

# Awarding Costs in International Commercial Arbitration

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## 1 Introduction

It is often said that international arbitration has become too complex and too expensive in recent years. Many corporate counsel and arbitration practitioners complain that international arbitration proceedings are nowadays dominated by extensive document production requests and lengthy written witness statements, which have resulted in an overly document-heavy procedure that runs counter to the original promise of arbitration as a speedy and cost-efficient way of settling business disputes. Added to that, one frequently hears that challenges to arbitrators seem to be on the increase; jurisdictional disputes are all the more common; and generally speaking, battles over procedure have become a frequent phenomenon. In these circumstances, it is hardly surprising that arbitration is sometimes perceived as a long-drawn-out, costly and highly litigious exercise.

There are different views as to the reasons for such development. Some argue that modern arbitral process is inherently flawed; others see the perceived problems merely as a reflection of broader trends. The latter view is premised on an assumption that a large part of the complexity and increased expense of modern-day arbitration is a result of a more diverse and interconnected business world, where significant transactions are ever more complex and document-intensive and where one encounters vastly different traditions and expectations that are difficult to reconcile. Against this background, it is only natural that international commercial disputes, too, tend to be increasingly complex, contentious and expensive.

Be that as it may, complaints about the costs of arbitration are undoubtedly commonplace. In fact, according to the Queen Mary Survey of 2015, “‘cost’ is seen as arbitration’s worst feature, followed by ‘lack of effective sanctions during the arbitral process’, ‘lack of insight into arbitration’s efficiency’ and ‘lack of speed’.”<sup>1</sup> Criticism about costs pertains not only to the absolute level of costs but also to the uncertainty as to what types of costs are recoverable in the first place, and the lack of universal method regarding the allocation of costs between the parties to an arbitration.

This article focuses on the following issues:

- (i) What are “costs” of arbitration? (*See* section 2.)
- (ii) How are costs allocated between the parties in the arbitration practice? (*See* section 3.)
- (iii) Is it possible to achieve more predictability and transparency in the determination and allocation of costs in the arbitration practice, and if so, how? (*See* sections 4 and 5.)

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<sup>1</sup> *See* the 2015 International Arbitration Survey on Improvements and Innovations in International Arbitration, undertaken by the School of International Arbitration, Centre for Commercial Law Studies, Queen Mary University of London (with the support of White & Case LLP), p. 5.

In addressing these questions, I shall limit myself to international commercial arbitration. In other words, investment treaty arbitration will fall outside the scope of discussion. This limitation is in order mainly because the allocation of costs in investment treaty arbitration differs from the practices adopted in international commercial arbitration. In particular, case law and legal literature suggest that the so-called “costs follow the event” rule is less frequently applied in investment treaty cases than in commercial disputes.<sup>2</sup>

In spite of the above-mentioned limitation, costs and their allocation in international arbitration is a broad and many-faceted topic. It is also noteworthy that, despite the importance of costs, relatively little has been written on the subject. However, as concerns about costs have grown, international arbitration community has devoted more attention to this topic in recent years. An important milestone was reached in 2012, when the ICC Commission on Arbitration & ADR set up a special Task Force on “Decisions as to Costs”. The purpose of the Task Force was to examine how cost allocation between the parties could be used effectively to control time and costs and to assist in creating fair, well-managed proceedings that would meet the users’ expectations.<sup>3</sup> Further to this study, the Task Force issued a report entitled “Decisions on Costs in International Arbitration” (hereinafter the “ICC Cost Report”), which was approved by the ICC Commission and launched in December 2015.<sup>4</sup> Some of the key findings of the ICC Cost Report will be referenced later in this article.

## **2 What are “Costs” of Arbitration?**

### ***2.1 Definition of Costs in the Arbitration Laws, Rules and Legal Literature***

The UNCITRAL Model Law on International Commercial Arbitration (as amended in 2006) is silent on cost awards in international arbitration. National arbitration laws have typically adopted at least rudimentary provisions on costs

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2 See, e.g. Bondar, Kateryna, *Allocation of costs in investor-State and commercial arbitration: towards a harmonized approach*, Arbitration International, 2016, p. 46, 57-58; Webster, Thomas H., *Efficiency in Investment Arbitration: Recent Decisions on Preliminary and Cost Issues*, Arbitration International, 2009, p. 493-494. – For further discussion on the “costs follow the event” rule and other methods of cost allocation between the parties, see subsection 3.2 below.

3 The present author served in the said Task Force as member for Finland; the other Finnish member was Mr. Petri Taivalkoski of Roschier Attorneys Ltd. Altogether, the Task Force comprised 57 members from a number of different jurisdictions. It was co-chaired by Professor Bernard Hanotiau, Professor Julian Lew, Ms. Wendy Miles and Mr. Philippe Cavalieros.

4 The ICC Cost Report is available at “[www.iccwbo.org/Advocacy-Codes-and-Rules/Document-centre/2015/Decisions-on-Costs-in-International-Arbitration---ICC-Arbitration-and-ADR-Commission-Report/](http://www.iccwbo.org/Advocacy-Codes-and-Rules/Document-centre/2015/Decisions-on-Costs-in-International-Arbitration---ICC-Arbitration-and-ADR-Commission-Report/)”

and their allocation in arbitral proceedings. However, few statutes provide any detailed definition of the types of costs that are recoverable.<sup>5</sup>

Different arbitration rules are not homogeneous in their treatment of costs. Some specify the recoverable costs of arbitration in more detail than others. For example, Article 40(2) of the UNCITRAL Arbitration Rules (2010) contains the following definition of the costs of arbitration:

2. The term “costs” includes only:
  - a) The fees of the arbitral tribunal to be stated separately as to each arbitrator and to be fixed by the tribunal itself in accordance with article 41;
  - b) The reasonable travel and other expenses incurred by the arbitrators;
  - c) The reasonable costs of expert advice and of other assistance required by the arbitral tribunal;
  - d) The reasonable travel and other expenses of witnesses to the extent such expenses are approved by the arbitral tribunal;
  - e) The legal and other costs incurred by the parties in relation to the arbitration to the extent that the arbitral tribunal determines that the amount of such costs is reasonable;
  - f) Any fees and expenses of the appointing authority as well as the fees and expenses of the Secretary-General of the PCA.

There are many institutional arbitration rules that follow, more or less closely, the definition of “costs” set out in the UNCITRAL Rules.<sup>6</sup> However, in institutional arbitrations, the arbitral tribunal’s fees are normally fixed by the respective institute and not by the tribunal itself, typically on an *ad valorem* basis by reference to the amount in dispute and in accordance with separate fee scales that each institute has issued. In such a system, the starting point is that both the arbitrators’ fees and the administrative charges will depend on the value of the case: the higher the amount of the claims submitted to arbitration, the higher the fees and charges, and *vice versa*. This practice is adopted by most international arbitration institutions (one notable exception being the LCIA, which charges administrative costs and fixes the arbitrators’ fees on an hourly basis and not by reference to the amount in dispute).

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5 See Blackaby, Nigel – Partasides, Constantine – Redfern, Alan – Hunter, Martin, *Redfern and Hunter on International Arbitration*, Sixth Edition, Oxford University Press 2015, para. 9.99; Born, Gary B., *International Commercial Arbitration*, Second Edition, Kluwer Law International 2014, p. 3085-3086.

6 See, e.g. Article 47.2(a)-(e) of the Arbitration Rules of the Finland Chamber of Commerce (2013; hereinafter the “FAI Rules”); Article 33.1(a)-(f) of the HKIAC Administered Arbitration Rules (2013; hereinafter the “HKIAC Rules”); Article 34(a)-(d) of the ICDR Arbitration Rules (2014; hereinafter the “ICDR Rules”); Article 38(a)-(g) of the Swiss Rules of International Arbitration (2012; hereinafter the “Swiss Rules”).

As can be noted, Article 40(2)(e) UNCITRAL Rules provides that also “legal and other costs incurred by the parties in relation to the arbitration” are considered part of the “costs of the arbitration”. Many institutional arbitration rules follow the same pattern.<sup>7</sup> This approach is not universal, though, as some arbitration rules treat party costs differently. For instance, the LCIA Rules, the SCC Rules and the SIAC Rules make a distinction between “costs of the arbitration” and “costs incurred by a party”. In practice, however, this distinction has little practical significance, because all of these rules empower the arbitral tribunal to apportion both the “costs of the arbitration” and the “costs incurred by a party” in the final award.<sup>8</sup>

In the legal literature, most commentators divide the costs into two categories: the costs of the arbitration proceeding itself (sometimes also referred to as the “procedural costs”), on one hand, and the costs of the parties, on the other hand. The latter comprises any costs incurred by a party individually in respect of the arbitration, such as the fees and expenses of an external counsel retained by a party for legal representation in the arbitration, expenses related to a party’s own witness and expert evidence, potential translation costs, transcript preparation, copying and printing charges, as well as travel and accommodation costs of a party’s counsel, witnesses and party-appointed experts. By contrast, the costs of the arbitration proceeding itself are not attributable to any particular party but concern all of the parties in the arbitration. Typically, they include the arbitral tribunal’s fees and expenses and the administrative charges of the arbitral institution under whose rules the proceedings are conducted. But apart from that, the costs of the arbitration may also include such other expenses that are common to all parties and that have been paid out of the advances on costs held by the arbitral tribunal or the administering institution.<sup>9</sup>

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7 See, e.g. Article 35(1) of the Arbitration Rules of the German Institution of Arbitration (1998; hereinafter the “DIS Rules”); Article 47.2(e) FAI Rules; Article 33.1(e) HKIAC Rules; Article 37(1) of the ICC Rules of Arbitration (2012; hereinafter the “ICC Rules”); Article 34(d) ICDR Rules; Article 38(e) Swiss Rules. See also the revised UNCITRAL Notes on Organizing Arbitral Proceedings (as adopted by the UNCITRAL Commission on 7 August 2016; hereinafter the “2016 UNCITRAL Notes”), para. 39, item (iv).

8 See Article 28 of the LCIA Arbitration Rules (2014; hereinafter the “LCIA Rules”); Rules 35 and 37 of the SIAC Arbitration Rules (2016; hereinafter the “SIAC Rules”); Articles 49 and 50 of the SCC Arbitration Rules (2017; hereinafter the “SCC Rules”).

9 See, e.g. Cavalieros, Philippe, *In-House Counsel Costs and Other Internal Party Costs in International Commercial Arbitration*, Arbitration International, 2014, p. 146; Lew, Julian D. M. – Mistelis, Loukas A. – Kröll, Stefan M., *Comparative International Commercial Arbitration*, Kluwer Law International 2003, para. 24-80, 24-84; Scherer, Maxi – Richman, Lisa – Gerbay, Rémy, *Arbitrating under the 2014 LCIA Rules: A User’s Guide*, Kluwer Law International 2015, p. 317; and Blackaby – Partasides – Redfern – Hunter, *supra* fn. 5, para. 9.85-9.92, where it is also noted (in para. 9.89) that the costs of the arbitration “include hiring rooms for hearings, and other meetings, between the parties and the tribunal, as well as the fees and expenses of the reporters who prepare the transcripts. These are usually organised and paid directly by the parties, and are disbursed by the parties in equal shares pending the tribunal’s final award. Occasionally, where the arrangements are made by the chairman of the tribunal, or by an administering institution, such costs are paid from the deposits held by the arbitral tribunal or the institution. In general, however, the parties usually prefer to control

As a practical matter, most of the overall costs of the arbitration invariably consist of “party costs”, i.e., the fees and expenses of parties’ counsel, expenses related to witness and expert evidence, and other costs that each of the parties has incurred in connection with the arbitration proceedings. This is illustrated by the study undertaken by the ICC Secretariat in conjunction with the preparation of the ICC Cost Report: a review of 221 ICC awards rendered in the year 2012 revealed that party costs made up no less than 83% of the total costs of the proceedings, while arbitrators’ fees/expenses and the ICC administrative charges accounted for a much smaller proportion (15% and 2%, respectively).<sup>10</sup> Anecdotal evidence suggests that the figures are broadly similar also in arbitration proceedings governed by other institutional rules.<sup>11</sup>

The definition of costs is important under those cost regimes which require, or allow, the arbitral tribunal to apportion the costs of the arbitration (including the parties’ legal costs) between the parties; for obvious reasons, it is less relevant when the tribunal is duty-bound, or decides in its discretion, to order each party to bear its own costs and to share the procedural costs equally. In proceedings where the arbitral tribunal is vested with the power to apportion the cost of the arbitration – and called upon to do so by one or more of the parties – the recoverability of certain types of costs is unlikely to raise much controversy. For instance, most arbitrators would readily agree that fees and expenses of external counsel are in principle recoverable (at least insofar as the arbitral tribunal is satisfied that the amount of costs claimed is reasonable).<sup>12</sup> However, the recoverability of certain other types of costs may be more controversial. In the following, I shall discuss five of such cost items: (a) costs incurred before the commencement of arbitration proceedings, (b) costs of ancillary proceedings, (c) success fees, (d) costs that are compensated by an insurer or other indemnifier, and (e) internal legal and management costs.

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these costs themselves rather than give the tribunal what may amount to a ‘blank cheque’ to buy in such services.”

10 See the ICC Cost Report, *supra* fn. 4, para. 2.

11 Little reliable information on this topic is available in the public domain. That said, as chair of the Board of the Arbitration Institute of the Finland Chamber of Commerce (hereinafter the “FAI”), the present author is privy to the statistics regarding arbitration proceedings conducted under the FAI Rules that entered into force on 1 June 2013. According to the study undertaken by the FAI Secretariat with respect to FAI awards, in 2014 the party costs accounted for 81,13% of the total costs of the arbitration, whereas arbitrators’ fees/expenses accounted for 14,27% and the FAI administrative charges for 4,6%. In 2015, the figures were 79,76%, 16,67% and 3,57%, respectively; and in 2016, they were 86,86%, 10,73% and 2,41%, respectively.

12 As to the requirement that costs be “reasonable”, see subsection 3.3(c) below.

## 2.2 *Controversial Types of Costs*

### (a) Costs incurred before the commencement of arbitration proceedings

As a rule, a party may seek reimbursement of its legal and other costs so far as those have been incurred in connection with the arbitration proceedings. It is not completely clear whether costs that have arisen *before* the commencement of the arbitration are recoverable in the ensuing arbitral proceedings. According to Hanotiau, only expenses which were “necessary for the preparation of the case” and “directly linked to the filing of the arbitration” are considered costs of the arbitration; costs of “preliminary mediation or conciliation” will therefore fall outside the scope of recoverable costs.<sup>13</sup>

When considering the recoverability of costs relating to prior mediation or other ADR proceedings, one should bear in mind that ADR rules sometimes provide that each party shall bear its own costs related to the ADR procedure.<sup>14</sup> Obviously, in such cases, a party is unlikely to succeed in claiming its costs related to an unfruitful ADR process as legal costs in the arbitration. But in the absence of such a provision in the applicable ADR rules, it is not excluded that a party may claim compensation also for its ADR costs in the arbitral proceeding, either as part of its claim for legal costs or as a separate claim for damages.

The same probably applies to costs of unsuccessful settlement negotiations which pertain to the same issues that constitute the subject-matter of a later arbitration and which are incurred in an attempt to avoid arbitral proceedings. Unless otherwise agreed or provided, there should be no reason why a party could not claim compensation for its negotiation costs from its adverse party in the arbitration. Indeed, the ICC Cost Report mentions that there are “a number of ICC awards” ordering costs to be paid “for a party’s work and loss of time” in connection with “unsuccessful negotiations with a view to a settlement”.<sup>15</sup>

### (b) Costs of ancillary proceedings

A question sometimes arises whether a party may seek reimbursement of costs that are not directly related to the arbitration itself but to some ancillary proceedings. For example, a party may have resorted to a state court for

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13 See Hanotiau, Bernard, *The parties’ costs of arbitration*, in Derains, Yves – Kreindler, Richard H. (ed.), *Evaluation of Damages in International Arbitration*, Dossiers of the ICC Institute of World Business Law, ICC Publication No. 668, Paris 2006, p. 214. Hanotiau refers in this context to an ICC award in case No. 5896 of 1992, where the arbitral tribunal ruled that the costs of arbitration could not include any expenses incurred before the reception of the Request for Arbitration by the ICC Secretariat. In Hanotiau’s view, “[s]ome of these costs may be claimed as damages, for example if buyer, claimant in the arbitration, had to defend before criminal courts” because of the opposing party’s “fraudulent conduct before the acquisition”. *Ibid.*, p. 223, fn. 2.

14 See, e.g. Articles 13.3-13.4 of the Mediation Rules of the Finland Chamber of Commerce (2016).

15 See the ICC Cost Report, *supra* fn. 4, para. 99.

conservatory or other interim measures of protection before initiating the arbitration proceedings. Are the costs of such interim measure proceedings recoverable in the following arbitration?

According to Hanotiau, “[i]t seems that the allowability of these costs as costs of the arbitration is generally not accepted. They should be claimed and allocated in the relevant procedures. Some of them might also be claimed as damages.”<sup>16</sup> The answer may not be that straightforward, however, but will depend on the applicable cost regime. In some jurisdictions (including Finland) the law provides that the costs of interim measure proceedings shall be determined and allocated between the parties only in connection with the decision on the merits of the dispute, i.e., in a final award rendered by the arbitral tribunal (provided that there is a valid and binding arbitration agreement, and the party initiates an arbitration following the interim measure proceedings).<sup>17</sup> In such cases, a party is allowed to request reimbursement of its costs of ancillary interim measure proceedings only in conjunction with the arbitration.

This question was specifically addressed in a final award recently rendered in an FAI arbitration between two Finnish parties, A and B. The main issue in dispute concerned the allegedly unlawful termination of the parties’ co-operation agreement by B. Before the arbitration proceedings were launched, A sought an injunction from Finnish state courts prohibiting B from terminating the co-operation agreement. The application was dismissed in both the District Court and the Court of Appeal. In the meantime, A commenced FAI arbitration proceedings against B, requesting *inter alia* that the arbitral tribunal (i) declare that the termination had been unlawful and (ii) order B to pay to A the costs and expenses arising out of the injunction proceedings, together with default interest in accordance with the Finnish Interest Act.

The arbitral tribunal ultimately found that the termination of the co-operation agreement by B had been unlawful. As regards the compensation of A’s costs related to the injunction proceedings, the arbitral tribunal stated as follows (direct quotation from the award, with only the names of the parties anonymized):

“A has claimed that as B has not been entitled to terminate the Agreement, A has had the right to seek an injunction. According to A, the Arbitral Tribunal has the power to decide who will bear the costs and expenses arising out of or in connection with the injunction proceedings in accordance with Chapter 7, Section 10 of the Finnish Code of Judicial Procedure. This provision of law reflects the principle that the party who has lost the main proceedings shall also be ultimately liable for the costs and expenses arising out of or in relation to the injunction proceedings.

B has asserted that A should be liable to pay the costs as [it] has lost the injunction proceedings in both instances. The courts have found that no legal

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16 See Hanotiau, *supra* fn. 13, p. 215.

17 See, e.g. Chapter 7, Sections 10 and 11 of the Finnish Code of Judicial Procedure (4/1734, as amended). – Under Finnish arbitration law, state courts may order interim measures of protection even if the parties to an arbitration agreement have not specifically agreed to vest the courts with such power. This follows from Section 5(2) of the Finnish Arbitration Act (967/1992, as amended), which provides that a court of law may grant interim relief, including protective measures the court has the power to grant under Finnish law, irrespective of the arbitration agreement and whether arbitral proceedings are pending or not.

grounds for an injunction order have existed. A's injunction application has therefore not been necessary. (...) B has further asserted that the Arbitral Tribunal is in fact bound by the findings of the Court of Appeal, according to which there have been no legal grounds for an injunction order (...)

The Arbitral Tribunal first notes that Chapter 7, Section 10 of the Finnish Procedural Code provides that the question as to which of the parties in the injunction proceedings shall finally bear the cost, shall be resolved when ruling on the main issue in the main proceedings and provided that a party has so requested. Furthermore, Section 11 of the same Chapter provides that an applicant who has unnecessarily resorted to injunction proceedings shall be liable to compensate the opposing party for the damage caused by the precautionary measures and their enforcement, and to cover the expenses incurred. In other words, the question as to who is liable to pay the cost arising from the injunction proceedings is to be decided based on who wins the main issue and whether the injunction proceeding in the light of the outcome of the main issue has been unnecessary. (...) The Arbitral Tribunal also notes that under Finnish law, as a main rule, the binding finality of court decisions is usually limited to the outcome of the decision, not to its reasoning. Furthermore the findings of a court in an injunction proceeding are not legally binding on the court or arbitral tribunal that is competent to decide on the main issue (...) Accordingly, the decisive matter here is whether the injunction proceeding initiated by A was unnecessary in light of the outcome of this arbitration. The answer is no – B has terminated the Agreement without grounds and therefore A's attempt to obtain an injunction to try to prevent the unlawful termination was necessary. (...) For the reasons stated above, the Arbitral Tribunal finds A's claims justified and accepts them and orders accordingly."

(c) Success fees

Some cost items are even more controversial than the ones discussed above. In particular, legal scholars and arbitration practitioners disagree on the compensability of so-called "success fees". Broadly speaking, the term "success fee" refers to various arrangements under which a counsel for the party has agreed with the client that he or she is allowed to charge an enhanced rate if the case is won. Some argue that it should be possible to order the losing party to pay also success fees in appropriate circumstances.<sup>18</sup> Others disagree and claim that there is no room for the recoverability of success fees in arbitration (unless otherwise agreed by the parties).<sup>19</sup> In light of the lack of consensus on this topic,

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18 See, e.g. Webster, Thomas H. – Bühler, Michael W., *Handbook of ICC Arbitration: Commentary, Precedents, Materials*, Third Edition, Sweet & Maxwell 2014, para. 37-57: "If, under the law applicable to the arbitration, contingent or conditional fees are possible, there would be no issue of principle as to including them."

19 See, e.g. Hanotiau, *supra* fn. 13, p. 219: "It also happens from time to time that counsel claim, beyond their legal fees, a success fee. Such success fees are normally not included in the costs fixed by the Arbitral Tribunal. They are not properly defence costs, since they do not cover real costs exposed for the defence of the case. They are rather a reward granted in consideration of the success obtained in the defence of the case and should be fully supported by the party concerned."

prudent counsel representing a party on a success fee basis should keep track of their hours in order to prepare for the possibility that, at the end of the day, the arbitral tribunal will decide that it is the time spent on the case that should form the basis for an application for costs.<sup>20</sup>

It became apparent also during the preparation of the ICC Cost Report that different arbitration practitioners have different views on whether “success fees” should be recoverable or not. However, as to arbitral case law, “the Task Force did not see enough cases to be able to draw conclusions or infer trends” in relation to success fees.<sup>21</sup> In fact, there were only a few awards which considered success fees.

In one case the claimant had concluded a success fee agreement with its counsel, providing that the counsel would be paid 20% of the refunded costs and be recompensed if the arbitral tribunal ordered the respondent to make payments to the claimant. The tribunal calculated the success fee and found it reasonable.<sup>22</sup> – In another case, however, the arbitral tribunal rejected a claim for a 3.5% success fee, excluding it from the legal fees to be reimbursed.<sup>23</sup> – The ICC Cost Report also mentions one arbitral award rendered under the LCIA Rules, which dealt with a success fee arrangement. In that case, the arbitral tribunal “specifically noted that it would not award the costs of a party’s success fee because this was a matter between the party and its lawyers”.<sup>24</sup>

(d) Costs compensated by an insurer or other indemnifier

Another question that has been subject to debate is whether a party may claim reimbursement of costs that have been (or will be) compensated by an insurer or other indemnifier who is not itself a party to the arbitration. In his analysis of a sample of ICC awards, Hanotiau notes that this issue seems to have been addressed only once. In that case, the arbitral tribunal concluded that “such costs were properly recoverable in the arbitration, since counsel was retained, not by the insurer, but by respondents and that consequently the duty to pay counsel was incumbent on respondents; the counterpart being that respondents were obliged to reimburse the insurer all the corresponding costs paid by the losing party in performance of the award.”<sup>25</sup>

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20 See Webster – Bühler, *supra* fn. 18, para. 37-57, where it is noted that “[i]n most instances the law firm involved [and representing a party on a success fee basis] will also have the usual backup to show work carried out on an hourly basis. Therefore, the Tribunal will have the option of relying on the amount of time spent or on the fee arrangement in deciding the allocation of costs.”

21 See the ICC Cost Report, *supra* fn. 4, para. 17.

22 *Ibid.*, Appendix A, p. 26.

23 *Ibid.*

24 *Ibid.*, p. 31.

25 See Hanotiau, *supra* fn. 13, p. 216 (with reference to the ICC case No. 7006).

Apart from traditional “before-the-event” insurers, difficult questions of recoverability of costs may arise in the context of so-called third party funding. At the risk of oversimplification, the terms “third-party funder” and “after-the-event insurer” refer to a person or entity that provides funds (or other material support) to a party in an arbitration for the prosecution or defense of the dispute and that is entitled to receive a benefit (financial or otherwise) from an award rendered in the arbitration. The funder may also agree to provide security for the opponent’s costs, if so ordered by the arbitral tribunal.

The use of third party funding in international arbitration has grown considerably over the past few years. Originally focused on investor-state arbitration, third party funding is steadily spreading to international commercial arbitration too. However, legislation in many countries is silent as to the legality of third party funding in arbitration. In most European jurisdictions it is legal; the picture in the United States is varied but funders largely find it hostile. Further, in Hong Kong, the Law Reform Commission (LRC) recently conducted an in-depth study of third party funding in arbitration in order to clarify the legal situation in the territory.<sup>26</sup> In the meantime, the International Council for Commercial Arbitration (ICCA) and Queen Mary University of London have set up a joint Task Force on Third-Party Funding, which intends to look at the issue of regulation, and the viability of imposing international best practice guidelines, in the use of third party funding in international arbitration.

Third party funding gives rise to various complex questions, not least with respect to the determination and allocation of costs. In recognition of this, the ICCA-Queen Mary Task Force on Third-Party Funding established a special subcommittee to address a range of policy and practical issues concerning costs that arise with the participation of third-party funders, including the effect of third-party funders on the decisions of arbitrators on cost allocation and security for costs applications. The subcommittee published its draft report on 5 October 2015.<sup>27</sup> While a detailed analysis of issues related to third party funding falls outside the scope of this article, it merits mentioning that the subcommittee reached *inter alia* the following conclusions based on its review of a number of arbitration laws, arbitration rules and arbitral awards dealing with the awarding of costs in the presence of a third-party funder<sup>28</sup>: (1) When a party is funded by a third-party funder it typically assumes an obligation to reimburse the funder for the costs advanced, in case of successful recovery; this should be sufficient for tribunals to accept that a funded party has incurred costs. (2) The fact that a party’s costs have been funded should generally not be regarded as a relevant

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26 See Clanchy, James, *Third Party Funding in Arbitration*, paper presented at the 23<sup>rd</sup> Croatian Arbitration Days: “Access to Arbitral Justice”, Zagreb, 3 December 2015, para. 4; and the LRC report “Third Party Funding for Arbitration” released on 12 October 2016 (available at “[www.hkreform.gov.hk/en/docs/rtpf\\_e.pdf](http://www.hkreform.gov.hk/en/docs/rtpf_e.pdf)”).

27 The draft report is entitled “ICCA-QMUL Task Force on TPH in International Arbitration, Subcommittee on Security for Cost and Costs, Draft Report, 5 October 2015” (hereinafter the “ICCA-QMUL Draft Report”). It is available at “[www.arbitration-icca.org/media/6/09700416080661/tpf\\_taskforce\\_security\\_for\\_costs\\_and\\_costs\\_draft\\_report\\_november\\_2015.pdf](http://www.arbitration-icca.org/media/6/09700416080661/tpf_taskforce_security_for_costs_and_costs_draft_report_november_2015.pdf)”.

28 *Ibid.*, p. 3.

factor in determining whether or not costs are to be allocated based on the outcome of the case. (3) It is not appropriate for tribunals to award funding costs (such as a conditional fee, ATE premium, or litigation funder's return), as they are not procedural costs incurred for the purpose of an arbitration.<sup>29</sup> (4) In principle, a tribunal will lack jurisdiction to issue a costs order against a third-party funder.

(e) Internal legal and management costs

One further controversial question regarding the recoverability of costs in international arbitration is whether a party may claim compensation for its internal legal, management and other costs that have arisen in connection with the arbitral proceedings. This is not a trivial matter, considering that the hidden cost of such "management time" can be high particularly in large and technically complex disputes. In the words of one experienced arbitration practitioner with background as in-house counsel of a major international corporation:

"Nowadays, especially in a post-financial crisis context, in light of the need for companies to better control outside counsel costs and to tackle an ever-increasing complexity of disputes, both from a technical and legal perspective, in-house counsel, senior officials, and in-house specialists increasingly are taking a strategic role, before, during, and after the arbitration process. And the time that in-house counsel, managers, internal experts, and other employees involved need to dedicate to the arbitration translates into costs. (...) [B]eyond the specific role of in-house counsel, expenses unrelated to the representation of the parties can encompass the following: 1. executive time and disbursements; 2. administrative costs, i.e., salary costs, fees, and out-of-pocket expenses for: (i) factual research; (ii) in-house legal advice; (iii) outside experts on factual or non-legal issues; (iv) processing the arbitration; (v) witnesses who are employees."<sup>30</sup>

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29 Regarding the recoverability of funding costs, the ICCA-QMUL Draft Report also notes that "[t]he success portion payable to a third-party funder results from a trade-off between the funded party and the funder, where the funder assumes the cost and risk of financing the proceedings and receives a reward if the case is won. This agreement is not linked to the arbitration proceedings as such. The reasonable legal fees incurred by a funded party should remain recoverable. (...) Funding costs may be claimed as damages where permitted by the applicable substantive law. It is unclear whether such funding costs would meet the relevant tests for causation and foreseeability." *Ibid.*, p. 10.

30 See Cavalieros, *supra* fn. 9, p. 146, 148. Cavalieros further submits that "[i]n certain highly technical cases, internal experts tend to play a crucial role and the time dedicated to an arbitration is often substantial. (...) From a managerial standpoint, the time spent on an arbitration is not spent on day-to-day matters and the resulting loss must be taken into account. (...) The same holds true for executives, since the time dedicated to an arbitration of a certain magnitude usually encompasses studying the case, giving instructions to the company's various departments, participating in hearings, and more broadly, spending time on matters which may be considered disruptions of their normal business activity." *Ibid.*, p. 148-149.

Arbitration laws and rules are silent on the compensability of parties' internal legal, management and other costs, leaving the issue to the discretion of arbitral tribunals *in casu*. Traditionally, most arbitrators have taken the view that costs of in-house counsel and employees' time spent on the arbitration are not recoverable costs. The rationale for refusing to award the prevailing party such "internal costs" is typically the fact that salaried employees of a party are compensated out of the company's profits, meaning that their salary is payable whether they have worked on the arbitration or engaged in unrelated activities.<sup>31</sup> Therefore, internal costs have been regarded as part of the normal cost of running a business enterprise rather than recoverable costs of the winning party.<sup>32</sup>

More recently, attitudes towards internal party costs seem to have changed to some extent. It has been submitted that "[t]he current trend, although modestly implemented, is to treat in-house lawyers in a similar fashion to outside lawyers provided that their costs are provable and that they are incurred in connection with the arbitration."<sup>33</sup> However, in-house counsel costs aside, it still seems to be the case that recoverable party costs rarely include any allowance for the time spent on the case by senior officials, directors or employees of the parties themselves, or the indirect costs of disruption to their ordinary business. Although some commentators believe that a party should be able to recover the costs of such management time, most arbitrators are probably still unsympathetic to this type of claim, if only because "[m]anagement time and cost spent on an arbitration is difficult to quantify, and difficult to allocate".<sup>34</sup>

Nevertheless, as companies increasingly control how their time is valued, one may expect that claims for "management time" will be made more regularly, either as part of the parties' legal costs or as part of a claim for damages.<sup>35</sup> But in order to succeed, such claims must be sufficiently detailed and satisfactorily substantiated. This requires, among other things, that in-house counsel keep

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31 See Gotanda, John Yukio, *Supplemental damages in private international law: the awarding of interest, attorneys' fees and costs, punitive damages and damages in foreign currency examined in the comparative and international context*, Kluwer Law International 1998, p. 191 (with reference to an arbitral award rendered in the SMA case No. 3064, *Derin Shipping & Trading Ltd. v. Delphi Petroleum* (Nov. 10, 1993)).

32 See Blackaby – Partasides – Redfern – Hunter, *supra* fn. 5, para. 9.92.

33 See Webster – Bühler, *supra* fn. 18, para. 37-47. See also the *Chartered Institute of Arbitrators: Guidelines for Arbitrators on Making Orders Related to the Costs of the Arbitration* (hereinafter the "CI Arb Guidelines"), published in *Arbitration*, 2003, p. 139, para. 62, according to which "[a] successful party who employs in-house lawyers may in the discretion of the arbitrator recover his costs on the normal basis as if those lawyers were in independent practice"; and Hanotiau, *supra* fn. 13, p. 216, who submits that "the costs of the time of the parties' personnel, including in particular in-house legal staff (...) are still not so often claimed in arbitration procedures. When they are, especially in large cases, they seem to be increasingly accepted, at least in respect of in-house counsel to the extent that the costs can be satisfactorily substantiated."

34 See Webster – Bühler, *supra* fn. 18, para. 37-55.

35 See Cavalieros, *supra* fn. 9, p. 152.

track of their and other party representatives' time and involvement in an arbitration.<sup>36</sup>

The ICC Task Force on Decisions as to Costs studied also the compensability of internal costs incurred in connection with arbitral proceedings. The study found out that arbitration practitioners hold contrasting views on whether the costs of in-house counsel, management and employees are reimbursable or not.<sup>37</sup> As regards management costs, some arbitral tribunals have held that these should not be awarded to a prevailing party, because managing conflicts is part of the management's role. Other tribunals, however, have taken the opposite view on the grounds that the time spent on an arbitration is not spent on managing the company, and should therefore be included in the recoverable costs.<sup>38</sup> As a general remark, arbitral tribunals tend to pay close attention to the justification given, and proof offered, for parties' claims for internal legal and management costs when considering whether they should be awarded.<sup>39</sup>

The compensability of internal legal, management and other similar costs was much debated also during the preparation of the 2016 UNCITRAL Notes. While both the UNCITRAL Commission and the UNCITRAL Working Group II on Arbitration and Conciliation acknowledged that this was a controversial matter, a number of country representatives expressed weighty concerns that the non-inclusion of a reference to such in-house costs might be mistakenly conceived to mean that only the legal fees of external counsel would be recoverable. In the end, it was decided that the Notes should explicitly recognize that "[t]here is no principle prohibiting the recovery of in-house costs incurred in direct connection with the arbitration".<sup>40</sup>

### **3 Allocation of Costs Between the Parties**

#### **3.1 Specific Party Agreements on Cost Allocation**

National arbitration laws typically allow parties to agree on the method of allocating the costs of arbitration between themselves. However, specific pre-dispute agreements on the allocation of costs are rare. In some jurisdictions, they may be used in contracts between unequal parties. For example, in Finland,

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<sup>36</sup> *Ibid.*

<sup>37</sup> See the ICC Cost Report, *supra* fn. 4, para. 74-75 and Appendix A, p. 27.

<sup>38</sup> *Ibid.*, Appendix A, p. 27, where it is also noted that "[b]oth views have also been expressed in relation to employees' costs."

<sup>39</sup> *Ibid.*

<sup>40</sup> See the 2016 UNCITRAL Notes, *supra* fn. 7, para. 40, which also states that "[s]ome arbitral tribunals have awarded such [in-house] costs insofar as they were necessary, did not unreasonably overlap with external counsel fees, were substantiated in sufficient detail to be distinguished from ordinary staffing expenses and were reasonable in amount." Para. 41 goes on to suggest that "[i]f not adequately addressed by the agreement between the parties, the applicable arbitration law or arbitration rules, it may be useful for the arbitral tribunal to identify whether in-house costs incurred by the parties will be recoverable and, if so, what records will need to be submitted to substantiate such cost claims."

managing director agreements sometimes provide that, in the event of a dispute, any resulting arbitration costs shall be borne solely by the economically superior party (i.e., the company that is the managing director's employer) regardless of the outcome of the dispute.

Arbitral tribunals will generally honour party agreements on the allocation of costs, subject to any mandatory restrictions.<sup>41</sup> As a practical matter, any such party agreement should be carefully drafted in order to ensure that an arbitral tribunal will interpret and apply it in accordance with the parties' intent. For instance, if the parties to a managing director contract wish to agree that a company shall assume liability for all of the costs of the arbitration irrespective of the outcome of the proceedings, they are well-advised to spell out in the arbitration clause that this undertaking covers not only the arbitral tribunal's fees and expenses but also any administrative expenses to be charged by the arbitration institute under whose rules the dispute will be settled. – The following example serves to illustrate the problems that may arise in case of imprecise drafting.

A sole arbitrator appointed by the FAI Board recently rendered a final award in FAI arbitration proceedings where the arbitration clause contained specific provisions on the cost allocation between the parties. The main dispute concerned the allegedly unlawful termination of a managing director agreement and related compensation claims that Mr. X had brought against company Y in which X had previously served as managing director. The arbitration clause set out in the agreement read as follows: "Disputes that may arise out of this Agreement shall, if the parties fail to reach an agreement by negotiation, be finally settled by arbitration in accordance with the Arbitration Rules of the Finnish Central Chamber of Commerce. The arbitration shall be held in Helsinki by one (1) arbitrator and the arbitral proceedings shall be conducted in the English language. The Company shall pay the fee of the arbitrator."

Apart from his main claims for compensation, X requested that the arbitral tribunal order Y, alone, to bear both the sole arbitrator's fee and the administrative fee to be charged by the FAI based on the above-quoted provision according to which "the company shall pay the fee of the arbitrator". Y, in turn, requested that the arbitral tribunal either set aside or adjust said provision on the basis of Section 36 of the Finnish Contracts Act so that Y would not be liable to pay the costs of the arbitration in the relationship between the parties.

The sole arbitrator first noted that Y had failed to put forward any compelling arguments why the provision in question should be set aside or adjusted. In fact,

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41 An example of such a restriction may be found in Section 60 of the English Arbitration Act, which invalidates pre-dispute agreements on the allocation of costs between the parties; pursuant to said provision, a party agreement to the effect that one party is to pay the whole or part of the costs of the arbitration is only valid if it has been made after the dispute has arisen. The justification for this statutory prohibition lies in "the fact that a situation in which one party has agreed to bear all his own costs or a fixed portion of the costs of the arbitration has the effect of discouraging what might well be legitimate and substantial claims while a party with a lesser burden of costs under a predispute agreement may pursue frivolous or vexatious claims." See Power, Jenny W. T. – Konrad, Christian W., *Chapter IV: The Award – Costs in International Commercial Arbitration – A Comparative Overview of Civil and Common Law Doctrines*, in Klausegger, Christian – Klein, Peter (ed.), *Austrian Arbitration Yearbook 2007*, MANZ'sche Verlags- und Universitätsbuchhandlung 2007, p. 273.

the provision could not be considered exceptional or unduly burdensome to Y as similar provisions were quite frequently found in arbitration clauses used in managing director contracts. Further, the sole arbitrator pointed out that the main dispute that constituted the subject-matter of the arbitration proceedings – namely the allegedly unlawful termination of a managing director agreement and related claims for compensation – was exactly the type of dispute in view of which parties typically agree to insert specific cost allocation provisions in their arbitration clause. Therefore, the sole arbitrator found the provision valid and binding, and ordered Y to bear the arbitrator’s fee in the relationship between the parties.

The sole arbitrator reached a different conclusion, however, with respect to the administrative fee to be charged by the FAI. He noted that the cost allocation provision in the arbitration clause only mentioned the arbitrator’s fee, without making any reference to the administrative charges of the arbitration institute (in this case, the FAI) under whose rules the dispute was to be settled. In the sole arbitrator’s view, it was reasonable to interpret the wording of the cost allocation provision to the effect that Y had not agreed to assume any payment liability for such administrative charges irrespective of the outcome of a dispute, and that X must have understood that. Consequently, having regard to the fact that both X and Y had partly lost their case on the merits, the sole arbitrator ordered each of them to pay half of the FAI administrative fee in the relationship between the parties.<sup>42</sup>

### 3.2 *Principal Methods of Cost Allocation in the Absence of a Specific Party Agreement*

In the absence of a specific party agreement on the allocation of costs, many arbitral tribunals first look at the national law for guidance when resolving parties’ claims for the apportionment of arbitration costs, including their legal fees. But this is not necessarily an easy exercise. The first difficulty arises from the fact that there is no general consensus as to which law applies to the determination of costs in cross-border arbitrations. Some legal scholars and arbitration practitioners opine that the governing law of the contract should be applicable to cost decisions too.<sup>43</sup> Most commentators, however, seem to favour the view that it is the law of the seat that applies to the arbitral tribunal’s award of costs.<sup>44</sup> Either way, the tribunal should respect any mandatory requirements

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42 The above FAI arbitration case was first referenced in a case note published on the FAI website on 21 August 2015 (available at “[arbitration.fi/fi/2015/08/21/fai-award-dealing-with-specific-cost-allocation-provisions-in-the-arbitration-clause/](http://arbitration.fi/fi/2015/08/21/fai-award-dealing-with-specific-cost-allocation-provisions-in-the-arbitration-clause/)”).

43 This view is adopted also by certain U.S. state courts. See Born, *supra* fn. 5, p. 3099 (including the case law referred to in fn. 545); the ICC Cost Report, *supra* fn. 4, para. 51; Waincymer, Jeffrey, *Procedure and Evidence in International Arbitration*, Kluwer Law International 2012, p. 1194.

44 See the ICC Cost Report, *supra* fn. 4, para. 51; Waincymer, *supra* fn. 43, p. 1194.

applicable to costs under the *lex arbitri* (such as the above-mentioned Section 60 of the English Arbitration Act).<sup>45</sup>

In practice, using national law to resolve parties' cost claims in international arbitration can be a complicated, time consuming and expensive process. It may also lead to arbitrary and unpredictable results. Not surprisingly, therefore, arbitrators in international cases routinely issue cost awards without much, if any, discussion on the question of applicable law.<sup>46</sup>

Gotanda illustrates the complexity involved in selecting the law applicable to cost decisions with the following example: Assume that an arbitration takes place in a U.S. jurisdiction that considers the awarding of costs and fees to be governed by substantive law but, through a choice-of-law analysis, the substantive law to be applied to the dispute is Swedish law, which considers the awarding of costs to be procedural. Sweden, under its own choice-of-law rules, would presumably treat the question as subject to the law of the U.S. jurisdiction, resulting in an endless cycle of searching for the appropriate body of substantive law to apply. This cycle must ultimately be broken by an arbitrary choice.<sup>47</sup>

Arbitration rules provide another key starting point for the determination and apportionment of arbitration costs. Different rules have adopted different approaches to cost allocation. Some include an express yet rebuttable presumption that the successful party will be entitled to recover its reasonable costs,<sup>48</sup> while others merely confirm the arbitral tribunal's authority to apportion the costs of the arbitration between the parties, without prescribing any guidelines as to the manner in which the costs are to be allocated.<sup>49</sup> As a result of the wide discretion that most arbitration laws and rules grant to arbitral tribunals in apportioning the costs of the arbitration, it will often be difficult for the parties to predict, in any given case, exactly how an arbitral tribunal will ultimately resolve their claims for legal and other costs of the arbitration.<sup>50</sup>

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45 See the ICC Cost Report, *supra* fn. 4, para. 52. The Report also notes that “[t]ribunals (and parties) may further take guidance from other non-mandatory provisions in the arbitration statute of the *lex arbitri*.” *Ibid.*, para. 53.

46 See Born, *supra* fn. 5, p. 3094-3095; Gotanda, John Yukio, *Awarding costs and attorneys' fees in international commercial arbitration*, Michigan Journal of International Law, Fall 1999, p. 17-18.

47 See Gotanda, *supra* fn. 46, p. 17, fn. 85 (with references to other sources). See also Waincymer, *supra* fn. 43, p. 1194, fn. 10 (noting that “[a] conflicts methodology that seeks to begin with characterisation as either procedural or substantive could also lead to renvoi situations where, for example, the arbitration takes place in a seat which considers costs to be a matter of substantive law and the tribunal selects a substantive law that treats costs as a procedural matter.”)

48 See, e.g. Article 35(2) DIS Rules; Article 47.4 FAI Rules; Article 28(4) LCIA Rules; Article 40(1) Swiss Rules; Article 42(1) UNCITRAL Arbitration Rules (2010).

49 See, e.g. Article 37(5) ICC Rules; Article 33.2 HKIAC Rules; Article 34 ICDR Rules; Rules 35(1) and 37 SIAC Rules.

50 See the ICCA-QMUL Draft Report, *supra* fn. 27, p. 7.

It is important to recognize that any views that an individual arbitrator has on the apportionment of costs are influenced by his or her own national background, professional experience and personal biases. Broadly speaking, there are two diametrically opposed approaches to cost allocation in international arbitration: the first is to make the losing party bear all of the costs of the arbitration (also known as the “loser pays” or “costs follow the event” principle, or the “English approach”); and the second is to order the parties to bear their own legal and other costs and to share the arbitrators’ fees and expenses and the administrative charges equally regardless of the outcome of the case (also known as the “American rule”). The “loser pays” (or “costs follow the event”) method is adopted by many common and civil law jurisdictions, whereas the “American rule” is applied in countries like the United States, Japan and China.<sup>51</sup> Both approaches have been supported by various policy reasons, as explained below.

The purposes of the “costs follow the event” principle are said to include the following: (1) punishing the losing party, (2) indemnifying the winning party, and (3) deterring frivolous and bad faith litigation.<sup>52</sup> With that being said, while the “costs follow the event” rule traditionally had a punitive component, the modern justification for it is founded on the concept that if and to the extent that a claimant is entitled in law and justice to obtain a sum of money from another party, it should not have to suffer any expense (beyond the cost of addressing a simple demand) for being awarded it; and conversely, if a respondent is exposed to a claim which at the end of the day is deemed not to be founded in law and justice, it should not suffer any expense for defending the action.<sup>53</sup> Additionally, the “costs follow the event” rule is considered beneficial in that it serves to deter claims with little merit, and to discourage parties from exaggerating their claims and counterclaims, as each party will know that raising vexatious or low-quality claims may result in an award ordering that party to bear all of the costs of the arbitration.<sup>54</sup>

The “American rule”, on the other hand, is based on a different rationale. In litigation, it was first adopted in 1796 by the United States Supreme Court, which outlined the following justifications for it: (1) First, as the outcome of any litigation is often uncertain, it would be unfair to punish the losing party for merely defending or prosecuting a lawsuit. (2) Second, if losing parties were forced to bear their opponents’ costs and fees, “the poor might be unjustly

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51 See Frank, Susan D., *Rationalizing costs in investment treaty arbitration*, Washington University Law Review, 2011, p. 794 fn. 128; and Gotanda, *supra* fn. 46, p. 8-9, where it is also mentioned that “[m]ost countries (...) apply the principle that costs follow the event in arbitrations. For example, arbitration laws in England and Mexico specifically state that the arbitral tribunal shall award the costs of the arbitration on the general principle that costs follow the event. In Australia, Israel, and Turkey, arbitrators are given the power to allocate costs and fees and customarily award them against the losing party.”

52 See Gotanda, *supra* fn. 46, p. 5.

53 See Wetter, J. Gillis – Priem, Chart, *Costs and their allocation in international commercial arbitrations*, American Review of International Arbitration, 1991, p. 330; Gotanda, *supra* fn. 46, p. 6.

54 See Gotanda, *supra* fn. 46, p. 6.

discouraged from instituting actions to vindicate their rights”. (3) Third, shifting costs would likely increase “the time, expense and difficulties of proof” in any given case and “would pose substantial burdens for the administration of justice”.<sup>55</sup> – In the field of arbitration, one further argument put forth in support of the “American rule” is that “[b]oth parties have agreed by contract to create a special forum which is privately financed and that they should in fairness pay in equal measure the costs of setting in motion and operating such a consensual regime.”<sup>56</sup>

It is sometimes claimed that the “costs follow the event” method is becoming the predominant approach in international commercial arbitration.<sup>57</sup> A few practitioners go so far as to allege that it “may now be said (with some trepidation) to be a general principle of international law”.<sup>58</sup> The study undertaken by the ICC Task Force on Decisions as to Costs does lend some support to the conclusion that, in the arbitration practice, the “costs follow the event” principle is generally favoured over the “American rule”, at least in certain parts of the world. The ICC Cost Report records that “[d]espite the fact that the ICC and at least half of the other major institutional rules contain no presumption in favour of the recovery of costs by the successful party, it appears that the majority of arbitral tribunals broadly adopt that approach as a starting point, thereafter adjusting the allocation of costs as considered appropriate.”<sup>59</sup> By contrast, the “American rule” “was applied far less frequently by tribunals.”<sup>60</sup>

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55 See Gotanda, *supra* fn. 46, p. 11. See also Wetter – Priem, *supra* fn. 53, p. 330-331, where it is stated that the “American rule” “presumably is founded on the theory that if a case is such that a full proceeding before a neutral forum is required to resolve the dispute neither party is to blame, regardless of the actual outcome. Both parties are seen as to expound a legitimate cause in pursuing and defending the action and neither should be penalized for doing so by means of a post facto allocation of costs based on the final outcome (which, experience shows, may be fortuitous).”

56 See Wetter – Priem, *supra* fn. 53, p. 331.

57 See, e.g. the ICCA-QMUL Draft Report, *supra* fn. 27, p. 7; Lew – Mistelis – Kröll, *supra* fn. 9, para. 24-82 (“An emerging trend can be recorded for the arbitration tribunal to order the losing party to pay all or the substantial part of the costs of the arbitration. This tradition is widely accepted and can be seen, for example, in England in France and Switzerland.”); Savage, John – Gaillard, Emmanuel, *Fouchard Gaillard Goldman on International Commercial Arbitration*, Kluwer Law International 1999, p. 686 (“It is increasingly common for the arbitral tribunal to order the party which is defeated on the merits of a dispute to pay all or a substantial part of the costs of the arbitration. That is traditionally the practice in some common law countries and now frequently occurs when the arbitral tribunal has its seat in continental jurisdictions such as France or Switzerland.”); and the 2016 UNCITRAL Notes, *supra* fn. 7, para. 48, which provides that while “[t]here are various methods for allocating costs”, the “general rule” is that “costs follow the event, i.e., the costs of the arbitration should be borne by the unsuccessful party or parties in whole or in part.”

58 See Gotanda, *supra* fn. 46, p. 34; Goldstein, Marc J., *Some Thoughts About Costs in International Arbitration*, International Arbitration News, Summer 2003, p. 18.

59 See the ICC Cost Report, *supra* fn. 4, para. 13.

60 *Ibid.*, Appendix A, p. 21.

As to Finland, the FAI has not made any comprehensive study on how strictly the “costs follow the event” principle (as set out in Article 47.4 FAI Rules) is applied in the arbitration practice. Still, it is probably safe to say that it is not uncommon to see arbitral tribunals adjust the costs to be awarded to the prevailing party even in cases where the latter has fully succeeded on its claims on the merits.<sup>61</sup> A recent report prepared under the auspices of the Arbitration Institute of the Stockholm Chamber of Commerce shows that the situation appears to be, by and large, the same also in SCC arbitrations.<sup>62</sup> Out of the 80 SCC cases examined, 46% (37 cases) resulted in claims being fully (or almost fully) upheld, 35% (28 cases) resulted in claims being rejected and 19% (15 cases) resulted in partially awarded claims. In the 37 cases where the claimant obtained virtually a full victory, 65% of the tribunals applied full apportionment, ordering the respondent to bear all of the costs of the arbitration (including legal fees of the parties). Interestingly, however, in the 28 cases where the respondent won, only 39% of the tribunals ordered the claimants to bear all costs. Thus, arbitrators in SCC proceedings were more reluctant to apply full apportionment when the respondent prevailed than when the claimant won the case.<sup>63</sup>

Not everyone agrees that the “costs follow the event” approach is the general pattern in current international commercial arbitration, though. Some legal academics and arbitration practitioners argue that, while “conventional wisdom” holds that most arbitral tribunals apply the “costs follow the event” principle, “there exists very little empirical data on the subject.”<sup>64</sup> Gotanda submits that “[a] few limited studies have found that the conventional wisdom may not be

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61 This perception is based on the present author’s experience as chair of the FAI Board since the year 2013. – As for the various considerations that FAI arbitral tribunals have invoked to support a deviation from the strict application of the “costs follow the event” principle, *see* subsection 3.3 below.

62 *See* Salinas Quero, Celeste E., *Costs of arbitration and apportionment of costs under the SCC Rules*, February 2016, available at “[www.sccinstitute.com/media/93440/costs-of-arbitration\\_scc-report\\_2016.pdf](http://www.sccinstitute.com/media/93440/costs-of-arbitration_scc-report_2016.pdf)” (hereinafter the “SCC Cost Report”). The SCC Cost Report analyzes 80 SCC awards rendered in domestic and international commercial disputes between the years 2007 and 2014, with the aim of “increasing confidence in and transparency of” the SCC practice regarding the determination and allocation of the costs of arbitration (*see* p. 2).

63 *See* the SCC Cost Report, *supra* fn. 62, p. 10 and p. 13, where it is also mentioned that “[i]t appears that when the claimant is the losing party, tribunals are more inclined to have regard to other circumstances than just the outcome of the case in reaching their apportionment decisions.”

64 *See* Gotanda, John Yukio, *Attorneys’ Fees Agonistes: The Implications of Inconsistency in the Awarding of Fees and Costs in International Arbitration*, in Fernández-Ballesteros, M. Á. – Arias, David (ed.), *Liber Amicorum Bernardo Cremades*, La Ley 2010, p. 546. *See* also Blackaby, Nigel – Partasides, Constantine – Redfern, Alan – Hunter, Martin, *Redfern and Hunter on International Arbitration*, Fifth Edition, Oxford University Press 2009, para. 9.94 (“An arbitral tribunal in an international commercial arbitration is generally reluctant to order the unsuccessful party to pay the whole of the winning party’s legal costs.”); and Frank, *supra* fn. 51, p. 794-795 (“Despite suggestions that the Roman (i.e., ‘loser-pays’) approach is universal or ‘axiomatic,’ this claim is disputed; or it is at least worthy of empirical verification. The reality is that there are multiple acceptable methodologies for addressing costs. As existing scholarship has not empirically confirmed whether a particular practice is uniform, the possibility of variance must be acknowledged.”)

true, and recent decisions seem to indicate that awards of costs and fees are often arbitrary and unpredictable.”<sup>65</sup>

There are many reasons why arbitral tribunals may feel reluctant to allocate the costs of the arbitration between the parties even when authorized to do so by the parties or the applicable arbitration law or rules. Already a quarter-century ago, Redfern and Hunter asserted that arbitrators frequently refrain from apportioning the costs because “the practice under which an unsuccessful party is expected to pay or contribute towards the successful party’s legal costs is by no means a universal practice, either in international arbitrations or, indeed, in national systems of law”; further, “there is a real difficulty in international commercial arbitration in assessing what the level of allowable costs should be.”<sup>66</sup> This view is echoed by Craig, Park and Paulsson, who contend that “in many cases”, the arbitral tribunal will order “that each party will be responsible for its own legal costs, perhaps in order to avoid adding insult to injury.”<sup>67</sup> Carter, in turn, submits that “[a]rbitrators may consider it too draconian to impose the burden of an opponent’s attorney fees on a losing party, and thereby create a system that could chill the assertion of claims unreasonably, without evidence of additional culpability in a particular case. Some claims are deservedly brought, even if they are largely unsuccessful for sound factual or legal reasons that emerge after an airing by adversarial process.”<sup>68</sup>

At any rate, even where the “costs follow the event” approach applies as the main rule (either by virtue of the applicable arbitration law or arbitration rules), it is seldom construed very strictly. In practice, there are certain recurring factors which tend to affect the arbitrators’ decisions on the allocation of costs. These will be discussed in the following subsection 3.3.

### **3.3 Factors Affecting Cost Allocation Decisions by Arbitral Tribunals**

#### **(a) Relative success of the parties**

In international commercial arbitration, parties’ relative success on the merits of the dispute is often a major factor in the arbitral tribunal’s decision on the allocation of costs. Under the “relative success” approach, apportionment of costs is based on the relative success and/or failure of the various claims and defences put forth by each party. In a sense, the “relative success” method

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<sup>65</sup> See Gotanda, *supra* fn. 64, p. 546.

<sup>66</sup> See Redfern, Alan – Hunter, Martin, *Law and Practice of International Commercial Arbitration*, Second Edition, Sweet & Maxwell 1991, p. 408.

<sup>67</sup> See Craig, W. Laurence – Park, William W. – Paulsson, Jan, *International Chamber of Commerce Arbitration*, Third Edition, Oceana Publications, Inc. 2000, p. 395.

<sup>68</sup> See Carter, James H., *A Kiss For Arbitration Costs Allocation*, *American Review of International Arbitration*, 2012, p. 479.

represents a “middle” approach between the “American rule” and the “costs follow the event” principle.<sup>69</sup>

Experience tells that there are many arbitrations where a party succeeds with its claims only partially. For instance, a party may prevail on liability but fail on quantum; or it may succeed on liability but be awarded only a fraction of the damages sought. However, determining the relative success and failure of the parties is rarely so straightforward in modern-day commercial disputes; it can be particularly difficult in complex cases involving multiple causes of action, counterclaims, set-off claims, multiple contracts and/or multiple parties.<sup>70</sup> Consider, for example, a case where the “winner” has succeeded on a slim majority of the multiple issues in the dispute, or where the “loser” has in fact won on most of the issues, but lost on particular issues that render it the net financial “loser” because it is ordered to pay money to the “winner”.<sup>71</sup> How should the “relative success” of each party be measured in such a scenario? The question defies easy answer.

The findings of the ICC Cost Report support the view that the parties’ “relative success” on the merits plays an important role in the cost allocation by arbitral tribunals. The Report concludes that “[e]ven where the applicable rules or statute do not create a presumption that the successful party is entitled to recover its reasonable costs, awards show that when deciding on costs tribunals often pay at least some regard to the relative success or failure of the parties.”<sup>72</sup> The Report goes on to suggest that, when applying the “relative success” approach, arbitrators may take into account the relative success of the prevailing party by: (i) assuming that if the claimant or respondent succeeded on its core or primary claim, then it is entitled to all of its reasonable costs;<sup>73</sup> (ii) apportioning costs on a claim-by-claim or issue-by-issue basis according to relative success

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69 See Bondar, *supra* fn. 2, p. 51; and Kreindler, Richard H., *Final Rulings on Costs: Loser Pays All?*, paper presented at the ASA Swiss Arbitration Association Conference on “Best Practices in International Arbitration”, Zurich, 27 January 2006, p. 2-3, where the “relative success” approach is relabelled as “‘costs follow the event’ pro rata”. According to Kreindler, the underlying rationale for this approach is to deter “meritorious but quantitatively inflated claims”. *Ibid.*, p. 3.

70 See the ICC Cost Report, *supra* fn. 4, para. 59.

71 The above example is given in Wade, Shai – Clifford, Philip – Clanchy, James, *A Commentary on the LCIA Arbitration Rules 2014*, Sweet & Maxwell 2015, para. 28-017.

72 See the ICC Cost Report, *supra* fn. 4, para. 59.

73 *Ibid.*, para. 61. See also Goldstein, *supra* fn. 58, p. 20-21: “[I]n most arbitrations there is a claim which stands apart and above the others as the ‘nub’ of the parties’ dispute. The winner on this ‘main claim’ likely deserves to recover a substantial part of its legal costs from the loser, with an important proviso: that the winner on the ‘main claim’ did not overwhelm the other side and the tribunal with less meritorious claims, on which it did not prevail or which it eventually elected not to pursue, but which consumed disproportionate resources of the parties and the Tribunal during the course of the proceedings. Thus, it deserves to be recognized as a practical matter that an arbitration would have been entirely unnecessary if the losing party had complied with its obligations under the contract and applicable law rather than either commencing arbitration or forcing the opposing party to do so.”

and failure;<sup>74</sup> or (iii) apportioning success against the amount of damages originally claimed or the value of the property in dispute.<sup>75</sup>

In SCC arbitration proceedings, arbitral tribunals seem to measure parties' relative success from different points of view. Some tribunals look at the quantum of claims awarded; others prefer to make a thorough claim-by-claim analysis; and still others take a more general approach, focusing on the main issues on which a party prevailed.<sup>76</sup> As regards the LCIA practice, commentators have noted that LCIA arbitral tribunals "rarely engage in a detailed assessment of the relative success and failure of each and every claim or counterclaim made by a party"; rather, "most Tribunals tend to take a broad-brush approach to this question."<sup>77</sup>

There are few guidelines providing any concrete assistance to arbitrators on this particular point. It merits mentioning, however, that the CI Arb Guidelines do address various questions related to partial success in a way that may prove helpful to arbitral tribunals. They provide, *inter alia*, as follows:

"There can be many situations where a party who has succeeded on part of his case (and has consequently obtained an award) has not been wholly successful. In many instances it would not be fair to penalise a successful party for having raised issues or made claims which have ultimately been held to be unsustainable. If it was reasonable to raise these issues or claims and if they have not led to a substantial extra expenditure of time or money, then it may be fair to award the claimant the whole of his costs on the basis of the principle that 'costs follow the event'. (...) The position however may be different if a successful party has failed on issues on which substantial amounts of time and money were spent. In such circumstances it may be appropriate to award to the successful party the general costs of the arbitration (to include the cost of issues on which he has succeeded) but to award to the party who has been unsuccessful overall the costs of the issues on which that party has succeeded. Orders of this kind can be difficult to administer not only because it is often difficult to separate the costs attributable to particular issues but also because such an order may require the tribunal to quantify the recoverable costs of both the successful and the unsuccessful parties. It is usually therefore more convenient and practicable to make allowance for issues on which the successful party has failed, by awarding to the successful party a proportion only of his costs, after making a necessarily approximate attempt to ensure that the proportion awarded mirrors the degree overall to which the successful party has succeeded on the more important issues to which time and money were devoted. If this approach is adopted, the arbitrator must bear in mind, in assessing what proportion should be awarded to the successful party, that the party which was unsuccessful overall will not be making any recovery of the costs relating to the issues on which he succeeded."<sup>78</sup>

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74 See the ICC Cost Report, *supra* fn. 4, para. 61.

75 *Ibid.*

76 See the SCC Cost Report, *supra* fn. 62, p. 21.

77 See Scherer – Richman – Gerbay, *supra* fn. 9, p. 325.

78 See the CI Arb Guidelines, *supra* fn. 33, p. 133, para. 19-20.

## (b) Effect of party conduct

In addition to the outcome of the case and the parties' relative success on the merits, parties' behaviour in the course of the proceedings can factor into a final award of costs. If the successful party has conducted the arbitration in an improper or unreasonable manner, the arbitral tribunal may find it appropriate to deprive it of some or all of its costs that would otherwise have been recoverable.<sup>79</sup> Moreover, in certain cases, there may be "reasons for ordering the successful party to pay some or all of the unsuccessful party's costs" as well.<sup>80</sup> As noted in the ICC Cost Report, "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."<sup>81</sup>

That party conduct can have a bearing on the arbitral tribunal's apportionment of costs is no new phenomenon. In his article addressing various ICC cost awards, Hanotiau points out two cases already from the mid-1990s where the arbitral tribunal penalized inappropriate party behaviour in its award of costs.<sup>82</sup> These two examples show that, even before the adoption of the 2012 ICC Rules and their specific provisions on the effect of party conduct on the apportionment of costs,<sup>83</sup> ICC arbitral tribunals have not hesitated to award costs against parties who act in bad faith and seek to delay or derail the arbitral proceedings.

The final award in ICC case No. 7453 of 1994 found that "[t]he first defendant's conduct (...) was dilatory from the beginning until the end of the proceedings and that conduct was obstructive, and it was calculated to be obstructive, of the Tribunal in carrying out its task. Much extra and unnecessary work was caused thereby for everyone concerned. The first defendant must bear and pay the entire

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79 See, e.g. Rosell, José, *Arbitration Costs as Relief and/or Damages*, *Journal of International Arbitration*, 2011, p. 117, who refers in this context to English law: "[I]n English law, an arbitrator may deprive a successful party of some or all of its costs where the successful party has conducted his part in the arbitration improperly, as seen in *Matheson & Co. Ltd. v. A Tabah & Sons*. This will also be the case where the successful party has grossly exaggerated its claims or if the arbitral tribunal considers that the claimant's conduct has been unreasonable." Rosell argues that the same approach is generally applicable in international commercial arbitration under all systems where "arbitral tribunals are empowered to take account of the circumstances of the case to allocate legal costs." *Ibid.*

80 According to Rosell, "[t]he successful party may be required to pay all or part of the costs of the other party in cases where the successful party has been guilty of serious impropriety in the conduct of the proceedings, where issues are clearly distinct and the successful party on aggregate has failed on a number of distinct issues, or where the claimant's success is so trifling that it cannot reasonably be said that there was any real merit in prosecuting the arbitration. The successful claimant could also be ordered to pay the respondent's entire costs where the claimant recovered less than what was tendered by the respondent if there was a sealed offer." *Ibid.* (Regarding "sealed offers" and their effect on the allocation of costs, see subsection 3.3(d) below.)

81 See the ICC Cost Report, *supra* fn. 4, para. 78.

82 See Hanotiau, *supra* fn. 13, p. 224, fn. 25.

83 See, in particular, Article 37(5) ICC Rules.

costs of this arbitration (...) and also the entire legal costs of the claimant and out-of-pocket expenses of the counsel to the claimant (...).<sup>84</sup>

The final award in ICC case No. 8486 of 1996, in turn, condemned the defendant's procedural conduct by noting that "[i]n the present case, the defendant loses its counterclaim, but the claimant's claim is granted only in part (...) Nonetheless, the costs of the arbitration shall be borne totally by the defendant. According to the general principles of international arbitration law, the Arbitral Tribunal must take into account for its decision on costs not only the result of the proceedings but also the behaviour of the parties during the proceedings (...) According to good faith, the parties to an international arbitration must in particular facilitate the proceedings and abstain from all delaying tactics (...) The behaviour of the defendant during the entire proceedings did not comply with these requirements in any way. The defendant made none of the advance payments on costs which are required for the proceedings. Further, not only did it file its counterclaim belatedly, that is, only after the first draft of the terms of reference; it also refused to sign the terms of reference, which had been modified according to its wishes, notwithstanding a detailed explanation by the arbitral tribunal of the terms' meaning and legal consequences, and it did not participate in the oral hearings although it had been given sufficient notice to appear. Further, it also contributed to unnecessary delay and confusion in the proceedings by appointing the counsel at the last moment, that is, after the closing of the oral hearings and shortly before the expiry of the latest time limit for a statement concerning the minutes of the hearings; compounded by the counsel's renunciation to the mandate only a few days afterward. The proceedings were further complicated by the same counsel again accepting his mandate on the same day, a fact which had not been communicated to the arbitrator (...)."<sup>85</sup>

More recently, various institutional arbitration rules have introduced specific provisions that explicitly permit the arbitral tribunal to consider party conduct when allocating the costs of the arbitration between the parties. For example, Article 37(5) ICC Rules provides that, in making its decisions on costs, the arbitral tribunal may take into account such circumstances as it considers relevant, "including the extent to which each party has conducted the arbitration in an expeditious and cost-effective manner". Similarly, Article 28.4 LCIA Rules allows the arbitral tribunal the latitude to allocate costs in a way that penalizes parties for unreasonable conduct during the arbitration proceedings.<sup>86</sup> In the same vein, Article 15(7) Swiss Rules and Article 25.3 FAI Rules provide that all participants in the arbitral proceedings shall act in good faith and "make every effort to contribute to the efficient conduct of the proceedings" in order to

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84 See Arnaldez, Jean-Jacques – Derains, Yves – Hascher, Dominique, *Collection of ICC Arbitral Awards – Recueil des sentences arbitrales de la CCI, 1996-2000*, Kluwer Law International 2003, p. 111.

85 *Ibid.*, p. 331.

86 See Wade – Clifford – Clanchy, *supra* fn. 71, para. 28-017, according to which "[t]hat unreasonable conduct might take the form of advancing unmeritorious arguments or being unnecessarily aggressive (...) It might also include the unreasonable rejection of settlement initiatives or offers made during the proceedings (either on an open basis or on a 'without prejudice, save as to costs' basis)."

“avoid unnecessary costs and delays”. The FAI Rules also stipulate that if the arbitral tribunal determines that a party has failed to comply with its duties under Article 25.3, “the tribunal may, in addition to any other measures available under the Rules or otherwise, take such failure into account in its allocation of the costs of the arbitration.”

The above-mentioned Article 25.3 FAI Rules “reflects the fundamental principle that FAI arbitration is meant to be expeditious and cost-efficient. Parties are expected to facilitate the proceedings and abstain from all delaying tactics.”<sup>87</sup> In practice, there are myriad ways in which a party may fail to fulfil its good faith obligations under Article 25.3. Without purporting to be exhaustive, the following is a list of certain procedural manoeuvres that parties to international arbitration proceedings have occasionally applied for whatever reasons and which may, depending on the circumstances, be considered an infringement of a party’s procedural obligations under Article 25.3 FAI Rules, thereby resulting in negative cost consequences for that party: (i) bringing frivolous or excessively inflated claims; (ii) raising new and unsubstantiated issues at a late stage of the proceedings; (iii) abandoning claims very late in the proceedings; (iv) continuing to repeat arguments on issues that are already decided by the arbitral tribunal by separate awards or procedural orders; (v) failing to comply with important procedural time limits without a valid excuse; (vi) filing submissions or adducing new evidence outside the procedural timetable; (vii) bringing unmeritorious challenges against the arbitrator(s); (viii) refusing to pay one’s share of the advance on costs without good cause; (ix) refusing to abide by the arbitral tribunal’s document production order without good cause; (x) failing to appear at the hearing without good cause; (xi) causing the hearing to be postponed by informing at the last moment that a key witness, party’s counsel or other party representative is unable to attend at the time originally scheduled; (xii) making unsubstantiated allegations of bribery, fraud, corruption, or authenticity of documents; (xiii) engaging in unnecessarily aggressive advocacy, e.g., by intimidating witnesses or manifesting complete lack of professional courtesy; (xiv) employing “guerilla tactics” such as threat of publicity in press or other media, or instituting parallel court or other legal proceedings in an attempt to delay or derail the arbitration, or to cause the other party financial or other distress.<sup>88</sup>

While the use of cost allocation to encourage efficient conduct of arbitral proceedings has gained wide acceptance in recent years, it is still not consistently applied in the arbitration practice. As a general remark, when arbitral tribunals wish to use their discretionary powers to apportion the costs to sanction obstructive party behaviour, they should make that intention clear to the parties

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87 See Savola, Mika, *Guide to the Finnish Arbitration Rules*, Kauppakamari 2015, p. 405.

88 *Ibid.*, p. 405-406. – As noted, the above list does not purport to be exhaustive. Other examples of bad party behaviour include false submissions made to mislead the arbitral tribunal; deliberate falsification of documentary, witness or expert evidence; and deliberate undermining of the arbitral process through *ex parte* communications with arbitrators – or counsel appointments late in the proceedings – that give rise to a conflict of interest, forcing the arbitrator to resign or jeopardizing the enforceability of the award. See the ICC Cost Report, *supra* fn. 4, para. 78-85 and Appendix A, p. 23-24.

from the outset so that the sanction will have a proper pre-emptive effect. This is why the ICC Commission Report “Techniques for Controlling Time and Costs in Arbitration” proposes that an arbitral tribunal should consider informing the parties already at the first case management conference “that it intends to take into account the manner in which each party has conducted the proceedings and to sanction any unreasonable behaviour by a party when deciding on costs.”<sup>89</sup> This starting point may then be codified in the arbitral tribunal’s first procedural order, preferably to be issued by consent of the parties.<sup>90</sup>

Looking at the ICC arbitration practice, the ICC Cost Report confirms that arbitrators tend to take party conduct into account when deciding on the allocation of costs between the parties.<sup>91</sup> Similar observations are made in the SCC Cost Report. According to the latter, party conduct is the second most important factor affecting the cost allocation in SCC proceedings, just after the outcome of the merits of the case. The report identifies the following considerations based on which SCC tribunals have adjusted the costs to be awarded to the party who prevailed in the arbitration in full or partially: whether the claims raised were frivolous or legitimate; whether the parties conducted the arbitration efficiently, or whether any of them obstructed the proceedings through late jurisdictional objections, excessive document production requests or failure to comply with the orders of the arbitral tribunal; and whether excessive time was spent addressing issues not properly framed, or subsequently withdrawn or rejected by the tribunal.<sup>92</sup>

Interestingly, and in contrast to many other guidelines and academic writings on this subject, the CI Arb Guidelines caution against attaching relevance to party conduct in the determination of costs without sufficiently weighty grounds: “Generally an arbitrator should exclude from consideration any matter not strictly connected with the arbitration or with the claims made in it. A general disapproval

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89 See the ICC Commission Report “Techniques for Controlling Time and Costs in Arbitration”, Second Edition, 2012, § 82 (available at “[www.iccwbo.org/Advocacy-Codes-and-Rules/Document-centre/2012/ICC-Arbitration-Commission-Report-on-Techniques-for-Controlling-Time-and-Costs-in-Arbitration/](http://www.iccwbo.org/Advocacy-Codes-and-Rules/Document-centre/2012/ICC-Arbitration-Commission-Report-on-Techniques-for-Controlling-Time-and-Costs-in-Arbitration/)”). The report also notes that “[u]nreasonable behaviour could include: excessive document requests, excessive legal argument, excessive cross-examination, dilatory tactics, exaggerated claims, failure to comply with procedural orders, unjustified applications for interim relief, and unjustified failure to comply with the procedural timetable.” *Ibid.*

90 See Brocker, Stefan, – Löf, Kristoffer, *The Proceedings*, in Franke, Ulf – Magnusson, Annette – Ragnwaldh, Jakob – Wallin, Martin (ed.), *International Arbitration in Sweden – A Practitioner’s Guide*, Wolters Kluwer 2013, p. 213, para. 238.

91 See the ICC Cost Report, *supra* fn. 4, para. 16.

92 See the SCC Cost Report, *supra* fn. 62, p. 18. See also the 2016 UNCITRAL Notes, *supra* fn. 7, para. 48, which provides that “[i]n allocating costs, the arbitral tribunal may also consider certain conduct of the parties. Conduct so considered might include a party’s (i) failure to comply with procedural orders of the arbitral tribunal or (ii) procedural requests (for example, document requests, procedural applications and cross-examination requests), that are unreasonable, to the extent that such conduct actually had a direct impact on the costs of the arbitration and/or is determined by the arbitral tribunal to have unnecessarily delayed or obstructed the arbitral proceedings.”

of a claimant's conduct is still no ground for refusing to apply the general principle. The question whether it was reasonable for a party to raise pursue or contest a particular allegation is, on the other hand, a relevant matter and if the arbitrator considers that the hearing has been prolonged by unreasonable conduct of this kind he is fully entitled to make an order which reflects this view (e.g. by depriving the successful party of a proportion of its costs). But in deciding whether it was reasonable for a claimant to bring a particular claim the arbitrator should act by reference to objective criteria (in particular whether the claim has been successful) and should exercise great caution before depriving a successful claimant of his costs merely because of the arbitrator's personal feeling that the claim was immoral, lacked merit or for some other reason ought not to have been brought."<sup>93</sup>

The authority to sanction improper party conduct through allocation of costs raises the question whether that authority should be exercised only at the end of the proceedings, i.e., in conjunction with the final award, or whether it can be done already during the arbitration. It can happen that a party requests that the arbitral tribunal issue an interim cost award before the issue of a final award, for instance, if the party considers that its opponent has acted in bad faith (or otherwise unreasonably) in connection with a document production request or an application for interim relief. Whether or not the arbitral tribunal may proceed accordingly depends, first and foremost, on the applicable arbitration law and rules. Some institutional arbitration rules, such as the 2012 ICC Rules, specifically empower the arbitral tribunal to make decisions on costs (other than those fixed by the respective arbitral institution) "at any time during the arbitral proceedings".<sup>94</sup> But even where the rules applicable to any given arbitral proceedings are silent on the permissibility of interim cost awards, arbitral tribunals probably have the power to issue such awards, at least by consent of the parties and subject to any mandatory restrictions of the *lex arbitri*.<sup>95</sup>

Interim cost awards are not unproblematic, though. The first difficulty is a practical one: the use of interim cost awards presupposes that parties systematically record and document their fees and costs with regard to specific

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93 See the CI Arb Guidelines, *supra* fn. 33, p. 132-133, para. 18.

94 See Article 37(3) ICC Rules. – In addition to arbitration rules, certain arbitration laws confer the power to render interim awards of costs on the arbitral tribunal, for example, in relation to applications for interim relief. See, e.g. Article 17G of the UNCITRAL Model Law on International Commercial Arbitration (2006, as amended), which provides as follows: "The party requesting an interim measure or applying for a preliminary order shall be liable for any costs and damages caused by the measure or the order to any party if the arbitral tribunal later determines that, in the circumstances, the measure or the order should not have been granted. The arbitral tribunal may award such costs and damages at any point during the proceedings."

95 See also the 2016 UNCITRAL Notes, *supra* fn. 7, para. 49 (noting that "[d]ecisions by the arbitral tribunal on costs and their allocation do not necessarily need to be made in conjunction with a final award. Decisions on costs may be made at any time during the arbitral proceedings (for example, when a partial award or a procedural decision is rendered) as well as after the award on the merits has been rendered.")

motions. In the real world, they rarely do this.<sup>96</sup> The second problem is that an arbitral tribunal may feel uncomfortable granting an application for costs on an interim basis due to the reason that, while a party may prevail at an interim stage, it may ultimately fail to succeed on the merits of the dispute. Because of these difficulties, arbitrators are generally reluctant to make cost decisions during the course of the proceedings, preferring instead to defer any cost issues until the end of the case “when, it is to be hoped, the [arbitral tribunal] will be better able to look at the particular issue in the overall context of the whole arbitration.”<sup>97</sup> In any event, arbitral tribunals should not issue interim cost awards without careful consideration and prior discussion with the parties on the use and desirability of such awards.<sup>98</sup>

(c) Reasonableness of the costs claimed

Even where the *lex arbitri* or the applicable arbitration rules contain a rebuttable presumption that costs will be awarded to the successful party, that presumption normally applies only so far as the arbitral tribunal finds that the legal and other costs claimed by the prevailing party are “reasonable”.<sup>99</sup> This limitation is significant especially in cases where the losing party disputes the amount of its opponent’s cost claim. By contrast, if the losing party admits it, arbitrators in most jurisdictions are probably bound by the party’s statement, meaning that they must not award an amount less than admitted even if they consider the costs to be excessively high.<sup>100</sup> But in the more common scenario, where a party contests the opposing party’s cost claim, the arbitral tribunal has wide discretion

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96 See Ulmer, Nicolas, *The Cost Conundrum*, Arbitration International, 2010, p. 246.

97 See the CI Arb Guidelines, *supra* fn. 33, p. 133, para. 22. See also the ICC Cost Report, *supra* fn. 4, para. 39-40 and Appendix A, p. 3; and Ulmer, *supra* fn. 96, p. 245.

98 See also the ICC Cost Report, *supra* fn. 4, para. 32, where it is stated that “if costs are to be assessed on an interim basis”, the arbitral tribunal should discuss “the frequency of such assessments and the basis on which they are to be made” with the parties early on in the proceedings.

99 See, e.g. Article 47.2(e) FAI Rules; Article 33.1(e) HKIAC Rules; Article 37(1) ICC Rules; Article 34(d) ICDR Rules; Article 28(3) LCIA Rules; Article 50 SCC Rules; Article 38(e) Swiss Rules; Article 40(2)(e) UNCITRAL Rules (2010).

100 This is certainly the situation in Finland, and according to the leading Swedish commentators, the same holds true in Sweden; see, e.g. Heuman, Lars, *Arbitration Law of Sweden: Practice and Procedure*, JurisNet, LLC 2003, p. 569. Hanotiau, however, seems to be of a different opinion: “Whether the costs claimed by the parties and in particular their legal costs will be considered reasonable is a function of various factors, for example whether the submissions on costs have been disputed by the other party. But the fact that the submissions have not been disputed does not mean that the costs submitted will always be taken for granted by the Arbitral Tribunal. Arbitrators are auxiliaries of justice. They should make sure that the arbitration process is fair, including an award of costs.” See Hanotiau, *supra* fn. 13, p. 219.

to determine the amount of legal and other costs that may be considered “reasonable” and awarded to the prevailing party.<sup>101</sup>

How should arbitrators exercise their discretion? There are no set criteria for determining “reasonableness” either in the national arbitration laws or any institutional arbitration rules, and commentators have offered varying guideposts on this topic. Rosell, for example, submits that “[t]he test of reasonableness requires the arbitrators to determine whether the activities for which the costs were incurred were necessary in light of the complexity of the case, and, in the case of an affirmative answer, if the amounts claimed were reasonable”.<sup>102</sup> The ICC Cost Report, in turn, notes that “[a] common-sense approach is to assess whether the costs are reasonable and proportionate to the amount in dispute or value of any property in dispute and/or the costs have been proportionately and reasonably incurred.”<sup>103</sup> Yet another approach is to separate the requirement of “proportionality” from the general test of “reasonableness” and to treat both as independent factors affecting the arbitral tribunal’s award of cost.<sup>104</sup>

As evident from the above, “reasonableness” is a broad concept that leaves much room for interpretation. Still, commentators have stressed that the test of “reasonableness” should not be construed as an invitation to mere subjectivity. Below is an oft-quoted opinion by judge Howard Holtzmann in a case before the Iran-United States Claims Tribunal which seeks to define objective criteria for the assessment of “reasonableness”:

“Objective tests of reasonableness of lawyers’ fees are well known. Such tests typically assign weight primarily to the time spent and complexity of the case. In modern practice, the amount of time required to be spent is often a gauge of the extent of the complexities involved. Where the Tribunal is presented with copies of bills for services, or other appropriate evidence, indicating the time spent, the hourly billing rate, and a general description of the professional services rendered, its task need be neither onerous nor mysterious. The range of typical hourly billing rates is generally known and, as evidence before the Tribunal in various cases including this one indicates, it does not greatly differ between the US and countries of Western Europe, where both claimants and respondents before the Tribunal typically hire their outside counsel. Just how much time any

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101 See the ICC Cost Report, *supra* fn. 4, para. 15, where it is also stated that “[g]enerally, arbitrators appear to be relatively willing to deduct legal fees on the basis of unreasonableness. Even where arbitrators begin from the starting point that the successful party is entitled to recover its costs, they frequently adjust the amount recovered, by awarding less than the full amount of the fees claimed.”

102 See Rosell, *supra* fn. 79, p. 116.

103 See the ICC Cost Report, *supra* fn. 4, para. 63.

104 This is the approach adopted by the CIArb Guidelines, which provide as follows: “The requirement of ‘proportionality’ is as difficult to define as that of reasonableness. It can however be explained by the following example. Suppose a claimant in an arbitration advances a claim for £5,000 damages and is wholly successful in recovering that amount but, in so doing, incurs costs amounting to £100,000 and suppose each item, examined in isolation, is reasonable, still a bill of £100,000 might be regarded as wholly disproportionate to the sum involved and therefore not recoverable. The concept of ‘proportionality’ requires the tribunal to take a global approach.” See *supra* fn. 33, p. 136, para. 41.

lawyer reasonably needs to accomplish a task can be measured by the number of issues involved in a case and the amount of evidence requiring analysis and presentation. While legal fees are not to be calculated on the basis of the pounds of paper involved, the Tribunal by the end of a case is able to have a fair idea, on the basis of the submissions made by both sides, of the approximate extent of the effort that was reasonably required. Nor should the Tribunal neglect to consider the reality that legal bills are usually first submitted to businessmen. The pragmatic fact that a businessman has agreed to pay a bill, not knowing whether or not the Tribunal would reimburse the expenses, is a strong indication that the amount billed was considered reasonable by a reasonable man spending his own money, or the money of the corporation he serves.”<sup>105</sup>

Other commentators are less optimistic than Holtzmann when it comes to finding generally acceptable yardsticks for the assessment of “reasonableness” of the parties’ legal costs in international arbitration. Gill, for instance, asserts that “[c]onsistency is problematic given the broad range of economic climates in which different counsel acting in international arbitrations operate and the different levels of complexity of individual cases.”<sup>106</sup> Added to that, “a party’s willingness to spend money on the case may have a huge influence on the costs incurred and a party whose limited spending budget is reflected in their choice of counsel and approach to the case may feel aggrieved at having to pay the costs of an opponent who chose considerably more expensive representation and conducted the arbitration proceedings without constraint.”<sup>107</sup> By the same token, it strikes as unsatisfactory to prevent the economically superior party from selecting “lawyers of its choice” merely “due to the impecuniosity of its counterparty”.<sup>108</sup>

The disparity between the costs claimed by each party was specifically addressed in the study undertaken by the ICC Task Force on Decisions as to Costs. The ICC Cost Report notes that arbitral tribunals have “often concluded that although one party’s costs were significantly higher than those of the other party, they still remained reasonable. In other words, imbalance does not automatically signify unreasonableness.”<sup>109</sup> For example, in one case, the arbitral tribunal found that while “there was a great disparity between the amounts claimed by each side for legal costs”, both amounts were reasonable since “the disparity reflected the parties’ differing strategies”.<sup>110</sup> Further, in another case, the arbitral tribunal stated that “[a] strong indication that the

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105 Quoted from Blackaby – Partasides – Redfern – Hunter, *supra* fn. 5, para. 9.97.

106 See Gill, Judith, *Choices and Strategies: A Rules-Based Look at Different Approaches to International Arbitration in the Wake of UNCITRAL’s 2010 Rules Revision Relating to Costs*, in van den Berg, Albert Jan (ed.), *International Arbitration: The Coming of New Age?*, ICCA Congress Series No. 17 (International Arbitration Conference, Singapore, 10-13 June 2012), Kluwer Law International 2013, p. 302.

107 *Ibid.*

108 *Ibid.*

109 See the ICC Cost Report, *supra* fn. 4, Appendix A, p. 26.

110 *Ibid.*

claimant's costs were reasonable was the fact that the respondent's costs were higher."<sup>111</sup>

When assessing whether the parties' claims for legal costs are reasonable, the arbitral tribunal will need to consider also the *proof of costs*. Not infrequently, a party may argue that its opponent's claim for legal costs is insufficiently substantiated. Different arbitrators will take a different stance on such allegations. Some give considerable weight to the way in which fees and costs are substantiated, and will require that counsel for the parties produce time-sheets itemizing the individual measures on which their cost claims are based and indicating the time spent on each of these measures, with the related fees. Others follow a more liberal policy in this respect. Depending on the arbitrators' individual expectations and preferences, a party who fails to provide a sufficiently documented cost claim may be penalized by being awarded only a part of its legal costs even though it may have fully succeeded on its core claims.

Born contends that "[i]n general, arbitral tribunals do not require, and prefer for the parties not to present, detailed documentary or other evidence about their respective costs. Although tribunals may demand more extensive evidence, summary statements of the costs billed by and paid to legal representatives are ordinarily sufficient."<sup>112</sup> Personally, I think this is something of an overstatement. The truth is that practices vary on this point: although "[m]any arbitrators would appear to simply accept a general fee note from counsel", "[o]thers have rejected [cost] claims for lack of supporting evidence."<sup>113</sup> Given the wide range of approaches, "a tribunal ought to advise the parties of its predisposition" already at an early stage of the proceeding, and the parties should "ensure that there is sufficient documentary evidence to support ultimate costs claims that may be brought."<sup>114</sup>

(d) Effect of settlement offers

The question of the impact of settlement offers on the allocation of costs is much debated in the legal literature. Considering that an amicable settlement can result

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111 *Ibid.*

112 See Born, *supra* fn. 5, p. 3096. See also Webster – Bühler, *supra* fn. 18, para. 37-44 (noting that "[u]sually, Tribunals are reluctant to review in detail the time spent by the lawyers in preparing the case.")

113 See Waincymer, *supra* fn. 43, p. 1236. See also Craig – Park – Paulsson, *supra* fn. 67, p. 394 (stating that "[r]ecoverable party costs should be considered as similar to an item of damage suffered due to the breaches of contract or tortuous behaviour of the other party, and the amounts claimed should be made the subject of proof like any other claim for damages.")

114 See Waincymer, *supra* fn. 43, p. 1236. See also the ICC Cost Report, *supra* fn. 4, para. 77 (noting that "[a]ny uncertainty or potential difficulties created by different expectations between parties and/or the tribunal regarding the required level of substantiation can be avoided if discussed early in the proceedings.")

in significant savings of time and costs, strong policy reasons speak in favour of taking reasonable settlement offers into account in the determination and allocation of costs between the parties. The CI Arb Guidelines explain the underlying logic as follows: “The making of a settlement offer during the course of an arbitration may have an important bearing on any award of costs. If there has been no settlement offer, it will be hard for an unsuccessful respondent to dispute that it was necessary for the claimant to incur the costs of the arbitration in order to obtain the monetary award which has been made. By contrast if the respondent has offered to settle in the course of the arbitration and the claimant eventually recovers less than the sum which was offered, it will have been a waste of time and money to pursue the arbitration for the period after the time when the settlement offer was made and could have been accepted.”<sup>115</sup> Consistent with this line of thinking, it has been suggested that “if a party rejects a settlement offer of X and goes on to obtain an award of X (or less than X), it generally should not be entitled to amounts expended after rejecting the settlement offer, and should instead be liable for the other party’s costs for that period.”<sup>116</sup>

However, the use of settlement offers to reduce costs of the arbitration may not be so straightforward in all circumstances. In some jurisdictions, legal privilege or confidentiality issues may preclude the parties from invoking, and arbitral tribunals from considering, settlement offers for the purposes of cost allocation.<sup>117</sup> But in the absence of any statutory or other mandatory restrictions, an arbitral tribunal may wish to take the issue up with counsel for the parties at the outset of the proceedings, e.g., at the first case management conference. Occasionally, parties themselves may wish to suggest – or the arbitral tribunal propose on its own motion – the use of so-called “sealed offer” procedure with a view to limiting unnecessary arbitration and related costs.

A “sealed offer” (often referred to as a “Calderbank letter” or “Calderbank offer”) is a mechanism used in a number of common law jurisdictions to encourage settlement by imposing cost penalties on those who continue with the proceeding in the face of a reasonable offer to settle. It is intrinsically linked with, and partly developed to attenuate, the seemingly harsh “English” approach that “costs follow the event”. In brief, it is a written offer to settle a dispute which has been referred to arbitration at a certain amount, made “without prejudice save as to costs”. What distinguishes the sealed offer from an ordinary offer to settle a dispute is the cost penalty which the arbitral tribunal is expected to attach to it against the offeree who does not accept the offer and fails subsequently to achieve a more favourable award by continuing the proceedings. The offer is “sealed” and

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115 See the CI Arb Guidelines, *supra* fn. 33, p. 134, para. 24.

116 See Born, *supra* fn. 5, p. 3100, fn. 549.

117 See the ICC Cost Report, *supra* fn. 4, para. 96 (noting that “[i]n some legal systems, a settlement offer is confidential between counsel, and therefore if not accepted cannot be referred to elsewhere.”)

“without prejudice” because it is not to be brought to the attention of the arbitral tribunal before the determination of the substantive dispute.<sup>118</sup>

Some commentators welcome the “sealed offer” procedure in international arbitration as a useful device to cap the potential costs of the parties.<sup>119</sup> Others remain skeptical, maintaining that while the system has an attractive logic, it is difficult to apply in international arbitration. As Ulmer puts it: “A central problem is logistical: in English and much other litigation, a case is decided and then costs are taxed. In international arbitration, costs are generally awarded in the final award; only occasionally, and in particularly large cases, are there separate cost hearings and awards. The arbitrators cannot take into account a sealed offer in assessing costs unless they are aware of the offer, and a respondent is not generally going to show the offer to the tribunal unless damages have been determined. Thus, to use the ‘sealed offer’ mechanism in international arbitration essentially requires a ‘bifurcation’ so that substantive claims are decided in an award, and then costs are fixed in a final ‘costs award’. This procedure, of course, itself means further hearings, awards and, ironically, costs.”<sup>120</sup>

(e) Other factors

One more issue that merits mentioning is that, when allocating the costs of the arbitration, arbitral tribunals sometimes treat the parties’ legal costs differently than the other costs of the arbitration, i.e., the arbitrators’ fees and expenses and the administrative charges. Why is that?

There seems to be no clear and satisfactory answer to this question. On the contrary, logic would imply that, when allocating the costs of the arbitration between the parties, arbitral tribunals would treat different cost items in a consistent fashion. In other words, absent any statutory provisions or party agreement to the contrary, the same rules of allocation should apply to both the legal costs of the parties, on one hand, and the arbitrators’ fees and expenses and the administrative charges, on the other hand.<sup>121</sup>

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118 See Anjomshoaa, Poupak, *Cost awards in international arbitration and the use of “sealed offers” to limit liability for costs*, *International Arbitration Law Review*, 2007, p. 39-40; Rosell, *supra* fn. 79, p. 116, 121-122; Ulmer, *supra* fn. 96, p. 245.

119 See Anjomshoaa, *supra* fn. 118, p. 40-41, 43; Rosell, *supra* fn. 79, p. 122, 126; and Wetter – Priem, *supra* fn. 53, p. 334 (noting that “[t]he well-entrenched English doctrines and practices of sealed offers, both on the merits of monetary claims and with respect to costs, are very useful devices having the effect of limiting unnecessary arbitration. It is believed that the methods developed in this area in England should be carefully studied and implemented in other jurisdictions.”)

120 See Ulmer, *supra* fn. 96, p. 245.

121 See Smit, Robert H. – Robinson, Tyler B., *Cost Awards in International Arbitration: Proposed Guidelines for Promoting Time and Cost Efficiency*, *American Review of International Arbitration*, 2009, p. 280. See also Wetter – Priem, *supra* fn. 53, p. 329. – Notwithstanding the foregoing, national arbitration laws occasionally provide for different treatment of different cost items. Arbitral tribunals shall of course comply with any such provisions of the *lex arbitri*, to the extent they are deemed mandatory. See Gotanda, *supra* fn. 46, p. 9-10 (including fn. 38), where the author notes that, in a few countries (such as Indonesia), arbitrators may award only the procedural costs against the losing party, but

Nevertheless, arbitral tribunals often derogate from this starting point, usually without giving any express reasons for their departure.<sup>122</sup> Indeed, some commentators have noted that, while “procedural costs” (i.e., the arbitrators’ fees and expenses and the administrative charges) tend to be awarded to a prevailing party, arbitral tribunals are “appreciably less inclined to award party costs to a prevailing claimant, and even less so to a prevailing respondent.”<sup>123</sup> Smit and Robinson assume that this trend may be caused by the arbitral tribunal’s “desire not to discourage novel or meritorious – even if unsuccessful – claims and defenses, and to achieve overall ‘fairness,’ given that party costs can be considerably higher than procedural costs and may even approach or exceed the amounts at stake or ultimately awarded to a party in the arbitration.”<sup>124</sup> Furthermore, in certain cases, it may result from the “party-appointed arbitrator dynamic” that prevails at the end of a case: costs can become part of bargaining among arbitrators about the overall result of the dispute, and “a party-appointed arbitrator may be willing to join in an award finding against the party that appointed that arbitrator only if the award does not also allocate attorneys’ fees against that party.”<sup>125</sup>

While there is much to be said about the correctitude of this kind of behaviour on the part of a party-appointed arbitrator, there is little that the parties can do to prevent it as they are not privy to the arbitral tribunal’s deliberations. Unfortunately, such improper practices add to the criticism that cost decisions in international arbitration suffer from lack of transparency and predictability.

#### **4 Addressing User Concerns: Lack of Predictability and Transparency of Cost Decisions**

The broad discretion that national arbitration laws and arbitration rules grant to arbitral tribunals in making decisions on costs has its consequences. It is hard to deny that arbitrators sometimes misuse that discretion by giving only cursory

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they are prohibited from awarding compensation to the winning party for its legal costs. Also, there are a limited number of other countries (such as Greece and Ukraine) where arbitral tribunals are generally reluctant to award attorneys’ fees, although not strictly speaking legally precluded from doing so.

122 See Anjomshoaa, *supra* fn. 118, p. 39 fn. 9; Derains, Yves – Schwartz, Eric A., *A Guide to the ICC Rules of Arbitration*, Kluwer Law International 2005, p. 371 (“Arbitral Tribunals may also consider that administrative costs and arbitrators’ fees and expenses, on the one hand, should be treated differently than legal and other possible expenses, on the other.”); and the ICC Cost Report, *supra* fn. 4, Appendix A, p. 20 (“Tribunals did not always apportion both the legal and arbitration costs in the same manner.”)

123 See Smit – Robinson, *supra* fn. 121, p. 271.

124 *Ibid.*, p. 272.

125 *Ibid.* See also Carter, *supra* fn. 68, p. 477; and Hanotiau, *supra* fn. 13, p. 221 (noting that “[o]ne should also be candid and recognize that the final allocation of costs is in some cases an argument put forward by a member of the panel to have him accept a result that is different from the one he wanted to reach, with the consequence, for example, that the claimant wins the case in totality but is not awarded the totality of its costs.”)

attention to cost issues, determining and allocating the costs almost as a matter of routine and without engaging in any detailed substantive analysis. This has led to complaints that the awarding of costs in international commercial arbitrations is often “arbitrary” and “unpredictable”.<sup>126</sup>

Over the last few years, an increasing number of international arbitration practitioners have voiced concerns about the lack of uniform practice for awarding costs. It has been pointed out that predictability is essential to a fair and well-functioning adjudicatory system: the fact that similarly situated parties may have received vastly different cost awards can undermine their confidence in, and the legitimacy of, arbitration as a means of resolving business disputes.<sup>127</sup> Additionally, the impossibility of predicting with any degree of certainty the outcome of the arbitral tribunal’s award of costs “discourages parties from settling cases and thus reduces the efficiency of the system.”<sup>128</sup>

Different ideas have been proposed to address this dilemma. Some argue that a more systematic use of the “costs follow the event” rule – according to which the loser should bear all of the costs of the arbitration – would be welcome as it would increase the predictability and transparency of cost decisions. However, the “costs follow the event” method is no panacea in international commercial arbitration already for the reason that it cannot be applied in the not infrequent cases where there is no clear winner and loser. Such situations call for a more nuanced approach.

This is where the so-called “Welamson doctrine” comes into the picture. Named after its principal advocate – former Swedish law professor and Supreme Court justice Lars Welamson – the doctrine is designed to allocate costs between the parties on a sliding scale in proportion to the relative success of the claims submitted before the court or arbitral tribunal. According to Gotanda, the “Welamson doctrine” “appears to be the more theoretically sound approach and has been applied in many countries in both arbitration and civil litigation.”<sup>129</sup> One of its advantages is that it encourages all parties to make their claims as realistic as possible, thereby facilitating amicable settlements.<sup>130</sup>

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126 See Born, *supra* fn. 5, p. 3094-3095; Carter, *supra* fn. 68, p. 477; Frank, *supra* fn. 51, p. 775; Gotanda, *supra* fn. 46, p. 1, 4; Gotanda, *supra* fn. 64, p. 539-540; Smit – Robinson, *supra* fn. 121, p. 267; and the “IBA Guidelines for Drafting International Arbitration Clauses” (adopted by the IBA Council on 7 October 2010), para. 68 of which reads as follows: “Costs (eg, arbitrators’ fees and expenses and, if applicable, institutional fees) and lawyers’ fees can be substantial in international arbitration. It is rarely possible to predict how the arbitral tribunal will allocate these costs and fees, if at all, at the end of the proceedings. Domestic approaches diverge widely (from no allocation at all to full recovery by the prevailing party), and arbitrators have wide discretion in this respect.”

127 See Gotanda, *supra* fn. 46, p. 25-26; Gotanda, *supra* fn. 64, p. 550.

128 See Gotanda, *supra* fn. 64, p. 550.

129 See Gotanda, *supra* fn. 46, p. 39.

130 *Ibid.* See also Frank, *supra* fn. 51, p. 793-794; Wetter – Priem, *supra* fn. 53, p. 274.

Professor Welamson originally developed the doctrine in the mid-1960s.<sup>131</sup> In the late 1980s, after becoming a judge in the Supreme Court of Sweden, he published the following graphical representation of his doctrine:<sup>132</sup>

0/6	1/6	2/6	3/6	4/6	5/6	6/6
- full compensation	- 2/3	- 1/3	set-off	+1/3	+ 2/3	+ full compensation

Wetter and Priem explain that the above figure “is meant to illustrate the following thesis in a simple case in which the plaintiff claims a specific amount of money, e.g. 120,000. This sum is deemed to be ‘the amount in dispute,’ which is one of the key determinants. If judgment is given for the full amount of 120,000, the defendant is ordered to pay all of the plaintiff’s costs. If judgment is given for only 50 percent, i.e. 60,000, then the costs of the plaintiff are set-off against those of the defendant, and thus each party is ordered to pay all of his own costs. If the court awards one-sixth of the amount, i.e. 20,000, to the plaintiff, then the plaintiff is ordered to pay not only all of his own costs but two-thirds of the costs of the defendant. Conversely, if the amount awarded is five-sixths of the amount claimed, i.e. 100,000, then the defendant is ordered to pay two thirds of the plaintiff’s costs.”<sup>133</sup>

Other academics have suggested different approaches. Gotanda proposes two separate courses of action depending on the amount in dispute. For small value and mid-sized value claims – which Gotanda defines as those cases where the monetary interest at stake is less than USD 200,000 – he proposes “a presumption of automatic fee-shifting”, meaning that “the loser will automatically pay all costs and fees in these cases, absent extraordinary circumstances.”<sup>134</sup> However, if the amount in dispute exceeds USD 200,000, then the proceedings would be bifurcated and the arbitral tribunal would issue its decision on costs separately from, and subsequent to, the award resolving the main claims. Depending on the circumstances, the arbitral tribunal would have the discretion “to order (1) separate briefing of the issues relating to claims for costs and fees, particularly in light of the decision resolving the main claims, (2) oral argument on the claims for costs and fees, either in person or via telephone

131 See Welamson, Lars, *Varför gynna käranden? Principer om rättegångskostnad under debatt*, in *Festskrift tillägnad Karl Olivecrona, Nordstedts*, Stockholm 1964, p. 684-709.

132 See Welamson, Lars, *Svensk rättspraxis: Civil-och straffprocessrätt 1980-1987*, Svensk Juristidning, 1989, p. 531.

133 See Wetter – Priem, *supra* fn. 53, p. 275.

134 See Gotanda, John Yukio, *Part I: International Commercial Arbitration, Chapter 7: Bringing Efficiency to the Awarding of Fees and Costs in International Arbitrations*, in Kröll, Stefan M. – Mistelis, Loukas A. (ed.), *International Arbitration and International Commercial Law: Synergy, Convergence and Evolution*, Kluwer Law International 2011, p. 151-152.

or video conference, or (3) both briefing and argument before issuing a separate decision on costs and fees.”<sup>135</sup>

Gotanda asserts that the adoption of the “costs follow the event” rule in small value cases will make cost awards more uniform and bring about predictability, because “[t]he presumption of the CFE approach lets parties know at the outset that the loser will likely pay the winner’s costs and fees. Such predictability is important as it enables parties to more accurately evaluate their cases and, as a result, facilitates settlements.”<sup>136</sup> However, when the amount in dispute is higher, “the efficiency of the presumptive CFE method gives way to the need for a separate process” where the parties can thoroughly plead their cost claims in light of the outcome of the main dispute, hoping “to garner a decision granting them a high percentage of their [cost] claims, making the amount spent on the secondary litigation [on costs] negligible.”<sup>137</sup>

Neither the “Welamson doctrine” nor the two-tier approach suggested by Gotanda provides a universal remedy for all difficulties that may arise in the determination and allocation of costs in international arbitration. The former works chiefly in simple cases where the main issue is quantum, rather than in those where the arbitral tribunal needs to consider both liability and quantum.<sup>138</sup> On the other hand, Gotanda’s two-tier model is rather mechanistic, and the proposed bifurcation of arbitral proceedings into “main proceedings” and “secondary litigation” on costs may be too cumbersome and inefficient for all disputes exceeding the suggested threshold of USD 200,000 (or any other relatively low amount that the threshold might be set at). Moreover, neither one of these approaches adequately takes into account the effect of improper party conduct on the apportionment of costs.

Consequently, some arbitration practitioners have developed even more sophisticated approaches to the awarding of costs in international commercial arbitration. In their well-known article on the subject, Smit and Robinson contend that “international arbitration’s characteristics are more amenable to the ‘loser pays’ principle of civil-law jurisdictions (and England) than to the American rule of each party paying its own party costs.”<sup>139</sup> However, while advocating the “loser pays” rule as a starting point, they suggest that it should be adjusted on an incident-by-incident basis to take account of numerous considerations such as the efficiency of proceedings, cost-incurring conduct of the parties, relative merits of the parties’ positions on the issues that required the arbitral tribunal’s resolution, and the like.<sup>140</sup> In fact, the proposed

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135 *Ibid.*, p. 152.

136 *Ibid.*, p. 153.

137 *Ibid.*, p. 154.

138 See Gotanda, *supra* fn. 46, p. 41; Wetter – Priem, *supra* fn. 53, p. 276.

139 See Smit – Robinson, *supra* fn. 121, p. 274.

140 *Ibid.*, p. 279-283.

“Smit/Robinson Guidelines for awarding costs in international commercial arbitration” include no less than 25 paragraphs or subparagraphs providing detailed considerations that arbitrators are asked to balance. The model is undoubtedly quite convoluted, and one “may question how much practical advice the typical arbitrator can derive from such a complicated matrix.”<sup>141</sup>

In his rebuttal to “Smit/Robinson Guidelines”, Carter disputes the underlying premise that the “loser pays” principle is “well suited to international commercial arbitration”.<sup>142</sup> He argues that, at least in the United States, arbitrators in international commercial disputes tend to start from the “presumption of no shifting” of either procedural costs (i.e., the arbitrators’ fees and expenses and the administrative charges) or attorneys’ fees regardless of the outcome of the case.<sup>143</sup> However, “arbitrators may and sometimes do shift some or all of the procedural costs because a non-prevailing party has unduly complicated the case with tenuous claims or applications.”<sup>144</sup> In Carter’s view, this should normally suffice to encourage efficient party conduct.<sup>145</sup> But shifting attorneys’ fees – which “regularly run into the millions of dollars on each side” – merely on the grounds that one party has prevailed on the merits of the dispute is “a more significant sanction”, and it “may not be reasonable in light of the need to protect parties’ rights to have their cases heard.”<sup>146</sup> Arbitral tribunals should therefore consider it only in the rare cases of manifestly unreasonable party conduct “that arbitrators find outside the normal bounds of adversary proceedings.”<sup>147</sup>

One of the latest contributions to the discussion on cost allocation in international commercial arbitration comes from Nowaczyk and Czech.<sup>148</sup> They start from the “bold application” of the “costs follow the event” (or, as they call it, the “winner-takes-all”) rule, but propose a few refinements to it. In particular, the authors suggest that the “event” which serves as a reference point for allocating costs should be specified more precisely.<sup>149</sup> To achieve this, the

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141 See Carter, *supra* fn. 68, p. 478.

142 *Ibid.*

143 *Ibid.*, p. 479-480. See also Kreindler, *supra* fn. 69, p. 14: “Overall, if a general statement had to be made, then it would be that ‘costs follow the event’ largely prevails in English and Continental European arbitration practice and the ‘American Rule’ largely prevails in US domestic and much US-seated international arbitration practice.”

144 See Carter, *supra* fn. 68, p. 479.

145 Carter justifies his view by noting that “[a]lthough the procedural costs ordinarily will not be as large as a party’s attorney fees, they can be substantial and offer a potential sanction that may be meaningful but not disproportionate in view of many arbitrators’ desire not to penalize assertion of all legitimate arguments.” *Ibid.*

146 *Ibid.*, p. 480.

147 *Ibid.*

148 See Nowaczyk, Piotr – Czech, Konrad, *Rethinking costs and costs awards in international arbitration: a call for less criticism of arbitration costs, but improvement of costs allocation practices*, ASA Bulletin, 2015, p. 494-513.

149 *Ibid.*, p. 496, 509.

authors consider it “important to reach within each arbitral institution a general compromise on the issue of who should be considered as the ‘winner’ of international arbitration carried under the auspices of the said institution and whether its identification can depend on parties’ success in arguing different issues secondary to the main claim”.<sup>150</sup> In addition, “within each institution there should be a clear compromise on what constitutes costs that are recoverable”.<sup>151</sup> The authors then proceed to suggest that “perhaps a claimant should be considered to be the winning party if he or she recovers, for example, more than 50% of the initial monetary claim (or some other substantial portion of its monetary claim indicated in a given set of institutional directions; e.g. 75% of the pursued monetary claim).”<sup>152</sup> Each arbitral institution could fix the applicable percentage, as well as the cost items that are generally deemed recoverable, following “an open query” addressed to it.<sup>153</sup>

Personally, I remain unconvinced of the benefits of the ideas put forth by Nowaczyk and Czech. One may legitimately ask whether any mechanical application of a mathematical criterion truly meets the users’ expectations and is well-suited to complex commercial disputes submitted to international arbitration. Also, it is questionable how eager most arbitration institutes would be to issue directions on what is to be understood by a “successful party” or “recoverable cost items” in any given arbitral proceedings. This might well be regarded as an improper intrusion into, and interference with, the domain of the arbitral tribunal.

## 5 Concluding Remarks

Costs matter.<sup>154</sup> Having said that, while complaints about arbitration costs are often founded, one ought to recognize that the resolution of large and complex commercial disputes will not – and cannot – become cheap. Even with the best-managed procedure, a major international arbitration will take time, require resources and generate costs. It is illusory to think that arbitration could be returned to some (real or imagined) past simplicity where disputes were (allegedly) resolved in cooperative procedures very fast and with minimal costs.<sup>155</sup>

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150 *Ibid.*, p. 507.

151 *Ibid.*

152 *Ibid.*, p. 510.

153 *Ibid.*

154 As one leading international arbitration practitioner put it: “When an international commercial dispute arises, the costs of resolving it may be as important to the parties as the merits of the claims themselves. Indeed, the cost of resolving a dispute may suffice, in some circumstances, to discourage a claim’s prosecution in a formal proceeding or to thwart its proper defense.” See Schwartz, Eric A., *The ICC Arbitral Process, Part IV: The Costs of ICC Arbitration*, in *The ICC International Court of Arbitration Bulletin*, May 1993, p. 8.

155 See Ulmer, *supra* fn. 96, p. 221, 248.

Still, as the costs of arbitration have increased, the question of what costs are recoverable – and how costs should be allocated between the parties – become all the more important. As to the method of allocation of costs, I doubt that the “loser pays all” principle is sufficiently widely accepted so as to serve as a universal starting point even in cases resolved under those arbitration laws and rules which do not provide that the unsuccessful party shall, as a rule, bear the costs of the arbitration in the relationship between the parties. Since cultural perspectives differ on this issue, one probably should not seek to impose any “one-size-fits-all” approach to cost recovery.<sup>156</sup> The better approach is to leave the arbitral tribunal sufficient discretion when making its award of costs *in casu*, with a view to taking into account all the case-specific circumstances such as the degree of success of each party and the effect of party conduct on the apportionment of costs.

Parties are generally free to agree on the recoverability and allocation of costs already before the arbitration is commenced, or after the proceedings have been launched. But as a practical matter, pre-dispute agreements on costs are rare, and it will often be unrealistic to assume that parties could spontaneously reach agreement on any cost issue once the dispute has matured into a full-fledged arbitration. Probably the way forward is to have the arbitral tribunal initiate a dialogue with the parties, at the earliest feasible time, with the aim of obtaining agreement on various issues relating to cost recovery.<sup>157</sup> A list of issues that an arbitral tribunal may wish to discuss with counsel for the parties at an early stage of the proceedings (preferably already in connection with the first case management conference) includes (but is not necessarily limited to) the following:<sup>158</sup>

- (i) What cost items are recoverable, in particular, whether parties may claim reimbursement of their internal legal and management costs;
- (ii) What records the arbitral tribunal should require of the parties to substantiate their respective cost claims;
- (iii) What method of cost allocation the arbitral tribunal should apply, in particular, how should it assess the relative success of the parties and the effect of their procedural behaviour on the apportionment of costs;
- (iv) Whether and how the arbitral tribunal should be informed about settlement offers that were better than, or came close to, the amount ultimately awarded by the tribunal and that would have saved significant costs and time had they been accepted;

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156 On this point, I subscribe to the views expressed by Kreindler, who submits that “[t]here is no true ‘consensus’ in international arbitration practice that ‘Loser Pays All’ should apply. (...) The solution lies not in the imposition or aspiration of a harmonized or homogenized approach to cost recovery to try to fit ‘all disputes,’ since no such one-size-fits-all approach (...) is neither warranted nor feasible.” See Kreindler, *supra* fn. 69, p. 14.

157 *Ibid.*, p. 17.

158 *Ibid.* See also the ICC Cost Report, *supra* fn. 4, para. 32.

- (v) Whether any of the parties is supported by a third-party funder and, if yes, what implications this may have for the arbitral tribunal's decisions on costs;
- (vi) Whether any of the counsel is representing a party on a success fee basis and, if yes, whether any success fees should be recoverable or not;
- (vii) The format and timing of the parties' cost submissions.<sup>159</sup>

Addressing cost issues at the outset of the proceedings has various benefits. Most importantly:

- (i) It ensures that the parties will be fully informed about the arbitral tribunal's approach to costs. This removes uncertainty and improves predictability.
- (ii) Also, the parties will be fully informed about the arbitral tribunal's expectations on submissions relating to costs. This, in turn, will allow the parties to properly record time spent and costs incurred during the arbitration, particularly with respect to internal legal and management costs.
- (iii) Finally, knowing that obstructive or otherwise unreasonable behaviour is likely to be penalized in the arbitral tribunal's allocation of costs may cause the parties to re-assess their litigation strategies and serves to encourage fair and efficient party conduct throughout the proceedings.<sup>160</sup>

The approach suggested above is not endorsed by all arbitration practitioners, though. Carter, for example, claims that it is "unrealistic" to encourage arbitrators and parties to discuss in detail any issues related to cost allocation at the outset of the arbitration; instead, "consideration of cost allocation" should be reserved "for the end of a case, where it belongs". This is allegedly because "[a]t the start of a case, the arbitrators naturally seek to establish a cooperative tone in their relations with counsel and one another and to encourage the parties' counsel to do the same. This facilitates agreement on scheduling and sometimes other aspects of the case. Devoting a part of the initial conference in a case to a discussion of how the arbitrators intend to sanction inefficiency or bad conduct through costs allocation would create quite a different atmosphere, and it would

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159 In most cases, arbitral tribunals will request the parties to file simultaneous cost submissions, typically after the final hearing has been completed or once the parties have submitted their written post-hearing briefs (if any). Alternatively, parties may include their cost claims (together with relevant invoices and other supporting documentation) as part of their post-hearing briefs. It is also customary to allow each party to briefly comment on the cost submission of the other party. *See* Hanotiau, *supra* fn. 13, p. 218; Savola, *supra* fn. 87, p. 313-314; Webster – Bühler, *supra* fn. 18, para. 37-44.

160 *See* the ICC Cost Report, *supra* fn. 4, para. 33; Kreindler, *supra* fn. 69, p. 17-18.

require all members of a tribunal to agree at the outset on a costs approach. That might not be realistic or a profitable use of time when arbitrators may just be getting acquainted with one another and some of the arbitrators may not wish to devote much thought to costs before learning about the case. The facts relevant to cost allocation may take on a different light at the end of the arbitration, depending on how it has progressed, and costs should be evaluated then.”<sup>161</sup>

While Carter’s position is not entirely without merit, I disagree with a view that international arbitrators would be generally unwilling or ill-advised to take cost issues up with the parties at an early stage of the proceedings. Besides, such discussion is hardly inconsistent with the arbitral tribunal’s attempt to create a good working relationship and atmosphere with the parties from the outset. Much will depend on the attitudes of individual arbitrators and counsel for the parties, and there have been cases where proactive tribunals have successfully applied the methods outlined in this article.<sup>162</sup>

In some arbitrations, it may be practical to divide the proceedings into two parts so that the outcome on the merits is known to the arbitral tribunal and the parties before the question of costs is addressed.<sup>163</sup> Admittedly, bifurcating cost issues from the merits makes sense as it allows the parties to argue their positions in light of the outcome of the main claims, which is typically the key factor in determining how costs should be apportioned. Equally important, it will allow the arbitral tribunal to make a more informed overall assessment of the cost claims, which will reduce arbitrary cost awards and ultimately improve predictability. Another advantage of this procedure is that it gives the parties the opportunity to address any special factors that may affect an award of costs, such as bad procedural behaviour or settlement offers made in the course of the proceedings.<sup>164</sup>

Bifurcation of the proceedings is commonplace in England but considered problematic in those legal systems, and under those arbitration rules, which require that costs be fixed in a final award. In such cases, it is customary for an arbitral award to deal at one and the same time both with the parties’ substantive claims and the question of costs.<sup>165</sup> Yet even under these regimes, it is possible to bifurcate the arbitration proceedings so that the substantive claims are resolved first in an interim award and the costs are addressed only subsequently

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161 See Carter, *supra* fn. 68, p. 480.

162 See also the ICC Cost Report, *supra* fn. 4, para. 34, where it is stated that any “concerns that raising the question of costs at the outset of the proceedings could cause discomfort for the tribunal or the parties, or limit the tribunal’s ability to be flexible in dealing with unexpected events during the course of the proceedings” may be alleviated “if the tribunal clearly indicates to the parties that it will take into account the arbitration as a whole when deciding on costs, and ensures that it has full discretion to do so under the applicable rules.”

163 See Wetter – Priem, *supra* fn. 53, p. 334.

164 See Gotanda, *supra* fn. 134, p. 153-155. Gotanda also notes that dealing with cost claims after the arbitral tribunal has resolved the main claims is not a new procedure; however, although it has been employed by some tribunals, its use is not widespread and the circumstances under which it has been used are not uniform. *Ibid.*, p. 152, fn. 57.

165 See Rosell, *supra* fn. 79, p. 122; Wetter – Priem, *supra* fn. 53, p. 334.

in a final award; effectively, this will reduce what was intended to be a “final” award on the merits of the case to the status of a partial award.<sup>166</sup> Whether or not bifurcation is appropriate depends on the circumstances and should be discussed between the parties and the arbitral tribunal on a case-by-case basis. Generally speaking, it is best suited to large and complex disputes where the costs are high and the parties are therefore comfortable with bearing the extra expenses that a separate process on costs will generate.<sup>167</sup>

The above suffices to show that there are various means to increase the transparency, predictability and overall quality of cost awards in international commercial arbitration. But they are not easily put into practice in an environment where too many arbitrators still treat cost issues as of secondary interest. To counter the growing criticism about costs, arbitral tribunals should acknowledge that costs are often of great importance to the parties and that arbitrators should therefore address cost claims as meticulously as they assess the merits of the case, providing sufficiently detailed and readily comprehensible reasons for their decisions on the determination and allocation of costs. In short, what is needed is not so much any major reform of the existing arbitration rules or guidelines, but more attentive, alert and informed arbitrators willing to discharge their duties in a way that is commensurate to the parties’ expectations and consistent with the best professional standards.

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166 See Blackaby – Partasides – Redfern – Hunter, *supra* fn. 5, para. 9.95; Rosell, *supra* fn. 79, p. 122; Wetter – Priem, *supra* fn. 53, p. 334.

167 See Gotanda, *supra* fn. 134, p. 153: “The greater the size of the claim for costs and fees, the more likely parties will expend resources to litigate the issue.”