Hong Kong's Law Reform Commission Green-Lights Outcome Related Fee Structures for Arbitration

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Hong Kong currently prohibits lawyers from using outcome related fee structures ("***ORFSs***"), including "No-Win, No-Fee" type arrangements, for arbitrations and other contentious matters. This looks set to change for arbitrations, however, following the publication late last year of a compelling Consultation Paper by the Outcome Related Fee Structures for Arbitration Sub-committee of the Law Reform Commission of Hong Kong (the "***Sub-committee***").

The Sub-committee's Recommendations

Hong Kong's Secretary for Justice first announced that a Sub-committee of the Law Reform Commission would consider the introduction of ORFSs for arbitrations during the 2019 Hong Kong Arbitration Week.

The arbitration community welcomed this news since, as previously covered on this blog, reforms to permit the use of ORFSs for arbitrations were arguably overdue in Hong Kong given their potential to enhance access to justice and meet

increasing client demand for new methods of funding arbitrations. ORFSs were also already available in other leading arbitral jurisdictions, with the exception of Singapore where reforms are currently being considered.

The Sub-committee's Consultation Paper was published on 17 December 2020 following an extensive review of the applicable legal regimes regulating ORFSs in other jurisdictions and the arguments for and against the use of ORFSs in arbitration.

The Sub-committee's headline recommendation is that the law in Hong Kong be amended to permit lawyers, including solicitors, barristers and Registered Foreign Lawyers, to use ORFSs for arbitrations, administered or *ad hoc,* seated in or outside of Hong Kong. ORFSs would also be available for emergency arbitrator proceedings as well as court and mediation proceedings under Hong Kong's Arbitration Ordinance (Cap 609).

The Sub-committee's proposed reforms would therefore allow lawyers in Hong Kong to use ORFSs throughout the entire lifecycle of an arbitration, including for arbitration-related court proceedings such as setting-aside or enforcing awards.

The Sub-committee's recommendations also address how the ORFS regime should operate in practice with safeguards like caps on the maximum amount payable to lawyers and prohibitions on the recoverability of such amounts from counterparties in the arbitration.

A Sea of Acronyms: CFAs, DBAs and Hybrid DBAs

An eye-catching feature of the Sub-committee's Consultation Paper is the recommendation that all forms of ORFSs, whether conditional fee agreements ("***CFAs***"), damages-based agreements ("***DBAs***") or hybrid damages-based agreements ("***Hybrid DBAs***"), be permitted.

CFAs, DBAs (also known as contingency fee arrangements) and Hybrid DBAs are similar in substance with the lawyer receiving a financial benefit if the proceedings are successful. They nevertheless have specific characteristics that arbitration users may wish to choose between:

- CFAs: the financial benefit is a success fee that can either be an agreed flat

fee or calculated as a percentage "uplift" on any legal fees charged to the client during the proceedings. CFAs can be structured as "No-Win, No-Fee" or "No-Win, Low-Fee" arrangements with no legal fees or reduced legal fees, respectively, being due to the lawyer if the proceedings are unsuccessful.

- DBAs: the financial benefit is calculated by reference to the outcome of the proceedings, for example as a percentage of the sum of damages awarded to or recovered by the client. No legal fees are due to the lawyer if the proceedings are unsuccessful (i.e., "No-Win, No-Fee").
- Hybrid DBAs: the financial benefit is calculated in the same manner as a DBA, but the lawyer is additionally entitled to certain legal fees irrespective of the outcome of the proceedings. Legal fees are typically at a discounted hourly rate (i.e., "No-Win, Low-Fee").

The Sub-committee's recommendation to allow these three forms of ORFSs deserves applause. Although an argument exists that DBAs are unnecessary if CFAs are available and vice-versa, the Sub-committee rightly concluded that 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 ORFSs.[fn]Consultation Paper, paragraph 4.74. For a strong endorsement of DBAs, and Hybrid DBAs in particular, see Lord Justice Jackson Law Society Speech "Commercial Litigation: The Post-Jackson World", paragraphs 3.1-3.20. Cf. Victoria Law Reform, Access to Justice— Litigation Funding and Group Proceedings: Consultation Paper (July 2017), paragraph 8.17.[/fn] From a practical perspective, the Sub-committee's approach has the advantage of providing arbitration users with the flexibility to select the type of ORFS that best suits their funding needs. (Consultation Paper, paragraph 4.20-4.23)

Relatedly, the Sub-committee's recommendations recognise the potential for respondents, rather than just claimants, to use ORFSs. The Consultation Paper gives an example of a DBA being structured to provide for a lawyer to receive a financial benefit if the damages awarded against their client fall below an agreed amount. (paragraph 5.73, 5.74(b)(iii), Recommendation 13(h)) Such flexibility would be welcomed by arbitration users.

The Sub-committee's proposed reforms compare favourably to the approach to ORFSs in other leading arbitral jurisdictions. In England & Wales, for example, CFAs and DBAs are permitted but, despite convincing criticisms of the illogical nature of

their exclusion, Hybrid DBAs are not.[fn]Lord Justice Jackson Law Society Speech "Commercial Litigation: The Post-Jackson World", paragraphs 3.6, 3.13. 3.14; The 2019 DBA Reform Project: Explanatory Memorandum (October 2019), pages 14-15; Consultation Paper, paragraphs 4.97, 5.50, 5.51.[/fn] Singapore's proposed reforms would permit CFAs but not DBAs or Hybrid DBAs.[fn]Singapore's Ministry of Law Consultation Paper on Conditional Fee Agreements, August 2019, paragraphs 1, 2, 7.[/fn]

Should ORFSs be Allowed in Hong Kong?

The Sub-committee's Consultation Paper puts forward a strong case for allowing lawyers in Hong Kong to enter into ORFSs with their clients. Indeed, the Sub-committee identifies such reform as essential to preserving Hong Kong's continued status as one of the world's leading arbitral seats and to maintaining its competitiveness. (Consultation Paper, paragraphs 4.4, 4.8-4.10) This reflects not only the significant demand from clients for ORFSs but the fact that nearly all of the arbitral seats with which Hong Kong competes, such as London, Paris, Geneva, New York and Mainland China, already permit some form of ORFS (with Singapore likely to join them in the near future). (Consultation Paper, paragraphs 3.2, 4.4, 4.10) Jurisdictions vying to position themselves as alternative arbitration seats have also embraced ORFSs; most recently with the Cayman Islands introducing legislation in January 2021 to permit contingency fees.

Allowing lawyers in Hong Kong to use ORFSs would enable them to compete on a level playing field with lawyers in other jurisdictions. (Consultation Paper, paragraph 4.27) In contrast, if "*Hong Kong continues to prevent its Lawyers from sharing* [the risk of arbitration] *through ORFSs, it is likely that clients will simply choose to arbitrate elsewhere*". (Consultation Paper, paragraphs 4.4)

The Sub-committee also recognised that ORFSs would enhance access to justice in Hong Kong by allowing clients to fund claims that they may otherwise be unable to bring. (Consultation Paper, paragraph 4.11-4.14.) Although Third Party Funding is now allowed in Hong Kong, the Sub-committee rightly acknowledged that not every case is suitable for it and Third-Party Funding can be difficult to obtain in practice even where the merits of a claim are strong. ORFSs would help to fill this gap.

With respect to the risks commonly associated with ORFSs, such as conflicts of interest between lawyers and their clients, excessive legal fees and increases in frivolous claims, the Sub-committee drew on the experience of other leading arbitral jurisdictions that already allow ORFSs to convincingly conclude that such concerns were misplaced in the context of arbitration or otherwise capable of being managed by implementing safeguards in the relevant laws and regulations to control how they operate in practice. (Consultation Paper, paragraph 4.2-4.3)

In terms of next steps, the Sub-committee has invited public views on the appropriate safeguards to be put in place in lawyer's professional codes of conduct and subsidiary legislation regarding the use of ORFSs, as well as the recommendations in the Consultation Paper more generally, as part of a consultation that runs until 16 March 2021. Hopefully the Sub-committee's recommendations will be finalized and promptly implemented in Hong Kong following the conclusion of this consultation.

Conclusion

The Sub-committee's Consultation Paper presents a compelling case for allowing CFAs, DBAs and Hybrid DBAs to be used in arbitrations and arbitration-related court proceedings. Such reforms would, if implemented, help safeguard Hong Kong's status as one of the world's leading arbitral seats.

It will be interesting to see whether Singapore's proposed ORFS reforms remain limited to CFAs or develop in due course to cover DBAs and Hybrid DBAs.