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The Asia-Pacific Arbitration Review

2024

Key developments in arbitration in Hong Kong

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Generated: February 8, 2024

Key developments in arbitration in Hong Kong

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Summary

IN SUMMARY

This article discusses the additional route for parties to Hong Kong International Arbitration Centre-administered arbitrations to apply for both mainland Chinese interim relief and enforcement through the One-Stop Diversified International Commercial Dispute Resolution Mechanism; the new funding options permitted by Hong Kong's new regime for outcome related fee structures for arbitration; and the Hong Kong Court of Appeal's decision in ***C v D*** relating to the distinction between admissibility and the jurisdiction of an arbitral tribunal.

DISCUSSION POINTS

- One-Stop Diversified International Commercial Dispute Resolution Mechanism
- Third-party funding and outcome-related fee structures for arbitration
- Hong Kong Court of Appeal's decision relating to the distinction between admissibility and jurisdiction

REFERENCED IN THIS ARTICLE

- Arbitration Ordinance
- Arbitration (Outcome Related Fee Structures for Arbitration) Rules
- Arrangement Concerning Mutual Assistance in Court-Ordered Interim Measures in Aid of Arbitral Proceedings by the Courts of the Mainland and of the Hong Kong Special Administrative Region
- *C v D*
- *Essar Oilfields Services Ltd v Norscot Rig Management PVT Ltd*
- Law Reform Commission of Hong Kong Consultation Paper 2020
- Provisions of the Supreme People's Court on Several Issues Concerning the Establishment of International Commercial Courts

ONE-STOP DIVERSIFIED INTERNATIONAL COMMERCIAL DISPUTE RESOLUTION MECHANISM

Presently, parties to Hong Kong-seated arbitral proceedings administered by a qualified institution can apply under the Arrangement Concerning Mutual Assistance in Court-Ordered Interim Measures in Aid of Arbitral Proceedings by the Courts of the Mainland and of the Hong Kong Special Administrative Region (the Arrangement) for interim measures directly from the relevant intermediate people's court (IPC). There are seven qualified institutions under the Arrangement:

- the Hong Kong International Arbitration Centre (HKIAC);
- the Hong Kong Arbitration Centre at the China International Economic and Trade Arbitration Commission;
- the International Court of Arbitration at the International Chamber of Commerce;

- the Hong Kong Maritime Arbitration Group;
- the South China International Arbitration Centre (HK);
- the eBRAM International Online Dispute Resolution Centre; and
- the Hong Kong Regional Arbitration Centre at the Asian-African Legal Consultative Organization.[1]

Applications for interim measures should be made to the IPC of the place of residence of the party against whom the application is made, or of the place where the property or evidence is situated.

Since 22 June 2022, in addition to the Arrangement, there has been an additional route for parties to arbitral proceedings administered by the HKIAC to apply for mainland Chinese interim relief and enforcement. To use this route, parties must apply to the China International Commercial Court (CICC) directly through the One-Stop Diversified International Commercial Dispute Resolution Mechanism (the One-Stop Platform). The HKIAC is the first and only arbitral institution outside the mainland to be included in the One-Stop Platform, which was set up by the Supreme People's Court of the People's Republic of China in 2018.

To make an application through the One-Stop Platform, the amount in dispute must exceed 300 million yuan or the cases must have a significant impact on mainland China.[2] Only cases that are regarded as international commercial cases can qualify through the One-Stop Platform and the cases must satisfy at least one of four conditions:[3]

- one party is a foreigner or a foreign enterprise or organisation;
- one party has its habitual residence outside mainland China;
- the subject matter of the dispute is outside mainland China; or
- the facts relating to the formation, change or termination of the commercial relationships occurred outside mainland China.

Through the One-Stop Platform, applications can be made before or after the commencement of the arbitration to preserve evidence or assets, or to prohibit conduct.[4] Parties may also make an application to set aside or enforce an arbitral award to the CICC.[5] Applications are made to the CICC through the HKIAC.

As the CICC is part of the Supreme People's Court of the People's Republic of China, the judges are regarded as being of the highest calibre in mainland China. They are likely to have experience in international arbitration, and be able to work proficiently in both Chinese and English.[6] Under the Arrangement, any documents submitted to the court that are not in Chinese must be translated into Chinese.[7] The decisions of the CICC are not subject to the supervision of higher courts or appeal. The One-Stop Platform process may also be more streamlined. For instance, under the Arrangement, if there are assets in multiple jurisdictions, applicants can only choose one court; under the One-Stop Platform, applicants do not have to choose which IPC to apply to.

That said, not all cases are qualified to be accepted by the CICC. In most cases, it may be easier to apply for interim measures under the Arrangement. As IPCs are likely to be more familiar with local affairs and have closer proximity to the provinces, the Arrangement may remain more suitable for cases where the evidence or assets that the applicant is trying to

preserve are concentrated in one city or province. On the other hand, if the assets are spread across mainland China, the One-Stop Platform may be more suitable.

As at 28 March 2023, the HKIAC has processed 91 applications to 34 mainland Chinese courts under the Arrangement,[8] of which 86 applications were for the preservation of assets, two were for the preservation of evidence and three were for the preservation of conduct. The total value of assets requested to be preserved amounted to approximately US$3.5 billion. In comparison, there have not yet been many applications made through the One-Stop Platform. However, it is expected that there will be an increase in applications made through the One-Stop Platform when more Hong Kong arbitration users become aware of this additional route.

THIRD-PARTY FUNDING AND OUTCOME-RELATED FEE STRUCTURES FOR ARBITRATION

In recent years, the Hong Kong Law Reform Commission has made strong efforts to offer more funding options for parties to arbitration. As a result, the common law doctrines of maintenance and champerty no longer apply to third-party funding and outcome-related fee structures for arbitration (ORFSAs) in Hong Kong.

Since 1 February 2019, third-party arbitration funding has been permitted under Part 10A of the Arbitration Ordinance (AO).[9] However, section 98O of the AO prohibits lawyers from providing arbitration funding to a party where the lawyers are acting for any party in relation to the relevant arbitration. The definition of 'arbitration funding' is 'money, or any other financial assistance, in relation to any costs of the arbitration', which is broad enough to include most of the ORFSAs described below as the lawyers would be deemed to be funding the arbitration using their own working capital.

From 16 December 2022, the use of an ORFSA is permitted for arbitrations that take place in or outside Hong Kong, except for personal injuries claims. Both Parts 10A and 10B of the AO adopt an extended meaning of 'arbitration', which includes court proceedings, proceedings before an emergency arbitrator and mediation proceedings.

ORFSA Agreements

The AO now permits three types of agreements: conditional fee agreements (CFAs), damages-based agreements (DBAs) and hybrid damages-based agreements (Hybrid DBAs).

Under a CFA, the lawyers agree with the client to be paid a success fee for the matter only in the event of a successful outcome for the client.[10] The lawyers and the client need to agree on what constitutes a successful outcome and specify it in the agreement. It could be success for the whole arbitration or only a part of it. For example, concluding a settlement agreement, which provides some of the relief sought by the client, may constitute success; success does not necessarily refer to winning the case.

A CFA could be a no win, no fee arrangement or a no win, low fee arrangement. Under a no win, no fee arrangement, no legal fees are payable unless the client succeeds. Under a no win, low fee arrangement, the client may agree to pay legal fees at a set rate during the proceedings and pay a success fee in the event of a successful outcome.

A DBA is a no win, no fee arrangement. Under a DBA, the lawyers agree with the client to be paid for the matter only in the event that the client obtains a financial benefit in the matter (the DBA Payment).[11] The term 'financial benefit' is broadly defined as 'any money or money's worth' including 'any avoidance or reduction of a potential liability'.[12] This definition

is drafted broadly to allow DBAs to be used by respondents as well. For example, the financial benefit may be the reduction of a debt. The DBA Payment is calculated by reference to the financial benefit that is obtained by the client in the matter.[13]

A Hybrid DBA is a no win, low fee arrangement. Under a Hybrid DBA, the lawyers agree to be paid a fee for the legal services rendered during the course of the matter regardless of the outcome of the case and, in the event that the client obtains a financial benefit in the matter, a DBA Payment will be charged by the lawyers.[14] A Hybrid DBA is therefore more flexible compared to the other two forms of agreements and offers opportunities for lawyers to increase their earnings without a commensurate increase in risk.[15]

There are caps imposed on the maximum fees that lawyers may charge. The success fee under a CFA cannot exceed 100 per cent of the fee that the lawyers would have charged if no agreement had been made (ie, the benchmark fee).[16] Under a Hybrid DBA, the DBA Payment is capped at 50 per cent of the financial benefit obtained.[17] Under a Hybrid DBA, if no financial benefit is obtained by the client, the client is not required to pay the lawyers more than 50 per cent of the irrecoverable costs,[18] which refer to any portion of the benchmark fee that is not recoverable from any other party to the arbitration.[19] If a financial benefit is obtained but the DBA Payment is less than 50 per cent of the irrecoverable costs, the lawyers may elect to retain 50 per cent of the irrecoverable costs instead of the DBA Payment.[20] This is to avoid a situation in which the lawyers have more incentive to be unsuccessful than successful. There is a limit imposed on the maximum aggregate sum of DBA Payments if multiple DBAs or Hybrid DBAs are entered into and the DBA Payments are calculated by reference to the same financial benefit.[21] For example, where one DBA is entered into in relation to a claim and there is a separate DBA for the counterclaim, the maximum aggregate sum of DBA Payments should not exceed 50 per cent of the financial benefit.

Singapore has recently permitted CFAs without any caps on the uplift fees.[22] However, DBAs and Hybrid DBAs are not permitted in Singapore.

An ORFSA agreement has to comply with certain formalities. For example, the agreement must be in writing, and signed by the lawyers and the client.[23] It should state the matter, the circumstances under which the legal fees and expenses are payable, and that the lawyers have informed the client of the right to seek independent legal advice. A cooling-off period of not less than seven days must be included in the agreement. During this period, the client may terminate the agreement by written notice without incurring liability. The agreement should also set out whether disbursements, including barristers' fees, are to be paid by the client regardless of the outcome. The grounds for termination before conclusion of the matter and the alternative basis upon which the lawyer is to be paid after termination must also be specified in the agreement.

Similar to Hong Kong's third-party funding regime, which requires the existence of a funding agreement to be disclosed to the counterparty and the arbitration body, an ORFSA agreement must also be disclosed to the counterparty and the arbitration body.[24] This could be an important factor for settlement as the counterparty would then know that the other party is pursuing the case without having to pay any legal fees at all or is only paying a discounted fee. They will also know that the other party's legal team have objectively assessed the case and have sufficient confidence in it to agree to act under a ORFSA agreement.

A key question regarding the ORFSA regime is whether the uplifted fees can be recovered from the losing party. Under Hong Kong's regime, the answer is normally no. As the losing

party is not a party to such ORFSA agreements, it has no control over the agreed pricing.[25] If the uplifted fees are recoverable from the losing party, this would mean that the costs to be paid by the losing party would purely depend on the successful party's agreement with its lawyers, which would be unfair to the losing party.

That said, if there are exceptional circumstances to justify the order, the arbitral tribunal may make such an order.[26] Such exceptional circumstances may be similar[27] to the circumstances in the High Court of England and Wales decision in ***Essar Oilfields Services Ltd v Norscot Rig Management PVT Ltd***.[28] In this case, the losing party was ordered to pay the third-party funder premium incurred by the successful party because the arbitrator was critical of the losing party's conduct during the performance of the underlying contract and during the arbitration. The arbitrator was of the view that the losing party had set out to financially debilitate the successful party, leaving the successful party with no alternative but to source litigation funding. Consequently, the arbitral tribunal considered that it had discretion to allow the successful party to recover some or all of the uplifted fees in extreme situations where it found this to be fair and equitable. This is different from Singapore's regime, which adopts a prohibition against the recoverability of the uplifted fees.

Commentary

Hong Kong's new ORFSA regime has a number of benefits. First, it improves access to justice and complements Hong Kong's third-party funding regime as not all cases are eligible or suitable for third-party funding and it is often difficult to obtain funding in practice. The ORFSA regime also better responds to client demand and provides pricing flexibility, as the lawyers' interests would be more aligned with those of the clients under an ORFSA agreement. The new regime also supports freedom of contract and filters out unmeritorious claims. Most importantly, it enables lawyers in Hong Kong to compete on a level playing field with other jurisdictions and maintains Hong Kong's competitiveness as a major arbitration hub, as most of the popular arbitral seats now allow some, if not all, types of ORFSAs.[29]

Despite these apparent benefits, some legal practitioners remain sceptical about the uptake of these new ORFSA agreements as the new regime also raises questions in relation to the availability of security for costs and what happens if a client terminates an ORFSA agreement.

Another issue that concerns lawyers is the treatment of disbursements such as barristers' fees. An ORFSA agreement should set out whether disbursements, including such fees, are to be paid by the client regardless of the outcome of the case.[30] More specifically, DBAs and Hybrid DBAs must set out whether barristers' fees are to be regarded as part of the DBA Payment or whether the client is liable to pay barristers' fees in addition to the DBA Payment.[31] If barristers' fees are included in the DBA Payment, in the event that the client fails to obtain any financial benefit, the firm of solicitors will have to pay barristers' fees. Under such an arrangement, the firm of solicitors also takes on the risk of the DBA Payment being consumed by barristers' fees if a financial benefit is obtained by the client.

In practice, there may be two ways to protect solicitors' interests. First, a barrister may take on the case under a separate DBA so that the client (instead of the solicitor) would be liable for the payment of counsel fees.[32] That said, the solicitor's DBA Payment and the barrister's DBA Payment together cannot exceed 50 per cent of the financial benefit. Another method is for the barrister to be engaged directly by the client,[33] which is possible in arbitration. In this way, the barristers' fee would not be subject to the cap on the DBA Payment as it would be

deemed an expense separately payable by the client. The solicitor may then charge a higher amount for the DBA Payment as the cap on the DBA Payment does not have to be shared with the barrister's DBA Payment.

Under an ORFSA agreement, the legal fees charged by the lawyers may be significantly higher than the legal fees charged if no such agreement had been made. For example, under a CFA, the total legal fees charged may be 100 per cent of the legal fees charged by the lawyers if no ORFSA agreement had been made. Also, under a no win, no fee CFA arrangement, the client does not have to pay any legal fees during the course of the matter. This prompts the question of whether law firms may require the client to pay security for costs as there may be a chance that the client is unable to afford the legal fees. 'Where a solicitor is acting under an ORFS[A] agreement, no payment on account or deposit on account should be collected for the uplifted portion of relevant fee',[34] so lawyers are not allowed to require clients to pay security for costs for the uplifted portion of the legal fees. Requiring clients to pay security for costs may also defeat the purpose of the regime, which is to provide access to justice and flexibility to funding.

In relation to the termination of the ORFSA agreement, the default position is that, if the lawyer or client reasonably believes that the other party has committed a material breach or has behaved or is behaving unreasonably, the party may terminate the ORFSA agreement before the conclusion of the matter.[35] This applies subject to the terms and conditions of the actual agreement. Therefore, lawyers may include some provisions in the ORFSA agreement to the effect that, if the client fails to disclose all relevant information, the lawyer may terminate the agreement and the client will have to pay a certain sum as compensation.

HONG KONG COURT OF APPEAL DECISION

In ***C v D***,[36] the Hong Kong Court of Appeal (HKCA) considered the issue of whether:

- non-compliance with pre-arbitral requirements in a tiered arbitration clause deprives a tribunal of jurisdiction; or
- the issue goes to admissibility of the claim.

This case concerned a multi-tiered dispute resolution agreement between two satellite operators. C is a Hong Kong company that carries on business as an owner and operator of a satellite, while D is a Thai company. The agreement provided that the parties would attempt to resolve any dispute by negotiation. If any dispute could not be resolved amicably within 60 business days, it would be referred by either party for exclusive and final settlement by arbitration in Hong Kong. It also provided that any award would be final and binding on each party, and the parties agreed to waive any right of appeal against the arbitral award.

D commenced an arbitration after its attempt to refer the dispute to the parties' respective senior management teams for negotiation failed. In response, C claimed that the arbitral tribunal had no jurisdiction to entertain the dispute because D had not properly complied with the pre-arbitral requirements of the multi-tiered dispute resolution agreement.

The arbitral tribunal held that there was no issue as to its jurisdiction to hear the case and proceeded to issue a partial award in favour of D. C applied to the Hong Kong Court of First Instance (CFI) to set aside the arbitral award on jurisdictional grounds under section 81 of the AO, which gives effect to article 34 of the United Nations Commission on International Trade Law's Model Law on International Commercial Arbitration.

At first instance, the CFI noted that, if the question was one of jurisdiction under the provisions of article 34, it could review the tribunal's decision de novo. In fact, however, the judge found that C's objection was not subject to review by the CFI under article 34 as it only went to the admissibility of the claim, rather than jurisdiction of the tribunal.

On appeal, the HKCA held that, while the distinction of admissibility and jurisdiction could not be read directly into article 34, it can be given proper recognition as a matter of statutory construction. The HKCA upheld the CFI's decision and found that C's objection was not that the substantive claim advanced by D could never be referred to arbitration or to be arbitrated at all, but only that the reference to arbitration was premature in that some pre-arbitration requirements should first have been observed or gone through. C's objection was targeted at the claim instead of at the tribunal, therefore it went only to the admissibility of the claim and not to the jurisdiction of the tribunal.

The HKCA's decision reflects the approach of the Hong Kong judiciary that the issue of whether a party has complied with a pre-condition to arbitration is:

> a question intrinsically suitable for determination by an arbitral tribunal, and is best decided by an arbitral tribunal in order to give effect to the parties' presumed intention to achieve a quick, efficient and private adjudication of their dispute by arbitrators chosen by them on account of their neutrality and expertise.[37]

The CFI has also raised examples of ways to ensure compliance with pre-conditions to arbitration. For example, the arbitrator may decide to order a stay of the arbitral proceedings in whole or in part pending compliance with the clause, impose costs sanctions or dismiss the claim outright as inadmissible.[38]

The CFI's approach has been followed in two subsequent Hong Kong cases: ***Kinli Civil Engineering Ltd v Geotech Engineering Ltd***[39] and ***T v B***.[40] It has also been followed in subsequent decisions in England and Wales, and Australia. Despite this, leave to appeal to the Hong Kong Court of Final Appeal was granted in December 2022 and the appeal will be heard in April 2023.[41]

C v D serves as a reminder that multi-tiered arbitration agreements should be drafted in explicit and unambiguous language. It is of the utmost importance that the parties' intention as to the scope of the disputes that may be submitted to arbitration is reflected clearly in the agreement. The case also reminds arbitration users that, when adopting a multi-tiered arbitration agreement, they should be prepared to take on the risk of extra time and costs potentially being incurred when disputes arise, as there may be challenges about whether the pre-arbitral requirements of the multi-tiered agreement have been fully complied with. There is also a chance that the losing party would rely on the language of the agreement as grounds to challenge the arbitral award after it has been granted.

CONCLUSION

Hong Kong's recent developments illustrate that much effort has been made to strengthen the cooperation between mainland China and Hong Kong in relation to arbitration-related matters, while the introduction of the new ORFSA regime and the decisions in ***C v D*** reflect the Hong Kong courts' supportive approach to arbitration.

These recent developments further consolidate Hong Kong's position as a well-recognised international arbitration hub and enable Hong Kong to remain one of the world's top arbitral seats.

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The authors would like to acknowledge and thank Abbie Cheung for her valuable assistance in preparing this article.

Endnotes

1 A list of contact details for institutions and permanent offices that are qualified under article 2(1) of the Arrangement is available on the website of Hong Kong's Department of Justice. Back to section

2 Provisions of the Supreme People's Court on Several Issues Concerning the Establishment of International Commercial Courts, article 2. Back to section

3 Provisions of the Supreme People's Court on Several Issues Concerning the Establishment of International Commercial Courts, article 3. Back to section

4 Provisions of the Supreme People's Court on Several Issues Concerning the Establishment of International Commercial Courts, article 14. Back to section

5 Provisions of the Supreme People's Court on Several Issues Concerning the Establishment of International Commercial Courts, article 14. Back to section

6 CICC, 'A Brief Introduction of China International Commercial Court', 28 June 2018. Back to section

7 Arrangement, article 4. Back to section

8 HKIAC, 'PRC-HK Interim Measures Arrangement: Frequently Asked Questions'. Back to section

9 Cap 609. Back to section

10 AO, section 98ZC(1). Back to section

11 AO, section 98ZD(a). Back to section

12 AO, section 98ZA. Back to section

13 AO, section 98ZD(b). Back to section

14 AO, section 98ZE. Back to section

15 Law Reform Commission of Hong Kong Consultation Paper 2020, paragraph 4.92(b). Back to section

16 Arbitration (Outcome Related Fee Structures for Arbitration) Rules (Cap 609D), Rule 4(1)(b). Back to section

17 Arbitration (Outcome Related Fee Structures for Arbitration) Rules, Rule 5(a). Back to section

18 Arbitration (Outcome Related Fee Structures for Arbitration) Rules, Rule 6(1)(c). Back to section

19 Arbitration (Outcome Related Fee Structures for Arbitration) Rules, Rule 6(2). Back to section

20 Arbitration (Outcome Related Fee Structures for Arbitration) Rules, Rule 6(1)(d). Back to section

21 Arbitration (Outcome Related Fee Structures for Arbitration) Rules, Rule 7. Back to section

22 Singapore's Legal Profession (Amendment) Act 2022. Back to section

23 Arbitration (Outcome Related Fee Structures for Arbitration) Rules, Rule 3. Back to section

24 AO, section 98ZQ. Back to section

25 Law Reform Commission of Hong Kong Consultation Paper 2020, paragraph 5.11. Back to section

26 AO, section 98ZU(3). Back to section

27 Law Reform Commission of Hong Kong Report 2021, paragraph 3.19. Back to section

28 [2016] EWHC 2361 (Comm). Back to section

29 Law Reform Commission of Hong Kong Consultation Paper 2020, paragraphs 4.6–4.33. Back to section

30 Arbitration (Outcome Related Fee Structures for Arbitration) Rules, Rule 3(v). Back to section

31 Arbitration (Outcome Related Fee Structures for Arbitration) Rules, Rule 5(b)(iv). Back to section

32 Law Reform Commission of Hong Kong Consultation Paper 2020, paragraph 5.45. Back to section

33 Law Reform Commission of Hong Kong Consultation Paper 2020, paragraph 5.46. Back to section

34 Principle 4.07 of the Hong Kong Solicitors' Guide to Professional Conduct, Volume 1. ^ Back to section

35 Arbitration (Outcome Related Fee Structures for Arbitration) Rules, Rule 9. ^ Back to section

36 [2022] HKCA 729. ^ Back to section

37 *C v D* [2022] HKCA 729, paragraph 63. ^ Back to section

38 *C v D* [2021] HKCFI 1474, paragraph 49. ^ Back to section

39 [2021] 6 HKC 524. ^ Back to section

40 [2022] 1 HKLRD 279. ^ Back to section

41 As at early April 2023. ^ Back to section

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