COSTS IN INTERNATIONAL COMMERCIAL ARBITRATION

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There is little hard data available on the subject of costs awarded in international commercial arbitration cases. Most modern arbitration statutes provide for costs to include legal fees but it is not at all clear that full legal costs are awarded in most cases. An informal survey indicates that many North American arbitrators are overly influenced by litigation precedents and only award full legal fees and other party expenses on rare occasions. At the same time, there is anecdotal evidence that some of the most experienced international arbitrators from the United States commonly award legal fees and, indeed, believe that this represents a major reason to choose arbitration over litigation for the resolution of international commercial disputes.

This article will examine the principles underlying the award of costs in international arbitration and propose a common approach in allowing legal fees and other expenses of the parties to be covered by an award.

Costs Jurisdiction

In most jurisdictions, it is axiomatic that costs will follow the event. It was not always so. Costs were unknown at common law although entitlement to costs was recognized early on in equity.

In 1743 Lord Hardwicke held that common law courts had no inherent jurisdiction to order costs but that courts of equity had such authority "from conscience and *arbitrio boni viri*, as to the satisfaction on one side or other on account of vexation."[1] A literal interpretation of this Latin maxim is that courts in equity had authority to order costs as part of their inherent jurisdiction to give judgment as an honest man would. In that case the court ordered costs in respect of those matters upon which the applicants prevailed.

According to the English Court of Appeal in *Andrews v. Barnes*,[2] the amount of costs was not fixed in equity and a court exercising its equitable jurisdiction to order costs had a wide discretion "not only as to the circumstances under which costs were to be awarded, but apparently as to the measure and fullness of the costs."

The English Court of Appeal had the opportunity early on to address the jurisdiction of arbitrators to award costs and the measure of those costs. In *Mordue v. Palmer*, Lord Mellish said:

Should a losing party in an arbitration proceeding have to pay for the legal costs of the winning party? Should an arbitrator have the authority to include payment of legal costs in an award? Murray Smith addresses these questions within the context of international commercial applications that vary from country to country.

> The Common Law Courts have no power to give costs between solicitor and client, and therefore when there is a reference, the arbitrator cannot give any other than costs between party and party. But it is otherwise with Courts of Equity; and I therefore think that, when a reference as to costs is made by a Court of Equity, the court gives the arbitrator jurisdiction to award costs as between solicitor and client if he shall think fit.[3]

Litigation Precedents

In the United States, the recovery of legal costs by a successful litigant is rare. Costs are usually confined to out-of-pocket disbursements and do not cover attorney fees. There is no concept of party and party costs as distinguished from solicitor and client costs.

The U.S. courts will recognize a contractual agreement that attorney fees are to be paid, but the rule is for no costs so that access to the courts is not restricted. It is said that the American rule for no costs has some relevance to arbitration.[4] However, this article will argue that the litigation precedent for costs in the U.S. should not be followed by arbitrators in international cases.

In many common law countries, authority to order costs in court cases is confined to a tariff of costs absent exceptional circumstances. In litigation cases, an increase in costs to the solicitor-client level is often tied to misconduct of a party. Where fraud or corruption has been alleged but not proven, an award of solicitor and client costs is common. In litigation, the usual order is for party and party costs as fixed by a tariff or scale in rules of court or in a statute. Solicitor and client costs, on the other hand, are intended to indemnify the party for reasonable legal costs incurred.

In British Columbia, a successful litigant will recover party and party costs which generally represent an indemnity of between 30% and 50% of actual fees expended. The courts will now award increased costs of approximately 50% of actual costs where there is a significant discrepancy between party and party costs and actual costs and an even higher percentage where there is misconduct.[5]

It is still only for cases involving serious misconduct that the courts will grant solicitor and client costs, *i.e.*, a full indemnity for actual and reasonable legal costs incurred.

In England, an award of costs in litigation is intended to more fully indemnify the successful party and approaches 70% to 80% of actual legal fees expended. The fees of the barrister may be claimed as a disbursement in the solicitor's

account for legal costs, thus generating a higher rate of recovery than in Canada where counsel fees are caught by a tariff.

Arbitration Practice

In Canada, prior to the adoption of the UNCITRAL Model Law for international cases, it was common for arbitrators to be granted the same authority to award costs as a court would have in litigation. With the adoption of the Model Law, the jurisdiction to award costs has become broader.

In modern arbitration the authority to order costs is not confined by laws or statutes other than the applicable arbitration statute.

In British Columbia, the British Columbia International Commercial Arbitration Act provides for the award of costs in the discretion of the arbitrator unless otherwise agreed by the parties. The award may include the costs of the arbitration, such as arbitrators' fees and expenses, as well as costs of the parties, including legal fees and expenses.

The English Arbitration Act of 1996 grants authority to the tribunal to make an award allocating costs subject to any agreement of the parties. The costs which may be awarded include the fees and expenses of the arbitrators and the legal or other costs of the parties.

The United States Arbitration Act does not make any reference to costs but some states have adopted the UNCITRAL Model Law for international cases with an amendment to provide for legal costs. For example, the Texas International Arbitration Statute (Chapter 172 of the Texas Civil Practice and Remedies Code), provides for arbitrators in international commercial cases to award costs, including the fees and expenses of the arbitrators and the legal fees and expenses of the parties. The arbitrator has a full discretion to specify the allocation and amount of costs absent an agreement by the parties on that issue.

The statutes of Texas, England, and British Columbia do not offer much guidance to arbitrators as to the method in allocating costs. The English Act does provide that the tribunal shall award costs on the general principle that costs follow the event unless the parties agree otherwise, or it appears to the tribunal that it is not appropriate in the circumstances.

While the UNCITRAL Model Law does not mention costs the UNCITRAL Arbitration Rules specify that the arbitral tribunal shall fix the costs of the arbitration including the reasonable costs for legal representation of the successful party if such costs were claimed during the arbitral proceedings.

The AAA International Arbitration Rules, revised in 1997, require the tribunal to fix the costs of arbitration in its award. Costs must be apportioned as the tribunal thinks reasonable in the circumstances and may include the fees and expenses of the arbitrator as well as the reasonable costs for legal representation of a successful party.

The ICC Rules of Arbitration provide that the costs of the arbitration shall include the fees and expenses of the arbitrators as well as the reasonable legal and other costs incurred by the parties for the arbitration. The AAA International Rules, the UNCITRAL Rules, and the ICC Rules also do not provide much guidance in determining a method for allocating costs.

The London Court of International Arbitration (LCIA) Rules provide that the costs of the arbitration other than the legal costs of the party shall be borne by the parties in a proportion to be determined by the tribunal. The tribunal is also given the power to order payment of the legal or other costs of a party on such reasonable basis as it thinks fit. The LCIA Rules do not provide a method for allocating costs or determining the amount of costs except to say that the general principle is that costs should reflect the relative success and failure of the parties unless particular circumstances would make it inappropriate to follow this general approach.

Common law costs are meant to partially indemnify the successful party in litigation and to discourage frivolous actions or unreasonable defenses. In pure theory, costs, including legal fees, are simply part of the loss suffered by the innocent party. Since the object of most systems of law is to put the party who has been wronged in the position he or she would have been in had the wrong not been committed, it seems to follow logically that full indemnity for legal costs and expenses should be awarded in international arbitrations barring exceptional circumstances, even though the practice which has developed in litigation has been to give full indemnity costs only where there has been some sort of wrongdoing in the conduct of the litigation.

Author Gary Born suggests that arbitrators from the United States are unlikely "to shift costs and fees (consistent with the "American rule" that each party bears its own costs and fees)".[6] He also questions whether U.S. courts would enforce an award of attorney fees absent prior party agreement or some authorization in the applicable institutional rules or *lex arbitri* to provide for fee shifting.

However, Born was writing before attitudes in the U.S. evolved to keep pace with international practice and the AAA International Rules were amended to specifically provide for cost awards to include reasonable legal fees. He would now, no

doubt, acknowledge a current international consensus as to the propriety of full indemnity costs.

While there may be some social policy basis for restricting full indemnity costs so as to not discourage litigation generally, it is inconsistent with the general notion of *restitutio in integrum* that full indemnity costs not be awarded in international arbitrations.

In modern arbitration the authority to order costs is not confined by laws or statutes other than the applicable arbitration statute. There is no tariff of costs as there is for litigation. In most cases the *lex arbitri* does not restrict the award of legal fees and often expressly authorizes indemnity for costs in the nature of legal fees.

The contractual basis for an arbitration excludes the relevance of any need to guarantee access to the courts. The party who is put to the cost of prosecuting a claim should be able to recoup those costs and likewise a party that is put to the cost of defending a claim which is not meritorious should be made whole by an award of full indemnity costs. Hardship and ameliorating circumstances may be taken into consideration in the exercise of the discretion to apportion and quantify costs. Failure to take into consideration the commercial reality of legal costs may lead to a failure to do justice.

Assessment of Costs

The general principle is that costs should follow the event. As recognized in the LCIA Rules, relative success and failure in the arbitration is also a guiding principle. However, lockstep adherence to success or failure on each and every issue may not be just in the circumstances. A party should not necessarily be penalized for presenting claims or defenses which are not ultimately successful.

The better approach is to consider whether such claims or defenses were frivolous or a waste of the tribunal's time. It is not always possible to predict every aspect of a claim or defense and the greatest weight ought to be given to determining which of the parties was substantially successful in the proceedings rather than assessing each claim or defense.

Factors which may be taken into consideration by the arbitrator include whether or not there were admissions of liability or of facts, offers to settle, the degree of success in relation to the amount claimed, and whether or not there has been misconduct by either party warranting sanction by way of costs.

There are many other factors which may influence the exercise of discretion regarding the allocation of indemnity costs and the reasonableness of those costs. The method of calculating legal fees differs from country to country and even within a country. Fees may be based on a contingent-fee arrangement or on a strict hourly calculation. In principle, the basis upon which the party has agreed to pay legal fees should not matter as long as the final fee is reasonable in all the circumstances. Factors which may be weighed in determining reasonableness include the complexity of the matters in issue, the degree of risk involved and the general degree of difficulty in conducting the arbitration.

It is generally accepted that the arbitrator may take into account the misconduct of a party in respect of matters leading up to the arbitration or which has been observed during the proceedings. Such misconduct may include tendering false or exaggerated evidence or unreasonable or obstructive conduct which prolonged proceedings or increased costs. However, the award of costs may never exceed the actual legal costs and expenses of the parties even if the misconduct is particularly offensive. The award of costs should not become a disguised form of punitive or aggravated damages.

As in all matters the arbitrator must give respect to the autonomy of the parties to agree in advance to the treatment which the arbitrator must give to costs. In many commercial agreements the parties agree to bear their own costs. However, there may be subtle variations in such agreements which preclude their application to all costs issues.

There is high authority in Canada that an agreement that each party "shall bear equally the expenses of the arbitration" was confined to arbitration costs, including arbitrator fees and expenses, but did not preclude an award of costs for reasonable legal fees and expert witness costs just because the agreement was restricted to "expenses" of the "arbitration" and not of the "parties."[7]

Practise Points

The arbitrator may wish to address the ambit of costs authority at a preliminary hearing. This would avoid any dispute as to the extent of the jurisdiction of the arbitrator to award costs at the end of the day. The authority of the arbitrator to award costs is always subject to the agreement of the parties at any time.

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The UNCITRAL Notes on Organizing Arbitral Proceedings were promulgated in 1996 and make provision for deposits but do not address the authority or methodology for awarding costs. However, the UNCITRAL Rules provide that legal fees and expenses of a party may be ordered but only where they have been claimed. It would therefore be appropriate for the arbitrator to ascertain at the outset whether

such a claim is being advanced so that a party is not prejudiced by oversight of the applicable rule.

Since most national laws and institutional rules which provide for the award of costs for legal fees and expenses of a party contemplate that those costs be reasonable, it may be necessary for the arbitrator to establish some mechanism for determining reasonableness. This is a difficult point in practice because the parties may not wish to address costs before the arbitrator has made an award on liability. It is difficult to focus on costs issues while the merits of the claim have yet to be determined.

Some parties would feel that they may be seen as overreaching if they are asking for full indemnity costs at the same time that they are asking for liability to be determined in their favor. It may also be impracticable to marshal the evidence as to what costs are reasonable at the same time as marshalling evidence in respect of the substantive claim.

Counsel will often wish to leave the matter of costs until after the liability award for fear that the arbitrator will cut the baby in half. It is also easier for counsel to argue costs in the context of an award already rendered.

The arbitrator will want to address costs in the final award and usually does not want to have to reconvene to address the reasonableness of costs. While it is theoretically possible to refer the taxation of what are reasonable costs to someone else, it is best left in the hands of the arbitrator who has decided the various issues and has observed the proceedings throughout. It may therefore be inevitable that the arbitrator must reserve the allocation of costs until after the award on liability and to further reserve the taxation of the reasonableness of costs until after the parties have had an opportunity to discuss and perhaps agree on the amount.

Reference should also be made to the governing arbitration statute or rules to ascertain any limitations on the arbitrator reserving a jurisdiction to determine the reasonableness of costs. For example, the British Columbia International Commercial Arbitration Act provides that the arbitral award may include an order for costs. But the proceedings are terminated by the final arbitral award, so the award should not be called final without some reservation regarding costs. The express reservation of jurisdiction for costs would most likely be construed as leaving the final award to be constituted by the costs award. Care must be taken not to leave the matter of costs to a time beyond the point at which the tribunal becomes *functus officio*.

The United States Arbitration Act does not specify when the mandate of the arbitrator expires, but the AAA International Rules mirror the provisions of the UNCITRAL Model Law which provide a 30-day limit after the final award within which the parties may seek an additional award as to claims presented but omitted from the final award.

Since the tribunal is obliged under those rules to fix the costs of arbitration in the award, it would seem that the failure to deal with costs within 30 days of the final award may render the arbitrator powerless to deal with costs thereafter.

For those states which have adopted the Model Law, such as Texas, the proceedings are terminated by the final award and the award also becomes final upon the expiration of the 30-day window for parties to apply for correction and interpretation of the award. The Texas statute, the Model Law, and the British Columbia statute, however, allow for the arbitral tribunal to extend the period within which it may make an additional award.

Another alternative is for the arbitrator to make a lump sum award of reasonable costs in all the circumstances. It would be difficult, though, to make such an award in the absence of submissions from the parties and the weighing of relevant factors. In practice, the most logical approach may be to make such apportionment of costs as is appropriate given the relative success of the parties and to specify whether costs are to include legal fees and expenses and then leave it to the parties to agree what amount is reasonable subject to the continuing jurisdiction of the arbitrator to hear the parties on all costs issues should they fail to agree. The parties could then be given a set period to raise arguments to change the costs as awarded and to advise the arbitrator of new evidence such as an offer to settle.

Conclusion

Costs in international arbitrations should include the reasonable legal fees and expenses of the successful party even in jurisdictions where there is no provision in the governing arbitration statute specifying that legal fees are included in costs entitlement.

The approach to be taken by an arbitrator in an international case is more akin to the approach of a court in equity than a court governed by common law since, like in equity, there is no restriction in arbitration which confines costs to a party and party tariff or any particular scale of allowable fees for legal services. The starting point ought to be full indemnity for the party who is put to the unnecessary expense of participating in the arbitration.

The approach taken by some arbitrators where they award full indemnity costs only where there has been some form of misconduct is wrong in principle and may be seen as a misdirected adherence to principles that would apply in litigation but do not restrict an international arbitrator. As in many aspects of international commercial arbitration practice, arbitrators should avoid slavish adherence to litigation precedents and should recognize the commercial reality of legal costs. ■

ENDNOTES

[1] *The Bailiffs and Burgesses of the Corporation of Burford v. Lenthall* (1743), 26 E.R., 731.

[2] *Andrews v. Barnes* (1888), 39 Ch. Div. 133 at 138 (C.A.).

[3] *Mordue v. Palmer* (1870), 6 L.R. Ch. App. 22 (C.A.), at p. 32.

[4] Gary Born, *International Commercial Arbitration in the United States*, Kluwer, 1994, at p. 95.

[5] *National Hockey League v. Pepsi-Cola Canada Ltd.* (1995), 2 B.C.L.R. (3d) 13 (C.A.).

[6] *Supra* note 4.

[7] *Re: Hope and Co-Operators Insurance Association* (1986), 53 O.R. (2d) 208 (Ont. Div. Ct.).