Kluwer Arbitration Blog

Alternative Fee Arrangements with Counsel: What Should be Noted by Arbitration Users?

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International arbitration is reputed for its flexibility shaped by the underlying principle of party autonomy. Past years have witnessed the development of various types of funding arrangements for arbitration users, including third-party funding ("**TPF**") and, most recently, alternative fee arrangements with counsel ("**AFAs**") in Singapore and Hong Kong. While these new initiatives undoubtedly increase flexibility for arbitration users and enhance international arbitration's user-oriented image, one may wonder – are there any accompanying potential pitfalls that arbitration users should take note of? How should arbitration users respond to these potential issues?

This article aims to examine AFAs as one of the funding options for arbitration users emerging most recently in Singapore and Hong Kong, and consider the potential pitfalls and the possible solutions. In particular, several important issues including disclosure and costs allocation of AFAs should be highlighted for arbitration users.

Emergence of AFAs in International Arbitration

AFAs differ from the traditional or standard fee arrangement where counsel bill their client solely based on time costs, representing the amount of work performed.

Under AFAs, the party's counsel may effectively act as a funder and such arrangement is conceptually and structurally similar to TPF in several aspects.[1)] This being the case, some benefits that arbitration users are able to enjoy from TPF, such as increased access to justice and the ability to pursue a meritorious claim while maintaining enough cash flow to continue conducting business as usual, also apply to AFAs.

AFAs can take various forms, some of which have no connection to the outcome of the case (such as fixed or capped fees), while others depend on the outcome of the case. There are normally two types of outcome-related fee structures, namely (i) conditional fee agreements ("**CFAs**"), where a part or all of the legal fees and costs, as well as uplift fees, are conditioned on the outcome of the case; and (ii) damages-based agreements or contingency fee agreements ("**DBAs**"), where legal fees and costs are payable as a percentage or proportion of the damages awarded. In different jurisdictions, the legislation governing different types of AFA may differ.

For instance, Mainland China adopts a flexible approach towards AFAs. Fees based on time costs, fixed or capped fees, as well as contingency fees calculated as a percentage of the amount awarded to the client, are all allowed. Historically, there was a 30% cap of the amount awarded to the client.[2] At the end of 2021, the cap was adjusted to the range of 6% to 18%, depending on the amount awarded to the client.[3]

Unlike Mainland China, Hong Kong and Singapore have traditionally banned outcome-related fee structures, such as CFAs and DBAs, due to prohibitions against maintenance and champerty. However, the year 2022 witnessed fundamental changes in this respect. Singapore enacted the Legal Profession (Amendment) Act 2022 to remove the historical prohibitions on CFAs in the context of arbitration and certain other types of proceedings, while DBAs continue to be banned. Hong Kong's Legislative Council introduced the Arbitration and Legal Practitioners Legislation (Outcome Related Fee Structures for Arbitration) (Amendment) Bill 2022, which not only allowed CFAs, but also DBAs in the context of arbitration.

The reforms in both Singapore and Hong Kong provide arbitration users with funding alternatives to pursue meritorious claims, level the playing field for lawyers in Singapore and Hong Kong vis-à-vis their counterparts in foreign jurisdictions such as London and New York who are already able to offer such arrangements, and enhance the competitiveness of Singapore and Hong Kong as leading arbitration centres across the globe.[4]

Pitfalls of AFAs: Singapore's Wariness towards DBAs

As the number of international arbitration cases employing AFAs is likely to rise in future, interesting questions arise, such as whether there are any potential pitfalls that arbitration users should be aware of when entering into these agreements, and how they should manage these.

Singapore and Hong Kong take different positions with respect to DBAs. Singapore does not allow DBAs at the moment on the basis that the payment received by lawyers under such agreements has no direct correlation with the work done, and the amount of damages that the client may recover is dependent on the client's particular circumstances and the damage that may be suffered, which would cause added risks of conflicts of interest for the lawyer.[5] Conversely, Hong Kong takes the position that concerns such as conflicts of interest and parties' inadequate compensation for losses are outweighed by benefits that include increased flexibility and access to justice.[6]

It is premature to comment on which approach is better. It appears that Singapore wishes to first take a more conservative approach on lifting historical prohibitions on DBAs, without ruling out the possibility of allowing the same in the future. Hong Kong is more inclined to entrust arbitration users with more flexibility. Other contributors to this blog have observed that by allowing all forms of AFAs, including CFAs, DBAs and hybrid DBAs, Hong Kong has enabled arbitration users to benefit from the flexibility of being able to select the type of AFA that best suits their funding needs, which could also potentially be combined with TPF.

Leaving aside the debate on the desirability of allowing DBAs, users of arbitrations seated in Hong Kong or Singapore should note the significant difference between the countries' legislation and discuss with their counsel to formulate the most suitable arrangement for their cases.

Disclosure of AFAs and Costs Allocation

Both Hong Kong[7)] and Singapore[8)] appear to take the position that disclosure should be limited to the existence of an AFA, which is similar to the approach with respect to TPF.[9)] However, there is no express requirement to disclose the AFA agreement or the terms therein. While the agreement or the terms therein may arguably fall within the scope of privileged or confidential documents that parties are entitled to withhold disclosure of, it is unclear under which circumstances such disclosure would be warranted.

Further, Singapore's view is that in any case, costs orders should not include any part of the uplift fees under CFAs, to avoid satellite litigation arising from the losing party's challenge of the CFA.[10)] Hong Kong takes a similar approach but empowers the Tribunal to apportion uplift fees between parties in the arbitration based on the exceptional circumstances of the case.[11)]

In this regard, further questions arise – should AFAs be completely excluded from the recoverable costs of the successful party in the arbitration? Should the conclusion be different if the AFA agreement or its terms are disclosed to the counterparty at the outset of the proceedings? What constitutes exceptional circumstances under Hong Kong law?

These questions are all useful in providing arbitration users with more certainty on how AFAs may affect the costs recovery of a successful party in an arbitration.

First, the author believes it is preferable to take a more flexible approach and at least provide the Tribunal with certain discretion on deciding the impact of AFAs on costs orders. AFAs take many forms, including CFAs and DBAs, and involve different degrees of costs consequences. It does not appear proper to entirely exclude costs arising from any form of AFAs, considering that:

- TPF costs have been held to constitute recoverable costs[12)] and AFAs are similar to TPF in several respects;[13)]
- There are investment arbitration cases where costs incurred under AFAs were decided by tribunals to constitute recoverable costs;[14)]
- In certain circumstances, the actual costs arising from AFAs might not largely differ from the costs that would have been incurred on a purely time cost basis;
- Preventing costs recovery may have negative implications on access to justice, as impecunious respondents might be unable to pay their lawyers' fees even if their lawyers successfully defended the case;[15)] and
- Some practitioners have advocated that there should not be an absolute bar to recovery of costs incurred under AFAs and that the tribunal should exercise its discretion and consider the specific circumstances of the case.[16)]

Second, similar to TPF, in the event that the AFA agreement or the terms therein are disclosed at an early stage, it does not appear unfair for the funded party to recover its AFA costs where reasonable from the unsuccessful counterparty, as such party would have been fully aware of its potential risk exposure in the event of an adverse costs award. Prior disclosure addresses the

concern that the opposing party could not have reasonably foreseen the risk of a higher adverse costs order arising from the counterparty's AFA.[17)]

Third, the ambit of "exceptional circumstances" under Hong Kong law should be further clarified. In this regard, the Law Reform Commission of Hong Kong only refers to the unusual facts of *Essar Oilfields Services Limited v Norscot Rig Management PVT Limited* [2016] EWHC 2361 (Comm) as an example. In this case, the breaching party deliberately tried to hurt the innocent party financially, with the aim of preventing the innocent party from pursuing its legitimate claim. It was directly because of the breaching party's conduct that the innocent party had no choice but to obtain TPF to be able to protect its legal rights. This went beyond the usual tussles which feature in contentious proceedings, and beyond the needs of an impecunious party looking for financial assistance to advance a meritorious claim.[18)] This appears to suggest that a party's reprehensible and unreasonable conduct, which leaves the other party no choice but to obtain funding to vindicate its legal rights, may constitute exceptional circumstances under Hong Kong law.

Conclusion

The variety of funding options available provides arbitration users with great flexibility and is a testament to arbitration's emphasis on party autonomy and a user-oriented approach. However, several issues remain unanswered in practice and the approaches taken are far from uniform, which cause difficulties for arbitration users. In addition to flexibility, arbitration users also expect foreseeability and certainty. More guidance and clearer regulation on funding arrangements in international arbitration (including AFAs) and enhanced uniformity are certainly needed.

References

?1, ?13 Report of the ICCA-Queen Mary Task Force on Third-Party Funding in International Arbitration, April 2018, p 36.

?2 Article 13 of Measures for the Administration of Lawyers' Fees (??????????).

?3 Article 3(6) of Opinions on Further Regulating Lawyers' Service Charges (????????????????).

?4 Second Reading Speech by Second Minister for Law, Mr Edwin Tong, on the Legal Profession (Amendment) Bill, 12 January 2022, paragraphs 20-21; Hong Kong's Legislative Council Panel on Administration of Justice and Legal Services, Paper on Arbitration and Legal Practitioners Legislation (Outcome Related Fee Structures for Arbitration) (Amendment) Bill 2022, 28 March 2022, paragraph 10.

?5 Second Reading Speech by Second Minister for Law, Mr Edwin Tong, on the Legal Profession (Amendment) Bill, 12 January 2022, paragraph 37.

?6 The Law Reform Commission of Hong Kong, *Report, Outcome Related Fee Structures for Arbitration*, December 2021, paragraphs 5.8-5.16.

?7 Arbitration and Legal Practitioners Legislation (Outcome Related Fee Structures for Arbitration) (Amendment) Bill 2022, Article 98ZQ.

?8 Ministry of Law of Singapore, *Public Consultation on Conditional Fee Agreements in Singapore*, 27 August 2019, paragraph 15.

?9 Article 98U of Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Ordinance 2017; Article 49A of Legal Profession (Professional Conduct) Rules 2015.

?10 Second Reading Speech by Second Minister for Law, Mr Edwin Tong, on the Legal Profession (Amendment) Bill, 12 January 2022, paragraph 44.

?11 Law Reform Commission of Hong Kong, *Report, Outcome Related Fee Structures for Arbitration*, December 2021, paragraphs 3.10-3.20; Arbitration and Legal Practitioners Legislation (Outcome Related Fee Structures for Arbitration) (Amendment) Bill 2022, Article 98ZU.

?12 See *Essar Oilfields Services Limited v Norscot Rig Management PVT Limited* [2016] EWHC 2361 (Comm) and *Tenke Fungurume Mining S.A. v Katanga Contracting Services S.A.S.* [2021] EWHC 3301 (Comm)

?14 See *Khan Resources Inc., Khan Resources B.V., and Cauc Holding Company Ltd. v. The Government of Mongolia*, PCA Case No. 2011-09, Award on merits, 2 March 2015, paragraph 447, "*Although this is not a fee that has been 'incurred' to date as required by Article 40(2)(e) of the UNCITRAL Rules, it is a fee that the Claimants have already incurred a legal obligation to pay. The Tribunal thus finds that it is recoverable under this same provision*."

?15 Edward Taylor and Kitty Zheng, *"No-Win No-Fee" Arbitration: a Win-Win for Hong Kong and Singapore?* Kluwer Arbitration Blog, 7 July 2020.

?16 See Gretta Walters, '*Chapter 24: Allocating Costs in International Arbitration: Do Alternative Fee Arrangements with Counsel Require Alternative Considerations?*', in Sherlin Tung, Fabricio Fortese, et al. (eds), *Finances in International Arbitration: Liber Amicorum Patricia Shaughnessy* (Kluwer Law International 2019), pp 455-456, 460.

?17 See Report of the ICCA-Queen Mary Task Force on Third-Party Funding in International Arbitration, April 2018, p 159.

?18 See Law Reform Commission of Hong Kong, *Report, Outcome Related Fee Structures for Arbitration*, December 2021, paragraphs 3.14-3.20.

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