to be set at the higher end of the range, ie 50%"*. As this Respondent noted, this *"potentially increases the number of lower value claims for which a DBA may be considered"*.

Comments from Respondents who opposed Recommendation 9(2)

10.16 Amongst the responses received, three opposed Recommendation 9(2). These Respondents were those which had advocated against any cap for DBA Payment, and so it follows that they did not agree with Recommendation 9(2) for the same reason.

Our analysis and response

10.17 Given the feedback from the public during our consultation, and in light of our Final Recommendation 7 on there being a prescribed cap for DBA Payment, we maintain this recommendation, namely that 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. As noted above, and consistent with comments received about the flexibility afforded by a higher cap, we have recommended that the prescribed statutory cap be 50%.

Final Recommendation 9

We recommend that:

- (a) Clients should be able to agree, on a case by case basis, whether:**
 - (i) the DBA Payment (and thus the DBA Payment cap) includes barristers' fees; or**
 - (ii) barristers' fees will be charged as a separate disbursement outside the DBA Payment.**
- (b) The DBA, including Hybrid DBA, should specify whether barristers' fees will be absorbed as part of the DBA Payment, or whether they are to be treated as "expenses" which the client is required to pay in addition to the DBA Payment.**
- (c) To the extent that barristers can be, and are, engaged directly, via a separate DBA, including Hybrid DBA, between client and barrister, 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.**

Chapter 11

Hybrid DBAs should be permitted

Responses to the Sub-committee's Recommendation 10

11.1 This Chapter discusses the responses regarding Recommendation 10 in the Consultation Paper:

"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."¹*

Comments from Respondents who supported the basic proposal in Recommendation 10

11.2 A Hybrid DBA allows a Lawyer to charge the client some (typically discounted) fees as the case proceeds,² and a DBA Payment in the event the client obtains a Financial Benefit in the matter.

11.3 Of the Respondents who commented specifically on Recommendation 10, all but one Respondent (who opposed the introduction of ORFSs in general as discussed in Chapters 2 and 5 above) agreed with the basic proposal that Hong Kong should allow Hybrid DBAs. This is in line with the majority view in the consultation that Hong Kong should introduce an ORFS regime for Arbitration, and that it should be as broad as possible. Among

¹ See Consultation Paper, at paras 5.49 to 5.55.

² In the event that the client obtains a Financial Benefit in the matter, the Lawyer should repay the client the recoverable portion of the fees that were already paid as work in progress by the client to the Lawyer as the case proceeds, while the irrecoverable portion of such fees should be set off against the DBA Payment, so as to avoid double recovery.

those supporting the basic proposal in Recommendation 10, only one Respondent, a local law firm, commented that the ORFS regime should be limited to certain types of ORFS only. That particular Respondent's preference was for Hybrid DBAs over CFAs or "pure" DBAs.

11.4 The response below, from a chamber of commerce, was typical:

"We agree ... the client should have full flexibility to negotiate with its lawyers the most appropriate fee structure to suit its individual circumstances."

11.5 A Government department expressed a similar view:

"Hybrid DBAs are substantively a form of DBAs and we see no strong reason why it should not be allowed based on the principle of freedom of contract. Allowing hybrid DBAs would introduce to the proposed local ORFS regime an additional form of arbitration funding arrangement and widen the choice of funding options to arbitration users."

11.6 An arbitral institution noted that a broad regime *"is important to enhance Hong Kong's position as a leading arbitration centre and creates a competitive edge over jurisdictions that prohibit or restrict the scope of ORFSs"*.

11.7 All of the international law firms that responded also supported a broad ORFS regime, including Hybrid DBAs. As one put it:

"... arbitrating parties should have the freedom to select the type of ORFS, whether it be CFA, DBA or Hybrid DBA, that best suits their needs".

11.8 Several law firms also noted that parties can already agree Hybrid DBAs with litigation funders, after Third Party Funding of Arbitration³ was introduced via amendments to the Arbitration Ordinance in 2019.⁴ Under such "Third Party Funder Hybrid DBAs", the funder pays the Lawyer's work in progress as the case progresses, and takes a percentage of the financial benefit obtained by the client (or a multiple of its investment) if the case succeeds. One international law firm commented that *"there is no sensible justification for allowing CFAs, pure DBAs and Third Party Funder Hybrid DBAs, but not Hybrid DBAs"*.

³ 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.

⁴ See Consultation Paper, at para 5.49.

11.9 Many Respondents noted that allowing Hybrid DBAs would be beneficial in addressing the cash flow problems that might otherwise face Lawyers in a "pure" DBA situation, where they are not entitled to charge any fees for the life of the matter. As a result, it is principally law firms with sufficient capital that can afford to offer such "pure" DBA arrangements for large or long-running cases. As one Government department noted: *"[Hybrid DBAs] would also allow greater pricing flexibility and aid the cash flow of lawyers especially in long-running disputes."*

11.10 Both the Law Society and the HKBA supported the introduction of Hybrid DBAs. A consumer/public interest group concurred:

"The [consumer/public interest group] agrees 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. It ensures that, for long-running matters, a solicitor can keep some money coming in, making the case more viable to take on."

11.11 In our view, this is a major advantage of allowing Hybrid DBAs, and would permit a much larger number of Hong Kong law firms to offer a range of ORFSs to their clients, and thus increase the options available to clients.

Comments from the Respondent who opposed the basic proposal in Recommendation 10

11.12 Only one Respondent disagreed with introducing Hybrid DBAs. This same Respondent, a local law firm, objected to introducing any form of ORFS for Arbitration, for the reasons set out in Chapters 2 and 5. None of its objections relates specifically to Hybrid DBAs.

Our analysis and response

11.13 It is clear that the majority of Respondents favoured Hong Kong introducing an ORFS regime for Arbitration that is as broad, and flexible, as possible. In this context, we note that Respondents overwhelmingly supported permitting Hybrid DBAs, along with other forms of ORFS, in order to maximise the choices available to clients and Lawyers when it comes to selecting the best fee structure for each case.

11.14 Like the majority of Respondents, we are of the view that Hong Kong would benefit from a broad, flexible ORFS regime for Arbitration. Against this background, we agree that there is no reason to exclude Hybrid DBAs if, as we recommend, Hong Kong permits CFAs and DBAs in their "pure" forms.

11.15 We agree with those who submitted that permitting Hybrid DBAs would aid cash flow, particularly for long-running matters, by enabling Lawyers

to keep some money coming in during the life of the dispute. Given that Lawyers are already able to enter essentially the same arrangement with Third Party Funders, we see no logical reason to prevent them from agreeing such arrangements with their clients. Indeed, allowing Hybrid DBAs will allow more Lawyers to offer ORFS arrangements for Arbitration to their clients, thus increasing the scope of the ORFS regime for Arbitration and enhancing access to justice.

11.16 We are also persuaded by the compelling arguments put forward by Lord Justice Jackson when recommending that England and Wales permit Hybrid DBAs, including:

- (a) Hybrid 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 generally 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;⁵
- (c) Hybrid DBAs are permitted in other jurisdictions, including in Canada, and have not caused any problems. On the contrary, the effect on the Canadian regime has been to increase access to justice;
- (d) permitting Hybrid DBAs 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 or she considers the case to be weak.⁶

11.17 Having reviewed the range of submissions received on the basic proposal in Recommendation 10, and observed that almost all of those who expressed a view supported it, we agree that Hybrid DBAs should be permitted.

Responses to the Sub-committee's invitation for submissions under Recommendation 10(a), (b) and (c)

11.18 Although almost every Respondent who commented on Recommendation 10 endorsed Hybrid DBAs, responses were fewer, and more mixed, to the invitation for submissions under Recommendation 10 (a) – (c). These address:

⁵ In our view, there may be limited, exceptional circumstances in which it is justified for a Tribunal to order a losing respondent to bear some of its opponent's costs under an ORFS for Arbitration or Legal Expense Insurance premium. See discussion in Chapters 3 and 6.

⁶ See Consultation Paper, at para 5.50.

- (a) whether the Lawyer should be permitted to retain only a proportion of the costs incurred if the case does not succeed;
- (b) if so, what is an appropriate cap on such costs; and
- (c) whether, if the DBA Payment is less than the capped amount of irrecoverable costs, the Lawyer should be entitled to retain the capped amount of irrecoverable costs instead of the DBA Payment.⁷

Comments from Respondents who supported Recommendation 10(a)

11.19 Eleven Respondents expressed their views on Recommendation 10 (a) – (c). Six of them expressed support for Recommendation 10 (a); that if the case is unsuccessful, the Lawyer should be permitted to retain only a proportion of the costs he or she has incurred in pursuing it.

11.20 In support of this view, one chamber of commerce explained:

"One of the key benefits of ORFSs is that they incentivise successful outcomes by rewarding the lawyer for success. This objective would be defeated if the lawyer can recover all of the legal costs even if the claim is unsuccessful."

11.21 The Law Society noted that limiting such costs *"would help enhancing access to justice but at the same time strikes a balance on the costs exposure of the Lawyers"*.

Comments from Respondents who opposed Recommendation 10(a)

11.22 The other five Respondents, including large law firms, an arbitrator/barrister and a litigation funder, preferred not to regulate how much a Lawyer can retain if the case is unsuccessful, but to leave this for negotiation by individual Lawyers and their clients on a case-by-case basis. Two Respondents (who submitted identical responses), commented that *"it would be far too complicated to put a cap on what portion of the payments the lawyers are allowed to retain"*.

Our analysis and response

11.23 We note that responses to Recommendation 10(a) were almost evenly divided. However, having carefully considered the arguments for and against this proposal, we are persuaded that the benefits of allowing Lawyers to retain only a proportion of their costs incurred in pursuing an unsuccessful

⁷ See Consultation Paper, at paras 5.53 to 5.55.

claim (where the client does not obtain any Financial Benefit) outweigh any undesirable implications of restricting their freedom to negotiate terms with their clients.

11.24 Without such limitation, Lawyers could persuade their clients to make a large DBA Payment (much larger than the costs actually incurred) in the event the client obtains a Financial Benefit in the matter, but to pay the full amount of costs incurred in the event the client fails to obtain a Financial Benefit in the matter. This is unfair to the client, who typically agrees to pay more (via a DBA Payment) in exchange for the Lawyer providing funding during the life of the matter, and – importantly – sharing the risk of failure. If the Lawyer will be paid his full costs even where the case is unsuccessful, the risk-sharing element is missing.

11.25 In reaching this conclusion, we note that the Respondents have generally expressed overwhelming support for including appropriate safeguards in any ORFS regime for Arbitration Hong Kong adopts. In our view, such safeguards are particularly important at the beginning of any new regime, to protect users of the system who are likely to be unfamiliar with its workings and the potential for unscrupulous Lawyers to use the regime to charge excessively high fees.

Comments from Respondents on Recommendation 10(b)

11.26 Having concluded that it is appropriate to limit the proportion of costs a Lawyer can retain if the case does not succeed (ie the client receives no Financial Benefit from its case), we have considered the Respondents' views on the appropriate level of limitation.

11.27 Out of the six Respondents that supported Recommendation 10(a), five of them suggested that **30%** was the appropriate cap. This is the same cap that was proposed in the English 2019 DBA Reform Project.⁸ The remaining Respondent, an arbitral institution, suggested a **50%** cap. None of these Respondents provided reasons for their proposals.

Our analysis and response

11.28 Respondents were almost evenly divided between those who supported capping such costs and those who favoured no cap at all. We note further the general support of Respondents for a broad, flexible ORFS regime for Arbitration in Hong Kong. Finally, we are mindful of Final Recommendation 7, in which we propose a cap of 50% on "pure" DBA Payments.

11.29 In light of the above, we recommend capping at **50%** the costs that a Lawyer can retain if the case is unsuccessful (such that no Financial Benefit is obtained). In our view, this is the appropriate level to prevent abuse

⁸ See Consultation Paper, at para 5.54.

of the system while retaining for Lawyers a sufficient degree of flexibility to negotiate a fee arrangement that is suitable for the circumstances of the case.

11.30 We note finally that 50% would be a maximum, and that it remains open to clients and Lawyers to agree that the Lawyer will retain less.

Comments from Respondents on Recommendation 10(c)

11.31 As the Sub-committee noted in the Consultation Paper, the 2019 DBA Reform Project proposals in England and Wales risk creating an anomalous situation, in which a Lawyer could recover more of his fees if the client receives no financial benefit from its case, than if the client receives only a small financial benefit.⁹

11.32 The Sub-committee recommended that any Hybrid DBA regime in Hong Kong should be structured to avoid such situation, and invited submissions as to whether any 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.

11.33 The majority of Respondents who commented on Recommendation 10(c) agreed that, if the DBA Payment is less than the capped amount of irrecoverable costs, the Lawyer should be entitled to retain the capped amount of irrecoverable costs instead of the DBA Payment.

11.34 The Law Society explained:

"This would help avoiding the 'anomaly situation' identified in the Consultation Paper (para 5.54), i.e. the solicitor would financially be better off if the client lost its case outright (where the 30% payment would be retained) than won a small sum (where the recovered costs, if much less than the time expended, and the DBA Payment might be lower than that)."

Our analysis and response

11.35 In order to avoid the anomalous situation set out above, we recommend introducing a regulation to provide that, if a DBA Payment plus the recoverable costs is less than the capped amount of irrecoverable costs (which is 50% of the irrecoverable costs incurred in pursuing the unsuccessful claim as discussed in paragraph 11.29 above), the Lawyer shall be entitled to retain the capped amount of irrecoverable costs instead of the DBA Payment plus the recoverable costs.

⁹ Under the 2019 DBA Reform Project, a 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.

Final Recommendation 10

We recommend that:

- (a) Prohibitions on the use of Hybrid DBAs in Arbitration by Lawyers should be lifted, so that Lawyers may choose to enter into Hybrid DBAs for Arbitration.**
- (b) In the event that a case under a Hybrid DBA is unsuccessful (such that no Financial Benefit is obtained),**
 - (i) the Lawyer should be permitted to retain only a proportion of the "benchmark" costs he or she has incurred in pursuing the unsuccessful claim; and**
 - (ii) that proportion should be capped at 50% of the irrecoverable costs incurred in pursuing the unsuccessful claim.**
- (c) The relevant regulations should provide that, if the DBA Payment plus the recoverable costs for a Hybrid DBA (in a successful scenario) is less than the capped amount of irrecoverable costs (which is 50% of the irrecoverable costs incurred in pursuing the unsuccessful claim), the Lawyer is entitled to retain the capped amount of irrecoverable costs instead of the DBA Payment plus the recoverable costs.**

Chapter 12

Clear and simple legislation and regulation

Responses to the Sub-committee's Recommendation 11

12.1 This Chapter discusses the responses regarding Recommendation 11 in the Consultation Paper:

"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."¹

Comments from Respondents who supported Recommendation 11

12.2 Those who commented on the form of legislative amendment to permit the use of ORFS for Arbitration by Lawyers in Hong Kong generally agreed that it should be in clear and simple terms. For example, a chamber of commerce suggested that any legislative amendments should be *"as simple and clear as possible, so that all relevant stakeholders, especially businesses, have a clear understanding of the new regime"*.

12.3 A law firm agreed, noting that *"[w]ithout clear and simple amendments being made to all applicable legislation and professional rules, Hong Kong is unlikely to reap the benefit of any liberalization of the rules on ORFSs"*.

12.4 Likewise, the Law Society also supported the recommendation, suggesting that the Sub-committee may consider the common law torts and offences of champerty and maintenance in the context of the Recommendations in the Consultation Paper.

¹ See Consultation Paper, at paras 5.56 to 5.57.

12.5 The HKBA agreed with Recommendation 11. The HKBA gave detailed comments and suggestions on the specific safeguards suggested. These are discussed in the context of Recommendation 12 in Chapter 13 of this Report. The HKBA also agreed that, if ORFSs were introduced, the barristers' "cab-rank" rule may need to be amended to provide 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"*. This is consistent with the English Bar Standards Board Handbook,² where a similar exception is set out.

12.6 Other Respondents acknowledged the need *"as to clear, simple and operable amendments to the relevant Ordinances and Codes of Conduct"*.

12.7 One of the Respondents, the Consumer Council, made it clear that it supported the recommendation to provide consumers with a variety of flexible fee arrangement choices under ORFSs, provided that:

"... consumers are empowered with all the relevant information they require so they may have the freedom to contract in alignment with their views on how they wish to manage their case, alongside the careful guidance of their legal representative. ... The Council welcomes transparency and guidance provided by legal practitioners to consumer clients to ensure those entering into ORFSs are properly informed and have a clear understanding of their rights and responsibilities under the ORFS. ..."

Insofar as consequential amendment of the relevant professional guides and codes of conduct for legal practitioners is essential to reflect this, the Council supports Recommendations 11 and 12. As the issues involved in the funding arrangements can be complex and have far reaching repercussions, financially or otherwise, the relevant professional guides and codes of conduct should ensure that clear, easy to understand language is used in the contracts and in the advice." (emphasis added).

Comments from Respondents who opposed Recommendation 11

12.8 There were no objections to Recommendation 11.

Our analysis and response

12.9 When considering the approach to permit Lawyers to use ORFS for Arbitration, we have considered (a) the Consultation Paper, (b) the submissions received from the Respondents, including those summarised in

² Bar Standards Board of England and Wales, *The Bar Standards Board Handbook* (2021), version 4.6, at Guidance gC91.

this Report, (c) the approach adopted to addressing similar issues in the common law jurisdictions of England and Wales and various Australian states, and (d) the current Hong Kong legal system. We have also borne in mind that breaches of the doctrines of maintenance and champerty in Hong Kong may constitute criminal offences as well as torts at common law, as observed in the Consultation Paper at paragraphs 1.5 to 1.21.

12.10 Given the unanimous support from all the Respondents who commented on Recommendation 11, we maintain as our final recommendation that (a) the Arbitration Ordinance; (b) the Legal Practitioners Ordinance; (c) The Hong Kong Solicitors' Guide to Professional Conduct; and (d) the HKBA's Code of Conduct should be amended to provide that CFAs and/or DBAs and/or Hybrid DBAs are permitted under Hong Kong law for Arbitration.

The Arbitration Ordinance and the Legal Practitioners Ordinance

12.11 In particular, the Arbitration Ordinance and the Legal Practitioners Ordinance will need to be amended to permit the use of ORFSs in Arbitration.

12.12 As a starting point, section 64 of the Legal Practitioners Ordinance will need to be amended to reflect the fact that ORFSs within the meaning of the new Part 10B of the Arbitration Ordinance (at Annex 1 attached to this Report) are permitted for Arbitration.

12.13 The core provisions will then be set out in a new Part 10B of the Arbitration Ordinance, with additional edits to Part 10A of the Arbitration Ordinance, primarily to make it clear that ORFSs are distinct from Third Party Funding and do not fall within the Third Party Funding regime (and vice versa),³ and that the common law torts and offences of champerty and maintenance do not apply to ORFSs for Arbitration.⁴

12.14 The more detailed legislative framework, and the particular safeguards which form part of the ORFS regime for Arbitration, should be set out in subsidiary legislation in as clear and simple terms as possible. This is discussed further in the context of Recommendation 12 in Chapter 13. Suggested safeguards to be included in the subsidiary legislation are set out in Annex 2 attached to this Report.

The Hong Kong Solicitors' Guide to Professional Conduct

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

³ See ss 98H, 98OA, 98Z and 98ZA(3) of the draft amendments to the Arbitration Ordinance in Annex 1 to this Report.

⁴ See ss 98ZE and 98ZF of the draft amendments to the Arbitration Ordinance in Annex 1 to this Report.

12.16 We recommend that The Hong Kong Solicitors' Guide to Professional Conduct should be amended to enable work relating to Arbitration to be excluded from such restriction.

HKBA's Code of Conduct

12.17 Paragraph 9.9 of the HKBA's 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.

12.18 In addition, as referred to in paragraph 1.31 of the Consultation Paper, the "cab-rank" rule requires 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"*.⁵ We note the comments of the HKBA, and agree that the rule is plainly inconsistent with CFAs given that the latter *"will require barristers to decide whether to take risks in the hope of reward"*,⁶ which would depend *"precisely upon their views of their clients' prospects of success"*.⁷

12.19 Accordingly, we recommend that the HKBA's Code of Conduct should be amended so that barristers may enter into ORFSs for Arbitration and may decline instructions involving ORFSs for Arbitration.

Final Recommendation 11

We recommend that:

- (a) Section 64(1)(b) of the Legal Practitioners Ordinance should be amended such that CFAs, DBAs and Hybrid DBAs for Arbitration would be valid under Hong Kong law.⁸**
- (b) Part 10A of the Arbitration Ordinance should be amended, and a new Part 10B added, such that CFAs, DBAs and Hybrid DBAs for Arbitration would be valid under Hong Kong law.⁹**
- (c) The Hong Kong Solicitors' Guide to Professional Conduct should be amended to permit solicitors to enter into ORFSs for Arbitration.**

⁵ HKBA, *Code of Conduct*, at para 6.1.

⁶ Peter Kunzlik, "Conditional Fees: The Ethical and Organisational Impact on the Bar" (1999) 62 MLR 850, at 862.

⁷ Same as above.

⁸ See the draft amendments to the Legal Practitioners Ordinance in Annex 1 to this Report.

⁹ See ss 98ZE, 98ZF, 98ZG and 98ZH of the draft amendments to the Arbitration Ordinance in Annex 1 to this Report.

- (d) The HKBA's Code of Conduct should be amended so that barristers may enter into ORFSs for Arbitration, and may also decline instructions involving ORFSs for Arbitration.**

Chapter 13

Form of regulation

Responses to the Sub-committee's Recommendation 12

13.1 This Chapter discusses the responses regarding Recommendation 12 in the Consultation Paper:

*"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."*¹

13.2 Again, almost all the Respondents who commented specifically on this issue agreed with the thrust of Recommendation 12, although a number commented that the framework could take the form of subsidiary legislation and/or professional codes of conduct.

Comments from Respondents who supported Recommendation 12

13.3 A number of Respondents who commented on Recommendation 12 favoured the more detailed regulatory framework being set out in subsidiary legislation.

13.4 As a litigation funder put it: *"[The funder] agrees with the Sub-committee's recommendation that the more detailed regulatory framework should be set out in subsidiary legislation which should be in simple and clear terms."* The funder noted that *"client-care provisions should be contained in a separate Code of Practice for Lawyers entering into ORFS for arbitration"*.

13.5 Other Respondents, an arbitrator/barrister and a professional body, agreed, noting as follows: *"[W]e agree that if a detailed regulatory framework becomes necessary, it should be set out in subsidiary legislation. It is further agreed that client care provisions should be set out."*

13.6 A law firm and a chamber of commerce also agreed for the same reasons they had supported Recommendation 11.

¹ See Consultation Paper, at paras 5.58 to 5.61.

13.7 A regulator noted that it had *"no preference to the most appropriate instrument(s) to provide for the detailed regulatory framework"*, but agreed *"with the need to set out appropriate provisions, whether in a statute or in the relevant professional codes of conduct, to deal proportionately with potential breaches of the regulatory framework"*.

13.8 The HKBA noted that *"[p]arties are regularly represented in international arbitration taking place in Hong Kong by lawyers from other jurisdictions who are neither admitted in Hong Kong nor registered as foreign lawyers"*, and was concerned that these lawyers would not be bound by Hong Kong's regulatory framework.

13.9 In terms of the specific provisions which should be provided for, the HKBA and the litigation funder submitted that a separate Code of Practice for Lawyers entering into ORFSs for Arbitration should contain provisions similar to the Code of Practice for Third Party Funding of Arbitration. For example, like litigation funders, Lawyers should be subject to minimum capital adequacy requirements when the Lawyers agree to fund costs other than their own legal fees. There should also be *"[p]rotection against potential divergence of interests: for example, independent advice should be available (at the lawyer's cost) in respect of settlement discussions or other potential areas of divergence in interests between the lawyers acting on an ORFS basis and their clients"*. Other suggestions included *"[r]equirements to ensure clients receive clear and accessible information, and independent advice, in relation to the ORFS and any associated ATE insurance"*, having *"[r]eporting and complaints procedures"*, and standards and practices governing *"promotional materials"*.

Comments from Respondents who opposed Recommendation 12

13.10 As with Recommendation 11, there were no substantive objections to Recommendation 12, save that one law firm commented that, in their view, the legislative framework should be contained in *"soft law"*, ie codes of conduct, rather than subsidiary legislation. The rationale for this was to *"provide the flexibility for the authorised body to update and amend the code of conduct from time to time, taking into account the latest developments and market practice"*.

Our analysis and response

13.11 Having reviewed the above responses, we agree that the detailed provisions should be set out in subsidiary legislation. In our view, this strikes the right balance between providing flexibility to review and adjust applicable safeguards (including caps), and ensuring that the legislative amendments are easy to find, clear to understand and have *"teeth"*. This also addresses, as far as possible, the HKBA's concerns that the safeguards should extend to any Lawyer qualified to practise law, and/or regulated, outside Hong Kong.

13.12 Otherwise, to the extent that further, more detailed client-care provisions are required, these can be set out subsequently in professional codes of conduct, either in the existing codes, or in a separate code which specifically addresses ORFSs. This will ensure that more trivial breaches can be dealt with more expeditiously by the professional bodies, without impacting the overall ORFS statutory regime for Arbitration. At this stage, however, we agree with the Sub-committee that a separate code of conduct or practice is not required. To the extent that the Law Society and the HKBA consider necessary, they can independently amend their existing codes of conduct (in addition to the changes highlighted in Chapter 12 (and Final Recommendation 11) above).

13.13 A more detailed review of the content and scope of the specific safeguards that are contemplated is discussed in Chapter 14 where Recommendation 13(a) is considered. The proposed safeguards to be included in subsidiary legislation are set out in Annex 2 attached to this Report.

Final Recommendation 12

We recommend that:

- (a) the more detailed regulatory framework should be set out in subsidiary legislation which, like the legislative amendments referred to in Final Recommendation 11, should be as simple and clear as possible to avoid frivolous technical challenges; and**
- (b) further client-care provisions (to the extent these are required) could also be set out in professional codes of conduct so that trivial breaches can be dealt with expeditiously by the professional bodies.**

Chapter 14

Specific safeguards and other matters relating to ORFSs

Responses to the Sub-committee's Recommendation 13(a)

14.1 Below is a summary of the responses regarding Recommendation 13(a) in the Consultation Paper, under which submissions are invited 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."¹*

Comments from Respondents who supported Recommendation 13(a)

The need for safeguards

14.2 Almost all Respondents who commented on Recommendation 13(a) agreed with the proposals made.

¹ See Consultation Paper, at paras 5.64 to 5.65.

14.3 One Respondent, a Government department, commented that *"appropriate safeguards for ORFSs for Arbitration should be put in place to minimise the potential risks such as those summarised in Chapter 4 of the Consultation Paper, and that the safeguards should be in line with international practice"*.

14.4 A regulator agreed with adopting *"appropriate measures ... to safeguard the interests of clients ... and lawyers by allowing the parties concerned to be provided with and apprised of all relevant information as well as the associated risks to facilitate them to make informed decisions before entering [in]to the relevant ORFS arrangement(s)"*.

14.5 Likewise, an arbitral institution commented that *"[m]ore detailed regulatory framework should be put in place to provide more specific safeguards regarding the operation of ORFSs in Hong Kong"*.

14.6 Another Respondent, a chamber of commerce, explained that *"while we believe that, under the principle of freedom of contract, businesses should generally be free to negotiate the terms of their agreement with their lawyers without the need for legislative intervention, certain safeguards may be necessary in the initial years of the new regime"*. This Respondent explained that such safeguards would *"in particular ... protect the interests of SMEs"*.

14.7 The Consumer Council also supported this recommendation, and expressed its approval for consumers to be provided with a variety of flexible fee arrangement choices under ORFSs for Arbitration as follows:

"... provided that consumers are empowered with all the relevant information they require so they may have the freedom to contract in alignment with their views on how they wish to manage their case, alongside the careful guidance of their legal representative. The Council also considers that there must be sufficient safeguards in place."

The Consumer Council said that it welcomed *"transparency and guidance provided by legal practitioners to consumer clients to ensure those entering into ORFSs are properly informed and have a clear understanding of their rights and responsibilities under the ORFS"*.

14.8 A litigation funder also agreed with safeguards being put in place. The funder's view was that such safeguards should be contained in a separate code of practice. This was also the view of the HKBA, which suggested *"that it is in the public interest that safeguards for financial and ethical matters be applied to provision of funding by Lawyers that are similar in nature to those covered by Hong Kong's Code of Practice for Third Party Funding of Arbitration"*. Another Respondent, a law firm, agreed, noting that the proposed safeguards should be addressed by way of a code of conduct, issued by an authorised body, similar to the approach taken for the regulation of Third Party Funding in Arbitration (and mediation). This law firm considered that this *"will provide the*

flexibility for the authorised body to update and amend the code of conduct from time to time, taking into account the latest developments and market practice".

The suggested safeguards

14.9 In terms of what precisely those safeguards should be, the majority of the Respondents who commented on Recommendation 13(a) agreed with the safeguards suggested in Recommendation 13(a), including a requirement 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. Opinions mainly differed only in respect of whether a client should be required to disclose an ORFS for Arbitration. One Respondent also disagreed with there being a "cooling-off" period (see paragraphs 14.11 to 14.13 below).

(i) Disclosure of the existence of ORFSs

14.10 On the question of disclosure, a number of Respondents agreed that the existence of an ORFS for Arbitration should be disclosed to the other party/ies and the Tribunal in the Arbitration. However, a consumer/public interest group and an arbitral institution did not agree. The consumer/public interest group commented that:

"An agreement entered between a lawyer and a client is a private agreement, the chosen type of which shall have no effect on the conduct of arbitration. Notification to the respondent and Tribunal is only required by the legislation where third party funding is involved."

An arbitral institution was of the same view, stating that there should be *"different policy considerations for TPF [third party funding] and ORFSs"*. The institution added that:

"Disclosure of TPF is appropriate because it involves a third party that has an interest in the arbitration. In contrast, ORFSs are arrangements between a client and its counsel, the identities of which have already been disclosed in the arbitration. ORFS arrangements are usually confidential unless and until a costs application is made. For those reasons, we recommend that no disclosure of ORFSs should be required under Hong Kong law."

(ii) "Cooling-off" period

14.11 The other area of divergence arose in relation to "cooling-off" periods. The majority of Respondents who commented on the "cooling-off" period were in favour. A regulator observed that *"the requirement to include a 'cooling-off' measure when purchasing life insurance provides a solid policy holder protection measure in the insurance regulatory framework"* and considered *"a similar mechanism in the case [sic] ORFS arrangements would be appropriate"*.

14.12 The Consumer Council agreed:

"The Council has always advocated in favour of the imposition of a mandatory cooling-off period to prevent unscrupulous traders from using undesirable trade practices or high pressure to induce consumers to enter into contracts. For ORFSs, in order that consumers have the same level of protection, the Council is of the view that there should be in place such a cooling-off period. As legal professionals are already required to abide by their respective codes of conduct which expect them to practice with the highest levels of ethics and propriety, there should not be much opposition to this cooling-off period being mandatorily imposed."

14.13 Only one Respondent, another professional body, disagreed slightly, only for what this Respondent referred to as "urgent cases". This Respondent therefore stated that "cooling-off" periods are not appropriate for "urgent cases", albeit without clarifying when, and in what circumstances, a case should be treated as "urgent".

(iii) Other proposed safeguards

14.14 A number of Respondents also gave suggestions about other specific safeguards that might be adopted. For example, a number of Respondents agreed that the ORFS should be in writing and signed by the clients and Lawyers.

14.15 Other Respondents suggested that provisions similar to those contained in the Code of Practice for Third Party Funding for Arbitration should be adopted. These provisions include requirements for Lawyers not to take any steps that cause or may cause any conflict of interest and reinforcement of the Lawyer's duty to act in the best interests of the client, and provide that the client is to retain control over the conduct of the Arbitration.

Comments from Respondents who opposed Recommendation 13(a)

14.16 There were no objections to Recommendation 13(a).

Our analysis and response

14.17 As we outlined in Chapters 12 and 13, we consider that appropriate amendments to the applicable legislation, including subsidiary legislation and Lawyers' codes of conduct, should be as simple and clear as possible. In terms of the more detailed provisions required to implement the legal regime, we agree with the Sub-committee that these should be introduced via stand-alone subsidiary legislation, and not by way of further amendments to the relevant Ordinances. Thus, we recommend that the specific safeguards should be set out in subsidiary legislation. If necessary, these safeguards can

be supplemented by amendments to the professional codes of conduct, but at this stage we consider that the key features and safeguards of the ORFS regime for Arbitration should be contained in subsidiary legislation and that, at this stage at least, a separate code of conduct is not necessary.

14.18 As we pointed out in the paragraph 14.9 above, the majority of Respondents who commented on Recommendation 13(a) agreed with the specific safeguards that the Sub-committee had identified and discussed in Chapter 5 of the Consultation Paper.²

14.19 Similar safeguards - in one form or another - are in place to varying degrees in all of the jurisdictions that permit ORFS that the Sub-committee reviewed, as discussed in Chapter 3 of the Consultation Paper.³ We consider that Hong Kong, informed by the experience and approach of other relevant jurisdictions, should develop its own model of regulation that suits its culture and needs.

14.20 After considering the relevant discussion in the Consultation Paper, all the responses received in the consultation as summarised in this Report, and Hong Kong's current legal framework and regulatory culture, we are of the view that the subsidiary legislation should include at least the following specific safeguards (in addition to the matters covered in the Final Recommendations above):

- (a) **the ORFS must be in writing and signed by the client;**⁴
- (b) **the ORFS should be clear in what circumstances a Lawyer's fees and expenses, or part of them, will be payable;**⁵
- (c) **the Lawyer should give the client all relevant information relating to the ORFS that is being entered into, and should provide that information in a clear and accessible form;**⁶
- (d) **the Lawyer should inform clients of their right to take independent legal advice, and the ORFS should include a corresponding statement that the client has been informed of the right to seek such independent legal advice.**⁷ However, as noted by one law firm Respondent, we agree that the Lawyer's duty should be discharged on so informing the client, such that an ORFS will not be invalid if the client chooses not to obtain such independent legal advice;

² See Consultation Paper, at paras 5.64 and 5.65.

³ See Consultation Paper, at paras 3.27, 3.47, 3.58 to 3.60, 3.82 and 3.85.

⁴ See item 1(g) of the recommended ORFS safeguards to be included in subsidiary legislation in Annex 2 to this Report.

⁵ See item 1(i) of the recommended ORFS safeguards to be included in subsidiary legislation in Annex 2 to this Report.

⁶ See item 1(h) of the recommended ORFS safeguards to be included in subsidiary legislation in Annex 2 to this Report.

⁷ See item 1(j) of the recommended ORFS safeguards to be included in subsidiary legislation in Annex 2 to this Report.

- (e) **the ORFS should be subject to a minimum "cooling-off" period of seven days during which the client, by written notice, may terminate the ORFS.**⁸ We acknowledge the comment made about "urgent cases" but consider that some form of "cooling off" period should always be adopted. We note too that it is difficult to define precisely when a case is "urgent". As the recommended "cooling off" period is relatively short, we do not believe that this will cause undue hardship to the Lawyer, while still providing protection for the client;
- (f) consistent with Final Recommendation 8, **the ORFS should state clearly the circumstances in which the Lawyer's payment, expenses and costs, or part of them, are payable by the client in the event that the ORFS is terminated by the Lawyer or the client;**⁹ and
- (g) **the ORFS should state whether disbursements, including barristers' fees, are to be paid irrespective of the outcome of the matter.**¹⁰

14.21 On the question of disclosure, we have considered carefully the responses provided, including those which suggested that an ORFS should not be disclosed in the Arbitration, at least not unless and until a costs application is made. We accept that an ORFS - being an arrangement between Lawyer and client – is different to a Third Party Funding agreement in the sense that an ORFS does not involve a third party. Nevertheless, we agree with the Subcommittee that in the interests of transparency and fairness, the relevant stakeholders are entitled to know whether an ORFS is in place, and if so, in respect of which aspect of the Arbitration. We note too that, consistent with its third party funding regime, Singapore has also recommended "[d]isclosure obligations placed on solicitors to disclose the existence of the CFA, to the Court or tribunal (where relevant), and to every other party to those proceedings".¹¹

14.22 We believe that Hong Kong should adopt the same position. Similar to Third Party Funding, the primary disclosure requirements should be contained in the new Part 10B of the Arbitration Ordinance, and require the Lawyer to disclose only the existence (and ending) of any ORFS for Arbitration in place.¹² The precise terms of the ORFS would not need to be disclosed, unless otherwise ordered by the Tribunal or the court.

⁸ See item 1(k) of the recommended ORFS safeguards to be included in subsidiary legislation in Annex 2 to this Report.

⁹ See items 1(i), 1(n), 1(o)(iii) and 1(o)(iv) of the recommended ORFS safeguards to be included in subsidiary legislation in Annex 2 to this Report.

¹⁰ See item 1(l) of the recommended ORFS safeguards to be included in subsidiary legislation in Annex 2 to this Report.

¹¹ Ministry of Law of Singapore, *Public Consultation on Conditional Fee Agreements in Singapore* (2019), at para 15.

¹² See ss 98ZP and 98ZQ of the draft amendments to the Arbitration Ordinance in Annex 1 to this Report.

Responses to the Sub-committee's Recommendation 13(b), (e), (f), (g) and (h)

14.23 Below is a summary of the responses regarding Recommendation 13(b), (e), (f), (g) and (h) of the Consultation Paper. We have grouped these together, as all discuss the criteria for payment of Success Fee or DBA Payment to a Lawyer under an ORFS for Arbitration.

CFAs

14.24 At Recommendation 13(b) of the Consultation Paper, the Sub-committee sought views as to: *"What should be the relevant method and criteria for fixing 'Success Fees' in CFAs."*

14.25 Few Respondents commented specifically on this question. Most chose to express general support for Recommendation 13(b), (e), (f), (g) and (h) together. The only comment specifically addressed to Recommendation 13(b) stated that the criteria for fixing Success Fees in CFAs *"[s]hould be a matter of negotiation between lawyers and clients"*.

DBAs

14.26 With respect to DBAs, responses were sought to the following questions:

"13(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.

13(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.

13(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.

13(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."¹³

¹³ See Consultation Paper, at paras 5.73 to 5.74.

14.27 A handful of Respondents addressed these questions together. A litigation funder commented:

"... the ORFS regime should be flexible to enable such arrangements to be left to the parties to negotiate and structure in the most appropriate way, depending on the circumstances of the case, provided there is a requirement ... for clients to receive independent advice..."

14.28 A large law firm commented that *"an encompassing definition of 'financial benefit' (as described in §5.74 [of the Consultation Paper]) should be adopted"*. Another two Respondents agreed, saying that DBA Payments should be *"based on the value of the 'financial benefit' when received by the client; and that 'financial benefits' could include 'money and/or money's worth"*, based on what the client and the Lawyers agree in writing.

14.29 Across the responses to Recommendation 13(g), a majority agreed that the definition of "money or money's worth" should include *"consideration reducible to a monetary value"*. The same majority agreed that financial benefit could include a debt owed to a client, eg under a judgment or settlement, rather than only money or property actually received, and that respondent parties 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"*.¹⁴

14.30 Only one Respondent, a chamber of commerce, preferred a narrower approach. It argued for *"a cautious and incremental approach ... especially in the initial years of the new regime"*, and advocated for limiting DBA Payments to *"a percentage of the damages recovered by the claimant in commercial arbitrations, and not to any other financial benefit that the claimant receives from the arbitration"*.

Our analysis and response

14.31 The majority of Respondents who commented on Recommendation 13(b), (e), (f), (g) and (h) preferred any ORFS regime for Arbitration to be as flexible as possible, so that Lawyers and clients can negotiate appropriate arrangements on a case-by-case basis.

14.32 We share this preference, which we believe is consistent with the overall approach to ORFS proposed in this Report. We believe that it is in the best interests of both clients and the legal profession to allow not only a broad range of ORFSs (CFAs, DBAs and Hybrid DBAs), but also the flexibility to apply ORFSs as best fit their specific circumstances. Such flexibility must, of course, be limited by effective safeguards, as noted in paragraph 14.20 above. However, we do not consider that defining Financial Benefit widely, for the purposes of calculating Success Fees and DBA Payments, places clients at

¹⁴ Recommendation 13(f) and (h).

greater risk than defining it narrowly. Similarly, we cannot see a justification for restricting ORFS arrangements for Arbitration to claimants and prohibiting respondents from agreeing CFAs or DBAs (including Hybrid DBAs) with their Lawyers in appropriate circumstances.

Recommendation 13(b)

14.33 Where there is no ORFS in place, Lawyers commonly charge by reference to the number of hours they spend on the case, multiplied by the Lawyer's hourly rate. That rate may be referred to as the "usual", "normal", "basic" or "benchmark" rate.

14.34 After careful consideration of the responses received and the position in other jurisdictions, we propose the following method and criteria for fixing Success Fees in CFAs.

14.35 When negotiating a CFA, Lawyers and clients will generally take into account the fee that the Lawyer would charge if there were no ORFS in place. That might be a fixed amount, but is more usually calculated by reference to the number of hours the Lawyer expects to spend on the case, multiplied by the Lawyer's hourly rate. The Lawyer will then propose either to waive the hourly fee altogether,¹⁵ or to discount it,¹⁶ in exchange for an additional payment in the event of a successful outcome for the client in the matter. That additional payment is the Success Fee. The Success Fee may be an agreed flat fee, or calculated as a percentage "uplift" on the fee that the Lawyer would have charged if there were no ORFS in place during the course of the Proceedings.¹⁷

14.36 Where the Success Fee is a flat fee, it is not necessary to fix a reference point. The amount of the fee (subject to a cap of 100% of "benchmark" costs as proposed in Final Recommendation 3(a)) will be entirely up to the Lawyer and client to decide, based on their respective views of what is reasonable in the circumstances of the case.

14.37 Where the Success Fee is calculated as a percentage "uplift", we consider it advisable to fix in the legislative framework a reference point against which that uplift will be calculated. In our view, that reference point should be the Lawyer's "benchmark" rate (ie the fee that the Lawyer would charge the client if there were no ORFS in place during the course of the Proceedings).

14.38 By contrast, we do not consider it necessary or advisable to prescribe or limit what particular situation(s) would constitute "success" or a "successful outcome" in the legislative framework. Our preference, and the clear preference of Respondents, is to leave it to the Lawyer and the client to agree, by reference to the circumstances of each case, what will amount to

¹⁵ This is known as a "no win, no fee" agreement.

¹⁶ This is known as a "no win, low fee" agreement.

¹⁷ See Consultation Paper, at 4.

"success" and trigger payment of the Success Fee.¹⁸ More detailed analysis is provided in Chapter 4 above.

Recommendation 13(e), (f), (g) and (h)

14.39 As noted in paragraphs 14.33 to 14.38 above, we do not consider it necessary or advisable to prescribe or limit what particular situation(s) would constitute "success" or a "successful outcome" in the legislative framework for CFAs or DBAs or Hybrid DBAs. Similarly, we do not consider that defining Financial Benefit widely, for the purposes of calculating Success Fees and DBA Payments, places clients at greater risk than defining it narrowly.¹⁹

14.40 Nor can we see a justification for restricting ORFS arrangements to claimants and prohibiting respondents from agreeing CFAs or DBAs (including Hybrid DBAs) with their Lawyers in appropriate circumstances. A party sued for US\$1 billion, but held liable for US\$100 million, may well consider itself "successful" and be willing to reward the Lawyer with a DBA Payment for helping to achieve that success. A party whose intellectual property rights have been stolen may wish to pay the Lawyer who acts in infringement proceedings by reference to the monetary value of the intellectual property rights. As a question of policy, we cannot see why the Financial Benefits in each of these examples are fundamentally different to an award of monetary damages, such that obtaining them should not constitute "success" for the purposes of triggering a DBA Payment.

14.41 We also consider that a DBA Payment should become payable as soon as the Financial Benefit is obtained by the client, rather than when the client actually receives money in hand. A Lawyer whose client is awarded damages in an Arbitration can reasonably claim to have earned the agreed DBA Payment as soon as the award is issued and the money becomes due to the client. At that stage, the Lawyer has performed the service he or she contracted to perform and should not have to wait for payment until the client has actually received the money, which can sometimes be years after the date of the award.

14.42 In light of the above, we consider that the legislation should define "DBA" as an agreement by which the client agrees to pay the Lawyer a fee only in the event the client obtains a Financial Benefit in the Arbitration, where the DBA Payment is calculated by reference to **the amount of any award, settlement or other Financial Benefit** that may be obtained by the client in the Arbitration.²⁰ "Financial Benefit" should also be broadly defined, to include "**money or money's worth**" (being any money, assets, security, tangible or intangible property, services, any amount owed under an award,

¹⁸ See s 98ZB of the draft amendments to the Arbitration Ordinance in Annex 1 to this Report.

¹⁹ See para 14.32 of this Report.

²⁰ See ss 98ZC and 98ZD of the draft amendments to the Arbitration Ordinance in Annex 1 to this Report.

settlement agreement or otherwise, and any other consideration reducible to a monetary value, including any avoidance or reduction of a potential liability).²¹

14.43 Based on the above, we recommend that the ORFS should set out:

for CFAs:

- (a) **the circumstances that constitute a "successful outcome" of the matter to which it relates;**²²
- (b) **the basis of calculation of the Success Fee which would be payable in the event of such "successful outcome", as well as the Success Fee premium, meaning the percentage uplift by which the amount of the legal costs which would be payable if there were no ORFS in place;**²³ and

for DBAs (including Hybrid DBAs):

- (c) **the Financial Benefit to which the DBA relates.**²⁴

Responses to the Sub-committee's Recommendation 13(c) and (d)

14.44 Recommendation 13(c) and (d) in the Consultation Paper sought views on:

- "(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.*²⁵

²¹ See s 98ZA(1) of the draft amendments to the Arbitration Ordinance in Annex 1 to this Report.
²² See item 1(o)(v) of the recommended ORFS safeguards to be included in subsidiary legislation in Annex 2 to this Report.
²³ See item 1(o)(vi) of the recommended ORFS safeguards to be included in subsidiary legislation in Annex 2 to this Report.
²⁴ See item 1(o)(vii) of the recommended ORFS safeguards to be included in subsidiary legislation in Annex 2 to this Report.
²⁵ See Consultation Paper, at paras 5.66 to 5.72.

Comments from Respondents who supported Recommendation 13(c)

14.45 A clear majority of Respondents who expressed a view on the issue considered that any ORFS regime for Arbitration should treat claims for personal injury differently from other claims. Almost all prefer to exclude personal injury claims completely from any ORFS regime for Arbitration.

14.46 Several Respondents expressed concerns about the potential for Lawyers or claims intermediaries to use ORFSs for Arbitration to exploit vulnerable personal injury victims. Although most acknowledged that it will be rare for a personal injury claim to be referred to Arbitration, such claims are, in fact, arbitrable in Hong Kong and many Respondents have genuine fears about "ambulance chasing", based on practices in other jurisdictions that allow ORFSs for personal injury claims in the courts.

14.47 Comments included:

"... it is inappropriate to pursue a personal injury claim under an ORFS. Meanwhile, to prevent some lawyers engaging 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, it is expected that consideration should be given to require personal injury claims to be pursued by other means."

and

"Most claimants in PI cases usually are not very sophisticated and they do not have experience in litigation. They might not be able to understand the technicalities of the ORFS arrangement and distinguish them from champertous or maintenance arrangements. They may have already been placed under financial and emotional stresses because of their injuries, and therefore might be prone to accept the 'assistance' from the claims intermediaries in the 'resolution'/'adjudication' of the claims for them."

14.48 The Law Society expressly asked that "personal injuries ('PI') claims be excluded altogether from the proposed ORFS, and that Lawyers are prohibited from entering these fees arrangement [sic] in respect of PI claims submitted to arbitration". The HKBA likewise suggested that "arbitrations involving personal injuries should be excluded from the scope of any law reform to permit ORFS".

Comments from Respondents who opposed Recommendation 13(c)

14.49 No Respondents expressly opposed the recommendation to exclude personal injury claims from the scope of any ORFS regime for

Arbitration. A number of Respondents were neutral, or opined that it was unlikely for personal injury claims to be arbitrated.

14.50 For example, a litigation funder considered that *"the number of personal injury claims referred to arbitration in Hong Kong is likely to be minimal"*. A Government department noted that *"in practice, arbitration is not common for settling personal injury claims. Arbitrations taking place in Hong Kong usually involve commercial parties, corporations and similar entities, rather than individuals"*. It concluded: *"It therefore appears that the introduction of ORFSs for Arbitration would have limited impact on the current practice in resolving personal injury disputes."*

Our analysis and response

14.51 We agree with the Sub-committee, and with a number of Respondents, that personal injury claims will rarely be arbitrated. Where a person is injured in the workplace in Hong Kong, he or she will typically have a claim for statutory compensation under the Employees' Compensation Ordinance (Cap 282). Claims for common law damages for workplace injuries and injuries suffered outside the workplace are more likely to come before the courts²⁶ (claims against insurers are the most likely exception to the general rule, as many insurance policies provide for disputes to be resolved by arbitration).

14.52 Nevertheless, as is evident from the Consultation Paper, in jurisdictions where ORFSs are permitted for personal injury claims, some Lawyers and claims intermediaries do engage in ambulance chasing. Such practices are obviously undesirable, not least because they target vulnerable individuals and undermine public confidence in the legal profession.

14.53 It is clear that a majority of Respondents are genuinely concerned about allowing Lawyers to offer ORFSs for Arbitration to individuals who have suffered personal injuries and are seeking compensation. These concerns are shared by both regulators of the legal profession in Hong Kong: the Law Society and the HKBA.

14.54 We understand and appreciate these concerns, and agree that individuals are generally more vulnerable to exploitation by unscrupulous professionals than corporate entities, which will typically be more sophisticated and more frequent users of arbitration.

14.55 In our view, personal injury claims would be only a very small minority of the cases arbitrated in Hong Kong, and only a very small minority of Lawyers and claims intermediaries would ever attempt to exploit individual claimants by charging unreasonable ORFS fees.

²⁶ See Consultation Paper, at paras 5.67 to 5.69.

14.56 Nevertheless, a number of Respondents have clearly indicated that they would oppose extending ORFSs to Arbitration of personal injury claims.

14.57 In light of this, we recommend that ORFSs for Arbitration should be void and unenforceable to the extent that they relate to personal injury claims.²⁷ However, we are mindful of the possibility that prescribing ORFSs for personal injury Arbitrations to be void and unenforceable could adversely affect parties' ability to pursue personal injury claims against their insurers (whose policies frequently require disputes to be resolved by arbitration), we recommend that this be reviewed two to three years after implementation of the ORFS regime.

Comments from Respondents on Recommendation 13(d)

14.58 There was a limited response to Recommendation 13(d), which asked for views on whether any additional category/ies of claim should be treated differently from other claims that are submitted to Arbitration if ORFSs are introduced.

14.59 Two Respondents (who submitted identical responses) proposed excluding from any ORFS regime *"non-commercial claims (other than Investor State dispute claims)"*. A chamber of commerce also recommended that *"at least in the initial years of the new regime, ORFSs in arbitration be restricted to commercial claims by businesses"*. An international law firm proposed that employment disputes, investment treaty disputes and State-to-State arbitrations *"should be treated differently if ORFSs are introduced"*. It noted that *"there may be resistance from respondent States and potentially taxpayers in those States if they are required to make DBA Payments and/or Success Fees"*, and proposed additional consultation on arbitrations involving a state.

14.60 Another Respondent, a Government department, disagreed:

"Consistent with the Government's approach towards legislating for third party funding for arbitration, there seems to be no practical need to expressly exclude a particular category of claims from the proposed ORFS framework. We are of the view that the use of ORFSs should be limited to matters which are arbitrable (i.e. capable of settlement by arbitration) under the relevant laws."

14.61 This Respondent noted that the Arbitration Ordinance:

"... does not explicitly exclude any specific categories of claims from arbitration, but provides that an arbitral award may be set aside by the court if (i) the subject-matter of the dispute is not capable of settlement by arbitration under the law of Hong Kong;

²⁷

See s 98ZK of the draft amendments to the Arbitration Ordinance in Annex 1 to this Report.

or (ii) the award is in conflict with the public policy of Hong Kong. Matters that are generally not arbitrable include criminal offences, competition law issues, family matters and disputes that have public policy ramification."

In the Respondent's view, the most effective way to limit any ORFS regime for Arbitration in Hong Kong was by reference to arbitrability.

14.62 Another Respondent (a professional body) observed that "[o]ther categories such as labour disputes, probate and matrimonial cases etc are not the subject of arbitration".

14.63 The majority of Respondents were silent on this question.

Our analysis and response

14.64 We have carefully considered the suggestion that any ORFS regime for Arbitration be limited, at least initially, to "commercial claims". However, we note that there is no definition of "commercial claims" in the Arbitration Ordinance. Nor does the Arbitration Ordinance distinguish or define any other category of arbitration. "Arbitration" is defined simply as "*any arbitration, whether or not administered by a permanent arbitral institution*".²⁸

14.65 We are mindful of the difficulties inherent in defining a category of "commercial claims" or "commercial arbitrations" in Hong Kong law that applies only in respect of an ORFS regime, and not in respect of any other aspect of Arbitration in Hong Kong, including Third Party Funding. Moreover, to the best of our knowledge, no other jurisdiction with legislation based on the UNCITRAL Model Law distinguishes between commercial and other claims in Arbitration. Finally, we note that, in practice, the majority of Arbitrations in Hong Kong involve corporate entities and commercial transactions.

14.66 On balance, we consider that it is not necessary to limit expressly any ORFS regime for Arbitration to commercial claims, nor to exclude any other category of claims. We consider that the proposed regime would be limited, in practice, by the doctrine of arbitrability and the right of a party to challenge an award that purports to dispose of a dispute that is not capable of settlement by Arbitration under Hong Kong law. In our view, this is the preferable approach because it is consistent with the overall approach under the Arbitration Ordinance, and offers sufficient protection to users of the proposed ORFS regime for Arbitration.

²⁸ Arbitration Ordinance, s 2(1).

Final Recommendation 13

We recommend that:

- (a) The subsidiary legislation should include provisions for at least the following safeguards:**
 - (i) the ORFS must be in writing and signed by the client;²⁹**
 - (ii) the Lawyer should give the client all relevant information relating to the ORFS that is being entered into, and should provide that information in a clear and accessible form;³⁰**
 - (iii) the Lawyer should inform clients of their right to take independent legal advice, and the ORFS should include a corresponding statement that the client has been informed of the right to seek such independent legal advice;³¹**
 - (iv) the ORFS should be subject to a minimum "cooling-off" period of seven days during which the client, by written notice, may terminate the ORFS;³²**
 - (v) the ORFS itself should state clearly:**
 - (1) in what circumstances a Lawyer's fees and expenses, or part of them, will be payable;³³**
 - (2) the circumstances in which the Lawyer's payment, expenses and costs, or part of them, are payable by the client in the event that the ORFS is terminated by the Lawyer or the client;³⁴ and**

²⁹ See item 1(g) of the recommended ORFS safeguards to be included in subsidiary legislation in Annex 2 to this Report.

³⁰ See item 1(h) of the recommended ORFS safeguards to be included in subsidiary legislation in Annex 2 to this Report.

³¹ See item 1(j) of the recommended ORFS safeguards to be included in subsidiary legislation in Annex 2 to this Report.

³² See item 1(k) of the recommended ORFS safeguards to be included in subsidiary legislation in Annex 2 to this Report.

³³ See item 1(i) of the recommended ORFS safeguards to be included in subsidiary legislation in Annex 2 to this Report.

³⁴ See paras 9.12 to 9.19 of, and items 1(i), 1(n), 1(o)(iii) and 1(o)(iv) of the recommended ORFS safeguards to be included in subsidiary legislation in Annex 2 to this Report.

- (3) whether disbursements, including barristers' fees, are to be paid irrespective of the outcome of the matter;³⁵**

in addition, for CFAs:

- (4) the circumstances that constitute a "successful outcome" of the matter to which it relates;³⁶ and**
- (5) the basis of calculation of the Success Fee which would be payable in the event of such "successful outcome", as well as the Success Fee premium, meaning the percentage uplift by which the amount of the legal costs which would be payable if there were no ORFS in place;³⁷ and**

for DBAs (including Hybrid DBAs):

- (6) the Financial Benefit to which the DBA relates.³⁸**

- (b) The Success Fee in CFAs should be fixed with reference to the fee that the Lawyer would charge the client if there were no ORFS in relation to the Arbitration.³⁹**
- (c) A DBA Payment should be payable (depending on the terms agreed between Lawyer and client) wherever a Financial Benefit is obtained by the client, based on the value of that Financial Benefit.⁴⁰**
- (d) The relevant Financial Benefit may be a debt owed to a client, eg under an award or settlement or otherwise, rather than money or property actually received.⁴¹**

³⁵ See paras 10.9 to 10.11 of, and item 1(l) of the recommended ORFS safeguards to be included in subsidiary legislation in Annex 2 to this Report.

³⁶ See item 1(o)(v) of the recommended ORFS safeguards to be included in subsidiary legislation in Annex 2 to this Report.

³⁷ See item 1(o)(vi) of the recommended ORFS safeguards to be included in subsidiary legislation in Annex 2 to this Report.

³⁸ See item 1(o)(vii) of the recommended ORFS safeguards to be included in subsidiary legislation in Annex 2 to this Report.

³⁹ See s 98ZB(2) of the draft amendments to the Arbitration Ordinance in Annex 1 to this Report.

⁴⁰ See ss 98ZC and 98ZD of the draft amendments to the Arbitration Ordinance in Annex 1 to this Report.

⁴¹ See s 98ZA(1) of the draft amendments to the Arbitration Ordinance in Annex 1 to this Report.

- (e) 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.⁴²**
- (f) Respondents in Arbitrations should be permitted to agree with their Lawyers that a DBA Payment shall be payable in the event the respondents are held liable for less than the amount claimed or less than an agreed threshold.⁴³**
- (g) ORFSs for Arbitration should be void and unenforceable to the extent that they relate to personal injury claims.⁴⁴**
- (h) No other categories of claims should be treated differently from other claims that are submitted to Arbitration if ORFSs are introduced.**

⁴² Same as above.

⁴³ Same as above.

⁴⁴ See s 98ZK of the draft amendments to the Arbitration Ordinance in Annex 1 to this Report.

Chapter 15

Charge separately for separate aspects of Arbitration

Responses to the Sub-committee's Recommendation 14

15.1 This Chapter discusses the responses regarding Recommendation 14 in the Consultation Paper:

"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."¹

Comments from Respondents who supported Recommendation 14

15.2 The majority of Respondents, who replied specifically on this issue, supported Recommendation 14. Those in favour of the recommendation include the HKBA.

15.3 Citing freedom of contract, a chamber of commerce stated that *"this should be a matter that the client should be free to negotiate with its lawyer, under the principle of freedom of contract"*.

15.4 Likewise, a professional body said that *"it should be a matter of commercial negotiation as between a client and the lawyers as to how other arbitration-related work should be charged, including (for example) whether or not this should be the subject of the same or a different DBA"*. As this Respondent put it, *"[t]his recommendation just reflects the above ability to be flexible in how a party might structure the engagement of its legal advisers"*. It emphasised that *"Hong Kong should aim for maximum flexibility in this regard"*.

15.5 Also emphasising flexibility and freedom of contract, the Consumer Council confirmed that it did *"not object to legal practitioners charging separately for work done in relation to separate but related aspects of the arbitration, thus offering further options and flexibility to consumer clients in managing their case"*.

15.6 A Governmental department also concurred, pointing out that they *"have no objection to this recommendation in principle as long as ORFSs are confined to the legal work performed in relation to Arbitration"*.

¹ See Consultation Paper, at para 5.75.

15.7 A litigation funder also supported this recommendation and noted that, provided there is a requirement for clients to receive independent advice, *"there should be commercial autonomy for parties to negotiate the most appropriate terms in the circumstances of the case"*.

Comments from Respondents who opposed Recommendation 14

15.8 No Respondents expressly opposed Recommendation 14.

15.9 Two Respondents, an arbitrator/barrister and a professional body, commented that much depends on whether appeals and enforcement actions are included in respect of the same DBA or different DBAs (including Hybrid DBAs), which seems to support the ability of clients and Lawyers to agree different ORFSs for different aspects of an Arbitration in line with the principle of freedom of contract and party autonomy. Consistent with this, and in line with the comments made in relation to Final Recommendation 13(c), (d), (e) and (f) above, these same Respondents noted that *"what constitute [sic] 'financial benefits' in the context of a particular case is clearly subject to what was negotiated and agreed as between the client and the lawyers"*.

Our analysis and response

15.10 The majority of Respondents who commented on Recommendation 14 clearly agreed that Lawyers and legal practices should be permitted to charge separately for work done in relation to separate but related aspects of the Arbitration. We agree with the Sub-committee that such approach upholds freedom of contract, and allows considerable flexibility for the client and the Lawyer not only to agree on how to structure their fee (and any ORFS) arrangements to suit their particular needs and circumstances, but also maximum flexibility to negotiate and agree what constitutes a Financial Benefit in the context of the particular case in which the ORFS is being used. As noted, this is consistent with Final Recommendation 13(c), (d), (e) and (f), discussed in Chapter 14 above.

15.11 Accordingly, we recommend that Lawyers should be permitted to charge separately for work done in relation to separate but related aspects of the Arbitration. This does not mean that every stage of an Arbitration - claim, counterclaim, set aside, enforcement, etc - must be subject to an ORFS. It does, nevertheless, allow clients to discuss with their Lawyers which aspects, if any, might be suitable for an ORFS, whether and how to define "success" and Financial Benefit for each aspect, and to negotiate and agree accordingly.

Final Recommendation 14

We recommend that:

- (a) 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.**
- (b) Subsidiary legislation should include provisions to require the following matters to be stated clearly in the ORFS:**
 - (i) the Arbitration or parts thereof (including any appeal, set aside or counterclaim) to which the ORFS relates;² and**
 - (ii) whether the ORFS covers the client's prosecution or defence of the claim (or both).³**

² See item 1(o)(i) of the recommended ORFS safeguards to be included in subsidiary legislation in Annex 2 to this Report.

³ See item 1(o)(ii) of the recommended ORFS safeguards to be included in subsidiary legislation in Annex 2 to this Report.

Chapter 16

Summary of our Final Recommendations

Final Recommendation 1

We recommend 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 2.10 to 2.32)

Final Recommendation 2

Where a CFA is in place, we recommend that any Success Fee premium and any Legal Expense Insurance premium agreed by a client with its Lawyers and insurers respectively shall not, in principle, be borne by the unsuccessful party. However, where in the opinion of the Tribunal there are exceptional circumstances, the Tribunal may apportion such Success Fee premium and/or Legal Expense Insurance premium between the parties if it determines that apportionment is reasonable, taking into account the exceptional circumstances of the case. (Paras 3.10 to 3.20)

Final Recommendation 3

Where a CFA is in place, we recommend that:

- (a) there should be a cap on the Success Fee of 100% of "benchmark" costs; and
- (b) barristers should be subject to the same cap in such circumstances. (Paras 4.18 to 4.26)

Final Recommendation 4

We recommend that prohibitions on the use by Lawyers of DBAs in Arbitration should be lifted, so that Lawyers may use DBAs for Arbitration. (Paras 5.10 to 5.17)

Final Recommendation 5

Where a DBA, or a Hybrid DBA, is in place, we recommend that any Legal Expense Insurance premium agreed by a client with its insurers shall not, in principle, be borne by the unsuccessful party. However, where in the opinion

of the Tribunal there are exceptional circumstances, the Tribunal may apportion such Legal Expense Insurance premium between the parties if it determines that apportionment is reasonable, taking into account the exceptional circumstances of the case. (Paras 6.7 to 6.9)

Final Recommendation 6

We recommend that the Success fee model should apply to DBAs, including Hybrid DBAs. (Paras 7.14 to 7.20)

Final Recommendation 7

We recommend that any DBA Payment be capped at 50% of the Financial Benefit obtained by the client. (Paras 8.14 to 8.23)

Final Recommendation 8

We recommend that:

- (a) A CFA, DBA, or Hybrid DBA should specify whether, and if so in what circumstances, a Lawyer or client is entitled to terminate the ORFS prior to the conclusion of the Arbitration.
- (b) Subsidiary legislation should specify, on a non-exhaustive basis, that a Lawyer is entitled to terminate an ORFS prior to the conclusion of the Arbitration if the Lawyer reasonably believes that:
 - (i) the client has committed a material breach of the CFA, DBA or Hybrid DBA; or
 - (ii) the client has behaved or is behaving unreasonably.
- (c) A CFA, DBA, or Hybrid DBA should specify an alternative basis (for example, hourly rates) on which the client shall pay the Lawyer in the event of such termination, save that the Lawyer may not charge the client more than the Lawyer's costs, expenses and disbursements for the work undertaken in respect of the Proceedings to which the CFA, DBA or Hybrid DBA relates.
- (d) The grounds on which a client may terminate a CFA, DBA or Hybrid DBA prior to the conclusion of the Arbitration should be a matter for agreement with the Lawyer in accordance with basic contractual principles, and no statutory requirements should apply. (Paras 9.12 to 9.19, 9.23)

Final Recommendation 9

We recommend that:

- (a) Clients should be able to agree, on a case by case basis, whether:
 - (i) the DBA Payment (and thus the DBA Payment cap) includes barristers' fees; or
 - (ii) barristers' fees will be charged as a separate disbursement outside the DBA Payment.
- (b) The DBA, including Hybrid DBA, should specify whether barristers' fees will be absorbed as part of the DBA Payment, or whether they are to be treated as "expenses" which the client is required to pay in addition to the DBA Payment.
- (c) To the extent that barristers can be, and are, engaged directly, via a separate DBA, including Hybrid DBA, between client and barrister, 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 10.9 to 10.11, 10.17)

Final Recommendation 10

We recommend that:

- (a) Prohibitions on the use of Hybrid DBAs in Arbitration by Lawyers should be lifted, so that Lawyers may choose to enter into Hybrid DBAs for Arbitration.
- (b) In the event that a case under a Hybrid DBA is unsuccessful (such that no Financial Benefit is obtained),
 - (i) the Lawyer should be permitted to retain only a proportion of the "benchmark" costs he or she has incurred in pursuing the unsuccessful claim; and
 - (ii) that proportion should be capped at 50% of the irrecoverable costs incurred in pursuing the unsuccessful claim.
- (c) The relevant regulations should provide that, if the DBA Payment plus the recoverable costs for a Hybrid DBA (in a successful scenario) is less than the capped amount of irrecoverable costs (which is 50% of the irrecoverable costs incurred in pursuing the unsuccessful claim), the Lawyer is entitled to retain the capped

amount of irrecoverable costs instead of the DBA Payment plus the recoverable costs. (Paras 11.13 to 11.17, 11.23 to 11.25, 11.28 to 11.30, 11.35)

Final Recommendation 11

We recommend that:

- (a) Section 64(1)(b) of the Legal Practitioners Ordinance should be amended such that CFAs, DBAs and Hybrid DBAs for Arbitration would be valid under Hong Kong law.
- (b) Part 10A of the Arbitration Ordinance should be amended, and a new Part 10B added, such that CFAs, DBAs and Hybrid DBAs for Arbitration would be valid under Hong Kong law.
- (c) The Hong Kong Solicitors' Guide to Professional Conduct should be amended to permit solicitors to enter into ORFSs for Arbitration.
- (d) The HKBA's Code of Conduct should be amended so that barristers may enter into ORFSs for Arbitration, and may also decline instructions involving ORFSs for Arbitration. (Paras 12.9 to 12.19)

Final Recommendation 12

We recommend that:

- (a) the more detailed regulatory framework should be set out in subsidiary legislation which, like the legislative amendments referred to in Final Recommendation 11, should be as simple and clear as possible to avoid frivolous technical challenges; and
- (b) further client-care provisions (to the extent these are required) could also be set out in professional codes of conduct so that trivial breaches can be dealt with expeditiously by the professional bodies. (Paras 13.11 to 13.13)

Final Recommendation 13

We recommend that:

- (a) The subsidiary legislation should include provisions for at least the following safeguards:
 - (i) the ORFS must be in writing and signed by the client;

- (ii) the Lawyer should give the client all relevant information relating to the ORFS that is being entered into, and should provide that information in a clear and accessible form;
- (iii) the Lawyer should inform clients of their right to take independent legal advice, and the ORFS should include a corresponding statement that the client has been informed of the right to seek such independent legal advice;
- (iv) the ORFS should be subject to a minimum "cooling-off" period of seven days during which the client, by written notice, may terminate the ORFS;
- (v) the ORFS itself should state clearly:
 - (1) in what circumstances a Lawyer's fees and expenses, or part of them, will be payable;
 - (2) the circumstances in which the Lawyer's payment, expenses and costs, or part of them, are payable by the client in the event that the ORFS is terminated by the Lawyer or the client; and
 - (3) whether disbursements, including barristers' fees, are to be paid irrespective of the outcome of the matter;

in addition, for CFAs:

- (4) the circumstances that constitute a "successful outcome" of the matter to which it relates; and
- (5) the basis of calculation of the Success Fee which would be payable in the event of such "successful outcome", as well as the Success Fee premium, meaning the percentage uplift by which the amount of the legal costs which would be payable if there were no ORFS in place; and

for DBAs (including Hybrid DBAs):

- (6) the Financial Benefit to which the DBA relates.

- (b) The Success Fee in CFAs should be fixed with reference to the fee that the Lawyer would charge the client if there were no ORFS in relation to the Arbitration.

- (c) A DBA Payment should be payable (depending on the terms agreed between Lawyer and client) wherever a Financial Benefit is obtained by the client, based on the value of that Financial Benefit.
- (d) The relevant Financial Benefit may be a debt owed to a client, eg under an award or settlement or otherwise, rather than money or property actually received.
- (e) 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.
- (f) Respondents in Arbitrations should be permitted to agree with their Lawyers that a DBA Payment shall be payable in the event the respondents are held liable for less than the amount claimed or less than an agreed threshold.
- (g) ORFSs for Arbitration should be void and unenforceable to the extent that they relate to personal injury claims.
- (h) No other categories of claims should be treated differently from other claims that are submitted to Arbitration if ORFSs are introduced. (Paras 14.17 to 14.22, 14.31 to 14.43, 14.51 to 14.57, 14.64 to 14.66)

Final Recommendation 14

We recommend that:

- (a) 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.
- (b) Subsidiary legislation should include provisions to require the following matters to be stated clearly in the ORFS:
 - (i) the Arbitration or parts thereof (including any appeal, set aside or counterclaim) to which the ORFS relates; and
 - (ii) whether the ORFS covers the client's prosecution or defence of the claim (or both). (Paras 15.10 to 15.11)

Draft Amendments to Legal Practitioners Ordinance (Cap. 159) and Arbitration Ordinance (Cap. 609)

(The following draft provisions are possible amendments of the Legal Practitioners Ordinance (Cap. 159) and the Arbitration Ordinance (Cap. 609) and are included to assist in explaining the proposals in this report. They are not the final version for the legislative process if legislation were to be introduced to give effect to the proposals.)

Amendments to Legal Practitioners Ordinance (Cap. 159)

*(Note: For ease of reference, the amendments to the existing text of s. 64 of Cap. 159 is shown in **red**)*

64. General provisions as to remuneration

- (1) Nothing in section 58, 59, 60, 61 or 62 shall give validity to—
 - (a) any purchase by a solicitor of the interest, or any part of the interest, of his client in any action, suit or other contentious proceeding; or
 - (b) any agreement—
 - (i) that is not an ORFS agreement for arbitration within the meaning of Part 10B of the Arbitration Ordinance (Cap. 609); and
 - (ii) by which a solicitor retained or employed to prosecute any action, suit or other contentious proceeding stipulates for payment only in the event of success in that action, suit or proceeding; or
 - (c) any disposition, contract, settlement, conveyance, delivery, dealing or transfer which is under the law relating to bankruptcy invalid against a trustee or creditor in any bankruptcy or voluntary arrangement with creditors within the meaning of the Bankruptcy Ordinance (Cap. 6).
(Amended 27 of 1998 s. 7)
- (2) A solicitor may take security from his client for his costs to be ascertained by taxation or otherwise.
- (3) Subject to the provisions of any rules of court, upon every taxation of costs with respect to any contentious business, the taxing officer may—
 - (a) allow interest at such rate and from such time as he thinks just on moneys disbursed by the solicitor for the client, and on moneys of the client in the hands of, and improperly retained by, the solicitor;
 - (b) in determining the remuneration of the solicitor, have regard to the skill, labour and responsibility involved in the business done by him, the general complexity of the matter and the amount or value of the matter in issue.

Amendments to Arbitration Ordinance (Cap. 609)

(Note: A new subsection (2) is to be inserted into section 98H of Cap. 609. For ease of reference, the new subsection (2) is shown in **red**.)

98H. Meaning of *funding agreement*

(1) A funding agreement is an agreement for third party funding of arbitration that is—

- (a) in writing;
- (b) made between a funded party and a third party funder; and
- (c) made on or after the commencement date of Division 3.

(2) To avoid doubt, a funding agreement is not to be construed to include an ORFS agreement for arbitration within the meaning of Part 10B.

(Note: The following provision is to be inserted into Division 3 of Part 10A of Cap. 609)

98OA. Part 10A not applicable to ORFS agreement for arbitration

This Part does not apply to an ORFS agreement for arbitration within the meaning of Part 10B.

(Note: The following new Part 10B is to be inserted after Part 10A)

Part 10B

Outcome Related Fee Structure Agreement for Arbitration

Division 1—Purposes

98Y. Purposes

The purposes of this Part are to—

- (a) ensure that an ORFS agreement for arbitration is not prohibited by particular common law doctrines;
- (b) provide for the enforceability of ORFS agreements for arbitration that meet certain general and specific conditions; and
- (c) provide for measures and safeguards in relation to ORFS agreements for arbitration.

98Z. Part 10B not applicable to funding agreements

This Part is not applicable to a funding agreement within the meaning of Part 10A.

Division 2—Interpretation

98ZA. Interpretation

(1) In this Part—

advisory body means the person appointed by the Secretary for Justice under section 98ZS(1);

arbitration includes the following proceedings under this Ordinance—

- (a) court proceedings;
- (b) proceedings before an emergency arbitrator; and

- (c) mediation proceedings;

arbitration body—

- (a) in relation to an arbitration (other than the proceedings mentioned in paragraphs (b) and (c))—means the arbitral tribunal or court, as the case may be;
- (b) in relation to proceedings before an emergency arbitrator—means the emergency arbitrator; or
- (c) in relation to mediation proceedings—means the mediator appointed under section 32 or referred to in section 33, as the case may be;

authorized body means the person appointed by the Secretary for Justice under section 98ZS(2);

Cap. 159 means the Legal Practitioners Ordinance (Cap. 159);

client, in relation to a lawyer, includes—

- (a) any person who retains or employs, or is about to retain or employ, the lawyer; and
- (b) any person who is or may be liable to pay the lawyer's costs;

code of practice means the code of practice issued under Division 6 and as amended from time to time;

conditional fee agreement—see section 98ZB;

damages-based agreement—see section 98ZC;

expenses means any of the following items—

- (a) disbursements incurred by the lawyer, or directly by the client of the lawyer in a matter;
- (b) any **legal expenses insurance** premium incurred by the client;

financial benefit—

- (a) means money or money's worth; but
- (b) does not include—
 - (i) any sum awarded in respect of lawyer's costs; and
 - (ii) any sum awarded in respect of expenses;

hybrid damages-based agreement—see section 98ZD;

lawyer means—

- (a) a person who is enrolled on the roll of barristers kept under section 29 of Cap. 159;
- (b) a person who is enrolled on the roll of solicitors kept under section 5 of Cap. 159;
- (c) a person who is qualified to practise the law of a jurisdiction other than Hong Kong, including a foreign lawyer as defined by section 2(1) of Cap. 159;

legal expenses insurance means a contract of insurance that provides reimbursement to a client or a lawyer for some or all of the legal fees, adverse costs or disbursements incurred in respect of a matter;

mediation proceedings means mediation proceedings referred to in section 32(3) or 33;

money or money's worth—

- (a) means any money, assets, security, tangible or intangible property, services, any amount owed under an award, settlement agreement or otherwise, and any other consideration reducible to a monetary value; and
- (b) includes any avoidance or reduction of a potential liability;

ORFS means outcome related fee structure;

ORFS agreement means any of the following agreements made between a client and the lawyer of the client—

- (a) a conditional fee agreement;
 - (b) a damages-based agreement;
 - (c) a hybrid damages-based agreement.
- (2) In this Part, a reference to an ORFS agreement for arbitration is a reference to an ORFS agreement—
- (a) made between a client and the lawyer of the client for an arbitration; and
 - (b) made on or after the day on which this Part comes into operation.
- (3) To avoid doubt, an ORFS agreement for arbitration is not to be construed to include a funding agreement within the meaning of Part 10A.

98ZB. Meaning of conditional fee agreement

- (1) A conditional fee agreement is an agreement, made between a client and the lawyer of the client for a matter, under which the lawyer agrees with the client to be paid a success fee only in the event of a successful outcome for the client in the matter.
- (2) In subsection (1)—

success fee means a payment calculated by reference to the fee that the lawyer would charge the client for the matter if no ORFS agreement were made for the matter;

successful outcome, in relation to a matter—

- (a) means any outcome of the matter falling within the description of being successful as agreed to between the client and the lawyer of the client; and
- (b) includes any financial benefit that is obtained by the client in the matter.

98ZC. Meaning of damages-based agreement

A damages-based agreement is an agreement, made between a client and the lawyer of the client for a matter, under which—

- (a) the lawyer agrees with the client to be paid only in the event the client obtains a financial benefit in the matter (**DBA payment**); and
- (b) the DBA payment is calculated by reference to the financial benefit that is obtained by the client in the matter.

98ZD. Meaning of hybrid damages-based agreement

A hybrid damages-based agreement is an agreement, made between a client and the lawyer of the client for a matter, under which the lawyer agrees with the client to be paid—

- (a) in the event the client obtains a financial benefit in the matter—a payment calculated by reference to the financial benefit; and
- (b) a fee, usually calculated at a discount, for the legal services rendered by the lawyer for the client during the course of the matter.

Division 3—ORFS Agreements for Arbitration Not Prohibited by Particular Common Law Offences or Tort

98ZE. Particular common law offences do not apply

The common law offences of maintenance (including the common law offence of champerty) and of being a common barrator do not apply in relation to any ORFS agreement for arbitration.

98ZF. Particular tort does not apply

The tort of maintenance (including the tort of champerty) does not apply in relation to any ORFS agreement for arbitration.

98ZG. Other illegality not affected

Sections 98ZE and 98ZF do not affect any rule of law as to the cases in which a contract is to be treated as contrary to public policy or otherwise illegal.

98ZH. Limited application of Part 10B for non-Hong Kong arbitration

Despite section 5, this Part applies in relation to an arbitration for which the place of arbitration is outside Hong Kong or there is no place of arbitration as if the place of arbitration were in Hong Kong.

Division 4—General Provisions for ORFS Agreements

98ZI. Application of Division 4

This Division applies in relation to any ORFS agreement for arbitration.

98ZJ. Validity and enforceability of ORFS agreements for arbitration

(1) An ORFS agreement for arbitration that meets—

- (a) all general conditions specified in the rules; and
- (b) all specific conditions specified in the rules for the kind of ORFS agreement to which the agreement belongs,

is not void or unenforceable only because of its being an ORFS agreement for arbitration.

(2) In this section—

rules means rules made by the advisory body under section 98ZL.

98ZK. ORFS agreement for arbitration void and unenforceable to the extent relating to personal injuries claim

(1) Despite section 98ZJ, an ORFS agreement for arbitration is void and unenforceable to the extent that it relates to a personal injuries claim.

(2) In this section—

personal injuries includes any disease and any impairment of a person's physical or mental condition;

personal injuries claim means a claim for damages in respect of personal injuries to a person or any other person or in respect of a person's death.

Division 5—Power to Make Rules

98ZL. Power of advisory body to make rules for matters under Part 10B

- (1) The advisory body may, in consultation with the Secretary for Justice and with the prior approval of the Chief Justice, make rules to—
 - (a) specify the general conditions referred to section 98ZJ(1)(a);
 - (b) specify the specific conditions referred to section 98ZJ(1)(b); and
 - (c) generally provide for the effective implementation of the purposes and provisions of this Part.
- (2) Any rules made under subsection (1) may—
 - (a) be of general application or make different provisions for different cases or classes of cases; and
 - (b) include the incidental, supplementary and consequential provisions that the advisory body considers necessary or expedient.

Division 6—Code of Practice

98ZM. Code of practice may be issued

- (1) The authorized body may issue a code of practice setting out the practices and standards with which lawyers who enter into ORFS agreements for arbitration are ordinarily expected to comply in connection with ORFS agreements for arbitration.
- (2) The authorized body must publish the code of practice in the Gazette.
- (3) The code of practice comes into operation on the day on which it is published in the Gazette.
- (4) The code of practice is not subsidiary legislation.
- (5) The authorized body may amend or revoke the code of practice.
- (6) Subsections (2) to (4) apply in relation to an amendment or revocation of the code of practice in the same way as they apply in relation to the code of practice.

98ZN. Non-compliance with code of practice

- (1) A failure to comply with a provision of the code of practice does not, of itself, render any person liable to any judicial or other proceedings.
- (2) However—
 - (a) the code of practice is admissible in evidence in proceedings before any court or arbitral tribunal; and
 - (b) any compliance, or failure to comply, with a provision of the code of practice may be taken into account by any court or arbitral tribunal if it is relevant to a question being decided by the court or arbitral tribunal.

Division 7—Other Measures and Safeguards

98ZO. Communication of information for ORFS agreements for arbitration

- (1) Despite section 18(1), information referred to in that section may be communicated by a party to a person for the purpose of having, or seeking, to enter into an ORFS agreement for arbitration with the person.

- (2) However, the person may not further communicate anything communicated under subsection (1), unless—
- (a) the further communication is made—
 - (i) to protect or pursue a legal right or interest of the person; or
 - (ii) to enforce or challenge an award made in the arbitration, in legal proceedings before a court or other judicial authority in or outside Hong Kong;
 - (b) the further communication is made to any government body, regulatory body, court or tribunal and the person is obliged by law to make the communication; or
 - (c) the further communication is made to a professional adviser of the person for the purpose of obtaining advice in connection with the ORFS agreement for arbitration.
- (3) If a further communication is made by a person to a professional adviser under subsection (2)(c), subsection (2) applies to the professional adviser as if the professional adviser were the person.
- (4) In this section—
communicate includes publish or disclose.

98ZP. Disclosure about ORFS agreement for arbitration

- (1) If an ORFS agreement for arbitration is made between a client and the lawyer of the client, the lawyer must give written notice of—
- (a) the fact that an ORFS agreement for arbitration has been made; and
 - (b) the name of the client.
- (2) The notice must be given—
- (a) for an ORFS agreement for arbitration made on or before the commencement of the arbitration—on the commencement of the arbitration; or
 - (b) for an ORFS agreement for arbitration made after the commencement of the arbitration—within 15 days after the ORFS agreement for arbitration is made.
- (3) The notice must be given to—
- (a) each other party to the arbitration; and
 - (b) the arbitration body.
- (4) For subsection (3)(b), if there is no arbitration body for the arbitration at the time, or at the end of the period, specified in subsection (2) for giving the notice, the notice must instead be given to the arbitration body immediately after there is an arbitration body for the arbitration.

98ZQ. Disclosure about end of ORFS agreement for arbitration

- (1) If an ORFS agreement for arbitration ends (other than because of the end of the arbitration), the client must give written notice of—
- (a) the fact that the ORFS agreement for arbitration has ended; and
 - (b) the date the ORFS agreement for arbitration ended.
- (2) The notice must be given within 15 days after the ORFS agreement for arbitration ends.

- (3) The notice must be given to—
 - (a) each other party to the arbitration; and
 - (b) the arbitration body (if any).

98ZR. Non-compliance with Division 7

- (1) A failure to comply with this Division does not, of itself, render any person liable to any judicial or other proceedings.
- (2) However, any compliance, or failure to comply, with this Division may be taken into account by any court or arbitral tribunal if it is relevant to a question being decided by the court or arbitral tribunal.

Division 8—Miscellaneous

98ZS. Appointment of advisory body and authorized body

- (1) The Secretary for Justice may, by notice published in the Gazette, appoint as the advisory body a person the Secretary for Justice considers appropriate to monitor and review the operation of this Part and exercise the powers under section 98ZL.
- (2) The Secretary for Justice may, by notice published in the Gazette, appoint as the authorized body a person the Secretary for Justice considers appropriate to exercise the powers under section 98ZM.

98ZT. Limitation on award of costs by arbitral tribunal

- (1) Despite section 74(3), an arbitral tribunal may not order costs falling within any of the following descriptions to be paid to a party where an ORFS agreement has been entered into with the lawyer of the party for that arbitration—
 - (a) if the ORFS agreement for the arbitration is a conditional fee agreement—the success fee within the meaning of section 98ZB(2);
 - (b) any premium for a legal expenses insurance contract;
 - (c) any part of the fee that is greater than the fee that the lawyer would have been entitled to be paid by the client if there were no ORFS agreement in respect of the arbitration (*normal fee*),
unless the arbitral tribunal is satisfied that are exceptional circumstances justifying the ordering of such costs.
- (2) To avoid doubt, subsection (1) does not prevent the arbitral tribunal from ordering a party to pay costs in an amount not exceeding the amount of the normal fee.

**Recommended ORFS safeguards to be included
in subsidiary legislation**

1. The subsidiary legislation should include provisions as set out below:
 - (a) any Success Fee in a CFA should be subject to a cap of 100% of "benchmark" costs;
 - (b) any DBA Payment should be capped at 50% of the Financial Benefit obtained by the client;
 - (c) to the extent that barristers can be, and are, engaged directly, via a separate DBA, including Hybrid DBA, by the client, 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;
 - (d) the Success fee model should apply to DBAs, including Hybrid DBAs;
 - (e) in the event that a claim under a Hybrid DBA is unsuccessful (such that no Financial Benefit is obtained),
 - (i) the Lawyer should be permitted to retain only a proportion of the "benchmark" costs he or she has incurred in pursuing the unsuccessful claim; and
 - (ii) that proportion should be capped at 50% of the irrecoverable costs incurred in pursuing the unsuccessful claim;
 - (f) if the DBA Payment plus the recoverable costs for a Hybrid DBA (in a successful scenario) is less than the capped amount of irrecoverable costs (which is 50% of the irrecoverable costs incurred in pursuing the unsuccessful claim), the Lawyer is entitled to retain the capped amount of irrecoverable costs instead of the DBA Payment plus the recoverable costs;
 - (g) the ORFS must be in writing and signed by the client;
 - (h) the Lawyer should give the client all relevant information relating to the ORFS, and should provide that information in a clear and accessible form;

- (i) the ORFS should be clear in what circumstances a Lawyer's fees and expenses, or part of them, will be payable, including in circumstances when the ORFS is terminated by the Lawyer or the client;
- (j) the Lawyer should inform clients of their right to take independent legal advice, and the ORFS should include a corresponding statement that the client has been informed of the right to seek such independent legal advice;
- (k) the ORFS should be subject to a minimum "cooling-off" period of seven days during which the client, by written notice, may terminate the ORFS;
- (l) the ORFS should state whether disbursements, including barristers' fees, are to be paid irrespective of the outcome of the matter;
- (m) subject to the parties agreeing otherwise, the Lawyer is entitled to terminate an ORFS prior to the conclusion of the Arbitration if the Lawyer reasonably believes that:
 - (i) the client has committed a material breach of the CFA, DBA or Hybrid DBA; or
 - (ii) the client has behaved or is behaving unreasonably;
- (n) where the ORFS is terminated prior to the conclusion of the Arbitration, the Lawyer may not charge the client more than the Lawyer's costs, expenses and disbursements for the work undertaken in respect of the Proceedings to which the CFA, DBA or Hybrid DBA relates;
- (o) (in addition to the matters stated above) the Lawyer should be required to include these terms in any ORFS:
 - (i) the Arbitration or parts thereof (including any appeal, setting aside or counterclaim) to which the ORFS relates;
 - (ii) whether the ORFS covers the client's prosecution or defence of the claim (or both);
 - (iii) whether, and if so in what circumstances, a Lawyer or client is entitled to terminate the ORFS prior to the conclusion of Arbitration; and
 - (iv) an alternative basis (for example, hourly rates) on which the client shall pay the Lawyer in the event of such termination;

for CFAs:

- (v) the circumstances that constitute a "successful outcome" of the matter to which it relates; and
- (vi) the basis of calculation of the Success Fee which would be payable in the event of such "successful outcome", as well as the Success Fee premium, meaning the percentage uplift by which the amount of the legal costs which would be payable if there were no ORFS in place; and

for DBAs (including Hybrid DBAs):

- (vii) the Financial Benefit to which the DBA relates; and
- (viii) whether barristers' fees will be absorbed as part of the DBA Payment, or whether they are to be treated as "expenses" which the client is required to pay in addition to the DBA Payment.

List of Respondents to the consultation

Responses were received from the following Respondents, arranged in alphabetical order:

1. Allen & Overy
2. Angela Ho & Associates
3. Asian Corporate Governance Association
4. Consumer Council
5. Department of Justice, Civil Division
6. Hong Kong Bar Association
7. Hong Kong Federation of Women Lawyers Limited
8. Hong Kong General Chamber of Commerce
9. Hong Kong Institute of Arbitrators
10. Hong Kong International Arbitration Centre
11. Hong Kong Professionals and Senior Executives Association
12. Insurance Authority
13. International Chamber of Commerce – Hong Kong
14. International Legal Finance Association
15. Kao, Lee & Yip
16. King & Wood Mallesons
17. Kirkland & Ellis
18. Liao Andrew, GBS, SC, JP
19. Omni Bridgeway Limited
20. Shearman & Sterling
21. The Law Society of Hong Kong
22. Wong Samuel Chat Chor