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## Guideline 9 : Guideline for Arbitrators on Making Orders Relating to the Costs of the Arbitration

### 1. Introduction

1.1 One of the most difficult and important functions which an arbitrator has to perform relates to the making of awards of costs. This guideline attempts to provide assistance on the main problems likely to be encountered in this area

1.2 Generally, this Guideline assumes that the seat of the arbitration is in England and Wales or Northern Ireland so that the Arbitration Act 1996 applies. The Act contains a number of provisions dealing with the costs of an arbitration. This Guideline also contains a comparative law overview of the subject. In general, the legislation referred to from outside England and Wales gives the arbitrator a broad discretion as to how to deal with costs. This contrasts with the more detailed English approach. Nevertheless, the central ideas are very similar. Indeed, the material in the 1996 Act on this subject was intended to reflect international practice. One consequence of this is that arbitrators sitting outside England, Wales and Northern Ireland will hopefully find useful the observations about how to comply with the 1996 Act in deciding how to exercise their discretion in this most important field.

1.3 Essentially the need for an award of costs arises because in the course of prosecuting or defending arbitration proceedings, the parties will or may incur costs of three different types

- (a) liability for the arbitrator's fees and expenses;
- (b) liability for the fees and expenses of any arbitral institution involved; and
- (c) legal and other costs incurred directly by the parties.

1.4 A party who is successful in bringing or resisting a claim will seek an order against the unsuccessful party for reimbursement of the costs which he has incurred. The order can be sought in relation to all three of the categories of cost set out above. An order of this kind is typically sought after the arbitrator has disposed of the main issues of liability and quantum raised by the claim. It may however be sought at an earlier stage; for example, at the stage of a partial (or interim) award under Section 47 of the Act.

1.5 The arbitral tribunal normally has a wide discretion as to making awards of costs and this enables it to have regard to the particular circumstances of the case and to make an order which seems fair in all the circumstances. There are inevitably however principles which have to be observed.

1.6 The Civil Procedure Rules, which deal with the making of orders for costs in actions before the Court, do not apply to arbitration and thus have no direct impact on orders to be made by arbitrators. Nor is there any longer any requirement that arbitrators must act "judicially" in the sense that they must follow the same principles as would be adopted by the Court in making an order for costs.

1.7 On the other hand, the Arbitration Act 1996 lays down certain principles most of which are non-mandatory in the sense that the parties may contract out of them. The most important of these is that, unless the parties otherwise agree, the tribunal must "award costs on the general principle that costs should follow the event" (Section 61(2)). Where an arbitrator is dealing with the amount of the recoverable costs (as opposed to their allocation between the parties), the arbitral tribunal is

given a wide measure of freedom to determine the basis on which the assessment is to be made. But, if the parties do not otherwise agree and the arbitral tribunal does not otherwise determine, the arbitral tribunal must decide on the recoverable costs on the basis set out in the Act (Section 63(5)). It is important that when making an award of costs an arbitrator should have regard to the relevant principles. Should he misdirect himself a party may seek leave to appeal to the Court on a point of law.

## **2. Topics to be Covered**

This guideline addresses the following topics:

- (1) Allocating the costs of the arbitration between the parties.
- (2) Determining the recoverable costs of the arbitration.
- (3) Capping the recoverable costs.
- (4) Security for costs.

## **3. Comparative View**

3.1 The detailed nature of the Arbitration Act 1996 contrasts with the position under most modern arbitration statutes around the world. Notably, the UNCITRAL Model Law, the French NCPC, the Swiss LDIP, the US Federal Arbitration Act, the Belgian and Dutch statutes are all silent on the subject. The arbitral tribunal under these provisions is assumed to have a broadly unfettered discretion on the subject.

3.2 The Swedish Act contains one brief provision:

"Section 42

Unless otherwise agreed by the parties, the arbitrators may, upon request by a party, order the opposing party to pay compensation for the party's costs and determine the manner in which the compensation to the arbitrators shall be finally allocated between the parties. The arbitrators' order may also include interest, if a party has so requested."

3.3 Section 1057 of the German ZPO says:

"(1) Unless the parties agree otherwise, the arbitral tribunal shall allocate, by means of an arbitral award, the costs of the arbitration as between the parties, including those incurred by the parties necessary for the proper pursuit of their claim or defence. It shall do so at its discretion and take into consideration the circumstances of the case, in particular the outcome of the proceedings.

(2) To the extent that the costs of the arbitral proceedings have been fixed, the arbitral tribunal shall also decide on the amount to be borne by each party. If the costs have not been fixed or if they can only be fixed once the arbitral proceedings have been terminated, the decision shall be taken by means of a separate award."

3.4 Section 2GJ of the Hong Kong Ordinance provides:

"(1) An arbitral tribunal may include in an award directions with respect to the costs of the relevant arbitration proceedings (including the fees and expenses of the tribunal) and in so doing may do all or any of the following(a) direct to whom and by whom and in what manner costs of arbitration proceedings are to be paid;  
b) tax and settle the amount of costs to be so paid;  
c) direct costs to be paid on any basis on which the Court can award costs in civil proceedings before the Court. This subsection is subject to any contrary provision of the relevant arbitration agreement.

(2) Costs awarded in respect of arbitration proceedings (other than the fees or expenses of the arbitral tribunal) are taxable by the Court, unless the award otherwise directs. This subsection does not limit the operation of section 21(1)."

3.5. In US arbitration practice, it is unusual for an arbitrator to award attorney fees unless the parties have specifically

agreed to this.

3.6. The UNCITRAL Rules contain detailed provisions on the subject in Articles 38-40. Article 38 empowers the tribunal to fix the costs including the fees of each arbitrator, the expenses of the tribunal and each of its members, expert assistance received by the arbitrators, the costs of the appointing authority and, to the extent that they are reasonable, the expenses of the witnesses and lawyers' fees. The latter must be expressly claimed. Article 39 requires the arbitrators' fees to be reasonable having regard to the amount in dispute, the complexity of the case, time spent on it and any other circumstances.

3.7 Article 40 adopts a costs follow the event approach although it allows the tribunal generally to apportion costs and lawyers' fees as it considers reasonable.

3.8 The Tribunal cannot charge extra amounts for interpreting or completing its award under articles 35 to 37 of the rules.

3.9 Outside England, a court challenge to an award on costs would be highly unlikely to succeed since it would have to be based on a breach of public policy or, in the US, a manifest disregard of the law.

3.10 Section 2GJ(2) of the Hong Kong Ordinance is alone among the legal systems covered here in allowing the court to tax costs.

3.11 In Australia the provisions of the Model Law have been complemented by section 27 of the International Arbitration Act 1974. This reads:

- (1) Unless the parties to an arbitration agreement have (whether in the agreement or in any other document in writing) otherwise agreed, the costs of an arbitration (including the fees and expenses of the arbitrator or arbitrators) shall be in the discretion of the arbitral tribunal.
- (2) An arbitral tribunal may in making an award:
  - (a) direct to whom, by whom, and in what manner, the whole or any part of the costs that it awards shall be paid;
  - (b) tax or settle the amount of costs to be so paid or any part of those costs; and
  - (c) award costs to be taxed or settled as between party and party or as between solicitor and client.
- (3) Any costs of an arbitration (other than the fees or expenses of an arbitrator) that are directed to be paid by an award are, to the extent that they have not been taxed or settled by the arbitral tribunal, taxable in the Court having jurisdiction under Article 34 of the Model Law to hear applications for setting aside the award.
- (4) If no provision is made by an award with respect to the costs of the arbitration, a party to the arbitration agreement may, within 14 days after receiving the award, apply to the arbitral tribunal for directions as to the payment of those costs, and thereupon the tribunal shall, after hearing any party who wishes to be heard, amend the award by adding to it such directions as the tribunal thinks proper with respect to the payment of the costs of the arbitration.

#### **4. Allocating the costs of the arbitration between the parties**

##### **4.1 By Agreement**

Generally the parties are free to reach agreement on the principles to be followed when an arbitrator is asked to make an order allocating the costs between the parties. There is one mandatory provision in the 1996 Act. This is that an agreement that one party is to pay the whole or part of the costs "in any event" is only valid if made after the dispute has arisen (Section 60). The section is based on public policy and invalidates any agreement that one party shall pay the other's costs whatever the outcome of the arbitration (or even that no costs shall be recoverable) unless made after the dispute has arisen.

This position contrasts spectacularly with that in the US where consumer and employment arbitration arrangements have been declared illegal where the non-consumer or employer has not agreed in advance to pay for the costs of the arbitration. In that situation, the concern is that the arbitration arrangements is unconscionable or a sham in preventing one party from pursuing his or her claims. The first type of problem is typically dealt with in England and the rest of the European Union by relying on the Unfair Contract Terms in Consumer Contracts Regulations to invalidate the arbitration clause as unfair. Arbitrations involving consumers is the subject of another guideline where this issue is considered.

#### **4.2 Arbitration Rules incorporated into the agreement**

4.2.1 Apart from this it is important that arbitrators should examine the contract between the parties to see if there is any provision relating to costs. Where the contract incorporates rules (eg the CIMAR or UNCITRAL Rules or the rules of an arbitral institution) those rules should be examined. The principles that they lay down for the allocation of costs, will or may displace or supplement the principles laid down by the 1996 Act.

#### **4.3. In the absence of any agreement**

4.3.1 Where there is no relevant agreement Section 61(2) of the Act provides: -

"..... 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".

4.3.2 The general principle that "costs should follow the event" is taken from the case-law applied by the Court prior to the coming into effect of the Civil Procedure Rules 1998. The concept is worded indirectly so that its meaning may not be entirely clear to the non-lawyer. It requires the arbitrator to consider what was the relevant "event". In most cases this can be equated with the outcome of the arbitration viewed in terms of the relative success of each party. Accordingly it would have been possible to express the general principle more directly, without change to its meaning, by adopting the formula that, as a general rule, the unsuccessful party should be ordered to pay the costs of the successful party. But difficulty can arise on either formulation in deciding what was the relevant "event" which costs should follow or, alternatively, what constituted "success."

4.3.7 It is important to note that Section 61(2) lays down a general principle followed by a wide exception "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". The exception gives effect to the broad principle that an arbitrator has a wide discretion in awarding costs. An arbitrator is entitled to have regard to all the circumstances including

- (i) the conduct of the parties
- (ii) whether a party has succeeded on part of its case even if it has not been wholly successful
- (iii) whether a successful party has failed on issues on which substantial amounts of time were spent
- (iv) any offer to settle the case drawn to the arbitrator's attention.

4.3.8 It is necessary to bear in mind that Section 61(2) requires an arbitrator to consider both the general principle and also the exception. In theory these should be considered

separately though this is not always possible. What is important is that an arbitrator ought not to disregard the general principle unless there are grounds for doing so. Consequently if an arbitrator decides that, in the particular case, it is not appropriate to award the successful party its costs (or that it appropriate to deprive the successful party of a proportion of its costs), the arbitrator should be prepared to justify his decision. The best course in those circumstances is for the arbitrator to set out in the award his reasons why in the circumstances it was not appropriate to award costs on the principle that they followed the event. In some cases this is essential.

4.3.9 A failure to provide satisfactory reasons can result in a challenge to the award of costs on the basis of an error of law under section 69(1). This can be excluded by agreement, notably to be bound by the ICC or LCIA rules.

#### **4.4. Recovery of Monetary Awards**

4.4.1 If a claimant recovers a monetary award, he is normally to be regarded as successful since he had to bring the arbitration in order to recover the sum in question. The "event" is the recovery of money. It is normally no ground for depriving the claimant of his costs that the amount recovered is less than that claimed unless the recovery is so small that it can be regarded as nominal or derisory.

4.4.2 The position may however be very different if the respondent has previously offered to pay the sum awarded (see under "settlement offers" below). If, moreover, a claimant who has succeeded in recovering a monetary award can be shown to have exaggerated his claim, it may sometimes be proper to deprive him of part (or even, exceptionally, the whole) of his costs. Much depends on the particular circumstances. If, for example, the exaggeration was not bona fide and led to a large increase in the cost of the arbitration, this could be a reason why it would not be appropriate to award the claimant the whole of his costs. Although (in the absence of an offer to pay the sum awarded) the outcome of the arbitration can be said to have justified the claimant in bringing it, nevertheless it may be appropriate that any extra time or cost incurred through exaggeration of the claim should be reflected in the eventual costs order. (Only in very exceptional circumstances would it be right to order a successful claimant to pay the respondent's costs).

4.4.3 Where there is a counterclaim and both parties recover monetary awards, the claimant on the claim and the respondent on the counterclaim, more difficult questions can arise. If the claim and counterclaim are closely related, as where they both arise out of the same transaction or series of transactions, it is normally the right course to set-off the two awards and to award costs to whichever party is shown to be entitled to a net recovery after deduction of the other award. In cases where there is no such link between the awards, it may be appropriate to award the costs of the claim to the claimant and the costs of the counterclaim to the respondent. There may also be circumstances which justify a special order for costs (see below under "partial success").

#### **4.5. The Conduct of the Parties**

4.5.1 Generally an arbitrator should exclude from consideration any matter not strictly connected with the arbitration or with the claims made in it. A general disapproval of a claimant's conduct is still no ground for refusing to apply the general principle. The question whether it was reasonable for a party to raise pursue or contest a

particular allegation is, on the other hand, a relevant matter and if the arbitrator considers that the hearing has been prolonged by unreasonable conduct of this kind he is fully entitled to make an order which reflects this view (eg by depriving the successful party of a proportion of its costs).

4.5.2 However, in deciding whether it was reasonable for a claimant to bring a particular claim the arbitrator should act by reference to objective criteria (in particular whether the claim has been successful) and should exercise great caution before depriving a successful claimant of his costs merely because of the arbitrator's personal feeling that the claim was immoral, lacked merit or for some other reason ought not to have been brought.

#### **4.6. Partial Success**

4.6.1 There can be many situations where a party who has succeeded on part of his case (and has consequently obtained an award) has not been wholly successful. In many instances it would not be fair to penalise a successful party for having raised issues or made claims which have ultimately been held to be unsustainable. If it was reasonable to raise these issues or claims and if they have not led to a substantial extra expenditure of time or money, then it may be fair to award the claimant the whole of his costs on the basis of the principle that "costs follow the event".

4.6.2 The position however may be different if a successful party has failed on issues on which substantial amounts of time and money were spent. In such circumstances it may be appropriate to award to the successful party the general costs of the arbitration (to include the cost of issues on which he has succeeded) but to award to the party who has been unsuccessful overall the costs of the issues on which that party has succeeded.

4.6.3 Orders of this kind can be difficult to administer not only because it is often difficult to separate the costs attributable to particular issues but also because such an order may require the tribunal to quantify the recoverable costs of both the successful and the unsuccessful parties. It is usually therefore more convenient and practicable to make allowance for issues on which the successful party has failed, by awarding to the successful party a proportion only of his costs, after making a necessarily approximate attempt to ensure that the proportion awarded mirrors the degree overall to which the successful party has succeeded on the more important issues to which time and money were devoted. If this approach is adopted, the arbitrator must bear in mind, in assessing what proportion should be awarded to the successful party, that the party which was unsuccessful overall will not be making any recovery of the costs relating to the issues on which he succeeded.

4.6.4 If the arbitrator is required to make an award of costs after the main issues of liability and costs have been determined, it is usually possible for him to stand back and, after reviewing the conduct of the arbitration as a whole, determine the proportion of the more important issues on which either party has succeeded, and to make an order which reflects this.

#### **4.7. Preliminary issues**

4.7.1 Sometimes particular points are taken as preliminary issues and the arbitrator is asked to make an award of costs at the time of issuing a partial/interim award dealing with that issue. If faced with an application of this kind the arbitrator has a number of different choices available to him:

(a) he may award the costs of the preliminary issue to the

party in whose favour he decides that issue (either with or without an order that those costs be determined and paid immediately).

(b) he may make an order for "costs in the arbitration". The effect is that the party who obtains an order for costs at the end of the arbitration is entitled to his costs of the particular part of the proceedings to which the order relates.

(c) he may order "costs reserved". This means that the decision about costs is deferred to a later occasion when, it is to be hoped, the arbitrator will be better able to look at the particular issue in the overall context of the whole arbitration. Where he has ordered "costs reserved", the arbitrator should make sure that the costs are dealt with at the end of the arbitration when the topic of costs as a whole is being addressed.

4.7.2 A choice between these various orders will depend on a large number of factors. Sometimes it is appropriate to view the preliminary issue as a discrete "case within a case". In such a situation it may be appropriate to order the costs of that issue to the winner on the ground that the relevant "event" is the outcome of the issue. In other circumstances it may be productive of potential unfairness to make an immediate order as to the costs of the issue. In that situation "costs reserved" may better serve the interests of fairness. There are also circumstances where it is clear that the party who ultimately succeeds should recover the costs of the issue so that "costs in the arbitration" is the appropriate order.

#### **4.8. Settlement Offers**

4.8.1 The making of a settlement offer during the course of an arbitration may have an important bearing on any award of costs. If there has been no settlement offer, it will be hard for an unsuccessful respondent to dispute that it was necessary for the claimant to incur the costs of the arbitration in order to obtain the monetary award which has been made. By contrast if the respondent has offered to settle in the course of the arbitration and the claimant eventually recovers less than the sum which was offered, it will have been a waste of time and money to pursue the arbitration for the period after the time when the settlement offer was made and could have been accepted.

4.8.2 The making of a settlement offer can thus have the effect that the relevant "event" after the date of the offer is whether or not the claimant has been successful in recovering more than has been offered. Another way of looking at the matter is that it would not be appropriate to allocate costs on the principle that costs should follow the event in relation to the period following the offer.

4.8.3 Settlement offers may be made in a wide variety of different situations. In this Guideline it is proposed to consider the typical situation where a respondent is facing a claim which is likely to succeed to some extent but for a lesser sum than has been put forward. The respondent wishes to obtain some protection against having to pay the whole costs of the arbitration. He can do this by making a settlement offer. There are three kinds of offer which can be made, namely "without prejudice", "sealed" and "open" offers. A fully "without prejudice" offer can never be referred to by either party at any stage of the proceedings (and so confers no protection in respect of costs). A "sealed" offer (sometimes called a "Calderbank" offer) is one which is made on the express or implied understanding that it will not be revealed to the tribunal until liability and quantum have been decided and the stage is reached when the question of costs is to be

decided. (A "sealed offer" may be made in correspondence between the parties or it may be placed in a sealed envelope which is delivered to the arbitrator to be opened only after all substantive issues have been decided). An "open" offer is one to which either party can refer at any stage of the proceedings. Normally the "sealed offer" method is adopted so as to avoid any possibility of the arbitrator being influenced by the offer when considering liability or quantum.

4.8.4 Assuming that a sealed offer is drawn to the arbitrator's attention at the stage when he is required to allocate the costs of the arbitration, there are certain points which he should bear in mind.

4.8.4.1 First, the arbitrator must take the offer into account in making his decision as to costs. While he retains a general discretion in awarding costs, the offer is clearly a material factor.

4.8.4.2 Second, the overriding question will be whether the claimant has achieved more by going on with the arbitration and obtaining an award than he would have done by accepting the offer. This equation requires the arbitrator to assess the value of the offer which was made. If the offer was made in a form which included a fixed sum together with interest to the date of the offer plus payment of the claimant's recoverable costs to be assessed, then it should be relatively simple for the arbitrator to come to a conclusion whether or not the claimant has done better by going on with the arbitration than by accepting the offer. If however the offer is for a fixed sum which includes costs, it may be difficult, or even impossible, for the arbitrator to determine whether, taking the claimant's costs into account at the stage when the offer could have been accepted, the net sum remaining would have been more or less than the sum eventually awarded. (In such circumstances the offer may have to be disregarded). Similarly if there is no offer to pay interest on top of the sum which is offered, that is a factor which will need to be evaluated when comparing the offer with what has been awarded.

4.8.4.3 Third, if the arbitrator finds that the claimant would have achieved the same or more by accepting the offer than by going on with the arbitration, the usual order to make is that the claimant is to recover his costs up to the time when the offer could have been accepted and that in respect of the period after that time the respondent is to recover his costs from the claimant. If however the claimant has achieved more by going on with the arbitration than he would have achieved by accepting the offer, the offer will have no effect on the arbitrator's order as to costs and it will be proper to approach the subject of costs as if no offer had been made. In deciding whether the claimant has done better by going on with the arbitration, it is necessary to make a precise comparison of the benefit to the claimant in accepting the offer as compared with the eventual award, so that if the claimant "beats" the offer, even by a small margin, the offer will have no effect, unless of course there are special circumstances which affect the matter.

4.8.4.4 Fourth, where the respondent has made a counterclaim, the offer should say whether the counterclaim has been taken into account. If the offer does not do this and there are no surrounding factors to indicate whether the counterclaim has been taken into account, the offer should be presumed to refer only to the claim. If it refers also to the counterclaim, the arbitrator should consider whether it is appropriate to make a single order for costs; if it is, he should

compare the success which the claimant has achieved in both pursuing the claim and resisting the counterclaim with that which he would have achieved in both respects by accepting the offer.

4.8.4.5 Fifth, if the offer is made so as to be open for acceptance for only a limited period or is ambiguous, incomplete or conditional, questions can arise as to whether it should reasonably have been accepted. No hard and fast rules can be laid down. except that the arbitrator will be more impressed by the ambiguity or incompleteness of an offer if the claimant wrote to the respondent pointing it out in contemporary correspondence than if he refers to it for the first time in his submissions as to why the offer should not be taken into account.

4.8.4.6 Sixth, it should be borne in mind that in a case where the claimant would have achieved more by accepting the offer than by pursuing the arbitration there can be additional factors, such as the unreasonable conduct of one or both parties, which can have the result of making it reasonable to deprive the claimant of all or part of his costs for the period up to the time when the offer could have been accepted or to deprive the respondent of all or part of his costs in respect of the period after that time.

4.8.4.7 Finally there are circumstances where a claimant (not the respondent) may wish to make a sealed offer to settle the case on terms which would give the claimant less than a full recovery. The object of so doing is so that if the offer is rejected and the claimant goes on with the arbitration, then (a) if he obtains a full recovery, he may be able to make a claim for "indemnity" costs in respect of the period after the offer could have been accepted (see below under "determining the recoverable costs of the arbitration") and (b) if he fails to make a full recovery but recovers only the amount specified in the sealed offer, he will have grounds for arguing that he should not be deprived of any proportion of his costs on the basis that he has been only partially successful.

## **5. Determining the Recoverable Costs of the Arbitration**

### **5.1 Introduction**

5.1.1 An arbitrator's award as to liability for costs may take any of the following forms:

Party A shall pay Party B its costs of the arbitration

Party A shall pay Party B its costs of the arbitration on an indemnity basis

Party A shall pay Party such-and-such a fraction of its costs of the arbitration

Party A shall pay Party B its costs of issues X, Y and Z only

Party A shall pay Party B its costs of the arbitration up to a such-and-such date or event.

5.1.2 An award in any of the above forms is not immediately enforceable. The amount of costs recoverable by the "receiving party" from the "paying party" must first be determined. Under Section 63(1) of the Act the parties are free to agree what costs of the arbitration are recoverable and they very often reach an agreement as to the amount of the recoverable costs. If they do not, the arbitral tribunal may determine by award the recoverable costs of the arbitration and the Act in Section 63(3) requires the tribunal to specify the basis on which it has acted. Finally, if the arbitral tribunal does not determine the recoverable costs, Section 63(4) enables any party to the arbitral proceedings to apply to the Court to determine the recoverable costs. It is however rarely in the interests of the parties for an arbitrator to refrain from determining the costs and thereby to leave their determination to the Court.

5.1.3 An order for the determination of the recoverable costs is typically sought after the arbitrator has disposed of the main issues of liability and quantum raised by the claim and after he has made an order allocating the costs between the parties (as in paragraph 35 above). There are however other situations in which the recoverable costs may have to be quantified. For example in some arbitrations it may be ordered or expected that the tribunal will determine the costs at the same time as it makes the order allocating them between the parties and, where this is so, the parties will usually be prepared at that hearing to provide itemised lists of the costs which they have incurred so that an assessment can be made. Another example is where the tribunal is being asked to make a partial/interim award and one party is seeking an order that it be paid the costs of that award and that payment be made immediately without awaiting the outcome of the arbitration as a whole. In all these different situations, however, certain basic principles apply.

## **5.2 Basis of the Determination**

5.2.1 If the arbitrator determines the recoverable costs of the arbitration it is incumbent upon him to specify the "basis" on which he has acted. That basis may be one which has been agreed by the parties. If there has been no such agreement, then the arbitral tribunal may determine the recoverable costs "on such basis as it thinks fit", provided that it is specified. Finally if the basis is neither agreed by the parties nor specified by the tribunal, costs are to be determined on the basis set out in Section 63(5) of the Act, namely "(a) . . . . That there shall be allowed a reasonable amount in respect of all costs reasonably incurred, and (b) any doubt as to whether costs were reasonably incurred or were reasonable in amount shall be resolved in favour of the paying party".

5.2.2 Section 63(5) sets out the "standard" basis for determining recoverable costs in litigation as adopted by the Court prior to the coming into effect of the Civil Procedure Rules 1998. The two points to notice are (i) that the key to recovery is whether costs were "reasonably incurred" and (ii) that the burden of proving reasonableness is on the receiving party.

5.2.3 Traditionally "reasonableness" has been determined on an item by item basis. If the item was reasonably incurred and the charge for it was in line with the level of costs generally charged at the time and in the circumstances when the professional charges were rendered, it was normally accepted as being reasonable and therefore recoverable. But since 1998 the Court has enquired, not only whether costs were "reasonable", but also whether they were "proportionate".

5.2.4 The requirement of "proportionality" is as difficult to define as that of reasonableness. It can however be explained by the following example. Suppose a claimant in an arbitration advances a claim for £5,000 damages and is wholly successful in recovering that amount but, in so doing, incurs costs amounting to £100,000 and suppose each item, examined in isolation, is reasonable, still a bill of £100,000 might be regarded as wholly disproportionate to the sum involved and therefore not recoverable. The concept of "proportionality" requires the tribunal to take a global approach.

5.2.5 One factor is whether the costs are proportionate by reference to the sum at stake but the sum at stake is only one factor among many.

These include: -

- (1) the conduct of all the parties;
- (2) the amount or value of any money or property involved;
- (3) the importance of the matter to all the parties;
- (4) the particular complexity of the matter or the difficulty or novelty of the questions raised;
- (5) the skill, effort, specialized knowledge and responsibility involved;
- (6) the time spent on the case
- (7) the place where and the circumstances in which work or any part of it was done.

(See Rule 44.5(3) of the Civil Procedure Rules).

5.2.6 There is no doubt that an arbitrator is entitled to take into account whether the receiving party's costs were "proportionate" and many arbitrators have always done this. A difficulty is created by the fact that Section 63(5) refers only to reasonableness. It is thought that an arbitrator could not be criticised if he regarded proportionality as an aspect of reasonableness. The safest course however is for the arbitrator to specify the "basis" on which he has acted in determining costs by reference to a formula which includes a reference to proportionality.

5.2.7 This can be done in many ways, one of which is for the arbitrator to follow the Civil Procedure Rules 1998 (see Rules 44.4(2) and 44.5(1)) by stating that he has adopted the basis set out in Section 63(5) supplemented by the following:

- (1) the tribunal will only allow costs which are reasonably incurred and are proportionate to the matters in issue; and
- (2) will resolve any doubt as to whether costs were reasonably incurred or reasonable and proportionate in amount in favour of the paying party.

5.2.8 An arbitrator is entitled to adopt this formula for determining costs on the "standard" basis, provided of course that the parties have not agreed otherwise. The arbitrator should however (a) notify the parties in advance that he proposes to do this so that they have an opportunity to comment and (b) specify in his award that he has acted on this basis.

5.2.9 The alternative basis for determining the recoverable costs is the so-called "indemnity" basis. This normally gives a somewhat higher recovery than the "standard" basis and is thus more favourable to the receiving party. There is one feature of "indemnity" costs which is the same as in "standard" costs; in both cases the tribunal should disallow costs which have been unreasonably incurred or were unreasonable in amount. However, the Civil Procedure Rules (Rule 44.4(3)) define the indemnity basis as one where "the court will resolve any doubt which it may have as to whether costs were reasonably incurred or were reasonable in amount in favour of the receiving party". This amounts to a partial reversal of the normal burden of proof on issues of reasonableness. In addition, it has been held that no question of proportionality arises where indemnity costs are concerned, though it can be difficult to distinguish between issues of reasonableness and issues of proportionality. The grounds on which indemnity costs can or should be ordered are briefly considered in paragraph 5.6.6 below.

### **5.3 Summary**

5.3.1 To summarize, the arbitrator may be asked to award costs either on the "standard" or on the "indemnity" basis. He may decide on the indemnity basis on his own motion provided that he gives notice of his intention so that the parties have an opportunity to comment. If he decides on the

“standard” basis, he may adopt Section 63(5) or he may adopt a basis which includes the test of proportionality. Again he may be asked to do this or he may do it on his own motion.

5.3.2 Provided that he complies with his duty under Section 33(1) to act fairly and impartially his award is not likely to be the subject of a successful challenge. He should however always specify in his award the basis on which he has acted.

#### **5.4 Procedure**

5.4.1 There is no need for the arbitrator to follow court procedures when determining the costs of the arbitration. The procedure is in his discretion and should be tailored to suit the circumstances of the case, based on the following essential steps:

- (1) any party claiming costs must submit an itemised list of claimed costs and the basis upon which he or she contends to be entitled to the costs concerned
- (2) the potential paying party is invited to raise objections
- (3) the party claiming costs is invited to reply to those objections
- (4) the arbitrator considers the list in the light of the objections and disallows and/or adjusts the recoverable costs where appropriate - this is known as “the assessment stage”
- (5) the arbitrator issues an award setting out the items of recoverable costs and the amount referable to each item.

Inevitably, each party to the arbitration will be in the role of both claimant for costs and potential paying party. So, in practice, the parties should be invited to submit their claims at broadly the same time with the same timetables for response and any replies to those responses.

5.4.2 Where there are large sums in issue, the arbitrator may hold a short oral hearing so that he can receive representations before making his decision. The tribunal may alternatively request written submissions about particular aspects of any possible costs order.

#### **5.5 The scope of the arbitrator’s power**

5.5.1 The only costs which the arbitrator can award are those which are reasonably incurred by a party to the arbitration in connection with the arbitration. This requirement of a connection may result in the arbitrator disallowing costs incurred before the service of the arbitration notice. In some cases, those amounts may be recoverable as damages rather than costs if a breach of duty has caused the expenses to be incurred. The connection requirement would not apply where it is essential that evidence be collected immediately in contemplation of arbitration. The key issues are whether the expenses have been incurred in connection with the arbitration and if so whether there is an entitlement to these costs generally.

5.5.2 As far as the arbitrator is concerned, the costs of the arbitration exclude those of applications to the Court unless the Court specifically reserves the matter to arbitrator to determine.

#### **5.6 Factors to be taken into account at the assessment stage**

5.6.1 First, it should be borne in mind that, if the parties have made a valid agreement as to costs, that agreement prevails.

5.6.2 Second, where a direction has been made under Section 65 of the Act, limiting the recoverable costs, the assessment must take that direction into account. The topic of “capping the recoverable costs” is discussed in Part 3 below.

5.6.3 Third, it will be necessary to apply the “basis” of the determination which has been fixed, whether by agreement or by the arbitrator’s decision. If the basis has not so far been fixed, it will be necessary to determine it.

5.6.4 Fourth, where costs are to be determined on the “standard” basis and proportionality is in issue, it is normally best to begin by applying a global approach and asking whether (by reference to the factors listed in paragraph 41), the sum claimed in respect of costs satisfies the

proportionality test. If it does, the arbitrator should then go on to consider whether each item of costs was reasonably incurred and whether the costs for that item were reasonable.

5.6.5 If the costs as a whole appear disproportionate, the arbitrator will seek to limit the recoverable costs to the amount which would have been incurred if the arbitration had been conducted in a proportionate manner. This may involve him in deciding how (given the factors set out in paragraph 41) the receiving party should have conducted his case. It may also involve him in considering whether the work in relation to each item was necessary and, if so, whether the cost of that item was reasonable. The question of whether the work was properly planned will usually be an important consideration. The arbitrator should award whatever sum would have been recoverable item by item if the arbitration had been conducted proportionately.

5.6.6 Fifth, it may be necessary to decide whether the costs, or certain items of cost, are to be determined on the "indemnity" basis. The effect of this has been discussed in paragraph 5.2.9 above. It is not possible to define the exact circumstances in which indemnity costs may be ordered. Unreasonable or improper conduct on the part of the paying party is the obvious example. It should be borne in mind however that indemnity costs are not awarded just to penalise a party for advancing a case which it has lost but are usually reserved the situations where the arbitrator is indicating his disapproval of the conduct in the arbitration of the party against whom the costs are awarded. Another example can arise where a claimant has made an offer to settle his claim at a specified figure, the offer is rejected, and the claimant continues with the arbitration. If the eventual award is more advantageous to the claimant than the proposals contained in his offer to settle would have been, it may be reasonable to award the claimant indemnity costs from the time when the respondent could have accepted the offer to settle (compare Rule 36.2 of the Civil Procedure Rules). Much however will depend on the circumstances of the particular case and purely tactical offers may have to be disregarded.

5.6.7 Finally, the arbitrator will inevitably have to decide upon matters of detailed quantum. Some of these are mentioned below.

## **5.7 The heads of recoverable costs**

### **5.7.1 Legal representation**

5.7.1.1 The costs of representatives of the appropriate level of skill and experience are generally recoverable, subject to the arbitrator's overriding discretion based on considerations of reasonableness and proportionality. If the arbitrator is of the view that the numbers of representatives or the fees claimed are in excess of what is reasonable, he may disallow some or all of the claims for costs made in respect of individual representatives.

5.7.1.2 A party may be represented in arbitration by a nonlawyer, such as a "claims consultant" and the reasonable costs of such a representative may also be recovered.

5.7.1.3 The law in England has recently changed to allow "conditional fees" - ie to allow an advocate to charge an enhanced rate if he wins the case. There is some debate as to whether and, if so, to what extent the new procedures can apply to arbitration. The safer view is that the traditional test applies, namely that a party can only recover a reasonable amount for representation and can only recover that amount if obliged to pay it to its representatives. The consequence of this is that in the event of success, the arbitrator must assess any amount payable to the claimant's representatives and consider independently whether it represents a reasonable figure and if not, what would be such an amount.

### **5.7.2 Costs of evidence**

The costs of evidence include those for preparing witness (including experts') statements, attendance of witnesses at the hearing, preservation of physical evidence, tests, expert reports etc. The receiving party may recover a reasonable amount in respect of these costs. The test to be applied is whether such costs were reasonably incurred in all the circumstances. The costs of needless duplication and evidence to prove facts admitted in the pleadings will normally be disallowed.

### **5.7.3 Party's own internal costs - Employees**

5.7.3.1 Reasonable compensation may normally be allowed for a person who represents himself or his employer in an arbitration.

5.7.3.2 The staff of a company or firm involved in an arbitration often dedicate substantial time to the case, including the generation of figures and attendance at the hearing. These costs, except for reasonable out-of-pocket expenses necessarily incurred in the arbitration, are normally irrecoverable on the general principle that the lay client's time in instructing those who conduct the proceedings is not allowable. This principle is not applied as strictly in commercial cases as it is to other types of proceedings and an arbitrator has a discretion to allow an element of costs in respect of such work if he is satisfied that the work done internally obviated the need for others to do it and hence led to an overall saving of costs. The arbitrator may determine that internal costs are to be included as part of the "...other costs of the parties".

5.7.3.3 A successful party who employs in-house lawyers may in the discretion of the arbitrator recover his costs on the normal basis as if those lawyers were in independent practice.

### **5.7.4 Accommodation and other administration costs**

The costs of hearing rooms, necessary photocopying and other similar items of administration are clearly recoverable unless unreasonable. The costs of a note or transcript are in the discretion of the arbitrator.

### **5.8. The Award as to Costs**

5.8.1 An arbitrator's order as to costs will not be enforceable unless

- (1) it is contained in an award and
- (2) it is for a quantified amount.

The award may be contained in the same award as deals with substantive issues or (provided that the arbitrator has not yet made a final award dealing with all issues) in one or more separate awards dealing with costs.

5.8.2 An award of costs is subject to the requirement of Section 52(4) that it shall contain the reasons for the award unless it is an agreed award or the parties have agreed to dispense with reasons. In a simple case it may be sufficient, when allocating costs, to refer to the principle that costs follow the event. Where an arbitrator is departing from that principle his award should explain his reasons for so doing; see paragraph 4.3.8 above.

5.8.3 Where the effect of the award is to quantify the amount of the recoverable costs, Section 63(3) require the arbitrator to specify:-

- (a) the basis on which he has acted; and
- (b) the items of recoverable costs and the amount referable to each.

Hence it is not sufficient to set out the aggregate amount payable in respect of costs; the award should state the sum

awarded in respect of each of the main heads of recoverable costs.

5.8.4 Where an arbitrator is making a partial/interim award dealing with a preliminary issue (see paragraph 4.7.1 above) and is awarding the costs of that issue to the party in whose favour he decides it, the arbitrator may be asked to make an order (a) determining the amount of those costs and (b) directing their immediate payment. There is no reason not to make such an order if the justice of the case so requires. It is however sometimes more convenient to defer all questions of the quantification of costs to the concluding stages of the arbitration.

5.8.5 At the end of a preliminary hearing dealing with purely procedural matters, an arbitrator may be asked to make an order for costs in favour of one of the parties (as opposed to ordering "costs in the arbitration"). Should he decide to make such an order, the most usual form of order is for the Claimant or the Respondent to have the costs "in any event". This means that the party in whose favour the order is made is entitled to have the costs, whatever other costs orders are made in the arbitration. Sometimes, however, an arbitrator may be asked to go further and to determine the amount of those costs and direct their immediate payment. An arbitrator should be cautious about making orders in this form as an order for the payment of costs must be contained in an award to be enforceable and there is no precedent for making partial/interim awards in respect of the costs of purely procedural hearings. However, if the arbitrator considers such an award to be reasonable, he or she should make such an order in the form of a reasoned award to facilitate the enforcement of the decision under the New York Convention and other municipal laws.

## **6. Capping the Recoverable Costs**

6.1 Section 65 of the 1996 Act introduced a new principle that, unless otherwise agreed by the parties, the arbitral tribunal might direct that the recoverable costs of the arbitration or of any part of the arbitral proceedings, shall be limited to a specified amount. The object of the section was to put a ceiling on the costs so that, while a party might spend as much as it liked on an arbitration, it would not be able to recover more than the ceiling limit from the other party. It was also to discourage those with deep pockets from intimidating their opponents into giving up through fear of incurring a liability for costs beyond their means.

6.2 The power given to an arbitrator to impose a "costs cap" is not mirrored by any of the Civil Procedure Rules 1998 and its exercise requires some care. While it was one of the objects of the 1998 Rules to ensure that an award of costs was "proportionate", an arbitrator who imposes a "costs cap" has to decide what amount of costs is proportionate to the arbitration before the relevant costs are incurred and not afterwards. A costs cap cannot apply or be varied retrospectively. A costs cap should refer to each party's costs and not to both parties' costs added together and will be presumed to do this unless otherwise specified.

6.3 The cardinal principle set out in Section 65 is that while a direction may be made or varied at any stage, this must be done sufficiently in advance of the incurring of costs to which it relates, or the taking of any steps in the proceedings which may be affected by it, for the limit to be taken into account.

6.4 The following points should be borne in mind.

6.4.1 First, the section applies "unless otherwise agreed by the parties" Consequently if the parties agree that there shall be no costs cap, an arbitrator has no power to impose one.

Likewise, if the parties agree a limitation on the recoverable Costs, that will bind the arbitrator. If an arbitrator of his own motion suggests that a "costs cap" should be ordered and both parties oppose the making of the order, he should desist from imposing a cap.

6.4.2 Second, an order under the section can be made either (i) on the application of one of the parties or (ii) of the arbitrator's own motion. In the latter case, however, he should allow the parties to make submissions to him before making the order.

6.4.3 Third, a "cost cap" should not be ordered until the arbitrator has sufficient knowledge of the dispute (or of the part of the proceedings to which the cap will relate) for him to be able to determine what amount of costs it would be reasonable for each party to devote to it. To assess the amount of any possible cap, an arbitrator will need to know, in broad terms, not only what sum is at stake, but also the other factors relevant in deciding on the "proportionality" of costs (see paragraph 41 above).

6.4.4 Fourth, as a cap may apply to "any part of the arbitral proceedings", it is open to an arbitrator to impose a "cap" in relation to a particular stage of the arbitration of which he has detailed knowledge or whose features he can predict with reasonable accuracy. But such an order can give rise to unnecessary complication unless it is intended to make a special order for costs in relation to that stage of the proceedings.

6.4.5 Fifth, an arbitrator would normally be unwise to set a different limit on the costs recoverable by one party from those recoverable by the other. But where the work involved on one side is so clearly likely to be greater than that involved on the other, fairness may require that, if a limit is set at all, different limits should be set to the costs recoverable by each side. Since it is not clear that Section 65 enables different limits to be set, it may be preferable in such circumstances to desist from ordering any limit to the recoverable costs. Another possible course is to set the limit at the higher of the two figures but to warn the parties that, when costs are determined at the end of the arbitration, the requirements of proportionality and reasonableness may dictate that what the parties actually recover may be less than the limit.

6.4.6 Sixth, where there is both a claim and a counterclaim the arbitrator will need to specify in his order whether the limit is to apply to one or the other or both.

6.4.7 Seventh, where a limit has been set and that limit subsequently proves to have been insufficient, it is possible for the limit to be varied. But the variation applies only in relation to costs not yet incurred. The original limit continues to apply to costs already incurred. This can give rise to problems of some complexity.

6.4.8 Eighth, the limit must be taken into account when allocating the costs of the arbitration between the parties, as well as when determining the recoverable costs of the arbitration. In the simple case where the arbitrator is minded to make an order for costs in favour of the claimant, he should bear in mind that the claimant may have incurred costs in excess of the limit (in which case the limit will apply) or below the limit (in which case he should reserve to himself the right to determine the amount of the claimant's recoverable costs in the event that they are not agreed).

6.4.9 Ninth, if, when allocating the costs of the arbitration, the arbitrator is minded to order that party A is to recover, say, 50 per cent of its costs or that each party is to recover a

specified proportion of its costs from the other, the arbitrator should go on to consider whether the limit is to apply before or after the proportion is assessed. As a general rule the fair course is to order that the proportion should apply to the capped figure. To do otherwise is normally unfair to the paying party. It is insufficient for the arbitrator to award, for example, "50% of the Claimant's costs to be paid by the Respondent" in a situation where a limit has been set. He should normally order "50% of the Claimant's costs to be paid by the Respondent not exceeding 50% of the limit".

6.4.10 Finally, in the light of the power given to arbitrators to fix the basis on which costs are to be recovered so that the requirement of "proportionality" is observed, there may be other ways of satisfying many of the objectives of Section 65 than by setting a ceiling to the recoverable costs.