THE LAW REFORM COMMISSION OF HONG KONG

REPORT

OUTCOME RELATED FEE STRUCTURES FOR ARBITRATION

EXECUTIVE SUMMARY

(This executive summary is an outline of the Report. Copies of the full Report can be downloaded from the Commission's website at: http://www.hkreform.gov.hk or obtained from the Secretariat of the Law Reform Commission, 4th Floor, East Wing, Justice Place, 18 Lower Albert Road, Central, Hong Kong.)

Consultation process

1. In December 2020, the Law Reform Commission's Outcome Related Fee Structures for Arbitration Sub-committee ("**Sub-committee**") published the Consultation Paper on Outcome Related Fee Structures for Arbitration ("**CP**"), pursuant to the following terms of reference:

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

2. The Sub-committee recommends in the CP that prohibitions on the use of outcome related fee structures[1] by Lawyers[2] in Arbitration[3] should be lifted. Under the current law, Lawyers are prohibited from providing "arbitration funding"[4] to a party where the Lawyer or his legal practice is acting for any party in relation to the relevant Arbitration.[5]

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1 For the purposes of the CP, an outcome related fee structure means an agreement between a Lawyer and client, whereby the Lawyer advises on litigation or arbitration proceedings ("**Proceedings**") which are contentious and the Lawyer receives a financial benefit if those Proceedings are successful within the meaning of that agreement.

2 A person who is qualified to practise the law of any jurisdiction, including Hong Kong. For the purposes of the Report, "Lawyer" includes (but is not limited to) Hong Kong barristers, solicitors and foreign lawyers registered under Part IIIA of the Legal Practitioners Ordinance (Cap 159) of Hong Kong.

3 Any arbitration, whether or not administered by a permanent arbitral institution, in or outside Hong Kong, including the following proceedings under the Arbitration Ordinance (Cap 609) of Hong Kong: (i) court proceedings; (ii) proceedings before an emergency arbitrator; and (iii) mediation proceedings.

4 "Arbitration funding" is defined in s 98F of the Arbitration Ordinance (Cap 609) of Hong Kong as *"money, or any other financial assistance, in relation to any costs of the arbitration"*.

5 Arbitration Ordinance (Cap 609) of Hong Kong, s 98O.

3. The Sub-committee received 23[6] responses from members of the public during the consultation. We are most grateful to all those who have commented on the CP ("**Respondents**").

Structure of the Report

4. The Report consists of 16 chapters dealing with 14 Final Recommendations:

(a) Chapter 1 briefly discusses the meaning of outcome related fee structure[7] ("**ORFS**") and the need to change the law in Hong Kong relating to ORFSs for Arbitration.

(b) Chapters 2 to 4 discuss the need to lift the prohibitions on the use of Conditional Fee Agreements ("**CFAs**") by Lawyers in Arbitration and other matters relating to CFAs, including the recoverability of Success Fee premium[8] and Legal Expense Insurance[9] premium from the unsuccessful party and the cap on the Success Fee[10] (Final Recommendations 1, 2 and 3).

(c) Chapters 5 to 8 discuss the need to lift the prohibitions on the use of Damages-based Agreements ("**DBAs**") by Lawyers in Arbitration and other matters relating to DBAs, including the recoverability of Legal Expense Insurance premium from the unsuccessful party, whether the Ontario model[11] or the Success fee model[12] should apply and the cap on the DBA Payment[13] (Final Recommendations 4, 5, 6 and 7).

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6 These responses came from 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.

7 For the purposes of the Report, an outcome related fee structure means any of the following agreements made between a Lawyer and client: CFAs, DBAs and hybrid damages-based agreements.

8 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.

9 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.

10 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. The difference between Success Fee and Success Fee premium is illustrated in the worked example of a "no win, low fee" arrangement at para 1.7 of the Report.

11 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.

12 The damages-based fee regime proposed in the 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, whereby costs recovered from the opponent are outside of, and additional to, the DBA Payment.

13 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. "Financial

(d) Chapter 9 examines the circumstances for termination of CFA, DBA or hybrid damages-based agreement ("**Hybrid DBA**") (Final Recommendation 8).

(e) Chapter 10 covers the treatment of barristers' fees (Final Recommendation 9).

(f) Chapter 11 discusses whether Hybrid DBAs should be permitted (Final Recommendation 10).

(g) Chapters 12 and 13 discuss the appropriate forms of regulation (Final Recommendations 11 and 12).

(h) Chapter 14 deals with the specific safeguards and other matters relating to ORFSs (Final Recommendation 13).

(i) Chapter 15 discusses whether Lawyers and legal practices should be permitted to charge separately for separate aspects of Arbitration (Final Recommendation 14).

(j) Chapter 16 sets out again, for quick reference, all of the Final Recommendations made in the previous chapters.

The draft provisions to amend the Arbitration Ordinance (Cap 609) of Hong Kong ("**Arbitration Ordinance**") and the Legal Practitioners Ordinance (Cap 159) of Hong Kong ("**Legal Practitioners Ordinance**") (**Annex 1**), the recommended ORFS safeguards to be included in subsidiary legislation (**Annex 2**) and the list of Respondents to the consultation (**Annex 3**) can be found at the end of the Report.

Chapter 2: Lifting prohibitions on the use of CFAs by Lawyers in Arbitration

5. Recommendation 1 in the CP 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. All but one of the submissions that commented on Recommendation 1 supported the recommendation. We agree with the Respondents 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. Furthermore, permitting ORFSs, including CFAs, is consistent with Hong Kong's overall policy of supporting freedom of contract. Additionally, the

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Benefit" is defined as "money or money's worth (ie 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), but does not include any sum awarded in respect of recoverable Lawyer's costs or recoverable expenses".

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.

6. 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. 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. We emphasise that these Final Recommendations are not applicable to mediation proceedings that do not fall within the Arbitration Ordinance[14] 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.[15]

7. We also 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 which are discussed in details in subsequent Chapters of the Report. Recommendation 1 in the CP is therefore maintained as **Final Recommendation 1** as follows:

> *"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."*

Chapter 3: Recoverability of Success Fee premium and Legal Expense Insurance premium from the unsuccessful party under CFAs

8. Recommendation 2 in the CP deals with the recoverability of Success Fee premium and Legal Expense Insurance premium from the unsuccessful party under CFAs. Almost all of the submissions that commented on Recommendation 2 supported the recommendation. To address some Respondents' concern, we also recommend in the Report that in exceptional circumstances, the Tribunal[16] should have the power to apportion those fees between the parties in the Arbitration based on the exceptional circumstances of the case. Our **Final Recommendation 2** is as follows:

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

15 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.

16 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.

"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."

Chapter 4: Cap on the Success Fee

9. Recommendation 3 in the CP recommends that there should be a cap on the Success Fee which is expressed as a percentage of normal or "benchmark" costs and invites proposals on what an appropriate cap should be, up to a maximum of 100%. It 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%.

10. A substantial majority of Respondents agreed with the recommendation. 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 same 100% as in England and Wales. In addition, we agree with some Respondents' comments that there is no reason or basis to differentiate between barristers and other Lawyers. For these reasons, our **Final Recommendation 3** is as follows:

"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."

Chapter 5: Lifting prohibitions on the use of DBAs by Lawyers in Arbitration

11. Recommendation 4 in the CP recommends that prohibitions on the use by Lawyers of DBAs in Arbitration should be lifted, so that Lawyers may use DBAs for Arbitration. All but one of the submissions that commented on Recommendation 4 supported the recommendation. We do not see a basis for permitting CFAs while prohibiting other forms of ORFS, including DBAs. We are also 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. We therefore recommend retaining Recommendation 4 in the CP

as our **Final Recommendation 4** as follows:

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

Chapter 6: Recoverability of Legal Expense Insurance premium from the unsuccessful party under DBAs

12. Recommendation 5 in the CP recommends that any after-the-event insurance ("**ATE Insurance**")[17] premium agreed by the claimant with its insurers should not be recoverable from the respondent. As with Recommendation 2, almost all of the Respondents who commented specifically on Recommendation 5 agreed with the recommendation. To address some Respondents' concern, we in addition recommend in the Report that in exceptional circumstances, the Tribunal should have the power to apportion those costs between the parties in the Arbitration based on the exceptional circumstances of the case. Our **Final Recommendation 5** is as follows:

> *"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

13. Recommendation 6 in the CP invites submissions on whether the Ontario model or the Success fee model should apply to DBAs. 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. In our view, there are the following two key difficulties with the Ontario model:

(a) The first difficulty is that it does not address the indemnity principle, which can give rise to a significant windfall for the losing opponent.[18]

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17 ATE Insurance is 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.

18 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

(b) 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.

14. In light of these issues, and considering the otherwise overwhelming support for the Success fee model from the Respondents, we make our **Final Recommendation 6** as follows:

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

Chapter 8: Cap on DBA Payment

15. Recommendation 7 in the CP 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, while the cap should be fixed after consultation. The majority of Respondents who commented on Recommendation 7 agreed with the recommendation. In light of this, and considering the fact that caps on DBA Payments are applied in other jurisdictions where ORFSs are permitted, we recommend imposing a cap on the DBA Payment.

16. In terms of what that cap should be, we note and agree with the view of a consumer/public interest group that a cap does not necessarily lead to overcompensation of Lawyers.[19] We further agree with the view that a higher cap could potentially increase the number of lower value claims for which a DBA may be considered. Taking also into consideration the 50% cap currently applying in England and Wales, we therefore make our **Final Recommendation 7** as follows:

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

Chapter 9: Circumstances for termination of CFA, DBA or Hybrid DBA

17. Recommendation 8(a) and (b) in the CP recommends that a CFA, DBA, or Hybrid DBA should specify whether, and if so in what circumstances:

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pay those recoverable costs, and the DBA Payment becomes the ceiling of recoverable costs to which the client is entitled.

[19] We take the view that 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.

(a) a Lawyer or client is entitled to terminate the fee agreement prior to the conclusion of Arbitration; and if so

(b) any alternative basis (for example, hourly rates) on which the client shall pay the Lawyer in the event of such termination.

18. 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.

19. In terms of what those grounds for termination are, 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. We agree that the relevant legislation should specify, on a non-exhaustive basis, the principal grounds upon which an ORFS can be terminated by the Lawyer, which will provide the primary safeguards highlighted by the Respondents. However, we do not consider it necessary to set out statutory grounds on which a client may terminate an ORFS. It 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.

20. As for the alternative basis on which the client shall pay the Lawyer in the event of such termination, we agree that the parties should be required to agree an alternative basis, 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 for the work undertaken. We therefore make our **Final Recommendation 8** as follows:

"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

21. Recommendation 9(1) in the CP 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. All but one of the submissions that commented on Recommendation 9(1) supported the recommendation. In light of the fact that the redrafted Damages-Based Agreements Regulations 2019 proposed in the 2019 DBA Reform Project[20] contemplate a client being able to choose whether to engage barristers through its solicitors or directly, and considering the overwhelming support for Recommendation 9(1), we agree with Recommendation 9(1).

22. For Recommendation 9(2) in the CP, a slight majority of the Respondents that commented specifically agreed with the recommendation, namely that a solicitor's DBA Payment plus a barrister's DBA Payment in relation to the same claim or litigation or arbitration proceedings should not exceed the prescribed DBA Payment cap. In view of the feedback from the public and our Final Recommendation 7 on there being a prescribed cap for DBA Payment, we maintain Recommendation 9(2). Based on Recommendation 9(1) and (2) in the CP (with some modifications), we make our **Final Recommendation 9** as follows:

"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

[20] 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.

(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

23. Recommendation 10 in the CP recommends that Hybrid DBAs should be permitted and invites submissions on the following issues in the event that the claim is unsuccessful (such that no financial benefit is obtained):

(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.

24. All but one of the Respondents who commented specifically on Recommendation 10 agreed with the basic proposal that Hong Kong should allow Hybrid DBAs. 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. We also agree with some Respondents 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.

25. 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 claim outweigh any undesirable implications of restricting their freedom to negotiate terms with their clients.

26. As for Recommendation 10(b), although all but one of the Respondents that supported Recommendation 10(a) suggested that **30%** was the appropriate cap, we recommend capping at **50%** the costs that a Lawyer can retain if the case is unsuccessful for the reasons below:

(a) Respondents were almost evenly divided between those who supported capping such costs and those who favoured no cap at all;

(b) there was a general support from the Respondents for a broad, flexible ORFS regime for Arbitration in Hong Kong; and

(c) a cap of 50% on "pure" DBA Payments is proposed in Final Recommendation 7.

27. The majority of Respondents who commented on Recommendation 10(c) agreed with the recommendation. In order to avoid the 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, we recommend retaining Recommendation 10(c) (with some modifications) in the CP and make our **Final Recommendation 10** as follows:

"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

28. Recommendation 11 in the CP 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 Hong Kong Bar Association's ("**HKBA's**") 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. Given the unanimous support from all the Respondents who commented on Recommendation 11, it is therefore adopted (with some modifications) as our **Final Recommendation 11** as follows:

"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.[21]

(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.[22]

(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."

Chapter 13: Form of regulation

29. Recommendation 12 in the CP 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. A

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

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

number of Respondents who commented on Recommendation 12 favoured the more detailed regulatory framework being 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.

30. We therefore recommend retaining Recommendation 12 (with some modifications) in the CP as our **Final Recommendation 12** as follows:

> *"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*
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> *(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

Safeguards

31. Recommendation 13(a) in the CP invites submissions on 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.

32. Almost all Respondents who commented on Recommendation 13(a) agreed with the proposals made. 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 the recommendation. Opinions mainly differed only in respect of whether a client should be required to disclose an ORFS for Arbitration.

33. After considering the relevant discussion in the CP, all the responses, and Hong Kong's current legal framework and regulatory culture, we make the following **Final Recommendation 13(a)**:

> *"We recommend that:*
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> *(a) The subsidiary legislation should include provisions for at least the following safeguards:*
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> *(i) the ORFS must be in writing and signed by the client;*[23]
>
> *(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;*[24]
>
> *(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;*[25]
>
> *(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;*[26]
>
> *(v) the ORFS itself should state clearly:*
>
> *(1) in what circumstances a Lawyer's fees and expenses, or part of them, will be payable;*[27]

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

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

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

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

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

(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;[28] *and*

(3) whether disbursements, including barristers' fees, are to be paid irrespective of the outcome of the matter;[29]

in addition, for CFAs:

(4) the circumstances that constitute a 'successful outcome' of the matter to which it relates;[30] *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;[31] *and*

for DBAs (including Hybrid DBAs):

(6) the Financial Benefit to which the DBA relates.[32]*"*

Criteria for payment of Success Fee or DBA Payment to a Lawyer

34. Recommendation 13(b) in the CP seeks views as to what should be the relevant method and criteria for fixing Success Fees in CFAs, while Recommendation 13(e) to (h) in the CP seeks views on 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.

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28 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, the Report.

29 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, the Report.

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

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

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

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."

35. 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. We share this preference and 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. However, 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. Such flexibility must, of course, be limited by effective safeguards. We also 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. We therefore make our **Final Recommendation 13(b), (c), (d), (e) and (f)** as follows:

"We recommend that:

(a) …

(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.[33]

(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.[34]

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

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

(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.[35]

(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.[36]

(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.[37]"

Whether personal injury claims and any other category/ies of claim should be treated differently

36. Recommendation 13(c) in the CP seeks views on 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.

37. Almost all Respondents who expressed a view on Recommendation 13(c) prefer to exclude personal injury claims completely from any ORFS regime for Arbitration. Several Respondents expressed concerns about the potential for Lawyers or claims intermediaries to use ORFSs for Arbitration to exploit vulnerable personal injury victims.

38. 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. 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. 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.

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

36 Same as above.

37 Same as above.

39. On the other hand, Recommendation 13(d) in the CP seeks 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. There was a limited response to the recommendation. 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 also 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. We therefore make our **Final Recommendation 13 (g) and (h)** as follows:

> *"We recommend that:*
>
> *(a) …*
>
> *(g) ORFSs for Arbitration should be void and unenforceable to the extent that they relate to personal injury claims.*[38]
>
> *(h) No other categories of claims should be treated differently from other claims that are submitted to Arbitration if ORFSs are introduced."*

Chapter 15: Charge separately for separate aspects of Arbitration

40. Recommendation 14 in the CP 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. The majority of Respondents, who replied specifically on this issue, supported the recommendation. 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. Based on Recommendation 14 in the CP (with some modifications in relation to safeguards), we make **Final Recommendation 14** as follows:

> *"We recommend that:*
>
> *(a) Lawyers and legal practices should be permitted to charge separately for work done in relation to separate but related*

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

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;[39] *and*

(ii) whether the ORFS covers the client's prosecution or defence of the claim (or both).[40]*"*

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

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