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“Best Practices in International Arbitration”

“Final Rulings on Costs: Loser Pays All?”

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1. The Focus of the Topic*

The costs of arbitration, including notably the costs of party representation and most particularly “attorney’s fees,” are qualitatively and quantitatively a significant component in the overall arbitration dispute. The trend is toward ever more intensive, and thereby ever higher, costs, especially in large-scale construction and investment disputes. Should the loser pay all, including attorney’s fees?

How should the disposition of the issue be handled: In the arbitration agreement? In the procedural directions of the tribunal? In the motivation of the final award on costs? Is a “best practice” on cost allocation, including attorney’s fees, desirable? Is it feasible? At what expense and with what attendant risks? Via changes to legislation? To institutional or ad hoc rules? Via promulgation of harmonizing “guidelines”?

* The original presentation style has intentionally been substantially preserved.

2. *The Differing Approaches, or "Practices," Respecting Cost Allocation in Recent Years*

There are various approaches or practices respecting cost allocation which have emerged in recent years.

-- *First*, "costs follow the event" pure – The victor takes all, the loser pays all costs of arbitration and all opposing costs of party representation (hereafter "attorney's fees" for short).

-- *Second*, "costs follow the event" pro rata – The loser pays all costs of arbitration and all opposing attorney's fees in proportional relationship to the outcome.

-- *Third*, "costs follow the event" modified – The loser pays all costs of arbitration, but not necessarily all or any opposing attorney's fees.

-- *Fourth*, costs to be shared equally – 50-50 as to either costs of arbitration or attorney's fees or both, irrespective of any disparity in respective investment in attorney's fees.

-- *Fifth*, the costs of arbitration are to be shared equally, respective attorney's fees to be borne by each side.

-- *Sixth*, the "American Rule" – Each party bears its own costs of arbitration and attorney's fees, irrespective of the outcome or other externalities.

-- *Seventh*, the "American Rule" exception – In the presence of manifest fraud, corruption, spuriousness, abusiveness of process, etc., the culpable party bears some or all of the costs of arbitration and/or attorney's fees of the other party.¹

¹ For prior discussions of the "American Rule," see, e.g., Kreindler, "Die Kostenentscheidung im Schiedsgerichtsverfahren aus US-amerikanischer Sicht," in German Institution of Arbitration (Deutsche Institution für Schiedsgerichtsbarkeit), *Kosten im Schiedsgerichtsverfahren, DIS-MAT X* (2005); Born, *International Commercial Arbitration* 910-13 (2001); Coe, *International Commercial*

3. *The Differing Rationales in Cost Allocation: Entry Barriers, Rewards and Deterrence*

Each of the foregoing approaches presupposes a particular rationale and reason for being, which may be summarized as follows:

In the case of "costs follow the event" pure, the victor is fully compensated for his successful outcome (even as an extension of his contractual/delictual right to his full *damnum emergens*). The loser is penalized for his unsuccessful availing of the procedure (even as an extension of his contractual/delictual duty to owe consequential or punitive damages): The victor's incurred costs are considered *prima facie* to be legitimate and compensable. Thereby putatively unmeritorious claims are generally intended to be deterred.

"Costs follow the event" pro rata follows a similar approach, but only in proportion or relation to the degree of success. Thereby, meritorious but quantitatively inflated claims are generally intended to be deterred.

"Costs follow the event" modified also follows a similar approach, but with a distinction made between costs of arbitration (institution, arbitrators, etc.) and costs of representation (attorney's fees, etc.), with the former but not the latter considered to follow the event. This is seen effectively as a compromise between "costs follow the event" and the "American Rule."

Costs to be shared equally is basically a 50-50 split, intended neither to deter nor to encourage significant investment in attorney's fees.

Arbitration 113-14, 178-79 (1997); Craig Park Paulsson, International Chamber of Commerce Arbitration § 21.04 (3d ed. 2000); Fouchard Gaillard Goldman, On International Commercial Arbitration §§ 1253-56 (Gaillard & Savage Eds. 1999); Mustill & Boyd, Commercial Arbitration 394-98 (2d Ed. 1989); Redfern & Hunter, Law and Practice of International Commercial Arbitration, §§ 8-85 to 8-92 (3d ed. 1999).

And a further modification is where the costs of arbitration are to be shared equally, but the respective attorney's fees are to be borne by each side, so that there is a partial application of the "American Rule."

Under the "American Rule" itself, potentially but not manifestly promising claims (even arguably excessive ones) are encouraged, or at least not discouraged, by the risk of cost bearing. Entry barriers to litigation are thereby lowered or removed, and each party bears the risk of its decision respecting the scope of investment in attorney's fees.

Finally, under the "American Rule" exception, there is the rare possibility of partial or complete cost recovery by the victor, *or by the non-culpable loser*, in the presence of abuse of process, manifest dilatoriness, etc. Thereby, abusive or bad-faith conduct even in relation to a meritorious/successful claim or defense is generally intended to be deterred.

4. Differing Endorsement, Application and Implementation in Recent Law and Practice

There has been differing endorsement, application and implementation of the foregoing approaches in recent legislation, arbitration rules, case law and awards.

Legislation.

In the area of legislation, for example, the English Arbitration Act 1996, Sec. 61(2) provides: "Unless the parties otherwise agree, the tribunal shall award costs on the general principle that *costs should follow the event except* where it appears to the tribunal that in the circumstances this is not appropriate in relation to the whole or part of the costs." [emphasis added] In Germany, Book Ten of the Civil Procedure Code, Sec. 1057(1), is largely to the same

effect. In Switzerland, Chapter 12 of the Private International Law Statute interestingly contains no mention whatsoever.

In the United States, the Federal Arbitration Act likewise contains no mention² while the Uniform Arbitration Act, Sec. 21(b), provides that absent a party agreement on costs, there shall be no tribunal award of costs.³ In the area of annulment proceedings relating to cost awards, there is both statutory support⁴ and case law precedent⁵ for the notion that where there is no express prior party agreement to have the arbitral tribunal allocate costs, or no express prior party agreement to have the arbitral tribunal allocate attorney's fees specifically, an arbitral award of such costs can be vacated, even on the uniquely American grounds of "manifest disregard of the law."⁶ The same

² The relevant provisions in the FAA, §§ 9-11, solely make reference to the "Award of arbitrators; confirmation; jurisdiction; procedure ... vacation; grounds; rehearing ... modification or correction; grounds; order." "Costs" are not mentioned in the FAA. "Fees" are mentioned only in § 7, in the context of witnesses.

³ 35 states of the United States have acceded to the UAA; 14 have enacted similar laws of their own. See Prefatory Note to the 2000 Revisions to the UAA at <http://www.law.upenn.edu/bll/ulc-uarba/arbitrat1213.htm>.

⁴ See UAA § 21(b) (revised 2000) ("An arbitrator may award reasonable attorney's fees and other reasonable expenses of arbitration if such an award is authorized by law in a civil action involving the same claim or by agreement of the parties to the arbitration proceeding."). See also CAL. CIV. CODE § 1717(a) ("In any action on a contract, where the contract specifically provides that attorney's fees and costs ... shall be awarded ... to the prevailing party, then ... the party prevailing on the contract ... shall be entitled to reasonable attorney's fees in addition to other costs."); TEX. CIV. PRAC. & REM. CODE ANN. § 171.048(c) ("The arbitrators shall award attorney's fees as additional sums required to be paid under the award only if the fees are provided for: (1) in the agreement to arbitrate; or (2) by law for a recovery in a civil action in the district court on a cause of action on which any part of the award is based."); VERMONT STAT. ANN. tit. 12, § 5665 (2003) ("An arbitration award may direct the payment of attorney fees if the parties have explicitly authorized the arbitrator to make such an award or if the award is based in whole or in part upon state or federal law which permits recovery of attorney fees."); *Monday v. Cox*, 881 S.W.2d 381, 384 (Tex. App. 1994) ("The [Texan] arbitration act provides that an arbitrator shall award attorney's fees when the parties' agreement so specifies or the state's law would allow attorney's fees from a court ...").

⁵ See, e.g., *Bacardí Corp. v. Congreso de Uniones Industriales*, 692 F.2d 210 (1st Cir. 1982); *Sammi Line Co. v. Altamar Navegacion SA*, 605 F.Supp. 72 (S.D.N.Y. 1985); *Transvenezuelian Shipping Co. v. Czarnikow-Rionda Co.*, 1982 A.M.C. 1458 (S.D.N.Y. 1981).

⁶ This concept originates in case law of the U.S. Supreme Court from the 19th Century, e.g., *United States v. Farragut*, 89 U.S. 406, 420 (1874) ("The award [in arbitration] was also liable, like any other award, to be set aside in the court below, for such reasons as ... exceeding the power conferred by the submission, [or] for manifest mistake of law ..."); cf. *Wilko v. Swan*, 346 U.S. 427, 436-37 (1953) ("In unrestricted submissions ... the interpretations of the law by the arbitrators in contrast to manifest disregard are not subject, in the federal courts, to judicial review for error in interpretation."); see also Kreindler, *Transnational Litigation: A Basic Primer* (1998) 294-95.

notion would of course also apply in the rare cases where by operation of U.S. law the possibility of an award of costs to the successful party is foreseen.⁷

In the area of U.S. enforcement of arbitral awards, there is some precedent to the effect that a U.S. enforcing court will not deny enforcement of both domestic and foreign cost awards, including under New York Convention Art. V.1.c⁸, where the award failed to ensure application of the above-referenced "American Rule,"⁹ but it will deny enforcement where the award failed to apply it even though the parties specifically agreed to apply it or where the *lex causae* required it.¹⁰

Otherwise, the "American Rule" is not considered to be in the nature of *ordre public*, so that foreign awards of costs and attorney's fees are respected by US enforcing courts.¹¹

Arbitration Rules.

In the area of arbitration rules, by way of example ICC Rules, Art. 31(3) provides that "[t]he 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.*" [emphasis added] By contrast, the AAA International Rules,

⁷ See, e.g., Racketeer Influenced and Corrupt Organizations ("RICO") Statute, 18 U.S.C. § 1964(c) ("Any person injured in his business or property by reason of a violation of section 1962 of this chapter may sue therefor in any appropriate United States district court and shall recover threefold the damages he sustains and the cost of the suit, including reasonable attorney's fees ...").

⁸ New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards), June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 38, art. V ("Recognition and enforcement of the award may be refused ... only if ... (c) The award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration."), available at http://www.uncitral.org/pdf/english/texts/arbitration/NY-conv/XXII_1_e.pdf.

⁹ See, e.g., Kreindler, id. 294 ("this does not mean that [the 'costs follow the event'] principle, as well as other approaches to apportionment, are not frequently applied in the context of arbitration on U.S. soil or where U.S. law may apply to an arbitration with a foreign situs.").

¹⁰ See Born, id. 912-13.

¹¹ Id. ("The 'American Rule' regarding costs of legal representation does not rise to the level of U.S. public policy ...").

Art. 31 provides that "... [t]he tribunal may apportion such costs among the parties if it determines that such apportionment is reasonable, taking into account the circumstances of the case." [emphasis added]

Probably most interesting in this respect are UNCITRAL Ad Hoc Rules, Art. 40(1) and (2).

Section 1 states: "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 that apportionment is reasonable, taking into account the circumstances of the case."

Section 2 provides: "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." [emphasis added]

The Swiss Rules of International Arbitration, Art. 40(5) stipulate: "Before rendering the award, the arbitral tribunal shall *submit its draft award to the Chambers for consultation* on the decision as to the assessment and apportionment of the costs." [emphasis added]

Treaties and Conventions.

An examination of relevant treaties in this respect is also enlightening, although not necessarily any more indicative of a particular trend or consensus. Thus the International Centre for the Settlement of Investment Disputes (ICSID) Convention, Art. 61(2) 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 these expenses, the fees and 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.” [emphasis added] The North American Free Trade Agreement (NAFTA), Art. 1135(1) provides: “A tribunal may also award costs in accordance with the applicable arbitration rules.” This is to be contrasted with the statement in *S.D. Myers v. Canada*, to the effect that NAFTA Chapter XI practice is not to award legal representation costs.¹²

Interestingly, the 2004 U.S. Model Bilateral Investment Treaty (BIT)¹³, Art. 28(6) takes a somewhat different approach: “When it decides a respondent’s objection under paragraph 4 or 5 [objections as to competence], the tribunal *may, if warranted*, award to the prevailing disputing party *reasonable costs and attorney’s fees* incurred in submitting or opposing the objection. In determining whether such an award is warranted, the tribunal shall consider *whether either the claimant’s claim or the respondent’s objection was frivolous*, and shall provide the disputing parties a reasonable opportunity to comment.”¹⁴ [emphasis added]

This kind of approach begs the question as to whether a tribunal can truly always reliably assess the frivolousness *vel non* of a preliminary objection in a vacuum, divorced from the overall facts and circumstances. Similarly, the refusal to grant bifurcation on jurisdiction or liability cannot always reliably be taken as an indication that the claim was not manifestly frivolous.

¹² *S.D. Myers v. Canada*, Final Award on Costs, 30 December 2002, para. 48, available at <http://www.dfait-maeci.gc.ca/tna-nac/documents/MyersFinalAward-Final-30-12-02.pdf>.

¹³ Available at http://www.ustr.gov/assets/Trade_Sectors/Investment/Model_BIT/asset_upload_file-847_6897.pdf.

¹⁴ Cf. also similarly, in international commercial arbitration, Born, id. 912 (“arbitrators invariably take into account ... the extent to which a party’s conduct needlessly complicated the proceedings ...”); Award in ICC Case No. 7006 (1992), XVIII Y.B. Comm. Arb. 58, 67 (1993); Award in ICC Case No. 6527 (1991), XVIII Y.B. Comm. Arb. 44, 53 (1993); Award in ICC Case No. 5759 (1989), XVIII Y.B. Comm. Arb. 34, 43 (1993); Award in ICC Case No. 4629 (1989), XVIII Y.B. Comm. Arb. 11 (1993); Award in ICC Case No. 6363 (1991), XVII Y.B. Comm. Arb. 186, 211 (1992).

Furthermore, inasmuch as costs may be regarded as a subspecies of general damages, the 1980 Vienna Convention on the International Sale of Goods (CISG), Art. 74 may be recalled: "Damages for breach of contract by one party consist of a sum equal to *the loss, including loss of profit, suffered by the other party as a consequence of the breach...*"¹⁵ [emphasis added] There is in fact isolated case law in the US respecting the ability to trump the "American Rule," excluding recovery of attorney's fees, by applying CISG in international sales disputes.¹⁶

Arbitral Awards.

An examination of arbitration awards is no more revealing of a consensus or harmonization in the area of costs. In the case of domestic commercial arbitration (e.g., where the parties, the *lex causae* and the *lex arbitri* all of same nationality), generally, although not exclusively, the approach followed is that of civil litigation in the respective country. Most countries follow one or another form of "costs follow the event"¹⁷ while US domestic arbitration generally may be seen as following the "American Rule."¹⁸

In the case of international commercial arbitration (e.g., with no full identity of nationalities of parties, *lex causae* and *lex arbitri*), largely awards

¹⁵ Available at <http://www.cisg.law.pace.edu/cisg/text/cisg-toc.html>.

¹⁶ See, e.g., *Zapata Hermanos Sucesores v. Hearthside Baking Co.*, 313 F.3d 385 (7th Cir. 2002).

¹⁷ See, e.g., *Donald Campbell & Co. v. Pollak*, [1927] AC 732, 811 ("the Court has an absolute and unfettered discretion to award or not to award [costs]."). See also *Alyeska Pipeline Serv. Co. v. The Wilderness Soc'y*, 421 U.S. 240, 247 (1975) ("for centuries in England there has been statutory authorization to award costs, including attorneys' fees. Although the matter is in the discretion of the court, counsel fees are regularly allowed to the prevailing party.").

¹⁸ Case law precursors of this rule may be found going as far back as *Arcambel v. Wiseman*, 3 U.S. (3 Dall.) 306 (1796) ("a charge ... for counsel's fees ... ought [not] to be allowed. The general practice of the United States is in opposition to it"); cf. also *Alyeska Pipeline*, id. 421 U.S. at 247 ("In the United States, the prevailing litigant is ordinarily not entitled to collect a reasonable attorney's fee from the loser. We are asked to fashion a far-reaching exception to this 'American Rule'; but having considered its origin and development, we are convinced that it would be inappropriate for the Judiciary, without legislative guidance, to reallocate the burdens of litigation in the manner and to the extent ... approved by the Court of Appeals.").

seem to follow “costs follow the event” or the “American Rule,” with variations, depending upon the weight attributed to the applicable arbitration rules, *lex causae*, *lex arbitri* and other factors.¹⁹ Various recent studies confirm the existence of certain “schools” of approach, but with no overarching harmonization. The 1991 ICC Study is a case in point.²⁰

In the area of international investment arbitration, certain distinctions must be made. In the case of investment arbitrations under institutional or ad hoc rules, the outcome does not appear to be dramatically different to the anecdotal impression gained from international commercial arbitration.

In the case of NAFTA or ICSID, the approach taken is largely one or another form of either “‘costs follow the event’ modified” (i.e., the loser pays all costs of arbitration, but not necessarily all or any opposing attorney’s fees) or the costs of arbitration are to be shared equally, the respective attorney’s fees to be borne by each side or the “American Rule” (each party bears its own costs of arbitration and attorney’s fees, irrespective of the outcome or other externalities).

There are also occasional examples of the “‘American Rule’ exception” (in the presence of manifest fraud, corruption, spuriousness, abusiveness of process, etc., the culpable party bears some or all of the costs of arbitration and/or attorney’s fees of the other party). Recent studies confirm the existence of certain “schools” of approach, with an emerging preference for some variant on the “American Rule.”²¹

¹⁹ See Craig, *id.* § 21.04(iii) (“There is no hard and fast rule as to either the categories or amounts of ‘reasonable legal and other costs incurred by the parties ...’”); Kreindler, *Fn.* 18 295-96 (“To the extent the applicable rules allow the judge to exercise discretion as to what constitutes ‘reasonable’ costs and attorney’s fees, ‘reasonable’ will be subject to different interpretations.”); Redfern, *Fn.* 2 §§ 8-88—8-91.

²⁰ Unpublished, discussed in Derains & Schwartz, *A Guide to the ICC Rules of Arbitration* (2005) 371 f.

²¹ See, e.g., “Cost Issue in Investor-State Arbitration Decisions Rendered Against the Investor: a Synthetic Table,” TDM Vol. No. 5 (Nov. 2005), available at <http://www.transnational-dispute-management.com>.

5. *Resulting Problem Areas in Recent "Practice" Respecting Cost Allocation*

In view of the wide range of approaches and lack of harmonization, it is apparent that certain problem areas present themselves. Competing legal/commercial cultures/expectations of cost recovery can prevail in one and the same arbitral proceeding. There may be competing expectations particularly of attorney's fees recovery. Furthermore, there appears to be an (intentional) lack of transparency or specificity respecting cost allocation in certain legislation, institutional rules, ad hoc rules, including those referenced above.

Among the thorny questions which arise here are, What does "unsuccessful party" mean? Is, for example, a defendant who successfully dismisses US\$ 99 million of an original US\$ 100 million claim "unsuccessful"? Is a claimant who fails on a highly complex, lengthily argued and pleaded issue of wholly first impression, but as to which the arbitral tribunal admits an utter absence of prior precedent or guidance, "unsuccessful"?

An examination of practice thus reveals a lack, in part perhaps intentional, of transparency or specificity respecting the nature and extent of "discretion" of the arbitral tribunal respecting the awarding of attorney's fees, especially in the context of the party's right to equal treatment and to an adherence to the agreed rules. A case in point is the possible tension between UNCITRAL Ad Hoc Rules Article 40(1) and Article 40(2) mentioned above.

There is also a lack, again perhaps intentional, of transparency or specificity respecting the scope of "discretion" enjoyed by the arbitrator on the one hand and the scope of duty owed on the other hand to "motivate" -- to

elucidate and to justify -- the cost component of the award. A case in point here is the possible tension between ICC Rules Articles 25(2) and 31(3).²²

The resulting problem areas also include a lack of full harmonization between (i) legislation allowing for party agreements stipulating cost allocation, (ii) arbitration rules -- otherwise resulting from such party agreement -- which afford tribunal discretion to allocate costs, and (iii) legislation or decisional law of a subsequent enforcing court which may point in yet another direction. Thus absent party agreement, tensions can arise respecting cost allocation between the *lex arbitri* and the *lex causae* respecting cost allocation, and give rise to consequences for enforceability of the costs component of the award.

Furthermore, the mosaic is made increasingly complex by the fact that there are indeed transparently conducted and largely publicly accessible costs awards in the investment arbitration area, particularly under the ICSID and NAFTA regimes. This transparency has also included a perceptible trend to decline to apply "Loser Pays All" and even decline to apply most of the variants of "costs follow the event." instead applying, in greater or lesser degree, the "American Rule."

Thus according to the Ben Hamida Study, most NAFTA and BIT-based ICSID cost awards have not awarded the victorious government defendant its costs of legal representation against the losing investor.²³ This development serves to make it appear as though the "American Rule" -- with its manifestly spurious, frivolous or malicious claim exception -- is more entrenched in international arbitration than is surely the case, but for the moment it is indeed fairly prevalent in treaty-based investment arbitration.²⁴

²² Article 25(2) of the ICC Rules provides: "The Award shall state the reasons upon which it is based." Article 31(3) states: "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."

²³ Ben Hamida, *id.*

²⁴ See, e.g., *S.D. Myers v. Canada*, *id.*; *Waste Management v. Mexico*, ICSID Case No. ARB(AF)/00/3 (NAFTA), Final Award, 30 April 2004, § 179 et seq., available at <http://naftaclaims.com/>

In addition, this development also raises questions as to whether treaty-based investment arbitration under NAFTA or ICSID gives rise to intrinsically different legitimate expectations of full cost recovery to the victorious investor than is the case in cost recovery in a non-investment commercial arbitration, and *delegitimizes* any expectations of cost recovery on the part of the government party.²⁵

Perhaps the unilateral right of the investor to sue means a unilateral expectation of cost recovery? Perhaps this form of arbitration and cost recovery is analogous to non-confidential judicial review of administrative conduct, where the administrative body normally enjoys no possibility of cost recovery in the event of an unsuccessful claim against it? And perhaps assigning the risk to the investor claimant of bearing the government respondent's defense costs is inconsistent with the purpose of such investment treaties?

Disputes/Mexico/Waste/WasteFinalAwardMerits.pdf. Cf. also Separate Opinion on Costs by T. Waelde in *International Thunderbird Gaming Corporation v. United Mexican States* (UNCITRAL), Final Award, 26 January 2006, http://www.naftaclaims.com/Disputes/Mexico/Thunderbird/-Thunderbird_Award.pdf in which the Tribunal awarded three quarters of the costs and attorney's fees of the Mexican state against the investor in the amount of ca. US\$ 1.25 million, § 16 to Dissenting Opinion, available at http://www.naftaclaims.com/Disputes/Mexico/Thunderbird/Thunderbird_-Dissent.pdf, referring to Ben Hamida Study: "From this survey, it is safe to infer that it is by now a standard principle of international investment law, in particular in the NAFTA context, but also in other ICSID cases, that in principle, each party bears its own legal costs and the costs of the arbitration are shared."

²⁵ But cf. *Methanex v. United States*, Final Award, NAFTA Tribunal, 3 August 2005, available at www.naftaclaims.com/Disputes/USA/Methanex/-Methanex_Final_Award.pdf. In *Methanex*, the cost award awarded ca. US\$ 3.5 million in costs against claimant investor Methanex for both the costs of arbitration and the United States' costs in defending the measures attacked. The Tribunal estimated that US\$ 1.5 million had been spent to conduct the arbitration, with some US\$ 2 million held by ICSID, on behalf of the parties, for payment of those costs. The cost award ordered Methanex to pay the United States for its US\$ 1 million share of that total deposit and some US\$ 3 million for the legal costs of the United States.

6. Possible Proposals for "Best Practice" in Final Rulings on Costs?

Overall, if a general statement had to be made, then it would be that "costs follow the event" largely prevails in English and Continental European arbitration practice and the "American Rule" largely prevails in US domestic and much US-seated international arbitration practice. However, "Loser Pays All" in its pure form -- as opposed to one of the various above-referenced forms of "costs follow the event" -- cannot necessarily be said to have general application to most recent arbitration cost awards, particularly in the treaty-based investment arbitration area.²⁶

Accordingly, there is no true "consensus" in international arbitration practice that "Loser Pays All" should apply. If this is so, then why should "Loser Pays All" -- whether in its pure form or in one or other variant form of "costs follow the event" -- nevertheless be considered or deemed to be the "best practice," and can and should it be implemented as a best practice?

The answer is, No! The solution lies not in the imposition or aspiration of a harmonized or homogenized approach to cost recovery to try to fit "all disputes," since no such one-size-fits-all approach is possible. Even if such an approach were deemed to be possible, it is neither warranted nor feasible.

²⁶ See, e.g., *Salini Costruttori S.p.A. and Italstrade S.p.A. v. The Hashemite Kingdom of Jordan*, ICSID Case No. ARB/02/13, Final Award, 31 January 2006, § 102, available at http://www.worldbank.org/icsid/cases/SalinivJordanAward_IncludingAnnex.pdf; Article 61(2) of the ICSID Convention provides that the Tribunal shall decide how and by whom the costs of the proceedings, including the expenses incurred by the parties, the fees and expenses of the members of the Tribunal and the charge for the use of the facilities of the Centre shall be paid. This Article confers a discretionary power on the Tribunal [*citing MINE v. Guinea*, Decision on Annulment, 22 December 1989, 4 ICSID Reports 109]. Moreover, ICSID Tribunals and more generally International Arbitral Tribunals, have not followed a uniform practice with respect to the award of costs and fees" [*citing* Gotonda, "Awarding Costs and Attorney's Fees in International Commercial Arbitration," Michigan J. Int'l L., 1-25 (1999), and Schreuer, *The ICSID Convention* (2001) 1220 to 1232]; the tribunal, "after taking into account all pertinent factors," decided that each side would bear its own expenses and the two sides would bear equally the fees and expenses of the tribunal and charges of the Centre; *see also* Separate Declaration on Costs by I. Sinclair, *id.* p. 37: "In my view, a distinction should have been made between the costs and expenses of the jurisdictional phase of the proceedings and the costs and expenses of the merits phase of the proceedings."

By way of example, let us consider the agreement to arbitrate, inasmuch as approaches to cost recovery begin with the agreement to arbitration. A pure ad hoc agreement should be allowed its stipulation on cost recovery, subject to any mandatory public policy constraints at the seat or at the place of enforcement. Barring any such constraint, such stipulation should supersede any contrary cost allocation provisions in the applicable *lex arbitri*, arbitration rules or *lex causae*.

What about arbitration legislation? A harmonization or homogenization of legislation would appear to be neither desirable nor feasible, apart from possible implementation through adoption of a corresponding provision in the UNCITRAL Model Law²⁷ or some other uniform act, restatement, uniform code or guidelines. Notably, the UML lacks such a provision and, for example, Germany inserted its own cost provision when largely adopting the UML. Other avenues, such as the 2004 UNIDROIT Principles of International Commercial Contracts²⁸, are conceivable, but not likely to be successful on a broad scale. Nor is such homogenization desirable: variants in approaches to cost recovery should remain open both to litigants and to arbitrators, as a function of the *lex causae*, *lex arbitri* and agreed arbitration rules.

What about arbitration rules as a vehicle for harmonization or uniformity? Likewise, variants in approaches to cost recovery should remain open as a function of the agreed arbitration rules. And the same applies to arbitration guidelines: can, for example, the IBA Rules respecting evidence or conflicts of interest respectively serve as a useful model for, e.g., "IBA Rules respecting Cost Recovery and Cost Awards in International Arbitration"? It is possible, but not likely to be a worthwhile effort. Homogenization on this issue is not

²⁷ Available at <http://www.uncitral.org/pdf/english/texts/arbitration/ml-arb/ml-arb-e.pdf>.

²⁸ Available at <http://www.unidroit.org/english/principles/contracts/principles2004/blackletter2004.pdf>.

desirable. "Loser Pays All" is, whether in its pure or variant forms, not sufficiently accepted to warrant such a harmonization.²⁹

Ultimately, an attempt to enumerate criteria for application of "Loser Pays All" in the one or other form is not necessarily doomed to failure, but not likely to be as useful as a specific discussion and creation of transparency on the subject between the given tribunal and parties, in the light of such concrete circumstances as nationalities and relevant cultural approaches to costs; the nature, size, complexity and novelty of the issues in dispute; the nationality, location, size, means and prevailing fee rates of the legal representation of the respective parties; and the nature, scope, availability and accessibility of witness and documentary evidence.

Other factors calling for consideration include the *lex causae* provisions, if any, on costs; the *lex arbitri* provisions, if any, on costs; the agreed rules provisions, if any, on costs; the agreed procedure respecting bifurcation; the agreed procedure respecting a partial or interim award; and provisions, if any, of the law at the place of likely enforcement; and any other relevant compensatory or punitive legal principles of relevance.

The problem and solution here are different, however. Absent any party agreement on cost recovery, the arbitral tribunal should or must achieve greater transparency toward the parties respecting the tribunal's understanding of its own rights, duties and discretion under the agreed rules or legislation, and not simply "rest on" the discretion or latitude which may be built into the rules or legislation.

²⁹ In this connection, it is worth noting the ALI/UNIDROIT Principles of Transnational Civil Procedure, adopted in 2004, available at <http://www.unidroit.org/english/principles/civilprocedure/main.htm>. Its Comment P-E states: "These Principles are equally applicable to international arbitration, except to the extent of being incompatible with arbitration proceedings, for example, the Principles related to jurisdiction, publicity of proceedings, and appeal." Article 25.1 provides: "The winning party ordinarily should be awarded all or a substantial portion of its reasonable costs. 'Costs' include court filing fees, fees paid to officials such as court stenographers, expenses such as expert-witness fees, and lawyers' fees."

At the earliest feasible stage, the arbitral tribunal should initiate a dialogue with the parties with the goal of obtaining agreement or otherwise stipulating more specifically the general principles of cost recovery; the nature, extent and content of factual and legal submissions and supporting evidence on costs; the timing and sequence of such submissions as well as opportunities for respective comment and rebuttal; and the timing and sequence particularly in the case of a bifurcation of jurisdiction/preliminary issues and the merits or of liability and damages.

Likewise, it must consider the possibility or advisability of accepting such submissions in a stepped fashion only *after*, and with full knowledge of, the rendering of the partial award on jurisdiction or the merits,³⁰ as the case may be and the parties' expectations respecting the general nature and extent of the tribunal's duty to motivate and justify its cost decision in the award and the tribunal's non-binding observations thereon. Correspondingly, the terms of reference or initial procedural order, to be amended in the course of the proceedings, could and should address the issue of cost recovery more specifically, and not leave it as an afterthought or a minor detail at the end of the dispute.

Achieving greater transparency in this way may have the following consequences for the arbitration. First, keeping the parties and their counsel "honest" with respect to litigation tactics. Second, causing the parties and their counsel to continually assess and re-assess the advisability -- and compensability -- of their tactics, including aspirations for discovery and other procedural devices, bifurcation of proceedings, methods of communicating their case to the tribunal, volume of submissions to the tribunal, length of hearings,

³⁰ Cf., e.g., *Salini*, id., Final Award, 31 January 2006, Separate Declaration on Costs by I. Sinclair, id. at p. 37: "... in my view, different considerations apply to the allocation of the costs and expenses of the Tribunal during the merits phase of the proceedings ... the Claimants should be reminded that their inability to satisfy the burden of proof could result in the payment of heavier costs than might otherwise have been the case."

number of witnesses for direct and cross-examination, site visits, employment of in-house counsel and other extraordinary managerial resources, etc.

Other possible positive consequences may include causing the parties to assess, perhaps differently than otherwise, the relative merits and timing of settlement discussions, causing the arbitral tribunal to address, or justify its decision not to address, the *lex causae* and/or *lex arbitri* with respect to cost allocation, and particularly in the case of cost submissions made *after* rendering of the award on the underlying issue, causing the parties to provide more tailored, specific and potentially useful factual and legal cost submissions and supporting evidence.³¹

Also when made *after* rendering of the award on the underlying issue, there is the prospect of causing the tribunal to motivate its cost award, including the exercise of any allowable "discretion," with a degree of specificity which at least allows the parties to understand the concrete reasoning of the outcome.³² Possible positive side effects in this respect include providing greater transparency and predictability in the decision-making relationship between party and counsel and providing greater transparency and predictability in the decision-making relationship between and among the tribunal members, thereby militating against gratuitous or unfounded efforts to "sway" the cost decision as recompense for an unfavorable decision on the merits.

³¹ Cf. *Pope-Talbot v. Canada*, Award in respect of Damages, 31 May 2002, para. 92, available at <http://www.asil.org/ilib/ilib0509.htm#J4> and *Waste Management v. Mexico*, Decision on Mexico's preliminary objections concerning the previous proceedings, 26 June 2002, paras. 52-53, available at <http://naftaclaims.com/Disputes/Mexico/Waste/-WasteAwardJurisdiction.pdf>, reserving to "a later stage questions relating to the costs and expenses of the present phase of the proceedings."

³² Cf. the criticism of the cost award in the *Methanex* decision, cited above, by Weiler, "Methanex Corp. v. U.S.A. – Turning the Page on NAFTA Chapter Eleven?," *J. World Investment & Trade* Vol. 6 No. 6 (Dec. 2005) 903 at 921: "What the Final Award will most be remembered for, however, may be the Tribunal's costs award. The result itself is beyond reproach, but the brevity with which the costs award was issued may have problematic, albeit unforeseen, outcomes.... It is just that the Tribunal was not explicit in connecting the dots for the reader as to why that award was necessary. As such, the costs award will likely serve as a shot across the bow, not only for claimants who engage in what may be seen as vexatious litigation but also for under-funded future claimants considering their prospects in commencing an arbitration against a government such as that of the United States."

Overall, the foregoing steps could also contribute to the emergence of a set of new, additional factors for the favoring or disfavoring of a particular seat of arbitration or *lex causae* with respect to the compensability of certain kinds of costs and factors in cost recovery generally. It may also contribute to better practices with respect to the drafting of cost recovery provisions in agreements to arbitration, and to other cost-related issues such as the number of arbitrators, nationalities and requirements of qualifications of arbitrators, etc. A further possible byproduct would be a more coherent and more generally applicable set of "best practices" applicable not so much as *stare decisis*, but as customary practice or even customary law for certain international arbitrations for which such practice or law is relevant.

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