

A Reform in Hong Kong Arbitration: Proposal to Liberalise the Use of Outcome Related Fee Structures

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(Article published in the China Law magazine 2022 No. 2)

I. Introduction

The arbitration services in the Hong Kong Special Administrative Region (Hong Kong) are internationally recognised. Hong Kong has been continuously ranked amongst the five most preferred seats for arbitration globally since 2015 according to the International Arbitration Surveys conducted by Queen Mary University of London. In 2015, Hong Kong was ranked third; in 2018, fourth; and last year, Hong Kong was ranked the third again, surpassing Paris. In terms of caseload of the Hong Kong International Arbitration Centre (HKIAC) alone, a total of 277 cases were submitted to HKIAC in 2021, and a total amount in dispute was HKD 54.6 billion¹.

The People's Republic of China is a signatory to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention) and has applied it to Hong Kong. Arbitral awards made in Hong Kong can be effectively enforced in 169 states. With unique advantages under "one country, two systems", the HKSAR signed the Arrangement Concerning Mutual Enforcement of Arbitral Awards between the Mainland and the HKSAR (the Arrangement), which took effect on February 1, 2000, with the Supreme People's Court in 1999. The Arrangement provides a simple and effective mechanism on reciprocal enforcement of arbitral awards similar to what is provided in the New York Convention, and has delivered fruitful results for both the mainland and Hong Kong. In 2020, the two sides reached a Supplemental Arrangement (Supplemental Arrangement Concerning Mutual Enforcement of Arbitral Awards between the Mainland and the HKSAR), allowing parties to make simultaneous

¹ <https://www.hkiac.org/zh-hant/about-us/statistics>

applications to both courts of the Mainland and Hong Kong for the enforcement of arbitral award, which is more in line with the spirit and intent of the New York Convention and international arbitration practice.

The Arbitration Ordinance was amended in 2017 to clarify that disputes over intellectual property rights are arbitrable and third party funding in arbitration is permissible in Hong Kong.

Another major breakthrough on enhancing Hong Kong as a desirable seat of arbitration is the Arrangement Concerning Mutual Assistance in Court-ordered Interim Measures in Aid of Arbitral Proceedings by the Courts of the Mainland and of Hong Kong signed in 2019. This arrangement, which has been described as a game-changer, makes Hong Kong the first jurisdiction outside the Mainland where, as a seat of arbitration, parties to arbitral proceedings administered by designated arbitral institutions would be able to apply to the Mainland courts for property preservation, evidence preservation and conduct preservation measures before the arbitral award is made.

We will continue to explore measures to advance its legal and arbitration services, and in particular focus on the needs of users. It is noted that some arbitration proceedings can be lengthy and involve high legal fees. In some jurisdictions, users may opt for legal fee arrangements that are more financially viable. For example, the conditional fee arrangements in the Mainland or England and Wales allow payment of the legal fees in full or in part after successful recovery of the claimed amount.

II. Current Situation in Hong Kong

The common law restrictions on maintenance, champerty and barratry prevent lawyers and clients from agreeing on conditional or contingency fees. In the context of arbitration where clients are mainly sophisticated commercial entities, it is appropriate to review such restrictions on fee structures and consider whether there is room to lift the restrictions for arbitrations.

Commercial entities are generally familiar with the use of conditional fee arrangement when engaging lawyers in their arbitrations. It is only natural therefore that they would expect the same from arbitrations in Hong Kong. Yet, at the moment, such practice is not permissible on the grounds of the common law crimes of maintenance, champerty and barratry. Furthermore, conditional fee arrangements for provision of legal services are prohibited by the rules or codes of conduct of the two legal professional bodies in Hong Kong. In the absence of this fee arrangement, commercial entities may use lawyers from either local area or other jurisdictions where such fee arrangement is allowed, or may even amend the arbitration clause and choose another arbitration venue where such fee structure is allowed. After this matter was brought to the attention of the Department of Justice (DoJ) by its Advisory Committee on Promotion of Arbitration, DoJ commissioned the Law Reform Commission of Hong Kong to study whether or not more flexible fee arrangements should be allowed in arbitration in spite of existence of such crimes as champerty in the common law.

The Law Reform Commission of Hong Kong, following its study and consultation², recommended to reform the current policy and open up new options in its report³ “Outcome Related Fee Structures for Arbitration”.

In the light of the study of the Law Reform Commission and the advice from the Advisory Committee on Promotion of Arbitration, the DoJ has decided to formulate a policy that more flexible fee arrangements, such as conditional fee or damages based fee arrangements, should be allowed for arbitration and the related court proceedings in Hong Kong. This will not only benefit the users of arbitration and hence encourage them to continue to seek arbitration in Hong Kong, but also provide lawyers with the options to agree on a fee structure that best suits their needs. In addition, as some entities or individuals may not be able to afford legal fees charged on time, which may prevent parties from recovering their costs, the proposed arrangement will facilitate the pursuit of justice.

² https://www.hkreform.gov.hk/tc/docs/orfsa_c.pdf

³ https://www.hkreform.gov.hk/tc/docs/rorfsa_c.pdf

It is important to emphasise that legal agents can of course continue to charge on the hourly rate basis which is the general norm in Hong Kong. However, given the options of a more flexible fee arrangement, the legal agents can devise and agree on a fee structure that is either conditional upon the outcome or related to damages awarded, or indeed a hybrid form of payment of some legal fees plus a damages-based payment.

With the new policy, the client and the lawyer can devise and agree on a flexible fee structure that best suits their circumstances and the case. Hence, instead of having a specified for certain fee structure, the new legal fee arrangement is named after the description of related policy “outcome-related fee structure for arbitration, or ORFSA), which is intended to encourage negotiations toward innovative fee structures. This ORFSA arrangement is particularly noteworthy as it not only addresses the needs of the clients, but also provides additional flexibility for the fee arrangement. In addition, it is more in line with the international practice in commercial arbitration, creates a competitive edge for Hong Kong, and at the same time provides appropriate protections and safeguards for the clients. For the first time, a flexible and innovative concept intended to help clients and lawyers to agree on an arrangement that best suits their needs has been introduced. We believe that this will boost the attraction of Hong Kong as a seat of arbitration and Hong Kong’s legal services.

The ORFSA arrangement is only applicable to arbitrations and arbitration-related litigations. It will be explicitly stated in the legislation that it would not be applicable to other court litigation matters and in particular not applicable to personal injury claims where a broad and different category of litigants and interests are involved.

The government has introduced a bill⁴ to amend the Arbitration Ordinance, the Legal Practitioners Ordinance. The Hong Kong Bar Association and the Law Society of Hong Kong will have to amend their own codes of conduct or rules to allow their members to benefit from the new policy. The Bar Association and the Law Society have expressed support to the proposed

⁴ https://www.legco.gov.hk/yr2022/chinese/panels/ajls/papers/arb504216c_20220323-c.pdf

amendments and indicated that their codes or rules would be amended accordingly.

To ensure that the implementation of the ORFSA is safeguarded and supervised, the proposed legislation will prescribe that the Secretary for Justice should appoint an advisory body to monitor and review the operation of the new policy and to make rules for its implementation and general conditions of ORFSA agreements. These rules will be introduced into the legal framework by means of subsidiary legislation. An authorised body will also be set up to issue a code of practice which lists routines and standards binding on lawyers.

The safeguard measures to be introduced in the form of subsidiary legislation include setting capping fees for different types of ORFSA, ensuring clients are aware of the right to free and independent legal advice when negotiating ORFSA agreements, allowing clients to terminate the ORFSA agreement within the “cooling-off” period, make terminable ORFSA agreement and clarify alternative basis of charge after the termination. We will adopt safeguard and supervision measures on the basis of the recommendations of the Law Reform Commission and the advice of the Advisory Body on Promotion of Arbitration, so as to prevent disputes concerning the ORFSA agreement from becoming satellite litigations between the client and its legal agents.

An ORFSA agreement is one made between a client and a lawyer and includes conditional fee agreement, damages-based agreement and hybrid damages-based agreement.

A conditional fee agreement is an arrangement wherein lawyers agree to be paid a success fee only in the event of a successful outcome for the client in the arbitration. This success fee is to be calculated by reference to the benchmark litigation cost (the fee that the lawyer would have charged the client without the ORFSA agreement). After taking into account the recommendation of the Law Reform Commission to set the cap at 100% of the benchmark costs, and the advice, comments or suggestions that we

may subsequently receive, we will propose a cap on the success fee in the subsidiary legislation.

Damages-based agreement is an arrangement wherein lawyers agree to be paid only when the client obtains a financial benefit in the matter. This fee is abbreviated as DBA fee. In the subsidiary legislations, consideration will be given as to whether the DBA fee will be capped at 50% of the financial benefit obtained by the client as recommended by the Law Reform Commission, or such other caps as may be appropriate.

The hybrid damages-based agreement is an arrangement wherein lawyers agree to be paid a DBA fee when the client obtains a financial benefit in the matter and in any event, plus a certain fee for the legal services rendered to the client during the course of the arbitration proceedings. Therefore, this hybrid form of legal fee includes a fee calculated based on damages, and a fee usually at a discounted rate for the legal services rendered to the client during the course of arbitration proceedings. In the subsidiary legislations, consideration will be given as to whether the DBA fee under the hybrid damages-based agreement will also be capped at 50% of the financial benefit obtained by the client. Finally, to deal with the fee that would be recoverable in any event, consideration will be given to the recommendations of the Law Reform Commission that the lawyer will be permitted to retain only a proportion of the benchmark litigation cost (i.e the fee that the lawyer would have charged without the ORFSA agreement) incurred in the event that the claim is unsuccessful, and that this cost will be capped at 50% of the irrecoverable costs incurred in pursuing the claim.

The imposition of a cap and a minimum fee to be recovered reflects the nature of risk sharing between the lawyer and the client, preventing abuse of the ORFSA system while giving the client and lawyers sufficient degree of flexibility to negotiate a fee arrangement that is suitable for the circumstances of the matter.

The legislation provides for the disclosure of ORFSA agreement to the parties and the arbitral tribunal or the court handling the arbitration related proceedings. The general principle that the tribunal retains

discretion to deal with costs is preserved but it is expressly provided that any success fee premium and any legal expenses insurance premium agreed by the client with his lawyers and insurers respectively shall not, in principle, be borne by the unsuccessful party, save in exceptional circumstances of the case that justify a deviation from this principle.

To illustrate what may amount to exceptional circumstances, we must refer to the case *Essar Oilfields Services Ltd v Norscot Rig Management PVT Ltd* [2016] EWHC 2361 (Comm). The DoJ considered the unusual factual circumstances of the case, and the tribunal, on the basis of the unusual circumstances, in particular the conduct of the losing party causing the winning party to bear the third party funder cost in order to pursue the case, decided to order the losing party to bear such cost incurred by the winning party. The DoJ therefore recommends that in the cases the tribunal considers exceptional, after taking into account such exceptional circumstances and determining that the apportionment is reasonable, the tribunal may apportion such success fee premium and/or legal expense insurance premium between the parties.

After the introduction of the ORFSA, the preferences of the parties to the arbitration are expected to be better addressed by means of flexible fee arrangements. Legal agents would be in a better position to secure a favorable arrangement to suit its needs for particular cases. Importantly, the ORFSA will strengthen the status of Hong Kong as a preferred seat of arbitration as it meets the needs of the parties while complying with international practice. Other benefits brought by the ORFSA include business opportunities for the insurance industry, providing legal expense insurance currently available in other jurisdictions. After the introduction of the ORFSA, combined with the existing legal framework that permits third-party funding for arbitration, it is believed that innovative and mutually beneficial arrangements for the third-party funder, the client and the lawyer can be reached, so as to best serve the interests of the commercial entity whilst preserving the integrity of the arbitration process. This is particularly relevant to clients that may not have the necessary cash flow to

pursue its claims in arbitration. As a result, the ORFSA can ultimately facilitate access to justice.

Another corollary is that the client may, through the discussions of the fee arrangement with the lawyers, become more aware of the strengths and weaknesses of the case and therefore may be more willing to compromise or resort to alternative dispute resolutions such as mediation. It has to be pointed out here that the ORFSA is not applicable to mediation as there is no commercial need for it.

In conclusion, the passing of this bill will reaffirm Hong Kong's position as an international arbitration center and allow Hong Kong to capitalise on national policy of the 14th Five-year plan as well as the Greater Bay Area Development Plan to support Hong Kong as the Asia-Pacific international legal and dispute resolution center.

Ends