ARTICLES

COST AWARDS IN INTERNATIONAL COMMERCIAL ARBITRATION: PROPOSED GUIDELINES FOR PROMOTING TIME AND COST EFFICIENCY

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I. INTRODUCTION

Arbitration costs – "procedural" (arbitrator fees and expenses and administrative fees) and "party" (attorneys' and experts' fees and expenses) – are on the rise in international commercial arbitration and a growing source of user disaffection.[1] The more significant arbitration costs become, the more important is the manner in which those costs are allocated and awarded as part of an arbitral award. While parties are free to prescribe the manner of allocating arbitration costs in their arbitration agreement, they seldom do; or they do so in such general terms as to provide little concrete direction or guidance to the arbitral tribunal.[2] Cost awards, commentators have observed, are therefore by and large entrusted to the broad discretion of the arbitral tribunal appointed in each particular case – as a result of which cost awards vary wildly from case to case and "sometimes fundamentally without any apparent reason."[3]

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[1] *See, e.g.,* Jean-Claude Najar, *Inside Out – A User's Perspective on Challenges in International Arbitration*, 25 ARB. INT'L 515, 517-20 (2009); Loukas Mistelis & Crina Michaela Baltag, *Trends and Challenges in International Arbitration: Two Surveys of In-House Counsel of Major Corporations*, 2(5) WORLD ARB. & MEDIATION REV. 83, 95 (2008) (identifying the costs of arbitration as "the single main concern of the users of arbitration").

[2] The leading international arbitration rules likewise provide little concrete guidance as to allocation of arbitration costs. Some arbitration rules, like the ICC and ICDR Rules, merely confirm the arbitral tribunal's duty and authority to allocate costs, without prescribing any guidelines as to the manner in which they are to be allocated. *See, e.g.,* ICC ARBITRATION RULES, Art. 31(3); ICDR INTERNATIONAL ARBITRATION RULES, Art. 31. Other arbitration rules, such as the LCIA and UNCITRAL arbitration rules, set forth a general principle that costs should follow the event – *i.e.,* that the costs of the arbitration shall be borne by the losing party to the extent of such loss – without providing further guidance as to how relative success or failure in the arbitration is to be determined for the purpose of such allocation of costs. *See* LCIA ARBITRATION RULES, Art. 28.4; UNCITRAL ARBITRATION RULES, Art. 40(1).

[3] Michael Bühler, *Awarding Costs in International Commercial Arbitration: An Overview*, 22(2) ASA BULL. 249 (2004); *see also* Jenny W.T. Power & Christian W.

While flexibility is rightly heralded as a virtue in international arbitration, this article explores the purpose of cost allocation in international commercial arbitration – or at least offers a constructive view on what it could be – and concludes that flexibility, while appropriate and necessary to a fair allocation of costs in a given case, can better serve the goals of international arbitration if it is exercised in accordance with prescribed guidelines fashioned with international arbitration's principal objectives in mind.[4]

Specifically, the purpose of cost allocation in international arbitration is, or if not, then it sensibly should be, principally to promote time and cost efficiency in international arbitration, by informing the decisions parties make before they arbitrate a claim to final award – including whether and how to prosecute potential claims, counterclaims and/or defenses in arbitration, whether and whom to instruct as outside counsel, and how to conduct the arbitral proceeding – *i.e.*, how much costs to incur. Arbitration can be made more cost effective if the cost-incurring choices parties make are informed *ex ante* by the factors that the arbitral tribunal will ultimately consider when determining the allocation of costs at the conclusion of the arbitration than if arbitral tribunals wield discretion to reinvent those factors in each case and identify them for the first time only when drafting a final award, after it is too late for the parties to do anything differently.

Several of international arbitration's leading luminaries have observed that predictable rules of cost allocation are desirable and would be preferable to unpredictable exercises of discretion.[5] But it is not enough to conclude that *some*

Konrad, *The Award – Costs in International Commercial Arbitration – A Comparative Overview of Civil and Common Law Doctrines*, *in* CHRISTIAN KLAUSEGGER, PETER KLEIN ET AL., AUSTRIAN ARBITRATION YEARBOOK 261, 261 (2007); John Yukio Gotanda, *Awarding Costs and Attorneys' Fees in International Commercial Arbitrations*, 21 MICH. J. INT'L L. 1, 2 (1999); Michael Bühler, *Costs in ICC Arbitration: A Practitioner's View*, 3 AM. REV. INT'L ARB. 116 (1992).

[4] *See* William W. Park, *Arbitration's Protean Nature: The Value of Rules and the Risks Of Discretion*, 19 ARB. INT'L 279 (2003) (positing that arbitral discretion is overrated and often comes at an unjustifiable cost; proposing that arbitral institutions seriously consider adopting default procedural protocols to govern how arbitrations are conducted).

[5] Michael Bühler's cogent and thoughtful articles on the subject of cost awards in international arbitration have long voiced the need for predictability and have called for rules establishing principles for the allocation of costs in international commercial arbitration. *See* Bühler, *Awarding Costs in International Arbitration: An Overview*, *supra* note 3, at 268 (suggesting that the "loser-pays rule" should "be applied in such a way that it improves both time and cost efficiency of arbitral proceedings"), *also* Bühler, *Costs in ICC Arbitration: A Practitioner's View*, *supra* note 3. Gary Born, in his leading treatise on international commercial arbitration has similarly called for the development of international standards for cost allocation "developed in light of the particular nature and needs of international arbitration." GARY B. BORN, INTERNATIONAL COMMERCIAL ARBITRATION 2494 (2009). Professor Rusty Park, in his seminal article on arbitration's protean nature, has also suggested that cost allocation may be an area worthy of

sort of predictable rules are desirable. What rules should they be? Few have attempted this ambitious further step, and apparently no one has come up with a proposal that would offer parties and arbitrators, not simply discretion, but identifiable guidelines for exercising discretion that maximize cost allocation's potential to advance time and cost efficiency in international arbitration.[6]

This article offers specific guidelines for awarding costs in international commercial arbitration where the source of the arbitral tribunal's authority to allocate costs – be it the parties' arbitration agreement, applicable institutional arbitration rules, or otherwise[7] – vests the tribunal, as is typically the case, with discretion. The guidelines proposed in this article are designed to encourage party choices that enhance international arbitration's goals of time and cost effectiveness. Predictable (yet flexible) guidelines that serve international arbitration's unique qualities should in turn serve to maximize the appeal of international commercial arbitration over its alternatives. It is anticipated that these guidelines serve as a "first word" on guidelines to govern cost allocation; further words, based on further experience and wisdom, may be both welcome and needed.

The objective throughout this proposed "experiment" in a "rules-rich procedure" for cost allocation in international commercial arbitration[8] is not to dispose entirely or even largely of an arbitral tribunal's discretion to allocate costs in accordance with the conduct and outcome of a particular arbitral proceeding, but rather to identify in advance guidelines for the exercise of that discretion, so that parties know what they are in for (a) before they sign up for international arbitration; (b) before they decide whether to pursue a particular claim, defense or counterclaim in arbitration; and (c) during the course of arbitration, but before

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experimentation in a "rules-rich procedure," to advance international arbitration's fairness and efficiency. *See* Park, *Arbitration's Protean Nature*, *supra* note 4, at 288, 295.

[6] *See* Gotanda, *Awarding Costs and Attorneys' Fees in International Arbitration*, *supra* note 3, at 27 (proposing a model approach for awarding attorneys' fees and costs in international commercial arbitration that begins with the premise that costs shall be borne by the "unsuccessful party," but providing that the tribunal may, "at its discretion," apportion the costs otherwise, in whole or in part, based upon what it determines to be "reasonable, taking into account the circumstances of the case").

[7] Typically, the authority to allocate costs will arise from the parties' arbitration agreement or the applicable institutional arbitration rules the parties choose to adopt. On occasion, the parties' specific choice of substantive law may be relevant to the allocation of costs, or the rules for allocating costs may be devised by the tribunal on the basis of its authority generally to prescribe the procedural rules for the arbitration. The sources of authority to allocate costs is a subject beyond the scope of this article, which focuses on the question of how arbitral tribunals are to allocate costs when the authority to do so is vested, by whatever source, in their sound discretion and/or otherwise subject only to broad-stroke general principles such as that the costs shall follow the event. *See*, *e.g.*, *supra* note 2.

[8] *See* Park, *Arbitration's Protean Nature*, *supra* note 4, at 295 (inviting experimentation in rules-rich procedures for international arbitration to see how the market will respond).

they arrive at a final award, so that they are incentivized to make cost-efficient decisions in their conduct of the arbitration.

II. AN ABSENCE OF CONSISTENCY OR PREDICTABILITY IN THE ALLOCATION OF COSTS IN INTERNATIONAL COMMERCIAL ARBITRATION

Costs matter. Users want to know how much it will cost to resolve a dispute in international arbitration relative to the size and merits of the claims or defenses asserted, not to mention the client's available resources or budget, and whether any, some, or all of those costs will either be recoverable from, or payable to, the other side depending upon the arbitration's outcome.[9] As others have already concluded – a conclusion that bears repeating without retreading the same ground – the prevailing rule of cost allocation in international arbitration, including under all of the leading institutional rules, is to leave its determination to the discretion of the arbitral tribunal, but with the result that international commercial arbitration offers no uniform approach for allocating costs, leading to cost awards that commentators variously describe as "inconsistent," "arbitrary," "unpredictable" and "without any apparent reason."[10]

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[9] *See, e.g.,* Bühler, *Awarding Costs in International Arbitration: An Overview*, *supra* note 3, at 249 ("Since commercial people want to know their likely financial exposure prior to investing their money, they often seek advice on how much the arbitration is going to cost them if they lose and whether they will recover their costs if they win"); Bühler, *Costs in ICC Arbitration: A Practitioner's View*, *supra* note 3, at 119 ("it cannot be denied that costs constitute a significant factor for any party contemplating setting in motion the machinery of arbitration"); Michael O'Reilly, *Rethinking Costs in Commercial Arbitration*, 69 ARBITRATION 122, 124 (2003) (reflecting on the English Arbitration Act 1996's default cost allocation provisions and remarking, "It is my impression that commercial people want a higher degree of certainty than the default provisions allow, even at the risk of what might appear to be an unjust result every now and again;" observing that clients frequently ask such fundamental questions as how much will the arbitration cost and will those costs be recoverable in whole or in part and are "astonished that I don't really know the answers with any degree of certainty."); Eric Robine, *What Companies Expect of International Commercial Arbitration*, 9 J. INT'L ARB. 31, 42 (1992) ("Parties are . . . concerned with predicting costs . . . There is nothing more embarrassing for an in-house lawyer than to be unable to tell his directors how much the arbitration will cost (or how long it will last) when these are key factors in deciding whether to come to an agreement or write off a case."); *id.* at 43 ("Better knowledge of the risks [that international arbitration] implies allows parties to make a better choice"); *see also* Gotanda, *Awarding Costs and Attorneys' Fees in International Arbitration*, *supra* note 3, at 4 (observing that the unpredictability of cost allocation in international arbitration, despite the monetary significance of such costs, makes "a case more difficult to settle, and ultimately undermines the legitimacy of the arbitral process").

[10] Power & Konrad, *The Award – Costs in International Commercial Arbitration – A Comparative Overview of Civil and Common Law Doctrines*, *supra* note 3, at 261 (observing that the differing approaches of arbitral tribunals to cost allocation "are sometimes difficult to apply and typically result in inconsistent or arbitrary awards");

While available empirical evidence is limited, commentators have identified a range of considerations employed by arbitral tribunals in the aggregate, across many cases. But such factors are not applied predictably or consistently from one case to the next and therefore fail to provide guidance to parties as to how costs will be awarded, *ex ante*. Relevant factors include the "outcome" of the merits of the dispute, which can lead to any of three basic approaches: (1) the "prevailing party" recovering all or substantially all of its costs; (2) costs apportioned according to the relative success or merit of the parties' respective positions when neither party wholly prevails; or (3) an equal apportionment (or, more accurately, no apportionment) of the costs.[11] Significantly, commentators have observed that the approaches taken to the allocation of the "procedural costs" (arbitrator fees and expenses and administrative fees) differ from "party costs" (attorneys' and experts' fees and expenses) – even in the same case. Procedural costs tend to be awarded to a "prevailing party," whereas arbitral tribunals are appreciably less inclined to award party costs to a prevailing claimant, and even less so to a prevailing respondent.[12] This trend may result from other relevant considerations

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Bühler, *Awarding Costs in International Arbitration: An Overview*, *supra* note 3, at 249, 252-53 (observing there is an "arbitral precedent to support nearly any approach a tribunal may wish to apply to its cost decision" and that the drafters of the UNCITRAL Model Law on International Commercial Arbitration and of the ICC Rules consciously chose not to identify rules for cost allocation but to leave the issue to the widest discretion of the arbitrators); Gotanda, *Awarding Costs and Attorneys' Fees in International Arbitration*, *supra* note 3, at 2 ("awards of costs and fees in international commercial arbitration are often arbitrary and inconsistent"); Bühler, *Costs in ICC Arbitration: A Practitioner's View*, *supra* note 3, at 152 (observing that tribunals in ICC arbitration exercise broad discretion in allocating procedural and party costs with the result that "allocations vary enormously without apparent justification from one arbitration to another"). *See also* Jenny Power, *Investment Arbitration – Determination of Costs in ICSID Arbitration*, *in* CHRISTIAN KLAUSEGGER, PETER KLEIN ET AL., AUSTRIAN ARBITRATION YEARBOOK 337, 338, 351 (2010) (observing that cost allocation under the ICSID Convention is committed to the discretion of the tribunal; reviewing ICSID cost decisions as of August 30, 2009 and concluding that while certain considerations are discernable, "it is impossible to predict which principles a particular tribunal will apply in apportioning costs in ICSID proceedings").

[11] *See* Bühler, *Costs in ICC Arbitration: A Practitioner's View*, *supra* note 3 (commenting on cost allocations in ICC awards); YVES DERAINS & ERIC A. SCHWARTZ, A GUIDE TO THE ICC RULES OF ARBITRATION 370-74 (2005) (same); Power, *Investment Arbitration – Determination of Costs in ICSID Arbitration*, *supra* note 10, at 340 (identifying approaches employed in ICSID awards).

[12] *See* Bühler, *Costs in ICC Arbitration: A Practitioner's View*, *supra* note 3, at 143 (observing that while it appears to be "the norm" in ICC awards that the prevailing party recovers its procedural costs, when it comes to party costs, the "simplest and possibly most common approach" is that each party pays its own legal costs, even when a claimant's claims are rejected as unfounded); DERAINS & SCHWARTZ, A GUIDE TO ICC ARBITRATION, *supra* note 11, at 372-73 (noting that party costs are "much less frequently" awarded to a prevailing claimant than are procedural costs, whereas in awards in which a

variously employed by arbitrators when allocating costs, such as a 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.[13] Thus, it is observed that arbitrators will often decide "that each party will be responsible for its own legal costs, perhaps in order to avoid adding insult to injury" or because parties to international arbitration reflect diverse backgrounds and norms in which a loser-pays principle has not achieved consensus.[14] In some cases, the allocation of costs may result from the party-appointed arbitrator dynamic: 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. Finally, commentators have observed the relevance of party conduct during the course of the arbitration to the allocations of costs. Procedural misconduct, dilatory tactics, inflated damages claims and spurious arguments and positions can all factor into a final award of costs.[15]

In sum, experience and the literature to date point to a number of identifiable considerations when allocating costs, but to a lack of consistency or predictability in how or when they are applied that might inform party behavior in advance. What trends are discernable from the limited available empirical data suggest that, if anything, a "loser pays" principle prevails when it comes to procedural costs,

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claimant obtained substantially less than half of what it sought or less than did the respondent, both procedural costs and party costs were typically allocated equally between the parties); Power, *Investment Arbitration – Determination of Costs in ICSID Arbitration*, *supra* note 10, at 345 (noting that where ICSID tribunals apportion administrative costs on a loser-pays basis, they remain reluctant to order the unsuccessful party to pay any of the successful party's legal fees and expenses).

[13] *See, e.g.,* Murray L. Smith, *Costs in International Commercial Arbitration*, 56 DISP. RESOL. J. 30, 33 (2001) ("A party should not necessarily be penalized for presenting claims or defences which are not ultimately successful"); Power, *Investment Arbitration – Determination of Costs in ICSID Arbitration*, *supra* note 10, at 340 (noting among other factors identified in a review of ICSID awards "the notion that losing parties should not be penalized for bringing claims which are novel or complex" and "the notion that the determination and apportionment of costs should be fair and equitable"); Gotanda, *Awarding Costs and Attorneys' Fees in International Arbitration*, *supra* note 3, at 2-3 ("It is not uncommon for [arbitration] costs to run into the millions of dollars, sometimes even exceeding the amount in dispute"); Mark Hoyle, *Costs in International Arbitration: The Issues for Future Harmonisation*, 6(1) TRANSNATIONAL DISPUTE MGMT (March 2009) ("The difficulty that has arisen now is that cost awards are often reaching or exceeding the substantive monetary award").

[14] W. LAURENCE CRAIG ET AL., INTERNATIONAL CHAMBER OF COMMERCE ARBITRATION 395 (3d ed. 2000); ALAN REDFERN & MARTIN HUNTER, LAW AND PRACTICE OF INTERNATIONAL COMMERCIAL ARBITRATION 397-98 (4th ed. 2004).

[15] *See* Bühler, *Awarding Costs in International Arbitration: An Overview*, *supra* note 3, at 265-66; Power, *Investment Arbitration – Determination of Costs in ICSID Arbitration*, *supra* note 10, at 340.

whereas party costs consisting of attorneys' fees and expenses are most often left to each party to pay on its own.

Does flexibility in the allocation of costs, at the price of predictability, best serve international arbitration's goals? Do emerging tendencies to award procedural costs to a prevailing party but leave party costs where they are make the most sense for international arbitration? The following section examines these questions more closely, in light of international arbitration's particular qualities and objectives.

III. THE PURPOSE OF COST ALLOCATION IN INTERNATIONAL COMMERCIAL ARBITRATION

Cost allocation in international commercial arbitration ought to serve to advance international arbitration's distinctive features. To be sure, one of those features is procedural flexibility. However, and as critics observe, flexibility comes at a price – in terms of time and cost. While everyone may be able to agree *ex ante* that time and cost efficiency are important to international arbitration, users do not always practice what they preach once they are in the context of an actual dispute, with the result that flexibility compromises time and cost efficiency by allowing parties-turned-adversaries to argue in each case for whatever procedures (and associated costs) will provide maximum tactical advantage.[16]

It is possible for *cost allocation* to serve as ballast between international arbitration's competing goals of flexibility and time/cost effectiveness. Cost allocation can serve to inform and economize the cost-incurring choices parties make in arbitration before they make them. But it can do so only if (a) the ground rules for cost allocation to be applied by the tribunal in its discretion are identified ahead of time for parties to conduct themselves accordingly; and (b) the ground rules that apply serve to enhance international arbitration's time and cost efficiency by encouraging parties to make cost-efficient choices in international arbitration.

Party costs, as distinguished from procedural costs, account for the overwhelming majority of the overall costs associated with international arbitration,[17] and increasing user disaffection with those costs. If cost allocation is to serve to enhance efficiency in international arbitration – and contrary to the trend observed by those who have studied the available empirical evidence thus far – party costs should be allocated in a manner that deters unwarranted claims and defenses and unnecessary arbitral procedures.

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[16] *See, e.g.*, Steven Seidenberg, *International Arbitration Loses its Grip: Are U.S. Lawyers to Blame?*, ABA J. (April 2010), *available at* http://www.abajournal.com/magazine/article/international_arbitration_loses_its_grip.

[17] Internal ICC International Court of Arbitration statistics indicate that party costs constitute, on average, 82% of all costs of the arbitration. *See* Report from the ICC Commission on Arbitration, *Techniques for Controlling Time and Costs in Arbitration*, at 11 (ICC Publication No. 843 2007).

Indeed, international arbitration's characteristics are more amenable to the "loser pays" principle of civil-law jurisdictions[18] (and England) than to the American rule of each party paying its own party costs. The so-called "American rule" is rooted principally in concerns over the public administration of justice and ensuring access to the courts for litigants of limited means, in a common-law judicial system where individual disputes serve to articulate and define the governing law through precedent, and express societal standards.[19] These considerations do not pertain to the same extent in international commercial arbitration. In international commercial arbitration, parties agree to a contractual dispute resolution mechanism as a term of doing cross-border business. Arbitration serves to facilitate international commerce by providing a means of resolving disputes, which are a byproduct – and cost – of doing business. The principal purpose of the parties' dispute resolution mechanism in international commercial arbitration is therefore to resolve private disputes between commercial parties – not to ensure access to social justice or to articulate social standards to be applied as precedent in other cases.[20] In addition, parties that agree to international arbitration presumptively possess the resources to engage in arbitration, should it become necessary to do so, and have agreed that they will do so. Accordingly, international commercial arbitration does not implicate the same access to social justice considerations as do national court systems – at least not on a systemic basis (arbitral tribunals could remain free to consider inequalities of means in individual cases). For these reasons, a "loser pays" principle is well suited to international commercial arbitration.

IV. ALLOCATING COSTS TO ACHIEVE GREATER TIME AND COST EFFICIENCY IN INTERNATIONAL COMMERCIAL ARBITRATION

But to conclude that a "loser pays" principle makes sense in international commercial arbitration does not go far enough. As commentators have observed, it is often this very principle in concept that leads to a prevalence of "50/50" splits in party costs (*i.e.*, more accurately, no allocation of party costs) – perhaps due to

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[18] It bears noting that the "loser pays" principle may be applied differently in practice in different civil-law jurisdictions. In many if not most civil-law jurisdictions, the amount awarded as costs – whether determined by statute or by the court – is ordinarily considerably less than the prevailing party's actual litigation costs. *See, e.g.,* Gotanda, *Awarding Costs and Attorneys' Fees in International Arbitration*, *supra* note 3, at 8 & n.29 (observing that "in England, Germany, and Switzerland the amount of attorneys' fees is determined by a fixed fee schedule, which may not reflect the actual fees incurred" and that this leads to "the successful party rarely recovering all of its litigation costs").

[19] *See, e.g.,* Fleischmann Distilling Corp. v. Maier Brewing Co., 386 U.S. 714, 718 (1967).

[20] While some commentators have called for more publication of arbitral awards as a potential source of *lex mercatoria* in international commerce, most international commercial arbitrations (as opposed to international investment arbitrations), including most arbitration awards, remain purely private affairs.

the influence of countervailing considerations such as not wanting to "add insult to injury" or punish meritorious, even if unsuccessful, positions. To apply a "loser pays" principle that serves to achieve greater time and cost efficiency in international arbitration requires deeper exploration of what it actually means for the loser to pay, and how that principle is to be applied in practice – lest it be applied in name, but with the same unpredictable outcomes and predominating "50/50" results that commentators have been observing.

For example, if a claimant succeeds in recovering 20% of its claimed damages, while the respondent succeeds in defending against 80% of the claim, is the claimant to recover 20% of its reasonable attorneys' fees and expenses? Is the respondent to recover 80% of its reasonable attorneys' fees and expenses? Should each recover both, respectively, resulting in a net offset that entitles respondent to recover approximately 60% of its reasonable party costs (assuming the parties retained comparably priced legal and expert representation)? Should each party's costs just be left to that party in view of the fact that each party was partially successful and presented a partially successful case? Tribunals can – and from available empirical evidence and anecdotal experience, in fact do – arrive at any of the above conclusions, applying in every instance, at least conceptually, a "loser pays" principle.

And what is the measure of "100%" from which 20, 80 or 60% – *i.e.,* "partial" success – derives? Does it include inflated and unwarranted damages claims? Or meritless counterclaims? Or costs needlessly incurred by the conduct of one party that do not actually or accurately reflect the core of the issue(s) that were necessary for an arbitral tribunal to decide? How does it account for claims seeking interim or equitable relief or specific performance, which are not quantifiable in monetary terms? A "loser pays" principle, without more, does not reliably identify either how to divide up the pie in a principled and predictable way, or what the dimensions of the pie ought to be.

Complicating matters, parties and arbitrators could spend considerable time, effort and expense arbitrating over these very issues, and how the award of costs should be allocated. The higher the costs become in arbitration, the higher the stakes of how they are allocated and – in something of a snowball effect – the more hotly contested, time consuming and expensive the allocation question – and therefore the party costs incurred – may also become.

If the "loser pays" principle is going to serve international arbitration's time and cost efficiency goals, it should be applied in a manner that consistently and predictably discourages unmeritorious claims, counterclaims and defenses, and reinforces successful ones. In the 20% versus 80% hypothetical posed above, it does not seem optimally cost effective for a claimant that is 20% successful to recover 20% of its fees from a respondent that prevailed on 80% of its case. Such a result effectively penalizes a predominantly successful defense. But similarly, it does not seem to optimize arbitration's cost efficiency if the claimant is obligated to pay 80% of the respondent's costs to successfully recover 20% of what it sought.

A balanced approach, which seeks to avoid overly formulaic allocations and skewed results – while at the same time avoid micro-parsing the parties' respective claims and defenses which can lead to more time and cost than it deters – would be a global allocation approach that looks at the merits of the case as a whole, and treats the allocation of costs as a sliding scale based upon a holistic assessment of where the merits came to rest as between claimant's position(s) and respondent's position(s).

A global allocation of merits approach appreciates the proposition that some issues will go more to the heart of a case and prove more important than others, and that claims and defenses will have *relative* merit, not absolute merit or a lack thereof. Sometimes, if not more often than not, successful claims and defenses are close calls, or at least close enough that economically rational parties need an arbitral tribunal to resolve the relative merits of their respective positions. And yet, in such instances, which ought to account for most arbitrations that proceed through hearing and require a final award and allocation of costs (because the parties' respective positions have sufficient merit that they do not settle), there should be some accounting for the parties' relative success, if the loser pays principle is to have any appreciable effect and not result, as commentators observe, in a default 50/50 split whenever each side partially prevails.

On other occasions, a tribunal may conclude that a dispute was not so close as to warrant arbitration, or a full merits hearing and award, to resolve. As a practical matter, arbitral tribunals do not often exercise the same institutional authority as national courts to summarily resolve disputes or to apply settlement pressure on the parties. Where a prevailing party was constrained to pursue arbitration of a claim or defense for which the merits – even if colorable or arguable in good faith – in the estimation of the arbitral tribunal nevertheless objectively should have been clear to the other party and summarily and consensually resolved, the prevailing party should be able to recover its reasonable costs, or so much of the costs as are commensurate with the tribunal's assessment of the relative merits, recognizing that the relative merits of each party's position is not static, but may evolve or emerge only in the course of the arbitral proceedings. Thus, a claim, defense, counterclaim or subsidiary issue of fact or law that is dispositive, may appear to be meritorious at the outset of arbitration, but with the development of the record prove not to be so. Conversely, a claim, defense, counterclaim or subsidiary issue of fact or law that may appear unfounded or speculative at the outset, may in the course of the proceeding prove not to be so. Arbitration is a process in which the parties and tribunal develop a record of the facts and relevant law necessary to resolve the dispute. Issues of fact or law material to the resolution of the dispute may emerge, submerge, or shift as the development of the arbitral record progresses. Arbitral tribunals are well situated to assess at the end of a case the percentage of costs that should, in view of the above considerations, be awarded to a prevailing party. So too are the parties and their counsel. The allocation of costs should incentivize the parties to make these evaluations and act accordingly.

At the same time, however, cost allocation should not devolve into a mini-arbitration of its own, in which each claim, defense, or disputed issue must be parsed and assigned a value that parties fight over – lest the objective of enhancing international arbitration's efficiency through cost allocation be lost as a result of cost allocation becoming an overly burdensome and time-consuming issue in its own right.

To apply a global allocation of merits approach to the 20% versus 80% hypothetical introduced above, it simply would not be sufficient to know that the claimant recovered 20% of its claim. Monetary results do not necessarily, or even commonly, reflect the *actual* balance of the *merits*. It may be that claimant's damages claims were inflated. Or it may be that either the claimant or respondent very clearly had the better of a dispositive issue on the merits (for which the other party should have known as much) that led to the partial, 20% recovery. The 20% recovery figure in of itself does not really capture whether the *merits* favored the claimant or the respondent, and who is therefore more appropriately taxed with a share, if any, of the other side's costs, as a result of burdening the other party with an arbitration in which one side was 20% successful.

Counterclaims deserve special attention in this context. While counterclaims are often asserted in good faith and meritorious, they are also often asserted principally for strategic reasons. Such strategic reasons can include a party's desire to create leverage with its adversary to settle the case, to position itself with the tribunal to achieve a "split the baby" zero outcome in the arbitration, or simply to avoid being postured completely on the defensive. These strategic counterclaims, however, nevertheless cost time and money to adjudicate. The allocation of costs based on a global merits approach – particularly if announced to the parties by the tribunal at the outset of the arbitration – may play a useful role in discouraging such costly strategic counterclaims.

Equally important to a global allocation of merits approach, which assigns the costs of arbitration based upon the parties' relative responsibility for incurring those costs when the merits of the case and its outcome are viewed as a whole, is the conduct of the parties during the proceeding. While this consideration gets paid frequent lip service, the preponderance of 50/50 splits and anecdotal experience suggest that it does not receive much application in practice. Basically, only egregious misconduct or dilatory behavior tends to count in the final allocation of costs. But if international arbitration is to be as time and cost efficient as it aspires to be, a more sensitive calibration of this factor may be in order.

Parties advocate for more or fewer procedures in arbitration depending upon their tactical objectives. The varieties of procedural gamesmanship employed are virtually limitless, but common examples include (i) sandbagging (*e.g.*, withholding legal or factual arguments from a party's initial presentation of case, in an attempt to deprive the other party of a full opportunity to respond to them, occasioning supplemental briefing); (ii) document dumps (overproducing documents to make work for the other side in identifying the relevant and material documents); (iii) withholding documents that reasonably should have been

produced without the need for follow-up demands or applications to the tribunal; and (iv) failing in other respects to abide by the terms of any procedures that are agreed upon or directed by the arbitral tribunal without good cause for doing so. There is simply no denying that parties with greater resources do sometimes attempt to leverage resource disparity to their advantage and impose unnecessary costs that are disproportionately burdensome on an adversary with fewer resources. When this occurs, and is brought to the attention of the tribunal, it should be relevant to the overall allocation of costs.

In addition, even when a party is not motivated by tactical advantage, and genuinely seeks additional procedures to which an opposing party objects, whether it is in the form of document production, briefing, witnesses, experts or anything else beyond what the other party agrees is necessary, they should ask themselves, and the tribunal should ask itself at the end of the day, whether the requested procedures and costs were necessary and helpful to the resolution of the case. If not, and a party should have known as much, costs may appropriately be assessed to discourage parties from imposing costly procedures they could and should have done without. In other words, parties should be incentivized to be cautious about requesting procedures that cannot be agreed, and only seek to do so when a party believes that the need for the additional sought-after procedures outweighs the risk that it may count against them in the overall assessment and allocation of costs. As with the merits, this requires a global assessment by the tribunal. If it is understood by parties *ex ante* that tribunals will make such an assessment, and not merely allocate costs only for misconduct, parties will have to assess their procedural needs more carefully, with the other side's costs in mind. A more robust assessment of each party's responsibility for the costs incurred in the conduct of the case ought to encourage more cost-efficient choices by parties when seeking to impose additional procedures on another party.

Finally, a word on the appropriate analysis for allocating party costs is in order. Some arbitral tribunals analyze the allocation of party costs in two stages: they ask first, which of the claimed attorneys' or expert fees and expenses are "reasonable"? And second, how should the parties' reasonable fees and expenses be allocated among the parties?[21] Other tribunals combine reasonableness and allocation as a single inquiry into which of a party's claimed costs should reasonably and appropriately be allocated to another party.[22] Because the factors

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[21] The ICC Arbitration Rules, for example, arguably contemplate this two-step analysis. First, the tribunal decides whether the claimed party costs constitute "reasonable legal and other costs incurred by the parties for the arbitration," so as to qualify for inclusion as one of the "costs of the arbitration" within the meaning of Article 31(1) of the ICC Rules. Second, after "fixing" the costs of the arbitration, the tribunal decides "which of the parties shall bear them or in what proportion they shall be borne by the parties" pursuant to Article 31(3) of the ICC Rules.

[22] The LCIA Arbitration Rules, for example, arguably call for this combined analysis for allocating party costs. Specifically, Article 28.3 of the LCIA Rules addresses the allocation of party costs separately from the procedural "arbitration costs" addressed in Article 28.3-4, and directs the tribunal, in order to "award that all or a part of the legal or

considered in determining the reasonableness of the claimed party costs and the appropriateness of allocating those costs to another party largely overlap,[23] the analytical path used to allocate party costs does not and should not ordinarily dictate different results as to the ultimate allocation of costs. The combined approach may be preferable insofar as it is simpler – requiring the tribunal to determine only which party costs are reasonable to allocate to another party, providing less opportunity for mini-arbitrations of the issue of allocation – and adds less "insult to injury" to the losing party (and, in particular, the losing party's counsel) to the extent it avoids a direct pronouncement on the reasonableness of the attorneys' fees and expenses incurred by that party. Accordingly, the guidelines proposed below do not segregate factors relevant to the reasonableness of a party's costs and the appropriateness of allocating those party costs to another party.

V. PROPOSED GUIDELINES FOR AWARDING COSTS IN INTERNATIONAL COMMERCIAL ARBITRATION

In light of the above general considerations and discussion, the following Guidelines for Awarding Costs in International Commercial Arbitration are proposed, to provide a framework for the exercise of arbitral discretion when allocating costs to enhance international arbitration's time and cost efficiency. The Guidelines proceed from the following efficiency-enhancing objectives, distilled from the discussion above:

(a) The allocation of costs should be kept relatively simple and not devolve into arbitrations within arbitrations.

(b) The "loser pays" principle ought to mean something in practice that is more responsive and sensitive to the relative merits of the case than is either a default "50/50" split (*i.e.*, no allocation) whenever both sides present a partially meritorious position or mechanical allocations of costs based upon the amount of relief requested versus awarded.

(c) Similarly, the allocation of costs ought to be more responsive and sensitive to the cost-incurring conduct of the parties during the course of the arbitration. If the parties' conduct of the arbitration factors into the

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other costs incurred by a party be paid by another party," to "determine and fix the amount of each item comprising such costs on such reasonable basis as it thinks fit."

[23] For example, the manifest lack of merit of a claim, defense or counterclaim may bear equally on the "reasonableness" of the party costs incurred in advancing that claim, defense or counterclaim, as it does on the appropriateness of allocating those costs to another party. Similarly, a party's misconduct during an arbitration can be relevant both to the reasonableness of the costs incurred in connection with that misconduct and the appropriateness of allocating those costs to the other party.

allocation of costs only at the extreme, when there is misconduct, it is not really going to influence the cost-incurring choices that parties make in virtually any arbitration and encourage those choices to be made more efficiently.

1. As international commercial arbitration is intended to provide a forum for dispute resolution that maximizes its users' ability to self-determine the manner in which their disputes will be resolved, parties may wish to address in their arbitration agreement the manner in which the "procedural" costs (arbitrator fees and expenses and administrative fees) and "party" costs (attorneys' and experts' fees and expenses) of arbitration will be allocated. Any agreement as to allocation of costs set forth in the parties' arbitration agreement (including in the arbitration rules selected by the parties in their arbitration agreement) should be honored and applied by the arbitral tribunal.

2. Where parties to international commercial arbitration have not identified with sufficient specificity in their arbitration agreement how they wish to have the subject of costs addressed, the arbitral tribunal should solicit the views, and if possible, agreement of the parties on the subject at the commencement of the arbitration. If agreement is not possible, the tribunal should identify for the parties at the commencement of the arbitration the guidelines and factors it will consider in allocating costs at the conclusion of the arbitration, taking into account the views of the parties, so that the conduct of the arbitration thereafter may be informed by applicable guidelines for the allocation of costs. The tribunal may include reference to those guidelines and factors in a procedural order or timetable in the arbitration.

3. If an alternative basis for cost allocation is not agreed upon by the parties or otherwise determined by the tribunal at the commencement of the arbitration, then the arbitral tribunal may apply the following guidelines:

   3.1 Costs shall be allocated in the final award in a manner that the arbitral tribunal believes under the circumstances of the case as a whole, and in light of the below guidelines, vindicates the objectives of time and cost efficiency in international commercial arbitration.

   3.2 Absent agreement by the parties to the contrary, there is no principled reason to allocate the "procedural" costs and "party" costs of the arbitration differently. Absent party agreement or good reason to proceed otherwise, the procedural costs and party costs will be aggregated together and allocated collectively as the "Costs" of the arbitration.

   3.3 The arbitral tribunal shall take into account in its allocation of the Costs of the arbitration the relative merits of each party's case within the context of the dispute as a whole and shall allocate the Costs of the arbitration to

fairly reflect the relative merits of the parties' positions on the issues that required the tribunal's resolution. The following non-exhaustive specific considerations may guide the arbitral tribunal's assessment of the relative merits of the case as a whole:[24]

(a) Whether any position taken by a party in the arbitration in respect of the merits was frivolous, meritless, asserted principally for strategic reasons or otherwise unreasonably maintained during the course of the arbitration in view of the law or the facts adduced in the arbitration, thus requiring the tribunal's determination of an issue that should not have required determination had the party sponsoring a position reasonably and objectively assessed the merits of its position under the circumstances.

(b) Whether either party asserted claims or counterclaims for monetary damages that were needlessly or unreasonably excessive.

(c) Whether any party was successful on any non-monetary claim, such as for equitable relief or specific performance.

(d) Whether any party made a settlement or other offer to another party either before or during the course of the arbitral proceeding that was rejected, in an amount or otherwise of a value in excess of what the offeree was finally awarded by the arbitral tribunal on the merits and whether, under all the circumstances, the offeree reasonably should have accepted the settlement or other offer at the time it was made or during any period of time in which it remained open.[25]

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[24] The tribunal may wish to conceive of the relative merits of the case based upon a system of points, with 100 points in total, and each side starting out with 50 points such that, were no points allocated, the result would be that each side bears its own Costs. Points may then be allocated to one side or the other, in accordance with the arbitral tribunal's assessment of the relative merits of each party's case and the several considerations that bear on the determination, to arrive upon a percentage allocation of the Costs of the case reflecting the relative merits.

[25] Ordinarily, of course, the fact and substance of any settlement offer will not be disclosed to the arbitral tribunal. Parties and arbitrators, however, may consider agreeing to the following procedure for allocating Costs: At the outset of the arbitration, each party indicates its best and final settlement offer in a sealed envelope provided to the tribunal, which the tribunal does not open until the end of the case. After the tribunal has decided the merits of the parties' respective claims and defenses, the tribunal opens the envelopes containing the parties' respective settlement offers, and then proceeds to allocate Costs in light of those settlement offers. This procedure should incentivize the parties to make reasonable settlement offers and provides a more concrete basis for the tribunal's determination as to whether a party's refusal to settle the case was reasonable. Similar settlement offer procedures are to be found in the English Civil Procedure Rules and

3.4 The arbitral tribunal shall take into account in its allocation of the Costs of the arbitration whether, and any extent to which, Costs were incurred by a party as a result of bad faith, dilatory tactics, lack of reasonable cooperation, or wasteful, unreasonable or other conduct of an opposing party during the course of the arbitral proceeding. The following non-exhaustive specific considerations may guide the arbitral tribunal's assessment of the parties' conduct during the course of the arbitral proceeding:[26]

(a) Whether any party failed to abide by the terms of any procedural timetable or rules governing the conduct of the proceeding that were agreed upon or directed by the arbitral tribunal, without good cause for doing so.

(b) Whether any party sought to leverage a relative resource disparity to its advantage and impose unnecessary costs on a party with fewer resources.

(c) Whether any procedures requested by a party and opposed by another party that accounted for a material portion of the overall Costs of the arbitration were, in the view of the tribunal in light of the final award, unnecessary or unhelpful to determine the merits of the case.

3.5 It is neither desirable nor practical for arbitral tribunals to allocate Costs mechanically or formulaically on the basis of the percentage of relief awarded versus requested (*i.e.*, a claimant's 20% recovery of its requested relief may not reflect the true merits of the case and does not account for party conduct). Costs shall be awarded in the discretion of the tribunal, based upon the relative merits and conduct of the parties in light of the case and its outcome as a whole.

3.6 The arbitral tribunal shall have discretion to take into account other considerations that the tribunal may deem relevant to the allocation of Costs in a particular case, which include, without limitation:

(a) The proportionality of the Costs incurred and to be allocated to the overall stakes and/or relief awarded in the arbitration. Absent extraordinary circumstances, Costs awarded to a party generally

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Practice Directions, Part 36 (Offers to Settle and Payments into Court), and in the U.S. Federal Rules of Civil Procedure, Rule 68 (Offer of Judgment).

[26] Using the 100-points system described *supra* note 24, the allocation of points based on the relative merits of the parties' respective positions in the arbitration may then be further adjusted, up and down, to account for considerations of party conduct.

should not exceed 20% of the amounts reasonably claimed in the arbitration.[27]

(b) The relative resources of the parties and their capacity to pay the Costs of the other party.

(c) The reasonableness of the party costs incurred by a party.

(d) The parties' reasonable expectations as to the allocation of Costs in light of the allocation of costs practices in the national courts of the parties' respective nationalities and domiciles.

(e) Overall fairness to the parties.

4. In determining the allocation of Costs, parties and arbitrators should take into account any mandatory rules concerning the allocation of arbitration costs of the country in which the arbitration is seated.[28]

VI. CONCLUSION

As costs continue to rise in international commercial arbitration, and concerns about costs along with them, the allocation of costs presents an important opportunity to promote greater time and cost efficiency, but only if predictable guidelines are identified in advance and are employed in a manner that encourages efficient party behavior. This article offers a first step toward employing cost allocation to achieve greater time and cost efficiency in international commercial arbitration through guidelines that are tied to the relative merits of the case and the parties' conduct of the arbitral proceedings.

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[27] Parties and arbitrators remain free, of course, to stipulate a different percentage limit of awardable Costs to amounts claimed either in the parties' arbitration agreement or at the outset of the arbitration.

[28] In England, for example, parties are precluded from agreeing, prior to the dispute arising, that one party pay "the whole or part of the costs of arbitration in any event," regardless of the outcome. Arbitration Act 1996, c. 23, § 60 (Eng.); ROBERT MERKIN, ARBITRATION LAW ¶ 18.77 (2010). For a discussion of choice-of-law issues concerning the allocation of legal costs in arbitration, *see* BORN, *supra* note 5, at 2494-95.