International Litigation

Awarding Costs in International Arbitration

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In a recent column, we discussed how interest awards in international arbitration often do not get the level of analysis and care that they probably deserve, especially considering the significant amounts that can be included in such awards.[1] Many arbitration users probably consider that the awards of costs in international arbitration are likewise often the result of a black-box type determination. There is evidence, notably as seen in published awards in investor-state arbitrations, that some arbitrators appear not to delve into the reasonableness of parties' costs and to accept the costs claimed by the prevailing party. Such an approach, of course, can unfairly reward and punish parties, should the costs have been excessive or there be significant issues as to which both parties prevailed. Other times, arbitral tribunals leave costs to be borne by the parties that incurred them, just as they generally are in U.S. court proceedings.

The International Chamber of Commerce (ICC) is now trying to shine light on this subject. A report recently published by the ICC's Task Force on Decisions as to Costs surveyed the practices and institutional rules and guidelines on the assessment of costs in international

commercial arbitration.[2] The purpose of the report is to inform users of arbitration how tribunals may allocate costs in accordance with the parties' agreement and/or any applicable rules or law.

The issue is significant because the cost of conducting international arbitrations can be considerable. Parties' legal fees and the fees and costs of consultants can amount to many millions of dollars. Arbitrators—sitting as a tribunal of three in major cases—must also be paid, either on an hourly basis or, as at the ICC, on the basis of the parties' valuations of the amount of money at stake. Less significant are the charges imposed by the arbitral institutions. The "party costs"—what the parties spend on their lawyers and their expert consultants and witnesses—amount, according to the report, to 83 percent of the average "overall cost" of ICC proceeding, leaving 17 percent for ICC arbitrator fees and costs.

Since arbitration is, at its core, an agreement between the parties, it is that agreement that should be the first source on the issue of costs. Parties can include in their agreement that the prevailing party is entitled to an award of costs, or they might agree that each side bears its own costs. The law of the place of arbitration is also important. For example, section 60 of the English Arbitration Act of 1996 provides that a clause requiring a party to pay all or part of the costs of the arbitration is valid only if made after the dispute has arisen.

Arbitral rules are also an important source, but rules of different arbitral institutions treat the award of costs in different ways. Some, like CIETAC, the Permanent Court of Arbitration (PCA), and the London Court of International Arbitration, include rebuttable presumptions that the prevailing party should be entitled to an award of its costs. For example, Article 42 of the Arbitration Rules of the PCA provides that the costs of arbitration "shall in principle be borne by the unsuccessful party or parties," although the tribunal "may apportion costs between the parties if it determines that apportionment is reasonable, taking into account the circumstances of the case."

In contrast, the rules of other institutions leave that decision to the discretion of the arbitrators. For example, Rule 34 of the 2014 International Arbitration Rules of the International Centre for Dispute Resolution (ICDR) of the American Arbitration Association (AAA) provides as follows:

The arbitral tribunal shall fix the costs of arbitration in its award(s). The tribunal may allocate such costs among the parties if it determines that allocation is reasonable, taking into account the circumstances of the case.

Article 37 of the ICC Rules likewise leaves the issue to arbitral discretion. Significantly, however, Article 37(5) also notes specifically that among the factors to be considered is "the extent to which each party has conducted the arbitration in an expeditious and cost-effective manner."

The task force builds on this point, stating—in bold print for emphasis—that the "ultimate objective" of its report is to "consider how the allocation of costs among the parties can be used effectively to control time and costs and to assist in creating fair, well-managed proceedings matching users' expectations" (Report, ¶7). In pursuit of this objective, the task force report includes a discussion of the kinds of undesirable conduct by a party that might result in the

assessment by the tribunal of costs against it because it has protracted or delayed the proceedings or otherwise engaged in improper conduct.

Improper Conduct

The report points out that the discretionary authority given to arbitrators by paragraph 5 of Article 37 "allows the conduct of all parties to be assessed in the course of the proceedings, and in some cases even prior to the proceedings, *irrespective of whether such conduct has caused a delay or otherwise increased the cost of the arbitration*" (emphasis added). The report explains that this kind of assessment is "a separate exercise from examining the parties' relative success or failure in the arbitration" and that "it is entirely within the discretion of the tribunal to find that a party's improper conduct or bad faith is the *sole determinative factor* in its decision on costs." (Report, ¶78, emphasis added.)

Thus, in the view of the drafters of the report, bad behavior or conduct constituting bad faith can result in punishment in the form of cost-shifting—even if the party engaging in such improper conduct has prevailed in the arbitration and might ordinarily expect to have costs awarded in its favor. Indeed, a tribunal following Article 37(5) could not only deny an award of costs to such an improper actor but it could also saddle it with costs of the non-prevailing party.

It remains to be seen the extent to which arbitrators will make use of this broad discretion afforded to them under the ICC rules to punish misbehaving but successful parties. It is also possible that the very existence of the availability of such sanctions may itself lead to fewer abuses of the arbitral process.

Reasonableness of Costs

Too often, arbitrators are reluctant to delve into the reasonableness of costs sought to be awarded by the parties. Rather, there often appears to be a willingness on the part of tribunals to accept broad summaries of such important costs as legal fees and consultants' charges without requiring details. The report points out (page 11) that there is no definition of reasonableness in institutional arbitration rules or national arbitration statutes. It refers to a "common sense approach" by which tribunals may "assess whether the costs are reasonable and proportionate to the amount in dispute or value of the property in dispute and/or the costs have been proportionately and reasonably incurred."

The report goes on to suggest (¶65) the factors that tribunals might take into account in determining whether costs sought are reasonable. These factors include (i) the reasonableness of the rates, (ii) the number and level of fee earners, (iii) the reasonableness of the level of specialist knowledge and qualifications of team members, and (iv) the reasonableness of the amount of time spent by various timekeepers. The report also suggests that any disparity between costs incurred by one party versus another may be "a general indicator of reasonableness as opposed to a separate factor in itself."

Proportionality is another factor to consider under the "reasonableness" umbrella. Arbitrations in which the dollar amounts sought do not seem to justify the amount spent in the case might have significance beyond the amount in dispute (such as setting precedent). In such situations, it would be wise to explain to the tribunal the reasons behind a seeming lack of proportionality.

Taken together, the task force may be understood to suggest, in respect to reasonableness of costs, that arbitral tribunals undertake what may be the hard work of assessing reasonableness, rather than simply or reflexively responding to requests for compensation for costs by granting them to the successful party or ruling that the costs will remain with the parties that incurred them. It may be harder work for arbitrators to dig in to the details of costs for legal fees and expert fees, but it would seem not unreasonable for the parties to an arbitration to expect that they will engage in these efforts.

Third-Party Funding

Anecdotally, it would appear that an ever-increasing number of claims in international arbitration are funded by financial institutions generally known as third-party funders. These funders arrange to pay legal fees (although claimants' lawyers may have to share to a certain extent in the risk) and other costs incurred by the claimant in return for a share of the proceeds.

The report discusses a number of issues unique to cases involving third-party funders. For example, the rationale behind allocating costs to a successful party is that the party should not be out of pocket as a result of having to seek adjudication to enforce or vindicate its legal rights. Recovery of the costs by the successful party therefore presupposes that it incurred legal fees. In the case of third-party funding, that supposition is questionable. Even more important is the risk of an un-level playing field. Should a claim financed by a third-party funder be successful, the claimant, having sued a financially responsible party, such as a foreign government, will typically be able to recover an award of costs. On the other hand, such a financed claimant, relying as it does on outside financing, might lack resources to pay costs should its claim be unsuccessful.

The report suggests (¶90) that, in order to "put both parties on equal footing in respect of any recovery of costs," the non-funded party might decide to apply to the tribunal early in the proceedings for interim or conservatory measures, including seeking security for costs or "some form of guarantee or insurance." In focusing on claimants that are funded, the task force seems to be inviting respondents to request that the tribunal probe into claimants' financing in ways that some may find obtrusive. The task force guards against this impression by suggesting that a tribunal might consider making a non-funded party seeking security for costs liable for costs and damages caused by security measures ordered "if the funded party were ultimately to prevail."

Conclusion

The task force report is a useful document in that it deals thoughtfully and comprehensively with a wide variety of issues bearing on the award of costs, a subject that is often neglected both in tribunal awards and in the international arbitration literature. The report not only presents

comments and suggestions on costs issues, but it also contains reports from the leading arbitral institutions on how arbitrators have dealt in practice with costs in their awards.

The report conveys the message that costs can and should be dealt with more thoroughly than they usually are. And, a thread that runs throughout the report is that the way in which cost issues are addressed can have a salutary effect in protecting against time-wasting and other inappropriate conduct on the part of parties and their counsel, thereby contributing to the more timely and efficient disposition of cases. The report is a document that should be read by every international arbitrator and should be kept as a reference by all persons serving as arbitrators.

Endnotes:

1. See New York Law Journal, May 22, 2014.

2. The second of the authors of this column was on the task force. The "report" can be found at http://www.iccwbo.org/Advocacy-Codes-and-Rules/Document-centre/2015/Decisions-on-Costs-in-International-Arbitration---ICC-Arbitration-and-ADR-Commission-Report/.

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