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Hong Kong Arbitration Week Recap: Update on Outcome Related Fee Structure for Arbitration in Hong Kong

Jacky Fung, Kathleen Wang (Freshfields Bruckhaus Deringer) · Thursday, October 19th, 2023 · HK45

On the third day of Hong Kong Arbitration Week 2023, the ADR in Asia Conference, the flagship event of the Hong Kong Arbitration Week, hosted a panel discussion on the Hong Kong Outcome Related Fee Structures for Arbitration (“**ORFSA**”) regime. The panel followed on from last year’s panel introducing ORFSA and explored updates to the regime and its uptake thus far in the Hong Kong arbitration landscape.

Panelists included John Choong (Freshfields Bruckhaus Deringer, Hong Kong), Kathryn Sanger (Herbert Smith Freehills, Hong Kong) and Tom Glasgow (Omni Bridgeway, Singapore). The panel discussion was moderated by Briana Young (Three Crowns, London).

Highlights from the panel are below.

The ORFSA Regime

Ms. Young started the discussion with an overview of the ORFSA regime in Hong Kong. Under the regime, for arbitration and related proceedings, lawyers can offer Conditional Fee Agreements (“**CFA**”), Damages Based Agreements (“**DBA**”) and hybrid DBAs (see Hong Kong Arbitration Ordinance (Cap. 609) (“**HKAO**”) [Part 10B](#)). Notably, this is one of the broadest regimes globally for success fees in arbitration. The panel then discussed the take up of ORFSA in Hong Kong and key considerations for stakeholders looking to engage in ORFSA.

Uptake on ORFSA

Mr. Choong highlighted that, as of September 2023, there have been four known ORFSA cases in Hong Kong, compared to the 87 third-party funding cases since the regime came into force in 2019. Although the ORFSA regime is still in its early days, Ms. Sanger remarked that there has already been a number of disclosures from opposing parties made under the HKAO. Some of these are from ongoing cases, indicating that parties have been restructuring their existing fee arrangements since the change in law. From Mr. Choong’s perspective, it is currently the larger firms that seem to be offering success fees, with smaller firms being less likely to do so.

For all firms, this is a case of familiarity breeding confidence, which will come with increasing client discussions on ORFSA arrangements. A step towards this is the establishment of success fee pricing committees within law firms. These committees assess each arrangement individually and across a portfolio to assess the risks on a firm-wide basis and provide a holistic view on the suitability of using ORFSA in a case.

Ms. Sanger also highlighted the flexibility of the regime, which can encourage uptake. This includes the ability to structure incremental uplifts (capped at the benchmark fee as mandated by the HKAO). These incremental uplifts are not “uplifts” in the traditional sense but still bring benefits to the firm. Ms. Sanger noted the common Spanish practice of offering small increments (such as a 1-3% uplift), which can be a helpful guide for Hong Kong practitioners.

Challenges to Adopting ORFSA

Rejecting lack of awareness as a potential hindrance given the scale of publicity and roadshows surrounding the regime, Mr. Choong explored other challenges which may better explain the reluctance to use ORFSA, including:

- **Lack of experience:** Practitioners may have little experience in drafting ORFSA agreements. It is also unclear whether certain agreements will be permissible or will breach the champerty and maintenance doctrines, rendering an agreement unenforceable, and potentially leading to criminal liability. The lack of experience also leads to an erroneous perception that ORFSA is an “all or nothing” regime, offering no benefits to the lawyers.

Such perceptions, Mr. Choong noted, are misplaced – the regime allows parties to structure fee arrangements flexibly, including in increments, and resulting in a shared objective between law firms and their clients. Further, adopting simpler ORFSA structures such as a generic CFA structure is an accessible option, and can address concerns around running afoul of champerty and maintenance rules.

- **Lack of access:** There is currently a lack of data such as success rates, and larger firms typically have greater access to data which can become valuable over time, to the detriment of smaller firms. The lack of ORFSA precedents also poses difficulties, especially in circumstances where fee arrangements are complex and may include multiple agreements, waterfall payment schemes and arrangements between different funders regarding the priority of payment.

Ms. Sanger later added that discussions are underway to develop template agreements, in addition to the [FAQs](#) currently published by the Department of Justice. She also noted that a practical checklist, drafted in consultation with the Hong Kong Law Society and Bar Association, will be published in due course.

Mr. Choong also discussed the difficulties posed by pricing success fees at the outset of an engagement, often without a full merits analysis. He also highlighted potential sensitivities in having conversations with new clients around financial metrics. Key to addressing these challenges is transparency with the client regarding all aspects of the arrangement and ensuring a full understanding of the proposed structure. This could also be mitigated by starting with simpler structures, such as a CFA, or involve an objective third party, like a funder.

Lastly, Mr. Choong briefly touched on the potential financial exposure inherent in ORFSA arrangements, such as delays in payment and credit risk, which might hinder adoption.

What Might Encourage Law Firms to Offer ORFSA?

Ms. Sanger highlighted, among others, two key benefits:

- **Value pricing:** Where clients are becoming increasingly cost-conscious, success fees allow lawyers to demonstrate their confidence not only in the merits of the case but also in the additional value they bring to the case in their ability to engage in nuanced discussions tailored to the client.
- **Client relationships:** In the same vein, success fees demonstrate to clients the law firm's willingness to take on risk and flexibility in finding the best option for the client. This strengthens client relationships. Ms. Sanger illustrated this with a recent arbitration that her firm handled for an impecunious client where they adopted a full contingency fee for the case. By engaging with the client on that level, Ms. Sanger explained, her firm was able to develop a strong relationship with the client in offering that level of confidence, faith and risk-sharing.

Risk Management Tools

Ms. Sanger also discussed the use of insurance products to offset the risks associated with an unsuccessful outcome, such as CFA insurance. In particular, Ms. Sanger noted the development of DBA insurance, which acts as another form of WIP (i.e., work in progress) insurance. Developed by a law firm and an English broker, she said the product covered up to 50% of a law firm's WIP and 100% disbursements when taking on full contingency. Anecdotally, insurers have been enquiring about offering insurance products in Hong Kong.

Ms. Sanger lastly noted the use of third-party funders as a parallel regime to ORFSA, and cooperation between funders and law firm to share the risk in the case.

ORFSA vs Third-Party Funding: Two Compatible Regimes?

Mr. Glasgow then provided insights from a funder's perspective on the interaction between ORFSA and third-party funding.

From Mr. Glasgow's perspectives, the two regimes are complementary. As the ORFSA regime is limited to arbitration, which typically have costs outside legal fees, such as expert costs, there remains a market for third-party funders to cover those costs. Further, law firms' relatively lower risk appetite allows third-party funders to offer risk management services for firms who wish to offer ORFSA but are concerned about cash flow. In fact, Mr. Glasgow notes that part of his company business in the US is precisely offering these products – providing overhead support to firms acting on contingencies, in return for a share of the contingency.

Practical Considerations in Assessing Suitability of ORFSA Arrangements

Mr. Glasgow set out a number of practical considerations:

- **Undertake a careful pricing analysis:** Any analysis should account for risks in the case and delays in payment.
- **Avoid confirmation bias:** Firms should be consciously evaluating the merits of a case independent of any contingency arrangement, including where necessary seeking independent advice (e.g., from a funder). This also includes potentially challenging the evidence and information received from the client.
- **Utilize risk management tools:** (as discussed above).
- **Consider the firm's case portfolio:** ORFSA arrangements should account for the possibility that some cases in a firm's portfolio may be loss-making. This underscores the importance of carefully pricing each case. For DBAs in particular, Mr. Glasgow emphasized the need to have a robust view on quantum, given that such agreements are contingent on the damages received in a case.

Conclusion

The panel discussion was enlightening in reflecting on the use of ORFSA since its launch and providing practical considerations for lawyers (and their clients) considering ORFSA. ORFSA is mutually beneficial to both law firms and clients – aside from providing clear financial incentives, they provide an alternative opportunity for risk-allocation and value pricing and allow for the flexibility necessary in long-running, complex cases. Having ORFSA as an option is also helpful for lawyers to build long-term relationships with their clients. Given ORFSA is still at its infancy stage in Hong Kong, the authors very much look forward to seeing detailed guidelines, checklists and template agreements from the authorities in relation to ORFSA in the future.

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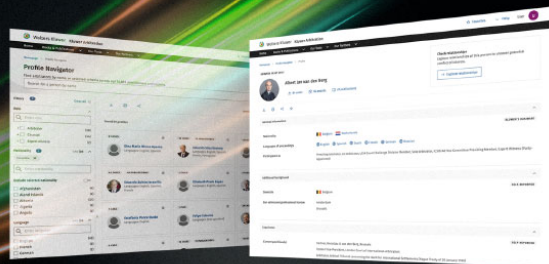
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