

Harbour Lecture

Decision on Costs – A Mind field for Arbitrators and Uncertainty for Participants
Neil Kaplan – 19 October 2016

It is an honour to be invited to give the first Harbour Lecture in Hong Kong. This series began in London. Lord Neuberger in his inaugural lecture traced the history of champerty and maintenance and showed its dilution over the years leading to its virtual abolition in 1967. He focused rightly on access to justice.

Lady Justice Gloster in a second lecture, concentrated on improving the procedures and techniques in the Commercial Court. Lord Dyson and Lord Justice Jackson concentrated on the elaborate and substantial changes that have been introduced in the United Kingdom to control the cost of civil litigation.

In this lecture I intend to concentrate on costs in arbitration, particularly commercial and treaty arbitrations.

I have always been bemused by the fact that costs always come at the end of courses and books on arbitration. It should really come at the beginning because if a party cannot afford to fund the arbitration, perhaps it should not start. This is particularly so where they face the risk of paying their opponents costs if they fail. This raises the access to justice issue focused on by Lord Neuberger and of course in recent times we have seen third party funders such as our hosts tonight fill this gap. The publication last week of Law Reform Commission Report on Third Party Funding recommends a change in the law relating to champerty and maintenance and it is most welcome.

Lawyers have always been the butt of jokes and none more so than in relation to fees. Gabriel Harvey put it succinctly in 1597 when he said “*no fee, no law*”. I also understand that there is a bird, called a lawyer bird, so named because of its long bill, and I will not go anywhere near Shakespeare on this point.

I was prompted to choose this topic because during the last two years I have had to deal with claims for costs (for both sides) totalling in excess of \$75 million. Joint claims for costs totalling \$30-50 million are not uncommon. These are very large sums of money the entitlement to which is often based on a broad brush approach in the exercise of a wide discretion.

The responsibility for dealing with such large claims for costs on a wholly discretionary basis is becoming a heavy and onerous task.

When I started at the Bar I was always reminded “*do not forget to ask for costs*”. To forget to do that today would be unimaginable.

The two major criticisms of arbitration are the cost and the delay. In a sense they are inter-related. The longer a case lasts the more it is likely to cost.

Delays are frequently blamed on the arbitrators. I think this is grossly unfair.

If it takes two major international law firms with a cast of scores of lawyers and paralegals between them, two years or more to prepare a case with long pleadings or memorials, huge lawyer drafted witness statements, long and complicated experts’ reports followed by an oral

hearing and post-hearing written submissions running to hundreds of pages, is it not just a little bit rich to expect three arbitrators with very little assistance to get the Award out in three or sometimes even six months. Parties, Counsel and arbitral institutions have to appreciate that what comes out depends on what goes in.

This lecture is not intended to deal with case management. Sensible case management can of course reduce time and thus would have an effect on costs. However, that lecture is for another day.

It is surprising to note that elaborate mechanisms are set up to control costs in litigation, but no such system exists in international arbitration. With the exception of the English statute, which I will discuss briefly later on, most arbitration statutes are silent on the method of cost allocation and the decision is left to the broad discretion of the arbitrators while giving primacy to the parties' agreement.¹ Nevertheless, briefly, it should be mentioned that some domestic laws may limit the effect of the parties' agreement. In England and Hong Kong, for example, parties' agreements regarding costs are not valid unless made after the dispute arises.²

In England, in litigation involving less than 10 million pounds, the Jackson Reforms introduced a system of costs budgeting.³ I do not see how this worthwhile domestic system would be useful in international arbitration, where in any event a large number of cases exceed 10 million pounds. However, as I will explain later, the tribunal does have a vital role in interfacing with the parties on the question of costs at the earliest stage of the arbitration.

In the same vein, most international arbitration rules confer on the Tribunal a very wide discretion as to whether costs should be awarded, to whom and in what amount.

For instance, ICC Rule 37.4 states that "*the final award shall fix the costs of the arbitration and decide which of the parties shall bear them or in what proportion they shall be borne by the parties.*" Rule 37.5 further states that "[i]n making decisions as to 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."

HKIAC Rule states as follows:

33.2 The arbitral tribunal may apportion all or part of the costs of the arbitration referred to in Article 33.1 between the parties if it determines that apportionment is reasonable, taking into account the circumstances of the case.

33.3 With respect to the costs of legal representation and assistance referred to in Article 33.1(e), the arbitral tribunal, taking into account the circumstances of the

¹ Gary Born, *International Commercial Arbitration* (Kluwer Law International, 2014), 3086 (stating that "virtually all developed legal regimes will give effect to the parties' agreement with regard to awards of legal costs in international arbitration").

² Section 60 of the English Arbitration Act 1996 ("An agreement which has the effect that a party is to pay the whole or part of the costs of the arbitration in any event is only valid if made after the dispute in question has arisen"); Sections 74(8)&(9) of the Hong Kong Arbitration Ordinance ("(8) A provision of an arbitration agreement to the effect that the parties, or any of the parties, must pay their own costs in respect of arbitral proceedings arising under the agreement is void. (9) A provision referred to in subsection (8) is not void if it is part of an agreement to submit to arbitration a dispute that had arisen before the agreement was made.")

³ See Civil Procedure Rules, Part 3 (The Court's case management powers). See also Lord Justice Jackson's Report: 'Review of Civil Litigation Costs: Final Report' (December 2009).

case, may direct that the recoverable costs of the arbitration, or any part of the arbitration, shall be limited to a specified amount.”

This is also true for investment arbitration.

Article 61(2) of the ICSID Convention provides:

“In the case of arbitration proceedings the Tribunal shall, except as the parties otherwise agree, assess the expenses incurred by the parties in connection with the proceedings, and shall decide how and by whom those expenses of the members of the Tribunal and the charges for the use of the facilities of the Centre shall be paid. Such decision shall form part of the award.”

Rule 28(1) of the ICSID Arbitration Rules provides:

“Without prejudice to the final decision on the payment of the cost of the proceedings the Tribunal may, unless otherwise agreed by the parties, decide... with respect to any part of the proceedings, that the related costs... shall be borne entirely or in a particular share by one of the parties.”

However, some arbitration rules, such as those of UNCITRAL, CIETAC, LCIA,⁴ and the PCA include a rebuttable presumption that the successful party may recover costs from the unsuccessful party.

For instance, the 2012 PCA Rules, Article 42(1) states *“the costs of arbitration shall in principle be borne by the unsuccessful party or parties. However, the arbitral tribunal may apportion each of such costs between the parties if it determines that apportionment is reasonable, taking into account the circumstances of the case.”*

For example, the 2010 UNCITRAL Rules provide that *“The arbitral tribunal shall fix the costs of arbitration in the final award and, if it deems appropriate, in another decision”* (Article 40(1)).⁵

⁴ 2014 LCIA Rules, Article 28. Especially, Article 28(1): *“The costs of the arbitration other than the legal or other expenses incurred by the parties themselves (the ‘Arbitration Costs’) shall be determined by the LCIA Court in accordance with the Schedule of Costs. The parties shall be jointly and severally liable to the LCIA and the Arbitral Tribunal for such Arbitration Costs.”*; Article 28(4)&(5): *“28.4. The Arbitral Tribunal shall make its decisions on both Arbitration and Legal Costs on the general principle that costs should reflect the parties’ relative success and failure in the award or arbitration or under different issues, except where it appears to the Arbitral Tribunal that in the circumstances the application of such a general principle would be inappropriate under the Arbitration Agreement or otherwise. The Arbitral Tribunal may also take into account the parties’ conduct in the arbitration, including any cooperation in facilitating the proceedings as to time and cost and any non-cooperation resulting in undue delay and unnecessary expense. Any decision on costs by the Arbitral Tribunal shall be made with reasons in the award containing such decision.*

28.5. In the event that the parties have howsoever agreed before their dispute that one or more parties shall pay the whole or any part of the Arbitration Costs or Legal Costs whatever the result of any dispute, arbitration or award, such agreement (in order to be effective) shall be confirmed by the parties in writing after the Commencement Date.”

⁵ The 2010 UNCITRAL Rules define, in Article 40(2), costs as follows: *“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*

They also elaborate that:

“42(1) The costs of the arbitration shall in principle be borne by the unsuccessful party or parties. However, the arbitral tribunal may apportion each of such costs between the parties if it determines that apportionment is reasonable, taking into account the circumstances of the case.

42(2) The arbitral tribunal shall in the final award or, if it deems appropriate, in any other award, determine any amount that a party may have to pay to another party as a result of the decision on allocation of costs.”⁶

Article 52(2) of the 2015 CIETAC Rules stipulates that:

“The arbitral tribunal has the power to decide in the arbitral award, having regard to the circumstances of the case, that the losing party shall compensate the winning party for the expenses reasonably incurred by it in pursuing the case. In deciding whether or not the winning party’s expenses incurred in pursuing the case are reasonable, the arbitral tribunal shall take into consideration various factors such as the outcome and complexity of the case, the workload of the winning party and/or its representative(s), the amount in dispute, etc.”⁷

All in all, as explained by Gary Born:

*“The overriding theme of these, and other, institutional rules is to grant the arbitral tribunal broad powers to award legal costs, according to standards established by the arbitrators; the exercise of these powers is left largely to the arbitrators, with general references to the degree of a party’s success on its claims and the reasonableness of a party’s legal expenses. All leading institutional rules also expressly confirm the arbitrators’ authority to “apportion” legal costs, allowing awards of less than 100% of a party’s reasonable costs.” [Gary Born, *International Commercial Arbitration* (Kluwer Law International, 2014), pp. 3093-3094].*

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.”

⁶ 2010 UNCITRAL Rules, Article 42. The 1976 UNCITRAL Rules contained to some extent a similar rule, according to Article 40, the tribunal is “free to determine” how to allocate the parties’ legal costs but the costs of arbitration, in principle, follow the event: “1. Except as provided in paragraph 2, the costs of arbitration shall in principle be borne by the unsuccessful party. However, the arbitral tribunal may apportion each of such costs between the parties if it determines the apportionment is reasonable, taking into account the circumstances of the case.

2. With respect to the costs of legal representation and assistance referred to in article 38, paragraph (e), the arbitral tribunal, taking into account the circumstances of the case, shall be free to determine which party shall bear such costs or may apportion such costs between the parties if it determines that apportionment is reasonable.”

⁷ Article 52(2) of the 2015 CIETAC Rules. The ‘costs follow the event’ rule was written into the CIETAC’s arbitration rules in 1994, where the principle was simply stated, without listing factors to consider in determining the reasonableness of the costs and with a 10% cap (10% of the amount awarded to the winning party). This provision changed to the current version in 2005. Arbitrators in cases administered by CIETAC accordingly follow this rule in practice. (See ICC Commission Report, *Decisions on Costs in International Arbitration*, ICC Dispute Resolution Bulletin 2015, Issue 2, p. 4, fn 3).

I agree with my colleague and friend Doug Jones who shares my bemusement with arbitral institutions' obsession with arbitrators' fees.⁸ It is clear to all that the costs of the arbitration, namely the arbitrators' fees and expenses, the hearing room etc., and the institutional fees are but a minor part of the total costs.⁹ The two main items are of course the legal fees of both sides and the costs of their experts' if appointed.¹⁰ No set of rules deals with these costs and so it is the Tribunal that has the ultimate responsibility.

Institutions are effectively powerless to do anything to control legal costs apart from sensibly encouraging more case management in an attempt to plan the costs in advance and to use costs effective procedure.

Interestingly, the 1996 English Arbitration Act contained a power that enabled arbitrators to cap recoverable costs at the outset of a case, but subject to later review. I am not aware that this provision is much used.

It may seem incongruous to some that arbitrators are frequently remunerated on an *ad valorem* basis. Yet, I have never heard it suggested by any institution that the parties' recoverable costs should be dealt with on a similar basis.

There is then the issue of whether the loser should pay the costs. That is the general rule in litigation in England, Australia, Hong Kong, Singapore, Switzerland and Germany. It is not the rule in U.S litigation.

As we all know, there is a substantial difference between the English and American approach to the award of attorney's fees in litigation. I am pleased to say that the difference is historical and not a knee jerk reaction such as driving on the other side of the road.

The English approach to costs including legal fees, namely that they follow the event or, the cost shifting approach, can be traced back to the Statute of Gloucester of 1275, which provided for the recovery of the successful Plaintiff's costs. This Statute was the basis for the law on this subject and it remained so until the Supreme Court of Judicature Act of 1875, which set up a procedure with which most of us are only all too familiar.

Interestingly, the cost shifting rule in Continental Europe can be traced back to Roman times. In 487 A.D. The East Roman emperor Zeno announced the rule that losing was sufficient ground to

⁸ See Doug Jones, 'Using Costs Orders to Control the Expense of International Commercial Arbitration', Chartered Institute of Arbitrators, *Roebuck Lecture* (9 June 2016), p. 2 ("*I should pause here to say that I am bemused by the focus of arbitral institutions on arbitrators' fees which not only represent a small part of the total cost of arbitration but when concentrated upon by arbitral institutions can easily ignore the value which arbitrators can add to the preservation and advancement of the institution of commercial arbitration. Perhaps it is easier to grasp the low hanging fruit, thus ignoring the wood for the trees.*"). Available online:

<http://www.ciarb.org/news/ciarb-news/news-detail/news/2016/06/13/roebuck-lecture-professor-doug-jones-examines-international-arbitration-costs>

See also Doug Jones, 'Using costs awards to control the cost of international commercial arbitration', *Harbour View Quarter 3 2016*, p. 21.

⁹ ICC Commission Report, Decisions on Costs in International Arbitration, ICC Dispute Resolution Bulletin 2015, Issue 2, p 3 (stating that arbitrators' fees make up only 15% of total arbitration costs in average).

¹⁰ *Ibid.*, p.3 ("*Party costs (including lawyers' fees and expenses, expenses related to witness and expert evidence, and other costs incurred by the parties for the arbitration) make up the bulk (83% on average) of the overall costs of the proceedings.*").

impose the obligation to pay the opponent's costs.¹¹ The rule became part of the Code of Justinian in the first half of the sixth century.¹²

As Derek Roebuck has detailed in his excellent book, *Dispute Resolution in the Reign of Elizabeth I*, these were litigious times. Things were so bad that an attempt was made to limit “*the infinite number of small and trifling suits commenced or presented in Her Highness' Courts at Westminster to the intolerable vexation and charge of Her Highness subjects*” by a Statute that provided that if in a personal injury case the debt or damages did not exceed 40 shillings, then the Plaintiff could not recover more costs than damages and in fact might be awarded less.

Professor Goodhart in his 1929 article on Costs published in the *Yale Law Journal*, refers to an interesting attempt in 1672 to use costs as a punishment by providing that the Plaintiff could recover his full costs of suit in an action for trespass against “*inferior tradesmen, apprentices and other dissolute persons, who trespass whilst hunting or fishing.*”¹³ Interestingly, the law that provided for costs to a successful defendant came more slowly. A start had been made by the Statute of Marlborough of 1267. The position was made clear, however, when a Statute of 1607 simply provided that the Defendant could recover its costs in all cases where a Plaintiff could have done so if successful.

So why did America move in the opposite direction? As John Leubsdorf put it in a 1984 article:

*“One of the most curious features of the American Rule in the 19th century was its almost total absence of justification. That lawyers should be paid by their clients rather than by opposing parties seemed so natural that, when attorney fee statutes began to appear, courts usually regarded them as imposing penalties on the acts of the defendant.”*¹⁴

However, one explanation is as follows: during early Colonial times lawyers were not held in high repute and were treated with suspicion. However, by the end of the 18th and early 19th Century I am pleased to say that the Bar had become more respectable and in New York, for instance, Counsel's fees were allowable. However, the recovery of Counsel's fees was based on a fixed fee. In 1829 the fixed fee was \$3.75. But as lawyers raised their fees over time and the

¹¹ See discussion in Werner Pfennigstorf, ‘The European Experience with Attorney Fee Shifting’, 47 *Law & Contemporary Problems* 37 (1984), p. 42.

¹² The decree is found in the Code of Justinian, Book VII, 51.5. Available online: <http://www.uwyo.edu/lawlib/blume-justinian/files/docs/book-7pdf/book7-51.pdf> (“7.51.5. *The Emperor Zeno. (Synopsis in Greek).*

The constitution ordains that every judge shall, in his decision, order the defeated party to pay all expenses of litigation, giving permission to the judge to order the payment of one-tenth more than the amount paid out, whenever the insolence of the defeated party gives him cause to do so, provided that the amount over and above the expense shall go to the fisc, unless the judge gives a part of it to the victor in order to repair the damages which he has sustained. 1. And not only may the plaintiff and defendant be so condemned when the judge has authority to give judgment against either party, but also when he (ordinarily) as no such power over the plaintiff, but the latter is defeated by a counter-claim, since he cannot (in such case) object to the judge, whether he is the president or a judge appointed by the emperor - for apparitors and executive officers are also attached to the latter. 2. If the judge fails to do so, he must himself make the damage good to the victor. 3. In case, however, a defendant (against whom judgment is rendered) shows his good faith by paying, or if the plaintiff abandons the suit, or the judge believes that he is not a malicious suitor, but that the case, in which he was condemned, was doubtful, he will escape condemnation to pay the costs. 4. It is proper, moreover, for the official staff of the magistrate (president) to assign an apparitor to the petty judges to carry out these provisions. Given March 26 (487).”

¹³ Arthur L. Goodhart, ‘Costs’, 38 *Yale Law Journal* 849 (1929), p. 853.

¹⁴ John Leubsdorf, ‘Toward a History of the American Rule on Attorney Fee Recovery’, 47 *Law & Contemporary Problems* 9 (1984), p. 28.

statutory amount was not revised, the position soon became that in effect lawyers' fees were not claimable. As Professor Goodhart noted, had the 1829 Statute allowed a reasonable fee as opposed to a fixed fee, the difference between the English and American rules might have disappeared.

This issue actually reached the US Supreme Court in the case of *Arcambel v Wiseman* in 1796. A lower Court had ordered a losing party to pay a winning party \$1600 towards legal costs. The Court reversed stating:

“We do not think that the charge ought to be allowed. The general practice of the United States is in opposition to it and even if that position were not strictly correct in principle, it is entitled to the respect of the Court until it is changed or modified by statute.”

In 1925 the Massachusetts Judicial Council in considering this issue stated:

“Though the principle of the English system of costs ought to be adopted, the system in detail would not and ought not to be made part of our jurisprudence. It is enough to read an English Bill of Costs to be convinced of that.”

Another reason why the English rule may not have been adopted in the USA is that the fear of having to pay the other side's costs would act as a disincentive to bringing an action and would thus be seen as a possible bar to the access to justice. And a still further reason was that litigation was seen as a gamble and that it was unfair and un-American to penalize the losing party and, as Professor Goodhart put it, it was also a bit unfair to hit a man when he was down.¹⁵

A Mr. Satterthwarte in an Article in 1923 put it more robustly when he said:

“an enlightened Judge must realize that, in spite of his most conscientious and painstaking efforts, he is, in a given case, as like as not to do injustice when he seeks to do justice.”

A salutary message for us all.

Thus, it was that conditions in the United States were ripe for the development of contingency fees the existence of which is presumably a substantial reason why the rule has not been materially changed to this day. It is only of course in recent times that contingency fee arrangements have been permissible in England but not in Hong Kong.

So turning to arbitration, it is not surprising that in American domestic arbitration we see the American Arbitration Association's rule in dealing with costs actually reflect the American approach. Article R-47(d)(ii) of the AAA's Commercial Arbitration Rules stipulates that the award of the arbitrators may include:

*‘an award of attorney's fees if all parties have requested such an award or it is authorized by law or their arbitration agreement’.*¹⁶

¹⁵ Goodhart, *supra* note 13, p. 877.

¹⁶ Full text of Article R-47(d): *“The award of the arbitrator(s) may include: i. interest at such rate and from such date as the arbitrator(s) may deem appropriate; and ii. an award of attorneys' fees if all parties have requested such an award or it is authorized by law or their arbitration agreement.”*

Interestingly, the international arm of the AAA, the IDRC, has a different approach. It gives a wide discretion to the tribunal and is more in accord with the other institutional arbitral rules I set out earlier. Article 34 of the ICDR's International Arbitration Rules,¹⁷ provides that

“[t]he arbitral tribunal shall fix the costs of arbitration in its award(s). The tribunal may allocate such costs among the parties if it determines that allocation is reasonable, taking into account the circumstances of the case.’ Such costs may include ‘the reasonable legal and other costs incurred by the parties’”

So now we know in brief how we got there. It is worth considering whether the English rule requires a rethink, at least in the context of arbitration. This raises the issue whether the loser pays doctrine, justified on the basis that the winner should be indemnified for all consequential losses, has negative consequences in that it has the effect of increasing the cost and whether it stands as a disincentive to settling. In some cases, it is the amount of costs that keeps the case alive. It can be argued that the risk of having to pay the other parties' costs in addition to your own has caused parties to leave no stone unturned to ensure the other party pays them, and this leads to a hugely expensive legal system.

I could not help noting an article in the *London Times* on 5th February this year.¹⁸ It referred to a Centre for Policy Studies think tank report which substantiates my view.¹⁹ The billable hour approach was referred to as “an outdated and unsustainable billing method for legal services.” It went on to claim that payment by time reveals inefficiency. All this rather echoes the observation of the president of the American Bar Association in 1975 that “[...] lawyers do not unfairly charge their clients. Rather, they simply do not dispense legal services efficiently”.²⁰

But more significantly, the think tank report cited Lord Justice Jackson who had highlighted that unrestricted cost shifting leads parties to leave no stone unturned. The more the costs increase the more determined that each party becomes to ensure that the other party pays them. This it suggested leads to a justice system that is exorbitantly expensive.

Thus it is often possible to get parties to compromise on the main issues that separate them. But how often have we heard in settlement negotiations something along these lines:

“There is no way I am going to pay or contribute to that person's legal costs”

In addition to assisting the settlement of cases, would the amelioration of the practice to award legal costs to a successful Claimant also have the effect of acting as a restraint on the build up of large legal fees because there would be a fear of no recovery, even if successful. Would this in turn lead to a more cautious presentation of cases to tribunals and help to avoid the kitchen-sink approach where everything – good and bad, gets thrown at the tribunal resulting in large claims for costs and a delay in receiving an award. As I said earlier what comes out very much depends on what goes in.

¹⁷ Rules Amended and Effective June 1, 2014.

¹⁸ Jonathan Ames and Frances Gibb, ‘£1,000-an-hour lawyers ‘restrict access to justice’’, *The Times* (5 February 2016). Available online: <http://www.thetimes.co.uk/tto/law/article4683325.ece>; See also Owen Bowcott, ‘City law firms charging up to £1,100 an hour’, *The Guardian* (5 February 2016). Available online: <https://www.theguardian.com/law/2016/feb/05/city-law-firms-charging-up-to-1100-an-hour>

¹⁹ Jim Diamond, ‘The Price of Law’, *The Centre for Policy Studies*. Available online: <http://www.cps.org.uk/publications/reports/the-price-of-law>

²⁰ James D Fellers, American lawyer, president, American Bar Association, *Los Angeles Times* (30 May 1975).

I wish to make it plain that I have no settled view on this topic, but I do think that the time has come for a debate on this issue and I hope this Lecture might engender that debate.

So having looked at the development of the two approaches and how they have found their way into arbitral rules, I next want to turn to the difficulties and complexities that face an arbitral tribunal in the exercise of this very wide discretion.

So let me take as an example a case between two large multinationals where each spends £15 million on its case. One side wins. Both had claimed their costs. The tribunal has a wide discretion. Why should it refuse the winner the bulk of its costs when the loser was claiming the same sum in the event it won? What is the role of the tribunal in those circumstances? Should it act as a costs policeman knocking down the winner's costs because it thinks the case was over-lawyered or the hourly rates were too high? Remember that this award will not be published, so whatever strictures the tribunal states, it will have no effect outside this case.

Now take the same case and instead of two multinationals pit one multinational against a small poorly funded company or an individual who is not overly wealthy. The multinational spends the same £15 million but the other party only spends £2.5 million.

In this case assume the multinational wins. Should it receive £15 million? Or should the tribunal recognize the inequality of arms and reduce the £15 million by a substantial percentage. Assume when thinking about this that the multinational was correct and behaved impeccably, and that the defence was a try-on. Does this make any difference? Would it make any difference if you knew that a costs order would bankrupt the respondent?

When we think upon these questions, it is worth stressing that tribunals may be proactive and award only those costs that they consider reasonable and proportionate to the amount in dispute and/or costs that have been proportionately and reasonably incurred. The observation on costs made by the Singapore High Court, when reviewing a decision on costs in arbitration, is highly relevant:

*"[...] the proportionality principle is not limited to a relationship between the amount involved in the dispute and the amount of costs awarded. What is truly meant by this principle is that when legal costs have to be assessed, all circumstances of the legal proceedings concerned have to be looked into, not only the amount of the dispute, though that is an important factor especially when assessing whether the amount of work done was reasonable, but also everything else that occurred"*²¹

The 2015 ICC Commission Report adequately summarised some of the main factors that a tribunal *may* take into account when considering whether the costs are reasonable/proportionate to monetary value/property in dispute:

- “(i) the reasonableness of the rates and number and level of fee-earners when evaluating whether the amount of work charged was reasonable;*
- (ii) the reasonableness of the level of specialist knowledge and responsibility retained for*

²¹ VV and Another v VW [2008] SGHC 11, para. 33; see also Lin Jian Wei and another v Lim Eng Hock Peter [2011] SGCA 29, para. 78 (“The approach that should be adopted in taxation is that the Court should first assess the relative complexity of the matter, the work supposedly done against what was reasonably required in the prevailing circumstances, the reasonableness and proportionality of the amounts claimed on an item by item basis and thereafter, assess the proportionality of the resulting aggregate costs.”)

the dispute, including the legal qualification of representatives, involvement of specialist teams or team members and level of seniority;
(iii) the reasonableness of the amount of time spent, at various levels and rates, on the various phases of the arbitration; and
(iv) any disparity between the costs incurred by the parties as a general indicator of reasonableness as opposed to a separate factor in itself.”²²

The ICC Commission Report also stated some of the factors that tribunals may, and “often do”, take into account when considering whether the amount of work done is proportionate and reasonable [i.e. whether the costs proportionately and reasonably incurred]

“(i) the overall importance of the dispute and the matters underlying the dispute to all parties;
(ii) the overall complexity of the matter;
(iii) the accurate representation of the amount in dispute (both in the claims and counterclaims);
(iv) the existence of unnecessary and meritless claims or counterclaims;
(v) the length and phases of the proceedings and, in particular, whether parties have unnecessarily prolonged the proceedings and/or increased their cost (e.g. as a result of repeated applications for document production, other procedural motions, unnecessary steps in the proceedings);
(vi) the withdrawal of any unmeritorious claims in a timely manner;
(vii) the manner in which the parties and their representatives have dealt with document production, both when requesting the production of documents and responding to such requests;
(viii) the scope, relevance and extent of fact evidence in written witness statements and oral testimony, including cross-examination;
(ix) the scope, relevance and extent of expert evidence in written expert witness reports and oral testimony, including cross-examination (e.g. number of experts, length of reports, relevance of material);
(x) the length and conduct of any oral hearings, including but not limited to evidentiary hearings;
(xi) the parties’ approaches to bifurcation and the determination of preliminary issues, including the outcome of any bifurcated or preliminary proceedings; and
(xii) where the parties have agreed to allow the tribunal to take into account settlement discussions after they have reached a conclusion on the merits, efforts by parties to resolve their dispute may be taken into account, in the event that such information is properly available to the tribunal.”²³

Now, assume a case where a claimant claims \$10 million. This sum comprises 5 claims of \$2 million each. The hearing lasts 5 days. The claimant wins on 1 head of claim only that takes a day to hear. Should claimant recover all his costs or just a proportion say one fifth? Some arbitrators might say that in the absence of an acceptable offer the claimant had to go to arbitration to get \$2 million and the fact that it claimed more is irrelevant. I call these bottom liners! Others would say that 4/5 of the hearing time was wasted and would award costs accordingly, i.e. deprive the claimant of 4/5 of its costs. Others might say that as respondent won on 4/5 issues, it should get its costs on the issues upon which it won. Others might say that as

²² ICC Commission Report, Decisions on Costs in International Arbitration, ICC Dispute Resolution Bulletin 2015, Issue 2, para. 65.

²³ *Ibid.*, para. 70.

both parties had some success there should be no order and each party should bear their own costs.

In other cases, both parties receive some relief and thus it is not easy to ascertain the “event” to which costs is supposed to follow. So you can see there are very wide parameters for the exercise of discretion in dealing with costs.

There are of course no easy or correct answers to these questions. I pose them only to show you that difficult questions arise when considering costs issues. Take another point. In the multinational’s case, they had three in house counsel working on the case. Should their salaries be an allowable legal cost? One party wishes to test its case through a mock arbitration before another arbitrator. Should these costs be allowed? One party has its witnesses trained not as to what to say but how to say it. Allowable?

Finally, as the Singapore Court of Appeal observed: *“What clients are willingly prepared to pay their counsel on a solicitor and own client basis is a private matter. However, when a successful party seeks to recover from the unsuccessful party costs which are wholly disproportionate to the injury caused to him, the Court should not sanction it”*.²⁴

Nevertheless, in dealing with quantification of costs, it is always helpful for the tribunal to bear in mind the words of the late Judge Holtzmann, expressed in a case in the US-Iran claims tribunal:

*“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. That is a classic test of reasonableness.”*²⁵

In conclusion, it is fairly clear that in international commercial arbitration, as detailed extensively in the 2015 ICC Commission Report, the dominant approach of arbitral tribunals is that costs follow the event subject to a careful scrutiny on the quantum of such costs.²⁶

²⁴ *Lin Jian Wei and another v Lim Eng Hock Peter* [2011] SGCA 29, para. 79.

²⁵ Separate Opinion of Judge Holtzmann; reported in *Iranian Assets Litigation Reporter* 10860 at 10863; 8 *Iran-US CTR* 329 at 332-333. [quoted also in Redfern and Hunter on *International Arbitration* (Sixth Edition, 2015), para. 9.97]

²⁶ ICC Commission Report, *Decisions on Costs in International Arbitration*, ICC Dispute Resolution Bulletin 2015, Issue 2, pp. 4-5 (“13. Despite 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. This was the approach in the majority of ICC awards examined, in 91% of HKIAC awards, in the majority of ICDR awards, in 90% of SIAC awards and in more than half of the SCC awards. This was also the case in most LCIA and PCA awards, which is not surprising as LCIA and PCA Rules contain a rebuttable presumption in favour of recovery of costs by the successful party.”). See also ICC, *Statistics Concerning Awards of Legal Costs*, 4 ICC Ct. Bull. 43 (1993). Summarised in Gary Born, *International Commercial Arbitration* (Kluwer Law International, 2014), pp. 3097-3098 (“study of ICC awards made between 1989 and 1991 reports that where claimants were largely successful, they were awarded a substantial portion of the arbitration costs in most cases (i.e., in 39 of 48 cases) and a substantial portion of their legal costs in about half of all cases (i.e., in 24 of 38 cases). Where claimants were partially successful, or where both parties obtained relief, the arbitrators typically ordered the parties to bear their own legal costs and shares of the arbitration costs; in some cases, however,

Another issue might be this: should a successful party enjoying the benefits of third party funding be able to claim the return of the premium paid to the funder. At first blush, it looks like a big ask. If a multinational wishes to use third party funding simply to lay off risk why should the premium be recoverable? However, take this situation: a small company is in dispute with a large one. The large one acts in such a way that the small one loses its line of credit and is on the verge of collapse. It has a good claim against the large company but cannot afford to commence arbitration. So it goes to a third party funder who agrees to support it for 30 percent of the proceeds. The small company wins. It claims as costs the 30 percent it had to pay to the very happy funder. The tribunal agreed that it was the unreasonable conduct of the large company that placed the small company in financial peril. Is it so outrageous in this circumstances that the small company should be reimbursed its 30 percent as costs necessarily incurred to assert its justifiable rights?

Interestingly, and after I wrote the above, the High Court in England has upheld an arbitral decision (of the arbitrator Sir Philip Otton) allowing the recovery of the costs of securing third party funding as part of the costs of the arbitration.²⁷ The High Court stated that the recovery of third party funding is permitted in principle according to Section 59(1)(c) of the Arbitration Act 1996 and Article 31(1) of the ICC Rules.

The judge relied heavily on Sir Philip's finding in relation to the respondent's conduct in the arbitration. The arbitrator, Sir Philip, considered that respondent had attempted to cripple the claimant financially. He found that as a consequence of respondent's treatment "[claimant] had no alternative, but was forced to enter into litigation funding... The funding costs reflect standard market rates and terms for such facility... [and] it was blindingly obvious to [Respondent] that the claimant... would find it difficult if not impossible to pursue its claims by relying on its own resources. The respondent probably hoped that this financial imbalance would force the claimant to abandon its claim."

I now turn to consider briefly whether there is any discernible trend in the allocation of costs in investment treaty cases.

Before doing so, I should just mention that the basic rule in public international law, as reflected in Article 64 the Statute of the International Court of Justice, is that each party bears its own costs.²⁸ But there is a discretion in the court. Nevertheless, in all cases (at least up to 2013) the

claimants were awarded a proportion of their legal costs relative to the extent of their success vis-à-vis their claims. Finally, in ICC cases where claimants obtained substantially less than half of the amounts claimed, or where the respondent recovered larger amounts than the claimant, tribunals generally have either left the arbitration and legal costs with the party that incurred them or ordered the unsuccessful claimant to pay some or all of the respondents' costs. Where one of the parties was uncooperative or inefficient, it was less likely to recover its costs (or its full costs); in some cases, a party that has adopted unnecessary litigation tactics has been held liable for costs. On the other hand, where there was a good faith basis for the parties' differing positions, ICC tribunals were more likely to leave the parties to bear their own costs."

²⁷ CL-2016-000188 *Essar Oilfield Services Limited v. Norscot Rig Management Pvt Limited* [2016] EWHC 2361 (15 September 2016). See also 'Landmark decision, High Court appeal allows recovery of third party funding costs in arbitration proceedings.', *4 New Square* (15 September 2016). Available online: <http://www.4newsquare.com/news/article.aspx?id=305>;

'English court upholds arbitrator's decision to award claimant the costs of third party funding', Herbert Smith Freehills (3 October 2016). Available online <http://hsfnotes.com/arbitration/2016/10/03/english-court-upholds-arbitrators-decision-to-award-claimant-the-costs-of-third-party-funding/>

²⁸ Article 64 of the Statute of the ICJ: "Unless otherwise decided by the Court, each party shall bear its own costs."

discretion has never been exercised.²⁹ Interestingly, in its Advisory Opinion in *Review of UNAT Judgment No. 158*, the ICJ considered the issue of costs in the context of mixed proceedings in front of the UN Administrative Tribunal, where typically claimants are individuals and the respondent is the UN. The Court supported UNAT's decision to dismiss the Claimant's request for exceptional costs 'without stating any standards or reasons'³⁰ and referred to 'the basic principle regarding the question of costs in contentious proceedings before international tribunals, to the effect that each party shall bear its own in the absence of a specific decision of the tribunal awarding costs'.³¹ The Court added that

*'[a]n award of costs in derogation of this general principle, and imposing on one of the parties the obligation to reimburse expenses incurred by its adversary, requires not only an express decision, but also a statement of reasons in support. On the other hand, the decision merely to allow the general principle to apply does not necessarily require detailed reasoning, and may even be adopted by implication.'*³²

As elaborated by Michelle Bradfield and Guglielmo Verdirame:

*"The public international law approach to costs, as articulated by the ICJ in the aforementioned Opinion, is therefore not entirely inconsistent with cost-shifting. The litmus test is rather the obligation to provide reasons. No such obligation arises where the general principle is followed, even where one of the parties put forward a detailed and reasoned claim for cost-shifting. If, however, an international court or tribunal decides to depart from that general principle and to award costs on a different basis, it must state its reasons."*³³

I have already mentioned that the applicable rules in treaty arbitration give the same sort of discretion as exists in commercial arbitration. But in treaty arbitration one party is a State and the bulk of States subject to treaty claims are not surprisingly the less well-off nations. Therefore, bearing in mind the effect that large claims for costs can have on a small country's economy and the social and political effects of such order, should treaty arbitrators be more cautious? On the other hand, one sees cases where relatively small investors have been treated badly by large and wealthy States and clearly different considerations would apply to this situation.

It is not easy to state a conclusion. Various empirical studies have been conducted to examine the dominant approach with regard to costs in international investment arbitration. Susan Franck considered 102 awards in the in the 1990-2006 period and found that each party bears its own costs was dominant as only 32.6% of the decisions had included some form of cost-shifting.³⁴ David Smith reviewed the [31] awards in the 2008-2009 period and concluded that the

²⁹ See discussion in Michelle Bradfield and Guglielmo Verdirame, 'Costs in Investment Treaty Arbitration', in Chiara Giorgetti (ed.), *Litigating international Investment Disputes: a Practitioner's Guide* (Brill Nijhoff, 2014), pp. 418-419; see also Espósito Massicci, 'Article 64', in Zimmermann, Tomuschat, Oellers-Frahm *The Statute of the International Court of Justice: A Commentary* (2006), at 1395 (stating that "neither the PCIJ nor the ICJ have ever decided to deviate from the general rule of allocation of costs.")

³⁰ *Review of UNAT Judgment No. 158*, ICJ Reports (1973), para. 97.

³¹ *Ibid.*, para. 98.

³² *Ibid.*

³³ Bradfield and Guglielmo, *supra* note 29, p. 419.

³⁴ Susan D. Franck, 'Rationalizing Costs in Investment Treaty Arbitration', 88 *Washington University Law Review* 769 (2011), pp. 807 & 810.

percentage of cost shifting was increased to 41.9% in this period.³⁵ Lucy Reed examined cases in the 2004-2010 period and found that 35% of the cases included cost-shifting.³⁶ Bradfield and Verdirame surveyed cases from 2010-2013 and found that cost-shifting has been applied in 46.3% of the cases.³⁷ It should be highlighted that Bradfield and Verdirame found that there was significantly more cost shifting in the UNCITRAL cases than in the ICSID cases. In UNCITRAL cases there was costs shifting in 68.8% of the cases but only 40% cost shifting in ICSID cases.³⁸ This is not surprising given the different wording in the respective rules dealing with costs to which I made reference earlier.

While the trend of cost shifting has been on the rise in international investment arbitration, as highlighted by Bradfield and Verdirame, the quantitative data does not show whether tribunals absolutely adopted the principle of 'costs follow the event' or 'pay your own way'.³⁹ Often cases did not refer to the two principles but instead examined various factors such as the equity and fairness of a particular outcome on costs.⁴⁰

³⁵ David Smith, 'Shifting Sands: Cost-and-fee Allocation in Investment Treaty Arbitration', 51 *Virginia Journal of International Law* 749 (2011), 753.

³⁶ Lucy Reed, *Allocation of Costs in International Arbitration*, 26(1) *ICSID Review - Foreign Investment Law Journal* 76 (2011), at p. 79.

³⁷ The sample included 67 claims, 51 of which have applied the ICSID Rules and the Convention, and 16 the UNCITRAL Rules. With regard to ICSID cases, "in 31 cases (60.8%) the outcome was that the parties paid their own costs and an equal amount of the arbitration fees. In 20 cases (40%) there was cost-shifting, either fully or partial. In eight cases (15.7%) costs shifted in full from the successful party to the unsuccessful party, while in 12 cases (23.5%) only partial cost-shifting occurred." (Bradfield and Guglielmo, *supra* note 29, p. 426). It is important to note that Bradfield and Verdirame found that only three tribunals clearly endorsed and then applied the principle of 'pay your own way'. With regard to UNCITRAL cases, Bradfield and Verdirame states as follows:

"There is significantly more cost-shifting in the UNCITRAL cases than in the ICSID cases, with 11 of the 16 (68.8%) UNCITRAL cases in 2010 - 2013 shifting costs; two (12.5%) fully shifting costs; and nine (56.3%) partially shifting costs. Every case within the sample was decided using the 1976 UNCITRAL Rules, so the provisions presume that costs associated with the arbitration should follow the event, while legal costs are subject to the tribunal's general, unfettered discretion.

Within those 16, the pattern of shifting does not quite tally with the ICSID cases. In relation to the UNCITRAL cases: 62.5% shifted all arbitration costs to the unsuccessful party, with no partial shifting of arbitration costs, while only 12.5% totally shifted legal fees and 31.3% partially shifted legal fees. Whereas, in relation to the ICSID cases: 19.6% shifted all arbitration costs to the unsuccessful party, with 13.7% partially shifting arbitration fees, while 17.6% totally shifted legal fees and 15.7% partially shifted legal fees. A striking difference between the UNCITRAL and the ICSID practice is that in 62.5% of UNCITRAL cases arbitration costs were shifted in full, whereas such shifting only occurred in 19.6% of ICSID cases. This is no doubt a reflection of the de facto position specified in the 1976 UNCITRAL Rules. Also, the approach towards arbitration costs and legal costs is vastly different between ICSID and UNCITRAL cases. Out of the 51 ICSID claims, there appears to be very little (if any) distinction drawn between cost-shifting of legal fees and arbitration costs. Whether cost-shifting is full, partial, or has not been undertaken, 42 of the 51 cases (82.4%) appear to have taken the same approach to the parties' legal fees as they did for the arbitration costs. Either they were both fully shifted to one party, partially shifted but in the same ratio, or else left to fall as they lie. The position is different under UNCITRAL, where only 43.8% of cases adopted the same approach to the parties' legal and arbitration costs." (Bradfield and Guglielmo, *ibid.*, pp. 434-435).

³⁸ Bradfield and Guglielmo, *ibid.*

³⁹ Bradfield and Guglielmo, *ibid.*, p. 426.

⁴⁰ Bradfield and Guglielmo, *ibid.*, p. 432.

It is my practice, both in commercial and treaty cases, to order both parties to exchange costs schedules in a format that I provide to them, after the closing of submissions but before they know the result. Obviously, each party is free to comment on the other's schedule.

Speaking of my own experience over 45 years, I have to say that the cases where each party was ordered to bear their own costs were extremely rare and based on extraordinary circumstances. However, it has also been extremely rare that a winning party recovered 100% of what it was claiming and quite often in the exercise of the wide discretion they were granted far less, having regard to some of the problems I have identified earlier in this lecture.

Parties are of course free to deal with costs in their arbitration agreement. One sees clauses that specifically exclude the recovery of costs. Under English and Hong Kong law such clauses are only valid if entered into after the dispute has arisen. Whereas I see the justification of this in consumer cases or in cases involving parties of unequal bargaining power, I am not persuaded that these provisions are justified as between entities of equal bargaining power. Interestingly, I have never seen a clause that permits cost recovery but seeks to limit the recoverable amount. Limitations on recoverable damages are commonplace.

So I end by asking what arbitrators can do to control the level of costs in a fair manner in accordance with the wide discretion usually afforded them.

I think that it is absolutely essential that the subject of costs is discussed at the very first directions hearing. In my view it is also essential that someone from senior management is present. The following are some of the topics that require a discussion at this very early stage of the proceedings:

- (a) now that the dispute has arisen, do the parties want to enter into a costs agreement, which might limit or exclude the recovery of costs;
- (b) would the parties like the tribunal to place a cap on recoverable costs based on the arbitrators' experience of similar cases but subject to a later review if appropriate;
- (c) would the parties like the tribunal to apply or work out an ad valorem scale for recovery of legal expenses;
- (d) the parties should be informed that the tribunal is prepared to take into account unequivocal without prejudice written offers of settlement which exceeds the amount actually awarded.⁴¹
- (e) but above all the tribunal should make clear that the costs shifting rule will not necessarily be followed because the tribunal will take into account the parties' conduct in the proceedings. For example, unnecessary prolixity, both oral and writing, relying on obviously bad points, calling too many witnesses, not calling the right witnesses, unnecessary interlocutory applications, writing unnecessarily excessive letters and generally behaving unprofessionally. The tribunal *may* also take into account whether the costs are reasonable/proportionate to monetary value/property in dispute and whether the amount of work done is proportionate and reasonable.

Finally, it is a good practice to include a specific clause in the first procedural order that informs the parties that they have a duty to arbitrate in good faith, which includes an obligation to cooperate with the opposing party and the tribunal. The tribunal should direct the parties to do all such things during the proceedings as may be reasonably needed to enable the award to be made

⁴¹ See *Calderbank v Calderbank* [1975] 3 All ER 333.

fairly and efficiently. The tribunal should also make clear that it will not hesitate to order costs to be paid forthwith, rather than waiting to the conclusion of arbitration, in respect of unnecessarily made interlocutory applications or adjournments. In this way the tribunal signals to the parties and their lawyers that their conduct throughout the arbitration will be very relevant to the ultimate decision on costs.

In my view it is very important for the tribunal to establish its credentials and experience with the parties at the very beginning of the proceedings and as I just said, this includes making clear to the parties that the tribunal is concerned from the outset of the whole issue of the costs of the arbitration. In other words, costs need to be dealt with upfront rather than as hitherto as somewhat of an epilogue.

All of the above having said, one must appreciate that just like the assessment of damages, the assessment of reasonable costs to be paid by a losing party is not a science. As the US Supreme Court said in relation to trial courts that is equally applicable to arbitral tribunals:

“[T]rial courts need not, and indeed should not, become green- eyeshade accountants. The essential goal in shifting fees (to either party) is to do rough justice, not to achieve auditing perfection. So trial courts may take into account their overall sense of a suit, and may use estimates in calculating and allocating an attorney’s time.”⁴²

I agree entirely with this approach. But that said, it still seems essential for arbitrators to engage with the parties early on in the process so that orders in relation to costs do not cause surprise and resentment. Surprise is often the basis for dissatisfaction with the process. It should be avoided at all cost.

I reiterate my thanks to Harbour Litigation Funding for the opportunity of speaking to you tonight and I thank you for your patience.

⁴² *Fox v. Vice*, 131 S. Ct. 2205 (2011), at 2216.