Hong Kong General Chamber of Commerce
香港總商會1861

香港總商會
香港金鐘道統一中心廿二樓
Hong Kong General Chamber of Commerce
22/F United Centre,
95 Queensway, Hong Kong
Tel (852) 2529 9229
Fax (852) 2527 9843
Email chamber@chamber.org.hk
www.chamber.org.hk

Helping Business since 1861

16 March 2021

Ms Kathryn Sanger and Ms Briana Young
Co-Chairmen
Outcome Related Fee Structures for Arbitration Sub-committee
The Law Reform Commission
4th Floor, East Wing, Justice Place
18 Lower Albert Road
Central, Hong Kong

Dear Ms Sanger and Ms Young,

Re: Consultation Paper on Outcome-Related Fee Structures for Arbitration

The Hong Kong General Chamber of Commerce is pleased to submit our views in response to the Sub-committee's proposed legislative amendments to permit lawyers to use outcome related fee structures ("ORFSs") for arbitrations taking place in and outside Hong Kong.

The Chamber welcomes the introduction of flexible fee structures - which include Conditional Fee Agreements, Damages-based Agreements and Hybrid Damages-based Agreements - for arbitration in Hong Kong, but recommends that reasonable measures be introduced to safeguard the interest of businesses, especially those of a smaller size, in such aspects as the fee negotiation process. Although we agree that the proposed amendments would enhance the city's attractiveness as a seat for arbitration, these should be implemented incrementally to allow all those concerned to adapt to the new regime.

We hope you will find our comments useful to your deliberations.

Yours sincerely,

George Leung
CEO

Encl.

The Law Reform Commission of Hong Kong's Consultation Paper "Outcome-Related Fee Structures for Arbitration" December 2020 ("the CP")

Response by The Hong Kong General Chamber of Commerce ("HKGCC")

Introduction

HKGCC welcomes this opportunity to respond to the CP.

The issue of whether the current prohibition of outcome-related fee structures (ORFSs) in Hong Kong for arbitration should be relaxed is an important one for businesses that may wish to refer disputes to arbitration, and deserves serious consideration. It is particularly apt to consider the issue at this time, when Hong Kong is not only competing as an international arbitration seat with other cities such as Singapore, London and New York, but also wishing to take advantage of its natural potential as an arbitration centre in respect of commercial projects emerging from the Belt and Road Initiative and the Greater Bay Area.

We set out below first our general comments on the issues raised in the CP from the business perspective, then respond to the specific recommendations and requests for submissions in the CP.

General Comments

In general, under the principle of freedom of contract, we believe that businesses should be free to negotiate with their lawyers whatever fee arrangements they wish, in the same way that they can negotiate pricing arrangements with suppliers of other products and services. We can see no valid public policy justification in today's Hong Kong environment for encroaching on this freedom by way of the blanket prohibition of ORFSs which currently exists in Hong Kong, thereby effectively restricting the fee arrangements between businesses and their lawyers for arbitration to an hourly rate structure.

Indeed, such intervention has the potential to increase the costs of doing business, in two ways:

- Many (perhaps most) businesses would welcome the opportunity to negotiate ORFSs as a means of helping them to budget more easily for legal costs, by giving them greater certainty as to the level and timing of the costs. Arbitration and litigation can be extremely lengthy, and it is often difficult to predict how long it will take for them to reach a final conclusion. Requiring businesses to submit only to hourly-rate charging can therefore expose them to a level of legal costs which is both unpredictable, and potentially extremely high. Such unpredictability may indeed deter them from resorting to arbitration in the first place, thereby denying them access to justice. On the contrary, ORFSs would give them the opportunity to have the benefit of greater certainty as to, and in many cases lower overall, legal costs.

- The current blanket prohibition on ORFSs restricts price competition between law firms in Hong Kong, by preventing them from offering a full range of pricing models and negotiating with clients the precise model that suits them. Permitting ORFSs should enable greater differentiation between law firms on pricing and increase competition on fees, which should ultimately benefit clients in terms of lower legal costs.

We therefore agree that the current blanket prohibition on ORFSs should therefore be relaxed for arbitration, as the CP proposes. This applies- as the CP also proposes- to the full range of ORFSs listed in the CP, namely conditional fee agreements ("CFAs"), damages-based agreements ("DBAs") and "hybrid" damages-based agreements ("Hybrid DBAs").

However, we do see the need for certain safeguards to be put in place, at least in the early years of a new regime where ORFSs are permitted.

Most businesses involved in commercial arbitration are sophisticated enough to look after themselves in negotiating fee arrangements with their lawyers, and do not need legislative intervention to protect them. However, small and medium-sized enterprises, in particular, may not have the expertise, or resources to obtain independent legal advice, to ensure that their own interests are protected in negotiating what can be relatively complex fee agreements with their arbitration lawyers. We therefore agree with the CP's proposals that caps should be placed on the uplift in success fees over normal fees (in CFAs), and the percentage of a damages award that can be charged as a fee (in DBAs and Hybrid DBAs). For the same reason, we also agree with the CP's proposal that the new legislation should list certain issues that must, as a minimum, be addressed in ORFSs.

Since permitting ORFSs would be such a significant change from the existing regime, we also believe that a cautious and incremental approach is appropriate, in terms of the scope of claims for which ORFSs in arbitration are allowed, and the definition of "financial benefit" which would allow the lawyer to receive a DBA payment. We believe that, at least in the early years of the new regime, ORFSs should only be permitted for commercial claims by businesses, and only an award of damages to the successful claimant should justify a DBA payment.

We comment further on the proposed safeguards in, and our recommended limitations of, the new regime in the next section of this paper.

Comments on Specific Recommendations and Answers to Requests for Submissions

Recommendation 1

The Sub-committee recommends 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.

We agree, for the reasons given in our General Comments above.

Recommendation 2

Where a CFA is in place, the Sub-committee recommends that any Success Fee and ATE Insurance premium agreed by the claimant with its Lawyers and insurers respectively should not be recoverable from the respondent.

We agree, for the reasons given in the CP, and in particular because (a) it would avoid the possibility of additional "satellite" litigation, on issues such as whether the amounts of the Success Fee and ATE Insurance premium are reasonable; and (b) it would be unfair for the losing party to be liable for these costs: the amount of the Success Fee and ATE premium should be a matter purely between the claimant and its lawyers.

Recommendation 3

Where a CFA is in place, the Sub-committee recommends that there should be a cap on the Success Fee which is expressed as a percentage of normal or "benchmark" costs. The Sub-committee invites proposals on what an appropriate cap should be, up to a maximum of 100%.

We agree that there should be a cap on the Success Fee, at least in the initial years of the new regime, for the reasons given in our General Comments above. We suggest that the cap is 30 per cent of normal legal costs (slightly higher than the 25 per cent in Australia, lower than the 100 per cent in England and Wales, and the same percentage as that which we suggest applies to DBAs: see our response to Recommendation 7 below).

The Sub-committee also invites proposals on whether barristers should be subject to the same, or a different, cap and, if different, what that cap should be, up to a maximum of 100%.

We suggest that the cap of 30 per cent should also apply to barristers' success fees. We see no reason for applying different percentages to solicitors' fees and barristers' fees.

Recommendation 4

The Sub-committee recommends that prohibitions on the use by Lawyers of DBAs in Arbitration should be lifted, so that Lawyers may use DBAs for Arbitration.

We agree, for the reasons given in our General Comments above. We see no valid reason for prohibiting DBAs while allowing CFAs. The client should have full flexibility to negotiate with its lawyers the most appropriate fee structure to suit its individual circumstances.

Recommendation 5

Where a DBA is in place, the Sub-committee recommends that any ATE Insurance premium agreed by the claimant with its insurers should not be recoverable from the respondent.

We agree, for the same reasons given in our answer to Recommendation 2 above in relation to CFAs.

Recommendation 6

The Sub-committee invites submissions on whether the Ontario model or the Success fee model should apply to DBAs.

It is the Sub-committee's preliminary view that the 2019 DBA Reform Project's recommendation to move to a Success fee model should be followed.

We agree with the Sub-committee's preliminary view that the Success fee model should be adopted. Consistently with the reasoning as to why the Success Fee and ATE payment should not be recoverable from the respondent, namely that the amount of this payment is a matter between the claimant and its lawyers (see our response to Recommendation 2 above), the question of recoverable costs should be kept separate from the question of the amount of the DBA payment.

Recommendation 7

The Sub-committee recommends that there should be a cap on the DBA Payment, which should be expressed as a percentage of the "financial benefit" or "compensation" received by the client. The cap should be fixed after consultation.

We agree that there should be a cap on the DBA payment, at least in the initial years of the new regime, for the reasons given in our General Comments above. Moreover, it would be invidious for a successful claimant, under a DBA payment structure, to have to pay most, if not all, of the sum recovered in the arbitration on legal fees. However, as submitted in our response to Recommendation 13 (e) to (h) below, we believe that the DBA payment should be applied only to the compensation (i.e., damages) received by the client and not to any other financial benefit, at least in the early years of the new regime.

The Sub-committee is of the view that there is scope for capping the maximum DBA Payment at less than the 50% cap currently adopted in England and Wales for commercial claims, particularly if the Success fee model is adopted, and that an appropriate range for consultation is 30% to 50%.

We suggest that the cap be set at 30 per cent, consistently with the cap of 30 per cent we suggest for the success fee under CFAs (see our response to Recommendation 3 above). This would also be consistent with the cap for the DBA payment in Mainland China.[1] As the CP argues, much arbitration work in Hong Kong concerns the Mainland in some way, and as DBAs are allowed on the Mainland, allowing them in Hong Kong would allow Hong Kong lawyers to compete for this work on a more level playing-field.[2] It follows that aligning the cap on DBA fees with that which exists in the Mainland would also further this objective.

Recommendation 8

The Sub-committee recommends that a CFA, DBA, or Hybrid DBA should specify whether, and if so in what circumstances:

(a) a Lawyer or client is entitled to terminate the fee agreement prior to the conclusion of Arbitration; and if so

(b) any alternative basis (for example, hourly rates) on which the client shall pay the Lawyer in the event of such termination.

As noted in our General Comments above, we believe that, under the principle of freedom of contract, businesses should generally be free to negotiate the terms of their agreement, including fees, with their lawyers, free of legislative intervention. However, we also explained that, at least during the initial years of the new regime, it would be advisable to put in place certain safeguards, particularly to protect the interests of SMEs. We agree with these recommended safeguards.

[1] CP para 5.34.
[2] CP paras 5.22, 5.33.

Recommendation 9

(1) The Sub-committee recommends that clients should be able to agree, on a case by case basis, whether:

(a) the DBA Payment (and thus the DBA Payment cap) includes barristers' fees; or

(b) barristers' fees would be charged as a separate disbursement outside the DBA Payment.

(2) To the extent that barristers can be, and are, engaged directly, this could also be arranged via a separate DBA between client and barrister. In such circumstances, 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.

We agree with these recommendations. Businesses should be free to negotiate with their lawyers whether or not the DBA payment includes barristers' fees. Where there is a separate DBA between a client and a barrister, we agree that the solicitor's DBA payment plus the barrister's DBA payment should not exceed the prescribed DBA payment cap (which we suggested be set at 30 per cent- see our response to Recommendation 7 above). As explained in our response to Recommendation 7, it would be invidious for a successful claimant, under a DBA payment structure, to have to pay most, if not all, of the sum recovered in the arbitration on legal fees.

Recommendation 10

The Sub-committee recommends that Hybrid DBAs be permitted.

We agree. As we submitted above in our response to Recommendation 4, the client should have full flexibility to negotiate with its lawyers the most appropriate fee structure to suit its individual circumstances.

In the event that the claim is unsuccessful (such that no financial benefit is obtained), the Sub-committee invites submissions as to:

(a) whether the Lawyer should be permitted to retain only a proportion of the costs incurred in pursuing the unsuccessful claim;
(b) if the answer to sub-paragraph (a) is "yes", what an appropriate cap should be in these circumstances; and
(c) if the answer to sub-paragraph (a) is "yes", whether the relevant regulations should provide that, if the DBA Payment is less than the capped amount of irrecoverable costs, the Lawyer is entitled to retain the capped amount of irrecoverable costs instead of the DBA Payment.

We agree that the lawyer should be permitted to retain only a portion of the legal costs if the claim is unsuccessful. One of the key benefits of ORFSs is that they incentivise successful outcomes by rewarding the lawyer for success. This objective would be defeated if the lawyer can recover all of the legal costs even if the claim is unsuccessful.

We believe that an appropriate cap on costs in the event of an unsuccessful outcome would be 30 per cent.

We agree that, if the DBA Payment is less than the capped amount of irrecoverable costs, the lawyer is entitled to retain the latter. This would avoid the anomalous situation referred to in the CP,[3] whereby a lawyer might receive a higher fee in the event of an unsuccessful outcome, than from an outcome that was partially successful.

Recommendation 11

The Sub-committee recommends that appropriate amendments in clear and simple terms be made to:

(a) the Arbitration Ordinance;

(b) the Legal Practitioners Ordinance;

(c) The Hong Kong Solicitors' Guide to Professional Conduct;

(d) the HKBA Code of Conduct; and

(e) any other applicable legislation or regulation

to provide (as applicable) that CFAs and/or DBAs and/or Hybrid DBAs are permitted under Hong Kong law for Arbitration.

Any legislative amendments that are necessary to effect the necessary changes to permit ORFSs in arbitration should be as simple and clear as possible, so that all relevant stakeholders, especially businesses, have a clear understanding of the new regime. Published guidelines on the new regime by the Government and relevant professional bodies would also be helpful for this purpose.

Recommendation 12

The Sub-committee recommends that the more detailed regulatory framework should be set out in subsidiary legislation which, like the legislative amendments referred to in Recommendation 11, should be simple and clear to avoid frivolous technical challenges. Client-care provisions should also be set out in professional codes of conduct so that trivial breaches can be dealt with expeditiously by the professional bodies.

We agree, for the same reason as given in our response to Recommendation 11 above.

[3] CP para 5.54.

Recommendation 13

The Sub-committee invites submissions on:

(a) Whether and how the professional codes of conduct and/or regulations should address what other safeguards are needed. For example to:
(i) be clear in what circumstances a Lawyer's fees and expenses, or part of them, will be payable;
(ii) include a requirement under professional conduct obligations to give the client all relevant information relating to the ORFS that is being entered into, and to provide that information in a clear and accessible form;
(iii) require a claimant using CFAs or DBAs or Hybrid DBAs to notify the respondent and Tribunal of this fact;
(iv) inform clients of their right to take independent legal advice; and
(v) be subject to a "cooling-off" period.

As explained in our General Comments above, while we believe that, under the principle of freedom of contract, businesses should generally be free to negotiate the terms of their agreement with their lawyers without the need for legislative intervention, certain safeguards may be necessary in the initial years of the new regime, in particular to protect the interests of SMEs. We believe the above safeguards would be reasonable.

(b) What should be the relevant method and criteria for fixing "Success Fees" in CFAs.

(c) Whether personal injury claims should be treated differently from other claims in Arbitration, by:

(i) imposing a lower cap on any Success Fee or DBA Payment in respect of a personal injury claim that is submitted to Arbitration; or
(ii) prohibiting Lawyers from entering into ORFSs in respect of personal injury claims that are submitted to Arbitration.

Given that the legalisation of ORFSs would constitute a significant new development, we believe it would be sensible to proceed cautiously and incrementally. As arbitration is relatively rarely used to settle personal injury claims, as the CP notes,[4] and private individuals might be more vulnerable and need greater protection in their negotiation of fee arrangements with their lawyers, we would recommend that, at least in the initial years of the new regime, ORFSs in arbitration be restricted to *commercial claims by businesses*. After these initial years, and in the light of the experience gained, consideration could then be given as to whether permission of ORFSs could be extended to other categories of claim.

(d) Whether any additional category/ies of claim should be treated differently from other claims that are submitted to Arbitration if ORFSs are introduced.

See our answer to (c) above: ORFSs should be restricted to commercial claims by businesses, at least in the initial years of the new regime.

[4] CP paras 5.67- 5.69.

(e) Whether a DBA Payment may be payable (depending on the terms agreed between Lawyer and client) wherever a financial benefit is received by the client, based on the value of that financial benefit.

(f) Whether the relevant financial benefit may be a debt owed to a client, e.g., under a judgment or settlement, rather than money or property actually received.

(g) Whether 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.

(h) Whether respondents should be permitted to use DBAs, e.g., to provide for a DBA Payment in the event the respondent is held liable for less than the amount claimed or less than an agreed threshold.

In answer to (e) to (h) (inclusive) above, and as noted in our answer to (c) above, we believe that a cautious and incremental approach is called for, especially in the initial years of the new regime, given that the legalisation of ORFSs will be a significant change from the existing position. We therefore recommend that DBA payments under DBA or Hybrid DBA Agreements be limited (as the term "DBA" itself suggests) to a percentage of the damages recovered by the claimant in commercial arbitrations, and not to any other financial benefit that the claimant receives from the arbitration. This would avoid the scope for difficulties, and potential disputes, as to the valuation of financial benefits other than damages recovered under (e) to (h), which in our view it would be advisable to do, at least in the initial years of the new regime. Our answers to (e) to (h) inclusive is therefore "no".

Recommendation 14

The Sub-committee recommends that 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.

We agree: this should be a matter that the client should be free to negotiate with its lawyer, under the principle of freedom of contract.

HKGCC Secretariat
March 2021