

Kluwer Arbitration Blog

Outcome Related Fee Structures Proposed for Arbitration in Hong Kong

Sophia Li (Herbert Smith Freehills LLP) · Wednesday, March 2nd, 2022 · Herbert Smith Freehills

At present, Hong Kong lawyers are prohibited from charging outcome related fees in arbitration. As discussed in a previous [blog](#), the landscape started to change since the publication of a [Consultation Paper](#) by the Outcome Related Fee Structures for Arbitration Sub-committee (the “*Sub-committee*“) of the Law Reform Commission of Hong Kong (the “*Commission*“). The Sub-committee proposed that the law in Hong Kong should be amended to permit lawyers to use outcome related fee structures (“*ORFSs*“) for arbitration taking place in and outside Hong Kong.

On 15 December 2021, the Commission published a comprehensive [Report](#) setting out recommendations on the use of ORFSs in arbitration, and the appropriate form of regulation and the specific safeguards relating to ORFSs. This blog looks at the key recommendations in the Report.

Overview of the Report

The Sub-committee, co-chaired by [Ms Kathryn Sanger](#) and [Ms Briana Young](#) of Herbert Smith Freehills, studied the legal regimes and experiences of a number of other jurisdictions including Singapore, England and Wales, Australia, Mainland China and the United States, and took into account public responses to the earlier Consultation Paper in formulating the final recommendations (“*Final Recommendations*“).

In the Report, ORFSs refer to three types of agreements which a lawyer may enter into with a client, namely conditional fee agreements (“*CFAs*“), damages-based agreements (“*DBAs*“) and hybrid damages-based agreements (“*Hybrid DBAs*“). The respective meaning of these three types of agreement is covered in Edward Taylor’s previous blogpost, [here](#).

The Report makes 14 Final Recommendations:

- Final Recommendations 1 to 3 concern lifting the prohibitions on the use of CFAs and other matters relating to CFAs, including the recoverability of success fee premiums and legal expense insurance premiums from the unsuccessful party and a proposed cap on the success fee;
- Final Recommendations 4 to 7 deal with lifting the prohibitions on the use of DBAs and other matters relating to DBAs, including the recoverability of legal expense insurance premiums from the unsuccessful party and the cap on the DBA payment;

- Final Recommendations 8 and 10 relate to Hybrid DBAs;
- Final Recommendation 9 concerns the treatment of barristers' fees; and
- Final Recommendations 11 to 14 deal with the appropriate forms of regulation, safeguards relating to ORFSs, and whether lawyers should be permitted to charge separately for separate aspects of an arbitration.

Key Recommendations

- Lifting the prohibitions

An overwhelming majority of the respondents to the Consultation Paper supported the recommendation to lift the prohibitions on the use of ORFSs. According to the Report, the proposed reforms are necessary to preserve and promote Hong Kong's competitiveness as a leading arbitration centre, enhance access to justice, and respond to increasing client demand for pricing and fee flexibility. Having analysed the arguments for and against the proposed reforms, the Commission concludes that the benefits of permitting the use of ORFSs in arbitration outweigh the potential disadvantages.

- Scope of the proposed reforms

That said, the proposed lifting of prohibitions is limited to arbitration and related court proceedings, including applications to the Hong Kong courts to set aside or to enforce an arbitral award, or for interim relief in support of an arbitration. One exception is arbitration related to personal injury claims, where ORFSs would be void and unenforceable (although we rarely see personal injury claims in arbitration). The recommendation to remove prohibitions on ORFSs does not extend to civil litigation, standalone mediation, and court proceedings such as matrimonial and family proceedings. Considering the less sophisticated nature of some parties in these proceedings, such limitation is understandable.

- Recoverability of the success fee premium and legal expense insurance premium

The Report recommends that the losing party should not be responsible for any success fee premium (i.e., the portion of success fee which exceeds the amount of fees which would be payable to the lawyer if there were no ORFSs in place) or legal expense insurance premium agreed by a client with its lawyers or insurers under the ORFSs. This is mainly because the losing party is not party to the fee arrangements between the successful party and its lawyer and/or insurer, and accordingly has no control or say over any pricing which is ultimately agreed. However the Report recommends that the arbitral tribunal should have power to apportion those costs between the parties in the arbitration if it determines that apportionment is reasonable in exceptional circumstances.

- Cap on the success fee and DBA payment

In respect of CFAs, the Report recommends that the success fee should be fixed by reference to the fee that the lawyer would charge the client if there were no ORFSs in relation to the arbitration, also known as the “benchmark” costs, and be capped at 100 per cent of the benchmark costs.

For example, let’s say the benchmark rate for a lawyer is HK\$10,000 per hour. The lawyer and a client agree in a CFA that a proportion of the benchmark costs will be charged during the course of the matter (e.g. 60%), to be uplifted to HK\$12,000 per hour in the event of successful outcome. The success fee premium in this scenario is HK\$2,000 per hour. In accordance with the Report’s recommendation, the maximum success fee that the lawyer can charge in the event of successful outcome would be capped at HK\$20,000 per hour in this scenario (i.e., with a success fee premium of 100 per cent of the benchmark costs).

As regards the DBAs and Hybrid DBAs, the Report recommends that the DBA payment should be payable in accordance with the terms agreed between lawyer and client wherever a financial benefit is obtained by the client, and should be capped at 50 per cent of the value of that financial benefit. The Report defines “financial benefit” broadly, to include “money or money’s worth” (being any money, assets, security, tangible or intangible property, services, any amount owed under an award, settlement agreement or otherwise, and any other consideration reducible to a monetary value, including any avoidance or reduction of a potential liability). For example, a party to an intellectual property rights case may wish to pay the lawyer who acts successfully in infringement proceedings by reference to the monetary value of the intellectual property rights. This broad definition would permit lawyers to offer DBAs to respondent clients, as well as claimants, and would extend DBAs to a broader range of cases.

The proposed caps are consistent with the position in England and Wales, and would apply to both solicitors and barristers.

- Termination of an ORFS

The Report recommends that the legislation should specify the principal grounds upon which an ORFS can be terminated by the lawyer before the arbitration concludes; for example, if the client has committed a material breach of the agreement, or behaved unreasonably. On the other hand, the Commission does not consider it necessary to set out statutory grounds on which a client may terminate an ORFS prior to the conclusion of the arbitration. In the Commission’s view, this should be a matter for agreement between the client and the lawyer in accordance with the basic principles of freedom of contract and party autonomy.

- Legislative framework and safeguards

The Report recommends that that the ORFS regime be regulated by subsidiary legislation. Proposed safeguards include:

- the ORFS must be in writing and signed by the client;
- the lawyer should inform clients of their right to take independent legal advice;
- the ORFS should be subject to a minimum “cooling-off” period of seven days;
- the ORFS itself should state clearly in what circumstances a lawyer’s fees and expenses, or part

of them, will be payable, 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, and whether disbursements, including barristers' fees, are to be paid irrespective of the outcome of the matter.

The Report also sets out draft amendments to the [Legal Practitioners Ordinance](#) (Cap 159) and the [Arbitration Ordinance](#) (Cap 609) of Hong Kong ("*Arbitration Ordinance*") in order to affect the recommended changes.

Going forward

The proposal to permit ORFSs has been warmly welcomed by the arbitration community in Hong Kong and beyond. It is hoped that legislative amendments will come into place by the end of 2022. If introduced, it would give commercial parties greater access to justice and more flexibility in respect of how they fund their disputes. This is particularly so for arbitration cases involving Mainland Chinese clients given the continuing rise in arbitrations seated in Hong Kong involving Mainland Chinese parties, and the fact that DBAs are permitted and often used in Mainland China already.

The proposed reform will enhance Hong Kong's competitiveness as an international hub for cross-border and international arbitration, by bringing it in line with other major arbitral seats such as London and New York. This is essential for lawyers in Hong Kong to remain globally competitive with lawyers in other major jurisdictions. Further, it is expected that with ORFSs in place, third party funding in arbitration (which was introduced via amendments to the Arbitration Ordinance in 2019) will gain more momentum and receive wider application in Hong Kong.

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