

**For discussion on
28 March 2022**

**Legislative Council Panel on
Administration of Justice and Legal Services**

**Arbitration and Legal Practitioners Legislation
(Outcome Related Fee Structures for Arbitration) (Amendment) Bill 2022**

INTRODUCTION

The Law Reform Commission of Hong Kong (“LRC”) published the Report on *Outcome Related Fee Structures for Arbitration*¹ (“Report”) on 15 December 2021. Having studied the Report, the Government proposes to adopt the recommendations in the Report by introducing amendments to the Arbitration Ordinance (Cap. 609) (“AO”) and the Legal Practitioners Ordinance (Cap. 159) (“LPO”). This paper briefs Members about the proposed Arbitration and Legal Practitioners Legislation (Outcome Related Fee Structures for Arbitration) (Amendment) Bill 2022 (“Amendment Bill”).

BACKGROUND

2. Lawyers in Hong Kong are prohibited from entering into outcome related fee structures (“ORFSs”) for work on contentious proceedings, including arbitration, by the common law doctrines of champerty, maintenance and barratry. Such prohibition is also expressly set out in the AO.²

3. Insofar as arbitration is concerned, other major arbitral seats permit some form of ORFSs, including Singapore which has recently passed relevant legislative amendments on 12 January 2022, to provide a framework for conditional fee agreements in relation to certain contentious proceedings. Hong Kong is a notable outlier in this respect.

4. In October 2019, LRC established the Outcome Related Fee

¹ The Report and the Executive Summary can be accessed on LRC’s website: <https://www.hkreform.gov.hk/en/publications/orfsa.htm>.

² See sections 98F and 98O of the AO: under the current law, lawyers are prohibited 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.

GOVERNMENT'S RESPONSES TO THE REPORT

10. Having considered the Report and consulted the Advisory Committee on Promotion of Arbitration⁶ which fully supports the implementation of the recommendations in the Report, the Government takes the view that the prohibition on the use of ORFSA by lawyers should be lifted, so that users of arbitration in Hong Kong and their lawyers may choose to enter into ORFSA. The proposed law reform is necessary to keep up with the latest practice in international arbitration, preserve and maintain Hong Kong's competitiveness as a leading arbitration centre in the Asia Pacific region and beyond, enhance access to justice and respond to client demand for pricing flexibility. It is essential that Hong Kong can offer what its competitors offer in terms of legal fees, and the structure of those fees, for arbitration work.

11. A table showing the final recommendations as set out in the Report and the Government's responses to those recommendations is at Annex.

PROPOSAL

12. Based on the draft amendments to the AO and LPO as recommended in the Report, the Government proposes to introduce legislative amendments to the AO and the LPO to –

- (a) provide that certain agreements using ORFSA are not prohibited by the common law doctrines of maintenance, champerty and barratry;
- (b) provide for the validity and enforceability of such agreements;
- (c) provide for the measures and safeguards in relation to such agreements; and
- (d) provide for related matters.

⁶ The Advisory Committee on Promotion of Arbitration, chaired by the Secretary for Justice comprising representatives from the legal, arbitration and relevant sectors in Hong Kong, was set up in December 2014 to advise and assist the Department of Justice ("DoJ") in respect of the promotion of arbitration in Hong Kong including advising on initiatives and overall strategies for the promotion of the HKSAR's arbitration services.

KEY FEATURES OF THE PROPOSED AMENDMENT BILL

13. The main provisions of the proposed Amendment Bill are summarised below.

New Part 10B Added to AO

14. The Amendment Bill will add a new Part 10B to the AO containing 8 Divisions, based on the draft provisions in the Report.

Division 1 of the New Part 10B — Purposes and Application

15. Division 1 of the new Part 10B will provide for the purposes and application of that Part. In particular, it will state that the purposes of the new Part 10B are to provide that certain agreements using ORFSA are not prohibited by the common law doctrines of maintenance, champerty and barratry, to provide for the validity and enforceability of such agreements and to provide for related measures and safeguards.

Division 2 of the New Part 10B — Interpretation

16. Division 2 of the new Part 10B will provide for the interpretation of key concepts. An ORFS agreement will be defined to mean a conditional fee agreement (“CFA”)⁷, a damages-based agreement (“DBA”)⁸ or a hybrid damages-based agreement (“Hybrid DBA”)⁹; the definition of lawyer will be given a broad meaning to include barristers, solicitors and 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 the LPO; and specific definitions will be given for expenses, legal expenses insurance and money or money’s worth.

⁷ 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.

⁸ A DBA is an agreement where the lawyer’s 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 (“DBA Payment”).

⁹ A Hybrid DBA is an agreement where 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.

Division 3 of the New Part 10B — ORFS Agreements for Arbitration Not Prohibited by Particular Common Law Offences or Tort

17. Division 3 of the new Part 10B will provide that ORFS agreements for arbitration are not prohibited by the common law doctrines of maintenance, champerty and barratry (as to both civil and criminal liability).

Division 4 of the New Part 10B — General Provisions for ORFS Agreements for Arbitration

18. Division 4 of the new Part 10B will provide for the validity and enforceability of ORFS agreements for arbitration. It will also provide that an ORFS agreement for arbitration is void and unenforceable to the extent that it relates to a personal injuries claim.

Division 5 of the New Part 10B — Power to Make Rules

19. Division 5 of the new Part 10B will empower the advisory body, in consultation with the Secretary for Justice and with the prior approval of the Chief Justice, to make rules to specify the general conditions and the specific conditions to be contained in different types of ORFS agreements. The rules may also generally provide for the effective implementation of the purposes and provisions of the new Part 10B.

Division 6 of the New Part 10B — Code of Practice

20. Division 6 of the new Part 10B will empower the authorized body to 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 those agreements.

Division 7 of the New Part 10B — Other Measures and Safeguards

21. Division 7 of the new Part 10B will provide for certain measures and safeguards where an arbitration involves an ORFS agreement for arbitration. It will allow the communication of confidential information relating to arbitral

proceedings to a person for the purpose of entering into, or seeking to enter into, an ORFS agreement for arbitration with the person. It will also deal with disclosure of information relating to an ORFS agreement for arbitration.

Division 8 of the New Part 10B — Miscellaneous

22. Division 8 of the new Part 10B will empower the Secretary for Justice to appoint an advisory body and an authorized body for the purposes of the new Part 10B.

Amendment to LPO

23. The Amendment Bill will amend section 64 of the LPO to enable the validity of ORFS agreements for arbitration.

CONSULTATION

24. On 17 December 2020, the Sub-committee conducted an extensive public consultation for a period of three months. Respondents to the consultation 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. As stated in the Report, an overwhelming majority of the respondents to the public consultation were in support of the proposal that ORFSA should be permitted under Hong Kong law.

25. In formulating the final recommendations in the Report, LRC has taken into account these public responses. The Report summarised the respondents' submissions and set out LRC's responses in the various chapters, and concluded with final recommendations on, inter alia, the need to permit CFA, DBA and Hybrid DBA in arbitration, how the fee under the CFA, DBA and Hybrid DBA regimes should be fixed, the circumstances for termination of ORFSA, the appropriate forms of regulation, the specific safeguards relating to ORFSA.

26. The DoJ has studied the Report and supports that LRC's recommendations should be adopted and implemented through legislative amendments. The Advisory Committee on Promotion of Arbitration was

consulted on 5 January 2022 on the recommendations set out in the Report, and the Advisory Committee fully supports the proposed amendments to the AO and the LPO. The Government agrees with LRC's analysis and recommendations on the various issues related to OFRSA as set out in the Report.

WAY FORWARD

27. The Government plans to implement the above legislative proposals by introducing the Amendment Bill into the Legislative Council in the first quarter of 2022.

Department of Justice
March 2022

**Responses of the Government to the recommendations made by the
Law Reform Commission of Hong Kong (“LRC”)
in the Report on Outcome Related Fee Structures for Arbitration (December 2021)**

LRC’s Recommendations¹	Government’s Responses
<p><u>Recommendation 1</u></p> <p>The LRC recommended 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.</p>	<p>We accept Recommendation 1. We agree that the recommendation should be reflected in the proposed amendments to the AO and the LPO.</p>
<p><u>Recommendation 2</u></p> <p>Where a CFA is in place, the LRC recommended 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.</p>	<p>We accept Recommendation 2. We agree that the recommendation should be reflected in the proposed amendments to the AO.</p>

¹ Capitalized terms shall have the meanings ascribed to them in the Report on *Outcome Related Fee Structures for Arbitration* published by the LRC.

LRC's Recommendations ¹	Government's Responses
<p><u>Recommendation 3</u></p> <p>Where a CFA is in place, the LRC recommended that:</p> <ul style="list-style-type: none"> (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. 	<p>We accept Recommendation 3. We agree that the recommendations contained therein should be reflected in the subsidiary legislation referred to in Recommendation 12.</p>
<p><u>Recommendation 4</u></p> <p>The LRC recommended that prohibitions on the use by Lawyers of DBAs in Arbitration should be lifted, so that Lawyers may use DBAs for Arbitration.</p>	<p>We accept Recommendation 4. We agree that the recommendation should be reflected in the proposed amendments to the AO and the LPO.</p>
<p><u>Recommendation 5</u></p> <p>Where a DBA, or a Hybrid DBA, is in place, the LRC recommended 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.</p>	<p>We accept Recommendation 5. We agree that the recommendation should be reflected in the proposed amendments to the AO.</p>

LRC's Recommendations ¹	Government's Responses
<p><u>Recommendation 6</u></p> <p>The LRC recommended that the Success fee model should apply to DBAs, including Hybrid DBAs.</p>	<p>We accept Recommendation 6. We agree that the recommendation should be reflected in the subsidiary legislation referred to in Recommendation 12.</p>
<p><u>Recommendation 7</u></p> <p>The LRC recommended that any DBA Payment be capped at 50% of the Financial Benefit obtained by the client.</p>	<p>We accept Recommendation 7. We agree that the recommendation should be reflected in the subsidiary legislation referred to in Recommendation 12.</p>
<p><u>Recommendation 8</u></p> <p>The LRC set out the following recommendations:</p> <ul style="list-style-type: none"> (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 	<p>We accept Recommendation 8. We agree that the recommendations contained therein should be reflected in the subsidiary legislation referred to in Recommendation 12. We also accept the views expressed by the LRC in Recommendation 8(d).</p>

LRC's Recommendations ¹	Government's Responses
<p>entitled to terminate an ORFS prior to the conclusion of the Arbitration if the Lawyer reasonably believes that:</p> <ul style="list-style-type: none"> (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. <p>(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.</p> <p>(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.</p>	
<p><u>Recommendation 9</u></p> <p>The LRC set out the following recommendations:</p> <ul style="list-style-type: none"> (a) Clients should be able to agree, on a case by case basis, whether: <ul style="list-style-type: none"> (i). the DBA Payment (and thus the DBA Payment cap) includes barristers' fees; or 	<p>We accept Recommendation 9. We agree that the recommendations contained therein should be reflected in the subsidiary legislation referred to in Recommendation 12.</p>

LRC's Recommendations ¹	Government's Responses
<p>(ii). barristers' fees will be charged as a separate disbursement outside the DBA Payment.</p> <p>(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.</p> <p>(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.</p>	
<p><u>Recommendation 10</u></p> <p>The LRC set out the following recommendations:</p> <p>(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.</p> <p>(b) In the event that a case under a Hybrid DBA is unsuccessful (such that no Financial Benefit is obtained),</p> <p>(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</p>	<p>We accept Recommendation 10. We agree that Recommendation 10(a) should be reflected in the proposed amendments to the AO and the LPO. We also agree that Recommendations 10(b) and 10(c) should be reflected in the subsidiary legislation referred to in Recommendation 12.</p>

LRC's Recommendations ¹	Government's Responses
<p>(ii). that proportion should be capped at 50% of the irrecoverable costs incurred in pursuing the unsuccessful claim.</p> <p>(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.</p>	
<p><u>Recommendation 11</u></p> <p>The LRC set out the following recommendations:</p> <p>(a) Section 64(1)(b) of the LPO should be amended such that CFAs, DBAs and Hybrid DBAs for Arbitration would be valid under Hong Kong law.</p> <p>(b) Part 10A of the AO 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.</p> <p>(c) The Hong Kong Solicitors' Guide to Professional Conduct should be amended to permit solicitors to enter into ORFSs for Arbitration.</p> <p>(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</p>	<p>We accept Recommendation 11. For Recommendations 11(a) and 11(b), we agree that the AO and the LPO should be amended such that ORFSs for arbitration would be valid under Hong Kong law. We will follow up with the Law Society of Hong Kong and Hong Kong Bar Association on Recommendations 11(c) and 11(d) in due course.</p>

LRC's Recommendations ¹	Government's Responses
Arbitration.	
<p><u>Recommendation 12</u></p> <p>The LRC set out the following recommendations:</p> <ul style="list-style-type: none"> (a) the more detailed regulatory framework should be set out in subsidiary legislation which, like the legislative amendments referred to in 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. 	<p>We accept Recommendation 12. We agree that the more detailed regulatory framework should be set out in subsidiary legislation and further client-care provisions could be set out in professional codes of conduct. We agree that at this stage, a separate code of practice is not required. We will follow up with the Advisory Body to be appointed under section 98ZT(1) of the Proposed AO Amendment and the two legal professional bodies in due course.</p>
<p><u>Recommendation 13</u></p> <p>The LRC set out the following recommendations:</p> <ul style="list-style-type: none"> (a) The subsidiary legislation should include provisions for at least the following safeguards: <ul style="list-style-type: none"> (i). the ORFS must be in writing and signed by the client; 	<p>We accept Recommendation 13. We agree that Recommendation 13(a) should be reflected in the subsidiary legislation referred to in Recommendation 12. We also agree</p>

LRC's Recommendations ¹	Government's Responses
<p>(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;</p> <p>(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;</p> <p>(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;</p> <p>(v). the ORFS itself should state clearly:</p> <ol style="list-style-type: none"> (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; <p>in addition, for CFAs:</p> <ol style="list-style-type: none"> (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 	<p>that Recommendations 13(b) to 13(g) should be reflected in the proposed amendments to the AO. We accept the views expressed by the LRC in Recommendation 13(h).</p>

LRC's Recommendations ¹	Government's Responses
<p>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</p> <p>for DBAs (including Hybrid DBAs):</p> <p>(6) the Financial Benefit to which the DBA relates.</p> <p>(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.</p> <p>(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.</p> <p>(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.</p> <p>(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.</p> <p>(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.</p>	

LRC's Recommendations ¹	Government's Responses
<p>(g) ORFSs for Arbitration should be void and unenforceable to the extent that they relate to personal injury claims.</p> <p>(h) No other categories of claims should be treated differently from other claims that are submitted to Arbitration if ORFSs are introduced.</p>	
<p><u>Recommendation 14</u></p> <p>The LRC set out the following recommendations:</p> <p>(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.</p> <p>(b) Subsidiary legislation should include provisions to require the following matters to be stated clearly in the ORFS:</p> <ul style="list-style-type: none"> (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). 	<p>We accept Recommendation 14. We agree that the recommendations contained therein should be reflected in the subsidiary legislation referred to in Recommendation 12.</p>