

Arbitral Cost Allocation Decisions – Should Guidelines Accompany Arbitral Discretion?

By Marc J. Goldstein

It has become fashionable among international arbitration lawyers to state that the allocation of costs in final awards has been, and remains, unpredictable, and that greater predictability would be useful to arbitration users and their legal advisors.¹ On this point there cannot be serious debate. The real question is, should arbitral tribunals change their ways, and if so what should they do differently, to achieve the desired greater predictability, while acting in a fashion that is consistent with other arbitral norms such as party autonomy, flexibility, impartiality, and efficiency?

While complaints about lack of predictability are legion, more difficult to come by are sound proposals to remedy the costs predictability "crisis." In that regard, the American practitioners Robert Smit and Tyler Robinson have moved the discussion a major step forward by proposing Guidelines for Awarding Costs in International Arbitration.² Perhaps inspired by the Smit-Robinson article, the

¹ E.g., Gillian Lemaire, *Costs in International Commercial Arbitration: The Case for Predictability*, Commercial Dispute Resolution (www.cdr-news.com), Mar. 12, 2009; White & Case LLP, *Focus on Costs in International Arbitration*, Lexology (www.lexology.com) October 30, 2009.

² Robert Smit and Tyler Robinson, *Cost Awards in International Commercial Arbitration: Proposed Guidelines for Promoting Time and Cost Efficiency*, 20 Am. Rev. Int'l Arb. 267 (2009)

ICC Commission on Arbitration has recently formed a task force to study decision on costs.

Smit-Robinson proceed from the premise that rules on cost-allocation, if established early in the case, should in principle have an important impact on counsel's choice of procedures, tactics, and modes of behavior. And since the chosen rules will affect mainly the parties' investments in legal costs, default rules in the absence of party agreement should be designed to maximize the time/cost efficiency of the arbitral process.³

In this chapter, I propose to review the Smit-Robinson Proposed Guidelines in light of the objectives stated by their authors.⁴ That exercise reveals, not

³ Other commentators have encouraged the development of guidelines, at least on a case-by-case basis so that the parties might have early insight into the tribunal's philosophy. *See, e.g.*, Richard Kreindler, *Final Rulings on Costs: Loser Pays All?*, Conference Paper presented at the Association Suisse de L'Arbitrage (ASA) *Best Practices in International Arbitration* conference in Zurich on January 27, 2006, and published in ASA Special Series No. 26 (July 2006) p.41 (calling for "specific discussion and creation of transparency on the subject between the given tribunal and parties," and "a dialogue with the parties with the goal of obtaining agreement or otherwise stipulating more specifically the general principles of cost recovery...")

⁴This chapter will not offer a review of the treatment of costs in various statutes, treaties, and rules of arbitration. This ground has been well-covered. *See, e.g.*, R. Kreindler, *supra* n.3, at pp. 4-8; J. Gardiner and T. Nelson, *Recovery of Attorney' Fees in International Arbitration: the Duelling 'English' and 'American' Rules*, in The 2010 Arbitration Review of the Americas -- a Global Arbitration Review Special Report; J.Y. Gotanda, *Awarding Costs and Attorneys' Fees in International Commercial Arbitrations*, 21 Mich. J. Int'l L. 1, 5-13 (1999); M. Buhler and H. Williams, *New York Law: Awards of Attorneys' Fees in International Arbitration*, Mealey's International Arbitration Report, Vol. 20 No. 5 at pp. 1-3 (May 2005); M.L. Smith, *Costs in International Commercial Arbitration*, AAA Handbook on International Arbitration Practice Chap. 26 (JurisNet 2010); S.H. Elsing, *The Award of Costs and Interest in International Arbitration* (Power Point Presentation at the ICDR Young & International Anniversary Program, Vienna, March 15, 2008).

surprisingly, that solving a systemic problem in international arbitration is considerably more difficult than identifying the problem. Solving the problem by promulgating guidelines that might be adopted by arbitral tribunals as “best practices” is even more difficult – in part due to the inherent difficulty of the subject and in part because a large segment of the arbitrator community resists having more procedural rules, viewing this as an encroachment on arbitral liberty. But the issue of cost allocation stands out, among key procedural aspects of international arbitration as one that has deserves more attention than it has received, up to now, to supplement the general exercise of discretion by arbitral tribunals with consensus guidelines that might bring about a convergence of arbitral practice.

Indeed, cost allocation is such an underdeveloped topic⁵ that scarcely any standard terminology has come into use beyond the expressions inherited from judicial practice (American Rule, English Rule, costs follow the event, etc.). In a recent international arbitration in which I acted as counsel, in a discussion about cost allocation our prominent Sole Arbitrator referred to a “*rule of proportionality*”

⁵ The seminal work on cost and cost allocation in international arbitration, tracing the history of the English and American Rules back to Roman law and through the centuries, is J.G. Wetter and C. Priem, *Costs and Their Allocation in International Commercial Arbitrations*, 10 Am. Rev. Int’l Arb. 249, at 328-334 (1992). The authors note that the “costs follow the event” rule as embodied in Roman law (“*poena temera litigantium*”), was “qualified by the subsidiary rule that the losing party was not ordered to pay costs if he could demonstrate that he had had reasonable cause to litigate, *probabile litigandi causam*.”

as a variant on the English Rule (of “costs follow the event”) – and this is a term I have been unable to find in any of the literature reviewed for this article. This arbitrator may have been hinting that the prevailing party would recover legal costs in the same ratio as its awarded damages would bear to the damages claimed, or he might have been suggesting that each party would be awarded legal costs in proportion to its success such that no allocation of costs to Claimant would be made if Claimant recovered only half of the damages claimed. Such formulaic approaches are justly criticized in Smit-Robinson, and in the discussion below I propose a refinement of the Smit-Robinson Proposed Guideline on this subject, to offer a concrete alternative to the confusing and manipulable “proportionality” approach.

But I suppose the “*rule of proportionality*” as understood by this arbitrator might have meant, in addition or alternatively, that a claimant party’s investment of time and effort in presenting its claim should be proportional to the amount in dispute, and/or that a claimant party’s investment of time and effort to respond to an apparently weak or meritless counterclaim should be proportional to the probability that the counterclaim might succeed. One would have thought the latter concepts are captured by the notion that the fees should be reasonable in

amount. Such is the confusion in our practice from the lack of consistency in approach from case to case.

A brief preliminary summary of the problem is in order. Most international arbitration rules in regular use around the world permit or direct the arbitral tribunal to determine in the final award how the costs of the arbitration shall be allocated between the parties, subject to any constraints on allocation in the applicable procedural law or in the arbitration agreement. Some national arbitration statutes also address the matter, one example being the UK Arbitration Act 1996 which enshrines the “costs follow the event” principle but in practical terms leaves arbitrators with wide discretion. Cost allocation lacks predictability, within cases and from case to case. Several factors contribute. Predictability within a case is lacking, unless the contract or the rules state flatly that each party shall bear its own costs (including arbitrator fees and counsel fees), mainly because arbitral tribunals rarely state criteria that will guide their final award discretion early enough in the case for the parties to take the guidance into account in fashioning strategy and tactics. Further, even well-known and sought-after arbitrators do not regard cost allocation as a subject on which their awards should reflect conceptual consistency. And even when some arbitrators may wish to adhere to common principles from case to case, trade-offs among arbitrators on a three-member

tribunal may lead to unprincipled costs decisions in service of achieving unanimous support for an outcome on the merits. Case to case unpredictability also takes contributions from lack of a tradition of stating reasons for cost awards, and persistent ambiguity about who is the real victor in multi-claim multi-counterclaim cases in which several varieties of monetary and non-monetary relief and counter-relief are sought. Even more fundamentally, no cohesive theories have evolved concerning how arbitrators should take into account judicial practice concerning cost allocation in the courts of the place of arbitration, in the parties' home countries, in the jurisdictions where their counsel are admitted to practice, and in the jurisdiction whose law applies to the merits. With all these ingredients, it is no small wonder that the dish is not to the liking of every diner at the table, and rarely cooks up the same from one meal to the next.

Smit-Robinson brings to this landscape a simple and insightful thesis: that cost allocation awards should serve a regulatory function, enhancing the time- and cost- efficiency of international arbitrations. But the fulfillment of this mission depends upon (i) arbitral tribunals consistently allocating costs in ways that reward efficient and penalize inefficient expenditure of legal costs, and (ii) arbitral tribunals informing the parties in the early stages of the case as to what principles

will guide allocation, at a time when they might heed guidance in deciding how to incur legal costs.

With this preview, we embark on a review of the most significant of the Smit-Robinson Proposed Guidelines.

Smit-Robinson Proposed Guideline #1 – Encouraging the Parties to Agree on Cost Allocation Standards

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' agreement (including the arbitration rules selected by the parties in their arbitration agreement) should be honored and applied by the arbitral tribunal.

While the principles stated in Guideline #1 are not controversial and deserve broad support, in Guideline #1 Smit-Robinson urge greater attention to costs allocation by drafters of arbitration agreements, not by arbitrators charged with enforcing those agreements. Should not the Guidelines should begin where the arbitration clause (including incorporates rules and statutes) leaves off? These are,

after all, Guidelines likely to be consulted mainly by arbitrators after they are appointed, not by drafters of new contracts.

The parties may in fact have quite divergent views on what are the cost-allocation implications of the language of the arbitration agreement, the contract's choice-of-law clause, the chosen institutional or *ad hoc* rules, and the applicable arbitration law (including any mandatory rules) which generally but not always will be the law of the seat of the arbitration. There is also the issue of the clause that fails to identify a seat, leaving the parties with uncertainty until the administering institution or perhaps a court names a seat.

Sometimes parties will want to know the arbitrators' views on the cost allocation issues, perhaps including how the arbitrators interpret the cost allocation language of the arbitration agreement, before they apply themselves to making agreement on costs allocation. Other times parties will want to proceed directly to a negotiation on costs allocation, or to the issuance of guidelines by the Tribunal.

Should arbitrators retain flexibility and discretion, until the end of the case, to decide what the parties' agreement means, or what the applicable law requires or allows, in relation to costs allocation? For the Tribunal to retain flexibility and

discretion on this question perhaps achieves no more than simply to tell the parties that cost allocation is a “wild card” and therefore they had best behave in a fashion that will not antagonize the Tribunal.⁶ Arbitrators might well distinguish between discretion in the interpretation of the agreement and the law, and discretion in the allocation itself. It is the latter which the arbitrator justifiably should retain. Discretion in fashioning the cost allocation rules themselves, on the other hand, is one special of “arbitral engineering,” by which I refer to a process, evident in some awards, of determining the overall result first, and then deciding the merits of particular claims, the damages, and the costs allocation, to conform to the intended overall result.

Suppose that the arbitrator believes that the “costs follow the event” rule as embodied in the applicable law is tempered by the ancient Justinian law principle

⁶ Professor Park wrote in a widely-read article several years ago that “the benefits of arbitrator discretion are overrated; flexibility is not an unalloyed good; and arbitration’s malleability often comes at an unjustifiable cost.” W.W. Park, *Arbitration’s Protean Nature: The Value of Rules and the Risks of Discretion*, 19 *Arb. Int’l* 279 (2003). Judge Holtzmann has also written on the need to strike a balance between certainty and flexibility in arbitral procedure, advocating comprehensive discussion of many aspects of procedure – not including costs allocation -- in the first procedural conference. H.M. Holtzmann, *Balancing the Need for Certainty and Flexibility in International Arbitration Procedures*, originally published in 12th Sokol Colloquium: International Arbitration in the 21st Century: Toward “Judicialization” and Uniformity? (R. B. Lillich and C.N. Brower, eds.).

of “*probabile litigandi causam*” (see footnote 5, *supra*). If the arbitrator fails to share that view with the parties, then the case proceeds with an “English Rule” masquerading as a modified American Rule, perhaps culminating in the prevailing party recovering only a fraction of its legal costs despite nearly total success on the merits, and that party will feel abused by what appears to be an arbitrary nullification of the English Rule.

The arbitrator need not fear that she is ceding her discretion to temper the final costs award based on the legitimacy of the losing party’s arguments, if she announces her allocation principles early in the case (and by all means before there have been any submissions on the merits). Therefore a useful First Proposed Guideline might look like this:

In advance of the first meeting or teleconference of the Tribunal with the parties, in furtherance of preparing the first procedural order, or otherwise at an early stage of the proceedings, the Tribunal may find it advisable to solicit the views of the parties concerning the cost allocation rules that the Tribunal must or should apply, if any, resulting from the parties’ agreement or the applicable law or arbitration rules. At the request of the parties and in other appropriate circumstances, the Tribunal may issue guidance, in the form of a partial award or otherwise, concerning the meaning of the arbitration agreement and the requirements if any of the applicable law and rules.

I note in passing that Smit-Robinson Guideline #4, concerning the application of mandatory rules of law⁷, has been brought forward into the procedural order stage by this Proposed Guideline #1, so that the parties might proceed with the case fully cognizant of any rules of law about cost allocation that the Tribunal considers to be mandatory. Some readers may be surprised to see in the Guideline the possibility of a partial award concerning cost allocation. But why should it be otherwise? If the Tribunal is interpreting the parties' agreement, or declaring the meaning of a mandatory rule of law or indeed whether an alleged mandatory rule is mandatory, these determinations should be made with finality. By their nature, they are not dependent on any evidence or points of law concerning the merits that parties might submit later on.

There may be a chorus of boos from an anxious group concerned that the prospect of a contested proceeding about the applicable law of cost allocation in the earliest days of the case. But this Guideline only presents the possibility of taking this course, if the parties want it or if the Tribunal in particular circumstances thinks early clarity will promote core arbitral values.

⁷ Smit-Robinson Proposed Guideline #4 provides: "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."

Smit-Robinson Proposed Guideline #2: Procedure for Identifying Guidelines Early in the Case

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 their 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.

Proposed Guideline #2 adopts what appears to be a common sense approach: if the parties can reach agreement, there is nothing more for the Tribunal to do; if they cannot, the Tribunal should identify "guidelines and factors it will consider in allocating costs."

One concern is that the Proposed Guideline as drafted may work best when there are very experienced international arbitration counsel on both sides. In that case, the parties are well-armed to decide whether their arbitration agreement has "sufficient specificity" concerning cost allocation. And in that event the Tribunal might "solicit the views" of the parties simply by a general invitation for comment.

But a Tribunal may wish to proceed in a different fashion if one or both counsel are not or may not be sufficiently experienced in international commercial arbitration to be conversant with the issues, or with the current conversation in the arbitration community. Such less experienced practitioners may be unable adequately to predict unpredictability; they may naively take undue comfort from a clause or rule that permits cost recovery by the "prevailing party."

Many of international arbitration's most vocal critics are counsel and parties who suffered because of an exercise of arbitral discretion that was not effectively anticipated because counsel simply had not traveled enough on the back roads and byways of this corner of the legal profession. The Guidelines should address the needs of that constituency.

I propose that the second sentence of Guideline #2 be modified as follows:

The Tribunal's solicitation of views of the parties may include the identification of guidelines and factors upon which the parties might agree or submit their comments to the Tribunal. If no agreement is reached, then the Tribunal, taking into consideration the parties' comments, should identify at the commencement of the arbitration the guidelines and factors it will consider in allocating costs....

The purpose of this proposed refinement is to simply place a burden on the Tribunal to facilitate a meaningful dialogue on cost allocation, to provide such counsel with the benefit of the Tribunal's expertise.

In my edit of Guideline #2 above I have placed a closing ellipsis where the Smit-Robinson Guideline has the phrase "at the conclusion of the arbitration...." The object here is raise the question of interim cost orders (or awards) – a subject to which we now briefly digress.

A Digression on The Possible Virtues of Interim Cost Allocation Orders

Nearly six years ago Michael Buhler wrote thoughtfully that tribunals should make more frequent and strategic use of their powers to make interim cost orders (a power sometimes conferred expressly, such as in Article 31(2) of the ICC Rules, but certainly available under other rules that are not as explicit).⁸ Anecdotal evidence suggests this is not often done, as tribunals are inclined to relate costs allocation to the final outcome, and therefore also are concerned that interim costs orders might cause them to be perceived as less impartial.

⁸ Michael W. Buhler, *Costs of Arbitration: Some Further Considerations*, in *Global Reflections on International Law, Commerce and Dispute Resolution, Liber Amicorum* in honor of Robert Briner, ICC Publishing, Publication 693, p. 179 at pp. 183-186 (November 2005).

But these concerns may be managed. A tribunal might announce in the first procedural order that it will consider issuing interim provisional costs orders (not awards of costs) in relation to any or all interlocutory applications.⁹ The first and most obvious benefit would be to encourage the parties to exercise more caution in presenting such interlocutory applications as interim measures requests and motions relating to disclosure and scheduling, as well as new claims of which arbitral jurisdiction may be uncertain. As the case progresses, and the tribunal grants or denies interim provisional costs orders on a series of controversies, the tribunal's approach to costs allocation (in terms of factors affecting allocation, and also as to reasonableness of counsel fees) would begin to emerge in ways that would help the parties to forecast how the ultimate winner is likely to fare on costs. And whereas these would be interim provisional orders only, they would establish no immediate rights to payment but rather only provisional debits and credits in what would amount to a running cost-allocation "account." Also, in complex and protracted cases, having such a cumulative record of interim costs decisions would spare the parties and the tribunal from the complicated task of carrying out a costs

⁹ The AAA's International Centre for Dispute Resolution has taken one step to encourage interim costs orders, providing in its ICDR Guidelines for Arbitrators Concerning Exchanges of Information that "the tribunal may ... allocate the costs of providing information among the parties, either in an interim order or in an award."

allocation retrospective at the end of perhaps several years of proceedings involving a dozen or dozens of interim applications for relief.¹⁰

For purposes of the Guidelines' advancement it is advisable that they take no position on whether interim cost orders should become the norm. However, Guideline #2 should state specifically that whether interim cost orders may be issued shall be one of the subjects on which the Tribunal will solicit the parties' views and issue appropriate guidance.

Smit-Robinson Proposed Guideline 3.1 – Vindicating the Objectives of Time and Cost Efficiency

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.

¹⁰ Michael Buhler argued in 2005 in favor of making interim costs orders in the form of interim awards, to establish a "pay as you go" protocol. With this I disagree, as I would expect that the incremental effect of deterring unwarranted applications would not justify the collateral scuffling and escalating of tensions between the parties over payments not voluntarily made. In a similar vein, Michael Schneider in a 1994 article proposed that the efficiency of arbitration be enhanced by separately pricing (and allocating) the costs of the arbitrators' services for several phases of a complex international arbitration. M.E. Schneider, *Lean Arbitration: Cost Control and Efficiency Through Progressive Identification of Issues and Separate Pricing of Arbitration Services*, 10 Arb. Int'l No. 2 119 (1994). That notion did not gain substantial traction in practice, as attention has shifted over the years from costs for the arbitrators' services to the legal costs incurred for the parties' own counsel and experts. Nevertheless, Me. Schneider's analysis should be regarded as offering support for more frequent use of interim costs orders to regulate inefficient conduct by counsel: "The decision by which the costs are awarded against the party losing on an issue, serves as an incentive against a party pressing an issue on which it stands little chance to win." *Id.* at p. 138.

The concept that cost allocation awards should vindicate efficiency objectives is unexceptionable, although Smit and Robinson are surely correct to point out in their discussion that time and cost efficiency objectives will be best served by arbitrators giving the parties guidance early in the case before most of the legal expenses are incurred. So perhaps Guideline 3.1 is not the appropriate point of departure in the promulgation of guidelines, and arguably the starting point should be what the Tribunal should inform the parties and when that information should be conveyed. Announcement of guidelines early in the case enhances efficiency by regulating the ensuing conduct of counsel. Cost allocation in final awards enhances efficiency to the extent it regulates conduct in future cases, by rewarding reasonable legal costs invested in well-justified claims or defenses, and penalizing inflated or meritless claims or contrived strategic counterclaims.

If the Tribunal has discretion in the allocation of costs, the first guideline the parties need to know is whether the Tribunal intends to follow the general principle that costs follow the event, or, alternatively, the general principle that each party shall bear its own costs. Perhaps that will be evident from the agreement if the parties, or the applicable law or arbitration rules. But if the parties are to be

encouraged to carry out the arbitration in a fashion that promotes time and cost efficiency, including possible settlement, they need to know this basic ground rule.

Accordingly, I suggest Revised Guideline 3.1 as follows:

Unless it has been established clearly by the agreement of the parties, the applicable law or rules, or a decision of the Tribunal, the Tribunal shall inform the parties whether the basic paradigm for cost allocation, subject to variation based on the circumstances of the case, shall be that costs follow the event, or that each party shall bear its own costs.

Proposed Revised Guideline 3.2 would then pick up Smit-Robinson Guideline 3.1, but with the preface "*[S]ubject to the basic paradigm identified in accordance with Section 3.1 above....*"

Smit-Robinson Proposed Guideline 3.3: A “Holistic” Approach to Cost Allocation

Smit-Robinson Proposed Guideline 3.3 states a general principle in its “chapeau” section and then proceeds to a series of “specific considerations” in subsections of the Guideline. Here I quote and discuss the “chapeau section” only, and I turn to some of the specific considerations later on.

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.

I am not convinced that Proposed Guideline 3.3 accomplishes what its drafters intend, and it is quite possible that its malleable language invites application in precisely the fashion Smit and Robinson criticize in the text of their article. The Proposed Guideline calls upon arbitrators to allocate costs according to “the relative merits of each party’s case within the context of the dispute as a whole....” “In their discussion of arbitral practice, Smit and Robinson rightly take exception to the tendency of costs awards to gravitate toward a no-allocation position, even when the “costs follow the event” principle is established by the arbitration agreement or the applicable law. By urging a “holistic” approach to costs, Smit and Robinson decry no-allocation cost awards when each side has won something, but an aggregation of the wins and losses should lead to naming a single victor for cost allocation purposes.

Suppose, for example, a Claimant goods seller nominally prevails on a claim of \$5 million of unpaid purchase price for defective goods – payments the Respondent purchaser withheld due to the defects -- while Respondent purchaser prevails on the counterclaim for damages of \$25 million (\$20 million, net of the

partial price withholding). To say there is no prevailing party, or two co-equal prevailing parties, in this scenario, and to leave each party to bear its own costs barring bad faith conduct, ignores the economic substance of the dispute and gives undue emphasis in the cost allocation to whatever technical contractual reason justified the conclusion that the seller was entitled to an award for the unpaid price. The “relative merits” that should be considered, in this scenario, are the fact that the economically significant aspect of the dispute is the harm caused by delivery of non-conforming goods, while the fact that the seller drafted the contract to prohibit a self-help remedy of reducing the price is not economically significant. But if “relative merits” is understood to refer to the relative persuasiveness of the parties’ respective positions on the key issues, then the seller in this equation could be rewarded, from a cost allocation perspective, for having ironclad contractual language, while the purchaser would be penalized, from that perspective, for winning on several hotly- and expensively-contested legal and factual issues involving, *e.g.*, the existence of defects, the ratio of conforming and non-conforming goods, the inadequacy of contractual remedies, the cost to cure the defects, and the loss-of-market-value damages.

If the Guideline is to encourage cost-efficient conduct by parties, there should be cost allocation consequences of winning and losing on the difficult and

close questions. Therefore the “chapeau” section of Proposed Guideline 3.3 might be restated as follows:

The arbitral tribunal shall take into account in its allocation of the Costs of the arbitration the relative significance to the commercial dispute of the issues on which each party has prevailed, and shall allocate the Costs of the arbitration to fairly reflect (i) the time and effort required for the prevailing party to prevail on an issue, and (ii) the proportionality of that investment of time and effort to the importance of the issue.

Proposed Guideline 3.3 then includes a non-exhaustive list of specific factors that may guide the arbitral tribunal’s assessment. The first two factors address frivolous or non-meritorious claims or positions asserted mainly for strategic reasons, including unreasonably inflated claims for damages:

... The following non-exhaustive specific considerations may guide the arbitral tribunal’s assessment of the relative merits of the case as a whole:

- (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.*

These considerations as drafted risk creating a probably unintended momentum in the direction of making any significant cost allocation in favor of a prevailing party depend on the extreme lack of merit or frivolousness of the positions taken by the loser – i.e. the American Rule. More precision is needed to make it clear that while frivolity is certainly a factor, it is not a necessary (or nearly so) condition for allocation of costs in favor of a prevailing party. The point should be that some cost allocation to a prevailing party is justified by the Guidelines even in the absence of frivolous or meritless claims or exaggerated damages calculations, and a determination that claims or defenses were frivolous or seriously lacking merit will be a factor in determining the amount to be awarded, especially if the nature of the meritless claims, and the way they were presented, caused large legal costs to be incurred.

Non-meritorious claims may be thought of as falling into two broad categories, although in reality there are obviously a series of points along a spectrum. The first category are those claims that are transparently meritless because they are clearly contradicted by a contract provision or a particular document (or group of documents) or by a settled principle of indisputably applicable law. The second group are those claims that have at least superficial plausibility, and they may be enhanced by effective presentation by skilled

advocates representing well-financed parties. (Indeed the willingness of a well-reputed law firm to advocate the position may lend the claims a credibility they might otherwise lack). If cost allocation guidelines are to fulfill an efficiency-inducing mission, they should not only discourage assertion of spurious claims, but also discourage a party from over-investing in the refutation of spurious claims, while fairly compensating a party that is essentially forced to a significant resource investment to unveil the baselessness of the adverse party's position.

Some cautious advocates will complain that such rules would encourage risk-taking by failing to address in a comprehensive way a position advanced by an adversary. But that is the kind of business decision that clients and counsel should be encouraged to make together: whether at the margin more legal resources and expertise should be brought to bear on a claim, to ensure that a meritless position is defeated, at the risk of not recovering all or part of the investment if the arbitral tribunal considers that this effort was excessive.

Thus, the Smit-Robinson Proposed Guidelines 3.3 (a) and (b) might be revised as follows:

(a) Whether a position asserted was frivolous, meritless, mainly strategic or tactical, or otherwise unreasonable, causing the adverse party and/or the arbitral tribunal reasonably to incur costs to respond and decide that would not have been incurred otherwise. But a finding that a position was asserted in this fashion shall not be considered a necessary finding before any allocation of costs may be made to a prevailing party.

(b) Whether any claims or counterclaims for monetary damages were needless or unreasonably excessive, causing the adverse party and/or the arbitral tribunal reasonably to incur costs to respond and decide that would not have been incurred otherwise. But a finding that a claim or counterclaim had such characteristics shall not be considered a necessary finding before any allocation of costs may be made to a prevailing party.

Smit-Robinson Proposed Guideline 3.4: Cost Allocation Consequences of Bad Faith, Obstructive, and Dilatory Tactics

Proposed Guideline 3.4 provides in substance that a party may be penalized in the cost allocation for bad faith conduct and dilatory or oppressive tactics, and use of procedures not useful or necessary to the outcome. This is a nearly universal principle and as such no comment is required.¹¹

¹¹ The text of Smit-Robinson Proposed Guideline 3.4 is as follows:

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:

(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

Smit-Robinson Proposed Guideline 3.5: Avoiding “Mechanical” Cost Allocation

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.

Proposed Guideline 3.5 presents some drafting difficulties; it is one of those situations where we know the problem and perhaps how to cure it in a particular instance, but stating the “cure” as a general principle is a challenge. This Guideline states in substance that arbitral tribunal should not allocate costs “mechanically or formulaically” on the basis of the ratio of claimed damages to damages recovered, and that instead the tribunal should apply “discretion... based upon the relative merits and conduct of the parties in light of the case and its outcome as a whole.” But “discretion” is not a cure; it is what exists today and is often applied to reach unsatisfactory formulaic outcomes. And reference to “the case and its outcome as a whole” might be what arbitrators now think they are doing when they make an

arbitration were, in the view of the tribunal in light of the final award, unnecessary or unhelpful to determine the merits of the case.

inscrutable (if not arbitrary) costs allocation that cannot be easily reconciled with the outcome on the merits.

Perhaps it is be helpful to state a paradigm case of the “ailment,” to see if that statement will help refine the Guidelines to get closer to a “cure.” Suppose that in my defective goods case scenario described above (which of course bears not the slightest resemblance to any actual case), the Respondent purchaser claimed \$40 million of damages, and at the end of the proceedings recovered \$20 million, and had legal expenses of \$1.5 million of which \$1.25 million reasonably was spent to prevail on liability issues, and \$250,000 was spent on presentation of damages evidence and argument. Smit-Robinson’s Guideline declares, in effect, that it is not appropriate in this instance to regard the Respondent as having been only 50 percent successful and deserving of a recovery of only half of its Costs. The latter result might be justified under Guideline 3.3(b) if the damages claim as initially formulated was excessive. But there are many cases where preliminary damages estimates prove inaccurate for legitimate reasons. And there are many cases where a large damages claim is well-supported by fact and expert evidence, but there is a subjective factor involved in the tribunal’s weighing of the evidence, and the tribunal elects to take a conservative view of things. In such cases, the party recovering half of the damages originally claimed is not fairly considered to

have half-failed and half-succeeded, and a rule to that effect would not have any efficiency-enhancing qualities.

Based on the foregoing, a revision of Proposed Guideline 3.5 might look like this:

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... The arbitral tribunal should be guided in exercising its discretion by considering the extent to which the incurrence of costs (i) corresponded to the issues on which the prevailing party prevailed¹², and (ii) represented a reasonable investment of effort in regard to the particular issue in light of the complexity of the issue, the merits of the adverse party's position, and the adverse party's strategy and tactics in presenting that issue to the tribunal.

Conclusion

Rob Smit and Tyler Robinson have contributed immensely to the advancement of a more systematic and consistent cost allocation paradigm in international arbitration. The effort to refine their proposed Guidelines should proceed apace. Discretion in the allocation of costs by tribunals should remain, but discretion in selection of principles to guide allocation of costs – i.e. failing to

¹² Buhler, supra note 2 at p. 188, gives the example of a case in which \$10 million of claims were asserted by Claimant, but Claimant focused nearly 100% of its effort on proving an \$8 million claim for economic loss, and nearly no time on a (perhaps mainly rhetorical) \$2 million claim for injury to reputation. Buhler argued that in such a case an award of more than 80% and conceivably 100% of costs might be warranted.

disclose the applicable principles at all, or disclosing them only at the time of the final award – is a systemic weakness that makes outcomes unpredictable and difficult to understand, and thereby undermines the legitimacy of international arbitration. Disclosure by tribunals of the applicable cost allocation principles early in the case process, before submissions on the merits beyond the pleadings, will result in more cost-effective arbitrations and more palatable outcomes for winners and losers.