

GUIDELINES TO AWARDING COSTS IN ARBITRATION

1 INTRODUCTION

The treatment of costs and expenses in arbitration has, at times, been problematic; not least because of the legal costs involved in pursuing disputes through arbitration. The purpose of this guideline is to assist arbitral tribunals in dealing with the issue of fixing and allocating costs as part of their awards under Articles 31 & 33 of Schedule 1 of the Arbitration Act 1996.

Clause 6 of Schedule 2 sets out the general approach in the following terms:

6 *Costs and expenses of an arbitration*

(1) *Unless the parties agree otherwise, —*

- (a) *The costs and expenses of an arbitration, being the legal and other expenses of the parties, the fees and expenses of the arbitral tribunal, and any other expenses related to the arbitration shall be as fixed and allocated by the arbitral tribunal in its award under article 31 of Schedule 1, or any additional award under article 33(3) of Schedule 1; or*
- (b) *In the absence of an award or additional award fixing and allocating the costs and expenses of the arbitration, each party shall be responsible for the legal and other expenses of that party and for an equal share of the fees and expenses of the arbitral tribunal and any other expenses relating to the arbitration.*

(2) *Unless the parties agree otherwise, the parties shall be taken as having agreed that,—*

- (a) *If a party makes an offer to another party to settle the dispute or part of the dispute and the offer is not accepted and the award of the arbitral tribunal is no more favourable to the other party than was the offer, the arbitral tribunal, in fixing and allocating the costs and expenses of the arbitration, may take the fact of the offer into account in awarding costs and expenses in respect of the period from the making of the offer to the making of the award; and*
- (b) *The fact that an offer to settle has been made shall not be communicated to the arbitral tribunal until it has made a final determination of all aspects of the dispute other than the fixing and allocation of costs and expenses.*

- (3) *Where an award or additional award made by an arbitral tribunal fixes or allocates the costs and expenses of the arbitration, or both, the High Court may, on the application of a party, if satisfied that the amount or the allocation of those costs and expenses is unreasonable in all the circumstances, make an order varying their amount or allocation, or both. The arbitral tribunal is entitled to appear and be heard on any application under this subclause.*
- (4) *Where—*
- (a) *An arbitral tribunal refuses to deliver its award before the payment of its fees and expenses; and*
- (b) *An application has been made under subclause (3),—*
- the High Court may order the arbitral tribunal to release the award on such conditions as the Court sees fit.*
- (5) *An application may not be made under subclause (3) after 3 months have elapsed from the date on which the party making the application received any award or additional award fixing and allocating the costs and expenses of the arbitration.*
- (6) *There shall be no appeal from any decision of the High Court under this clause.*

Clause 6 establishes a four tier process for dealing with costs:

- (1) agreed between the parties (clauses 6(1) & (2)),
- (2) fixed by the arbitral tribunal (clause 6(1)(a)),
- (3) costs lie where they fall, with the costs and expenses of the arbitral tribunal shared equally between the parties (clause 6(1)b)), and
- (4) fixed by the High Court on review (clause 6(4)).

For domestic arbitrations, Schedule 2 applies unless the parties opt-out of those provisions, and for international arbitrations, the Schedule applies only if the parties opt-in (section 6). For the purposes of dealing with costs and expenses, this guideline makes no distinction between domestic and international arbitrations.

The core principles underlying the application of clause 6 are:

- (a) preserving *party autonomy* in arbitration, and
- (b) the implication that *costs follow the event*, meaning that the costs of the arbitration should be borne by the unsuccessful party or parties.¹ The rationale for this principle is that the successful party should not have been

¹ See Article 42(1) of the 2010 UNCITRAL Rules.

forced to go through the arbitration process at all, and should not be penalised by having to pay for it.

Problems tend to arise where the parties have not agreed on how costs and expenses are to be apportioned, and the arbitral tribunal is then left to make an award of costs under clause 6(1)(a).

2 COSTS AND EXPENSES

Costs and expenses are defined in clause 6(1) as being “*the legal and other expenses of the parties, the fees and expenses of the arbitral tribunal, and any other expenses related to the arbitration.*”

The costs of the arbitration are typically:

- (a) the arbitral tribunal’s fees,
- (b) the fees of the appointing authority,
- (c) the arbitral tribunal’s travel and accommodation expenses,
- (d) administration costs, room hire (if not covered by the parties directly) and
- (e) the costs of any tribunal appointed experts and advisers, including their travel and accommodation costs.

These costs should be reasonably non-contentious.

The parties’ costs are their costs incurred in the arbitration. They will include:

- (i) legal fees and disbursements,
- (ii) expert witnesses, and
- (iii) in some cases fact witnesses, and their respective costs in attending and giving evidence.

Indirect costs (for example, income or time lost to the parties as a result of disruption to their businesses) will generally not be recoverable.

There is also an overarching expectation that the costs and expenses will be reasonable, and they will have actually been incurred.²

3 AGREEMENT

There are a number of opportunities for the parties to agree on how costs are to be dealt with.

² For the widely accepted test of *reasonableness* see the separate opinion of Judge Holtzmann in the case before the Iran-US Claims Tribunal, quoted in *Williams & Kawharu on Arbitration* (Lexis Nexis, 1st Edition 2011), at para 16.7

The first such opportunity is in the agreement to arbitrate, followed by the point at which the dispute is referred to arbitration; and in the event that the basis upon which costs are to be allocated has not been agreed at that stage, costs can be covered at the preliminary conference or Procedural Order No 1.

Any such agreement should cover the following:

- (1) *Costs follow the event?* Whether or not the unsuccessful party should cover the arbitral tribunal's costs and expenses and the other party's costs and expenses, or should costs *lie where they fall*?
- (2) *How are the successful party's costs and expenses to be assessed?* Should this be reasonable costs, proportional to the dispute and properly and actually incurred? or should they be fixed by reference to the High Court Rules or some other scale?
- (3) *Reasonable contribution to the successful party's legal expenses or full indemnity?* In addition to paying all the costs of the arbitral tribunal, should the unsuccessful party reimburse the successful party all its costs and expenses of the arbitration (reasonable costs, properly incurred)? or should it make a contribution of, say, 2/3?
- (4) *To what extent should the arbitral tribunal retain a residual discretion in allocating costs,* notwithstanding any agreement of the parties applying one of the options (1) – (3) listed above?

Depending on the nature and extent of the agreement as to costs, the arbitral tribunal may or may not have a role in assessing and fixing the costs and considering the circumstances of the case which may warrant a departure from the agreed allocation.

4 FIXED AND ALLOCATED BY THE ARBITRAL TRIBUNAL

Where the arbitral tribunal is to fix and allocate costs and expenses in terms of clause 6(1)(a), subject to any agreement between the parties and any interim orders as to costs, it does so in the final award; after issues of liability have been determined in the partial award.

The first duty of the arbitral tribunal is to fix the costs, and then to consider the allocation of them.

The discretion to award costs must be exercised judicially and in accordance with established principles.³

³ See *Casata Ltd v General Distributors Ltd* [2006] 2 NZLR 721 (SC) at para 107 per McGrath J, but note more generally the dissenting judgments of Tipping & Blanchard JJ.

The general rule is that *costs follow the event*;⁴ the losing party is to pay the arbitral tribunal's costs and expenses and the successful party is entitled to be reimbursed its costs and expenses of the arbitration.

This requires the arbitral tribunal to make a number of determinations:

- (1) What are the costs and expenses of the arbitral tribunal?
- (2) What are the costs and expenses of the successful party in the arbitration?
- (3) On balance, which of the parties was successful? and to what extent?
- (4) How should those costs and expenses be allocated?
- (5) Are there any circumstances in the case which would warrant a departure from the allocation?

By far the most problematic issues are (2) fixing the costs and expenses of the successful party, (3) determining which was the successful party, and to what extent, and (4) allocating them between the parties. These issues may be exacerbated when there are more than 2 parties, and a number of claims, counterclaims and set-offs are involved.

Which party was successful and to what extent?

Success in arbitration is typically not a *zero-sum* analysis. Each party is likely to have won on some issues and lost on others, and some issues may hold greater significance to the dispute than others. This is ultimately a matter of discretion for the arbitral tribunal.⁵

While a claimant may have lost on several issues, but have recovered a substantial sum will usually be considered to have been successful, the degree of success may warrant a reduced costs award. The threshold for making such a reduced award may be where the successful party has raised issues which have caused a significant increase in costs or delays in the proceedings.⁶

How to fix and allocate costs

The general principles to be applied to fixing and allocating costs and expenses are:

- (a) Costs and expenses must be reasonable, proportional to the dispute and must be actually incurred.⁷

⁴ If the parties wish to apply the principles in the High Court Rules 2008 (rules 14.1-14.12), they may agree to do so, but they need not be slavishly followed in arbitration - see *Marx v A-G* [1974] 2 NZLR 372.

⁵ See Colin YC Ong & Michael O'Reilly, *Costs in International Arbitration* Lexis Nexis 2013 at page 85

⁶ *Re Eligindata No 2* [1992] 1 WLR 1207 and *The Rozel* [1994] 2 Lloyd's Rep 161, Phillips J at 170

⁷ For a definition of *reasonable*, see the test outlined by Judge Holzmann, referenced in footnote (1) above.

- (b) The arbitral tribunal must then determine whether or not the losing party must make a *reasonable contribution* to those costs, reimburse the full amount fixed, based on a full indemnity, or contribute a proportion of such amount adjusted for the circumstances of the case.⁸

It follows in making this determination that the arbitral tribunal must consider the submissions of the parties, and give reasons for its determination.⁹

It may be that the parties agree to apply the High Court Rules to costs,¹⁰ but short of such agreement, the arbitral tribunal is under no obligation to do so, as they are generally not relevant to arbitration.

Where the costs are disputed, the arbitral tribunal's consideration should be on a line by line basis, testing the reasonableness of each cost. The tribunal must then have regard to any indemnity for such costs included in any agreement between the parties, and interim orders given as to costs during the arbitral process and the overall proportionality of the costs having regard to the dispute.

Increasingly, conditional fee arrangements are being entered into by counsel with their clients, whereby the fee is reduced if that party is unsuccessful and a premium is payable if that party is successful. Short of an indemnity agreement between the parties, such fee arrangements should not be taken into account in fixing party costs. Conditional fee arrangements are commercial arrangements particular to the client and their lawyers and they are not relevant to a consideration of reasonable cost.

5 CIRCUMSTANCES OF THE CASE

There are a number of circumstances which the arbitral tribunal may take into account when allocating costs:

⁸ The rationale for full indemnity costs is that the successful party should be compensated for the loss it has incurred in recovering what it was entitled to recover, and should not have to pay the cost of pursuing the claim. The counter arguments of access to justice used in relation to court actions arguably don't apply to private commercial arbitration. See *Williams & Kawharu on Arbitration* at para 16.8.

⁹ See, however, the majority decision given by McGrath J in *Casata*, in which the Supreme Court held that an arbitral tribunal has a duty to consider costs, even if the parties had made no claim for costs and no submissions on the issue (notwithstanding clause 6(1)(b) which provides for costs to *fall as they lie* in such an eventuality). The majority decision is heavily criticized in *Williams & Kawharu on Arbitration* at para 16.5.

¹⁰ See *The Marble & Granite Centre Ltd v Emery*, High Court Auckland, M1384/98, Robertson J at p 11; *HW Broe Ltd v Jones* 24/9/90, Greig J, HC Wellington CP629/89; and *Ruapehu District Council v Asphaltic Construction Ltd* 10/2/93, Neazor J, HC Wellington CP970/91. The alternative views in *Young v Kerr Construction (Whangarei) Ltd* (2002) 16 PRNZ 311, and *O v SM* [2000] 3 NZLR 114 may be distinguished on the basis that the High Court Rules have subsequently changed significantly.

- (1) *Interim costs awards* – when considering applications for interim orders, it may be appropriate to also make an order as to the costs relating to that order, based on the conduct of the parties or other considerations.
- (2) *The degree of success of the parties* – where a determination on liability effectively favours neither party's position, it may be appropriate for costs to *lie as they fall*, or to allow a proportionate contribution.
- (3) *Conduct of the parties* – particularly in making inflated claims, submissions without merit, or simply applying for orders, or failing to comply with timetabling or similar orders, which have the effect of increasing the cost to the other party with no particular benefit to the offending party or to the arbitration process.
- (4) *Any other factor which the arbitral tribunal deems relevant* – for example where despite the success of one party, the other party's position is not without merit and was not unreasonably pursued.

6 CALDERBANK OFFERS

Where a party has made an offer to settle the dispute (a *Calderbank offer*¹¹) and that offer is rejected, in terms of clause 6(2)(a) of the Schedule 2, if the award is no more favourable than the rejected offer, the arbitral tribunal may take that fact into account in awarding costs and expenses in respect of the period from the making of the offer to the making of the award.

The settlement offer should not be disclosed until the substance of the dispute (other than costs) has been determined (clause 6(2)(b)).

For the purposes of clause 6, whether or not a settlement offer is *without prejudice*, sealed or unsealed, or *without prejudice save as to costs* is not relevant to determining costs in arbitration. All such offers may be taken into account.

7 PROCEDURE

The procedure for fixing and allocating costs in terms of clause 6 should be as follows:

- the successful party should itemise the claimed costs in its claim submission (as well as addressing any potential issues over the extent to which it has been successful)
- the other party should then be given the opportunity to make any submissions objecting to the claim
- the successful party should then be given the opportunity to reply

¹¹ The reference derives from the English Court of Appeal case of *Calderbank v Calderbank* [1975] 3 All ER 333.

- the arbitral tribunal then considers the submissions, including on a line by line basis where appropriate
- the arbitral tribunal then issues the final award, identifying a quantified amount and setting out reasons for the costs as fixed and the allocation between the parties.

8 CONCLUSION

It is consistent with the core principle of party autonomy that the parties agree on how costs are to be apportioned, and they should be encouraged to do so, whether in the agreement to arbitrate, at the time the dispute is referred to arbitration, or in the preliminary conference. However, as there may be circumstances in the case which warrant adjustment to the amount determined, a discretion should be left to the arbitral tribunal in terms of clause 6.

If no such agreement is made, and if either party to the arbitral proceedings makes a claim for costs, the arbitral tribunal then has the authority to fix and allocate costs between the parties in terms of clause 6(1)(a) of Schedule 2.

In fixing those costs, the arbitral tribunal must have regard to whether or not the costs claimed are reasonable and proportionate having regard to the dispute, and it must be satisfied those costs were actually incurred.

In allocating the costs between the parties, the underlying principle is that *costs follow the event*. Whether the unsuccessful party reimburses the entirety of the costs as fixed by the tribunal, or a lesser amount, will depend on the circumstances of the case.¹²

¹² For further guidance, the following texts may be of assistance:

- Michael O'Reilly, *Costs in Arbitration Proceedings* (2nd Ed), LLP London 1997
- Colin YC Ong & Michael O'Reilly, *Costs in International Arbitration*, Lexis Nexis 2013