

Determination, Payment and Allocation of Costs in International Commercial Arbitration

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Budapest, 20 May 2016

To Danijel

STATEMENT ON THE ORIGINALITY OF THE STUDY

I hereby declare that the dissertation contains no materials accepted for any other degrees in any other institutions, and that it contains no materials previously written and/or published by another person, except where appropriate acknowledgment is made in the form of bibliographical reference.

Patricia Živković
Budapest, 20 May 2016

ABSTRACT

This thesis provides a structural doctrinal analysis of the legal issues related to the determination, payment and allocation of costs in international commercial arbitration. It focuses on theoretical underpinnings of these issues and their practical considerations. Three cost-related stages of arbitration proceedings are analysed in this thesis – determination, payment and allocation. Some of the topics addressed are: the nature and source of the obligation to pay costs in arbitration, national court scrutiny over decisions on costs, the nature of the obligation to pay the advance on costs, the consequences of the non-payment of the advance in arbitration, the prohibitive nature of costs of the arbitration, newly developed industry of third party funding, and the standard of allocation of costs in arbitration. The analysis includes more than ten national arbitration acts and arbitration rules.

ACKNOWLEDGMENTS

*“Try not. Do. Or do not. There is no try.”**

For as long as I can remember, one of the dreams I wanted to achieve in life, was to become a respected professor in academia. Embarking on the pursuit of my S.J.D. degree was the first step I took in attempting to make this dream a reality. What I perhaps underestimated then, is that doctoral research, as a (temporary) career choice, bestows you with a high level of independence (which should not necessarily be viewed as a negative thing). Along with this independence, however, exists the oft-unspoken truth: that the journey is also a path of solitude with numerous challenges along the way, some of which will make you question why you have chosen to do this. But I am validated now, and for that reason, I have not taken for granted support provided by my professors, colleagues, friends and family during my doctoral studies. They have been a tremendous help in my process of researching and writing, both professionally and personally. Here I would like to express my gratitude to them.

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* Irvin Kershner, *Star Wars: Episode V - The Empire Strikes Back*, 1980.

During my work on this study, I have also been aware that progress is only possible as long as I keep on challenging myself and my stream of thought. Hence, I made conscious efforts into obtaining opinions of experts in the field, on the issues I was dealing with in this study. Their constructive opinions pointed out the weaknesses in my reasoning, or shed light on new issues and perspectives – all of which motivated me to improve and ensure that my work was of a high standard and quality. In this regard, I would like to thank Professor John J. Barceló, Professor Howard Hunter, Professor Peter Hay, Professor Vladimir Pavić and Professor Markus Petsche, for the stimulating, brain-teasing discussions related to several parts of my thesis. Very special thanks also go to Professor Ronald Brand and Professor Harry Flechtner who demonstrated tremendous support during my research at the University of Pittsburgh. They have provided me with insights into the theoretical challenges of my thesis, which has enabled my work to transform into a study I am very proud of.

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ABBREVIATIONS

Arbitration Rules

2012 ICC Rules	Rules of Arbitration of the International Chamber of Commerce, in force as of 2012
2014 LCIA Rules	Arbitration Rules of London Court of International Arbitration, in force as of 2014
2013 SIAC Rules	Arbitration Rules of the Singapore International Arbitration Centre, in force as of 2013
2010 SCC Rules	Arbitration Rules of the Arbitration Institute of the Stockholm Chamber of Commerce, in force as of 2010
1998 DIS Rules	Rules of the German Institution of Arbitration, in force as of 1998
2013 UNCITRAL Rules	Arbitration Rules of the United Nations Commission on International Trade Law, as amended in 2013
2013 Vienna Rules	Rules of Arbitration of Vienna International Arbitral Central
2012 Swiss Rules	Rules of International Arbitration of the Swiss Chambers of Commerce Association for Arbitration and Mediation, in force as of 2012
2014 ICDR Rules	Arbitration Rules of the International Centre for Dispute Resolution, in force as of 2014
2015 Zagreb Rules	Rules on Arbitration of Croatian Chamber of Economy, in force as of 2015
Decision on the Costs of the CEE	Decision on the Costs of Arbitration Proceedings of the Croatian Chamber of Economy, in force as of 2011

National arbitration acts

German CCP	German Code of Civil Procedure
1996 EAA (or EAA)	English Arbitration Act, in force as of 1996
Swedish AA	Swedish Arbitration Act
Italian CCP	Italian Code of Civil Procedure

Croatian AA

Croatian Arbitration Act

Austrian CCP

Austrian Code of Civil Procedure

Singaporean IAA

Singaporean International Arbitration Act

ICC documents

2015 ICC Report on Costs

ICC ADR Commission's Report on Decisions on Costs in International Arbitration

ICC Note on Administrative Secretaries

ICC Note on the Appointment, Duties and Remuneration of Administrative Secretaries

Conventions, model laws and other materials

New York Convention

1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards

Model Law on Arbitration

UNCITRAL Model Law on International Commercial Arbitration

2015 Consultation Paper

Consultation Paper on Third Party Funding for Arbitration released by Third Party Funding for Arbitration Sub-committee of the Law Reform Commission in October 2015

IBA Guidelines on Conflicts

IBA Guidelines on Conflicts of Interest in International Arbitration

2014 Swiss Guidelines for Arbitrators

Guidelines for Arbitrators 2014 of Arbitration Court of the Swiss Chambers' Arbitration Institution

CHAPTER I

INTRODUCTION AND OVERVIEW OF THE STUDY

When discussing access to justice under the rule of law in the United Kingdom, Lord Bingham wittily repeated the old saying that justice is “*open to all, just like the Ritz Hotel.*”¹ The same can be said, and even more justified, for access to *arbitral* justice. Arbitration is contractually based and privately funded dispute resolution mechanism available to the parties involved in commercial disputes. However, the costs of arbitration can often reach high amounts, which may be qualified as prohibitive when it comes to access to arbitral justice. In that sense, the proverb stated above is fully applicable.

Despite such a conclusion, the costs of international commercial arbitration are often disregarded as a topic, or simply taken for granted, but their importance and significant amounts have recently shed light on many cost related issues, which are still unresolved in arbitration law. The importance of the subject matter of this study is further discussed under Part 1 of this Chapter [I.1].

The cost related topics are rarely addressed in scholarly writing comparing to other areas of arbitration law. There are several studies conducted on the legal issues pertaining the determination, payment, and allocation of costs in international commercial arbitration. This study is complementary to the existing work, and it covers the gaps in scholarly writing or it contributes to the existing discussion, as explained under Part 2 of this Chapter [I.2]. The scope of the study is, however, limited in order to provide more comprehensive results. These limitations and bases on which the research is conducted as well as methodology are presented in Part 3 of this Chapter [I.3]. Finally, the definition of the costs of arbitration is provided for the purposes of this study, as there is not a uniform definition provided in the

¹ Tom Bingham, *The Rule of Law* (London: Penguin, 2010), 86.

doctrine to this point [I.4], and the summary of the thesis is introduced in the last Part of this Chapter [I.5].

1.1 Importance of the Subject Matter of the Study and Thesis Statement

The subject matter of this study - pertaining to legal issues involving the payment of costs in international commercial arbitration – will be set within a broader and evolving arbitration reality, but also with certain limitations as to its scope. In recent decades, arbitration has undergone certain changes, one of which includes the changes related to the costs. There were shifts in comparative advantages, as well as, in comparative disadvantages of arbitration as a dispute settlement mechanism.² While once viewed as cheap and speedy, arbitration today is no longer enjoying these attributes, at least not as the main advantages.³ These changes were a direct result of a shift in the arbitration reality – the raise in the complexity of the cases submitted to international arbitral tribunals.⁴ At the same time, parties more often than not show unwillingness to accept measures which would accelerate proceedings.⁵ Finally, in 2006, the survey on “Corporate Attitudes and Practices” in international arbitration revealed that “[a]rbitration costs are rising but still represent value for money”, with 39% of the survey participants confirming international arbitration to be more expensive than litigation.⁶

Having these developments in mind, it does not come as a surprise that in a survey conducted nine years later, in 2015, by Queen Mary University “costs” are listed as

² Tibor Várady, “What Is Pro-Arbitration Today?,” *Croatian Arbitration Yearbook* 21/22 (2015 2014): 9.

³ *Ibid.*, 9–10; Gary B. Born, *International Commercial Arbitration* (Kluwer Law International, 2014), 86; Joerg Risse, “Ten Drastic Proposals for Saving Time and Costs in Arbitral Proceedings,” *Arbitration International* 29, no. 3: 453.

⁴ Várady, “What Is Pro-Arbitration Today?,” 9.

⁵ Risse, “Ten Drastic Proposals for Saving Time and Costs in Arbitral Proceedings,” 454.

⁶ Queen Mary University of London, “International Arbitration: Corporate Attitudes and Practices 2006,” 2006, 19, <http://www.arbitration.qmul.ac.uk/docs/123295.pdf>.

arbitration's number one worst feature, followed by the "lack of effective sanctions during the arbitral process", "lack of insight into arbitrators' efficiency", and "lack of speed".⁷ The efficiency of arbitral proceedings, which is often related to or even defined by the interrelation of costs and time, gained much attention in literature and at international arbitration conferences over the last decade, but certainly even more so during the period of 2012-2016, in which the research for this study was conducted.⁸ Authors frequently suggest procedural steps which might save time, and hence costs in a proceeding⁹, or they emphasize the importance of the quality of an award rather than saving time and costs. Also, when discussing the influence of the anticipated costs allocation on the efficiency during the proceedings, the authors suggest¹⁰, but also point out the limitations¹¹ of the use of cost allocation as a means for sanctioning party's behaviour. The most comprehensive collection of these measures can be found in the Report on Techniques of Controlling Time and Costs in Arbitration introduced in 2007 by the Arbitration Commission of the International Chamber of Commerce ["ICC"], which also mentioned costs as means to "encourage efficient conduct of the proceedings".¹²

The increased demand for decreasing arbitration costs along with the recognition of that the issue of costs is one of the building blocks of achieving efficiency in arbitration

⁷ Queen Mary and White & Case, "2015 International Arbitration Survey: Improvements and Innovations in International Arbitration," 2015, 2, 7.

⁸ Just to name a few articles dealing with time and cost-efficiency in international arbitration, without specifying whether they promote or criticize suggested measures: Robert H. Smit and Tyler B. Robinson, "Cost Awards in International Commercial Arbitration: Proposed Guidelines for Promoting Time and Cost Efficiency," *Am. Rev. Int'l Arb.* 20 (2009): 267–83; Vladimir Pavić, "Disciplinary Powers of the Tribunal," *Austrian Yearbook on International Arbitration*, 2014, 167–79; Risse, "Ten Drastic Proposals for Saving Time and Costs in Arbitral Proceedings"; Jennifer Kirby, "Efficiency in International Arbitration: Whose Duty Is It?," *Journal of International Arbitration* 32, no. 6 (2015): 689–96; Cristina Florescu, "Towards Achieving Efficiency in International Arbitration," *Austrian Yearbook on International Arbitration*, 2015, 51–71.

⁹ Risse, "Ten Drastic Proposals for Saving Time and Costs in Arbitral Proceedings."

¹⁰ Smit and Robinson, "Cost Awards in International Commercial Arbitration: Proposed Guidelines for Promoting Time and Cost Efficiency"; Risse, "Ten Drastic Proposals for Saving Time and Costs in Arbitral Proceedings," 462–64.

¹¹ Pavić, "Disciplinary Powers of the Tribunal."

¹² See §82 in: "Report on Techniques for Controlling Time and Costs in Arbitration" (ICC Arbitration Commission, 2007).

emphasizes the need for a better understanding of the legal framework relating to the payment of costs and the decision-making process related to cost claims. The lack of or unfamiliarity with such proper regulation of costs can jeopardize the legitimacy of arbitration as a mainstream dispute settlement mechanism for commercial disputes. The reduction of the amounts of costs, and their use in achieving efficiency depict only one dimension of the problem. Solutions which are usually suggested are mostly practice-oriented, and they mainly focus on the procedural behaviour of the parties as well as on the allocation of costs.

However, it is undisputable that the disadvantages caused by more expensive and less efficient proceedings will not go away and they will gradually bring costs to the spotlight within arbitration community (if they have not already), although it is mentioned that these changes go “under the radar” of the parties when choosing arbitration over other dispute settlement mechanisms¹³. By focusing only on the cause of higher costs and on the final allocation, the arbitration community leaves out two equally important aspects of costs –the determination and payment of costs. With higher costs in question, which raises the stakes in arbitration, the efficiency may be jeopardized already at these two stages of an arbitration proceeding. When risking higher monetary stakes by choosing to arbitrate their disputes, parties become more interested in how costs are determined and what to do in case of default in payment. Due to the private nature of arbitration, a party is forced to contemplate what legal means it has on its disposal when the costs of arbitration become unaffordable.

The determination and payment of costs, together with the allocation, are going to be the prime focus in this thesis. The adopted presumption is that raising the efficiency can be achieved not only by reducing the costs, but can also be achieved through an adequate and developed legal framework for costs in arbitration. **This thesis will demonstrate that there**

¹³ Christian W. Konrad and Jenny Power, “Costs in International Arbitration - A Comparative Overview of Civil and Common Law Doctrines: Determination of Costs,” *Austrian Yearbook on International Arbitration*, 2008, 401.

is need for harmonization, where not already achieved, of arbitration law on cost related legal issues, because the lack of such regulations is one of the factors which are jeopardizing the efficiency of decision-making on cost, and thereby the legitimacy of international commercial arbitration as such.

The need for another study on this topic is evidenced not only by the level of importance that this issue has for the efficiency and legitimacy of arbitration as such, but also by the lack of comprehensive doctrinal work on this issue. This thesis will not only synthesise the existing doctrinal and empirical work on the pertaining legal issues in the realm of arbitration costs, but it will also provide a deeper doctrinal perspective, in order to discover legal inconsistencies and uncertainties. The next section will present how this thesis fits within the existing academic work, while the section after that will explain scope, limitation, and methodology of the undertaken research.

1.2 Existing Academic Work

The legal issues regarding the determination, payment, or allocation of costs in international commercial arbitration have not been given significant attention in scholarly work to date. Chapters on costs are part of almost every textbook or casebook on international commercial arbitration, but they are often of a limited focus, either in terms of the jurisdictional scope or of the number of issues they address.¹⁴ In the past ten years there has been a rise in the amount of articles in academic and practitioner journals in this area as

¹⁴ For example: Fabian von Schlabrendorff and Anke Sessler, “Part II – Commentary on the German Arbitration Law (10th Book of the German Code of Civil Procedure), Chapter VI Making of the Award and Termination of the Proceedings, § 1057 – Decision on Costs,” in *Arbitration in Germany: The Model Law in Practice* (Kluwer Law International, 2007), 416–31; Jörg Risse, “Part III – Commentary on the Arbitration Rules of the German Institution of Arbitration (DIS Rules), Section 25 – Advance on Costs of Arbitral Tribunal,” in *Arbitration in Germany: The Model Law in Practice* (Kluwer Law International, 2007); A. Cremades and A. Mazuranic, “Costs in Arbitration,” in *International Arbitration in Switzerland: A Handbook for Practitioners*, 2nd ed. (Kluwer Law International, 2013); Jeff Waincymer, *Procedure and Evidence in International Arbitration* (Kluwer Law International, 2012).

well, but again, they often focus on one or two jurisdictions in their analysis, or present a limited scope of legal issues, or the findings are written solely only for the practical use.¹⁵

The major work on this subject, titled “*Costs in Arbitration Proceedings*” and published in 1997 by Michael O’Reilly, examined the approach of national courts of England and Wales.¹⁶ This study was expanded by the same author and co-author Colin Ong in the first edition of “*Costs in International Arbitration*”, published in 2013.¹⁷ They have encompassed wide scope of legal issues pertaining the determination, payment, and allocation of costs. This thesis can be found complementary to the O’Reilly and Ong’s monograph thus far as it offers a deeper theoretical background and more focused analysis of the chosen issues. Finally, the compilation of the national reports in the publication “*Costs in*

¹⁵ Here are some examples of journal articles. As it can be seen from the titles, they often focus on one or two legal issues, and address them from the perspective of one or two jurisdictions: Smit and Robinson, “Cost Awards in International Commercial Arbitration: Proposed Guidelines for Promoting Time and Cost Efficiency”; Risse, “Ten Drastic Proposals for Saving Time and Costs in Arbitral Proceedings”; Judith Gill, “Choices and Strategies: A Rules-Based Look at Different Different Approaches to International Arbitration in the Wake of UNCITRAL’s 2010 Rules Revision Relating to Costs,” *International Arbitration: The Coming of a New Age?*, ICCA Congress Series, 14 (2013): 297–304; Konrad and Power, “Costs in International Arbitration - A Comparative Overview of Civil and Common Law Doctrines: Determination of Costs”; Micha Bühler, “Non-Payment of the Advance on Costs by the Respondent Party – Is There Really a Remedy?,” *ASA Bulletin* 24, no. 2 (2006); Anna-Maria Tamminen, “The Obligation to Pay the Advance on Costs under the Vienna Rules and Austrian Law,” *Austrian Yearbook on International Arbitration*, 2009; Simon Greenberg, “Law Applicable to Costs Claims in International Arbitration: Why Does It Matter?,” *Austrian Yearbook on International Arbitration* 2015 (2015); M. Secomb, “Awards and Orders Dealing with the Advance on Costs in ICC Arbitration: Theoretical Questions and Practical Problems,” *ICC International Court of Arbitration Bulletin* 14, no. 1 (Spring 2003); Venus Valentina Wong and Alfred Siwy, “Recalcitrant Parties and the Tribunal’s Power to Order Cost Advance Payments,” *Austrian Yearbook on International Arbitration* 2014 (2014): 201–21; I. Fadlallah, “Payment of the Advance to Cover Costs in ICC Arbitration: The Parties’ Reciprocal Obligations,” *ICC International Court of Arbitration Bulletin* 14, no. 1 (Spring 2003); Dmytro Galagan and Patricia Živković, “If They Finance Your Claim, Will They Pay Me If I Win: Implications of Third Party Funding on Adverse Costs Awards in International Arbitration” (Eurasian Forum on Law and Economics 2015, Tbilisi, Georgia, 2015), 173–81, <http://www.efle.net/images/EFLE.2015.pdf>; Philippe Cavalieros, “In-House Counsel Costs and Other Internal Party Costs in International Commercial Arbitration,” *Arbitration International* 30, no. 1 (March 2014): 145–52; Bernhard Berger, “Arbitration Practice: Security for Costs: Trends and Developments in Swiss Arbitral Case Law,” *ASA Bulletin* 28, no. 1 (2010): 7–15; William Kirtley and Koralie Wietrzykowski, “Should an Arbitral Tribunal Order Security for Costs When an Impecunious Claimant Is Relying upon Third-Party Funding?,” *Journal of International Arbitration* 30, no. 1 (March 1, 2013): 17–30; Detlev Kühner, “The Impact of Party Impecuniosity on Arbitration Agreements: The Example of France and Germany,” *Journal of International Arbitration* 31, no. 6 (2014): 807–818; Giulio Palermo and Malcolm Robach, “Judicial Review of Arbitrators’ Fees. A Swiss Law Perspective,” *ASA Bulletin* 32, no. 3 (2014): 595–608; Christopher Koch, “The Limits of Arbitrators’ Powers to Adjudicate Fees and Expenses - Commentary on the Swiss Supreme Court Decision 136 III 597 of 10 November 2010,” *Arbitration International* 27, no. 2 (2011): 233–48.

¹⁶ Michael O’Reilly, *Costs in Arbitration Proceedings* (London: Lloyd’s of London Press, 1997).

¹⁷ Colin Ong and Michael O’Reilly, *Costs in International Arbitration*, 1st edition (Singapore: LexisNexis, 2013).

International Arbitration: A Central Eastern and Southern Eastern European Perspective” is another work in this area, but it was written primarily for practical purposes, and it provides solely national perspective without deeper doctrinal analysis.¹⁸

Substantive work was published within last five years on one specific cost-related issue - the industry of third party funding, which has become more significant for the arbitration stakeholders, especially for claimants. The ICC Institute of World Business Law published the collection of essays on “*Third-Party Funding in International Arbitration*” in 2012, prevalingly focused on investment arbitration.¹⁹ There are two other publications which focused more on third party funding in commercial arbitration. One of them was published in 2012 and written by Lisa Bench Nieuwveld and Victoria Shannon.²⁰ This work provided elaborated analysis of the regulation of third party funding both in litigation and arbitration, mostly only in common-law jurisdiction (Australia, the United Kingdom, the United States of America, Canada), and additionally in Germany and the Netherlands, as civil law countries, and in the mixed legal system of South Africa.

Lastly, the publication “*Third-Party Funding in International Arbitration and Its Impact on Procedure*” by Jonas von Goeler, published in 2014, is a comprehensive, detailed, and sourceful work on this issue.²¹ For that reason, the analysis of third party funding in this thesis is restricted to the availability and use of such funding by impecunious parties only [see **IV.4**]. Besides this limitation of the scope of the study, there are other restrictions and premises which were set from the beginning in order to provide more comprehensive and

¹⁸ Günther Horvath, Christian Konrad, and Jenny Power, eds., *Costs in International Arbitration: A Central Eastern and Southern Eastern European Perspective* (Wien: Linde Verlag, 2008).

¹⁹ ICC Institute of World Business Law, International Chamber of Commerce, and ICC Institute of World Business Law, *Third-Party Funding in International Arbitration*, ed. Bernardo M. Cremades and Antonias Dimolitsa, ICC Publication, no. 752E (Paris: International Chamber of Commerce, 2013).

²⁰ Lisa Bench Nieuwveld and Victoria Shannon, *Third-Party Funding in International Arbitration* (Alphen aan den Rijn: Kluwer Law International, 2012).

²¹ Jonas von Goeler, *Third-Party Funding in International Arbitration and Its Impact on Procedure*, vol. 35, International Arbitration Law Library (Kluwer Law International, 2016).

more focused work on the cost-related topics. In order to elaborate more on how this thesis fits in the existing work on costs, the scope of the study and the used methodology used are explained in the following Part.

1.3 The Scope of Study and Methodology

As already mentioned, the legal issues regarding the following stages of arbitration proceedings related to the costs will be addressed in this thesis:

- 1) the determination of the amount of costs,
- 2) the payment of the advance on costs, and
- 3) the allocation of costs in the last award²².

Throughout the analysis of the legal framework which deals with these types of decisions, as defined in international conventions, national arbitration laws, arbitration rules, arbitral awards, court decisions, and scholarly work, the prevailing theme will be how to achieve greater efficiency in the decision-making process in those three instances. The efficiency in international commercial arbitration is best achieved through harmonisation, which disregards differences between different national solutions, or provides regulation where there is none or is very obscure, builds bridges between common law and civil law solutions, and most importantly it increases predictability and legal certainty.²³

There are several limitations as to the scope of the study: it is focused on *international commercial* arbitration. When suitable, and comparable in principle, legal sources from

²² For the purpose of this study, the author has adopted, for the reasons presented under III.3.1.1, the phrase “last award”, instead of “final award”, as a term describing an arbitral decision which completes the mission of the arbitral tribunal.

²³ For the full list of advantages of harmonisation see in: Loukas Mistelis, “Is Harmonisation a Necessary Evil? - The Future of Harmonisation and New Sources of International Trade Law,” in *Foundations and Perspectives of International Trade Law* (London: Sweet and Maxwell, 2001), 21–22.

domestic and *investment* arbitration might be used. However, those types of arbitration which presuppose that one party is economically weaker, such as *consumer* or *employment* arbitration, are excluded from the analysis to every extent, except when the U.S. law is discussed. The rationale behind this restriction is due to the fact that, although all types of arbitration share to a certain extent some common procedural aspects, for this study it is important to assume that parties are equally or similarly economically strong and sophisticated parties. Especially when the discussion is focused on costs, the involvement of weaker parties to an arbitration agreement would cause a severe change in the principles under which the discussion is led. Hence, they are excluded from the analysis.

The harmonisation argument, which will be a thread intertwined through all the Chapters, will serve the purpose of enhancing the overall efficiency of the decision-making process related to cost related legal issues. It does not deal *per se* with the enhancement of time and cost-efficiency, i.e. the achievement of speedier proceedings and reduction of costs, but it is a building block of efficiency. The use of the allocation of costs to enhance such efficiency is only to a limited extent analysed in Chapter V. One of the most successful harmonisation instruments in the realm of arbitration law is the UNCITRAL Model Law on International Commercial Arbitration [“Model Law on Arbitration”], adopted in 1985 and amended in 2006. It did not, however, adopt any provision as to the determination, payment, or allocation of costs. Therefore, probably the best opportunity for harmonisation was so far unexploited. This thesis will present the legal issues which require and desire such harmonisation.

Moreover, it is important to emphasize that this thesis is not an attempt to answer the question of which procedure is more expensive: international commercial arbitration or international commercial litigation. The author acknowledges that both procedures have their advantages and disadvantages, due to which parties make their informed choice as to which

on dispute resolution mechanism fits their needs. The parties in international commercial disputes can, and usually do, incur significant costs in both procedures.²⁴ The increased costs of international commercial arbitration are referenced only to emphasize the importance of the issues discussed, since an increase of financial risks usually leads to an increase of the parties' concerns and greater scrutiny of the pertaining legal issues.

The methodology used throughout the research for this study consisted of a doctrinal analysis and a comparative law method. As to the latter, the analysed materials consisted of national laws, arbitration rules, court decisions, and arbitral decisions. The encompassed jurisdictions are England and Wales, Germany, Switzerland, France, Sweden, the United States of America ["U.S."], Austria, Portugal, Croatia, Singapore, Philippines, and others. The choice of these jurisdictions does not in any way set the value judgement on their laws in comparison with other jurisdictions, but the choice partially relies on the preferred choices of the seat of arbitration²⁵ and partially on the author's familiarity with these legal systems. The legal solutions adopted in these jurisdictions will be presented as the basis of the discussion of almost every issue in this thesis, unless there is severe shortage in the sources within a particular jurisdiction related to the respective legal issue.

As to the arbitration rules, the basis for this study consisted of the 2012 Rules of Arbitration of the ICC ["2012 ICC Rules"], 2014 Arbitration Rules of London Court of International Arbitration ["2014 LCIA Rules"], 2013 Arbitration Rules of the Singapore International Arbitration Centre ["2013 SIAC Rules"], 2012 Rules of International Arbitration of the Swiss Chambers of Commerce Association for Arbitration and Mediation ["2012 Swiss Rules"], 2010 Arbitration Rules of the Arbitration Institute of the Stockholm

²⁴ Born, *International Commercial Arbitration*, 87.

²⁵ London, Paris, Geneva, and Stockholm are among six most preferred seats in international arbitration. See in: Queen Mary and White & Case, "2015 International Arbitration Survey: Improvements and Innovations in International Arbitration," 12.

Chamber of Commerce [“2010 SCC Rules”], 1998 Rules of the German Institution of Arbitration (*Deutsche Institution für Schiedsgerichtsbarkeit*) [“1998 DIS Rules”], 2013 Rules of Arbitration of Vienna International Arbitral Central [“2013 Vienna Rules”], 2014 Arbitration Rules of the International Centre for Dispute Resolution [“2014 ICDR Rules”], and 2015 Rules on Arbitration of Croatian Chamber of Economy [“2015 Zagreb Rules”].²⁶ As to the *ad hoc* arbitration, the solutions provided in the Arbitration Rules of the United Nations Commission on International Trade Law, as amended in 2013 [“2013 UNCITRAL Rules”], will be presented among other sources. These arbitration rules will be the main framework for the analysis, as well as the arbitral awards rendered under these rules. It was not always possible, however, to obtain decisions under all of these rules. Also, while due consideration was given to the solutions provided under all the mentioned arbitration rules, when the rules are overlapping, those which are listed are only named exemplary, while the emphasis is on those which depart from mainstream and which provide for peculiar solutions.

The comparative analysis in this study, which compares the national laws, arbitration rules, court decisions, and arbitral decisions, is conducted as a doctrinal analysis. This means that the analysis of legal issues focuses on the internal (inter-state or inter-institutional) and external (state-to-state, institution-to-institution) consistency among the laws and rules. In other words, to achieve harmonisation, the critical observance is made as to the inconsistencies and/or vagueness of the solutions within and among the legal systems or the practices of arbitration institutions.

This methodology will be backed with some empirical data based mostly on electronic surveys and the author’s observations, which were obtained during her exchanges

²⁶ The ICC, the LCIA, the SIAC, and the SCC were listed among seven first preferred arbitration institutions in 2015. See in: *Ibid.*, 17.

with her mentor, other professors, colleagues in academia and law firms, presenters at international conferences, and other active participants of arbitration community.

1.4 Definition of Costs of Arbitration: Procedural Costs and Party Costs

There is no uniform definition of the costs in arbitration. National laws as well as arbitration rules provide for their own notions under which they address different types of costs. The phrases “costs of the proceedings”²⁷, “costs of the arbitration”²⁸ or “costs of the arbitration proceedings”²⁹ might all look the same at the first glance; however, the difference comes out after examining what they refer to. More often than not, these notions are used for the different groups of costs. To demonstrate such a difference one can refer to definitions of the costs provided in 2012 ICC Rules, 2012 Swiss Rules, 2013 SIAC Rules, and 2010 SCC Rules. All these rules use the same term - the “costs of the arbitration”. However, under Article 37(1) of the 2012 ICC Rules and Article 38 of the 2012 Swiss Rules, this term refers both to the costs required for the proceedings itself, such as arbitrators’ fees and institutional fees, as well as to the costs incurred by the parties, i.e. their legal fees and other expenses. On the other hand, Rule 31 of the 2013 SIAC Rules and Article 43(1) of the 2010 SCC Rules uses this term only to address the costs required for the proceedings itself, while the costs of the parties are not encompassed.

For the purpose of this thesis the *costs of arbitration*, or sometimes simply *costs*, will be used as an “umbrella” term for all the costs incurred by the parties in arbitration. The costs

²⁷ For example, Section 609(1) of the Austrian Code of Civil Procedure, as in force as of 1 January 2014.

²⁸ For example, Section 59(1) of the 1996 English Arbitration Act; Sec 37-42 of the Swedish Arbitration Act (SFS 1999:116); Art. 37(1) of the 2012 ICC Rules; Art. 41(1) of 2014 ICDR Rules; Art. 28(1) of the 2014 LCIA Rules, Art. 38 of the 2012 Swiss Rules; Art. 43(1) of the 2010 SCC Rules; Rule 31 of the 2013 SIAC Rules; Art. 40 of the 2013 UNCITRAL Rules.

²⁹ For example, Section 1051 para.1 of the German Code of Civil Procedure, as promulgated on 5 December 2005, last amended by Article 1 of the Act dated 10 October 2013 (Federal Law Gazette I page 3786); Art. 35 para.1 of the 1998 DIS Rules.

of the arbitration will be divided into *procedural* costs and *party* costs. The procedural costs are the costs required either for the services of an arbitral tribunal or an arbitral institution. It usually includes institution related fees, i.e. filing fee and administrative fee, and the arbitrators' fees and other expenses, e.g., the fees of experts appointed by the tribunal and the administrative secretary's fees and expenses. The term "*party* costs" may be somewhat misleading as all the costs of the arbitration are entirely funded by the parties. For the purposes of this thesis, *party* costs will have much narrower meaning and it will encompass costs other than *procedural* costs. In that regard, *party* costs prevailingly consist of attorney costs, and other expenses which were incurred in relation to the arbitration proceedings, but which are not included or covered either in the tribunal's fees and expenses or institutional fees.

1.5 Executive Summary

Legal framework for the legal issues discussed in this thesis is on different levels of harmonization. Even if harmonization is achieved to a certain extent, it is rarely at the satisfactory level in all jurisdictions. In general, higher levels of harmonization of legal solutions are available at the stages of the determination and allocation of costs. The least harmonized, or at all regulated, is the stage of the payment of costs in arbitration. All three stages of arbitral proceedings are analysed in this thesis.

Chapter II elaborates on the process of the determination of procedural costs in international commercial arbitration. The Chapter has two parts, where the first one presents the level of harmonization achieved in the legal framework on the determination of procedural costs in international commercial arbitration [II.1], while the second part deals with the court scrutiny of the arbitral tribunal's decision on the amount of costs [II.2].

Chapter III focuses on the determination of the advance on costs. Besides the introductory notes on the determination and the purpose of the payment of the advance on costs [III.1], this Chapter focuses on the enforcement of the obligation to pay the advance, in case of default of one of the parties to pay its share [III.2]. The discussion on the nature of the obligation to pay the advance introduces three approaches which were developed in this regard: the contractual approach, the procedural duty approach, and the interim measures approach. The choice among these approaches, which is made by an arbitral tribunal or a court, influences the type of a decision that will be rendered in this matter. Hence, the last Part of this Chapter elaborates on the enforcement issues or benefits distinctive for each respective type of these decisions [III.3].

Chapter IV continues on the topic of the failure to pay the advance on costs, which was analysed in part in Chapter III. Chapter III dealt with the nature of the obligation to pay the advance and the solutions provided for the non-defaulting party to enforce such a defaulting party's obligation. The focus in Chapter IV switches from solutions which are aimed at making the arbitration agreement operative to solutions available to the parties to disregard the arbitration agreement in case of non-payment of the advance. The first part offers a general overview of the national approaches regarding the opposition of pro-arbitration approach and the non-payment of the advance by one of the parties [IV.1]. More specifically, Chapter IV deals with the situations where either of the parties wishes to *disregard the arbitration agreement* based on the prohibitive costs of arbitration, and it presents conflicting national approaches to this matter [IV.2 and IV.3]. This makes it diametrically opposite to the solutions offered in Chapter III, which dealt with solutions which purpose was to *enforce the obligation to pay the advance* and, hence, preserve the arbitration proceedings. The last Part of Chapter IV analyses the availability of third party funding and its impact on the impecunious party's right to access arbitral justice [IV.4].

Chapter V deals with the third stage at which cost-related decisions are made. Although significant harmonization is already achieved, allocation of costs in international arbitration is often referred as to be “consistently inconsistent”.³⁰ Chapter V, therefore, starts with the expectations of the parties which depend on the legal theory and rules regarding the allocation of costs in *civil litigation* of their home jurisdictions [V.1] Afterwards, the analysis focuses on specific legal issues related to the allocation of costs, such as the arbitrator’s power to allocate the cost [V.2], the prevailing international standard of allocation of costs of the arbitration, [V.3], the factors which are most often taken into account [V.4], and differentiation as to which costs can be recovered and/or allocated [V.5].

³⁰ John Y. Gotanda, “Consistently Inconsistent: The Need for Predictability in Awarding Costs and Fees in Investment Treaty Arbitrations,” *ICSID Review* 28, no. 2 (Fall 2013): 420–37.

CHAPTER II

DETERMINATION OF PROCEDURAL COSTS IN INTERNATIONAL COMMERCIAL

ARBITRATION

The process of the determination of procedural costs in international commercial arbitration, which is two-staged and it takes place at the beginning of an arbitral proceeding for the purposes of the determination of the advance on costs and at the end of proceedings when the last award is rendered and the costs are fixed, is often disregarded by scholars and practitioners, while large amount of attention is given to the allocation of costs [see Chapter V]. Nevertheless, the determination of costs is equally important and it entails several legal issues. This Chapter firstly provides the understanding of the legal framework as to the determination of *procedural* costs. Since *party* costs prevailingly consist of legal fees, and their determination is based on the agreement between a party and its counsel, they will be addressed in more details only in Chapter V, which analyses the allocation of the costs of arbitration. After introducing the legal framework on the determination of costs, this Chapter focuses on the prevailing legal issues regarding the determination and investigates the particularities related to the determination of certain types of costs and national court's scrutiny over this stage.

The proper understanding of the process of determination, especially at the beginning of the proceedings, brings predictability for the parties regarding the financial risk they might need to bear in arbitration proceedings. The predictability offers the possibility to create more effective, less time-consuming and, therefore, less costly proceedings, which in international disputes is best achieved if harmonized rules are established. The analyses in the first two sections of this Chapter is conducted in a way to investigate and detect whether there is any

level of harmonisation achieved in the legal framework regarding the power to determine the costs [1].

Once the costs are determined, one of the parties might be dissatisfied with the amount or an arbitral tribunal might be confronted with obstacles in the process of making a determination. In such situations, the parties may, or should, be able to refer to national courts. The court's scrutiny in this regard and its scope as well as the harmonisation of the national approaches are analysed in the second Part of the Chapter [2].

II.1 Determination of Procedural Costs in International Commercial Arbitration

The determination of the amount of procedural costs of arbitration is primarily governed by the law of the seat of arbitration, as *lex arbitri*, the parties' agreement, and their mutual agreement with the arbitrators. In *ad hoc* proceedings, i.e. those which are not administered by any arbitration institution, national laws play a crucial role as to the determination of the amount of costs of arbitration, although, as is shown below, these laws rarely deal with this matter directly [II.1.1]. Even if they address the matter, the main legal source as to the determination of costs in *ad hoc* arbitration is the parties' agreement, and an agreement between the parties and the arbitrators [II.1.2]. Party autonomy, limited only with mandatory rules of *lex arbitri*, can be exercised also in submitting the administration of the parties' dispute(s) to an arbitration institution, which would result in the acceptance of the respective institution's rules on the determination of costs, including the cost schedule [II.1.3]. This choice is possible, of course, in *ad hoc* settings as well, by referring to the cost schedule of the preferred arbitration rules or by applying the 2013 UNCITRAL Rules.

II.1.1 Determination of Procedural Costs under National Arbitration Acts

National arbitration acts rarely directly provide for the rules on the determination of the amount of costs. However, it is identifiable from their provisions that the power to determine the costs is not solely in the hands of an arbitral tribunal, not even in *ad hoc* settings. In this Part, the discussion is focused on the determination of procedural costs, while the amount of legal costs depends on the agreement between the party and the counsel, and the recoverable part of these fees is decided upon only at the final stage of a proceeding.

Section 1057(2) of the German Code of Civil Procedure [“German CCP”]³¹ provides that

“Insofar as the costs of the arbitration proceedings have been established, the arbitral tribunal is to also decide in which amount the parties to the dispute are to bear such costs.”

The phrase in this provision “*insofar as the costs [...] have been established*” in this provision clearly signals that the determination of the amount of costs takes place earlier than the decision as to the allocation of costs, but also that the amount needs to be already established. As it is shown below, the establishment of the amount in institutional arbitration will be conducted usually by an arbitration institution, according to the cost schedule. In *ad hoc* arbitration, there are no such institutional schedules, unless specifically agreed to by the parties, so the question is whether the tribunal may determine the costs and how it should determine the amount of procedural costs, including its own fees.

The English Arbitration Act [“1996 EAA”]³², provides under Section 63 that the recoverable costs of the arbitration, which include both procedural and party costs as provided

³¹ German Code of Civil Procedure, as promulgated on 5 December 2005, last amended by Article 1 of the Act dated 10 October 2013 (Federal Law Gazette I page 3786).

under Section 59 of the 1996 EAA, are determined by the parties' agreement and in lack of such an agreement, by an arbitral tribunal. The determination of the recoverable arbitrators' fees and expenses is, however, subject to the court control "[i]f there is any question as to what reasonable fees and expenses are appropriate in the circumstances", as provided under Section 64(2) of the 1996 EAA. Such court scrutiny of the determination of arbitrators' fees and expenses shows that the parties' agreement is a necessary element to the fixing this type of costs, as will be discussed more below [II.1.2].

The Swedish Arbitration Act ["Swedish AA"]³³, similarly, provides under Section 38 for the tribunal's power to fix security for their compensation and then to determine the amount in the last award, but subject to the limitation of the validity of such determination as provided under Section 39, according to which "[a]n agreement regarding compensation to the arbitrators that is not entered into with the parties jointly is void".

The Italian Code of Civil Procedure ["Italian CCP"]³⁴ contains the most explicit provision related to this matter. The Italian CCP provides in Article 814(2) that "*where the arbitrators themselves fix the amount of the expenses and of the fee, their decision shall not be binding upon the parties if they do not accept it.*" The Croatian Arbitration Act ["Croatian AA"]³⁵ provides the same in Article 11(5): "*If an arbitrator has determined the amount of his own expenses and fees, his decision does not bind the parties unless they accept it*".

To summarize, national arbitration laws rarely directly govern the power to determine the amount of procedural costs at the beginning of the proceedings. They usually regulate the final allocation of all costs of the arbitration in the last award and the fixation and

³² The EAA is available here: <http://www.legislation.gov.uk/ukpga/1996/23/contents>.

³³ The Swedish Arbitration Act (SFS 1999:116).

³⁴ Code of Civil Procedure – Book IV, Title VIII, Articles 806–840, as in force as of 2006.

³⁵ Zakon o arbitraži (Arbitration Act), NN 88/01.

recoverability of such costs in relation to allocation [see Chapter V].³⁶ Much more regulation and guidance is provided in institutional arbitration, in which arbitration rules usually regulate the determination of the amount of procedural costs in detail, for the purposes of setting the advance on costs [see Chapter III]. As to the party costs, their determination is not usually discussed at the beginning of a proceeding, but only when the award is finalized. Lack of discussion and regulation as to the determination of both procedural and party costs has considerable effect on the final decision on the allocation, as will be discussed in Chapter V.

In any case, the determination of the amount of procedural costs is dependent on the parties' consent on such determination, as provided clearly in the Swedish AA, and less explicitly in the 1996 EAA. This is not limited only to *ad hoc* arbitration and it is a mandatory rule even when not explicitly regulated in national law.

³⁶ Section 1057 (1) of the German CCP: "Unless the parties to the dispute have agreed otherwise, the arbitral tribunal is to decide, in its arbitration award, on the share of the costs of the arbitration proceedings that the parties to the dispute are to bear, including the costs accruing to the parties that were necessary in order to appropriately file a request for arbitration proceedings or to defend against such a request."; Section 609, para. 1 of the Austrian Code of Civil Procedure states that "where the arbitral proceedings are terminated, the arbitral tribunal **shall decide upon the obligation to reimburse the costs of the proceedings**, provided the parties have not agreed otherwise" [emphasis added], while para. 3 sets that "together with the decision upon the obligation to reimburse the costs of the proceedings, the arbitral **tribunal shall [...] determine the amount of costs to be reimbursed**" [emphasis added]. ³⁶ Section 63(3) of the EAA states that: "The tribunal may determine by award the recoverable costs of the arbitration on such basis as it thinks fit. If it does so, it shall specify- (a) the basis on which it acted, and (b) the items of recoverable costs and **the amount referable to each**" [emphasis added]; Art. 35 of the Croatian Act on Arbitration states that: "Upon a request by a party, **the arbitral tribunal shall determine** in the award or an order for the termination of the arbitral proceedings **which party and in which proportion has to reimburse the other party** the necessary costs of arbitration, including expenses of party representation and the fees of arbitrators, and/or has to bear its own expenses" [emphasis added].

II.1.2 Party Autonomy and a Tripartite Agreement

II.1.2.1 The Parties to a Tripartite Agreement

Party autonomy has a strong and prevailing influence under national laws, when it comes to the allocation of costs at the end of the proceedings and this autonomy and its limitations will be discussed further in Chapter V. At the stage of the determination of the costs, party autonomy, i.e. the parties' agreement, is still a valuable legal basis when it comes to the method of calculation, but it is not by itself sufficient to provide a legal basis for the determination of all costs, especially not for arbitrators' fees and institution related fees.

A tripartite agreement, i.e. an agreement between the parties and the arbitrators, is built on the parties' agreement. In *ad hoc* settings, the tripartite agreement is more palpable as it is negotiated directly between the parties and the arbitrators. In institutional arbitration, the negotiations are often avoided by the parties' choice of arbitration rules and the arbitrators' acceptance of the appointment to the office, which presupposes the acceptance of the rules designated by the parties. In those situations, an arbitral institution is administering the proceedings, which usually includes the determination of costs, and this reduces the need for the arbitrators and the parties to deal with the cost-related matters directly by themselves. However, notwithstanding the lack of discernibility of the tripartite agreement in institutional arbitration, this agreement is still the main bases for the determination of arbitrators' fees and institution-related fees.

The tripartite agreement, i.e. *receptum arbitri*, is a separate agreement between the arbitrators and the parties to an arbitration agreement, pursuant to which the arbitrators

undertake to perform specified functions in return for remuneration.³⁷ Its importance regarding the determination of arbitrators' fees is often emphasized in *ad hoc* arbitration.³⁸ This is not without valid reason. Since *ad hoc* arbitration proceedings are usually not governed by institutional rules, therefore, their respective fee schedules along with the parties' negotiations with the arbitrators are the sole basis for the determination of an amount of arbitrators' fees.³⁹

The basis for the determination of arbitrators' fees and institution-related fees is, hence, either a tripartite agreement with arbitrators and/or the parties' agreement with an arbitration institution. The distinction between the parties' agreement and the tripartite agreement is particularly important regarding the determination of arbitrators' fees. One of the particularities related to this type of fees was already mentioned above, by emphasizing the parties' consent on their amount. This is expressly stated, as explained under previous section, under the Swedish AA, the Italian CCP, and the Croatian AA. It is considered that arbitrators are free to determine their fees, but such a determination is not binding on the parties, unless they accept it.⁴⁰ In other words, without the consent of an arbitrator and the parties, there is not a tripartite agreement.

Hence, it is advisable in *ad hoc* settings that the arbitrators approach the parties with their suggestions as to the method of calculation of their own fees.⁴¹ The 2013 UNCITRAL

³⁷ Born, *International Commercial Arbitration*, 1967.

³⁸ Konrad and Power, "Costs in International Arbitration - A Comparative Overview of Civil and Common Law Doctrines: Determination of Costs," 404; Born, *International Commercial Arbitration*, 2022.

³⁹ Nigel Blackaby et al., *Redfern and Hunter on International Arbitration*, 6th ed. (Oxford University Press, 2015), para. 4.203; John Yukio Gotanda, "Setting Arbitrators' Fees: An International Survey," *Vanderbilt Journal of Transnational Law* 33, no. 4 (2000): 783; Julian D.M. Lew, Loukas A. Mistelis, and Stefan Michael Kröll, *Comparative International Commercial Arbitration*, 2003, 284; Born, *International Commercial Arbitration*, 2018.

⁴⁰ Horvath, Konrad, and Power, *Costs in International Arbitration: A Central Eastern and Southern Eastern European Perspective*, 158.

⁴¹ Blackaby et al., *Redfern and Hunter on International Arbitration*, 2015, para. 4.203.

Rules, which are often invoked in *ad hoc* arbitration, encourage the same approach in Art 41(3) by stating that:

“[p]romptly after its constitution, the arbitral tribunal shall inform the parties as to how it proposes to determine its fees and expenses, including any rates it intends to apply.”

This gives the parties an opportunity to make comments regarding the method of the calculation early in the proceedings.⁴² The agreement as to the method of calculation, which may be a designation of a particular costs schedule of one of the institutional arbitration rules, is then usually documented in a constitution order, signed by the arbitrators and the parties. In order for the negotiations to run smoothly, the 2013 UNCITRAL Rules suggest having two available reviews of the determination process, one for the method of calculation, and the other available for the adjustment of the amount determined. Both of these reviews are discussed below [see **II.2**].

Although the negotiations between the parties and the arbitrators as to the determination of the fees are less manifest in institutional arbitration, that does not mean that there is no conclusion of a tripartite agreement in such settings. It is considered that the rules of the institution, including the fee schedule, are accepted by the parties by choosing to submit the case to the institution and by the arbitrators by accepting their appointments.⁴³ As to the arbitrators' consent, Article 2(i) of the 2014 LCIA Schedule of Arbitration Costs states that “[t]he tribunal shall agree in writing upon fee rates conforming to the Schedule prior to its appointment by the LCIA Court.” At the same time and under the same rule, the hourly

⁴² Gill, “Choices and Strategies: A Rules-Based Look at Different Different Approaches to International Arbitration in the Wake of UNCITRAL’s 2010 Rules Revision Relating to Costs,” 300.

⁴³ Tibor Várady, “Remuneration of Arbitrators as a Threshold Issues: Economic Sense and Procedural Realities,” in *Corporations, Capital Markets and Business in the Law: Liber Amicorum M. Buxbaum* (London: Kluwer Law International, 2000), 591; Born, *International Commercial Arbitration*, 2019.

rate for the fees is communicated to the parties by the Register at the time of the appointment of the tribunal.⁴⁴

The invalidity of a tripartite agreement regarding the determination of arbitrators' fees can have severe consequences for the legitimacy of arbitral proceedings. If one of the parties or both parties do not agree to the amount set by a tribunal, the tribunal risks rendering the decision *in causa sua* [see **II.1.2.2.a**] and a possibility for the award to be successfully challenged on the basis of a violation of public policy. For that reason, the parties who contest the amount of the fees can have recourse to a national court when dissatisfied with an amount [see **II.2**].

The parties cannot impose either their method of calculation or amount on an arbitrator, but they need to be freely agreed by all the parties to a tripartite agreement. Party autonomy in this regard is therefore limited, and it can be exercised only by *proposing* the method to calculate the fees. This autonomy can be exercised either directly, by setting their own method for the calculation of costs, or by choosing the arbitration rules. If parties have agreed on arbitration rules, then they are deemed to have accepted them to govern their arbitral proceedings.⁴⁵ The parties can also choose in *ad hoc* arbitration to apply only rules regarding the costs of the specific institution. In cases where the parties have opted for institutional arbitration, the mechanism of concluding the tripartite agreement changes. The consent of all involved in such an agreement as to the determination of the amount of the fees will still be required, but it will be given by the parties through their choice of arbitration rules (and the applicable cost schedule) and by the arbitrators through their acceptance of appointment.

⁴⁴ Section 2(i) of the 2014 LCIA Schedule of Arbitration Costs.

⁴⁵ Gary B. Born, *International Commercial Arbitration*, Kluwer Law International, 2009, p. 1753.

An overview of the rules on the determination of procedural costs as provided in arbitration rules is provided in the section **II.1.3**. Before examining the legal framework of arbitration rules, the particularities of a situation in which one or both of the parties do not agree to the amount of fees suggested by an arbitral tribunal is discussed.

II.1.2.2 The Repercussion of the Lack of a Party's Consent on the Tripartite Agreement on the Amount of Arbitrators' Fees

As the determination of arbitrators' fees is a matter of an agreement between the parties and the arbitrator, lack of consent from any of the three parties may have severe consequence for the efficiency and legitimacy of arbitration proceedings. Therefore, it is important to recognize the plausible legal obstacles and solutions in case of lack of consent from one of the parties to a tripartite agreement.

Firstly, if the arbitrator or the tribunal proceed with the determination of the amount of their fees or ordering payment despite the lack of any of the parties' consent, such a decision may be qualified as a decision in their own matter (*in causa sua*), and therefore contrary to international public policy [**1.2.2.a**]. Also, an agreement on the amount achieved with only one of the parties may qualify as grounds for a challenge of an arbitrator, given that her or his impartiality might be in question [**1.2.2.b**]. Finally, it is argued that the proper solution for both of these situations is for the parties, or arbitrators, to refer to a national court [**1.2.2.c**].

II.1.2.2.a Delivering a Decision In Causa Sua

The arbitrators have the power to request the advance on costs in *ad hoc* settings. The real question is what happens if the parties have not consented to an amount of fees, which is usually suggested by the arbitrators. In some jurisdictions, a decision on costs was considered to be the decision *in causa sua* if there is no agreement of the parties on the amount of the fees in advance.⁴⁶ In the German doctrine and jurisprudence, decisions rendered *in causa sua* were held against public policy and therefore unenforceable.⁴⁷ In France, a similar approach is adopted by their courts, which states that the arbitrators cannot be judges in their own matter.⁴⁸

There is also a slightly different perspective, which states that a concept of the decision *in causa sua* is too wide. Under this view, it is considered that the decision of the tribunal on its own fees does not violate public policy since the award cannot be enforced by the arbitrators and such a decision on fees is subject to the courts' scrutiny.⁴⁹ In other words, there is no need to claim that their decision is non-enforceable due to a violation of public policy since the arbitrators do not have the power to determine their own fees in the first place and any decision they might render will not bear any *res judicata* effect regarding them.

⁴⁶ Fabian von Schlabrendorff and Anke Sessler, "Part II – Commentary on the German Arbitration Law (10th Book of the German Code of Civil Procedure), Chapter VI Making of the Award and Termination of the Proceedings, § 1057 – Decision on Costs," in *Arbitration in Germany: The Model Law in Practice*, 2nd edition (Kluwer Law International, 2015), 368.

⁴⁷ *Ibid.* This attitude was somewhat changed in 2012, as will be elaborated below.

⁴⁸ Philippe Fouchard, "Relationship Between the Arbitrator and the Parties and the Arbitral Institution," *ICArb. Bulletin*, 1995, para. 26.

⁴⁹ von Schlabrendorff and Sessler, "Part II – Commentary on the German Arbitration Law (10th Book of the German Code of Civil Procedure), Chapter VI Making of the Award and Termination of the Proceedings, § 1057 – Decision on Costs," 2007, 421.

In a case before the Swiss Supreme Court in 2010, the parties challenged the interim award rendered under the Swiss Rules.⁵⁰ The arbitrators in that case unilaterally calculated the amount of the advance for their fees and ordered the parties to pay it.⁵¹ They made three justifications for their decision. Firstly, *receptum arbitri* entitled them to the payment of the fees and expense. Secondly, by accepting the Swiss Rules the parties accepted the obligation to pay the advance.⁵² Thirdly, they claimed that the Swiss Rules also vested the arbitrators with the power to fix their fees unilaterally.⁵³

The Swiss Supreme Court decided not only that the arbitrators' decision in question is not appealable as an award, but it also stated that the tribunal had no power to fix its own fees.⁵⁴ The Swiss Supreme Court limited arbitrators' power only to allocating the costs, reasoning that any decision on the determination of the amount of their own fees would be outside of the scope of the arbitration clause.⁵⁵ Also, the Swiss Supreme Court stated that any dispute in relation with the amount of the fees should be resolved by ordinary courts, and hence the decision on costs in the case had no *res judicata* effect as to the arbitrators. The court stated that it but was a mere "*statement of account or a description of the claims which the arbitrators have against the parties.*"⁵⁶ Finally, the Swiss Supreme Court stated that otherwise, if it allowed the tribunal to have power to fix its own fees, this would be a decision *in causa sua*, and therefore contrary to public policy.⁵⁷

⁵⁰ Swiss Supreme Court decision 136 III 597 (2010); For the commentary on this decision see in: Christopher Koch, "The Limits of Arbitrators' Powers to Adjudicate Fees and Expenses - Commentary on the Swiss Supreme Court Decision 136 III 597 of 10 November 2010," *Arbitration International* 27, no. 2 (2011): 233–48.

⁵¹ For details on the arbitration case see in: Koch, "The Limits of Arbitrators' Powers to Adjudicate Fees and Expenses - Commentary on the Swiss Supreme Court Decision 136 III 597 of 10 November 2010," 233–36.

⁵² *Ibid.*, 235.

⁵³ *Ibid.*, 236.

⁵⁴ *Ibid.*, 237, 239.

⁵⁵ *Ibid.*, 239.

⁵⁶ *Ibid.*, 248; Palermo and Robach, "Judicial Review of Arbitrators' Fees. A Swiss Law Perspective," 601.

⁵⁷ Koch, "The Limits of Arbitrators' Powers to Adjudicate Fees and Expenses - Commentary on the Swiss Supreme Court Decision 136 III 597 of 10 November 2010," 239; Palermo and Robach, "Judicial Review of Arbitrators' Fees. A Swiss Law Perspective," 601.

More precisely, and in the words of the Swiss Supreme Court, the tribunal did not have the power to decide on its own fees due to the fact that the “*claims arising from the relationship between the parties and arbitrators do not arise under arbitration agreement and [...] it would represent an unacceptable situation in which the arbitrators were judges in their own cause*”.⁵⁸

This approach could, for example, be confirmed by examining the solutions provided in the Swedish AA as well. Section 37(2) of this Act states:

“In a final award, the arbitrators may order the parties to pay compensation to them, together with interest from the date occurring one month following the date of the announcement of the award”.

At the same time, Section 41 of the Swedish AA provides that

“[a] party or an arbitrator may bring an action in the District Court against the award regarding the payment of compensation to the arbitrators. Such action must be brought within three months from the date upon which the party received the award and, in the case of an arbitrator, within the same period from the announcement of the award.”

In other words, while the Swedish AA provides for the arbitrators’ power to determine the compensation owed to them in the award, the award cannot be enforced by arbitrators, and it is subject to a court review. Hence, it can be said that no decision *in causa sua* was rendered.

In 2012, the German Federal Court of Justice came to a similar conclusion.⁵⁹ In this setting aside proceeding, it restated the reasoning that arbitrators rendering a decision

⁵⁸ Koch, “The Limits of Arbitrators’ Powers to Adjudicate Fees and Expenses - Commentary on the Swiss Supreme Court Decision 136 III 597 of 10 November 2010,” 248.

⁵⁹ Bundesgerichtshof, III ZB 63/10 (2012). The author would like to thank her colleague Ira Miessler for kindly providing the translation of this decision and for discussing the matter in detail.

regarding their own self-interest, payment of fees, would be against public policy.⁶⁰ However, even though the tribunal in that case determined the amount in dispute, by which the amount of fees is calculated, the German Federal Court of Justice found no such violation. It stated that the prohibition to judge *in causa sua* means the arbitrators initially cannot award their own payment claims against the parties themselves, i.e. that they are not allowed to a relief in the award.⁶¹ Instead, if the tribunal conducts the proceedings without sufficient advance on costs, it cannot stipulate the unpaid arbitral costs in the award, but can only litigate for its fees and expenses before a state court.⁶² Since there is an obligation for the tribunal under Section 1057(1) of the German CCP to decide in an award on allocation of the costs of the arbitration, the German Federal Court of Justice considered that it was within the legislator's will for the tribunal to be entitled to assess the value of the dispute under the same Section when needed.⁶³ This decision takes effect only between the parties and if either party considers that the value or the determination was set too excessively, then they should bring this claim to an ordinary court.⁶⁴

At the first sight, the German Federal Court of Justice's decision seems in large part to adopt the same reasoning as the Swiss Supreme Court. Firstly, both courts found no violation on the public policy grounds, although they acknowledged that decision-making *in causa sua* would represent such a violation. They both "circumvented" the issue by limiting the effect of an award as to the parties only, while providing no relief for the arbitrators. In other words, the award is enforceable only between the parties. The arbitrators will have no right to enforce a decision on the payment of the fees that they themselves have determined in the last award. The courts also referred the parties (and the arbitrators) to an ordinary court with their

⁶⁰ Ibid.

⁶¹ Ibid.

⁶² Ibid.

⁶³ Ibid.

⁶⁴ Ibid.

claims regarding the payment of arbitrators' fees. However, while the Swiss Supreme Court found that there was no *award* to be enforced in the first place, the German Federal Court of Justice upheld the challenged awards.

To clarify, the Swiss Supreme Court declined the possibility for the arbitrators to ease the enforcement of their payment through rendering a decision on their fees in a form of an award, in the word of the Swiss Supreme Court, such a decision

“does not in any way deal with the actual dispute between the parties, it therefore cannot be a partial award that ends the proceedings for some of the claims in dispute. Contrary to its outward designation as Interim Award, the contested decision doesn't deal with any material or procedural preliminary issues which would have to be clarified before a final decision terminating a part of the proceedings could be issued.”⁶⁵

Indeed, in that case the “interim award” was rendered specifically for the purpose of the payment of the tribunal's fees and expenses.⁶⁶ On the other hand, in the German case, the challenged awards terminated the arbitration proceedings, as they were rendered upon the claimant's withdrawal of the claim. Hence, it is not surprising that the German Federal Court of Justice did not render the same decision as the Swiss court did regarding the determination of whether there is an award or not. Moreover, while the tribunal in the Swiss case dealt with the non-payment of the advance, it can be concluded from the facts of the German decision that the parties paid the advance, so the tribunal was merely adjudicating the allocation of the advance among the parties.

⁶⁵ Koch, “The Limits of Arbitrators' Powers to Adjudicate Fees and Expenses - Commentary on the Swiss Supreme Court Decision 136 III 597 of 10 November 2010,” 246.

⁶⁶ *Ibid.*, 235.

In the instance when the tribunal has set the amount in dispute and one of the parties is not satisfied with such a decision, the question becomes what happens if such determination of an amount in dispute, which affects the amount of tribunal's fees, is successfully challenged before a court by one of the parties. The award is still final and binding between the parties, and can in the meantime be successfully enforced. The German Federal Court of Justice predicted in such a case for the party to ask for the amount in excess back from the arbitrators themselves.⁶⁷ The somewhat clear division of the limitation of the *res judicata* effect of an award, which binds *only* the parties, avoids the issue of the decision-making *in causa sua*. However, the practical consequences of rendering any kind of an award without an existent and valid tripartite agreement are troublesome for the legitimacy of arbitration. The result of such an approach can lead to enforcement difficulties and cause parallel court proceedings. It would be advisable, therefore, for the parties and the arbitrators to raise these issues as early in an arbitration proceeding as possible.

The analysis of the Swiss and German decisions might provide for tailored-made solutions for arbitrations conducted in jurisdictions, where the arbitration institutions allow the tribunal to determine their own fees [see under **II.1.3**]. If the fees of the arbitrators are fixed by an arbitration institution, the issue can still be whether the parties can object to the amount.

The next section addresses another issue related to the lack of party's consent as to the determination of the arbitrators' fees – the possibility for an aggrieved party to challenge the arbitrator's partiality if the arbitrator agreed to the amount only with the other party.

⁶⁷ Bundesgerichtshof, III ZB 63/10, 1(e) (2012).

II.1.2.2.b Does a Fee Arrangement with Only One of the Parties Impair Arbitrator's Impartiality?

An existent and valid tripartite agreement is the only valid basis for the arbitrators to claim the payment of their fees and expenses. Any dispute as to that matter shall be referred to a court, either by an arbitrator or a party, as will be explained in the next section. If, however, one of the parties disputes the amount, while the other is ready to pay it, another issue may emerge: can the arbitration continue based on such a one-sided agreement or the impartiality of an arbitrator might be impaired?

A small caveat needs to be made at this point related to the payment of the advance on costs, which, as will be explained in Chapter III, when paid under arbitration rules can usually be paid by both or by *one of the parties*. Such substitute payment of the advance is generally acceptable in *ad hoc* settings as well. It could hardly be argued then that such an arrangement was not envisaged by the parties, and that they could raise any claims against the arbitrators solely on this basis. This section, on the other hand, focuses on the question of whether the *final* payment of the *final* amount of arbitrators' fees can be made by only of the parties. This raises a different set of issues.

England and Wales is a jurisdiction which has developed case law on this matter, particularly related to the payment of the commitment and interim fees, as required by an arbitrator. The discussion was not only focused on whether the arbitrators had a right to require such fees, which could be qualified as misconduct if they did, but also whether they had a right to conclude a one-sided agreement, under which only one of the parties would make the required payment. While the answer to the first question was highly dependent on the circumstances of a case, the answer to the second one was a loud and clear "no". However, a one-sided agreement regarding the fees did not automatically mean that an arbitrator was bias.

This three-fold analysis of a right to require the payment, right to enter into a one-sided agreement, and the impact of such an agreement on the impartiality of an arbitrator was analyzed in depth in the following three cases: *K/S Norjarl A/S v. Hyundai Heavy Industries Co., Ltd.* [“Norjarl case”], *Turner v Stevenage Borough Council* [“Turner case”], and *Brian Andrews v John H Bradshaw, H Rendell & Son Limited* [“Andrews case”].⁶⁸

The *Norjarl* case is somewhat different from the other two as it concerned the payment of commitment fees. The commitment fees are usually sought when the arbitrators are asked to reserve weeks, or even months, for hearings in complicated cases, and when such a reservation of time might be lost if the parties settle and they terminate the arbitrator’s mandate, or the proceedings are prolonged over the time schedule initially foreseen.⁶⁹ The *Norjarl* case resolved an issue when and how such a commitment fee may be sought.

Justice Phillips elaborated on the availability of commitment fees in arbitration as follows:

“While payment of a commitment fee may be a perfectly proper and reasonable term of a contract under which a professional man agrees to hold himself available to perform services over a specific period, there is no basis upon which entitlement to such a fee can arise as an implied term of a contract to provide such services.

For an arbitrator who has accepted an appointment without reservation subsequently to insist upon payment of a commitment fee as a condition of

⁶⁸ *K/S Norjarl A/S v. Hyundai Heavy Industries Co., Ltd.*, 1 Lloyd’s Law Rep. 260 (1991) (n.d.); *Turner v Stevenage Borough Council*, [1997] 3 W.L.R. 309, [1998] Ch. 28 (Court of Appeal 1997); *Brian Andrews v John H Bradshaw, H Rendell & Son Limited*, 1999 WL 807160 (Court of Appeal (Civil Division) 1999).

⁶⁹ Blackaby et al., *Redfern and Hunter on International Arbitration*, 2015, para. 4.212.

continuing to perform his services will, in my judgment, constitute misconduct.”⁷⁰

Nevertheless, in the *Norjarl* case, the court stated that the parties’ request for the arbitrators to hold a 60 day period some two years ahead went beyond the duty of arbitrators. At the same time, it also stated that it “*it was not improper for the arbitrators to respond to the parties’ request [...] with a request that the should [...] be granted a commitment fee, albeit that neither party was under any obligation to agree to this proposal.*”⁷¹ In other words, while a commitment fee is not an implied term of a tripartite agreement and there is not a possibility for an arbitrator to impose it unilaterally, the circumstances may justify such a proposal even at the later stages of a proceeding. However, this should be understood as a mere proposal for the alternation of the terms of an initial agreement, to which both parties should agree.

The court in the *Norjarl* case addressed the importance of insisting on the conclusion of an agreement on commitment fees before the acceptance of the appointment. The court also addressed the issue of a conclusion of such an agreement with only one of the parties and its effects. In that regard, Justice Phillips stressed the importance of acquiring the consent of *both* parties. In particular, it was stated that before the acceptance of the appointment, if an arbitrator wishes to stipulate the amount and basis of the remuneration as a condition of acceptance of the appointment and one party objects to the terms proposed on the ground that they are unreasonable, the arbitrator should hesitate before accepting the appointment on the basis of an agreement reached with the other party alone.⁷² After the arbitrator has accepted his appointment, “*it is [even] less desirable for him to conclude an agreement about fees [...] with one party if the other party is not prepared to join in that agreement.*”⁷³

⁷⁰ K/S *Norjarl A/S v. Hyundai Heavy Industries Co., Ltd.*, 1 Lloyd’s Law Rep. 260 (1991) (n.d.).

⁷¹ *Ibid.*

⁷² *Ibid.*

⁷³ *Ibid.*

The same reservation towards a one-sided agreement regarding the arbitrator's fees was expressed in the two other cases mentioned above. In the *Turner* case, the initial tripartite agreement contained no express term as to the payment of interim fees, but it contained an hourly rate for the calculation of arbitrators' fees and the deadline by which the case should have been decided. Due to the prolongation of that deadline, the arbitrator made a request for the payment of interim fees, upon the acceptance of which the arbitrator conditioned his continuance of the proceeding. The first issue the court discussed in the proceedings for the removal of arbitrator under section 23 of the 1950 EAA was whether the arbitrator had a right to claim an interim payment. Interim fees were in this regard treated differently than commencement fees as the court found them to be an implied term of the tripartite agreement. This finding, however, depended heavily on the circumstances of the case, as Justice Staughton elaborated:

“Now, the question that we have to decide is whether there is such a term in the contract in this case. [...] There is a provision [...] for payment of fees that are due before the award is collected. But I would not regard that as negating a possible implication that an interim payment of fees may be due at some earlier time. [...] The arbitrator expected the arbitration to be concluded in three months or so. Instead of that he was involved in a long series of preliminary meetings. [...] Was it necessary for him to incur expense for so long as they pleased, provided only that at the end of the day when he eventually made an award he would then have a right to reimbursement? That does not seem to me to be good law or good sense.”⁷⁴

⁷⁴ Peter Turner and Reza Mohtashami, *A Guide to the LCIA Arbitration Rules* (Oxford, 2009).

Except for this differentiation between the commencement and interim fees, where the former are usually not implied under the tripartite agreement, there is a consensus as to the one-sided agreement regarding the arbitrator's fees.

In the *Turner* case, the arbitrator accepted one party's cheque, which was subsequently returned, and Justice Staughton established the following statement on this, somewhat "temporarily" exercised one-sided agreement:

"[The *Norjarl* case] shows that it is wrong for an arbitrator to agree to accept a fee from one party after the start of the arbitration and not from the other. He may, it seems, do so if he agrees on that course before the arbitration starts, but not afterwards. [...] If the arbitrator has no right to make a demand and does make one he is wrong to do so. He is certainly wrong if he accepts from one party money [...] and retains it whilst the other party does not contribute. The position is not so clear to my mind if the arbitrator has a right to make a demand, as I hold he has in this case, but nevertheless only one party responds to his request."

Since in the *Turner* case the arbitrator returned the received payment no misconduct was found and he was not removed from the case. The question still stands what happens when an arbitrator continues to act after she or he receives a payment of the interim fee, which is final as to its amount, on which she or he is entitled, but such payment is made only by one of the parties.

A similar issue, related to the minimum fees, was addressed in the *Andrews* case. The arbitrator in that case received the payment of the initial minimum fee from only one of the parties and eventually rendered an interim award. The non-paying party filed for the removal of the arbitrator due to the misconduct and partiality of the arbitrator under Section

24(1) of the 1996 EAA. The issue arose when the arbitrator insisted on the agreement, proposed after his appointment, which differed from the initially agreed applicable arbitration rules. One of the parties agreed to arbitrators' new terms and paid the minimum fee, while the other did not.⁷⁵ The court once again reiterated that "*it was unwise and inappropriate for the arbitrator, after accepting appointment [...], to enter into a one-sided agreement of this nature and to receive any payment under it from only one party.*"⁷⁶ The arbitrator, consequently, was not removed as no misconduct or partiality was proven, since the interim award was generally favorable for the non-paying part and the arbitrator eventually agreed that he had no right to insist on the subsequent agreement regarding his fees.

These three cases – *Norjarl*, *Turner*, and *Andrews* – did not cover every possible situation that might arise regarding the lack of consent of one of the parties to the agreement on arbitrator's fees, but they pointed out well the circumstances which need to be carefully examined when concluding a tripartite agreement, as well as any further agreement as to the arbitrator's fees. First thing that matters is the type of the fees which is the issue – while commitment fees are not an implied term of the tripartite agreement, the interim payment of *ordinary* fees is. The second most important circumstance is the timeline. Any departure from the initially agreed terms, e.g., those contained in any arbitration rules, should be insisted on at the time of the acceptance of the appointment. Any further insistence on the payment of the additional fees can lead to a case similar to those mentioned in this section. The conclusion of such an agreement with only one party can seriously disturb the trust of the other party in the fairness of the proceedings, and the impartiality of an arbitrator who concluded such a one-sided agreement.

⁷⁵ *Brian Andrews v John H Bradshaw, H Rendell & Son Limited*, 1999 WL 807160 (Court of Appeal (Civil Division) 1999).

⁷⁶ *Ibid.*

Interestingly, none of the arbitrators were removed from their positions in these three cases, either because they did not agree to conclude an agreement with only one of the parties, or they returned the payment received from only one party, or no bias was proven even though they acted upon the one-sided payment. The threshold to show arbitrator's misconduct and partiality when concluding a one-sided agreement regarding their fees seems to be high, but not inconceivable one. Unless explicitly concluded upon the acceptance of the appointment with both parties, any term on the payment of the fees can constitute plausible grounds to claim that arbitrator is bias, especially if it is evident that the other party is disputing the basis for such payment.

As briefly mentioned at the beginning of this section, the concluding question related to this issue is whether this case law is or should be applicable to the situation in which one of the parties pays the whole advance on costs in institutional arbitration [see Chapter **III**]. There are two grounds on which the applicability of this case law may be distinguished. Firstly, in case when the advance on costs is paid under arbitration rules, such advance is *explicitly* provided for, so it is a term of a tripartite agreement between the parties and an arbitrator. Secondly, payment of the advance by *only one of the parties* is also the usual term of arbitration rules, as it will be discussed in Chapter **III**. It could hardly be argued then that such an arrangement was not envisaged by the parties, and that they could raise any claims against the arbitrators solely on this basis.

Notwithstanding who paid the fees and whether the basis for such payment is to be disputed, both parties and the arbitrators reserve the right to contest the amount of the fees, as it is discussed under the following section.

II.1.2.2.c Recourse to Court in Case of a Contested Amount

As it was already clarified, the right of the arbitrators to receive remuneration is recognized as their principle right, but it is subject to the agreement between the parties and the arbitrator.⁷⁷ The two former sections showed that all three parties to such an agreement should agree and that no amount can be unilaterally imposed or changed. The proper forum to solve a disagreement regarding the amount of arbitrator's fees is a competent national court.

For example, Article 28 (2) of the 1996 EAA states that:

“Any party may apply to the court (upon notice to the other parties and to the arbitrators) which may order that the amount of the arbitrators' fees and expenses shall be considered and adjusted by such means and upon such terms as it may direct”.

The Swedish AA allows a similar recourse to courts in Section 41(1), which states that “[a] party or an arbitrator may bring an action in the District Court against the award regarding the payment of compensation to the arbitrators.” This legal remedy is usually indicated in the awards rendered in Sweden. The recourse to court in these situations is a legal remedy available to all the parties to a tripartite agreement, but it also confirms that the arbitrators cannot render the decision on the amount of their fees by themselves and that the consent of all the parties is needed. In other words, if one of the parties explicitly contests the amount of the arbitrators' fees, the *receptum arbitri* is not considered to be validly concluded.⁷⁸

Substituting a court decision for an agreement between the arbitrators and the parties is not the only possible way to resolve such a case. Arbitrators may well continue to perform

⁷⁷ Lew, Mistelis, and Kröll, *Comparative International Commercial Arbitration*, 283, 286.

⁷⁸ Várady, “Remuneration of Arbitrators as a Threshold Issues: Economic Sense and Procedural Realities,” 593.

their duties without a fee agreement, or the parties can appoint new arbitrators.⁷⁹ If the arbitrators proceed without an agreement on the amount of fees, a disagreement as to this amount may be discovered later in the proceedings. The same happens in a case where the parties and the arbitrator agreed on the, for example, hourly rate or *ad valorem* method of calculation with a margin of discretion between the minimum and maximum fee because in these situations the final amount of the fees will be set only later in the proceedings. When arbitrators proceed without stating the exact amount of their fees, which is not always predictable at the beginning of the proceedings, or agreeing solely on the method of calculation, it will depend on the applicable law whether a tripartite agreement is valid. Even when such an agreement is considered valid, the parties solely agreed to a method of calculation, or in lack of such a provision, to a default rule on the calculation of arbitrators' fees, as determined in *lex arbitri*. In other words, if the amount of fees is not explicitly established and contested at the beginning of the proceeding, one way of confirming the courts' jurisdiction in this regard is by stating that the parties and the arbitrator validated a tripartite agreement with their performance under it and the fees are to be determined by a national court either under the method they agreed on or under the *lex arbitri*.

This imposes a question what happens when the parties disagree to an amount set in the institutional arbitration, where the advance on costs is usually set at the beginning of the proceedings, but the final amount of the fees is fixed at the end. This is discussed in more details under Part II.2 of this Chapter.

⁷⁹ See more in: *Ibid.*

II.1.3 Determination of Procedural Costs under Arbitration Rules

II.1.3.1 Power to Determine Procedural Costs

The main advantage of institutional arbitration regarding the process of the determination of procedural costs is the involvement of institutional bodies, which reduces the need for the parties to negotiate fees directly with arbitrators.⁸⁰ For example, under the 2012 ICC Rules, arbitrators' fees are determined by the International Court of Arbitration of the ICC ["ICC Court"], in accordance with the fee schedule in force at the time of the commencement of the arbitration.⁸¹ The ICC Court fixes administrative charges as well. The administrative charges are another feature of institutional arbitration and the method of their calculation is discussed under Section **II.1.3.3**. Costs other than those determined by the ICC Court may be decided by the arbitral tribunal at any time during the proceedings.

A similar solution is provided under other arbitration rules. Under the 2014 LCIA Rules, the LCIA Court has the power to determine the amount of the procedural costs which afterwards will be stated in the award itself, while the arbitral tribunal has the power to decide upon their allocation among the parties.⁸² Under both arbitration rules, the party costs are left completely at tribunal's discretion regarding the allocation of costs [see Chapter V].

⁸⁰ Born, *International Commercial Arbitration*, 2019.

⁸¹ Article 37(1) of the 2012 ICC Rules: "The costs of the arbitration shall include the fees and expenses of the arbitrators and the ICC administrative expenses fixed by the Court, in accordance with the scale in force at the time of the commencement of the arbitration, as well as the fees and expenses of any experts appointed by the arbitral tribunal and the reasonable legal and other costs incurred by the parties for the arbitration."

⁸² Article 28.1 of the 2014 LCIA Rules: "The costs of the arbitration (other than the legal or other costs incurred by the parties themselves) shall be determined by the LCIA Court in accordance with the Schedule of Costs. The parties shall be jointly and severally liable to the Arbitral Tribunal and the LCIA for such arbitration costs."

Article 28.2 of the LCIA Rules: "The Arbitral Tribunal shall specify in the award the total amount of the costs of the arbitration as determined by the LCIA Court. Unless the parties agree otherwise in writing, the Arbitral Tribunal shall determine the proportions in which the parties shall bear all or part of such arbitration costs."

Under the 2013 SIAC Rules and the 2010 SCC Rules, the principal method is the same – the institution’s body determines procedural costs – and either the SIAC Registrar or the SCC Board makes the determination.⁸³ The exception to this rule is provided in the 1998 DIS Rules, under which Section 25 of the 1998 DIS Rules provides:

“The arbitral tribunal may make continuation of the arbitral proceedings contingent on payment of advances on the anticipated costs of the arbitral tribunal. It should request each party to pay one half of the advance. In fixing the advance, the arbitrators’ total fees and the anticipated reimbursements as well as any applicable value added tax may be taken into consideration.”

Although not expressly stated, it is confirmed by practice and scholars that this section clarifies that an arbitral tribunal has the power to determine the amount of fees.⁸⁴ Other provisions of the 1998 DIS Rules indicate the same. For example, Section 40(2) provides that the “*fees shall be fixed by reference to the amount in dispute, which is to be assessed by the arbitral tribunal at its due discretion*”, while section 40(3) provides for the tribunal’s power to reduce the fees in case of a premature termination of the proceedings.

An interesting collaboration of the institution and an arbitral tribunal is provided under the 2012 Swiss Rules. The 2012 Swiss Rules provide for special procedure of the determination of the arbitrator fee by an arbitral tribunal, subject to the approval of the Court of Arbitration of the Swiss Chambers’ Arbitration Institution. The Swiss Court of Arbitration is basically monitoring the arbitrators’ financial management by requiring arbitrators to

⁸³ Rule 32.1 of the 2013 SIAC Rules: “The fees of the Tribunal shall be fixed by the Registrar in accordance with the Schedule of Fees and the stage of the proceedings at which the arbitration ended. In exceptional circumstances, the Registrar may allow an additional fee over that prescribed in the Schedule of Fees to be paid.” Art. 43(2) of the 2010 SCC Rules: “Before making the final award, the Arbitral Tribunal shall request the Board to finally determine the Costs of the Arbitration. The Board shall finally determine the Costs of the Arbitration in accordance with the Schedule of Costs (Appendix III) in force on the date of commencement of the arbitration pursuant to Article 4.”

⁸⁴ Risse, “Part III – Commentary on the Arbitration Rules of the German Institution of Arbitration (DIS Rules), Section 25 – Advance on Costs of Arbitral Tribunal,” 748.

inform them of any decision concerning the advance on costs, and by scrutinizing ‘decisions as to the assessment and apportionment of the costs’ contained in tribunal’s decisions.⁸⁵ All procedural costs, including arbitrators’ fees, expert fees, and filing and administrative fees are set by an arbitral tribunal and its decision is subject to the approval and adjustment by the Swiss Court of Arbitration.⁸⁶ Although such an approval and adjustment is binding on the tribunal, legal scholars are of the opinion that “*by choosing to arbitrate under the Swiss Rules, the parties vest the arbitral tribunal with the authority to fix its fees unilaterally and to incorporate this decision into its award.*”⁸⁷

A similar solution is provided under the 2014 ICDR Rules. Under this set of rules, the arbitrators’ fees and expenses are set throughout the cooperation of the tribunal and the Administrator. While the fees and expenses are fixed by the tribunal in the last award, the Administrator is designating “*an appropriate daily or hourly rate of compensation in consultation with the parties and all arbitrators*”, and deciding on any dispute regarding the arbitrators’ fees and expenses.⁸⁸

The 2015 Zagreb Rules deal only with the power to allocate the costs, while the determination of the amount of the procedural costs is governed by the rules contained in the 2011 Decision on the Costs of Arbitration Proceedings of the Croatian Chamber of Economy

⁸⁵ Koch, “The Limits of Arbitrators’ Powers to Adjudicate Fees and Expenses - Commentary on the Swiss Supreme Court Decision 136 III 597 of 10 November 2010,” 234.

⁸⁶ Art. 40(4) of the 2012 Swiss Rules: “Before rendering an award, termination order, or decision on a request under Articles 35 to 37, the arbitral tribunal shall submit to the Secretariat a draft thereof for approval or adjustment by the Court of the determination on costs made pursuant to Articles 38(a) to (c) and (f) and Article 39. Any such approval or adjustment shall be binding upon the arbitral tribunal.”

⁸⁷ Koch, “The Limits of Arbitrators’ Powers to Adjudicate Fees and Expenses - Commentary on the Swiss Supreme Court Decision 136 III 597 of 10 November 2010,” 236.

⁸⁸ Article 35 of the 2014 ICDR Rules: “1. The fees and expenses of the arbitrators shall be reasonable in amount, taking into account the time spent by the arbitrators, the size and complexity of the case, and any other relevant circumstances. 2. As soon as practicable after the commencement of the arbitration, the Administrator shall designate an appropriate daily or hourly rate of compensation in consultation with the parties and all arbitrators, taking into account the arbitrators’ stated rate of compensation and the size and complexity of the case. 3. Any dispute regarding the fees and expenses of the arbitrators shall be determined by the Administrator.”

[“Decision on the Costs of the CEE”]. Article 5(1) of the Decision on the Costs of the CEE provides that the President of the Court will decide on the amount of the advance payment of the fees for the arbitrators, the administrative costs, and the material costs of the proceedings (expenditure of arbitrators, fees and expenditure of witnesses, costs of interpretation and translation etc.).⁸⁹

Except in those rare situations in which arbitration rules put the determination of procedural costs into the hands of an arbitral tribunal, arbitration institutions usually retain this power for themselves. However, the involvement of a tribunal in the determination process may further depend on the methods of calculation of arbitrators’ fees and expenses. These methods are discussed under the following section [II.1.3.2]. Afterwards, the calculation methods for administrative charges are analysed [II.1.3.3].

II.1.3.2 Arbitrators’ Fees and Expenses

II.1.3.2.a Methods of Calculation of Arbitrators’ Fees

The methods for the calculation of the arbitrators’ fees can either be set explicitly in an agreement between the parties and the arbitrators, or by agreeing on specific arbitration

⁸⁹ Art. 5(1) of the Decision on Costs of the CCE: “After establishing the number of arbitrators in the proceedings (that is: one or three), the amount of the advance payment for the predictable costs of the proceedings from Article 2, paragraph 2, points b), c) and d) shall be regulated by the President of the Court”. Art. 2(2) of the Decision on Costs of the CCE: “The costs of proceedings consist of:

- a) the registration fee;
- b) the fees of the arbitrators and mediators;
- c) the administrative costs
- d) the material costs of the proceedings (expenditure of arbitrators, fees and expenditure of witnesses, costs of interpretation and translation and other expenditure)“.

rules.⁹⁰ In absence of such an agreement, the calculation of the fees of the tribunal is based on *lex arbitri*.⁹¹

On the other hand, there are two basic methods for the calculation of the arbitrators' fees provided by arbitration institutions: time-based method and *ad valorem* method, i.e. the method of calculation according to the percentage of the amount in the dispute.⁹² In general, the time-based method is adopted in the 2014 LCIA Rules and the 2014 ICDR Rules⁹³, while the 2012 ICC Rules, the 2013 SIAC Rules, the 2010 SCC Rules, the 2012 Swiss Rules, and the 1998 DIS Rules provide for *ad valorem* method and the fees or arbitrators are determined in accordance with the fees schedules. Without going into an indefinite discussion on which of these methods leads to a cheaper arbitration proceeding, it can still be stated that each of the methods has its advantages and disadvantages.

The time-based method, where fees are calculated on hourly or daily rates promotes the principle that the amount in dispute does not reflect the actual complexity of the case and therefore it is fairer as it determines the fees based on the arbitrators' actual time spent on the case.⁹⁴ This method also supposes an indirect influence of the arbitrators as to the determination of the final amount of their fees, even when the hourly or daily fee is set by an institution's body, as the arbitrators stay responsible for reporting on hours or days they worked on a case.⁹⁵

On the other hand, the calculation of arbitrators' fees as a percentage of an amount in dispute discourages the parties of making frivolous claims and it presents an incentive for the

⁹⁰ Lew, Mistelis, and Kröll, *Comparative International Commercial Arbitration*, 285.

⁹¹ *Ibid.*

⁹² *Ibid.*, 284.

⁹³ Art. 35(2) of the 2014 ICDR Rules: "As soon as practicable after the commencement of the arbitration, the Administrator shall designate an appropriate daily or hourly rate of compensation in consultation with the parties and all arbitrators, taking into account the arbitrators' stated rate of compensation and the size and complexity of the case."

⁹⁴ Turner and Mohtashami, *A Guide to the LCIA Arbitration Rules*, para. 8.06.

⁹⁵ Born, *International Commercial Arbitration*, 2020.

arbitrators to handle the case more efficiently.⁹⁶ It also enhances the predictability of overall costs for the parties of overall costs and it makes the fees proportionate with the amount in stake.⁹⁷

Nevertheless, it is rare that arbitration rules adopt a “pure” version of either of these methods. It is more common for them to provide for the combination of these two or some other kind of adjustment.⁹⁸ Therefore, the possible calculation methods can be:

- a) calculation of arbitrators’ fees exclusively on the basis of the time spent,
- b) calculation of arbitrators’ fees exclusively as a percentage of the amount in dispute,
- c) calculation method based on time spent combined with other elements, and
- d) calculation method based on the amount in dispute combined with other elements.⁹⁹

Although the 2014 LCIA Rules and the 2014 ICDR Rules provide for a time based method for the calculation, this method is actually a combination method where the rate is based on a daily or hourly rate, they also take into consideration other circumstances of the case when fixing the final fee.¹⁰⁰ Neither of these rules provide for the schedule for the arbitrator’s fees.¹⁰¹ Both the 2014 ICDR Rules and the 2014 LCIA Rules provide that the complexity of the case should be taken into account when fixing the amount. The 2014 LCIA

⁹⁶ Jason Fry, Simon Greenberg, and Francesca Mazza, *The Secretariat’s Guide to ICC Arbitration*, no 729E (Paris: International Chamber of Commerce, 2012), 364.

⁹⁷ *Ibid.*

⁹⁸ This division and terminology of these methods was introduced in: Christian Bühring-Uhle, *Arbitration and Mediation in International Business* (New York: Kluwer Law International, 1996), 196.

⁹⁹ *Ibid.*, 116–19.

¹⁰⁰ Article 35(1) of the 2014 ICDR Rules: “The fees and expenses of the arbitrators shall be reasonable in amount, taking into account the time spent by the arbitrators, the size and complexity of the case, and any other relevant circumstances.”; Art. 2(i) of the 2014 LCIA Schedule of Arbitration Costs: “The Tribunal’s fees will be calculated by reference to work done by its members in connection with the arbitration and will be charged at rates appropriate to the particular circumstances of the case, including its complexity and the special qualifications of the arbitrators”.

¹⁰¹ However, the LCIA Rules provided for such a schedule until the revision of the Schedule of Arbitration Costs in 2013. The Schedule before provided for arbitrators’ fees within the range of £150 and £350 per hour. See more in: Turner and Mohtashami, *A Guide to the LCIA Arbitration Rules*, para. 8.12. Today it only states the possible maximum of an hourly fee, which is £450.

Rules, besides this and other relevant circumstances, also explicitly state that the special qualifications of the arbitrators should be taken into account.

On the other hand, as mentioned above, the majority of the arbitration rules provide for the calculation of arbitrators' fees based on the amount in dispute, i.e. *ad valorem* method. However, none of these rules provide for a calculation based exclusively on the percentage of an amount. The 2012 ICC Rules, the 2012 Swiss Rules, and the 2010 SCC Rules provide for the combination method since their scales provide for a minimum and maximum of the fee, while the final fee is fixed by taking into account other factors. On the other hand, the 2013 SIAC Rules, the 1998 DIS Rules, the 2013 Vienna Rules, and the 2015 Zagreb Rules provide for the calculation of arbitrators' fees as a sum of a fee base, and a percentage of the amount in dispute.

The 2012 ICC Rules provide a Scale of Arbitrators' Fees in Appendix III. The scale determines possible minimum and maximum rates for the fees depending on the amount in dispute stated in US Dollars. However, the fees are not entirely linked only to the amount in dispute. According to Article 2(2) of Appendix III of the 2012 ICC Rules, the ICC Court makes the decision on the final amount between the minimum and maximum taking into consideration the diligence and efficiency of the arbitrator, the time spent, the rapidity of the proceedings, the complexity of the dispute, and the timeliness of the submissions of the draft award. If the amount in dispute is not stated, the ICC Court has full discretion as to the determination of the amount of fees. Moreover, under Article 37(2) of the 2012 ICC Rules, the ICC Court has discretion to set the fees in the amount lower or higher than amount provided in the scale "*should this be deemed necessary due to the exceptional circumstances of the case.*"

The arbitrators are asked to make a submission, stating the amount of time they have spent on the case, describing the work and any other relevant factors.¹⁰² The ICC Court will, depending on the criteria stated above, set a lower or higher amount of the arbitrators' fees. A reason for setting higher amount of fee can be tribunal's good performance, while a reason for a lower amount of fee can be tribunal's extensive delay in rendering the award.¹⁰³ In December 2015, the ICC Court decided to go a step further regarding the prevention of the excessive delays and it officially announced two decisions for enhancing the efficiency and transparency of ICC arbitration.¹⁰⁴ One of them referred to the reducing the fees in case of a delay. The ICC Court provided that ICC arbitral tribunals are expected to submit draft awards within three months after the last substantive hearing concerning matters to be decided in an award or the filing of the last written submissions (excluding cost submissions), if these are submitted after the last hearing.¹⁰⁵ In case of delay, the ICC Court, unless the delay is justified by factors beyond the arbitrators' control or to exceptional circumstances, may lower the arbitrators' fees as follows:

- for draft awards submitted for scrutiny up to seven months after the last substantive hearing or written submissions, whichever is later, the fees that the Court would otherwise have considered fixing are reduced by 5 to 10%;
- for draft awards submitted up to 10 months after the last substantive hearing or written submissions, the fees that the Court would otherwise have considered fixing are reduced by 10 to 20%; and

¹⁰² Fry, Greenberg, and Mazza, *The Secretariat's Guide to ICC Arbitration*, 394.

¹⁰³ *Ibid.*, 395.

¹⁰⁴ "ICC Court Announces New Policies to Foster Transparency and Ensure Greater Efficiency" (ICC, January 5, 2016), <http://www.iccwbo.org/News/Articles/2016/ICC-Court-announces-new-policies-to-foster-transparency-and-ensure-greater-efficiency/>.

¹⁰⁵ *Ibid.*

- for draft awards submitted for scrutiny more than 10 months after the last substantive hearing or written submissions, the fees that the Court would otherwise have considered fixing are reduced by 20% or more.¹⁰⁶

The new policy also provides the ICC Court with the power to increase the arbitrators' fees if a tribunal has conducted the arbitration expeditiously.¹⁰⁷

The 2012 Swiss Rules adopt the same method as the 2012 ICC Rules. The Appendix B of the 2012 Swiss Rules sets the scale for the fees separately for a sole arbitrator and a three-member tribunal. The amount of fees depends on the amount in dispute stated in Swiss francs. However, the 2012 Swiss Rules set the minimum and maximum of the fees that can be set, while it is up to the tribunal to decide on the final amount under Article 39(1) taking into consideration the amount in dispute, the complexity of the subject-matter, the time spent, and other relevant circumstances. The tribunal is also explicitly instructed how to assess the circumstance of discontinuation of the arbitration proceedings. In such a case, the fees can be less than the minimum amount in the Schedule in the Appendix B.

The 2010 SCC Rules provide the same method of calculation of the fees of an arbitral tribunal. The Schedule of Fees in Appendix III links the fees for the sole arbitrator or chairmen to the amount in dispute stated in Euros. The fees are calculated for the Chairperson, while the co-arbitrators are paid 60% of that amount, according to Article 2(2) of Appendix III. The Schedule sets the minimum and maximum fee, but the 2010 SCC Rules do not contain any instructions, such as the 2012 ICC or the 2012 Swiss Rules, for the Board to follow in order to set the fee of a Chairperson.

The 2013 Vienna Rules, the 2013 SIAC Rules, and the 1998 DIS Rules provide for the calculation of arbitrators' fees as a sum of a fee base and a percentage of the amount in

¹⁰⁶ Ibid.

¹⁰⁷ Ibid.

dispute. Two of the three rules mentioned, the 1998 DIS Rules being an exception, provide base fee for only one arbitrator. According to Article 44(7) of the 2013 Vienna Rules, if the case is decided by an arbitral tribunal, the fees “shall be raised to two-and-a-half times”, but in particularly complex cases, it can be increased up to 30 percent. The Schedule of Fees of the 2013 SIAC Rules provide for the calculation for the maximum amount payable to one arbitrator.

The 1998 DIS Rules provide for a method of calculation similar to these rules, but the main difference is that it provides under Article 1 of the Appendix to Section 40 Subsection 5 of the 1998 DIS Rules for a fixed fee when the amount in dispute is less than 5,000 Euro and when the amount in dispute is between 5,000-50,000 Euro. The fees are fixed separately for a chairperson, a sole arbitrator, and for each co-arbitrator. For amounts in dispute above 50,000 Euro, a fee basis plus a percentage of the amount is a provided calculation method.

Under the 2013 UNCITRAL Rules, which are designed for *ad hoc* settings, the method of calculation of the fees and expenses of the arbitrators is to be suggested by the arbitral tribunal. Under Article 41 of the 2013 UNCITRAL Rules, the arbitral tribunal in fixing its fees shall take the schedule or method of an appointing authority into account to the extent that it considers appropriate in the circumstances of the case, and it should promptly after its constitution inform the parties as to how it proposes to determine its fees and expenses, including any rates it intends to apply. The 2013 UNCITRAL Rules also provide for the possible review by appointing authority of the tribunal’s decision as to the method of calculation within 15 days of receiving that proposal, and the appointing authority shall make any necessary adjustments thereto, which shall be binding upon the arbitral tribunal.

Besides the nuances among the methods of calculation, arbitration rules differ also as to the rules on the apportionment of the fees among the members of the tribunal.

II.1.3.2.b Apportionment of the Fees among the Members of the Tribunal

An analysis of the arbitration rules shows four possible approaches regarding the allocation of the fees among the members of the tribunal. Firstly, there are rules which provide *a different scale for the calculation of the fees of the chairperson and the co-arbitrators*. For example, the Appendix to Section 40 Subsection 5 of the 1998 DIS Rules provides for a fixed fee of both chairperson and co-arbitrators when the amount in dispute is up to 50,000 Euro, but when the amount in dispute is higher than 50,000 Euro, the fees of each co-arbitrator are calculated as a sum of a base fee with an addition of certain percentage of the amount exceeding the stated amount in dispute. The fee for the chairperson in these cases is calculated by adding 30% to these fees.

Another method for the apportionment of the fees among the members of the tribunal is the one in which *the scale for the calculation of the fees of the chairperson is set, while co-arbitrators' fees are calculated as a percentage of the former*. The Schedule of Costs under the 2010 SCC Rules provides for calculation of the minimum and maximum fee of the chairperson. According to the Article 2(2) of the Schedule of Costs, the co-arbitrators' fees are, on the other hand, calculated as a percentage of the fee of chairperson: each of them receives 60 percent of that amount, but a different percentage may apply.

A somewhat opposite approach to this one is provided in the 2012 Swiss Rules: *the rules set the scale for calculation of the fees of the whole tribunal with a separate rule on division of this amount between the arbitrators and co-arbitrators*. The Appendix B of the 2012 Swiss Rules provides for the scale for calculation of the fees for the whole tribunal, and this amount is then divided in accordance with Article 39(3) which states: “(...) *As a rule, the presiding arbitrator shall receive between 40% and 50% and each co-arbitrator between 25% and 30% of the total fees, in view of the time and efforts spent by each arbitrator*”.

Nevertheless, a different arbitrators' agreement on the apportionment prevails over this suggested apportionment.¹⁰⁸ If they, however, decide to award different amount of fees to co-arbitrators, reasons for such a decision need to be indicated.¹⁰⁹

Finally, the 2012 ICC Rules are an example of rules which are *silent on the matter* and the allocation of the fees between the members of the tribunal depends on their agreement and on the decision of the institution. The 2012 ICC Rules do not explicitly provide for any of the approaches mentioned above. The practice, however, provided for the solution in which the arbitrators are strongly encouraged to discuss allocation of the fees among themselves and to communicate the agreement to the ICC Secretariat.¹¹⁰ If there is no agreement between the members of the tribunal, the ICC Court's general practice is to allocate 40 percent of the total fees to the chair person and 30 percent to each co-arbitrator.¹¹¹ Both the arbitrators as well as the ICC Court can decide differently. Most often, the decision can be to raise chairperson's portion of the fees to 50 per cent due to her or his workload and contribution.¹¹² However, the co-arbitrators' shares can vary as well. For instance, in one case, one of the co-arbitrators was paid 40 percent of the total fees, yet in another, one co-arbitrator was paid only 20 percent.¹¹³

II.1.3.2.c Arbitrators' Expenses

Arbitrator's expenses usually cover out-of-pocket expenses, travel expenses, and allowance for personal living expenses. National arbitration laws recognize an arbitrator's

¹⁰⁸ T. Zuberbühler, Ch. Müller, and Ph. Habegger, eds., *Swiss Rules of International Arbitration: Commentary* (Kluwer Law International, 2005), 333.

¹⁰⁹ *Ibid.*

¹¹⁰ Fry, Greenberg, and Mazza, *The Secretariat's Guide to ICC Arbitration*, 398.

¹¹¹ *Ibid.*, 397.

¹¹² *Ibid.*, 398.

¹¹³ *Ibid.*

right to reimburse these expenses, but do not usually contain any guidelines for their determination.¹¹⁴ In *ad hoc* arbitration, the reimbursement of the tribunal's expenses depends on the agreement of the parties and the arbitrators.¹¹⁵ Arbitration rules or other institutional guidelines are, on other hand, more helpful in this matter.

Some rules are more detailed than the others and they provide separate guidelines for the accounting of such expenses. This approach, for example, is done in the 2012 Swiss Rules. Under the Article 38 and 40(4) of the 2012 Swiss Rules, the expenses are determined by the tribunal and then subjected to the approval of the Arbitration Court. According to Article 3 of Schedule of Costs, they are supposed to be reasonable and may include expenses for travel, accommodation, meals, and any other costs related to the conduct of proceedings. The Arbitration Court issues guidelines for arbitrators which, among other issues, address the accounting of such expenses. The Guidelines for Arbitrators 2014 of Arbitration Court of the Swiss Chambers' Arbitration Institution ["2014 Swiss Guidelines for Arbitrators"] provide for the reimbursement of *actual costs* for which receipts are submitted. These can be: travel expenses, hearing costs, interpreter, court reporter and translation services, courier, and any expert appointed by the tribunal.¹¹⁶ Besides these expenses, each member of tribunal is entitled to a flat-rate *per diem* allowance for personal living expenses.¹¹⁷

Similar guidelines are provided also by the DIS. The Guidelines for the Reimbursement of Arbitrators' Expenses 2005 allow for reimbursement of travelling expenses, expenses incurred by an arbitrator for a meeting in connection with arbitration, expenses for accommodation, and other expenses such as costs of meetings, mail and courier services, telecommunication services and photocopies. Another set of arbitration rules which

¹¹⁴ Article 814(1) of the Italian CCP; Article 37(1) of the Swedish AA; Article 28(1) of the 1996 EAA; Article 11(4) of the Croatian AA.

¹¹⁵ Konrad and Power, "Costs in International Arbitration - A Comparative Overview of Civil and Common Law Doctrines: Determination of Costs," 406.

¹¹⁶ Article 3(a) of the 2014 Guidelines for Arbitrators.

¹¹⁷ Article 3(c) of the 2014 Guidelines for Arbitrators.

provide for determination in accordance with the guidelines are the 2013 SIAC Rules. Under Article 32(2) of the 2013 SIAC Rules reasonable expenses are fixed by the Registrar and reimbursed in accordance with the 2014 Practice Notes for Administered Cases. Articles 16-19 of the 2014 SIAC Practice Notes provide for the reimbursement of out-of-pocket expenses, including travel expenses upon submission of the receipts, but also for payment of flat-rate allowance.

Other arbitration rules do not contain such a detailed approach, but they do recognize the right for the reimbursement of arbitrators' expenses. Under Article 37(1) of the 2012 ICC Rules, the expenses of the tribunal are determined by the ICC Court. The ICC Court states the amount of the personal expenses which have been determined as reimbursable by the Secretariat and paid to the arbitrators.¹¹⁸ The arbitrators are required, under the Secretariat' Note to the Arbitral Tribunal on the Conduct of the Arbitration, to submit the receipts before reimbursement.¹¹⁹

The 2014 LCIA Rules follow a similar approach. The LCIA Schedule of Costs provides that “[t]he Tribunal may also recover such expenses as are reasonably incurred in connection with the arbitration, and as are in a reasonable amount, provided that claims for expenses should be supported by invoices or receipts.” The reimbursable expenses are determined by the LCIA Court, as provided under Article 28(1) of the 2014 LCIA Rules.

II.1.3.2.d Costs for Experts and Other Assistants Appointed by an Arbitral Tribunal

The payment of the fees and expenses of the experts appointed by the tribunal is usually arranged by the tribunal. Article 43(1) of the 2013 Vienna Rules provides that “if the

¹¹⁸ Fry, Greenberg, and Mazza, *The Secretariat's Guide to ICC Arbitration*, 400.

¹¹⁹ *Ibid.*

arbitral tribunal considers certain procedural steps necessary that would have cost implications, such as the appointment of experts (...) the arbitral tribunal shall notify the Secretary General and arrange for these potential costs to be covered”.

Another arrangement for the payment of experts fees can be done by requiring the parties for an advance payment. Under Article 45(1) of the 2015 Zagreb Rules, the tribunal will, in agreement with the Permanent Arbitration Court Registrar, establish an advance payment to cover the costs of experts, and if the advance is not paid, the evidence will not be taken. Under the 2012 ICC Rules, the fees and expenses of any experts are also paid in advance by the parties, or one party, according to Article 1(12) of the Appendix III of the 2012 ICC Rules.

Another solution is for these fees and expenses to be paid out of advance payments already deposited. For example, under Article 21(5) of the 2014 LCIA Rules “*the fees and expenses of any expert appointed by the Arbitral Tribunal [...] shall be paid out of the deposits payable by the parties [...] and shall form part of the Arbitration Costs*”.

Other rules do not provide for any method of payment of these fees in advance, but they do recognize them as a part of procedural costs and provide for the possibility to reimburse them. Under Article 4 of the Appendix III of the 2010 SCC Rules, the expenses of any expert appointed by the tribunal may be included in the expenses of the arbitrators which are fixed by the Board. Under Article 40(4) of the 2012 Swiss Rules, the costs of expert advice and of any other assistance required by tribunal are set by tribunal and then submitted for the approval or adjustment by the Court. The 2014 Swiss Guidelines for Arbitrators provide that these costs will be reimbursable only if they are actual costs and only after the submission of a receipt or other proper substantiation for a receipt. Under the 2013 SIAC

Rules, the tribunal has the power to determine the reimbursable costs of expert advice and of other assistance required by it.

In *ad hoc* arbitration, the payment of the experts appointed by a tribunal is typically done also through the advance payment of their fees by the parties.¹²⁰ If one of the parties does not pay its share, tribunal will ask the other party to pay the advance in full.¹²¹ It is considered under some arbitration acts, such as under Section 37(1) of the 1996 EAA, that “[t]he fees and expenses of an expert [...] appointed by the tribunal for which the arbitrators are liable are expenses of the arbitrators”; however, they are still paid by the parties, as they are under Section 28(1) jointly and severally liable expenses of the arbitrators and the tribunal will usually find costs of an expert it appointed to be reasonable in their amount.¹²²

Besides the experts, the tribunal may appoint other assistants, such as an administrative secretary, or a court reporter. The determination of their fees and their recoverability is discussed in Chapter V [see **V.5.1**].

II.1.3.3 Filing Fee and Administrative Charges: Methods of Calculation and Refundability

There are two types of institution related fees - a filing fee and an administrative fee – which are payable to an arbitration institution. A filing fee is a fee payable at the beginning of the proceedings. This fee covers initial costs of the institution regarding the notification of the respondent of the arbitration proceedings and the constitution of a tribunal.¹²³ It accompanies

¹²⁰ Cremades and Mazuranic, “Costs in Arbitration,” 190.

¹²¹ Ibid.

¹²² Konrad and Power, “Costs in International Arbitration - A Comparative Overview of Civil and Common Law Doctrines: Determination of Costs,” 426.

¹²³ Cremades and Mazuranic, “Costs in Arbitration,” 175.

either the request for arbitration¹²⁴ or submission of a claim¹²⁵. Some rules specifically order the payment of the filing fee for submission of the counterclaim as well.¹²⁶

The filing fee covers the initial costs of processing the request for arbitration, usually until the constitution of the tribunal.¹²⁷ Therefore, if it is not paid, the proceedings upon this claim will not be continued, i.e. they will be terminated.¹²⁸

Administrative fee is usually part of the advance on costs, which it is intended to cover the costs of the arbitration through to the very end of the case.¹²⁹ Consequently, the payment of this fee, as well as the consequences of non-payment, is discussed in Chapter **III** and **IV**.

The filing (registration) fee is either set as a fixed amount, or it is charged according to the amount in dispute (*ad valorem* method). Arbitration rules which set the filing fee as a fixed amount are the 2012 ICC Rules¹³⁰, the 2014 LCIA Rules¹³¹, the Vienna Rules¹³², the SIAC Rules¹³³, the 2010 SCC Rules¹³⁴, and the 2015 Zagreb Rules¹³⁵, while the 1998 DIS Rules¹³⁶ provide for the *ad valorem* method. The 2012 Swiss Rules use the combination of these two methods. As an initial rule for the calculation of a filing fee, Swiss Rules accept the *ad valorem* method.¹³⁷ However, if the amount in the dispute is not determined, these rules

¹²⁴ Article 1(1) of the Appendix III of the 2012 ICC Rules; Article 1(i) of the Schedule of Fees of the 2014 LCIA Rules; Article 3(1) of the 2010 SCC Rules; Article 1(1) of the Appendix B of the 2012 Swiss Rules.

¹²⁵ Section 7(1) of the 1998 DIS Rules; Article 10(1) of the 2013 Vienna Rules.

¹²⁶ Sec. 11(1) of DIS Rules; 1(3) of the Appendix B of SWISS Rules.

¹²⁷ Fry, Greenberg, and Mazza, *The Secretariat's Guide to ICC Arbitration*, 362.

¹²⁸ Article 1(5) of the Appendix B of the 2012 Swiss Rules; Section 7(2) of the 1998 DIS Rules; Article 10(4) of the 2013 Vienna Rules; Article 3(2) of the 2010 SCC Rules.

¹²⁹ Fry, Greenberg, and Mazza, *The Secretariat's Guide to ICC Arbitration*, 362.

¹³⁰ Article 1(1) of the Appendix III of the 2012 ICC Rules.

¹³¹ Article 1 (i) of the Schedule of Arbitration Costs of the 2014 LCIA Rules.

¹³² Annex 3 of the 2013 Vienna Rules.

¹³³ Schedule of Fees of the 2013 SIAC Rules.

¹³⁴ Article 1(1) of the 2010 SCC Rules.

¹³⁵ Tariff no. 1 of Decision on the Costs of the CCE.

¹³⁶ Section 18 of the Appendix to Section 40 Subsection 5 of the 1998 DIS Rules.

¹³⁷ Article 1(1) of the Appendix B of the 2012 Swiss Rules.

provide for the fixed amount of the filing fee to be paid in that case.¹³⁸ Notwithstanding which one of the methods is to be applied, the parties are guaranteed predictability, since in both cases the parties can calculate in advance what their filing fee will be. This fee is usually non-refundable.¹³⁹ However, the ability to refund a filing fee can be used as a tool to promote an early settlement of the dispute. This is demonstrated in the 2014 ICDR Rules.

The 2014 ICDR Rules offer two schedules for the calculation of the institution's fees: Standard Fee Schedule and Flexible Fee Schedule. In both Schedules, the filing fee depends on the amount in the dispute. The Standard Fee Schedule provides for only the Initial Filing Fee payable at the moment of filing a claim or a counterclaim, while the Final Fee is payable only when a hearing is held. On the other hand, the Flexible Fee Schedule provides not only for the Initial Filing Fee and the Final Fee, but also for the Proceed Fee, which is payable within 90 days of filing a request for arbitration. The Initial Filing Fee and Proceed Fee can be considered as a payment of the filing fee in two installments.

The reasoning behind these two fee schedules is detectable only after one considers the ability to obtain a refund and the amounts of the Initial Filing Fee and the Proceed Fee. In the Standard Fee Schedule, the Initial Filing Fee is refundable. The Administrative Fee Schedule of the 2014 ICDR Rules provide for a Refund Schedule, in which the percentage of the refunded amount depends on the period of time in which the case was settled or withdrawn. The longest period in which the refund is still possible is 60 days after the filing. Only 25% of the filing fee can be reimbursed in that case.

On the other hand, the Flexible Fee Schedule does not allow any refund, either of the Initial Filing or of the Proceed Fee. However, it provides for a lower Filing Fee and in that

¹³⁸ Article 1(2) of the Appendix B of the 2012 Swiss Rules.

¹³⁹ Article 1(1) of the Appendix III of the 2012 ICC Rules; Article 1(i) of the Schedule of Costs of the 2014 LCIA Rules; The Schedule of Costs of the 2014 SIAC Rules; Article 10(3) of the 2013 Vienna Rules; Article 1(2) of the Appendix III of the 2010 SCC Rules; Article 1(1) of the Appendix B of the 2012 Swiss Rules.

way it implicitly promotes the settlement or the withdrawal of the case within the 90-day period before the payment of the Proceed Fee, subject to the loss of the Filing Fee. It depends on a party to choose which fee schedule suits it better. If there is a higher chance for the settlement, it should choose the Flexible Fee Schedule. If that is not a case, the Standard Fee Schedule is a better choice. This schedule provides for a higher Initial Filing Fee, but in the case of a scheduled hearing, the final fees will be lower. Also, in case of a settlement, the party will still have the possibility to get refund of certain amount.

The calculation of the administrative fee according to the amount in dispute is the prevailing method of calculation under the arbitration rules.¹⁴⁰ The 2014 LCIA Rules are an exception as they provide for a calculation of the administrative fee on the basis of the time spent by the Secretariat of the LCIA in the administration of the arbitration. The Schedule determines hourly rates for Registrar and other Secretariat personnel.¹⁴¹

The 2012 Swiss Rules provide as most of the rules for an *ad valorem* method, but with a certain particularity. Under the 2012 Swiss Rules, according to Article 2(2) of the Appendix B, the administrative fee is payable only if the amount in dispute exceeds the threshold of CHF 2,000,000. Another exception is the 1998 DIS Rules, since it does not provide for payment of the administrative fee at all.¹⁴²

Furthermore, an interesting method of calculation is provided in the 2015 Zagreb Rules, which only indirectly links the administrative fee to the amount in dispute. The

¹⁴⁰ Appendix III of the 2012 ICC Rules; Article 3 of the Appendix III of the 2010 SCC Rules; Scale of Arbitrator's Fee and Administrative Costs in Appendix B of the 2012 Swiss Rules; No. 18 under Appendix to the Section 40 Subsection 5 of the 1998 DIS Rules; Schedule of Fees of the 2013 SIAC Rules.

¹⁴¹ Schedule of Arbitration Costs of the 2014 LCIA Rules also provides for calculation of other administrative charges. Time spent by the members of the LCIA Court in carrying out their functions in deciding any challenge brought under the applicable rules is charged at hourly rates advised by members of the LCIA Court (Article 1(iii)). Also, a sum equivalent to 5% of the fees of the Tribunal (excluding expenses) with respect to the LCIA's general overhead has to be paid (Article 1(iv)).

¹⁴² DIS Rules provide for the payment of a fee called "administrative fee" (Sec. 7(1) and 11(1)). However, this is a filing fee in the sense that it is paid upon the filing of a claim or a counterclaim and the non-payment leads to termination of the proceedings (in a case of a claim) or presumption that the counterclaim was not filed.

administrative fee is calculated as a percentage of the arbitrator's fee – 20% of the fee of sole arbitrator, or 10% of the fees of the tribunal.¹⁴³ Since the fees of the arbitrators are based on the amount in dispute, the administrative fee reflects it indirectly as well.

II.2 National Courts' Scrutiny over the Determination of Procedural Costs

The strong pro-arbitration approach, which highly influenced arbitration-related regulation and jurisprudence after the adoption of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards in 1958 ["New York Convention"], resulted in the reduction and limitation of court scrutiny over arbitration. This limitation and the well-developed *kompetenz-kompetenz* doctrine gradually led to the shift of national court's focus from the stage of the commencement of arbitration to the control of a final result of it, i.e. arbitral award. In the meantime, the pro-arbitration approach became legitimate part of today's legal reality, so it receives a fair share of its own criticism now.¹⁴⁴ Moreover, arbitration in general is undergoing changes which might undermine its legitimacy, or at least be a severe drawback in its development.¹⁴⁵

Disputes regarding the arbitrators' fees and other costs of arbitration are one of the drawbacks which might undermine the legitimacy of arbitral proceedings. As it will be shown throughout this study, the problem-solving is almost always focused on the inter-arbitration regulation instruments, i.e. party autonomy, tribunal's procedural flexibility, and arbitration

¹⁴³ Tariff no. 6 of the Decision on the Costs of the CCE.

¹⁴⁴ Várady, "What Is Pro-Arbitration Today?"

¹⁴⁵ While once marked as cheap, and speedy, arbitration today is no longer enjoying these attributes, at least not as the main advantages. See in: Tibor Várady, "What Is Pro-Arbitration Today?," *Croatian Arbitration Yearbook* 21/22 (2015 2014): 9–10; Gary B. Born, *International Commercial Arbitration* (Kluwer Law International, 2014), 86; Joerg Risse, "Ten Drastic Proposals for Saving Time and Costs in Arbitral Proceedings," *Arbitration International* 29, no. 3: 453. Having these developments in mind, it does not come as surprise then that in a survey conducted in 2015 "costs" are listed as a number one arbitration's worst feature, and followed by "lack of effective sanctions during the arbitral process", "lack of insight into arbitrators' efficiency", and "lack of speed". See in: Queen Mary and White & Case, "2015 International Arbitration Survey: Improvements and Innovations in International Arbitration," 2, 7.

rules. The study presented in this and in other Chapters tests whether the formerly juxtaposed principle of extensive court control and the pro-arbitration approach at this point of the development of arbitration law have developed common grounds. In other words, whether there is a need to foster trust and to harmonize the national courts' supervisory and assistance powers related to arbitration, more specifically in regard to disputes related to costs.

II.2.1 Challenge of the Decision on Costs in the Ordinary Course before the National Courts

II.2.1.1 National Courts' Power to Set or Adjust the Fees of the Tribunal

Setting the tribunal's fees by a national court takes place when the amount of the fees is not agreed by the parties and the arbitrator. Article 814(2) of the Italian CCP, for example, provides that "*where the arbitrators themselves fix the amount of the expenses and the fee, their decision shall not be binding upon the parties if they do not accept it*". In that case, the same article states that the amount of the expenses and the fee shall be determined by an order of the president of the court in whose district the arbitration has its seat, upon the arbitrators' petition and after hearing the parties. Under the Italian CCP, the parties have no right to file a petition, but they can only not accept arbitrators' decision on their fees. It is on the arbitrators to turn to the court and ask for a decision on this matter. Furthermore, the parties can only disagree with the decision on the fees if it is rendered by the "arbitrators themselves". This would exclude such a challenge if the fees are determined by an arbitration institution.

The adjustment of the arbitrators' fees, on the other hand, is done after the fees have already been set. It is, however, considered that the court's power to adjust the fees implies

the power to set them as well.¹⁴⁶ The usual reason for the adjustment of the arbitrator's fees is the reduction of excessive fees, but it might also be the reduction of the fees due to the procedural failure made by the tribunal.¹⁴⁷ A court which adjusts or sets the fees scrutinizes the agreement, or substitutes the lack of the agreement between the parties and arbitrators.

Section 28(2) of the 1996 EAA provides that “*any party may apply to the court (upon notice to the other parties and to the arbitrators) which may order that the amount of the arbitrators' fees and expenses shall be considered and adjusted by such means and upon such terms as it may direct*”. This section deals with the question whether the fees of the arbitrators are reasonable in the absence of any express agreement on the matter.¹⁴⁸ It provides for the possibility for the parties to ask from the court to adjust the arbitrators' fees when they consider them to be unreasonably high. It does not, however, give the same right to the arbitrators when the parties want them to agree on lower fees.

The arbitrators, however, have an indirect right to pursue higher fees they find to be reasonable. Section 56(1) of the 1996 EAA allows them to “*refuse to deliver an award to the parties except upon full payment of the fees and expenses of the arbitrators*”. The burden is again on the parties to address the court under Section 56(2), but the court “*may order that the tribunal shall deliver the award on the payment into court by the applicant of the fees and expenses demanded*.” This section does not guarantee the arbitrators that they will be paid the amount they demand, since according to Section 56(3) of the 1996 EAA the assessment of the payable amount will be made in accordance with Section 28 and any agreement relating to the payment of the arbitrators. Therefore, they may be paid even less than they demanded.

¹⁴⁶ Várady, “Remuneration of Arbitrators as a Threshold Issues: Economic Sense and Procedural Realities,” 595.

¹⁴⁷ Fouchard, “Relationship Between the Arbitrator and the Parties and the Arbitral Institution,” para. 26.

¹⁴⁸ Robert Merkin and Louis Flannery, eds., *Arbitration Act 1996*, 4th ed. (London: Informa, 2008), 73.

Nevertheless, this right gives them the opportunity to indirectly ask for the assessment of their fees by the court.

The Swedish AA gives this right to both the arbitrators and the parties. But unlike the 1996 EAA, according to Section 40, the Swedish AA gives no right to the arbitrators to withhold the award pending the payment of the compensation. Therefore, Section 41(1) states, “*a party or an arbitrator may bring an action in the District Court against the award regarding the payment of compensation to the arbitrators*”. This claim can be brought “*within three months from the date upon which the party received the award and, in the case of an arbitrator, within the same period from the announcement of the award*”. The Swedish AA demands that the award itself must contain clear instructions regarding what should be done in order to bring such a claim. According to Section 41(2), the decision that the court made upon such a claim, by which the fees of an arbitrator are reduced, is binding also on the party that did not bring the action.

Under the German doctrine it is considered that the court’s power to adjust the fees of the tribunal is provided in Section 315 of the German Civil Code [“German CC”].¹⁴⁹ Paragraph 1 of this Section provides:

“Where performance is to be specified by one of the parties to the contract, then in case of doubt it is to be assumed that the specification is to be made at the reasonably exercised discretion of the party making it.”

This specification is considered to be declaratory, according to Section 315(2) of the GCC. According to paragraph 3, the specification should be equitable to be binding on the other party; otherwise it will be made by judicial decision.

¹⁴⁹ von Schlabrendorff and Sessler, “Part II – Commentary on the German Arbitration Law (10th Book of the German Code of Civil Procedure), Chapter VI Making of the Award and Termination of the Proceedings, § 1057 – Decision on Costs,” 2007, 421; Várady, “Remuneration of Arbitrators as a Threshold Issues: Economic Sense and Procedural Realities,” 594.

In Austria, the challenge of the amount of the fees is possible through court's review under Section 36 of the Enforcement Act.¹⁵⁰ The fees will be successfully challenged only if they are not in accordance with Section 879 of the Austrian Civil Code, which states that a contract is void if it violates a legal prohibition or is against public policy.¹⁵¹

Some legal scholars exclude the applicability of these challenges of decision on fees provided by the national laws in cases of institutional arbitration, since the parties are deemed to be aware of the amount of the arbitrators' fees when agreeing on arbitration rules.¹⁵² This might be an acceptable solution in a case where the costs, especially fees of the tribunal, are determined by the arbitration institution as a third party in accordance with the schedule of costs, preferably set in accordance with the amount in the dispute agreed by the parties. In that case, the parties and the arbitrators have agreed to a method (schedule relating to the amount in the dispute) and terms (determination by a designated third party) of the determination of the fees.

The revision of the equitability of such fees should be available in cases where the tribunal decides on its own fees.¹⁵³ The same conclusion should prevail in cases of institutional arbitration where the amount in dispute is set by the parties, but there is discretion between the minimum and maximum fees that can be charged related to that amount.¹⁵⁴ In the end, even if the arbitration institution decides on the amount of the fees, the recourse to the court should be possible if the institution is acting unreasonably.¹⁵⁵

¹⁵⁰ Konrad and Power, "Costs in International Arbitration - A Comparative Overview of Civil and Common Law Doctrines: Determination of Costs," 417.

¹⁵¹ Ibid., 418.

¹⁵² Fouchard, Gaillard & Goldman on *International Commercial Arbitration*, Kluwer Law International (1999), pp. 625-626.

¹⁵³ Under the German doctrine and jurisprudence, the tribunal will, otherwise, render the decision *in rem suam* and violate public policy. See in: von Schlabrendorff and Sessler, "Part II – Commentary on the German Arbitration Law (10th Book of the German Code of Civil Procedure), Chapter VI Making of the Award and Termination of the Proceedings, § 1057 – Decision on Costs," 2007, 418.

¹⁵⁴ Ibid., 418–19. The authors pointed out that; "(...) in order to avoid any uncertainties, if this issue is not fully regulated in any applicable institutional arbitration rules, it is advisable for the arbitrators to explicitly fix page

The Swedish Supreme Court allowed a challenge of the fees under Section 41 even when an institution set them.¹⁵⁶ The proposal for the reform of the Swedish AA which was made by a parliamentary committee appointed in 2014 concluded that there are strong arguments in favour of introducing an exception to the right to bring this action in cases where the compensation was set by an arbitration institution.¹⁵⁷

The court scrutiny over the arbitrators' fees can be substituted in *ad hoc* settings through the party agreement on the 2013 UNCITRAL Rules, which provide for two-level review at the stage of the determination of the fees and expenses. In other words, when the parties opt for these rules, they have designed the process of scrutiny over the arbitrators' fees by themselves. These reviews, however, were introduced only in 2010 reform of the UNCITRAL Rules.¹⁵⁸ Prior to that, there was no review of the amount of the arbitrators' fees and expenses set by the arbitral tribunal, which was highly criticized.¹⁵⁹ The first review is the review of the tribunal's proposal as to the method of calculation of the fees, which was analysed under **II.1.3.2.a**.

The second one is the review of the final amount of the fixed fees and expenses. Under Article 41 of the 2013 UNCITRAL Rules, "*within 15 days of receiving the arbitral tribunal's determination of fees and expenses, any party may refer for review such determination to the appointing authority.*" If the appointing authority or the Secretary-

their fees or the amount in dispute in agreement with the parties at an early stage of the arbitral proceedings. Many institutional arbitration rules include a detailed schedule of costs. If such rules provide for arbitrators' fees as a percentage of the amount at stake and do insofar not leave any discretion in the amount of fees due a reference to such rules can be sufficient to establish such an agreement, provided the amount in dispute has been fixed."

¹⁵⁵ Waincymer, *Procedure and Evidence in International Arbitration*, 1252.

¹⁵⁶ Case No. Ö 4227-06/NJA 2008 s. 1118 (Supreme Court of Sweden 2008).

¹⁵⁷ Anja Havedal Ipp, "Time to Upgrade: Review of the Swedish Arbitration Act," October 17, 2015, <http://kluwerarbitrationblog.com/2015/10/17/time-to-upgrade-review-of-the-swedish-arbitration-act/>. The summary of the committee's proposal in English can be found here: <http://www.sccinstitute.com/about-the-scc/news/2015/proposals-to-update-the-swedish-arbitration-act/>.

¹⁵⁸ Born, *International Commercial Arbitration*, 2019.

¹⁵⁹ *Ibid.*

General of the PCA, in case the parties have not designated the appointing authority, finds that the arbitral tribunal's determination is inconsistent with the arbitral tribunal's proposal or is otherwise manifestly excessive, it shall adjust the arbitral tribunal's determination, and any such adjustments shall be binding upon the arbitral tribunal.

II.2.1.2 National Courts' Power to Decide on the Recoverability of the Costs of the Arbitration

Sections 63 and 64 of the 1996 EAA bestow the power to decide on the recoverability of the costs of arbitration with English courts. Section 63 states that unless it is otherwise agreed by the parties, the tribunal is to decide on the recoverable costs in arbitration. If the tribunal does not decide, any party may apply to the court and ask for determination of the recoverable costs. The court's assessment of the recoverable costs is subject to a tribunal's decision, except in the case of the fees of the tribunal, which remain subject to court's assessment even if the tribunal already decided on the matter.¹⁶⁰ Section 64 of the EAA governs the assessment of the tribunal's fees.

According to Section 64(2) of the 1996 EAA, "*the recoverable costs (...) shall include in respect of the fees and expenses of the arbitrators only such reasonable fee and expenses as are appropriate in the circumstances*". Section 64(3) allows the assessment of the fees and expenses of the arbitrators if they are not "*the matter (...) already before the court on an application under section 63(4)*". In other words, the recoverability of the fees of the tribunal can be assessed either under Section 63(4) (when the tribunal did not decide upon this issue at all) or under Section 64(3) (after it was decided by the tribunal itself).

¹⁶⁰ Hunter M. And Landau T., *The English Arbitration Act 1996, Text and Notes*, Kluwer Law International, 1998, p. 52.

The distinction between court's powers under Section 64(2) and the one under Section 28 and 56 is that under this Section court does not deal with the agreement on the fees between the arbitrators and parties.¹⁶¹ It deals with the amount that can be reimbursed and the allocation of the same between the parties.¹⁶²

II.2.2 Challenge of the Decision on Costs in the Proceedings for Setting Aside of the Award before National Courts

The previous section dealt with challenges of the decision on costs in the ordinary course before the national courts. These recourses can be made in most cases either before or after the award was made. However, when law does not provide for such recourse at all, or when it provides it only as recourse to the court before the award is rendered, challenge of the decision on costs is still possible in the proceedings for setting aside the award.

There are two situations which need to be distinguished. The decision on costs can be either directly or indirectly challenged.

¹⁶¹ Merkin and Flannery, *Arbitration Act 1996*, 147.

¹⁶² *Ibid.*

II.2.2.1 Indirect Challenge of the Decision on Costs

An indirect challenge takes place when the challenge does not address the part of the award dealing with the costs. If the award is successfully challenged, the decision on costs will follow its destiny, notwithstanding the fact that it is rendered as a part of the award or in separate award.¹⁶³ The same conclusion is reached when the award is only partially set aside.¹⁶⁴

The successful challenge of the award, depending on the grounds on which it was based may have one more important effect on the fees of the tribunal – their reduction. Namely, the French and the Italian jurisprudence found that an arbitrator's fees might be reduced or completely refunded to the parties in a case where the challenge was successful due to their procedural error.¹⁶⁵

II.2.2.2 Direct Challenge of the Decision on Costs

A direct challenge of the decision on the costs consists either of challenging the part of the award dealing with the costs, or a separate award rendered on this issue.¹⁶⁶ Under Austrian law this is the only recourse to court that can be made regarding the decision on costs after the award is rendered.¹⁶⁷ Article 611(1) of the Austrian CCP provides that

¹⁶³ von Schlabrendorff and Sessler, "Part II – Commentary on the German Arbitration Law (10th Book of the German Code of Civil Procedure), Chapter VI Making of the Award and Termination of the Proceedings, § 1057 – Decision on Costs," 2015, 376.

¹⁶⁴ Ibid.; Micha Bühler and Marco Stacher, "Costs in International Arbitration," in *Arbitration in Switzerland: The Practitioner's Guide* (Kluwer Law International, 2013), 1391.

¹⁶⁵ Fouchard, "Relationship Between the Arbitrator and the Parties and the Arbitral Institution," para. 26.

¹⁶⁶ von Schlabrendorff and Sessler, "Part II – Commentary on the German Arbitration Law (10th Book of the German Code of Civil Procedure), Chapter VI Making of the Award and Termination of the Proceedings, § 1057 – Decision on Costs," 2015, 376.

¹⁶⁷ Konrad and Power, "Costs in International Arbitration - A Comparative Overview of Civil and Common Law Doctrines: Determination of Costs," 416–17.

“recourse to a court against an arbitral award may be made only by means of an action for setting aside.” German law contains a similar provision. Section 1059(1) of the German CCP states that “only a petition for reversal of the arbitration award by a court (...) may be filed against an arbitration award.” However, according to the decision of the German Federal Court of Justice rendered in 2012 [see **II.1.2.2.a**], the issue of excessive arbitrator’s fees is to be solved before a national court in ordinary proceedings. These two procedures are more complementary than conflicting. Since, as shown above, the tribunal’s decision on their own fees is considered binding between the parties, but it does not provide an enforceable title for arbitrators, the decision as to the amount of their fees is considered to be outside of their mandate and therefore it is not an appealable “award” in its true sense. On the other side, the tribunal’s decision as to the allocation of the costs of the arbitration and on the quantification, i.e. recoverability, of party costs is within its mandate [see Chapter **V**] and it can therefore be challenged as an *award*.

Similarly, the 1996 EAA and the Swedish AA allow the challenge of the decision on costs both in the proceedings for setting aside the award as well as in the recourse through the ordinary action before national courts granted by these acts in regard to the amount of arbitrators’ fees.¹⁶⁸ All three types of decision on costs are subject to a plausible challenge – the decision on the amount of the costs (except for the arbitrators’ fees and expenses), the decision on the allocation, and the decision on recoverability. The question is – on which grounds can a decision on costs be challenged? National acts usually provide closed lists of the grounds for challenging the award.¹⁶⁹ Not all of these grounds can be invoked against the decision on costs.

¹⁶⁸ Section 41 of the Swedish AA; Section 64 of the 1996 EAA.

¹⁶⁹ Merkin and Flannery, *Arbitration Act 1996*, 156.

One of the possible grounds is the violation of public policy. One possible violation of public policy is rendering the decision *in causa sua*, as it was previously recognized in German jurisprudence.¹⁷⁰ In France, if arbitrators decide on their own fees without an agreement with the parties, their decision will be considered to be a decision in their own matter.¹⁷¹ However, since the prevailing approach is that in those situations such a decision will not be considered binding on the parties since the arbitrators decided outside the scope of their mandate, or if the parties who paid an excessive amount will be referred to *ordinary* procedure before national courts, this claim plays a non-significant role.

There are other claims that can be made under public policy ground. In Germany, but also in other jurisdictions according to scholarly writing, a violation of public policy can be found in those situations where the party is deprived of its right to be heard by not being allowed to submit the statements regarding the costs.¹⁷² The violation of the right to be heard under other national acts can be invoked as a separate ground. In England and Wales, a violation of the right to be heard can take place, for example, when the parties were not allowed to make representations: regarding the limitations of the costs, the security for the costs, or the liability and determination of recoverable costs.¹⁷³

Another ground for challenging the decision on costs can be a failure to render the decision on costs.¹⁷⁴ This ground can be, for example, invoked under Section 68(2)(d) of the 1996 EAA. The decision on costs can also be challenged for not being within the jurisdiction

¹⁷⁰ von Schlabrendorff and Sessler, “Part II – Commentary on the German Arbitration Law (10th Book of the German Code of Civil Procedure), Chapter VI Making of the Award and Termination of the Proceedings, § 1057 – Decision on Costs,” 2015, 367.

¹⁷¹ Fouchard P., Relationship Between the Arbitrator and the Parties and the Arbitral Institution, ICC ICArb. Bull. 12-23 (Supp. 1995) in Varady T., Barcelo J et. Al., International Commercial Arbitration, 5th edition, West, 2012, p. 379.

¹⁷² von Schlabrendorff and Sessler, “Part II – Commentary on the German Arbitration Law (10th Book of the German Code of Civil Procedure), Chapter VI Making of the Award and Termination of the Proceedings, § 1057 – Decision on Costs,” 2015, 375; Waincymer, *Procedure and Evidence in International Arbitration*, 1261.

¹⁷³ O’Reilly, *Costs in Arbitration Proceedings*, 128.

¹⁷⁴ *Ibid.*, 129; Waincymer, *Procedure and Evidence in International Arbitration*, 1261.

of the tribunal.¹⁷⁵ Such a challenge was made in the Qiagen case¹⁷⁶, where the party challenged the tribunal's power to shift the legal costs on the grounds that by doing so that it exceeded its powers. The court did not set aside the decision, since the applicable rules in that case provided for the tribunal's power to allocate the legal costs. Besides this ground, an improper allocation of the costs can be invoked as a separate ground to challenge the decision on costs, as it will be discussed in Chapter V.

II.3 Conclusions on Chapter II

The main focus of Chapter II was on raising awareness of the importance of concluding a valid tripartite agreement. A tripartite agreement is an agreement between the parties and the arbitrators. The choice of the method of the calculation of procedural costs, including arbitrators' fees, and their final amount has to be in every case based on such an agreement. Turkey stands out as a peculiar system in which the arbitrator's fees, in absence of the agreement with the parties, are calculated in accordance by tariff provided annually by the state.¹⁷⁷ Other jurisdictions, as those analysed in this chapter, leave it open for the parties to negotiate with the arbitrator(s).

In that regard, it was shown in this Chapter how the lack of regulation and discussion in the doctrine regarding the process of the determination of procedural costs results with many unsettled legal issues which can jeopardize the legitimacy of arbitration. Admittedly, a

¹⁷⁵ O'Reilly, *Costs in Arbitration Proceedings*, 129.

¹⁷⁶ *F. Hoffmann-La Roche Ltd., et al. v. Qiagen Gaithersburg, Inc.*, 2010 U.S. Dist. LEXIS 81374, No. 09 Civ 7326 (WHP) & No. 09 Civ 7396 (WHP) (SD N.Y., August 11, 2010).

¹⁷⁷ Ergun Özsunay and Murat R. Özsunay, "Arbitration in Turkey: Analysis of the Turkish Legislation on Arbitration in the Lights of the UNCITRAL Model Law," 23, accessed March 30, 2016, http://www.ispramed.it/root/wp-content/uploads/2012/10/ICC-TURK.ARB_.pdf.

certain level of harmonization of the rules regarding the process of determination of procedural costs is already achieved in institutional arbitration. However, in *ad hoc* settings, there are legal issues which stem from the lack of regulation of a tripartite agreement in national laws. A tripartite agreement, i.e. agreement between the parties and the arbitrators, is a basis for the determination of arbitrators' fees.

Legal issues analysed in this Chapter stem mainly from the lack of consent of one or both parties as to the amount of procedural costs, especially of the arbitrators' fees. For example, if the arbitrators try to impose an amount of their fees in the award on any of the parties, there is a risk of rendering a decision *in causa sua*. The jurisprudence found this decision-making to be outside of the scope of arbitration agreement and against public policy, for example, in Switzerland. Similarly, the German court confirmed that *res judicata* effect of the award is limited only to the parties. Hence, the arbitrators cannot benefit from enforcing the award in which they set their own fees.

The English jurisprudence dealt in detail with another issues - one-sided agreements, i.e. agreements between an arbitrator and only one of the parties, regarding the amount or the payment of specific arbitrators fee. The *Norjarl*, *Turner*, and *Andrews* case unilaterally condemned the one-sided agreements as undesirable, especially after the appointment is accepted, and confirmed that they can be used as grounds for the challenge of the arbitrator who concluded it. Again, the lack of regulation of the tripartite agreement can be pointed out as the sole basis why these issues were so widely discussed and why some of them reached the highest courts within respective jurisdiction. As long as is stays this way, the arbitrator's entitlement to fees and expenses, which she or he may draw from the tripartite agreement, will stay highly disputed.

The improvement of regulation in this regard is not the only way to address these concerns. In the second part of Chapter II another solution is presented - court scrutiny over decisions on costs. As the disputes regarding the arbitrators' fees, which arise under the tripartite agreement, are not within the tribunal's jurisdiction, the proper forum before which these issues should be brought is a national court. This seems to be an accepted solution in all the analysed jurisdictions. It is suggested, however, at this point to promote such court assistance instead of nurturing the old-fashion hostility between national judges and arbitrators. The standards of national courts as to the setting and adjustment of the fees are less problematic in any case than their power to scrutinize the final allocation of costs. This is discussed in Chapter V.

CHAPTER III

DETERMINATION AND ENFORCEMENT OF THE OBLIGATION TO PAY THE ADVANCE ON COSTS IN INTERNATIONAL COMMERCIAL ARBITRATION

The advance on costs is one of the critically important features of arbitration. It serves the purpose of ensuring the payment of the arbitrators' fees and expenses, and administrative charges, when the proceedings are administered by an institution. Unlike in litigation, where judges are public officials performing their duties without any dependence on the parties' funding, in arbitration all the costs of the arbitration are funded by the parties, as explained in **Chapter II**.

The process to determine the advance on costs is a just one stage of the determination of the procedural costs in arbitration. The advance on costs is set at the beginning of the proceedings by an arbitral tribunal or a body of an arbitration institution, as it was explained above and will be analysed in more details below. While the method of calculating and the process of the determining the advance are regulated in detail in institutional arbitration, the enforcement of an obligation to pay, and consequences of the failure to pay are not thoroughly regulated either in arbitration laws or in arbitration rules. Not only does the lack of regulation on this matter causes practical problems when a party fails to pay its share of the advance, but it also involves theoretical considerations as to the nature of the obligation to pay the advance.

As it will be shown below, certain arbitration institutions give more attention to the issue of the non-payment and they provide more detailed rules. The regulation of this issue by only a few of arbitration institutions confirms that the solutions are scattered and non-uniformed. In *ad hoc* settings as well as in institutional arbitration when the enforcement of

an obligation to pay and the consequences of the failure to pay are not thoroughly regulated, the solution of these issues depends on the applicable national law. The applicable law will depend on the qualification of the legal issue, and as it will be shown below, the arbitral and judicial practice have developed several approaches as to the enforcement of the obligation to pay the advance. In any case, even when an arbitral tribunal or a court has the power to impose the payment of the advance, the enforcement of such decisions might be questionable.

This chapter will analyse all the issues briefly presented in this introduction in order to establish the level of the harmonization of national approaches achieved, if any. It starts with an overview of the rules regarding the determination and consequences of the payment of the advance on costs [III.1]. The second part focuses on the national approaches as to the enforcement of the obligation to pay the advance, and it also discusses which forum is or should be competent to hear the advance related claims [III.2]. The analysis in Part 2 also determines the nature of the decision which would be rendered in these cases, which is discussed in more details in the third part of this chapter, together with the pertaining legal issues as to the enforcement of such decisions [III.3].

III.1 Determination, Purpose of the Advance on Costs and the Consequences of the Non-Payment of the Advance on Costs

III.1.1 Determination and Purpose of the Advance on Costs

The advance on costs is a designed means of assuring the payment of the procedural costs of arbitration, and to finance the administration of the proceedings in institutional arbitration, by determining the amount of anticipated costs at the beginning of the

proceedings, and requesting the parties to deposit it in equal shares.¹⁷⁸ The amount set as the advance is only temporarily determined, i.e. it is provisional, and it does not represent the final amount to be paid to the arbitrators or the institution. Its provisional nature stems from the possibility to be adjusted throughout the proceedings, and the final amount of the procedural costs may be higher or lower than the set advance.¹⁷⁹ In case it is lower, the amount in excess of the actual procedural costs will be reimbursed to the parties.¹⁸⁰ Also, the apportionment of the shares of the advance between the parties does not in any way influence the final allocation of the costs in the final award.¹⁸¹

National laws rarely provide for the payment of the advance on costs, while in the practice developed in international arbitration, the payment of the advance is regularly sought as a condition for the arbitrators to be ready to continue with the proceedings.¹⁸² As shown in Chapter II, cost provisions in national law identify who has the power to determine, i.e. fix, the amount of procedural costs, and the same Chapter analyses the legal source of the obligation to pay and the method for the calculation of procedural costs, which are eventually allocated in the last award. The methods of calculation regularly overlap with the methods for the calculation of the advance as well, while the legal basis for the payment of the procedural costs in general and for the payment of costs are different. The source of the parties' substantive obligation to pay the procedural costs is a tripartite agreement, either with the arbitrators or the arbitration institution, depending on the type of the procedural costs in

¹⁷⁸ For example see: Section 25 of the 1998 DIS Rules; Article 36(2) of the 2012 ICC Rules; Article 24(1) of the 2014 LCIA Rules; Article 41(1) of the 2012 Swiss Rules.

¹⁷⁹ The advance is subject to readjustment, if needed. See: Article 36(5) of the 2012 ICC Rules, Section 25 of the 1998 DIS Rules, Article 41(3) of the 2012 Swiss Rules, Article 24(1) of the 2014 LCIA Rules; Article 30(4) of the 2013 SIAC Rules.

¹⁸⁰ For example, see Article 41(5) of the Swiss Rules; See also: Jacob Grierson and Annet van Hooft, *Arbitrating under the 2012 ICC Rules* (Kluwer Law International, 2012), 142.

¹⁸¹ Bühler, "Non-Payment of the Advance on Costs by the Respondent Party – Is There Really a Remedy?," 291; Grierson and van Hooft, *Arbitrating under the 2012 ICC Rules*, 139.

¹⁸² Tamminen, "The Obligation to Pay the Advance on Costs under the Vienna Rules and Austrian Law," 282.

question. The source of the obligation to pay a share of the advance on costs in arbitration and its nature is discussed under the following part of this Chapter [III.2].

Therefore, the process determining the advance overlaps to a certain extent with the process of fixing the procedural costs. However, little can be found in national laws on the payment of the advance. To be precise, it can be stated that national laws focus primarily on the tribunal's power to decide on the recoverability of party costs and to allocate the costs of the arbitration in the last award, rather than on the earlier stages of the proceedings. Arbitration rules, as a reflection of the parties' autonomy, provide much more on this matter. This Part presents only an overview of the provisions on the advance and the method of calculation, with a special focus on the legal basis for the payment of the advance, and the consequences of the non-payment. This remaining portion of this Section deals with the nature and the enforcement of the obligation to pay the advance [III.2].

Only Section 38 of the Swedish AA provides for the tribunal's right to request and fix the security for their compensation, and they can realise the payment from such a security when the award in regard to their fees becomes enforceable, and the parties fail to fulfil their payment obligations in accordance with the award. In other jurisdictions, arbitration laws do not explicitly regulate this arbitrators' right. This does not mean that the advance on costs cannot be required by the arbitrators in other jurisdictions. It is, however, a completely different issue whether they can *order* the payment. In Switzerland, for example, the stance of the doctrine and jurisprudence is that the tribunal may render only a binding decision on the allocation of the costs of arbitration, but it cannot render a binding award ordering payment of their fees.¹⁸³

¹⁸³ Philippe Bärtsch and Dorothee Schramm, *Arbitration Law of Switzerland: Practice and Procedure* (JurisNet, LLC, 2014), 72.

Unlike in institutional arbitration where the payment of the advance is regulated by the chosen arbitration rules to which parties agreed, in *ad hoc* settings it is much more debated what is the source for the arbitrators' right to request and the parties' obligation to pay the advance. As mentioned, national arbitration laws do not usually provide for such obligation. If the parties do not choose some other arbitration rules to be applied in *ad hoc* arbitration, such as the 2013 UNCITRAL Rules, which oblige them to pay advance, the questions are whether the advance can be requested and is there an obligation to pay it at all.

The doctrine recognizes several legal grounds for such an obligation. Beside the national arbitration laws and arbitration rules which were already mentioned, these grounds can be grouped in the following way: (1) the parties explicitly provided for such obligation in their agreement with the arbitrators, (2) the parties explicitly provided for such an obligation in their arbitration agreement, or (3) if such an obligation was not explicitly provided in the arbitrator's contract (i.e. the tripartite agreement), the parties' obligation may be constructed on the basis of certain national laws' provisions as a default mechanism, or from the generally accepted principle of conducting the proceedings they agreed to in good faith.¹⁸⁴

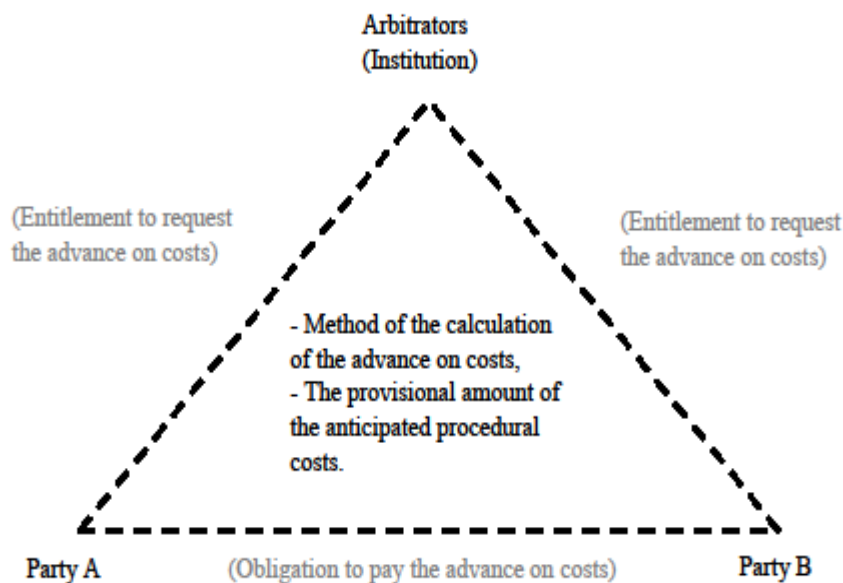
The legal basis mentioned under the third point function as a default mechanism in the absence of the explicit agreement as to the payment of the advance. For example, under Austrian law, the tripartite agreement is qualified as a contract for services, and the parties' obligation to pay the advance may be based on Section 1170 of the Austrian Civil Code, which allows contractors to claim a reasonable part of its remuneration and expenses in advance.¹⁸⁵ If such a construction is not possible under the applicable law, it is still considered that the payment of the advance should be in accordance with the principle of

¹⁸⁴ Tamminen, "The Obligation to Pay the Advance on Costs under the Vienna Rules and Austrian Law," 284–88.

¹⁸⁵ *Ibid.*, 283.

good faith, which means that a party, once it consented to arbitration, should not do anything to hamper those proceedings.¹⁸⁶

Furthermore, while the legal basis named under the first and third point share a common ground for the tribunal's right to request and the parties' obligation to pay – the tripartite agreement, the second basis, i.e. the parties' arbitration agreement, seemingly does not fit into this picture. The graph of the contractual relations under the first and third point is shown here:



Graph 1

As the graph shows, same as the basis for setting the final amount of the procedural costs, the source or the base for the arbitrators' right to request the advance, and the parties' obligation to pay is a tripartite agreement. The first point listed above mentions it explicitly, while under the third point, such parties' obligation is either provided as a default rule under the applicable law or it is considered an implied term of the tripartite agreement. In any case, the

¹⁸⁶ Ibid., 286; Bühler, "Non-Payment of the Advance on Costs by the Respondent Party – Is There Really a Remedy?," 292.

tripartite agreement is the source of the obligation to pay the advance, and the arbitrators' right to request it.

The second point, however, does not fit in this graph. Namely, even if the parties agreed to pay in their agreement in *ad hoc* proceedings, although highly unconceivable since the payment of the advance is in arbitrators' interest, the parties' agreement would provide no entitlement for the arbitrators to request it, but would only provide for a party's obligation undertaken towards each other.¹⁸⁷ The arbitrators would need to turn again to the implied terms of the tripartite agreement or to national law governing their contract with the parties.

Whichever ground is accepted as the underlying basis, this only sets the obligation for the parties to pay the advance on costs. It does not define the nature of such obligation, i.e. whether it is a substantive obligation or only a procedural duty, not does it obligate the parties to pay any specific amount. As it was shown above, the tribunal's or institution's power to determine the final amount of costs is not absolute. The amount of the costs is based on the agreement between the parties and the tribunal (institution). The process of the determination of the amount of the advance enjoys several differences from the calculation of the final amount of costs. Firstly, the nature of the advance on costs is provisional, unlike the payment of the final amount of procedural costs, which was discussed under the previous Chapter. Hence, the question is whether the parties, who initially undertook the obligation to pay the advance, are obliged to pay any amount set. This can be specifically problematic issue when the obligation to pay the advance is construed under the good faith principle or in institutional arbitration without a cost schedule. However, arbitrators or arbitration institutions are not entitled to *order* payment of the advance to the parties [see **II.1.2**]. The only option they may exercise is to retain the performance of their part of the contract, or to perform it without

¹⁸⁷ Similarly argued in: Tamminen, "The Obligation to Pay the Advance on Costs under the Vienna Rules and Austrian Law," 284.

payment of the advance.¹⁸⁸ This may lead to the conclusion that the parties may be obliged to pay the advance, but not *any* amount set as the advance, and it leaves the parties without access to arbitral tribunal with their claims. On the other hand, it can be argued that the arbitrators are obliged to continue with the proceedings, and leave the court to determine the fees, but this is not a very realistic option for the parties.¹⁸⁹ When it comes to the payment of the final costs, national courts, as discussed in Chapter II, played an important role. Such court scrutiny may not always be available for the amount set as the advance, given its provisional nature. Moreover, there is a well-established rule, as it is discussed below, as to the right of unilateral payment of the required amount of the advance, i.e. payment by only one of the parties.

Substitute payment is a particularly important feature of the advance on costs, which differentiates it from the payment of the final fees. This is particularly important to observe when only one of the parties disagrees with the amount of the advance. As discussed under Chapter II, the one-sided agreements or lack of any agreement as to the amount of arbitrators' fees should be avoided, and the court should be asked as early as possible in the proceedings to adjust the fee proposed by the arbitrators. It seems, however, that this would leave the obligation to pay the final fees intact, but the issue is focused as to the amount which should be paid. When it comes to the payment of the advance on costs, substitute payment indicates that the parties need not both to agree to the amount of the advance on costs, but the tribunal/institution will be entitled to request such payment from only one of the parties, and only procedural consequences will follow in case of a party's default. Therefore, a party cannot be forced to pay the amount set as the advance toward the arbitrators or the institution, but it seemingly also cannot disagree with the set amount. Hence, the parties

¹⁸⁸ Várady, "Remuneration of Arbitrators as a Threshold Issues: Economic Sense and Procedural Realities," 592.

¹⁸⁹ Ibid.

might be interested, especially the claimant, to have recourse to courts, similarly as to the one regarding the payment of the final fees, i.e. the non-reimbursable fees. Such recourse should be available, and the courts should in that case apply the standard of reasonableness, as the standard for the determination of the recoverable costs widely applicable in arbitral practice [see **V.4.6**]. This can all influence the determination of the nature of the obligation to pay the advance *between the parties* [see **III.2**]

Also, since the advance is set at the beginning of the proceedings, this does not pose a question of the arbitrators providing their service without any funding, as it was discussed under the previous Chapter, and the focus is more oriented towards the enforcement of the obligation to pay a share of the advance *between the parties*, which will be discussed under the following part of this Chapter [see **III.2**]. At this point, it should be stated that since there is a possibility for a unilateral consent regarding the amount of the advance through making a substitute payment, and the advance is an indication of the anticipated procedural costs, it should not be taken for granted that the parties accepted the tribunal's absolute discretion on that matter. This can all affect the legal relation between the parties regarding the payment of the advance, including the nature of the obligation.

Since national arbitration acts rarely regulate the payment of the advance at the beginning of the proceedings, it is advisable both for the arbitrators to insist on such a stipulation in their *receptum arbitri*, and for the parties to either stipulate such an obligation in the agreements, or to designate the 2013 UNCITRAL Rules or any other rules providing for the advance as applicable. If the parties agree on the application of the UNCITRAL Rules, the tribunal will usually record its agreement on the amount of the advance with parties, and the terms of payment in a constitution order. Otherwise, the lack of any rule or stipulation on the advance might create difficulties for all the sides involved, including the arbitrators.

In institutional arbitration, the determination and the consequences of non-payment of the advance are explicitly regulated. All the analysed arbitration rules provide for the payment of the advance, and they set the method for the calculation.¹⁹⁰ By choosing the applicable arbitration rules which provide for such payment, the parties agree to it and they make it part of their arbitration agreement.¹⁹¹ The arbitrators acquire the right to require such a payment by accepting their appointment.

However, institutional arbitration rules may differ regarding certain aspects of this payment. As explained in Chapter II, either the institution or the tribunal has the power to fix the procedural costs of arbitration, and the same can be said for the determination of the amount of the advance. The 2012 ICC¹⁹², 2014 LCIA¹⁹³, 2014 SIAC¹⁹⁴, 2010 SCC¹⁹⁵ and 2012 Zagreb¹⁹⁶ Rules put the administration of the advance in the hands of the institution, while the 1998 DIS¹⁹⁷ and 2012 Swiss¹⁹⁸ Rules provide for the tribunal to decide on this issue.

¹⁹⁰ Article 36 of the 2012 ICC Rules; Article 41 of the 2012 Swiss Rules; Article 42 of the Vienna Rules; Section 25 of the 1998 DIS Rules; Section 24 of the 2014 LCIA Rules; Article 45 of the 2010 SCC Rules; Article 5 of the Decision on the Costs of the CEE; Article 30(2) of the 2013 SIAC Rules.

¹⁹¹ Tamminen, "The Obligation to Pay the Advance on Costs under the Vienna Rules and Austrian Law," 284.

¹⁹² Article 36(2) of the 2012 ICC Rules: "As soon as practicable, **the Court shall fix the advance on costs (...)**" [emphasis added].

¹⁹³ Article 24(1) of the 2014 LCIA Rules: "**The LCIA Court may direct the parties, in such proportions as it thinks appropriate, to make one or several interim or final payments on account of the costs of the arbitration. (...)**" [emphasis added].

¹⁹⁴ Rule 30.2 of the 2013 SIAC Rules: "**The Registrar shall fix the advances on costs of the arbitration**" [emphasis added].

¹⁹⁵ Article 45(1) of the 2010 SCC Rules: "**The Board shall determine an amount to be paid by the parties as an Advance on Costs.**" [emphasis added].

¹⁹⁶ Article 5 of the Decision on the Costs of the CEE: "After establishing the number of arbitrators in the proceedings (that is: one or three), the amount of the advance payment for the predictable costs of the proceedings from Article 2, paragraph 2, points b), c) and d) **shall be regulated by the President of the Court**" [emphasis added].

¹⁹⁷ Section 25 of the 1998 DIS Rules: "**The arbitral tribunal may make continuation of the arbitral proceedings contingent on payment of advances on the anticipated costs of the arbitral tribunal. It should request each party to pay one half of the advance. In fixing the advance, the arbitrators' total fees and the anticipated reimbursements as well as any applicable value added tax may be taken into consideration. The provisional advance paid by the claimant to the DIS pursuant to section 7 sub. 1 shall be credited to the claimant's share of the advance on costs.**" [emphasis added].

¹⁹⁸ Article 41(1) of the 2012 Swiss Rules: "**The arbitral tribunal, once constituted, and after consulting with the Court, shall request each party to deposit an equal amount as an advance for the costs referred to in Articles 38(a) to (c) and the Administrative Costs referred to in Article 38(f) (...)**" [emphasis added].

A decision on the advance on costs is usually rendered at the beginning of the proceedings¹⁹⁹, after filing a claim²⁰⁰, or after receiving an answer to request for arbitration²⁰¹. As already mentioned, the advance is meant to cover only procedural costs.²⁰² It is usually calculated on the basis of the aggregate value of all claims by reference to the costs schedules, whenever such are provided. If not, the calculation of the advance will follow the method adopted under those rules for calculation of the costs in the final award.

Under most of the arbitration rules, it is explicitly provided that the advance is paid by both parties (claimant and respondent) in equal shares.²⁰³ However, exceptions are possible. For example, under the 2014 LCIA Rules, the LCIA Court has full discretion in deciding in which proportion parties should pay the advance.²⁰⁴ Under the 2014 ICDR Rules there is no explicit rule regarding the apportionment of the advance between the parties. Nevertheless,

¹⁹⁹ Stefan Brocker and Kristoffer Löf, “Chapter 8 The Proceedings,” in *International Arbitration in Sweden: A Practitioner’s Guide*, (Kluwer Law International, 2013), 210.

²⁰⁰ Although it is not specifically provided in the ICDR Rules, an administrator usually calculates the amount of the advance after consultations with the tribunal. See more in: Martin F. Gusy, James M. Hosking, and Franz T. Schwarz, eds., *A Guide to the ICDR International Arbitration Rules* (Oxford: Oxford University Press, 2011), 283.

²⁰¹ For example, under the ICC Rules, the advance shall be fixed “as soon as possible”. In practice, the Court is usually not invited to fix it until the Answer to Request is received. See more in: Fry, Greenberg, and Mazza, *The Secretariat’s Guide to ICC Arbitration*, 369.

²⁰² Article 36(2) of the 2012 ICC Rules; Article 24(1) of the 2014 LCIA Rules; Article 41(1) of the 2012 Swiss Rules; Article 45(2) of the 2010 SCC Rules; Article 5 of the Decision on Costs of the CEE. The 1998 DIS Rules are an exception under which the advance is used only to secure the payment of the tribunal’s fees. Section 25 of the 1998 DIS Rules: “**The arbitral tribunal may make continuation of the arbitral proceedings contingent on payment of advances on the anticipated costs of the arbitral tribunal.**” [emphasis added].

²⁰³ Under Article 36(2) of the 2012 ICC Rules, the advance on costs “shall be payable in equal shares by the claimant and the respondent”; Article 41(1) of the 2012 Swiss Rules provides that the advance is paid by both parties in equal amount as well as Article 45(3) of the 2010 SCC Rules, Article 30(2) of the 2013 SIAC Rules, Section 25 of the 1998 DIS Rules. A different allocation between the parties, called alternative allocation, is possible in multi-party arbitrations. One of the arbitration rules which provide for specific calculation in this situation is the 2012 ICC Rules. Article 36(4) of the 2012 ICC provides for the method of calculation of the advance on costs in a case where there are more than two parties, due to either joinder of a party under Article 7 of the 2012 ICC Rules or multiple parties’ claims submitted under Article 8 of the 2012 ICC Rules. The calculation of the advance in multi-party arbitration under these Rules can be done either by calculating the single advance on costs payable by both sides in the same amount or by dividing it in a manner that takes into account the extent to which each party is involved. In other words, in both situations, single advance is calculated. However, in the second case additional allocation is applied, meaning that the single advance is not simply divided on the respondents’ and claimants’ side, but the Court fixes a different amount for each party to pay. More on the calculation of alternative allocation see in: Fry, Greenberg, and Mazza, *The Secretariat’s Guide to ICC Arbitration*, 380.

²⁰⁴ Article 24(1) of the 2014 LCIA Rules: “**The LCIA Court may direct the parties, in such proportions as it thinks appropriate, to make one or several interim or final payments on account of the costs of the arbitration**” [emphasis added].

usual practice under those rules is that the advance on costs is paid in equal shares by the parties.²⁰⁵

There is also a possibility for the parties not to pay shares of the same advance, but that each party pays its own *separate* advance. The rules provide for the possibility to fix separate advances when a counterclaim is submitted.²⁰⁶ When separate advances are fixed each of the parties shall pay the advance on costs corresponding to its claims.²⁰⁷ The purpose of the separate advance is to overcome the consequences of the situations in which one party refuses to pay the *overall* advance on costs that has been calculated and included the advance for its own claims.²⁰⁸ Without the possibility to set separate advances, the non-defaulting party would have the following choice: either to pay the full *overall* advance, or not to pay the defaulting party's share. In that case, the party would put itself at risk that all of the claims, including its own, would be considered to be withdrawn, as will be explained in the next section [see **III.1.2**].

Regarding the means of the payment, the parties are most often required to deposit the money in a designated account managed either by the institution or the presiding arbitrator, depending on the authority that administers the financial aspects of the proceedings.²⁰⁹ Payment by guarantee is allowed and accepted under the 2012 ICC, 2012 Swiss, and 2010 SCC Rules.²¹⁰

²⁰⁵ Gusy, Hosking, and Schwarz, *A Guide to the ICDR International Arbitration Rules*, 283.

²⁰⁶ Article 36(3) of the 2012 ICC Rules, Article 41(2) of the 2012 Swiss Rules, Article 45(3) of the 2010 SCC Rules, Article 30(2) of the 2013 SIAC Rules.

²⁰⁷ Article 36(3) of the 2012 ICC Rules.

²⁰⁸ Fry, Greenberg, and Mazza, *The Secretariat's Guide to ICC Arbitration*, 374.

²⁰⁹ *Ibid.*, 372; Risse, "Part III – Commentary on the Arbitration Rules of the German Institution of Arbitration (DIS Rules), Section 25 – Advance on Costs of Arbitral Tribunal," 749.

²¹⁰ Cremades and Mazuranic, "Costs in Arbitration," 184.; Article 1(5), 1(7) and 1(9) of Appendix III of the 2012 ICC Rules; Article 45(6) of the 2010 SCC Rules; The 2012 ICC Rules provide for the most detailed rules in situations the payment by guarantee is possible and these are:

As to the payment of the advance in *ad hoc* settings, once the arbitrators and the parties reach such an agreement, the practical aspects of this determination and payment are the same as in institutional arbitration. The advance is paid at the beginning of the proceedings by both parties in equal shares.²¹¹ For example, the 2013 UNCITRAL Rules, which are often used in *ad hoc* arbitration, provide that “*the arbitral tribunal, on its establishment, may request the parties to deposit an equal amount as an advance*”. Separate advances are also considered to be a possible solution where respondent has filed a counterclaim.²¹²

The payment in *ad hoc* arbitration is made also by making a deposit in a designated account managed by the presiding or sole arbitrator, which is opened exclusively for that purpose.²¹³ The LCIA offers the services of fundholding, i.e. the service of holding and disbursing advances in relation to procedural costs in non-LCIA arbitrations, including the proceedings under the UNCITRAL Rules, or in accordance with some other *ad hoc* procedures.²¹⁴ The amount deposited in that way is supposed to cover arbitrators’ fees and expenses and costs of expert advice and other assistance required by the tribunal, i.e. the procedural costs of arbitration.²¹⁵

1) if a party’s share of the advance on costs is greater than US\$ 500,000 (the “Threshold Amount”), such party may post a bank guarantee for any amount above the Threshold Amount (Article 1(5) of Appendix III of ICC Rules);

2) if a party that has already paid in full its share of the advance on costs, pays the unpaid portion of the advance owed by the defaulting party, it can pay it by posting a bank guarantee (Article 1(7) of Appendix III of ICC Rules);

3) when the separate advance fixed for the claim of either party exceeds one half of such global advance as was previously fixed, a bank guarantee may be posted to cover any such excess amount (Article 1(9) of Appendix III of ICC Rules).

²¹¹ Ibid., 176, 182.

²¹² Ibid., 182.

²¹³ Ibid., 183; David D. Caron and Lee M. Caplan, *The UNCITRAL Arbitration Rules*, 2nd ed. (Oxford University Press, 2012), 898.

²¹⁴ The LCIA guidelines on fundholding are available at the website: <http://www.lcia.org/Fundholding/Fundholding.aspx>.

²¹⁵ Caron and Caplan, *The UNCITRAL Arbitration Rules*, 897.

III.1.2 Procedural Consequences of the Non-payment of the Advance

Since the advance serves the purpose of securing the procedural costs of arbitration, the consequences of the non-payment of the advance may be severe. There are three perspectives that we need to take into account when discussing the possible consequences of the failure to pay either by one party or by both parties. These three perspectives may involve different solutions, depending on the interest of different stakeholders in arbitration: an arbitration institution, arbitrator(s), a non-defaulting party, or a defaulting party.

An arbitration institution undertakes the following procedure: it calls for substitute payment to be made by a non-defaulting party, and in the absence of such payment, the proceedings are terminated and the claims for which such payment was not made are deemed withdrawn. For example, under Article 36(5) of the 2012 ICC Rules, “*any party shall be free to pay any other party’s share of any advance on costs should such other party fail to pay its share*”. In practice, the ICC Secretariat sends payment reminders to the defaulting party and also to the other parties before the Secretary General decides to trigger the procedure for the withdrawal of the claims under Article 36(6) of ICC Rules.²¹⁶ Article 36(6) of the 2012 ICC Rules provides that when the advance on costs have not been paid “*the Secretary General may direct the arbitral tribunal to suspend its work and set a time limit, (...), on the expiry of which the relevant claims shall be considered as withdrawn*”. The same solution is provided under Article 30(5) and (6) of the 2013 SIAC Rules, Article 45(4) of the 2010 SCC Rules, and Article 24(3) of the 2014 LCIA Rules.

The second perspective is the one of the arbitrator(s), since under some arbitration rules, such as the 1998 DIS Rules, it is up to an arbitral tribunal, and not the institution, to ask

²¹⁶ Fry, Greenberg, and Mazza, *The Secretariat’s Guide to ICC Arbitration*, 387.

for substitute payment from the non-defaulting party.²¹⁷ The consequences are, however, the same. Two other options provided for the arbitral tribunal are either to stay or continue the proceedings.²¹⁸ The difference is that under the 2012 ICC Rules, for example, the Secretary General decides on the suspension of proceedings only after the consultation with the arbitral tribunal. However, the tribunal's opinion is in no way binding upon the Secretary General.²¹⁹ On the contrary, under the 1998 DIS Rules, the tribunal's decision to stop or continue the proceedings is completely at its discretion.²²⁰ The same solution is provided in Article 41(4) of the 2012 Swiss Rules, according to which the arbitral tribunal has the same power to notify the parties in order that one or more of them may make the required payment and if such payment is not made, it may order the suspension or termination of the arbitral proceedings.

In *ad hoc* settings, for example, according to Article 43(4) of the 2013 UNCITRAL Rules, the tribunal will ask the parties for the initial payment and substitute payment if the required advance is not paid in full. In case such payment is not made even after the notice on the failure is given to the parties, the tribunal “*may order the suspension or termination of the arbitral proceedings*”. German law provides for the same consequences due to the non-payment in *ad hoc* arbitration, under the general rule of the retention of one's own performance as long as the other party does not perform its obligation.²²¹

While the institution and the arbitral tribunal will usually not be interested in the continuance of arbitration without the advanced payment, the non-defaulting party might

²¹⁷ Jörg Risse, “Part III - Commentary on the Arbitration Rules of the German Institution of Arbitration (DIS Rules), Section 25 - Advance on Costs of Arbitral Tribunal,” in *Arbitration in Germany: The Model Law in Practice* (Kluwer Law International, 2015), 673.

²¹⁸ *Ibid.*

²¹⁹ Fry, Greenberg, and Mazza, *The Secretariat's Guide to ICC Arbitration*, 388.

²²⁰ Risse, “Part III - Commentary on the Arbitration Rules of the German Institution of Arbitration (DIS Rules), Section 25 - Advance on Costs of Arbitral Tribunal,” 673.

²²¹ von Schlabrendorff and Sessler, “Part II – Commentary on the German Arbitration Law (10th Book of the German Code of Civil Procedure), Chapter VI Making of the Award and Termination of the Proceedings, § 1057 – Decision on Costs,” 2015, 368.

have such interest, especially if it is the claimant. The non-defaulting party has the following possibilities: it can ask the national court (or the tribunal) to order the payment of the share of the advance to the defaulting party; it can pay the full amount on the advance on costs, including the defaulting party's share (substitute payment) and then seek reimbursement²²²; it can ask for a separate advance to be set and imposed on each of the parties, when counterclaims are submitted²²³; or it can terminate the arbitration agreement and submit its claims to a national court²²⁴. The determination of payment by a separate advances was already discussed above, while the right to terminate the arbitration agreement due to the non-payment of the party is discussed in Chapter IV.

Regarding the remaining two options, under which the non-defaulting party decides to pay the whole advance, certain questions arise. First, does the paying party have a right to ask for the reimbursement of a substitute payment *during* the course of arbitration? If yes, what is the appropriate forum to decide upon such a claim and at which stage of the proceedings? These and other aspects of the possible reimbursement for the paying party will be discussed in the following Part of this Chapter.

III.2 Enforcement of the Obligation to Pay the Advance the Costs

When the obligation to pay the advance on costs is established, as well as the consequences of the non-payment, the enforcement of such an obligation becomes an issue when one of the parties fails to comply with it. The non-payment of the advance usually

²²² Fry, Greenberg, and Mazza, *The Secretariat's Guide to ICC Arbitration*, 384; Cremades and Mazuranic, "Costs in Arbitration," 185; Risse, "Part III – Commentary on the Arbitration Rules of the German Institution of Arbitration (DIS Rules), Section 25 – Advance on Costs of Arbitral Tribunal," 749; Gusy, Hosking, and Schwarz, *A Guide to the ICDR International Arbitration Rules*, 284.; Article 24(4) of the 2014 LCIA Rules; Article 41(4) of the 2012 Swiss Rules.

²²³ Fry, Greenberg, and Mazza, *The Secretariat's Guide to ICC Arbitration*, 384; Cremades and Mazuranic, "Costs in Arbitration," 185.; Article 41(2) of the 2012 Swiss Rules.

²²⁴ Risse, "Part III – Commentary on the Arbitration Rules of the German Institution of Arbitration (DIS Rules), Section 25 – Advance on Costs of Arbitral Tribunal," 749.

occurs on the respondent's side.²²⁵ However, arbitration rules do not distinguish the consequences of the non-payment by claimant or by respondent, although practical differences exist. When a claimant does not pay or is not financially capable to pay its part of the advance, arbitration rules give the opportunity to make substitute payment to the respondent in order to overcome the consequences of the claimant's failure. Although it is not impossible to imagine that the respondent would have an interest in resolving the case in arbitration, it might not be that often that the party who did not commence the proceedings in the first place will be eager to continue. The claimant might resort to third-party funding, a recently developed industry supporting impecunious parties in arbitration, in order to cover its share of the advance [see Chapter IV]. If the claimant does not opt for such an option or it was not granted third party funding, it might be interested in pursuing the enforcement of the respondent's obligation to pay its share of the advance.

The analysis presented above sets forth that by concluding an arbitration agreement the parties agree to pay the advance on costs under the terms either explicitly or implicitly agreed between them, or in accordance with the law applicable to the arbitration agreement. The existence of the obligation to pay the advance between the parties is not sufficient *per se* for the enforcement of the same, as the qualification of the nature of such an obligation may differ and consequently the remedies for the failure differ as well.

Arbitral and judicial practice developed three understandings of the nature of the parties' obligation to pay the advance, leaving this area of arbitration law highly non-harmonized. The parties' agreement when it envisages the applicability of certain arbitration rules, as it will be shown below, may provide for the remedies available to a non-defaulting party.

²²⁵ Michael Bühler, "Note – Sentence Partielle Du 1er Juin 2004 Dans L'affaire CCI No 12491/KGA/EC," *ASA Bulletin* 24, no. 2 (2006): 290; "Working Group I - Preventing Delay and Disruption of Arbitration," ICCA Congress Series (Stockholm, 1990), 104.

This part analyses the three approaches which were adopted in practice and it explains the doctrinal reasoning behind each of them. These are: the contractual approach [III.2.1], the procedural duty approach [III.2.2], and the interim measure approach [III.2.3].

III.2.1 The Contractual Approach as the Prevailing Perspective: England and Wales, Germany, and Switzerland

The contractual approach as to the qualification of the nature of the obligation to pay the advance in international arbitration is one of the approaches established in the doctrine and accepted in part of the arbitral practice. Under this approach, the obligation to make the payment of the advance is considered to be a *substantive* obligation owed by the parties *to each other*. Upon default to perform such an obligation, the other party has a right to seek, either from the arbitral tribunal or the national court, the reimbursement of substitute payment, or a specific performance regarding the payment of an advance on costs. In this regard, research showed that the current doctrine and decisions rendered by arbitral tribunals prevalingly focus on the *nature* of the obligation to pay, while they neglect to explain the legal basis. The first section will, therefore, focus on the sources and legal basis of the advance-related payment claims [III.2.1.1], while the second section elaborates on before which forums such claims can be brought [III.2.1.2].

III.2.1.1 Sources and Legal Bases for the Claims Related to the Payment of the Advance on Costs

The sources of an obligation to pay the advance which will be analysed under this section are: (1) the arbitration agreement and (2) the arbitrators' contract, i.e. tripartite

agreement. Following the discussion on the sources of such obligation, the analysis delves on the issue to *who* is that obligation owed. The issue is discussed solely from the non-defaulting party's perspective because of several reasons. First, even though the arbitration institutions are entitled to ask for the payment of the advance, research has shown that none of the institutions have ever filed such a request before a national court. The same can be stated for the enforcement of the arbitrators' entitlement to ask for the advance. It seems that both arbitration institutions and arbitrators use this entitlement only as a condition for the continuance of the proceedings.

On the other hand, the arbitrators' right to receive compensation once they finish their mandate differs from their entitlement to the advance, and can be enforced before courts as explained in Chapter II. However, for the compensation claim to be successful, this means that the arbitrators agreed and provided their service without the payment of the advance or at least the paid in advance was not sufficient to cover their fees and expenses. Because the arbitrators and institutions will in most cases condition the continuation of the proceeding upon the payment, rather than filing a claim against a defaulting party, their perspective was left out from the present discussion.

On the other hand, the non-defaulting party may be more interested in enforcing the right to pay the advance in equal shares, instead of terminating the arbitration agreement. The enforcement of such an obligation includes both the situation where a non-defaulting party decides to request an order against the defaulting party to make a payment to the institution or the arbitrators, and the situation in which the non-defaulting party decides to pay the whole advance on costs, i.e. to make substitute payment, and it is interested in seeking the *immediate* reimbursement. It needs to be stressed that both of these recourses are analysed only from the perspective under which they are made *during* the arbitration proceedings.

Any decision made regarding the reimbursement of the advance in general does not influence the final allocation of the costs made by the tribunal at the end of the proceedings.²²⁶ The party who makes a substitute payment always has a possibility, instead of seeking the immediate reimbursement, to wait until the final award to recover.²²⁷ Therefore, this Part of Chapter **III** will deal with the possibility to seek the performance of this obligation or the compensation for the failure to do so *during* the arbitration proceedings.

The focus of the research for this Part is on situations where there is no explicit provision which allows the reimbursement claim or a request for a specific performance to be filed before the tribunal or the national court. Those arbitration rules which contain such explicit provision will be mentioned only in order to analyse the differences between the solutions available in institutional and *ad hoc* arbitration, in jurisdictions where such arbitration rules are applicable. Such explicit provisions require doctrinal revision *per se* as well, however, and the possible legal complications that they might cause will be addressed under the section dealing with the enforcement of the decisions on the reimbursement or of the order to make the payment [see **III.3**].

The right of a party to either ask for the order of the payment or the immediate reimbursement depends on the source and legal basis for an obligation to pay the share of the advance and the obligations and relations created under that them. The source is important to define the nature of an obligation to pay the share of an advance: whether it is considered to be a substantive obligation or merely a procedural duty, or the remedy is offered as an interim measure. As already mentioned, the contractual approach allows the non-defaulting party to immediately pursue legal remedies, such as damages, the reimbursement of the substitute payment, and/or specific performance. On the other hand, under the procedural duty

²²⁶ Tamminen, “The Obligation to Pay the Advance on Costs under the Vienna Rules and Austrian Law,” 299.

²²⁷ *Ibid.*, 292.

approach, which will be elaborated on below [see **III.2.2**], the failure of one of the parties to pay its share will result only with the procedural consequences, such as the suspension or termination of the proceedings.²²⁸ Of course, even in that case the non-defaulting party can prevent these consequences by making a substitute payment. Nevertheless, it would not have a right to seek reimbursement immediately *during* the arbitration proceedings.

The issue of immediate reimbursement does not need to be discussed in situations where a specific rule or parties' agreement provides for such possibility. The 2010 SCC Rules contain such a possibility in Article 45(2), which states that “[*i*]f the other party makes the required payment, the arbitral tribunal may, at the request of such party, make a separate award for reimbursement of the payment.” Similarly, under Article 30(6) of the 2013 SIAC Rules, the tribunal may, on the application of a party, issue an award for unpaid costs. The 2013 Vienna Rules provide for such a possibility as well by stating in Article 42(4) that “(...) upon the paying party's request the arbitral tribunal may order the non-paying party by an award or other appropriate form to reimburse the paying party, to the extent it finds that it has jurisdiction over the dispute”. More straightforward proposition is the one of the 2014 LCIA Rules which provides in Article 24(3) that “[*t*]he party paying the substitute payment shall be entitled to recover that amount as a debt immediately due from the defaulting party”. In this case, a party does not need to obtain a separate decision that the debt is due, for it is empowered to immediately proceed to the enforcement stage.²²⁹

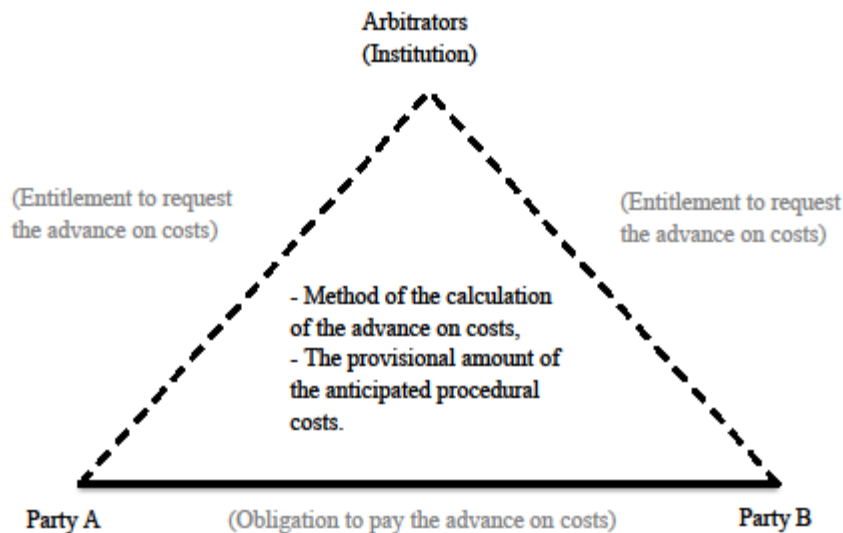
The discussion is further focused solely on institutional or *ad hoc* settings where an explicit rule or agreement does not exist. In such cases, procedural law of arbitration, jurisprudence, and the specific doctrine have recognized the obligation to pay a share of the

²²⁸ More on a difference between the nature of substantive obligation and procedural duty, and their consequences see in: Nikolaus Pitkowitz, “Shared Funding of Arbitration Proceedings: Fact or Fiction?,” *Austrian Yearbook on International Arbitration*, 2011, 43.

²²⁹ Tamminen, “The Obligation to Pay the Advance on Costs under the Vienna Rules and Austrian Law,” 292.

advance both as a substantive obligation under contractual approach or as a procedural duty, the breach of which only results in procedural consequences. The legal bases for the payment of the advance which were already mentioned above were: the parties' agreement with arbitrators (tripartite agreement), the arbitration agreement, the national laws' provisions as a default mechanism, and the principle of conducting the proceedings they agreed to in good faith. These bases served to prove that there is an obligation of the parties to pay the advance to the *arbitrators*, who accepted the arrangement through their acceptance of the appointment as a condition for the continuation of the proceedings, as it was shown in the graph 1. It remains, however, to see whether the parties *owe* the same obligation *to each other*.

From the above mentioned legal basis, the arbitration agreement should be established and recognized as the main source for establishment of the obligation to pay the advance on costs *mutually owed between the parties*, and this part of thesis focuses on it as it is marked in this graph 2:



Graph 2

However, the proper understanding of the tripartite agreement, from which the arbitrators' entitlement stems, is needed to clarify the legal relation between the parties.

Namely, the tripartite agreement provides for the obligation to pay a share of an advance, jointly owed by the parties.²³⁰ Since the obligation is not jointly and *severally* owed, it follows that under the tripartite agreement, the parties owe payment *to the arbitrators*, who can accept the payment of the advance from only one of the parties, but it is not clear whether the parties have any grounds to sort out immediately, before the last award, their proportions of liability for the payment of the advance. No mutual parties' obligation to pay can be established and no right for the reimbursement can be invoked without being specifically addressed in the parties' or tripartite agreement, or in the material provisions which govern them.

As to the arbitration agreement, under German law, for example, it is considered to be predominantly procedural agreement, which includes also substantive obligations.²³¹ One of the substantive obligations which arise out of the arbitration agreement is the obligation to pay the share of advance on costs, which is *owed by the parties to one another*.²³² This stance of the German jurisdiction was also confirmed by the national courts which recognize enforceable mutual obligations of the parties to pay their share of costs that arises from the arbitration agreement.²³³ In such court proceedings, it was held that the arbitration agreement cannot be invoked as defence because it would render the arbitration agreement ineffective.²³⁴

The legal basis for the claim arising out of this obligation is, according to the commentators, Section 426(2) of the German CC.²³⁵ This Section provides that

²³⁰ Wong and Siwy, "Recalcitrant Parties and the Tribunal's Power to Order Cost Advance Payments," 202, 204.

²³¹ *Ibid.*, 207.

²³² *Ibid.*

²³³ "Comment on the Case No. 36 C 19607/0, 17 June 2003 (Local Court Düsseldorf)," ITA Board of Reporters, n.d.; Pitkowitz, "Shared Funding of Arbitration Proceedings: Fact or Fiction?," 38; Tamminen, "The Obligation to Pay the Advance on Costs under the Vienna Rules and Austrian Law," 293.

²³⁴ "Comment on the Case No. 36 C 19607/0, 17 June 2003 (Local Court Düsseldorf)."

²³⁵ Wong and Siwy, "Recalcitrant Parties and the Tribunal's Power to Order Cost Advance Payments," 207–8.

“to the extent that a joint and several debtor satisfies the obligee and may demand adjustment of advancements from the other obligors, the claim of the obligee against the other obligors passes to him”.

There is no doubt that if the parties to the arbitration agreement are considered to be jointly and severally liable, this Section will give them a right to seek reimbursement before a national court. However, without an explicit provision in arbitration laws, or without strong doctrinal or judicial persuasiveness, such an obligation can hardly be considered jointly and severally owed by the parties, if one takes into account that the substitute payment is considered both in the institutional and *ad hoc* arbitration to be solely an *optional* instrument, left entirely to non-defaulting party’s discretion.

The idea behind the joint and several liability of debtors is to provide a creditor with the mechanism to more effectively enforce her or his rights by providing that “[i]f the contribution attributable to a joint and several debtor cannot be obtained from him, the shortfall is to be borne by the other obligors obliged to adjust advancements” (Art. 462 (1) of the German CC). If the substitute payment is considered to be only an option, and not the obligation of the non-defaulting party, there is no joint and several obligation owed by the parties and consequently, there is no obligation owed by the parties to *each other* under Article 462 of the German CC. More specifically, in the absence of qualifying the obligation to pay the advance to be severally and jointly owed by the parties, the claim for reimbursement of the share paid as a substitute payment cannot be based on the Article 462 (2) of the German CC.

Another problem with this approach that might arise is a lack of solutions when one party’s disagrees with the amount of the advance. This was already briefly mentioned above, but if one of the parties in *ad hoc* settings refuses to pay the advance because it considers it

excessive, one can hardly argue that there is an obligation to pay at all. Even if the other party pays instead, this would lead to the one-sided agreement on the advance, which presents the anticipated fees of the arbitrators. It might be advisable for the arbitrators in such case to proceed without the payment of the advance, and let the court adjust the final fees.²³⁶ One can, however, argue that the advance is only a deposit or a security device, and as such it is only suggestive as to final amount of the fees, but not binding. As such, it does not require such level of scrutiny as the final amount of the arbitrators' fees.

Similarly to the German doctrine and jurisprudence, the Swiss doctrine recognizes the non-defaulting party's right to claim reimbursement. The legal basis for making such a claim is, however, different from the one provided in the German doctrine.

Namely, in 2010, the Swiss Federal Supreme Court upheld the award in which the damages for breach of an arbitration agreement were awarded.²³⁷ The case involved an arbitration proceeding which was commenced in May 2006 in Switzerland and it was followed by parallel proceedings before an Israeli court, commenced by the respondent, a few months later. The claimant, who started the arbitration, requested the state court to suspend the proceedings and sought from the arbitral tribunal to render a "*declaratory judgment finding that [the respondent] had violated the arbitration agreement by introducing [...] state court proceedings and that it had to compensate [the claimant] for the damage resulting therefrom.*"²³⁸ On August 3, 2009, the tribunal issued an interim award declaring that the respondent breached the arbitration agreement by commencing the court proceedings and awarding damages to the claimant. This award was challenged before the Swiss Federal Supreme Court, but the court acknowledged that the tribunal decided "*on its own jurisdiction*

²³⁶ Similarly in: Várady, "Remuneration of Arbitrators as a Threshold Issues: Economic Sense and Procedural Realities," 592.

²³⁷ "X Ltd. v. Y AG (Swiss Federal Supreme Court 2010)," *ITA Board of Reporters*, n.d.

²³⁸ *Ibid.*

regarding the examination of a violation of the arbitration clause contained in a contract” and not on the court’s jurisdiction, as claimed by the respondent in the challenge proceedings.²³⁹ The respondent also complained that there was a violation of public policy. One of the grounds on which the respondent based its claim for such violation was that the tribunal prevented it or punished it for pursuing its constitutional right of free access to a competent, independent and impartial court. The Swiss court, however, concluded that there was no such violation of the public policy, since parties are free to waive such right by concluding the arbitration agreement.

In accordance with this approach, the Swiss doctrine considers the amount paid as substitute payment on behalf of the defaulting party to be the amount of damage caused by non-payment.²⁴⁰ In that case, the breach of arbitration agreement would consist of the non-payment of a share of the advance by one of the parties. In order to successfully claim the reimbursement of the amount paid, the non-defaulting party will need to prove not only the existence and the amount of damage, but also the respondent’s breach of its obligation and the causal link between the breach and the damage.²⁴¹ The breach would be, as mentioned, the non-payment of the advance as promised under the contract, which would lead to the necessity of making the substitute payment, amount of which would be the amount of damages. There is, however, thus far no confirmation of this approach in the Swiss court practice.

The formation of the legal grounds for the non-defaulting party’s request is not uniform throughout the arbitral and court practice. The departure from any national law is possible when an arbitral tribunal is deciding on the reimbursement of the payment of the

²³⁹ Andrea Meier and Georg von Segesser, *X Ltd. v. Y AG*, A contribution by the ITA Board of Reporters (Swiss Federal Supreme Court 2010).

²⁴⁰ Thomas Rohner and Michael Lazopoulos, “Respondent’s Refusal to Pay Its Share of the Advance on Costs,” *ASA Bulletin* 29, no. 3 (2011): 559.

²⁴¹ *Ibid.*, 559–61.

advance made by a non-defaulting party. The ICC tribunal, deciding on the reimbursement of such payment, in the ICC Case No. 17050/GZ, adopted the contractual approach on the matter, but then expressed the view that *“it is unnecessary to decide the issue of the law governing the arbitration agreement, since the Parties’ rights and obligations flow directly from the contract, and the terms of the arbitration agreement referring to the ICC Rules.”*²⁴² Since the ICC Rules contain no provision on the reimbursement claim, this decision is somewhat unclear on this matter.

In any case, the tribunal established the breach of a contractual obligation, and stated that the reimbursement of the amount paid can be either compensated as damages, or the reimbursement claim can be granted on the ground of specific performance.²⁴³ In a similar manner, the contractual approach as to the non-payment of the advance on costs was adopted by other ICC tribunals as well.²⁴⁴ For example, in the ICC award No. 11330, the arbitral tribunal held that *“the parties in arbitrations conducted under the ICC Rules have a mutually binding obligation to pay the advance on costs as determined by the ICC Court, based on Article 30-3 ICC Rules which – by reference – forms part of the parties’ agreement to arbitrate under such Rules.”*²⁴⁵

Since obligations under an arbitration agreement are not explicitly regulated in the arbitration laws of the jurisdictions in the mentioned cases, the construction of the legal basis for the request for the payment of the advance depends on the general provisions of a civil code. There might be doctrinal pitfalls under such solutions that can be solved by including the explicit provision in the arbitration laws which will determine the parties’ liability to be joint and several. Such provision exists, for example, in Article 37(1) of the Swedish AA:

²⁴² X (Cyprus) v. Y (Luxembourg), Z (Luxembourg), ICC Case No. 17050GZ (2010), para. 34.

²⁴³ Ibid., para. 36.

²⁴⁴ For example, the ICC case no. 10526 and the ICC case no. 11330 cited in: Secomb, “Awards and Orders Dealing with the Advance on Costs in ICC Arbitration: Theoretical Questions and Practical Problems,” 62–63.

²⁴⁵ Cited in: Ibid., 63. In the 2012 ICC Rules, the advance on costs is regulated in Article 36.

“*The parties shall be jointly and severally liable to pay reasonable compensation to the arbitrators for work and expenses.*” Despite this clear provision on the nature of the obligation to pay the fees, Article 38(1) of the Swedish AA provides for the substitute payment only as an option, and not the obligation, for the non-defaulting party, which seemingly contradicts the concept of the joint and several liability of the parties as provided under Article 37(1). Also, this section refers to the obligation to pay the fees, not the advance on costs. Leaving this contradiction aside, the Swedish legislator, the Stockholm Chamber of Commerce, and the Swedish Supreme Court differentiated the solutions available to the parties arbitrating under the 2010 SCC Rules and to those arbitrating in *ad hoc* settings within Swedish jurisdiction, i.e. without an agreement on the application of these Rules.

Namely, while the 2010 SCC Rules explicitly provide for a possibility to make a request to the tribunal for reimbursement, the Swedish Supreme Court decided in 2000 that such a request is not possible in *ad hoc* arbitration.²⁴⁶ This decision will be discussed in more details under the next section where the procedural duty approach is analysed because although the Swedish AA contains a provision that provides for a joint and several liability of the parties to pay the costs, this obligation is not a substantive obligation, according to the Swedish court practice.

On the other hand, similarly to the Swedish AA, the 1996 EAA provides that “[t]he parties are jointly and severally liable to pay to the arbitrators such reasonable fees and expenses (if any) as are appropriate in the circumstances.” The enforcement of this liability is guaranteed provisions under Sections 28 and 41 of the 1996 EAA.²⁴⁷ Section 28 of the 1996 EAA will be addressed as the plausible legal basis for the non-defaulting party to file a claim before *the tribunal* to order the other party to make the payment of its share. Section 41

²⁴⁶ Swedish Supreme Court, Case No. T 5119-99, 29 December 2000.

²⁴⁷ Wong and Siwy, “Recalcitrant Parties and the Tribunal’s Power to Order Cost Advance Payments,” 214.

of the 1996 EAA, on the other hand, can be used both as a basis for such a claim as well as for the legal basis for the claim of *immediate reimbursement*, when substitute payment is made.

Section 41(7)(d) of the 1996 EAA provides that “[i]f a party fails to comply with [...] *peremptory order*, then, [...] the tribunal may [...] make such order as it thinks fit as to the payment of costs of the arbitration incurred in consequence of the non-compliance.” A peremptory order can be rendered by the tribunal under Section 41(5) when the defaulting party “without showing sufficient cause fails to comply with any order or directions of the tribunal.” Therefore, it is considered that this Section offers a cure for the non-defaulting party who wishes to ask the tribunal to *order the defaulting party to make a payment* as well as to the non-defaulting party who wishes to make a substitute payment and ask for the *immediate reimbursement*.²⁴⁸

This remedy, which is provided under the 1996 EAA, speaks in favour of qualifying an obligation to pay the advance as *substantive obligation mutually owed* between the parties. This was confirmed by the English court in 2014 when it decided in the case *BDMS Ltd* [“BDMS”] v *Rafael Advance Defence Systems* [“Rafael”] [“BDMS decision” or “BDMS case”], on whether the respondent’s breach of arbitration agreement, which consisted of the failure to pay its share of the advance, is repudiatory.²⁴⁹ The English High Court accepted the contractual approach regarding the obligation to pay the shares of the advance when addressing the issue and hence it concluded that the respondent’s non-payment constituted a breach of the contract.²⁵⁰ In other words, the obligation to pay the advance, under the 1998

²⁴⁸ Ibid., 214–15; Guy Pendell and Juliette Huard-Bourgois, “Chapter 17: Rights and Duties of the Parties and Counsel,” in *Arbitration in England, with Chapters on Scotland and Ireland* (Kluwer Law International, 2013), n. 85.

²⁴⁹ *BDMS Ltd v Rafael Advance Defence Systems* [2014] EWHC 451 (Comm) (High Court 2014).

²⁵⁰ Ibid. See para. 43 of the *BDMS decision*: “It would therefore appear that the majority of arbitral and court decisions favour the contractual approach, as do the majority of commentators. In my judgment, as a matter of English law that approach is consistent with the contractual agreement to arbitrate under the Rules and the

ICC Rules, which were applicable in that particular case, was considered by the English High Court to be a contractual obligation.

Although the choice of the arbitration rules is considered to form a part of the arbitration agreement, the English, and the ICC tribunals' approach differs from the one, for example, taken in the German law. In the former two examples, the obligation to pay the advance becomes a part of the arbitration agreement *by virtue of the arbitration rules* chosen by the parties. Under the latter, it can be stated that such an obligation does not become part of an arbitration agreement by virtue of the chosen arbitration rules, but rather that it is inherent to every arbitration agreement.²⁵¹ The explicit reference through the choice of the applicable arbitration rules to an obligation to pay the advance does not make it by itself material and enforceable, unless an arbitration act does not contain a provision as the one stipulated in Section 39 of the 1996 EAA, which states that “[t]he parties are free to agree that the tribunal shall have power to order on a provisional basis any relief which it would have power to grant in a final award”, which “includes, for instance, making [...] an order to make an interim payment on account of the costs of the arbitration.” However, “[u]nless the parties agree to confer such power on the tribunal, the tribunal has no such power.” This qualification will hence depend, in the end, on the legislators or national courts' discretion, and finally the policy which they decide to adopt. This is an important consideration to be taken into account when deciding before which forum a claim should be brought.

mandatory terms in which Article 30(3) is expressed – “shall be payable”. In the present case it was expressly agreed that the arbitration “shall take place under the rules of the International Chamber of Commerce” and thereby that the parties would, as a matter of contract, comply with mandatory requirements imposed on the parties under the Rules. The contractual approach is also consistent with the only common law court decision to which I was referred, namely the Alberta Court of Appeal decision in *Resin Systems Inc. v Industrial Service & Machine Inc* [2008] ABCA 104, considered further below, which emphasised the breach of a mandatory rule by the “defaulting party”. I accordingly conclude that a failure to pay the advance required under Article 30(3) does involve a breach of the arbitration agreement.”

²⁵¹ Fadlallah, “Payment of the Advance to Cover Costs in ICC Arbitration: The Parties' Reciprocal Obligations,” 55.

At this point, a brief overview should be made. Under the German, Swiss, and English law and in the practice of the ICC tribunals, the obligation to pay the share of the advance is considered to be a *substantive obligation owed by each party to the other one*, arising from an *arbitration agreement*. In the Swedish jurisdiction, this is so only under the SCC Rules which provide explicitly for the possibility of the reimbursement claim. Besides this, there are other nuances regarding the claim on reimbursement which need to be taken into account and which call for the proposal of the uniform approach in this matter. Under German law, the reimbursement is possible due to qualification of the parties' obligations as the liability of joint and several debtors. Under Swiss law the claim for the reimbursement should be formed as a claim for damages. The 1996 EAA explicitly provides for the grounds on which such a claim can be filed, recognizing indirectly the material nature of this obligation. The nuances among these legal systems create legal uncertainty for arbitral tribunals and parties in international arbitration, and calls for providing uniform solutions under national arbitration laws and arbitration rules.

The legal basis for such a claim should be independently provided in arbitration laws, in order to exclude the variety of the legal grounds, which change from one legal system to another. However, even if arbitration laws provided for specific grounds based on which the non-defaulting party can seek the *reimbursement* of substitute payment, this does not clarify the situation regarding the possibility to sue the defaulting party and then ask the court or the tribunal to order the defaulting party to pay its share of an advance, i.e. to require specific performance. This requires observing whether any of the legal grounds for the reimbursement claim can be used as a basis for the non-defaulting party to seek *specific performance* against the defaulting party.

Under German law, in which the payment of the share of advance is *owed by the parties to one another*, Section 426(2) of the German CC does not suffice as the legal basis

for a request for specific performance, since this Section governs the debtors', i.e. parties', obligation which they jointly and severally *owe to the arbitrators*. The object of this obligation is a payment of the share to the arbitrators or the arbitral institution, i.e. the performance for the benefit of a third party. If this qualification of the legal relationship between the parties is adopted, under Sections 328 – 335 of the German CC, which governs contracting for the benefit of a third party, the non-defaulting party would have a right to demand the performance to the arbitrators (institution) under Section 335 of the GCC.²⁵²

According to Swiss law, the damages can be used as a legal basis for a claim only if the non-defaulting party makes the substitute payment. If no such payment is made, no damages are incurred, although there is a breach.²⁵³ According to the Swiss doctrine, the possible claim for specific performance can be substantiated on the basis of the principle of good faith, in accordance with which the parties to the arbitration agreement are obliged “*to omit all conduct which might delay the normal process of the arbitration proceedings.*”²⁵⁴ Finally, under the 1996 EAA, as mentioned above, Sections 28(5) and 41(7)(d) can be a valid basis for the non-defaulting party to file a claim before the tribunal against the defaulting party who failed to pay its share of advance.²⁵⁵ The legal remedies available under Section 41(7)(d) were already explained above²⁵⁶, while under Section 28(5) of the 1996 EAA, it is derived that the arbitrators have a right to bring the claim against a party who fails to pay the

²⁵² Section 335 of the German CC: “The promisee may, where a different intention of the parties to the contract may not be assumed, demand performance for the third party even if the latter is entitled to the right to performance.”

²⁵³ Rohner and Lazopoulos, “Respondent’s Refusal to Pay Its Share of the Advance on Costs,” 554.

²⁵⁴ *Ibid.*, 555.

²⁵⁵ Wong and Siwy, “Recalcitrant Parties and the Tribunal’s Power to Order Cost Advance Payments,” 214.

²⁵⁶ Section 41(7)(d) of the EAA provides that “[i]f a party fails to comply with any other kind of preemptory order, then, [...] the tribunal may do any of the following: [...] (d) make such order as it thinks fit as to the payment of costs of the arbitration incurred in consequence of the non-compliance.” A preemptory order can be rendered by the tribunal under Section 41(5) when the defaulting party “without showing sufficient cause fails to comply with any order or directions of the tribunal”. A non-defaulting party can based on these provision seek for the preemptory order in case of non-compliance with the obligation to pay the share of the advance.

share of advance, but at the same time, a right to ask the tribunal to initiate such a claim is given to the non-defaulting party as well.²⁵⁷

Although research shows that the claim for the *payment* in this particular matter is not as frequently filed by the parties or discussed in the doctrine, most probably due to the reasons of efficiency, nevertheless it should not be neglected in this analysis. Once the obligation to pay a share of an advance is qualified as a substantive obligation, the non-defaulting party should be allowed both to require the payment to be made by the defaulting party or to make a substitute payment, and then seek for the reimbursement. Due to the lack of regulation in this matter of arbitration, various legal systems provide not only for different remedies regarding the reimbursement claim. In some jurisdictions having a right for such a claim does not guarantee one the right to seek specific performance.

As shown above, the contractual approach qualifies the parties' obligation to pay the advance on costs as a *mutually* owed *substantive* obligation, in case of a breach, the non-defaulting party has a right to request specific performance or reimbursement of substitute payment, based on the law applicable on the arbitration agreement. Although this approach may be described as the prevailing one, the procedural duty approach and the interim measures approach provide testimony for the non-harmonization of this area of arbitration law. The qualification of the nature of the obligation will depend on the national courts' and arbitral tribunals' will. This is an important consideration to be taken into account when determining before which forum a claim should be brought. The possible forums are both the arbitral tribunal and the national court. Advantages and disadvantages of both of these forums are discussed under next section.

²⁵⁷ Wong and Siwy, "Recalcitrant Parties and the Tribunal's Power to Order Cost Advance Payments," 214. Section 28(5) of the 1996 EAA provides: "Nothing in this section affects any liability of a party to any other party to pay all or any of the costs of the arbitration (see sections 59 to 65) or any contractual right of an arbitrator to payment of his fees and expenses."

III.2.1.2 Forums Which Can Decide on the Advance-Related Claims

Once the obligation to pay the share of an advance is considered to be substantive and there is right to seek reimbursement, i.e. it is perceived as specific performance, then it remains to be seen which forum would be the adequate one for these claims. According to the 1996 EAA, the appropriate forums are the national court under the Section 28(5) and the arbitral tribunal under the Section 41. In other words, the tribunal will initiate the proceedings regarding its fees before a national court, while the non-defaulting party may ask from a tribunal to issue a peremptory order, if the other party fails to pay its share of advance. The division between these two forums is not so clear in other jurisdictions. In general terms, one of the advantages for the arbitral tribunal's jurisdiction is cost and time efficiency of the procedure, which can be achieved by not commencing parallel proceeding before a court.²⁵⁸ Further, it is argued that if the tribunal is competent to decide on them, this may deter defaulting parties from defaulting in the first place.²⁵⁹

More specifically, when deciding on a suitable forum, the attention needs to be given also to the division between a claim for reimbursement and a claim payment of the share. Regarding the forum to which the non-defaulting party may turn to with its *claim for reimbursement*, the doctrine does not question the national courts' jurisdiction over such claims. Even more, in the German doctrine and jurisprudence, it was considered that only courts have jurisdiction to decide on the claims related to payment.²⁶⁰ This German perspective, as it will be shown below, was questioned in the doctrine. The doctrine now suggests a different approach which allows the tribunals to decide on the reimbursement

²⁵⁸ Tamminen, "The Obligation to Pay the Advance on Costs under the Vienna Rules and Austrian Law," 297.

²⁵⁹ Ibid.

²⁶⁰ Pitkowitz, "Shared Funding of Arbitration Proceedings: Fact or Fiction?," 37; Tamminen, "The Obligation to Pay the Advance on Costs under the Vienna Rules and Austrian Law," 293.

claims.²⁶¹ The Swiss doctrine considers the tribunal to be an adequate forum for such claims as well.²⁶²

Nevertheless, there are plausible doctrinal doubts whether arbitral tribunals have the power to decide on these claims. These doubts need to be addressed at this point. It was discussed in the doctrine whether the arbitral tribunal's decision on a claim for reimbursement would represent a decision *in causa sua* and whether the claims arising under the arbitration agreement could generally be decided by the tribunals.²⁶³ However, both of these concerns can be persuasively contradicted. The tribunal which is deciding on the reimbursement of substitute payment is not deciding on its own matter since by then it has already received the payment of the whole advance, which was provided by one of the parties. Indeed, the source for the substantive obligation of the parties to pay its shares of the advance, owed to each other or to the tribunal, is the arbitration agreement. However, when the claim for the reimbursement is submitted, the tribunal is dealing only with the substantive obligation to pay the share which parties *owe to each other* and not with its entitlement to require it. Therefore, the tribunal will not be deciding in its own cause, but solely *in the parties' matter*. The commentators confirm such conclusion.²⁶⁴

Similarly, the claims arising under the arbitration agreement should be considered to fall under the tribunal's jurisdiction due to the auxiliary nature of the arbitration agreement to the underlying contract.²⁶⁵ The exception to such scope of tribunal's jurisdiction should be that the tribunal cannot be the judge in its own matter, which is not the case when the claim for reimbursement is filed. However, it may be argued differently. Namely, in a case of arbitration rules or a parties' agreement providing specifically for the tribunal's power to

²⁶¹ Wong and Siwy, "Recalcitrant Parties and the Tribunal's Power to Order Cost Advance Payments," 209.

²⁶² Rohner and Lazopoulos, "Respondent's Refusal to Pay Its Share of the Advance on Costs," 555.

²⁶³ Wong and Siwy, "Recalcitrant Parties and the Tribunal's Power to Order Cost Advance Payments," 208–9.

²⁶⁴ *Ibid.*, 209.

²⁶⁵ *Ibid.*, 208.

render such decision, it is clear that the parties predicted such claims and clearly agreed for them to be within the scope of tribunal's jurisdiction. Widening this scope without the parties' consent, especially the defaulting party's consent, would violate the parties' agreement. The principle of efficiency of arbitration or a deterring argument should not override the demand for the parties' ability to predict at the moment of the conclusion of the arbitration agreement which claims can be brought to the tribunal.

Moreover, arbitration clauses usually provide that “*all disputes arising out of or in connection with the present contract*”²⁶⁶ will be resolved in arbitration proceedings. In that regard, the claim for reimbursement could not be characterized as “*arising out of or in connection*” with underlying contract, but rather from the arbitration agreement itself.²⁶⁷ In other words, although under the contractual approach, the obligation to pay the share of the advance arises from the arbitration agreement, the tribunal would seem not to be suitable forum to decide on the claims arising from such an obligation. Therefore, a more suitable forum to decide upon such claims would be, under this argumentation, national courts. This, however, is not a conclusion with which the doctrine would agree. Quite the opposite, the research showed that the doctrine is trying to argue for the tribunal's jurisdiction in this matter.²⁶⁸

The third reason which is discussed as a plausible reason to deny the tribunal jurisdiction over such claims is based on the fact that it is usually the arbitration institution which is in charge of the advance on costs.²⁶⁹ This is, however, not a plausible argument once we assume that the obligation to pay the share of advance is a *substantive obligation*. Arbitral

²⁶⁶ See Standard and suggested arbitration clause under ICC Rules.

²⁶⁷ See more on interpretation of the scope of tribunal's competence in: Nikolaus Pitkowitz, Chapter II: The Arbitrators and the Arbitration Procedure – Shared Funding of Arbitration proceedings: Fact or Fiction? In Christian Klausegger, Peter Klein, et al. (eds), *Austrian Yearbook on International Arbitration 2011*, p. 34-36.

²⁶⁸ See: Wong and Siwy, “Recalcitrant Parties and the Tribunal's Power to Order Cost Advance Payments”; Rohner and Lazopoulos, “Respondent's Refusal to Pay Its Share of the Advance on Costs.”

²⁶⁹ Rohner and Lazopoulos, “Respondent's Refusal to Pay Its Share of the Advance on Costs,” 555.

institutions have no power to decide on the substantive claims of the parties, and, therefore, their assistance in the collection of the payments should not be regarded as a denial of the tribunal's power on such claims between the parties.²⁷⁰

The same dilemma regarding the tribunal's jurisdiction is posed when it comes to a claim for *ordering the defaulting party payment of its share of the advance*, i.e. it is still questionable whether the tribunal can render an award ordering the defaulting party to pay its share to the tribunal. It is possible to argue that by rendering an award in which the payment is ordered would be a decision in its own matter, and, therefore, should not be allowed.²⁷¹ Not all scholars agree with such a conclusion, for the decision on advance is, in their opinion, the enforcement of the right of the party to obtain from the defaulting party the payment of a share of arbitrator's fees, and not the ruling on its own fees.²⁷²

While the conclusion that a decision on *specific performance* is not a decision *in causa sua* might be defensible in institutional arbitration, it might harder be to make that argument equally strong in *ad hoc* settings. Namely, in *ad hoc* arbitration, in which there is no schedule of costs, one needs to be aware that a possible reason for the non-payment might be that the defaulting party does not agree to the amount set by the tribunal. If a party refuses to pay its share because it does not accept the amount, the following issue arises: whether there is a substantive obligation to pay at all? For comparison, in institutional arbitration the amount is determined in accordance with the schedule which was accepted in advance by the parties who agreed on the arbitration rules. The amount which is afterwards determined according to such a schedule does not, therefore, touch upon the existence of a substantive

²⁷⁰ It was similarly argued in: Ibid., 556. The authors stated that the tribunal's adjudication on reimbursement is not inconsistent with the fact that the institutions are in charge on collection, since the institutions do not have a power to compel the non-defaulting party to pay, and the tribunal is deciding on a breach of the arbitration agreement and not of the arbitration rules.

²⁷¹ Wong and Siwy, "Recalcitrant Parties and the Tribunal's Power to Order Cost Advance Payments," 208.

²⁷² Ibid.; von Schlabrendorff and Sessler, "Part II – Commentary on the German Arbitration Law (10th Book of the German Code of Civil Procedure), Chapter VI Making of the Award and Termination of the Proceedings, § 1057 – Decision on Costs," 2015, 368.

obligation to pay such amount. The reason is simple: the parties knew or could have known the amounts which they are going to be requested to pay and consequently, their obligation to pay such an amount was triggered at the moment of the conclusion of an arbitration agreement. There is, nevertheless, still an outstanding question of what if a party does not agree to the amount, especially if such an amount was set by the tribunal. For example, both under the German arbitration law and the 1998 DIS Rules, it is the tribunal who determines the costs, so the institutional and *ad hoc* arbitration resemble each other in this regard more than under other arbitration rules and jurisdictions.

If the parties and the arbitrators never agreed on the amount to be paid and there is no other method for the determination provided, the issue is whether *the parties are obliged to pay at all*. If the answer was positive, the arbitrators would be free to impose any amount they wish on the parties and as long as one of the parties agrees on it, they could issue an order for specific performance requiring the payment, or the agreeing party could advance the whole amount and require reimbursement. According to the reasoning given by the German Federal Supreme Court the 2012 decision mentioned above [see under **1.2.2.a**], in a case when a non-paying party reimbursed the party who paid the advance, but disagreed with the amount of such advance, the party would have to refer its claim regarding the amount of the advance to a national court.²⁷³ In other words, in such a situation, the obligation to pay the advance would exist, and the remedy for a party disagreeing with the amount would be to file a claim before a national court. The German Federal Supreme Court supported such a solution with Section 315 of the German CC. Section 315 of the GCC provides: “*Where performance is to be specified by one of the parties to the contract, then in case of doubt it is to be assumed that the specification is to be made at the reasonably exercised discretion of the party making it.*” The paragraph 3 of Section 315 provides further that “[w]here the

²⁷³ Bundesgerichtshof, III ZB 63/10 (2012).

specification is to be made at the reasonably exercised discretion of a party, the specification made is binding on the other party only if it is equitable” and “[i]f it is not equitable, the specification is made by judicial decision.” The remedy is clear, but the question remains: do the parties empower the tribunal with a unilateral right of specification in *ad hoc* settings?

As it was discussed in a Chapter II, the method for a calculation of the fees, and also for the calculation of the advance, is dependent on the negotiation between the arbitrator(s) and the parties. If the agreement is not reached as to the method, and subsequently as to the amount, the tribunal is to set the fees, and the parties can get recourse in the national court for a possible adjustment. It follows that the lack of an agreement as to the amount of fees in *ad hoc* setting does not touch upon the parties’ obligation to pay the advance on costs, which could be a too extensive conclusion as discussed under III.2.1. Nevertheless, any other conclusion could be a basis for a dilatory tactic of a party resisting the arbitration who would not agree to any amount suggested by the tribunal, forcing the other party to cover it. In such a situation, it would even be questionable as to whether there is an obligation to pay the costs allocated under the last award, since the obligation to pay never came to existence. The resolution on this matter would once again fall to the national courts, practically leading to the similar dispute resolution mechanism as if the parties are required to request the court for an adjustment of fees, but only with a different burden of proof.

The German Federal Supreme Court was also clear regarding the appropriate forums who can hear the claims regarding the costs. Any claim regarding *the reimbursement of the advance* should be referred to a national court and during those proceedings the tribunal shall stay the arbitration proceedings.²⁷⁴ The *order to pay the share* could not be a matter brought before the tribunal as well, as the same court stated that the payment of the fees cannot be

²⁷⁴ Ibid.

decided in the award - the tribunal can only suspend its work or continue with the proceedings and then subsequently litigate for its fees and expenses before a national court.²⁷⁵

The choice between the court and the arbitral tribunal as an appropriate forum for hearing the advance-related claims should be based on the practical repercussions. For example, in case of a *claim for reimbursement*, it would be more efficient for the non-defaulting party to seek the reimbursement before an arbitral tribunal. Once the substitute payment is made, the arbitral tribunal will continue with its work. Since, as discussed above, the tribunal has an authority to render a decision concerning the reimbursement claim, this would be a more practical solution for a non-defaulting party. The other solution, which is the commencement of court proceedings in this matter, would incur unnecessary costs for the party.

The choice of a forum when the non-defaulting party wishes to ask for *the payment of the share to the tribunal or the institution*, requires further practical observations. For example, the non-defaulting party will most likely not be in a position to obtain such a court's decision within the deadline set for the payment of an advance, and the arbitration proceedings will, consequently, be terminated, without any prejudice to start the new ones [see **III.1.2**]. The commencement of the new arbitration proceedings will be postponed and it will depend on the court's decision on this matter. During that time, the statute of limitations for the main claims will continue to run. On the other hand, if the non-defaulting party decides to sue before a tribunal, in case where there is no specific provision on tribunal's jurisdiction in this matter, it is questionable whether the tribunal or the institution will accept to continue with regard to such a claim, while only one share of the advance is paid.

²⁷⁵ Ibid.

The form of the decision and, consequently, the enforcement issues may also contribute to this debate, and for that reason they are discussed under Part III.3 of this Chapter. Before that, other approaches as to the qualification of the nature of the payment of the advance are discussed. The following section explains the procedural duty approach.

III.2.2 The Procedural Duty Approach: A Bifurcated Stance in the Swedish and the Austrian Jurisdiction

Quite the opposite view is taken in the doctrine and practice by those who consider the obligation to pay the advance to be merely a procedural duty. In other words, defaulted payment of the share of the advance has only *procedural* consequences, such as the termination of the proceedings, or the presumed withdrawal of the claim. From the procedural duty approach, it also follows that there is no possibility to file a claim for the *immediate* reimbursement of substitute payment.²⁷⁶

The Austrian jurisdiction is a rare example of jurisdiction in which this approach is adopted, at least in *ad hoc* settings. Scholars consider that under the Austrian Code of Civil Procedure [“Austrian CCP”]²⁷⁷, the decision on reimbursement can be a part of a final award rendered by the arbitral tribunal or decided by the state court after the conclusion of the arbitral proceedings which ended without an award.²⁷⁸ This is a direct repercussion of the fact that in the Austrian doctrine, the arbitration agreement is considered to be a procedural contract, while the claim for costs in Austrian litigation is merely a procedural claim.²⁷⁹ This

²⁷⁶ Pitkowitz, “Shared Funding of Arbitration Proceedings: Fact or Fiction?,” 34.

²⁷⁷ Law of 1 August 1895 Austrian Code of Civil Procedure, RGBl. Nr. 113/1895, as amended by the 2013 Amendment to the Austrian Arbitration Act -“SchiedsRÄG 2013”, BGBl. I Nr. 118/2013 in force as of 1 January 2014.

²⁷⁸ Different authors cited in: Pitkowitz, “Shared Funding of Arbitration Proceedings: Fact or Fiction?,” 37, 50.

²⁷⁹ Wong and Siwy, “Recalcitrant Parties and the Tribunal’s Power to Order Cost Advance Payments,” 202–3.

doctrinal view is especially relevant for *ad hoc* arbitrations in which it can be considered to be applicable till this date.

The jurisprudence confirmed this doctrinal approach. The Higher Regional Court of Vienna held that the tribunal “*exceeded the limits of its responsibility*” by rendering a partial award in which it ordered the respondent to immediately reimburse claimant for its substitute payment.²⁸⁰ The partial award was, however, rendered under the 2006 Vienna Rules. The Court reasoned that “*the parties agreed that the arbitral tribunal had jurisdiction over their substantive-law disputes out of the contract (...) but not over substantive-law claims which resulted from the arbitration clause itself (...)*”.²⁸¹ The Court’s decision should still be considered binding for *ad hoc* tribunals with their seat in Austria. Such perspective, however, received a critique by other commentators, who provided a persuasive doctrinal argumentation for the arbitration agreement as a possible source of the obligation to pay the advance which is to be considered a substantive obligation and for the legal basis of the claim for the reimbursement under Section 1042 of the Austrian Commercial Code which regulates unjust enrichment.²⁸² The Austrian jurisprudence confirmed that the decision on the reimbursement of substitute payment cannot be rendered by national courts as well.²⁸³

It will be interesting to see how will the novelty on this matter, which was introduced in the 2013 Vienna Rules, be implemented within this jurisdiction. The 2013 Vienna Rules now explicitly provide that the tribunal may order the non-paying party to reimburse the paying party, but only “*to the extent it finds that it has jurisdiction over the dispute*”. This

²⁸⁰ Pitkowitz, “Shared Funding of Arbitration Proceedings: Fact or Fiction?,” 39.

²⁸¹ Decision of the High Regional Court in Vienna (Docket No 2 R 55/05f) cited in: Nikolaus Pitkowitz, Chapter II: The Arbitrators and the Arbitration Procedure – Shared Funding of Arbitration proceedings: Fact or Fiction? In Christian Klausegger, Peter Klein, et al. (eds), *Austrian Yearbook on International Arbitration 2011*, p. 39.

²⁸² Wong and Siwy, “Recalcitrant Parties and the Tribunal’s Power to Order Cost Advance Payments,” 202–6. The authors provided a persuasive doctrinal argumentation for the arbitration agreement as a possible source of the obligation to pay the advance which is to be considered a substantive obligation, and for the legal basis of the claim for the reimbursement under Section 1042 of the Austrian Commercial Code which regulates unjust enrichment.

²⁸³ Vienna International Arbitral Centre, *Handbook Vienna Rules: A Practitioner’s Guide* (Vienna: VIAC, 2014), 253.

stipulation in the rules was introduced solely to avoid any confusion on whether the tribunals have jurisdiction to decide on this matter.²⁸⁴ The tribunal's jurisdiction is hence a prerequisite to establish *contractual* basis for the claim on reimbursement.²⁸⁵ However, since otherwise, i.e. without the application of the 2013 Vienna Rules, the Austrian court came to a conclusion that this is solely a procedural duty and that the tribunal has no jurisdiction to decide upon it, the enforcement of such a tribunal's decision could be rejected as to be a decision rendered in excess of the tribunal's mandate.

On the other hand, the courts can also conclude that by agreeing to the 2013 Vienna Rules, the parties agreed to expand the tribunal's scope of jurisdiction over such claims as well. This, however, also means that it is up to the parties to agree on the nature of such an obligation and the forum where they wish to vindicate such substantive rights. The reconciliation of the solution provided in the 2013 Vienna Rules and the stance adopted within the Austrian legal system will be an interesting development to follow, especially given that the rule regarding the right of the party to make a request to the tribunal for the reimbursement of substitute advance was proposed by the Working Group and incorporated in the government's draft, but never in the final version of the Austrian CCP.²⁸⁶

A similar attempt was done when the Swedish AA passed in 1999 and the refusal to implement such an explicit right into this Act was used as a justification later by the Supreme Court to deny the non-defaulting a right to ask for the reimbursement, as it will be explained below.²⁸⁷ Article 37(1) of the Swedish AA provides that “[t]he parties shall be jointly and severally liable to pay reasonable compensation to the arbitrators for work and expenses.” This provision which indicates the *substantive* nature of the obligation to pay the advance and

²⁸⁴ Ibid.

²⁸⁵ Ibid.

²⁸⁶ Tamminen, “The Obligation to Pay the Advance on Costs under the Vienna Rules and Austrian Law,” 294.

²⁸⁷ Wong and Siwy, “Recalcitrant Parties and the Tribunal's Power to Order Cost Advance Payments,” 211–12.

the right of the arbitrators to receive the payment from only one of the parties, while it is up to the parties to arrange their mutual obligation afterwards. On the other hand, Article 38(1) of the Swedish AA provides for the substitute payment as an option for the non-defaulting party which is not obliged to cover the whole debt and this seems to contradict the concept of the several liability of the parties as provided under Article 37(1). The Swedish legislator, the Stockholm Chamber of Commerce, and the Swedish Supreme Court differentiated the solutions available to the parties arbitrating under the 2010 SCC Rules and the parties arbitrating in *ad hoc* settings in Sweden, i.e. without an agreement on the application of these rules. Similarly to the contradiction within the Austrian jurisdictions, in the settings where the parties did not explicitly provide for such a solution, the obligation to pay the advance is only a procedural duty, while by agreeing on the applicability of the 2010 SCC Rules the parties integrate the payment obligation owed to each other into their contract, enforcement of which is put under the jurisdictions of the arbitral tribunal.

To be more precise, Article 45(4) of the 2010 SCC Rules explicitly provides for the possibility to make the request to the tribunal for reimbursement, while the Swedish Supreme Court decided in the Case No. T 5119-99 that such a request is not possible in *ad hoc* arbitration, or at least where there is no parties' agreement on the matter. The Swedish Supreme Court was reluctant to grant such a right for several reasons. Firstly, because it found that "*it would not be compatible with the fact that a party is not, as against the arbitrators, liable to make the payment*".²⁸⁸ Secondly, such payment would entail enforcement issues since "*several enforcement titles could be issued for the same amount*".²⁸⁹ The Court also stressed that such a right was considered during the preparatory works to the Act of 1999, but was not proposed in the end. Consequently, in that light, the Swedish

²⁸⁸ Case No. T 5119-99 (Swedish Supreme Court 2000).

²⁸⁹ Ibid.

Supreme Court held not “*suitable to introduce, by way of case law, a provision on right of temporary regress*”.²⁹⁰

The Swedish Supreme Court’s reasoning is persuasive, especially in relation to the fact that this issue and a plausible solution were discussed and rejected by the legislator. When deciding that the creation of such right by case law is not an appropriate venue, the Court obviously recognized the legal consequences such a right could entail and it paid due attention to legal certainty. However, the Swedish Supreme Court held that such a request is not granted, unless the parties have agreed otherwise. Although it was previously stated that party autonomy could integrate such a right into their contract, this seems to contradict with the Supreme Court’s opinion.

The parties’ agreement would establish clear ground for such a request, but the parties’ agreement would not solve the issue of the several enforcement titles, i.e. the interim decision on the reimbursement or payment of the advance and the last award in the arbitral proceedings, which was the main concern of the Swedish Supreme Court. If the Court’ motivation was to provide legal certainty and prevent undesirable legal consequences in enforcement proceedings, it is difficult to assume that the parties’ agreement can override these principles, since the parties will most likely not provide details on such subsequent procedure in their agreement. In the end, the result is similar to the one under Austrian law. There is no right to recourse for the reimbursement or payment of the advance *during* arbitration proceedings and the parties need to wait till the end of the proceedings for the final allocation of costs in order to receive reimbursement.²⁹¹

Moreover, under both of these legal systems, it seems that the parties are free to provide for the possibility of such a request to be submitted solely to *the arbitral tribunal*,

²⁹⁰ Ibid.

²⁹¹ Brocker and Löf, “Chapter 8 The Proceedings,” 211.

while it would seem impossible to compel the national courts to decide on such a matter since national law does not allow them. Also, the national courts are still in charge of the enforcement of the tribunal's decision made upon such a request, so they will have the last word as to the qualification of the nature of the obligation. In the Austrian jurisprudence, a somewhat bifurcated approach seems to prevail, as the Austrian Supreme Court confirmed its readiness to recognize foreign arbitral awards on the reimbursement, although under Austrian law such a claim is considered outside of the scope of tribunal's jurisdictions.²⁹² Enforcement related issues of the separate award and other decisions related to the payment of the advance on costs will be further discussed in Part III.3 of this Chapter.

The contractual approach was in certain cases dismissed in the ICC practice as well, and the procedural duty approach was adopted. For example, in the ICC case 12491, the arbitral tribunal held that the provision on the advance in the 1998 ICC Rules is exclusively a condition precedent to the implementation of the arbitration.²⁹³ The arbitral tribunal recognized only the procedural consequences as possible consequences of the non-payment: the non-defaulting party can either choose to pay the entire amount on advance or if such payment is not made, the claim is deemed withdrawn.²⁹⁴ However, this approach still remains advocated in a minority of cases and doctrinal opinions. It leaves the non-defaulting party without any access to the tribunal unless it is ready to make the substitute payment, while the contractual approach provides such a party with other remedies that do not put the whole burden of costs on its side. The following section will present the approach which can be seen as a compromise between these two: the interim measures approach.

²⁹² Vienna International Arbitral Centre, *Handbook Vienna Rules*, 254.

²⁹³ Bühler, "Note – Sentence Partielle Du 1er Juin 2004 Dans L'affaire CCI No 12491/KGA/EC," 296.

²⁹⁴ Ibid.

III.2.3 The Interim Measure Approach: A Compromise between the Contractual and Procedural Duty Approaches

Under the interim measures approach it is considered that there is no contractual obligation among the parties to pay the advance, but rather solely *between the parties and arbitral tribunal (institution)*.²⁹⁵ By dismissing the contractual obligation between the parties, i.e. the substantive obligation which the parties owe to each other, the interim measures approach is very similar to the opinion that such obligation is only a procedural duty. Such a conclusion is justified to a certain extent. The doctrine, courts, and arbitral tribunals consider under this approach any decision rendered on the payment of an advance to be a procedural decision of administrative nature.²⁹⁶ The difference is the fact that there is a possible remedy for the parties in the form of the tribunal's decision, unlike under the procedural duty approach.

A request for the interim measure based on the non-payment of the advance will, however, depend on the applicable arbitration rules and the provision regarding these measures. According to Article 28(1) of the 2012 ICC Rules “(...) *the arbitral tribunal may, at the request of a party, order any interim or conservatory measure it deems appropriate*”. In the ICC case No. 11405, the tribunal granted such a remedy in a case regarding the non-payment of an advance. When deciding on whether the prerequisites for such an interim measure were fulfilled, the tribunal concluded that it “*has to consider and balance the legitimate interests of both parties*”. Following that approach, it stated that while the claimant clearly showed its legitimate reason to seek for an interim measure, this being the respondent's financial difficulties, the respondent failed in doing so. Also, the arbitral

²⁹⁵ Secomb, “Awards and Orders Dealing with the Advance on Costs in ICC Arbitration: Theoretical Questions and Practical Problems,” 64.

²⁹⁶ Bühler, “Note – Sentence Partielle Du 1er Juin 2004 Dans L'affaire CCI No 12491/KGA/EC,” 293.

tribunal concluded that “*a condition of particular urgency or of irreparable prejudice should not be required*”.

This solution was not available under the 2006 Vienna Rules, which provided in Article 22(1) that interim measures can be taken if the arbitral tribunal considers them “*necessary in respect of the subject matter of the dispute, as otherwise the enforcement of the claim would be frustrated or considerably impeded or there is a danger of irreparable harm.*” The jurisprudence held that this rule excluded or, at least, limited the possibility to grant an interim measure for the *immediate* reimbursement of the costs in two regards. First, the reasons for the exclusion of a possibility for granting such measures in case of the non-payment of the advance was the fact that they were only available in respect of the “*subject matter of the dispute*” which the advance certainly is not.²⁹⁷ The second limitation was that the requesting party needed to prove a possible frustration or impediment of enforcement or danger of irreparable harm. Both of these would be on the non-defaulting party to prove as a consequence of non-payment by the other party.²⁹⁸

The 2013 Vienna Rules in Article 33(1) excluded these limitations by simply providing that “*the arbitral tribunal may at the request of a party grant interim or conservatory measures against another party.*” The exclusion of these limitations does not by itself mean that the interim measures approach will be adopted by the arbitral tribunals. Nevertheless, in case they decide to adopt it, they will not be prevented by the language of the rule. However, the limitations are still left in Section 593(1) of the Austrian CCP²⁹⁹, which means that an interim measure as a remedy for the non-defaulting party in *ad hoc*

²⁹⁷ Pitkowitz, “Shared Funding of Arbitration Proceedings: Fact or Fiction?,” 48.

²⁹⁸ *Ibid.*, 49.

²⁹⁹ Section 593(1) of the Austrian CCP provides: “Unless otherwise agreed by the parties, the arbitral tribunal may, upon request of a party and after hearing the other party, order such interim or protective measures it deems necessary in respect of the subject-matter in dispute if the enforcement of the claim were otherwise frustrated or significantly impeded, or there were a risk of irreparable harm. The arbitral tribunal may request any party to provide appropriate security in connection with such measure.”

arbitration would not be available within this jurisdiction. A tribunal in a French jurisdiction came to a different conclusion. In 1998 the *Tribunal de grande instance Beauvais* ordered the respondent, who failed to make a payment of its share of an advance under the 1998 ICC Rules, in a form of an interim measure.³⁰⁰

Although this approach is a compromise between contractual and procedural duty approaches, it has been criticized from the perspective of both of these approaches. Scholars supporting the contractual approach have stated that the interim measures approach “*has not gained wider significance*”.³⁰¹ Moreover, the ICC tribunal, supporting the procedural duty approach in the ICC case No. 12491, dismissed the interim measure approach on similar grounds by concluding that such a decision ensures neither the effectiveness of the subsequent award on merits nor security for an award on costs.³⁰² However, there are also ICC tribunals which reached a decision declaring the obligation to pay the advance to be of administrative nature. For example, in an interim award rendered on March 26, 2002, the ICC sole arbitrator decided that the provision on interim measures of the ICC Rules covers the issue of payment of the advance as well.³⁰³ The same tribunal stated that the contractual nature of the obligation to pay the advance cannot be established either under the ICC Rules, or under the applicable laws.³⁰⁴ The main reasoning, made under the ICC Rules by the tribunal was that the power of the ICC court

“to discharge the parties from the obligation to pay each half of the global advance on costs, by fixing separate advances, implies that the parties are not

³⁰⁰ “*Société Fertalge Euromade v. SA Kaltenbach Thuring, Tribunal de Grande Instance de Beauvais 1998*,” *Revue de l’Arbitrage*, 2002; Wong and Siwy, “Recalcitrant Parties and the Tribunal’s Power to Order Cost Advance Payments,” 213.

³⁰¹ Fadlallah, “Payment of the Advance to Cover Costs in ICC Arbitration: The Parties’ Reciprocal Obligations,” 56.

³⁰² Bühler, “Note – Sentence Partielle Du 1er Juin 2004 Dans L’affaire CCI No 12491/KGA/EC,” 295.

³⁰³ “Parties Not Indicated, 26 March 2002,” *ASA Bulletin* 21, no. 4 (2003): 802–9.

³⁰⁴ *Ibid.*, para. 19.

contractually bound (each towards the other) to pay half of the advance on costs when a counterclaim is raised.”³⁰⁵

Since fixing the separate advance works as a protection of the claimant against excessive counterclaims submitted by the respondent (counter-claimant) and hence the respondent (counter-claimant) “*should not be allowed to pay alone the global advance on costs and then be entitled to be reimbursed by the claimant (and counter-respondent).*”³⁰⁶ In other words, the tribunal stated that

“if it is justified that a claimant should not be obliged to pay an excessive amount for the advance on costs because the respondent has presented [...] counterclaim, the same protection should be given to the respondent.”³⁰⁷

Both the contractual and the interim measures approaches provide the non-defaulting party with a possible remedy. There are, however, differences between certain aspects of granting such remedy. The main differences are related to the burden of proof rules and the form of the decision that can be rendered. The interim measures approach is more restricting regarding the burden of proof rules for a non-defaulting party than the contractual one. While the latter places the burden of proof in order to be excused from its obligation to pay its share of advance on the non-paying party, the former puts burden of proof to show legitimate reason for asking such a remedy on the non-defaulting party.³⁰⁸

The form of decisions is the second difference. Arbitration rules having specific rule on this issue provide for the tribunal to render a decision on the reimbursement in the form of

³⁰⁵ Ibid., para. 17.

³⁰⁶ Ibid., para. 18.

³⁰⁷ Ibid.

³⁰⁸ Secomb, “Awards and Orders Dealing with the Advance on Costs in ICC Arbitration: Theoretical Questions and Practical Problems,” 65.

the award.³⁰⁹ Since the contractual approach supposes the existence of a contractual obligation and a decision based on the substantive law, the award seems the appropriate form for the decision under that approach. This is not to say that there are not any drawbacks of this form of a decision. As it will be shown below, rendering an award on the advance-related issue may lead to the inconsistency of such an award with the last award in the enforcement proceedings under the New York Convention [see **III.3.1**]. However, under the interim measures approach, two types of decisions can be rendered. An arbitral tribunal is usually given the opportunity to choose between an award and a procedural order as a possible form of the decision.³¹⁰ The ICC sole arbitrator in the interim award rendered on March 26, 2002, stated that since the issue was of the “*payment of a determined amount of money, the Arbitrator considers it appropriate to issue an award, which should be enforceable.*”³¹¹

Such a statement that an advance-related decision should be enforceable, especially if it is qualified as an award, does not bind national courts. Both procedural orders and awards entail certain enforcement issues, which are discussed under the following section.

III.3 Enforcement of the Decisions on the Payment of the Advance on Costs

When the non-defaulting party has a right under the prospective jurisdiction and it pursues it in order to receive the order for the payment of the advance or the immediate reimbursement, the last step for it will be the enforcement of that decision. As mentioned above, the forms of the decisions which tribunals may render under the contractual approach and the interim measures approach are: an award or a procedural order. Both of these

³⁰⁹ Article 45(2) of the 2010 SCC Rules; Article 30(6) of the 2013 SIAC Rules; Article 42(4) of the 2013 Vienna Rules. The 2013 Vienna Rules provide that such decision can be in a form of an award or “*other appropriate form*”.

³¹⁰ Article 28(1) of the 2012 ICC Rules.

³¹¹ “Parties Not Indicated, 26 March 2002,” para. 20.

decisions serve the non-defaulting party in the enforcement of its rights, but not with equal efficiency. In order to provide the party with the most efficient remedy, the tribunals should take into account the procedure of enforcement, which is available for certain types of their decisions in the jurisdiction of the seat of the arbitration.

The enforcement of the advance-related courts' decisions is not discussed under this Chapter merely because the enforcement of these decisions does not raise as many issues as the enforcement of the tribunal's decisions. The analysis of the enforcement procedure allows the top-down perspective as to the qualification of the nature of the obligation in question, which provides a clear picture on how legislators and national courts qualify this issue.

III.3.1 Enforcement of the Awards on the Payment of the Advance

III.3.1.1 Qualification of the Advance-Related Decision as an "Award"

An award as the form of the decision on the reimbursement is an appealing form for the decision on the immediate reimbursement at first sight, since it seemingly guarantees easier enforcement. However, national courts enforcing the awards look beyond the label it was given. There is a certain psychological effect constituted by labelling a decision as an *award* and the probable influence such labelling might have on enforcement.³¹² Before deciding on such a label, three questions must be explored before deciding whether the award is indeed the suitable type of a decision. Firstly, is the reimbursement of costs a matter that can be decided in an award? Secondly, if it is a subject-matter that meant to be settled in an award, which type of an award is deemed to be appropriate? And finally, what are the effects

³¹² The possibility that “*advocates may attempt to persuade a tribunal to construe a decision as an award so as to encourage or discourage enforcement and res judicata, depending upon whether they want the decision to be reviewed, challenged or enforced, or to bring the claim in another forum*” was recognized in: Eduardo Zuleta Jaramillo, “The Relationship Between Interim and Final Awards - Res Judicata Concerns,” *Arbitration Advocacy in Changing Times, ICCA Congress Series* 15 (2011): 235.

of such an award under *res judicata* doctrine? As it will be explained below, an issue of the enforcement of such an award is covered by positive effect of *res judicata*, but such enforcement should be observed also within the negative effect of *res judicata* and how it influences subsequent rendering of a last award and the final allocation of costs.

When it comes to the first two questions, due attention needs to be given to the definition of an award and to the definition of the types of an award. As already mentioned, the qualification of a decision as an *award* by an arbitral tribunal does not bind the national court, as much as the tribunal's qualification of the obligation as a contractual one does not bind the court. The court may re-qualify a decision labelled as an "order" to be an award, and *vice versa*, it can re-qualify an "award" to be an order.³¹³ There is, however, no universally accepted definition of an award, while at the same time the qualification of a decision as an *award* provides for the legal consequence of the utmost importance: only an *award* may be set aside or enforced under the New York Convention.³¹⁴ More importantly, such a decision cannot be reviewed on merits and is practically enforceable all over the world.³¹⁵ For that reason, the qualification of a decision on reimbursement of costs as an *award* can be of crucial importance for the party asking for it.

National courts, as will be shown below, which are confronted with requests to set aside or to enforce a decision, often focus the debate on whether a decision is an award around an issue of the *finality* of such a decision. However, while the *finality* of a decision is important it is not the only and sometimes not even the decisive quality of a decision which is needed in order to qualify such decision as an award.

³¹³ Jennifer Kirby, "What Is an Award, Anyway?," *Journal of International Arbitration* 31, no. 4 (2014): n. 2; Emmanuel Gaillard and John Savage, eds., *Fouchard, Gaillard, Goldman on International Commercial Arbitration* (The Hague ; Boston: Kluwer Law International, 1999), para. 1351.

³¹⁴ Kirby, "What Is an Award, Anyway?," 477.

³¹⁵ *Ibid.*, 478.

One of the definitions defines an award “as a final decision by the arbitrators on all or part of the dispute submitted to them, whether it concerns the merits of the dispute, jurisdiction, or a procedural issue leading them to end the proceedings”.³¹⁶ There are three elements that can be identified in this definition, which a decision must meet in order to be qualified as an award: one, it must be made by the arbitrators; two, it has to resolve a dispute; and three, it must be binding.³¹⁷ The decision on the reimbursement of costs satisfies the first one of these elements. As to the third requirement, decisions which only bind the parties on condition that they expressly accept them are not awards.³¹⁸ Since a decision on reimbursement is binding without any condition, it should satisfy also the third element.

However, it is questionable whether such a decision resolves a dispute. It is considered that this element requires that the arbitrators decide the dispute either wholly or in part.³¹⁹ Two dimensions can be distinguished in this regard: the first dimension concerns the scope of a subject of a decision. The second dimension deals with the nature of a subject. According to the scope of a subject, the arbitrators can decide the dispute *wholly* or in *part*. By deciding on the reimbursement of costs, the arbitrators would decide in *part*, as it is rendered *during* proceedings, and the remaining material issues are to be resolved afterwards.

The remaining issue is whether a decision on reimbursement falls within the second dimension, i.e. whether the nature of the subject of such a decision qualifies it as an award. Orders allowing witnesses testimony and document production are examples of when when arbitrators do not decide the dispute.³²⁰ Considering a decision on reimbursement to be equal

³¹⁶ Gaillard and Savage, *Fouchard, Gaillard, Goldman on International Commercial Arbitration*, para. 1353; Kirby, “What Is an Award, Anyway?,” 476.

³¹⁷ Gaillard and Savage, *Fouchard, Gaillard, Goldman on International Commercial Arbitration*, paras. 1354–56. The authors also emphasized, as the fourth element, that the award can be partial. This element will be discussed in this thesis together with the second requirement which requires the award to resolve a dispute, and then in more details when the enforcement of a partial and an interim award will be discussed.

³¹⁸ *Ibid.*, 1356.

³¹⁹ *Ibid.*, para. 1355.

³²⁰ *Ibid.*

to such measures is possible under the procedural duty approach described above. However, under the contractual approach, such decision is considered to be a decision on substantive obligations under the arbitration agreement, and therefore it is not equal to the measures related to evidence production. For that reason, these examples are insufficient to conclude whether the reimbursement of costs would be a decision that *resolves a dispute*. In order to make this determination, it is necessary to analyse what is usually the content of the decisions which *are* qualified as awards and as such resolve a dispute.

The arbitration community, including scholars, arbitrators and arbitration institutions, has not yet come to consensus regarding the definition of the different types of awards.³²¹ As it could have been seen, the terminology is not a decisive factor, but it can be misleading one. The principle of efficiency of any proceedings, including the arbitration and the court proceedings, requires clarification regarding the different types of arbitral awards. For that reason, the terminology used in the analysis of this thesis will be specified according to the subject of the decision and used accordingly. Since the classification of awards differs from one jurisdiction to another and from one scholar to another, such differences will be duly acknowledged in the footnotes.

There are four types of an award that can have costs as their subject matter: a partial award, an interim award, an interlocutory award, and a last award. Here is the overview of the main differences between them. A *last* award, which is often called a *final* award, is the easiest to distinguish from the remaining three. The reason why term *final* is inappropriate for the purposes of this thesis is because *finality* as a feature of an award is analysed in a section related to the *res judicata* concept. In order to avoid any misunderstandings, this study used

³²¹ Zuleta Jaramillo, “The Relationship Between Interim and Final Awards - Res Judicata Concerns,” 234.

the term *final* award an award which “puts an end to at least one aspect of the dispute” and a *last* award for a decision which “completes the mission of the arbitral tribunal”.³²²

Unlike the *last* award, the *partial* and the *interim* award do not complete the mission of the arbitral tribunal, i.e. they do not put an end to arbitration proceedings and it is much more difficult to distinguish them. A *partial* award is a *final* award that can be defined as a decision which “yield[s] a final settlement of some of the claims submitted to arbitration, and they typically have a direct monetary impact”³²³, or similarly as a decision “that finally dispose[s] of part, but not all, of the parties’ claims in an arbitration”³²⁴. An interim award, on the other hand, is either a substitutable term for a partial award or it is considered to be a decision “that does not dispose finally of a particular claim”.³²⁵ However, it is sometimes considered that an *interim* award “may also represent a final word on the merits but usually regarding a claim that can be recognized but does not require affirmative enforcement”, for example, in a case of bifurcation of the proceedings where the issue of liability is decided separately from the amount of damages.³²⁶ Finally, the third type of awards are interlocutory awards which “are not directed to the merits; they deal with such issues as jurisdiction, and the determination of the applicable law”.³²⁷

The purpose of this analysis is not to resolve the long-standing discussion in doctrine regarding the definitions of the different types of awards. In any case, although it would be

³²² The author acknowledges that the term *final award* is an established term in arbitration rules, scholarly work, and arbitral practice for the award which concludes the arbitration. However, for theoretical clarity, such terminology should not be accepted in thesis. For longer discussion on this issue see: *Ibid.*, 242.

³²³ Tibor Varady, John J Barceló, and Arthur Taylor Von Mehren, *International Commercial Arbitration: A Transnational Perspective* (St. Paul, Minn.: Thomson/West, 2012), 746.

³²⁴ Born, *International Commercial Arbitration*, 3015.

³²⁵ *Ibid.*, 3020; Similarly in: Zuleta Jaramillo, “The Relationship Between Interim and Final Awards - Res Judicata Concerns,” 247; Sometimes, a term “interim award” encompasses also decisions having monetary effect, or it is considered to be a term which is broader than a “partial award”. For the thorough analysis of this issue see: Hse Yu Chiu, “Final, Interim, Interlocutory or Partial Award: Misnomers Apt to Mislead,” *SaC LJ* 13 (2001): 470–471.

³²⁶ Varady, Barceló, and Von Mehren, *International Commercial Arbitration*, 746.

³²⁷ *Ibid.*; Zuleta Jaramillo, “The Relationship Between Interim and Final Awards - Res Judicata Concerns,” 248. One thing that is certain is that the terms “partial”, “interim” and “interlocutory” are used interchangeably, and there is no clear-cut and universally accepted definition

helpful to have universally accepted definitions, classification should not make those who are reviewing an arbitral tribunal's decision blind regarding its true nature. The term "award" should be defined in a teleological sense, by answering the question: what is a purpose of an award. The first answer is: "*all awards are intended to have the same effect, i.e. final and binding with respect to the matters dealt with in the award*".³²⁸ However, such a definition might seem circular given that these effects of an award are also the main features of a decision which are required for it to be enforced or to set aside as an award, as will be discussed below. The second question, which follows from this theoretical circle, and which can help more in identifying a decision as an award, is: "Is there a legitimate reason a party may want state courts to enforce the decision at issue? Or set it aside?"³²⁹

In order to decide whether a decision in which the tribunal grants certain amount of money as reimbursement of a substitute advance payment made by the non-defaulting party above mentioned considerations should be taken into account. Firstly, is this decision intended to have a final and binding effect with respect to the matters dealt with an award? The answer should be: "yes". Otherwise, such a decision would not have any purpose due to the fact that the costs are allocated in a last award. This decision is, therefore, aimed to have a final and binding effect with respect to the reimbursement of the costs at that stage of proceedings.³³⁰

Furthermore, is there legitimate reason for a party to want state courts to enforce the decision at issue or set it aside? The answer is the following: a legitimate reason for rendering a decision on reimbursement *during* the arbitration proceedings can only be *immediate* enforcement. Otherwise, the party could wait until the last award is rendered which contains

³²⁸ Chiu, "Final, Interim, Interlocutory or Partial Award," 472.

³²⁹ Kirby, "What Is an Award, Anyway?," 478.

³³⁰ There might be some concern raised whether this decision is *final* or solely *provisional* in relation to the decision on allocation of costs in a last award, but this concern will be addressed in a discussion which follows on the negative effect of *res judicata*.

the final allocation of the costs, and since there is a legitimate interest for the enforcement, there will naturally be an interest of the opposing party to set this kind of awards aside. Therefore, in light of this discussion, a decision on immediate reimbursement would qualify as a matter which is decided in an award. It is less important how that award is labelled. Yet, to provide even more theoretical clarity in light of the classification of awards presented above, such an award should be considered either *partial*, for it decides on the merits and has a direct monetary effect, or *interlocutory*, if the issue of costs would not fall under the narrow concept of the merits. In any case, such an award should not be labelled as *interim*.³³¹

III.3.1.2 The Repercussions of the *Res Judicata* effect

The theoretical qualification of a decision as a partial or interlocutory award does not always and in every jurisdiction result with a decision which is enforceable as an award. For that, one needs to look at the *res judicata* effect of such decision and respective jurisprudence in that regard. Since there is a lack of national courts' decisions on the enforcement of awards on immediate reimbursement, the analysis will focus on the enforcement of partial and interlocutory awards in general. By analogy, similar conclusions should be reached for the awards on the reimbursement of costs.

³³¹ According to the classification adopted in this thesis, an "interim" award is the one that is considered to be a decision that does not dispose finally of a particular claim, or if it does, it is usually regarding a claim that can be recognized but does not require affirmative enforcement. Varady, Barceló, and Von Mehren, *International Commercial Arbitration*, 746. The decision on the immediate reimbursement of costs can be considered to be an "interim award" if such a label substitutes a term "partial award" or is considered to be an umbrella term for "partial" and "interlocutory" awards. Chiu, "Final, Interim, Interlocutory or Partial Award," 467; The author is nevertheless of an opinion that the term "interim", which can be defined and confused with a term "provisional" or "temporary", should not be used as a qualifying term for an award. Similar suggestion can be found in: *ibid.*, 470.

The doctrine of *res judicata* of arbitral awards has been determined by the positive and the negative effect.³³² The former presupposes that an award is final and binding between the parties and hence that it is enforceable.³³³ The latter effect, which may also be referred as the *ne bis in idem* principle, prevents the parties from re-arbitrating the issues which are already decided in the award.³³⁴ If the decision has both of these effects, it is considered to be *res judicata*. The question that follows is whether the partial and interlocutory awards have such an effect.

The arbitration rules rarely regulate both the positive and the negative effect. One of the exemplary rules that regulate both are the 2012 ICC Rules and the 2014 LCIA Rules. According to Article 34(6) of the 2012 ICC rules:

“Every award shall be binding on the parties. By submitting the dispute to arbitration under the Rules, the parties undertake to carry out any award without delay and shall be deemed to have waived their right to any form of recourse insofar as such waiver can validly be made.”

Similarly, Article 26(8) of the 2014 LCIA Rules provide:

“Every award (including reasons for such award) shall be final and binding on the parties. The parties undertake to carry out any award immediately and without any delay (subject only to Article 27); and the parties also waive irrevocably their right to any form of appeal, review or recourse to any state court or other legal authority, insofar as such waiver shall not be prohibited under any applicable law.”

³³² Filip De Ly and Audley Sheppard, “ILA Interim Report on Res Judicata and Arbitration,” *Arbitration International* 25, no. 1 (2009): 2.

³³³ Zuleta Jaramillo, “The Relationship Between Interim and Final Awards - Res Judicata Concerns,” 235.

³³⁴ *Ibid.*

Neither of these arbitration rules makes any difference between the different types of awards when it comes to their final and binding effect. Under Article 2 of the 2012 ICC Rules, the definition of an “award” encompasses “*inter alia*, an interim, partial or final award.” Therefore, partial and interlocutory awards on the reimbursement of costs shall be final and binding under these Rules. This conclusion is even clearer under the 2014 LCIA Rules, which provide in Article 26(1) that “[...] *separate awards [...], including interim payments on account of any claim or cross-claim (including Legal and Arbitration Costs) [...] shall have the same status as any other award made by the Arbitral Tribunal.*”

Other arbitration rules and national arbitration acts, cover also the positive, and some of them also the negative, *res judicata* effect by stating that the award, including any separate award, shall be final and binding and that the parties undertook an obligation to comply with it.³³⁵ This does not in any way guarantee that, once the decision is labelled as an award and governed by the arbitration rules and the national laws which provide that it shall be complied with, such a decision will be enforceable under the New York Convention. This harmonization would be desirable, but it is not thus far part of legal reality. The debate on the nature of the decision as such starts usually only once one of the parties tries to enforce it under the New York Convention. National courts are then invited to decide retroactively whether such a decision was an award enforceable under the New York Convention in the first place.

³³⁵ Section 1055 of the German CCP: “*The arbitral award has the same effects between the parties as a final and binding court judgment.*” Article 1484(1) of the French Arbitration Act: “*As soon as it is made, an arbitral award shall be res judicata with regard to the claims adjudicated in that award.*” Section 58(1) of the 1996 EAA: “*Unless otherwise agreed by the parties, an award made by the tribunal pursuant to an arbitration agreement is final and binding both on the parties and on any persons claiming through or under them.*” The 2013 SIAC Rules provide for both the positive and negative *res judicata* effect of an award: “[...] *by agreeing to arbitration under these Rules, the parties undertake to carry out the award immediately and without delay, and they also irrevocably waive their rights to any form of appeal, review or recourse to any state court or other judicial authority insofar as such waiver may be validly made and the parties further agree that an award shall be final and binding on the parties from the date it is made*” (Article 28.9). On the other hand, the 2010 SCC Rules provide only for a positive *res judicata* effect: “*An award shall be final and binding on the parties when rendered. By agreeing to arbitration under these Rules, the parties undertake to carry out any award without delay*” (Article 40).

So far, the majority of scholars and courts accept the partial award to be enforceable under the New York Convention.³³⁶ It is more difficult to reach the same conclusion when it comes to interlocutory awards, e.g., awards on jurisdiction. The Colombian Supreme Court, for example, has seen a decision on jurisdiction to be “*simply a preliminary and preparatory interim decision that [...] does not settle the dispute on the merits submitted to arbitration*”.³³⁷ The Supreme Court continued by explaining that under the New York Convention only “*a decision which settles ‘differences between persons’*” is an enforceable award, but not “*a decision which settles the ‘differences arising’ out of ‘the arbitration’, such as jurisdiction and other issues.*”³³⁸ One can notice that, at this point, it is important how one defines a partial and interlocutory award. As stated above, the partial award disposes finally of part of the claims submitted by a party to arbitration, while the interlocutory award does not deal directly with the merits. The overall discussion in this subsection is based on the assumption that the obligation to pay the advance is qualified as a substantive obligation. In that regard, it was already mentioned that even though such a claim is not initially submitted to arbitration, it is impliedly inherent to any arbitration. In that case, the obstacles to enforcement are still present, but less likely to happen. The opponents may agree with the Colombian Supreme Court and present the decision on the immediate reimbursement of costs as an example of a decision which “*settles the ‘differences arising’ out of ‘the arbitration’.*” It would follow that such a decision does not represent an award for the purposes of the New York Convention, and therefore would not be enforceable. There are also national courts which reached an opposite conclusion, by confirming the *res judicata* effect of the awards on jurisdiction, such as Swiss courts.³³⁹ In any case, the practice shows reluctance or at least a

³³⁶ Born, *International Commercial Arbitration*, 3620–21; Wong and Siwy, “Recalcitrant Parties and the Tribunal’s Power to Order Cost Advance Payments,” 218; Rohner and Lazopoulos, “Respondent’s Refusal to Pay Its Share of the Advance on Costs,” 558.

³³⁷ Zuleta Jaramillo, “The Relationship Between Interim and Final Awards - Res Judicata Concerns,” 266.

³³⁸ Ibid.

³³⁹ De Ly and Sheppard, “ILA Interim Report on Res Judicata and Arbitration,” 17.

confusion regarding the enforceability of the awards which are not the *last* awards. Decisions on reimbursement on costs fall short of any clarity regarding their nature and even more then of their enforceability.

The ostensibly “provisional” nature of the decision on reimbursement does not help in bringing more clarity to this issue either. The enforceability of partial awards which seemingly have only the so-called “provisional effect” was addressed in jurisprudence. The Singaporean High Court decided in the case PT Perusahaan Gas Negara (Persero) TBK [“PGN”] v CRW Joint Operation (Indonesia) [“CRW”] [“PT Perusahaan case” or “PT Perusahaan decision”] whether a partial award which enforced the substantive, but provisional, right can be enforced.³⁴⁰ The facts and circumstances of the case resemble a situation in which partial awards on the reimbursement of the advance are made.

In the PT Perusahaan case, the arbitration proceedings were commenced once in 2009 and the second time in 2011, in order to give effect to the dispute adjudication board’s decision [“DAB decision”]. The 2009 Award, which compelled PGN to pay the sum awarded in the DAB decision, was set aside on the ground that “*the parties’ arbitration agreement does not permit an arbitral tribunal to compel PGN to comply with the DAB decision unless the same arbitral tribunal in the same arbitration goes on to hear and determine the primary dispute on the merits and with finality*”.³⁴¹ For that reason, CRW commenced the new arbitration proceedings in 2011, and adjusted the request accordingly: it required the tribunal to decide on both a primary and a secondary dispute. The secondary dispute referred “*to the dispute which arises from PGN’s failure to pay CRW, whether promptly or at all, pursuant to*

³⁴⁰ PT Perusahaan Gas Negara (Persero) TBK v CRW Joint Operation (Indonesia) and another matter (High Court of Singapore 2014). The court’s decision refers to an “interim award”, as the tribunal qualified it as such. However, in light of the above definitions, the award which has a monetary effect will be addressed as a “partial award”.

³⁴¹ Ibid., para. 11.

the DAB decision".³⁴² The primary dispute "*refer[s] to the parties' underlying dispute which forms the subject-matter of the DAB decision.*"³⁴³ The 2011 tribunal decided on the secondary dispute in its partial award. The enforcement of it was the subject of the High Court's decision. The 2011 Award provided that "[p]ending the final resolution of the Parties' dispute raised in these proceedings [...] [PGN] shall promptly pay the sum of US\$17,298,834.57 as set out in the DAB [d]ecision."³⁴⁴

At this point, certain legal and factual resemblances between this dispute and a possible dispute related to the reimbursement of costs can be deduced. The dispute in which one party sues the other for the reimbursement *during* arbitration proceedings resembles the secondary dispute under which CRW required *immediate* relief related to the payment of the amount set in the DAB Decision. This relief was granted by the tribunal, and its enforcement was confirmed by the Singaporean High Court, which also addressed it as a right to be "*pa[id] now and argue[d] later*".³⁴⁵ Similarly, the right to the *immediate* reimbursement of the advanced payment can be construed as a right to be "paid now and argued later", by giving the right to claim the share of the advance *during* the proceedings, and leaving the discussion on the final allocation for *later*.

PGN challenged the enforcement of the award and requested to be set aside. One of the main arguments was that this award was a *provisional* award because its finality was "*only up until the time the 2011 tribunal hears and determines the primary dispute on its merits and with finality.*"³⁴⁶ On the other hand, CRW argued that the 2011 Partial Award was not a provisional award, but final and binding on the secondary dispute since the last award will determine with finality only the primary dispute. The most interesting part of the

³⁴² Ibid., para. 6.

³⁴³ Ibid.

³⁴⁴ Ibid., para. 114.

³⁴⁵ Ibid., para. 141.

³⁴⁶ Ibid., para. 16.

decision was the Singaporean High Court's analysis and an acceptance of the so-called term of a "provisional" award. The Singaporean High Court defines the "provisional award" as an "*award granting a relief which is intended to be effective for a limited period*", and as an example the court mentioned "*an award which is to be effective pending the determination with finality of every aspect of the parties' dispute*".³⁴⁷ The partial award on costs would possibly fall under this definition given that it determines the issue of the costs until the last award, which contains final decision on the allocation.

The Singaporean High Court in the PT Perusahaan case decided that the tribunal was not prevented from rendering a "provisional award" under the applicable arbitration act, which did "*not override the parties' autonomy to agree in their contract that they should have substantive provisional rights which [...] are enforceable*".³⁴⁸ In other words, the 2011 Partial Award decided with finality on CRW's substantive but provisional right to be paid promptly. This sounds as an appealing solution for the partial awards on costs as well. However, although the Singaporean High Court did its best in trying to explain that having the *provisional* award which is also final and binding is not an oxymoron, the decision has several shortcomings. First of all, as explained above, an award is a decision which is intended to have the final and binding effect with respect to the matters dealt within, and which is to be enforced and could be challenged in proceedings for setting aside. As such, an award cannot and should not have an "expiration date". The so-called "provisional award", which is pending on the subsequent tribunal's decision, is not an award. It is the exact opposite of an award.

The Singaporean High Court was probably aware of the possible counter-arguments in regard of its main line of argumentation and provided an alternative line to support its

³⁴⁷ Ibid., para. 124.

³⁴⁸ Ibid., para. 136.

conclusion. It explained that if one finds the *provisional awards* not to be allowed, the award in question is not provisional at all. Although it seems interesting that the court chose this line of argumentation only as an *alternative*, it provides more conclusiveness with regard to the analogy with the partial awards on costs. Namely, the Singaporean High Court concluded that although the 2011 Partial Award was “pending the final resolution of the parties’ dispute”, it provided for perpetual and irreversible finality as to PGN’s obligation to conceptually and actually pay the specified sum in the DAB Decision.³⁴⁹ This conclusion is more in accordance with the nature of an award.

At this point, it can be concluded that provisional effects of a decision are difficult to be subsumed under the definition of an award. Finality is a feature which is intertwined into the awards’ fabric and it is not easy to be abandoned. The awards are decisions which are rendered to be enforced under the New York Convention and this entails certain repercussions. When deciding on the costs *during* the proceedings, the tribunal should think ahead and anticipate possible obstacles. When trying to solve the enforcement issues in advance, putting in a sentence such as “*pending any final decision on the allocation of costs*” may become a complication for itself. Therefore, the appealing shortcuts should be carefully examined. The partial award on costs rendered *during* the proceedings is to be considered final and enforceable; otherwise, it is not an award. As such, it determines with finality that the non-defaulting party has a substantive right to require payment from the defaulting party promptly.

The Singaporean High Court was therefore right in concluding that provisional substantive rights should be enforced, but it seems to be too broad when translating the provisional nature of the rights onto the award itself. This might not have been the case, if the two other issues which are addressed below were concluded on differently. The Singaporean

³⁴⁹ Ibid., para. 149.

High Court discussed the issue of whether the last award will vary the 2011 Partial Award and the issue of whether the 2011 Partial Award precluded the 2011 Tribunal from rendering the last award. These two issues will be addressed, as described by the Singaporean High Court, in more details after the *negative effect of res judicata* is explained.

The *negative effect of res judicata*, which is also known as *ne bis in idem*, of such an award should also be observed. This negative effect is usually the first association which is made as to *res judicata* effect. It prevents the subject matter that was already once arbitrated to be re-arbitrated or re-litigated.³⁵⁰ In this way, procedural efficiency is protected, as well as the integrity of judgements, as the party who tries to re-arbitrate the issue will be deemed to lack a legitimate and legally protected interest to do so.³⁵¹ This is the most controversial issue when it comes to the awards on the reimbursement of costs. It was already explained above that the final decision on costs is substantively different from the decision in which the payment of the advance or reimbursement is ordered. Nevertheless, there are doubts as to whether the partial or interlocutory award on the reimbursement of costs can be considered to have a negative *res judicata* effect on the decision on allocation of costs in the last award. In other words, does such an award prevent the tribunal from dealing with the allocation of costs?

In order to determine whether an arbitral award prevents subsequent arbitration or litigation, the so-called triple identity test is used in the civil law countries. The triple identity test requires the following requirements for the application of the *res judicata* doctrine: the

³⁵⁰ De Ly and Sheppard, “ILA Interim Report on Res Judicata and Arbitration,” 2; Zuleta Jaramillo, “The Relationship Between Interim and Final Awards - Res Judicata Concerns,” 235; Julie Raneda and Nathalie Voser, “Recent Developments on the Doctrine of Res Judicata in International Arbitration from a Swiss Perspective: A Call for a Harmonized Solution,” *ASA Bulletin* 33, no. 4 (2015): 742; James M. Westerlind, “The Preclusive Effect of Arbitration Awards,” *Mealey’s Litigation Report: Reinsurance* 21, no. 8 (August 20, 2010): 1.

³⁵¹ Raneda and Voser, “Recent Developments on the Doctrine of Res Judicata in International Arbitration from a Swiss Perspective: A Call for a Harmonized Solution,” 743.

identity of the parties, the identity of the relief sought, and the identity of cause.³⁵² From the analysed arbitration acts, only Section 39(3) of the 1996 EAA explicitly provides that any such decision “*shall be subject to the tribunal’s final adjudication; and the tribunal’s final award, on the merits or as to costs, shall take account of any such order*”. Without such an explicit provision, in order for the award on the reimbursement of costs to have a preclusive effect on the decision on the allocation of the costs in the *last* award, these two decisions need to meet the requirements of the above mentioned triple identity test.

Both decisions would be rendered among the same parties. However, one of the reliefs in the former award would be the reimbursement of the share of the advance, while in the latter it would be the reimbursement of the *overall* costs incurred during the proceedings. Although these reliefs resemble each other, the legal causes of action are distinguished. The legal cause of action for the claim of reimbursement of the costs *during* the proceedings is the violation of a substantive obligation to pay a share of the advance, while the cause for the request for the allocation of the costs is an achieved success in the arbitration proceedings. Therefore, it seems to be a rather weak argument to claim that once the party obtained the partial or interlocutory award on reimbursement *during* the proceedings that such an award precludes the tribunal to allocate the costs in the *last* award.

In the PT Perusahaan case, the Singaporean High Court argued similarly when dealing with the questions as to whether the 2011 partial award had the preclusive effect on the last award and whether the last award was to revisit the subject-matter of the 2011 Partial Award. The Singaporean High Court stated that the DAB Decision would be a matter of the primary dispute and the subject of the last award, whilst the 2011 partial award had had a

³⁵² De Ly and Sheppard, “ILA Interim Report on Res Judicata and Arbitration,” 15–16; Zuleta Jaramillo, “The Relationship Between Interim and Final Awards - Res Judicata Concerns,” 235; Some jurisdictions, such as Switzerland, provide for the identity of facts as the third condition. See more in: Raneda and Voser, “Recent Developments on the Doctrine of Res Judicata in International Arbitration from a Swiss Perspective: A Call for a Harmonized Solution,” 748–752.

different subject-matter. According to the court “the true distinction between the primary and the secondary dispute is not topical but temporal: argue *later*, pay *now*”.³⁵³ Temporal distinction is detectable when it comes to the partial award and the last award on costs. In the language of the Singaporean High Court, the partial award was concerned with “how much PGN should pay *now*” [emphasis added], while letting the tribunal to hear the primary dispute and, in that respect, the parties to “argue later”.³⁵⁴ The award rendered in the primary dispute will be based “on different contractual provisions, different evidence, different submissions of law and at a different point in time”.³⁵⁵ By analogy, the partial award on costs would determine how much should be paid *now*, while leaving the discussion on how to allocate the costs for a discussion *later*. The earlier decision would not have any preclusive effect on the discussion on allocation. Moreover, the Singaporean High Court found in the Perusahaan case that since the 2011 Partial Award was final, it could not be varied by the decision on the primary dispute.³⁵⁶ Nevertheless, the court also stated that the last award will need to accommodate or take into account the 2011 Partial Award.³⁵⁷ The same can be concluded when the partial award on costs is rendered.

Since the essence of the award is that it cannot be revisited, in a scenario in which a non-defaulting party is also a winner in a dispute, the tribunal should pay special attention to the allocation of the costs. While it can be concluded that rendering the decision on the payment of advance does not alter in any way the power of the tribunal to allocate the costs in its final decision, as it is confirmed in Section 39(3) of the 1996 EAA, it might alter the *amount* of the costs which are allocated. In other words, the tribunal might be required to make necessary calculations in accordance with the amounts paid by each of the parties as an

³⁵³ PT Perusahaan Gas Negara (Persero) TBK v CRW Joint Operation (Indonesia) and another matter, 166 (High Court of Singapore 2014), para. 166.

³⁵⁴ Ibid.

³⁵⁵ Ibid.

³⁵⁶ Ibid., para. 162.

³⁵⁷ Ibid., para 154.

advance on costs. If the award on reimbursement or payment of the advance was issued *during* the proceedings, the questions are whether and how the tribunal should take this into account when the final amount to be allocated is calculated.

If the partial award on costs was *successfully enforced* during the arbitration, the issue vanishes and the tribunal shall address the final allocation as in the situation where each of the parties paid its share of advance. In such a case, each of the parties would pay 50% of the advance, and none of them will owe to the other any amount on this ground. In that case, the tribunal will allocate the costs as if the parties paid the advance in equal shares. The winner will, of course, have the right to request the payment of the remainder of costs, which it paid as a part of its share of advance, as will be discussed in Chapter V. For example, in the SCC Case No. 158/2011, the tribunal stated that parties paid each its own share of advance and in accordance with that allocated the costs to the claimant in the following way:

“Claimant is ordered to reimburse Respondent’s costs for its defense in the present arbitration in the amount of € 10,000 and the share of the costs of the arbitration paid by Respondent as determined the Arbitration Institute of the Stockholm Chamber of Commerce”.³⁵⁸

On the other hand, the non-defaulting party *might not enforce* the partial award on costs during the arbitration, leaving the factual situation as if it paid the whole advance. The practice is that if one of the parties paid the whole advance, but did not require an immediate reimbursement, the tribunal will take this also into account when it determines the final amount to be allocated. The tribunal decided in such way in the ICC case no. 16015:

“The Respondent shall pay the Claimant the amount of US\$ Y for the costs of the arbitration fixed by the Court. As the Claimant has already advanced this

³⁵⁸ SCC Case No. 158/2011, 38 Yearbook Commercial Arbitration (n.d.).

amount in full to the Court, the Respondent is hereby ordered to reimburse the Claimant the amount of US\$ Y³⁵⁹.

This, however, is not acceptable solution as the non-defaulting party will still hold the enforceable title which will give it right to request the payment of the 50% of the advance to which is not anymore entitled. This illustrates the *temporal* distinction between the partial and the last award mentioned above. The Singaporean High Court in the Perusahaan case addressed this issue first by stating that “*the [partial] award will simply, in accordance with its terms, cease to have effect at that point in time.*”³⁶⁰ The award on the obligation to pay the advance usually does not contain any term which determines that is subjected to any future decision, and it should remain so since it is not a “provisional” award as it was described above. For that reason the first suggestion made by the Singaporean High Court is not helpful when dealing with the partial awards on costs. Besides, the partial awards are given *res judicata* effect by arbitral tribunals, as well as by national courts, and their effect neither ceases to exist when the last award is rendered, nor may the last award alter the findings established in the partial award.³⁶¹

If such an award was not successfully enforced, there are two possibilities for the tribunal. First option is the one provided in Section 39(3) of the 1996 EAA, according to which the tribunal “*shall take account of any such order*” when making the final adjudication. It may deduct this amount from the final amount of the costs which are allocated in the final award and instruct the winner, which would in this scenario be the non-defaulting party, to enforce both awards separately. This, however, might not be the most effective solution for the winning party. On the other hand, it was that party who sought for

³⁵⁹ ICC case no. 16015, 38 Yearbook Commercial Arbitration 174–204 (n.d.).

³⁶⁰ PT Perusahaan Gas Negara (Persero) TBK v CRW Joint Operation (Indonesia) and another matter, 143 (High Court of Singapore 2014), para. 143.

³⁶¹ *Sàrl X. v. Y. AG*, Case No. 4A_606/2013, 33 ASA Bulletin 614 (Federal Supreme Court of Switzerland, 1st Civil Law Chamber 2014); *Mexican Construction Company v Belgian Company (member of a Consortium)*, Final Award, ICC Case No. 3267 (1984).

the former decision to be rendered, so instructing the same party to enforce the decisions it obtained first should not be considered unfair. Also, there are three features of an “award” which confirm the same conclusion. Firstly, it is inherent to an award not to be revisited by the arbitral tribunal later. Secondly, the *last* award contains a decision regarding the *remaining* parts of the dispute, which were not addressed by the partial or interlocutory awards. In other words, the arbitral tribunal *is not allowed* to decide anything differently, but to merely decide under the assumption that the advance was paid in equal shares by the parties. Any other request by the non-defaulting party, who won the case, but at that moment still did not enforce the earlier award, should be precluded. As shown above, the *res judicata* effect of the partial or the interlocutory award would encompass any relief seeking the reimbursement of an advance made at the end of the arbitration proceeding since it would be made between the same parties and based on the same cause. The same solution was suggested in the Perusahaan case as well, where the court stated that in the case when the tribunal concludes that CRW was awarded too much in the partial award, similarly as the non-defaulting and losing party who was awarded the reimbursement, the last award should order the *return of excess*, and the “*partial award and the final award will stand together for enforcement*”.³⁶²

The second option for the tribunal is to decide as if there was no award on the reimbursement (since it was not enforced) and as the winner covered the whole advance. This is in no way desirable situation since the winning party would have two enforceable titles against the same party and based on the same cause and with the same relief. It speaks for itself that this would be a clear violation of the *res judicata* doctrine. If the tribunal, however, opts for this option despite its pitfalls, the other losing party may oppose the enforcement of

³⁶² PT Perusahaan Gas Negara (Persero) TBK v CRW Joint Operation (Indonesia) and another matter, 152 (High Court of Singapore 2014)., para. 152.

the subsequently enforced award due to the lack of legal interest. It is questionable, however, on which grounds can this petition may be introduced in the enforcement proceedings. Since the New York Convention contains exhaustive list of conditions for the recognition and enforcement, it cannot be an additional ground in that sense.³⁶³ It might, however, be considered part of procedural law of the forum, and hence applicable as a procedural condition under Article III of the New York Convention. Otherwise, it would entail an impracticable solution involving additional litigation for the losing party, which would need to make separate motions under existing New York Convention, such as violation of public policy.³⁶⁴

The last scenario which needs to be taken into account is the one in which the party who did not default on payment of the advance, lost the case in the end. In such case, the winning party, i.e. the party who initially failed to pay the advance, but against which the decision on payment was not successfully enforced, according to some scholars, would have the right to offset the final award against such a decision.³⁶⁵ The approach is clarified by stating that “[s]uch a consideration is, however, not a case where an issue is “revisited” in the final award, but simply a matter of offsetting like in cases where the debtor has paid certain amounts in the course of the arbitration”.³⁶⁶ Similarly, the court in the Perusahaan case concluded that the tribunal needs to “do no more than make [the] finding and issue a final award requiring CRW to *return the excess*” [emphasis added].³⁶⁷

³⁶³ Albert Jan van den Berg, *The New York Arbitration Convention of 1958: Towards a Uniform Judicial Interpretation* (Deventer-Boston: Kluwer Law and Taxation Publishers, 1994), 239.

³⁶⁴ An interesting discussion was led on this matter by Greek courts, the short analysis available here: Antonios Tsavdaridis, “Is a Fully Paid Award Still Enforceable under the New York Convention?,” *International Law Office*, September 27, 2012.

³⁶⁵ Wong and Siwy, “Recalcitrant Parties and the Tribunal’s Power to Order Cost Advance Payments,” 218.

³⁶⁶ *Ibid.*

³⁶⁷ PT Perusahaan Gas Negara (Persero) TBK v CRW Joint Operation (Indonesia) and another matter, 153 (High Court of Singapore 2014)., para. 153.

In case where the non-defaulting party paid 100% of the advance and later obtained a partial award on the reimbursement of 50%, but did not enforce it, *the excess* for the defaulting and winning party would be exactly the 50% which it was ordered to pay during the proceedings. Therefore, according to the above mentioned suggestions, the tribunal should apportion in its *last* award this 50% of the amount of the advance to the winning, but initially defaulting party. This still does not resolve an issue of the probability that the partial award can be subsequently enforced. Therefore, it might happen that the prevailing party will attempt to enforce the last award and not to comply with the partial one. However, in the words of the High Court in the *Perusahaan* case, “once again, the [partial] award and the [last] award will stand together for enforcement”.³⁶⁸ Under the Singaporean International Arbitration Act³⁶⁹ [“Singaporean IAA”] this was also specifically provided in Section 19B which stated that

“[a]n award made by the arbitral tribunal pursuant to an arbitration agreement is final and binding on the parties [...] and may be relied upon by any of the parties by way of [...] set-off [...] in any proceedings in any court of competent jurisdiction”.

Although the idea of offsetting the awards through the enforcement procedure seems to be a solution, one should be aware that the *express* and *precise* regulation provided in the Singaporean IAA is rather unique. The application of *general* set-off procedural rules under the New York Convention may involve more discussion on the matter. According to Article III of the New York Convention, Contracting States “shall recognize arbitral awards as binding and enforce them in accordance with *the rules of procedure of the territory where the award is relied upon*” [emphasis added]. The commentaries refer to the application of the law

³⁶⁸ *Ibid.*, para. 153.

³⁶⁹ International Arbitration Act (Chapter 143A) [Revised Edition 2002, incorporating amendments as at 1 June 2012].

of the forum to the question of set-off under this stipulation in Article III, but at the same time they warn on the differing results in practice.³⁷⁰ Also, this leads to another impracticability given the wide applicability of the New York Convention, and the number of countries in which the non-defaulting party will be “forced” to invoke the partial award whenever the other party tries to enforce the last award and, *vice versa*, is substantial. Such a cat-and-mouse game can involve many negative repercussions for both parties.

Taking all this into account, labelling a decision on the reimbursement as an award loses its attractiveness that was emphasized at the beginning of this section. Sometimes it seems it is better for all the parties involved not to have an award on this matter, rather than to open a “Pandora’s box” of legal uncertainties regarding the enforcement of an award on the reimbursement of costs, which subsequently often lead to “satellite” proceedings. This, for example, happened in the arbitration between RCBC Capital Corporation [“RCBC” or “Claimant”] versus Banco de Oro Unibank Inc. [“the Banco” or “Respondent”], which resulted in two consolidated cases before the Supreme Court of the Republic of Philippines: RCBC v the Banco and the Banco v Court of Appeals and the RCBC [“RCBC case” or “RCBC decision”].³⁷¹ On May 12, 2004, arbitration proceedings were commenced. The arbitral tribunal rendered a partial award on May 28, 2008, ordering the Respondent to reimburse the share of advance to the Claimant who made a substitute payment. On July 11, 2008, the Respondent started the proceedings for setting aside this partial award which were finally decided only on December 10, 2012 by the Supreme Court. In the meantime, the tribunal already rendered the last award on June 16, 2010. Already at this point, one can notice that the litigation regarding the challenge of the partial award lasted longer than the arbitration itself. The partial award on costs was eventually set aside. Let alone the fact that

³⁷⁰ Berg, *The New York Arbitration Convention of 1958*, 240.

³⁷¹ RCBC Capital Corporation v. BANCO DE ORO UNIBANK, INC.; BANCO DE ORO UNIBANK, INC. V COURT OF APPEALS and RCBC CAPITAL CORPORATION (Supreme Court of Republic of Philippines 2012).

the costs of this four-year long satellite litigation were an additional burden on the party who sought such a partial award, but also since it lost in the end, the partial award did not even serve its purposes of an *immediate* reimbursement as being not enforced at all.

Although not expressly recognized by the national courts, reason for the challenge can be summed up as a lack of sufficient and clear regulation in this regard. Namely, since the Claimant failed in formulating its request for a partial award on reimbursement, the tribunal took the initiative and “*interpret[ed] the Claimant’s [...] letter as an application by the Claimant to the Tribunal for the issue of a partial award against the Respondents in respect of their failure to pay their share of the ICC’s requests for advance on costs.*”³⁷² The tribunal went even further and forwarded the Matthew Secomb’s paper which deals with this very subject and the solutions available under auspices of the ICC Rules in order for them to be better prepared in their argumentation.³⁷³ This paper was cited multiple times throughout this thesis and it is the most comprehensive source for the ICC tribunals’ practice regarding the reimbursement of the costs *during* the arbitration proceedings. The 2012 ICC Rules do not explicitly provide for a possibility to seek the *immediate* reimbursement or an order for payment. Secomb’s paper collects ICC decisions rendered on this matter and it acknowledges three approaches as presented in this thesis: the contractual approach, the procedural duty approach and the interim measures approach.

One of the main grounds for a challenge made by the Respondent was that the award was issued with evident partiality. The Supreme Court eventually agreed with the Respondent on this ground and concluded that the tribunal’s act “*of furnishing the parties of Matthew Secomb’s article, considering the attendant circumstances, is indicative of partiality such*

³⁷² Ibid.

³⁷³ Ibid.

that a reasonable man would have to conclude that [it] was favouring the Claimant”.³⁷⁴ The Supreme Court concluded so because by forwarding this paper to the parties the tribunal “practically armed [the Claimant] with supporting legal arguments under the ‘contractual approach’”, and this availed the Claimant “of a remedy which was not expressly allowed by the [ICC] Rules but in practice has been resorted to by parties in international commercial arbitration proceedings”.³⁷⁵ The Supreme Court consequently vacated the partial award on costs.

The facts of the case reveal the following conclusion: there is a need to regulate the party’s rights regarding the enforcement of the obligation to pay the advance and the tribunal’s powers in that regard. The ICC decided not to regulate a party’s right to request the *immediate* reimbursement, but it leaves it to the practice to come up with the solution. As seen in the RCBC case, this can lead to the parties’ inability to formulate their requests and arbitral awards quashed due to the partiality of a tribunal helping the parties to formulate such requests. In May 2015, the ICC Commission on Arbitration and ADR had an opportunity to change this, but instead it issued and accepted The Final Report as to the Decisions on Costs, which focused solely on the allocation of costs.³⁷⁶

It should also be mentioned that although the partial award in the RCBC case was set aside, it does not prevent the Claimant from enforcing it in some jurisdictions.³⁷⁷ At the same time, the last award which was rendered by the tribunal did not take the partial award into

³⁷⁴ Ibid.

³⁷⁵ Ibid.

³⁷⁶ “ICC Arbitration and ADR Commission Report - Decisions on Costs in International Arbitration,” *ICC Dispute Resolution Bulletin*, no. 2 (2015).

³⁷⁷ Patricia Živković, “Enforcement of an Award Set Aside: The So-Called ‘Preferred Approach’ and Its Application under English Law | Kluwer Arbitration Blog,” accessed May 13, 2015, <http://kluwerarbitrationblog.com/blog/2015/04/08/enforcement-of-an-award-set-aside-the-so-called-preferred-approach-and-its-application-under-english-law/>.

account, and it awarded the whole amount of the advance to the Claimant again. In such a way it provided the Claimant with two enforceable titles in some jurisdictions.

The analysis provided in this part of the Chapter leads to the following question: Is the award the most appropriate form of a decision on payment of the advance on costs during the arbitration? Taking into account all the issues which such a decision entails, the answer is “no”. At this point, it is a matter of policy how this decision should be qualified. Therefore, the qualification as an *award* should not be done automatically and without due consideration given to other existing solutions. One such solution would be the qualification of such a decision as an *order on interim measure*. The consequences of this qualification are analysed under the next section.

III.3.2 Enforcement of the Decisions under the Interim Measure Approach

There are two types of decisions which can be rendered under the interim measure approach: award or procedural order. Again, the issue of nomenclature arises, just as under the contractual approach. The difference is that under this approach, in any case, these decisions will not deal with the contractual obligation of a party, but they will provide for an interim measure. This might be of crucial importance, especially for the qualification of such a decision as an award. The jurisdictions take opposite views as to the enforceability of the award containing an interim measure. Some of them will find such an award enforceable under the New York Convention, while other will refuse to qualify such a decision as an award.³⁷⁸

³⁷⁸ Wang Schenchang and Cao Lijun, “National Courts and Lex Fori,” in *Pervasive Problems in International Arbitration* (Kluwer Law International, 2006), 175.

A procedural order is another type of decision available if the interim measures approach is accepted. They are not enforceable decisions under the New York Convention. Therefore, their enforcement will depend on national laws, usually the procedural law applicable at the seat of arbitration. For example, under the 1996 EAA such courts' assistance is offered under Section 42(1), which provides that “[u]nless otherwise agreed by the parties, the court may make an order requiring a party to comply with a peremptory order made by the tribunal.” This is, however, offered only in cases where the tribunals are sitting in England and Wales.³⁷⁹ Article 16(2) of the Croatian AA provides similarly that “[i]f a party to which interim measures [set by an arbitral tribunal] relate does not agree to undertake them voluntarily, the party that made the motion for such measures may request their enforcement before the competent court.” The arbitral tribunals should be aware of whether their procedural orders will be enforceable under the national laws of the countries where the enforcement will be probably sought. Austrian, German and Swiss jurisdiction are examples of countries in which foreign tribunals' procedural orders can be enforced.³⁸⁰

This impracticability may be avoided by changing the forum which orders the payment of the share of the advance as an interim measure. However, the court's competence to render such a decision might differ from jurisdiction to jurisdiction. For example, under Section 1033 of the German CCP “[i]t is not incompatible with an arbitration agreement for a court to grant, before or during arbitral proceedings, a provisional or conservatory measure of protection relating to the subject-matter of the arbitration upon request of a party.” The question will, of course, then be whether the interim measure as to the payment of the share of the advance is an interim measure *related to the subject-matter of the*

³⁷⁹ Wong and Siwy, “Recalcitrant Parties and the Tribunal's Power to Order Cost Advance Payments,” 220.

³⁸⁰ *Ibid.*, 219.

arbitration. The same issue would arise under Section 585 of the Austrian CCP as well.³⁸¹ Therefore, a mere change of the forum might not lead to the desirable solution.

III.4 Conclusion on Chapter III

The advance on costs is one of the critically important features of arbitration. It serves the purpose of ensuring the payment of the arbitrators' fees and expenses and administrative charges. Due to the importance of it, it is surprising then that the payment of the advance on costs is not oft-discussed in scholarly work and arbitral practice. However, once the payment is not made, this area of arbitration law shows a large scale of non-harmonization as to several legal issues. Some of these issues were analysed in this Chapter, such as the existence of the obligation to make the payment, the qualification of the nature of such an obligation and available reliefs in a case of non-payment, the agreement as to the amount which needs to be paid, the legal bases on which such payment may be sought, and the forums before which an advance-related claim may be made and the enforcement stage of the decisions of these forums.

The starting point for the discussion related to the payment of the advance on costs is the differentiation of three approaches as to the nature of such obligation: the contractual approach, the procedural duty approach and the interim measure approach. This already signals the lack of adequate harmonization of arbitration law which can jeopardize the legitimacy of arbitration. Furthermore, these approaches are developed in arbitral and judicial practice, which affords many nuances even within each of these approaches.

³⁸¹ Section 585 of the Austrian CCP states: "It is not incompatible with an arbitration agreement for a party to request, before or during arbitral proceedings, from a court an interim or protective measure and for a court to grant such measure."

It was clarified that the payment of the *final* fees and of the *advance* on these fees is ought not to be treated as the same obligation. While it is undisputed that the arbitrators and institutions have a contractual right to receive the *final* fee, they may not have the same right for the advance. The contractual approach, which promotes the existence of a party's contractual obligation to pay its share of the advance is, however, the prevailing approach among the three mentioned above. It is still, however, far from being a harmonized approach. National courts and tribunals, disagree on whether this nature stems from explicitly provided stipulations in the arbitration agreement or is it inherent to the arbitration agreement as such. They also disagree as to the legal bases on which the payment-related claims can be made. The contractual approach seems to be most appealing from the practical side as well, especially since it provides the paying party with an immediate relief. This is particularly welcome in cases with high amount in dispute or which can be expected to take more time to be decided.

The choice among the approaches does not mean the end of the discussion. Each of them has advantages and disadvantages as discussed in this Chapter. The contractual and interim measure approaches, if adopted, can entail different forms of decisions – an arbitral award or a procedural order. When it comes to the enforcement of arbitral awards, new issues emerge. Rendering a decision on reimbursement of the advance on costs in a form of a partial award poses several queries as to the relation of such a partial award and a last award. These issues, as long as they remain unsolved, further perplex the whole proceedings, and lead to legal uncertainty. One of the above discussed cases testified that rendering a partial award on the payment of the advance on costs can result in long and highly undesirable parallel court proceedings.

To conclude, the payment of the advance seems to be a device which is both significant and characteristic for arbitration as a dispute resolution mechanism. For that

reason it should probably receive more attention from the arbitration community. Some of the concerns discussed in this Chapter can severely prolong the arbitration proceedings, jeopardize legal certainty and legitimacy of the proceedings, or simply be abused by the party opposing the arbitration. While the enforcement of the obligation to pay the advance is crucial for the proceedings to be properly conducted, the parties might wish to explore other options as well. This discussion is further developed under the following Chapter which focuses on the possibility to disregard the arbitration agreement once the party does not pay or is financially incapable to pay the advance.

CHAPTER IV

THE PROHIBITIVE COSTS OF ARBITRATION AND THE PARTIES' RIGHT TO DISREGARD THE ARBITRATION AGREEMENT: CONFLICTING NATIONAL APPROACHES

Chapter III dealt with the nature of the obligation to pay the advance and the solutions provided for the non-defaulting party to enforce such a defaulting party's obligation. The focus in this chapter switches from the solutions available only to the *non-defaulting party* to the issues arising from the non-payment and solutions for it from the perspective of *both parties*. More specifically, this Chapter deals with the solutions for the either of the parties who wishes to *disregard the arbitration agreement* based on the non-payment of the advance. This makes it diametrically opposite to the solutions offered in Chapter III, which dealt with the solutions which purpose was to *enforce the obligation to pay the advance* and, hence, preserve the arbitration proceedings.

An arbitration agreement imposes several financial burdens on the parties which can reach high amounts depending on the circumstances of a particular case. Hence, the impecuniosity of a party, which is characterized as the financial incapacity to meet its monetary obligations, including the payment of the costs of arbitration, can have severe impact on party's access to arbitral (or any) justice. The most comprehensive collection of papers on this topic can be found in the publication titled "*Financial Capacity of the Parties – A Condition for the Validity of Arbitration Agreements?*", based on the conference organized

by the German Institution of Arbitration (DIS) in 2002.³⁸² As this publication confirmed, the approaches of different jurisdictions were not uniform, and there was no international consensus on how to treat party's impecuniosity in arbitration. This thesis continues and extends this research in order to see whether there was any development in the harmonization of national approaches in Europe on this matter in the past decade.

The term impecuniosity is closely related to the term of insolvency, as incapacity to pay debt, but it does not need to overlap with the state of bankruptcy, i.e. the formally commenced procedure discarding the debt. There is also a difference in principles which apply, depending on whether impecuniosity overlaps with the state of bankruptcy or not. It is often pointed out that arbitration and bankruptcy procedures are of a different nature: arbitration procedure is based on the principle of parties' autonomy and privity, and it presupposes the decentralization of the forum, while bankruptcy proceedings are judicial, collective, and centralized.³⁸³ In this type of situation, the most frequent discussion is related to the effect of bankruptcy laws on the arbitrability of the dispute in question, the conduct of arbitration, and the validity of an arbitration agreement.³⁸⁴ At the same time, the relation of the impecuniosity of a party and arbitration involves different principles and issues.

In Europe, the importance of principles and rights involved in the discussion positions the impecuniosity issues at the crossroad of two international treaties: the New York Convention and the 1950 European Convention for the Protection of Human Rights and Fundamental Freedoms ["ECHR"]. When one of the parties is impecunious, the principles of

³⁸² Deutsche Institution für Schiedsgerichtsbarkeit, *Financial Capacity of the Parties: A Condition for the Validity of Arbitration Agreements?*, Schriftenreihe Der August-Maria-Berges-Stiftung Für Arbitrales Recht 16 (Frankfurt am Main: Peter Lang, 2004).

³⁸³ Sara Nadeau-Séguin, "When Bankruptcy and Arbitration Meet: A Look at Recent ICC Practice," *Dispute Resolution International* 5, no. 1 (May 2011): 82; Christian Dorda, "Arbitration and Insolvency Proceedings," *Annals FLB - Belgrade Law Review* LVII, no. 3 (2009): 83–84; Robert B. Kovacs, *International Arbitration and Insolvency: Towards a Transnational Approach to Their Interaction* (unpublished doctoral thesis), 2, accessed September 28, 2015, <http://archive-ouverte.unige.ch/unige:74855>; Patricia Živković, "Bankruptcy and International Arbitration: Some Comparative Snapshots," *Slovenian Arbitration Review* IV, no. 3 (November 2015).

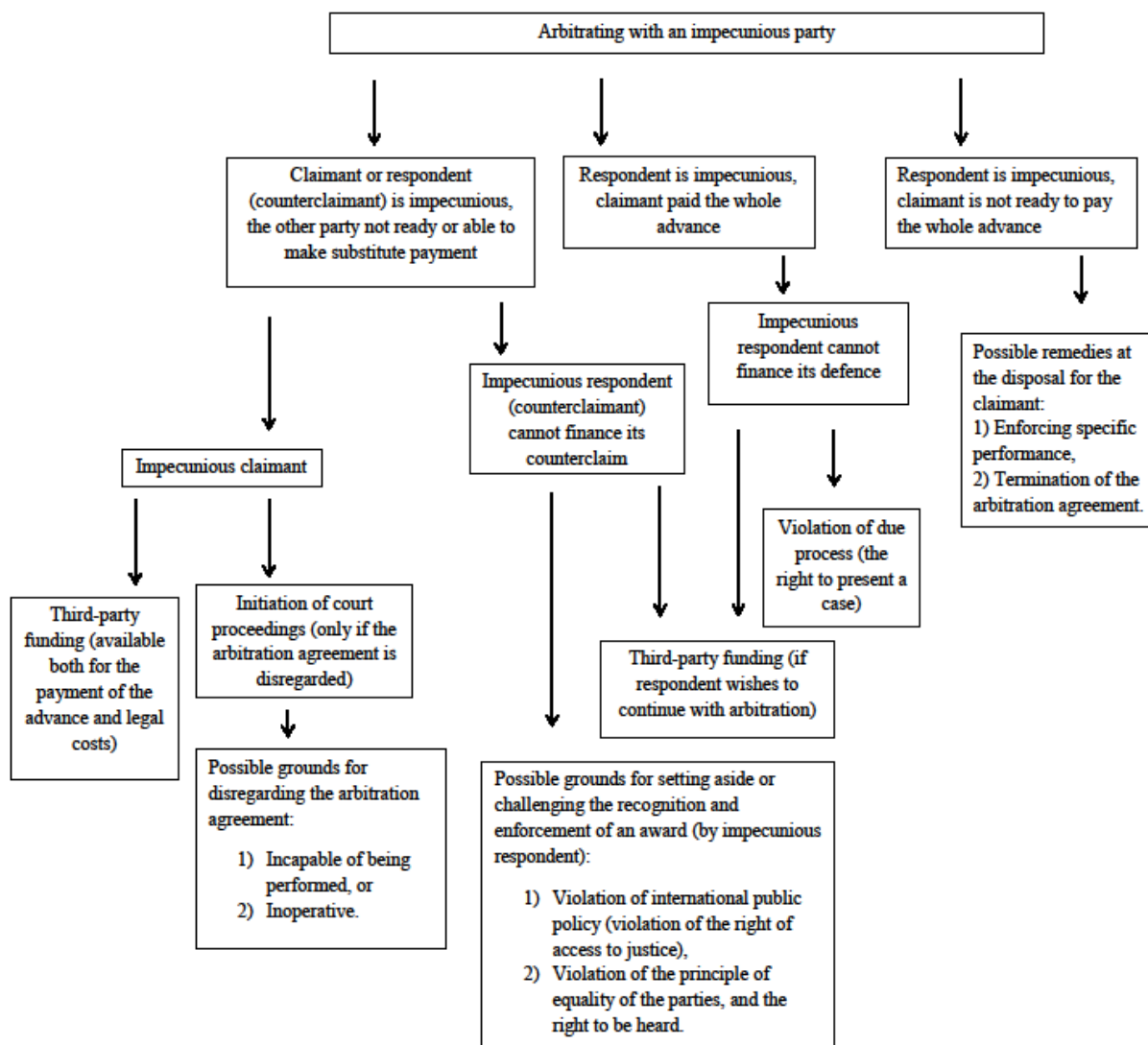
³⁸⁴ See more in: Živković, "Bankruptcy and International Arbitration: Some Comparative Snapshots."

party autonomy and the enforcement of parties' agreements are in a direct conflict with the right of access to justice. National courts have rendered opposing decisions in similar factual settings, and these issues were discussed in the doctrine as well. The analysis in this chapter focuses on court decisions and scholarly writings from the following jurisdictions: Germany, England and Wales, and France. In addition, the approaches adopted in Portugal, Austria, and Hungary will be discussed as well. As will be seen, both courts and scholars in these jurisdictions have provided different, often conflicting perspectives on the issue at hand.

The grounds for courts' decisions as well as the consequences and possible solutions can differ depending on which party is invoking impecuniosity. The analysis in this Chapter is, therefore, divided in several parts depending on the procedural position of a party: claimant or respondent. The analysis is firstly done under the assumption that impecunious parties did not opt for or were not granted third-party funding, and that in case of an impecunious (counter)claimant, the respondent was not ready to make substitute payment.

The impecuniosity of a party in arbitration is not a simple issue to solve, and it does not have only one single possible outcome, as shown in this graph³⁸⁵:

³⁸⁵ This is an extended version of a similar graph presented in: Stefan Kröll, "Impecuniosity of Parties and Its Effects on Arbitration – From the Perspectives of Austrian Law," in *Bank-Related Instruments to Secure the Right to Arbitration despite the Impecuniousness of a Party*, Schriftenreihe Der August-Maria-Berges-Stiftung Für Arbitrales Recht 16 (Frankfurt am Main: Peter Lang, 2004), 153.



As shown in the graph, when it comes to **impecunious claimants**, the issue is the following: if by concluding an arbitration agreement the parties waive the right to have recourse to national courts, do the parties waive such a right under *any* circumstances, including the unavailability of an arbitration forum due to impecuniosity? In other words, the question is whether there is any possibility for a claimant to disregard the arbitration agreement once it does not have the funds to commence arbitration proceedings. There are two plausible grounds discussed in jurisprudence, as it will be shown below, based on which some national courts allowed an impecunious claimant to disregard the arbitration agreement: the non-performability or inoperativeness of an arbitration agreement.

In situations involving an **impecunious respondent**, certain differences emerge in comparison with the claimant's lack of funds. Namely, when the claimant does not have funds to pay for the costs of arbitration, this usually blocks the commencement, or continuation of the arbitration proceedings. Arbitrators are, of course, free to commence or continue the proceedings without any advanced payment, but it is somewhat too optimistic to expect that they will do so, especially if it is clear that one of the parties has no funds to finance arbitration in the first place. As shown in Chapter II, in this situation the case file will most often not even reach the tribunal without the payment of the advance on costs.

Due to the usual claimant's readiness to pay the whole advance on costs, proceedings are regularly conducted and an award is rendered even if the respondent is impecunious, so legal issues related to impecuniosity are discussed at the stage of the setting aside or the recognition and enforcement of an award. The respondent might be, for example, financially incapable of submitting its counterclaims, or to afford other costs, such as attorney's fees, which are necessary for effective defence. These situations may lead to the violation of international public policy, and/or the violation of the principle of equality of parties and the right to be heard.

The first part of this Chapter addresses the issue whether the non-payment of the advance can lead to disregarding the arbitration agreement in general, notwithstanding the impecuniosity of one of the parties [IV.1]. This is done in order to provide an overview of the national approaches regarding the opposition of pro-arbitration approach and the non-payment of the advance by one of the parties. The second part focuses on the impecuniosity of the claimant and the resulting prohibitive procedural costs as the basis for the invalidation of the arbitration agreement [IV.2]. The third part focuses on the impecuniosity of a respondent (counterclaimant) and its right of access to justice [IV.3]. In both groups of cases, the main discussion is led under assumption that an impecunious party did not obtained or

was not granted third party funding and the centre of a discussion was juxtaposition between the principle *pacta sunt servanda* and the party's right of access to justice. Finally, the fourth part analyses how third party funding can be of use for impecunious parties in international commercial arbitration [IV.4].

IV.1 The right to Termination or Disregarding the Arbitration Agreement Based on the Non-Payment of the Advance

The termination of an arbitration agreement due to the non-payment of the advance may be based on different grounds. For example, by not paying an advance, the party is obstructing the continuation of arbitration proceedings, because, unlike litigation, arbitration is completely dependent on the parties' funding. Therefore, by not paying the advance, it can be concluded that the party does not want to arbitrate any more, i.e. that it waived its right to arbitrate.

It can be stated that it is rare that such a consequence is provided for under arbitration laws. One exception is Section 5 of the Swedish AA which states:

“A party shall forfeit his right to invoke the arbitration agreement as a bar to court proceedings where the party: (...) fails, within due time, to provide his share of the requested security for compensation to the arbitrators.”

However, the waiver granted under this Section is not general. The Swedish Supreme Court, when dealing with the limits of such a waiver, decided that “*it was clear that the loss of right to rely on an arbitration clause was not general but specific to the dispute which had been submitted for arbitration*”.³⁸⁶ In other words, it is considered that a party is waiving its

³⁸⁶ Swedish Supreme Court, Case no. Ö 2289-05 (12 May 2008)

agreement to arbitrate, but only in relation to those claims that were submitted at the moment the advance was meant to be paid. At least one ICC tribunal adopted the Swedish solution. It decided that, since the respondent had not paid its share of the advance of costs, the claimant had the right to rescind the arbitration agreement, and that claimant was not obliged to make substitute payment.³⁸⁷

Not all jurisdictions follow the approach that the non-payment results in a waiver of the arbitration agreement. The Swiss doctrine, for example, represents the opposite view according to which the fact that the party did not pay does not mean that it waived the right to arbitrate.³⁸⁸ Similarly, the US court acknowledged the waiver of the arbitration agreement as a consequence of the non-payment of the advance.³⁸⁹ However, this decision was only reached after both the claimant and the respondents failed to pay the advance. The court concluded that *“both plaintiff and defendant (...) have waived the arbitration agreement by their collective and simultaneous repudiation of it through their refusal to reach an agreement as ordered by the arbitrators over the payment of fees”*.³⁹⁰ Therefore, the arbitration agreement was waived only after all the parties failed to come to an agreement on the payment of the fees that would allow them to proceed with arbitration.

The Tenth Circuit referred to the waiver theory as well. It did so to justify its decision on lifting the stay of the court proceedings in the case between Pre-Paid Legal Services, Inc. [“Pre-Paid”] and Todd Cahill on May 26, 2015 [“Pre-Paid case” or “the Decision”].³⁹¹ Mr. Cahill was a former employee of Pre-Paid who left to join another network marketing

³⁸⁷ Jean-Louis Delvolvé and Gerald H. Pointon, *French Arbitration Law and Practice: A Dynamic Civil Law Approach to International Arbitration* (Kluwer Law International, 2009), 103.

³⁸⁸ Cremades and Mazuranc, “Costs in Arbitration,” 185.

³⁸⁹ Washington Umberto Cinel v. George Barna, Court of Appeal of the State of California (Court of Appeal, Second District, Division 1, California 2012).

³⁹⁰ *Ibid.*

³⁹¹ PRE-PAID LEGAL SERVICES, INC., Plaintiff–Appellee, v. Todd CAHILL, Defendant–Appellant (United States Court of Appeals, Tenth Circuit 2015).

company. On August 14, 2012, Pre-Paid commenced court proceedings against Mr. Cahill, in which it alleged the misuse of trade secret information. As a response, Mr. Cahill filed a motion to stay the district court proceedings due to the existence of an arbitration agreement in his employment contract. The motion for a stay was granted. In February 2013, Pre-Paid commenced arbitration proceedings before American Arbitration Association [“AAA”].

In the arbitration proceedings, Pre-Paid paid its share of deposit while Mr. Cahill failed to do so. Due to this failure, the arbitration proceedings were suspended in June 2013, and finally terminated in July 2013. Pre-Paid then moved to lift the stay of the district court proceedings. On April 16, 2014, the district court granted the motion and lifted the stay. Mr. Cahill appealed the district court's decision. The Tenth Circuit affirmed the district court's lifting of the stay, and stated that this was in accordance with the purpose of the arbitration “to provide a cost-effective and efficient means of resolving a claim”. Although not directly referring to the waiver theory, this theory is intertwined within the Tenth Circuit's opinion. For example, when discussing the purpose of the arbitration, it cited the case of *Ralph Brandifino v. Cryptometrics, Inc.*, [“Brandifino case”] which stated that such purpose “*is thwarted by a party's default in failing to pay the required fees*” and that “*the paying party's right to have its dispute adjudicated and not to be unreasonably held at the mercy of a nonpaying party outweighs the strong presumption in favor of arbitration.*”³⁹²

Moreover, although the decision was based on the legal requirements for a stay as provided in Section 3 of the Federal Arbitration Act³⁹³, the Tenth Circuit also stated that

³⁹² *Ralph BRANDIFINO, Petitioner, v. CRYPTOMETRICS, INC., Respondent* (Supreme Court, Westchester County, New York 2010); *PRE-PAID LEGAL SERVICES, INC., Plaintiff-Appellee, v. Todd CAHILL, Defendant-Appellant* (United States Court of Appeals, Tenth Circuit 2015).

³⁹³ Section 3 of the Federal Arbitration Act: “If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.”

“Mr. Cahill originally sought a stay of the district court proceedings to pursue arbitration. But then he failed to meet the AAA's fee requirements. Now he seeks to keep the stay in place for more arbitral proceedings, which he thwarted in the first place.”³⁹⁴

Such behaviour is a reflection of the waiver theory or estoppel. Similarly, in the *Brandifino case*, the court was not prepared to make a finding of waiver by the party who failed to pay its share of the fees without giving it one last chance to express its intent to arbitrate in accordance with the parties' agreement. It eventually granted the petition for lifting the stay “unless [it] receives notification, within 20 days of [the decision], that [the non-paying party] has paid the [amount] due the AAA, in which case the petition shall be denied.”³⁹⁵

The waiver theory is not the only possible basis for disregarding the arbitration agreement. Contract law provides for other grounds as well. These grounds can sometimes be closely related to the state of impecuniosity of one of the parties to the arbitration agreement. The state of impecuniosity of one of the parties requires the observance of many additional circumstances of each case, and, therefore, represents a unique situation in which a right of access to justice is put in jeopardy. For that reason, the termination of an arbitration agreement by an impecunious party or its counterparty will be analysed in detail below [IV.2 – IV.4]. At this point, it remains to see whether there are any grounds provided in contract law, besides the theory of waiver, which would allow the termination or disregarding the arbitration agreement in case of the non-payment of the advance.

As long as a national legal system accepts the obligation to pay the advance to be a substantive obligation under an arbitration agreement, one of the possible grounds for the

³⁹⁴ PRE-PAID LEGAL SERVICES, INC., Plaintiff–Appellee, v. Todd CAHILL, Defendant–Appellant, FN7 (United States Court of Appeals, Tenth Circuit 2015).

³⁹⁵ Ralph BRANDIFINO, Petitioner, v. CRYPTOMETRICS, INC., Respondent (Supreme Court, Westchester County, New York 2010).

termination may be a repudiatory breach in common law systems. In 2014, the English High Court rendered the decision in the case *BDMS Ltd v Rafael Advanced Defence Systems* [“*BDMS decision*” or “*BDMS case*”] on whether the respondent’s breach of arbitration agreement, which consisted of the failure to pay its share of the advance, is repudiatory.³⁹⁶ The facts of the case reveal that the claimant paid its share of the advance, but the respondent refused to do so until the claimant also paid the security for costs.³⁹⁷ The ICC finally gave a notice on the withdrawal of the claims due to the non-payment of the advance.³⁹⁸ The claimant subsequently commenced court proceedings, where the respondent filed a request for a stay under Section 9 of the 1996 EAA due to the existence of the arbitration clause.³⁹⁹ The English High Court accepted the contractual approach regarding the obligation to pay the shares of advance when addressing the issue and it concluded that the respondent’s non-payment constituted a breach of the contract.

In order to determine whether this breach was repudiatory, the following requirements can be deduced from the paragraph 57 of the *BDMS decision*: (1) the defendant’s refusal to participate needs to be *absolute*, and not conditioned (a so-called “wider pattern of repudiatory conduct”); (2) the breach *should deprive the claimant to arbitrate*, which will not happen if the claimant can pay the respondent’s part of the advance; (3) in that regard, although substitute payment is not the claimant’s obligation, it is a “*machinery for dealing with this situation*”; (4) the non-payment will substantially deprive the claimant of the

³⁹⁶ *BDMS Ltd v Rafael Advance Defence Systems* [2014] EWHC 451 (Comm) (High Court 2014).

³⁹⁷ *Ibid.*, para. 11.

³⁹⁸ *Ibid.*, para. 31.

³⁹⁹ Section 9(1) of the 1996 EAA states: “A party to an arbitration agreement against whom legal proceedings are brought (whether by way of claim or counterclaim) in respect of a matter which under the agreement is to be referred to arbitration may (upon notice to the other parties to the proceedings) apply to the court in which the proceedings have been brought to stay the proceedings so far as they concern that matter.”

benefits, if it could not have *avoided the consequence*; (5) it has to be proven that *the arbitration agreement was repudiated*, not merely the reference to arbitration in that case.⁴⁰⁰

The English High Court eventually decided that the breach in the *BDMS case* was not repudiatory. In its reasoning the Court seemingly distinguished between the first and further requirements stating that

“for the reasons set out in (2) to (5) above I am not satisfied that the refusal and/or failure of the [respondent] to pay its advance share of costs in this case was repudiatory in circumstances where it did not form part of a wider pattern of repudiatory conduct, as it did not for the reasons set out in (1) above”.⁴⁰¹

The English High Court found that the refusal was not absolute, but only conditioned on the payment of security for costs. Regarding the remaining requirements, the English High Court found the breach not to be repudiatory because it did not prevent claimant to arbitrate since it

⁴⁰⁰ Paragraph 57 of the *BDMS* decision produced in whole: “(1) This is not a case in which the Defendant was refusing to participate in the arbitration. It was in fact actively participating in the arbitration, as illustrated by its involvement in the settling of the TOR and in exchanges as to the scope of the preliminary issue hearing. Its refusal to “play by the rules” was limited to the issue of payment of its advance share on costs, a matter which was due to be addressed at the forthcoming preliminary issue hearing. Further, the refusal was not absolute, but was a refusal to pay unless security for costs was provided. (2) That breach did not deprive the Claimant of its right to arbitrate. It was at all times open to the Claimant to proceed with the arbitration by posting a bank guarantee for the Defendant’s share and then seeking an interim award or interim measure order that the advance be paid by the Defendant. On any view it could have sought such an order in a final award. It could also have objected against withdrawal to the ICC Court pursuant to Rule 30(4). (3) Although it is correct to state that the Claimant had no obligation either to pay the Defendant’s share of advance costs or to object to withdrawal, the Rules provide means whereby the arbitration could be proceeded with and the withdrawal of the claim avoided. The Rules contemplate, address and provide machinery for dealing with this situation. (4) For a breach to go to the root of the contract it is generally necessary to show that the innocent party has been deprived of substantially the whole benefit of the contract. It is difficult to see how the Claimant is “deprived” of that benefit when he has the means, expressly afforded to him by the Rules, to prevent that occurring and to seek recourse. (5) It has to be proved that the arbitration agreement was repudiated, not merely the arbitration reference. Even if a claim is deemed withdrawn as a result of default in payment of the advance on costs, there is no restriction on the same claim being brought to arbitration again at a future time (Article 30(4)). Future arbitration of the same claim is expressly contemplated so that irrevocable consequences as to arbitrability do not necessarily attach to the consequences of a failure to pay the advance on costs. (6) In summary, for the reasons set out in (2) to (5) above I am not satisfied that the refusal and/or failure of the Defendant to pay its advance share of costs in this case was repudiatory in circumstances where it did not form part of a wider pattern of repudiatory conduct, as it did not for the reasons set out in (1) above.”

⁴⁰¹ *BDMS Ltd v Rafael Advance Defence Systems* [2014] EWHC 451 (Comm) (High Court 2014).

could pay the whole advance, avoiding the withdrawal of the claims, and then seeking specific performance, i.e. the reimbursement from the counterparty. Furthermore, it was only the arbitration reference that was repudiated, and not the whole arbitration due to the lack of any preclusion of the claimant was from submitting the claim in new proceedings.

The *BDMS decision* is one of the rare decisions which deals, in general, with the right to terminate an arbitration agreement due to the repudiatory breach of the party who failed to pay the advance, and in such detailed manner. As will be discussed in other parts of this chapter, it is more often for the courts to deal with the prohibitive costs of arbitration, incurred either on the claimant's or the respondent's side. Interestingly, the English High Court opted for the contractual approach, i.e. that the payment of the share of the advance is a contractual obligation, but it referred the party to make substitute payment and then seek an interim award or interim measure order for the payment before the arbitral tribunal. This approach is opposite to the waiver theory in the U.S., where the case law allowed the party to have recourse to court, once its counterparty failed to cover its share. It is also contrary to the legislator's will expressed in the Swedish AA according to which a party forfeits its right to invoke the arbitration agreement if it fails to provide his share of the advance.

The laws and decisions discussed under this part dealt with the non-payment in general. It remains to be seen whether the impecuniosity of a party as an underlying reason adds anything up to this situation. The following Parts of this Chapter will analyse whether the impecuniosity of a party influences either the defaulting or non-defaulting party's right to disregard the arbitration agreement in any regard.

IV.2 Impecuniosity of the Claimant and Prohibitive Procedural Costs as the Basis for the Invalidation of the Arbitration Agreement

The right of access to justice lies at the heart of the discussion regarding claimant's impecuniosity. As will be shown below, those national courts which allow impecunious claimants to disregard an arbitration agreement often justify their decision by stating that otherwise the claimant would have no legal protection of its rights, i.e. it would not have access to justice. The opposite point of view is adopted, for example, by English and French courts, which do not seem to be concerned with the right of access to justice even when the claimant directly invokes Article 6 of the ECHR, as it will be discussed below. The latter courts even then insist on the enforceability of arbitration agreements. The European Court of Human Rights ["ECtHR"] has not thus far decided on this issue.

Article 6(1) of the ECHR states that "*[i]n the determination of his civil rights and obligations [...], everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law. [...]*". It provides for a two-fold set of rights: the right of access to justice of certain quality, and the right of access to court.⁴⁰² The right of access to court is not explicitly mentioned in Article 6(1) of the ECHR, but it was established in the case law of the ECtHR that states are obligated to guarantee such effective access.⁴⁰³ The effective access to court was confirmed to be dependent on the financial capacity of a party. For example, according to the ECtHR in *Airey v Ireland* (1979), when the applicant could not afford the legal fees, and therefore was refused to be

⁴⁰² Fredrik Ringquist, "Do Procedural Human Rights Requirements Apply to Arbitration - A Study of Article 6 of the European Convention on Human Rights and Its Bearing upon Arbitration," 21–22, accessed February 25, 2015, <http://lup.lub.lu.se/luur/download?func=downloadFile&recordId=1561507&fileId=1565>.

⁴⁰³ A. R. Mowbray, *Cases, Materials, and Commentary on the European Convention on Human Rights* (Oxford: Oxford University Press, 2012), 387.

represented by solicitors before the High Court, the right of access to court was violated.⁴⁰⁴ Similarly, in *Kreuz v Poland* (2001), the ECtHR concluded that “*the imposition of the court fees on the applicant constituted a disproportionate restriction on his right of access to a court*”.⁴⁰⁵ Hence, the right of access to justice, as guaranteed under Article 6(1) of the ECHR, should not be conditioned upon the financial capacity of a party.

As arbitration agreement is considered to be a waiver of a right of access to courts under article 6(1) of the ECHR, the issue of the effect of the party’s financial capacity on the access to (arbitral) justice is still open.⁴⁰⁶ However, under Article 6(1) of the ECHR there is no explicit guarantee of the right to arbitrate under the ECHR.⁴⁰⁷ That could be interpreted to mean that, once a party has concluded an arbitration agreement, it waived also all the protection which the state usually provides in order to assure the effectiveness of access to courts. The analogy can be made with another right provided under Article 6(1) of the ECHR – right to a public hearing. It is considered that the right to a public hearing is waived automatically by concluding an arbitration agreement.⁴⁰⁸ As stated by the ECtHR in *Suovaniemi and others v. Finland* (1999), the reason for this waiver is the fact that the “*one of the very purposes of [arbitration] is often to avoid publicity*.”⁴⁰⁹ The confidentiality of arbitration proceedings is guaranteed by majority of arbitration rules, which makes it inherent to arbitration itself.⁴¹⁰

Similarly, the funding of the proceedings in arbitration from private sources is one of the main features of arbitration. Legal aid is not provided in arbitration, except for self-

⁴⁰⁴ Ibid., 387–89.

⁴⁰⁵ Ibid., 401–3.

⁴⁰⁶ It is well-established since the *Deewer v Belgium* (6903/75 [1980] ECHR 1 (27 February 1980)) case that an agreement to arbitrate constitutes a waiver of this right.

⁴⁰⁷ Ringquist, “Do Procedural Human Rights Requirements Apply to Arbitration - A Study of Article 6 of the European Convention on Human Rights and Its Bearing upon Arbitration,” 35.

⁴⁰⁸ Ibid., 36.

⁴⁰⁹ *Suovaniemi and others v. Finland* (The European Court of Human Rights 1999), Application no. 31737/96.

⁴¹⁰ For example, Article 30 of the 2014 LCIA Rules; Article 44 of the 2012 Swiss Rules on International Arbitration; Article 46 of the 2010 SCC Rules.

obtained aid in the form of third-party funding. Therefore, the parties, by knowing that the costs will be covered by them, automatically waive the right to seek any financial help from a state to pursue their claim before an arbitral tribunal.

Since there is no explicit obligation on the part of the state to guarantee recourse to an arbitral tribunal, one might ask whether there is an implicit obligation of a state to invalidate the waiver of a right of access to courts once an impecunious party has no access to an arbitral forum. Some national courts' decisions speak in favour of disregarding such a waiver, while others insist on the enforcement of the same. However, some scholars warn that it should not be read more than it is reasonably conceivable into this waiver. For example, Wagner elaborates on this issue as follows:

“If the impecunious party were held to its agreement, it would be deprived not only of its right to recourse in a court of law but of its right to recourse altogether. [...] But it is possible to ask what rational parties would have stipulated had they made the issue of impecuniosity one of the subjects of their contract drafting. To pose the question in more precise terms, would a party agreeing to arbitrate future disputes also agree to effectively lose its right if it lacks the funds to pay for the arbitration proceedings? – The answer must be no.”⁴¹¹

Although Wagner doubts whether Article 6(1) of the ECHR has any bearing on the issue of impecuniosity⁴¹², he brings an interesting thought on the content of the waiver given in the form of an agreement to arbitrate. Since the main motivation of the parties for concluding the

⁴¹¹ Gerhard Wagner, “Poor Parties and German Forums: Placing Arbitration under the Sword of Damocles?,” in *Financial Capacity of the Parties: A Condition for the Validity of Arbitration Agreements?*, Schriftenreihe Der August-Maria-Berges-Stiftung Für Arbitrales Recht 16 (Frankfurt am Main: Peter Lang, 2004), 12; This brings up an interesting issue of the foreseeability of impecuniosity at the time of the conclusion of an arbitration agreement. Reiner persuasively argues that “irrespective of whether the impecuniosity was foreseen or not”, a party cannot be denied access to justice. See in: Andreas Reiner, “Impecuniosity of Parties and Its Effects on Arbitration – From the Perspectives of Austrian Law,” in *Financial Capacity of the Parties: A Condition for the Validity of Arbitration Agreements?*, Schriftenreihe Der August-Maria-Berges-Stiftung Für Arbitrales Recht 16 (Frankfurt am Main: Peter Lang, 2004), 41.

⁴¹² Wagner, “Poor Parties and German Forums: Placing Arbitration under the Sword of Damocles?,” 12.

arbitration agreement is to change the venue for their claim, i.e. to exchange the judicial proceedings for arbitration, the issue is what happens if that venue becomes unavailable. Similarly, Wagner elaborates that “[i]f the agreement was binding even where the party lacked the funds necessary to initiate arbitral proceedings, its effect would not be limited to substituting one law enforcement mechanism for another, [...] but it would foreclose enforcement of the underlying substantive right in the first place.”⁴¹³ In other words, does it mean that, when the parties agreed to arbitrate, they have waived their right of access to court as long as they have an available arbitral venue to pursue their claims, or irrespectively whether they can subsequently vindicate their rights in arbitration or not?

Nothing in this thesis suggests that there is an obligation of a state to guarantee the parties’ access to arbitral justice, but the analysis rather focuses on whether such a waiver is still valid if it presents a violation of a right of access to justice. In other words, should states at least open the “door” for the parties to have recourse to national courts once the “door” to arbitration is closed? In that case, the states would not be protecting the right of access to *arbitral* justice, but access to justice as such.

The terminology and the legal bases on which the issues involved in the cases of impecuniosity can be discussed are based on one of these three relations: 1) access to justice as guaranteed under Article 6(1) of the ECHR as due process principle, 2) contract law and the doctrines of supervening impossibility of performance based on the grounds of justice, and 3) Article II(3) of the New York Convention.⁴¹⁴ National courts took the opposite approaches on this matter: they either allowed the impecunious party to disregard the arbitration agreement, and to have recourse to national courts [IV.2.2], or they insisted on the

⁴¹³ Ibid.

⁴¹⁴ Matti S. Kurkela and Santtu Turunen, *Due Process in International Commercial Arbitration* (Dobbs Ferry, N.Y. : Oceana, 2005), 64.

enforcement of the arbitration agreement, even though one of the parties lacked financial capacity to commence arbitral proceedings [IV.2.3].

IV.2.2 Jurisdictions Allowing Impecunious Claimants to Disregard an Arbitration Agreement

German courts have a long tradition of availing the parties to an arbitration agreement with a remedy for their impecuniosity. Unilateral termination for grave cause in case of an impecunious party was accepted as a basis for the termination of an arbitration agreement by German courts for a very long period of time.⁴¹⁵ The termination in those cases was based on the provision on performance in good faith which is provided in section 242 of the German CC. The underlying reasoning for allowing the termination of an arbitration agreement is the preservation of a right of access to justice, as explained in the decision rendered by the German Federal Court of Justice on January 30, 1964:

“By its contents, an arbitration agreement is designed to assign certain legal disputes from state courts to arbitral tribunals. It is however not designed to cut off *the rights of one party to seek legal protection*. Therefore, if an arbitration agreement - for whatever reason - turns out to be inexecutable for practical or factual reasons, any party has the right to [extraordinarily] terminate the arbitration agreement for good reason” [emphasis added].⁴¹⁶

⁴¹⁵ Emmanuel Gaillard, “Impecuniosity of Parties and Its Effects on Arbitration: A French View,” in *Financial Capacity of the Parties: A Condition for the Validity of Arbitration Agreements?*, Schriftenreihe Der August-Maria-Berges-Stiftung Für Arbitrales Recht 16 (Frankfurt am Main: Peter Lang, 2004), 79.; BGHZ 41, 104 (January 30, 1964). BGHZ 51, 78 (November 21, 1968); BGHZ 77, 63 (April 10, 1980); BGHZ 102, 199 (November 12, 1987).

⁴¹⁶ BGHZ 41, 104 (January 30, 1964). The author would like to thank Mark Schönhaar, who translated the decision to English and made it possible to be included in this overview.

The right of an impecunious claimant to terminate an arbitration agreement is also supported in the Austrian case law and doctrine.⁴¹⁷ According to the decision rendered by the Austrian Supreme Court in 1936 the arbitration agreement creates “*long-term obligation between the parties to which the general principles for long-term legal relations must apply.*”⁴¹⁸ The termination for important reasons is one of them, and one of important reasons is considered to be the impecuniosity of a party which deprives it “*of the possibility of having its case decided by a judge or an arbitrator.*”⁴¹⁹ Namely, the Austrian court in its reasoning as a ground on which the termination should be justified invoked the right to access to justice.⁴²⁰ It found the denial of justice to be unacceptable in the given circumstances.

The termination of an arbitration agreement for grave cause in case of impecuniosity of one of the parties was the prevailing judicial opinion in Germany until 2000, but although the legal basis for disregarding the arbitration agreement was changed afterwards, the remedy for the preservation of a right of access to justice remained. Namely, when deciding on the issue of impecuniosity, the German Federal Court of Justice rendered a decision on September 14, 2000, in which it reaffirmed that an impecunious claimant (party) is entitled to a remedy, but on different grounds than in previous cases: it decided for the first time that impecuniosity rendered the agreement to arbitrate *incapable of being performed*, excluding the need to justify the termination of an arbitration agreement.⁴²¹ This approach was followed

⁴¹⁷ Reiner, “Impecuniosity of Parties and Its Effects on Arbitration – From the Perspectives of Austrian Law,” 40–41.

⁴¹⁸ Ibid.

⁴¹⁹ Ibid., 41.

⁴²⁰ Reiner, Andreas, Impecuniosity of Parties and its Effects on Arbitration – From the Perspectives of Austrian Law in Financial capacity of the Parties – A Condition for Validity of Arbitration Agreements?, (Frankfurt am Main: Peter Lang, 2004), 41. Austrian court mentioned the necessity for protection of right to access to justice in 1936, before ECHR existed as an international instrument. Therefore, ECHR can only strengthen this argument in this jurisdiction as a reason for setting aside the arbitration agreement.

⁴²¹ CLOUT Case 404, Not indicated v. Not indicated, Volume XXVII Yearbook Commercial Arbitration 2002, Kluwer Law International 265 (Bundesgerichtshof 2000); Wagner, “Poor Parties and German Forums: Placing Arbitration under the Sword of Damocles?,” 24; Kühner, “The Impact of Party Impecuniosity on Arbitration Agreements,” 815.

by a Cologne court on June 5, 2013.⁴²² This case involved an impecunious claimant who could not cover the costs of arbitration. The court invoked directly the solution as provided in the decision of the German Federal Court of Justice from 2000, which provided for *automatic* cessation of an arbitration agreement. The issue of whether this newly developed theory is justified or whether the solution based on the termination of an arbitration agreement was the correct approach to a party's impecuniosity in arbitration was a trigger for the scholarly debate.⁴²³

The main criticism, however, was not about the result that the German Federal Court of Justice reached, but regarding the ground on which it decided.⁴²⁴ The fact that the impecuniosity of a party is merely the *underlying reason* for the non-payment of the advance, which is then treated differently by courts, provokes interesting questions. This non-payment, according to the German courts, renders the arbitration agreement *incapable of being performed*. Therefore, it can be justified to ask whether any other reason for such a non-payment would render the agreement incapable of being performed, and the answer would probably be “no”.⁴²⁵ To further assess the appropriateness of this legal basis, the first question which needs to be answered is what the definition of the *non-performability* of arbitration agreement is. Section 1032(1) of the German CCP was adopted, and to a certain extent adapted, from Article 8(1) of the UNCITRAL Model Law⁴²⁶, which was “similar in purpose

⁴²² OLG Köln, Order of 5 June 2013, Case No. 18 W 32/13

⁴²³ Wagner, “Poor Parties and German Forums: Placing Arbitration under the Sword of Damocles?,” 24–31.

⁴²⁴ Wagner, 24.

⁴²⁵ Wagner gave an example of different underlying reason for non-payment according to which a party would use it “to protract the proceedings”. According to Wagner, although the procedural consequences would be the same, due to the underlying reason in service of dilatory tactic, this **would not render** the arbitration agreement “incapable of being performed”. See in: Wagner, Gerhard, Poor Parties and German Forums: Placing Arbitration under the Sword of Damocles? in *Financial capacity of the Parties – A Condition for Validity of Arbitration Agreements?*, (Frankfurt am Main: Peter Lang, 2004), 27.

⁴²⁶ Peter Huber, “Part II – Commentary on the German Arbitration Law (10th Book of the German Code of Civil Procedure), Chapter II – Arbitration Agreement, § 1032 – Arbitration Agreement and Substantive Claim before Court,” in *Arbitration in Germany: The Model Law in Practice* (Kluwer Law International, 2015), 118.

and content” to Article II (3) of the New York Convention.⁴²⁷ Therefore, in order to examine whether German courts decided on appropriate grounds to address this issue, one should look at the commentaries of both Article II(3) of the New York Convention and Article 8(1) of the UNCITRAL Model Law.

In his commentary on the New York Convention, Van den Berg already warned the arbitration community of a possibility that financial issues might be used as an argument under the concept “incapable of being performed”, provided in Article II(3).⁴²⁸ He emphasized two situations where financial issues should not be taken as a ground leading to the non-performability of the arbitration agreement: first, the arbitration agreement should still be considered capable of being performed even if the respondent will not be able to satisfy the award and, secondly, the same conclusion should be reached when payments cannot be made because foreign exchange is not available.⁴²⁹ When it comes to impecuniosity as a reason for the non-performability of an arbitration agreement, this commentator has not expressly stated it as a third case where an arbitration agreement must *not* be deemed incapable of being performed.

Later commentaries have mentioned the following examples when the arbitration agreement was found to be non-performable: the arbitral tribunal cannot be constituted, the arbitral tribunal refuses to act, or arbitration is no longer possible at the agreed place of arbitration.⁴³⁰ These examples lead to a conclusion that the arbitration agreement which is incapable of being performed is usually a consequence of a pathological clause, which cannot

⁴²⁷ *UNCITRAL 2012 Digest of Case Law on the Model Law on International Commercial Arbitration* (New York: United Nations, 2012), 33, <http://www.uncitral.org/pdf/english/clout/MAL-digest-2012-e.pdf>.

⁴²⁸ Berg, *The New York Arbitration Convention of 1958*, 159–60.

⁴²⁹ *Ibid.*, 160.

⁴³⁰ Dorothee Schramm, Elliott Geisinger, and Philippe Pinsolle, “Article II,” in *Recognition and Enforcement of Foreign Arbitral Awards: A Global Commentary on the New York Convention* (Kluwer Law International, 2010), 108.

be “cured” by tribunal.⁴³¹ However, there is doubt expressed in the doctrine whether impecuniosity falls within these examples.⁴³²

Similar doubt exists regarding Article 8(1) of the UNCITRAL Model Law. The UNCITRAL Model Law was prepared and later enacted as national arbitration law by more than 70 countries.⁴³³ However, this Model Law remained silent on the issue of impecuniosity. As a matter of fact, it remained silent regarding majority of issues dealt within this thesis. As previously mentioned, Article 8(1) contains a similar stipulation to that of the Article II(3) of the New York Convention. The Digest of Case Law on the Model Law on International Commercial Arbitration mentions the decision of the German Federal Court of Justice from 2000 as an example of an *extensive interpretation* of the phrase of “incapable of being performed”.⁴³⁴ The examples of the arbitration agreements not capable of being performed under the UNCITRAL Model Law are similar to those examples provided under the New York Convention. They are the following: the designations of institution or appointing authority are unclear, the parties designating a non-existing institution or appointing authority, or the designated institution or appointing authority refusing to cooperate as expected by the parties.⁴³⁵ One can easily spot the difference between these examples and the impecuniosity of one of the parties. The former are usually a consequence of the parties' poor drafting skills, while the latter is a circumstance that occurs on one party's side, and usually nothing is provided in the arbitration agreement in that regard. This supports the conclusion

⁴³¹ Pieter Sanders, ed., *ICCA's Guide to the Interpretation of the 1958 New York Convention: A Handbook for Judges* (International Council for Commercial Arbitration, 2011), 53, http://www.arbitration-icca.org/media/1/13890217974630/judges_guide_english_composite_final_jan2014.pdf.

⁴³² Schramm, Geisinger, and Pinsolle, “Article II,” 108.

⁴³³ Status on the UNCITRAL Model Law on International Commercial Arbitration (1985), with amendments as adopted in 2006, available at: http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/1985Model_arbitration_status.html (last access on 18 March 2016).

⁴³⁴ *UNCITRAL 2012 Digest of Case Law on the Model Law on International Commercial Arbitration*, 43.

⁴³⁵ Digest of Case Law on the Model Law on International Commercial Arbitration, available at: <http://www.uncitral.org/pdf/english/clout/MAL-digest-2012-e.pdf>, (last access on 23 May 2014).

that this might not be the best suited basis to assess the effect of impecuniosity on arbitration agreement in the first place.

The other set of the examples of arbitration agreements which were found incapable of being performed contains the following situations: the death of an arbitrator who was named in the arbitration agreement or the arbitrator's refusal to accept the appointment, if the replacement was clearly excluded by the parties.⁴³⁶ Again, these grounds are different from impecuniosity, since they are conditions or stipulations predicted by the parties in the agreement without which arbitration cannot take place. Impecuniosity is almost never predicted by the parties in the arbitration agreement and even if it was predicted, it would be a *resolutive condition*, rather than the *suspensive* one.⁴³⁷ This means that it would not be *conditio sine qua non* for arbitration process (as, for example, arbitrator named in arbitration agreement) or stipulation that has creative purpose for the arbitration process (for example, exclusion of replacement of arbitrator), but it would be a condition which should not occur. However, if it occurs, it terminates the arbitration agreement. Resolutive condition is, therefore, a basis for agreement to become *inoperative*, rather than incapable of being performed. Therefore, even if impecuniosity would be provided as a resolutive condition in the arbitration agreement itself, it would not render the arbitration agreement incapable of being performed, but inoperative.

From the above presented analysis of the concept of “incapable of being performed” under the New York Convention and the UNCITRAL Model Law, it follows that it does not encompass impecuniosity. Furthermore, the test of whether the arbitration agreement is still capable of being performed is not suitable because the non-defaulting party is, as per rules,

⁴³⁶ Sanders, *ICCA's Guide to the Interpretation of the 1958 New York Convention: A Handbook for Judges*, 53.

⁴³⁷ Black's law dictionary defines **resolutive condition** as “[a] condition that upon fulfillment terminates an already enforceable obligation and entitles the parties to be restored to their original positions. — Also termed resolutive condition; dissolving condition.” On the other hand **suspensive or potestatory condition** is “[a] condition that will be fulfilled only if the obligated party chooses to do so.”

invited to make substitute payment. Therefore, the decision of the court whether the arbitration agreement was capable or not of being performed would depend on the will of one of the parties, i.e. the one who chooses to make or not to make a substitute payment. Related to that, Wagner stated that the non-defaulting party by not making substitute payment may “remain idle without destroying the underlying contract.”⁴³⁸ This conclusion is in accordance with arbitration rules and national laws providing for the withdrawal of claims and the termination of proceedings in case of non-payment, without any prejudice to subsequent submission of the same claim in new proceedings. Therefore, the lack of payment or substitute payment does not touch upon the validity of arbitration agreement. It is difficult to defend then that the non-payment due to impecuniosity and subsequent lack of substitute payment which do not invalidate the arbitration agreement would render the agreement incapable of being performed and, therefore, *automatically* invalid.

Moreover, as already mentioned, both the arbitral tribunal as well as the institution, depending on the type of arbitration chosen by the parties, have the possibility to suspend or terminate the proceedings, if the payment of the advance is not made. Again, the decision whether the arbitration agreement would be rendered incapable of being performed lies in the hands of the arbitrators or the institution deciding to continue or not to continue arbitration proceedings. This is not in accordance with the current interpretation of the phrase “incapable of being performed” given by national courts, since the destiny of an arbitration agreement would depend on the decision of a third party whether the arbitration agreement. As it was correctly put by another scholar:

“[...] it is simply wrong to say that the arbitration agreement is incapable of being performed for the reason that the arbitrators may refuse to begin with their work.

⁴³⁸ Wagner, “Poor Parties and German Forums: Placing Arbitration under the Sword of Damocles?,” 27.

The agreement could very well be performed, the critical point being that it should not be performed for reason of fairness and equality.”⁴³⁹

Fairness and equality, which are the key issues when the party lacks funds, are much better observed when the issue of impecuniosity is discussed as the basis for the termination of the arbitration agreement. Termination for grave cause, where a party’s right to seek legal protection is put forward, is an example of an approach where fairness and equality is observed. Such termination would be followed by an *inoperative* arbitration agreement, and this was the approach adopted by German courts for a long time, as mentioned above. The difference is that it adds a middle step, where the termination is not granted automatically, but only after a careful observation of the court, and after the other (non-insolvent) party is given an opportunity to pay all the costs. Therefore, this seems to be a more appropriate ground for disregarding the arbitration agreement, especially since the procedural consequences of the non-payment of the advance do not touch upon the substantive validity of arbitration agreement.

Finally, another criticism regarding finding the arbitration agreement incapable of being performed when one of the parties is incapable of covering its share of procedural costs is that this goes against almost widely accepted rule that the mere lack of financial means does not excuse the party from performance.⁴⁴⁰ This is going to be successfully used by some courts in order to deny an impecunious claimant the right to disregard the arbitration agreement, as discussed under the following part [IV.2.3]. However, this rule does not exclude the possibility for a party to terminate or to accept the repudiation or a waiver of the arbitration agreement, which can consequently lead to the conclusion that the arbitration agreement became *inoperative*. Hence, by the mere re-characterisation of the issue of

⁴³⁹ Ibid.

⁴⁴⁰ Ibid.

impecuniosity, these pitfalls can be avoided, as will be shown in the analysis of the case of *Resin Systems Inc. v Industrial Service & Machine Inc*⁴⁴¹, discussed below within this Chapter [see **IV.3.1**]. Regardless of the outcome of this discussion, it can still be concluded that German courts are readily preserving the right of access to justice over the *pacta sunt servanda* principle.

In 2012, a Hungarian court came to a similar conclusion.⁴⁴² The case before the Szeged Court of Appeal involved a bankrupt party whose claim was dismissed by the first instance court.⁴⁴³ The Szeged Court of Appeal reversed the first instance court's decision based on four grounds, one of them being the excessive arbitration costs, which should have been paid in advance.⁴⁴⁴ The court held that the arbitration in the given circumstances was detrimental to the party, incompatible with the purpose of insolvency proceedings, and that is preventing the enforcement of the party's rights. Due to these reasons, the Szeged Court of Appeal concluded that the arbitration agreement was incapable of being performed, and allowed the bankrupt party to have recourse to the national court.

Notwithstanding some factual differences, or differences in legal grounds, the German, Austrian, and Hungarian courts had a common line of reasoning, which was mirroring their concern for the impecunious party's right to vindicate its rights. They emphasized this right and its significance, thus leaving behind the principle of *pacta sunt servanda*.

It remains to see whether those solutions which were discussed under Part I of this Chapter, such as the waiver of the arbitration agreement under the Swedish AA in the case of

⁴⁴¹ *Resin Systems Inc. v Industrial Service & Machine Inc.* (Court of Appeal of Alberta 2007).

⁴⁴² The author would like to thank Petra Kovacsics, who translated the decision to English and made it possible to be included in this overview.

⁴⁴³ Szegedi Ítéletábla, Gf.I.30.014/2012.

⁴⁴⁴ The other three reasons were: 1) no possibility for other creditors to intervene in the proceedings, 2) the non-public nature of arbitration, and 3) a limited court review of the arbitral awards.

the non-payment of the advance can be of any assistance to the impecunious claimant. Since in this case, it is the claimant who is unable to cover its share, it seems unlikely that this party will have any benefit from this solution since this relief provides the party interested in suing to turn to national courts if the other party does not cover its share of costs in arbitration. Therefore, the claimant, a party which is interested in conducting the proceedings in the first place, will also be the party waiving its right to arbitration once it does not make the necessary payment. It will not, however, be able to invoke the waiver on its own, while the respondent will most likely have no interest to commence court proceedings. Although the U.S. courts provided for a similar solution, as discussed in Part I of this Chapter, they have also dealt with the effect of prohibitive costs on the validity of an arbitration agreement.

The consideration of a party's right to vindicate its rights is not given attention only in those jurisdictions where the ECHR is applicable, but the same can be made in other countries. From these, the best example where the court dealt with the impecunious claimant's right to vindicate its rights and how prohibitive costs might deter this right is the decision of the Supreme Court of the United States ["U.S. Supreme Court"] in the case of *Green Tree Financial Corp.-Alabama et al. v. Randolph* ["Green Tree case"].⁴⁴⁵ Although the decision in the *Green Tree case* dealt with a consumer claim, scholars confirmed that the principles applicable to the arbitration agreement which were discussed in this decision are widely applicable.⁴⁴⁶ The respondent filed a suit before the district court, which subsequently granted the motion to compel arbitration, submitted by petitioner. The Court of Appeal for the Eleventh Circuit then reversed this order. This court held that "*the agreement to arbitrate*

⁴⁴⁵ *Green Tree Financial Corp. - Alabama et al. v Randolph* (Supreme Court of the United States 2000).

⁴⁴⁶ Richard A. Bales and Mark B. Gerano, "Determining the Proper Standard for Invalidating Arbitration Agreement Based on High Prohibitive Costs: A Discussion on the Varying Applications of the Case-by-Case Rule," *Transactions: The Tennessee Journal of Business Law* 14 (2013 2012): 65.

posed a risk that respondent's ability to vindicate her statutory rights would be undone by "steep" arbitration costs, and therefore was unenforceable."⁴⁴⁷

The U.S. Supreme Court recognized the party's possibility for a party to invalidate the arbitration agreement due to the prohibitive costs of arbitration, but it set the burden of proof to be on one of the parties which is seeking the invalidation by stating that:

"[...] we believe where [...] a party seeks to invalidate an arbitration agreement on the ground that arbitration would be prohibitively expensive, that party bears the burden of showing the likelihood of incurring such costs."⁴⁴⁸

In the *Green Tree case*, the parties have not designated any particular arbitration institution or arbitrator to resolve their dispute, and the U.S. Supreme Court found that the respondent, a party seeking the invalidation of the arbitration agreement, failed to make any factual showing that the excessive costs would be incurred.⁴⁴⁹ In other words, the U.S. Supreme Court acknowledged that the prohibitive costs may be used as the basis for the invalidation of the arbitration agreement, as long as the relief-seeking party meets the burden of proof. It did not, however, provide more guidance on this matter.

Although this approach protects the impecunious party's vindication of its rights and it guarantees accessibility to the forum if other national courts opt for the option presented in this section, there are certain drawbacks inherent to this approach which need to be taken into account. Namely, if they allow the impecunious party to have recourse to courts, the question is what happens if the party subsequently ceases to be impecunious. In that regard, the legislators might wish to explore the possibility to regulate a possibility to suspend an arbitration agreement.

⁴⁴⁷ *Green Tree Financial Corp. - Alabama et al. v Randolph* (Supreme Court of the United States 2000).

⁴⁴⁸ *Ibid.*

⁴⁴⁹ See footnote 6 in: *Ibid.*

Also, when deciding whether the arbitration agreement should be disregarded due attention should be given to the analysis whether the impecunious party would be better off in litigation.⁴⁵⁰ This is only one of the tests developed, for example, in the U.S. jurisprudence. The U.S. jurisprudence has developed four tests as to the measurement of the costs balance: 1) the subjective test, which compares the costs of arbitration to the litigant's ability to pay, 2) the comparative test, which compares the costs of arbitration to those of litigation, 3) the cost/benefit test, which compares the costs of arbitration to the likelihood of the potential recovery, and 4) the incentive-based test, which considers whether the plaintiffs or their representatives have any incentive, given the amount of costs, to pursue their claims.⁴⁵¹ Regarding the comparative test, the availability of legal aid is one of the circumstances that should be taken into account. If the impecunious party would not qualify for legal aid in litigation, or the costs of litigation would not be significantly lower, the impecunious party could not effectively exercise its right of access to justice before national courts either.

The next pitfall of this approach is the "creeping" violation of expectations and interests of the party with sufficient funds. Namely, the party (either claimant or respondent) which is involved in arbitration with an impecunious party is not liable for making substitute payment for the counterparty, in order to cover the advance and commence arbitration. It is even less so responsible for the other party's legal fees. At the same time, if the arbitration agreement is disregarded, the party which was willing to proceed with arbitration and to pay its share of costs might find itself in an unfair position, and before a foreign national court which it wanted to avoid in the first place.

⁴⁵⁰ Bales and Gerano, "Determining the Proper Standard for Invalidating Arbitration Agreement Based on High Prohibitive Costs: A Discussion on the Varying Applications of the Case-by-Case Rule," 72.

⁴⁵¹ Ramona L. Lampley, "The Price of Justice: An Analysis of the Costs That Are Appropriately Considered in a Cost-Based Vindication of Statutory Rights Defense to an Arbitration Agreement," *Brigham Young University Law Review* 2013, no. 4 (July 2013): 847.

The practice before German courts, until 2000, was to set a time limit for the party which was financially stable to decide whether it is willing and in a position to bear all the costs of the arbitration proceedings, and in case it did not or could do so, the impecunious party would obtain the right to terminate an arbitration agreement.⁴⁵² This would give the non-impecunious party an option, but still if it was without sufficient capacity to fund the whole proceedings (i.e. beyond its share), this party could end up before a national court without any fault on its side. This repercussion is especially important in international arbitration. If the arbitration agreement is disregarded in such setting, this may bring the claim before a foreign national court for at least one of the parties.⁴⁵³ This is exactly what was supposed to be avoided by concluding the arbitration agreement. Hence, while the impecunious party should be better off in litigation, national courts should balance this against the other party not being (severely) worse off.⁴⁵⁴

These pitfalls might have been part of reasoning or motivation for those courts which gave the preference to the principle of the binding force of arbitration agreements over the right of access to justice. Their decisions are presented in the next section.

IV.2.3 Jurisdictions Which Do Not Allow Impecunious Claimants to Disregard an Arbitration Agreement

Jurisdictions which have established a strong approach based on the principle of a binding force of arbitration agreements, and for that reason were ready to disregard the fact that an impecunious party has no access to any forum are England and Wales, and France.

⁴⁵² Kühner, “The Impact of Party Impecuniosity on Arbitration Agreements,” 815.

⁴⁵³ *Ibid.*, 816.

⁴⁵⁴ For further discussion on balancing the parties’ interests, the availability of legal aid for foreign corporations in Germany, and whether it makes sense to disregard arbitration agreements in international settings see in: Wagner, “Poor Parties and German Forums: Placing Arbitration under the Sword of Damocles?,” 18–19.

The Court of Appeal in England and Wales in the case of *Haendler & Natermann GmbH v. Mr. Janos Paczy* [“Paczy decision”] stated the following when dealing with an impecunious claimant:

“In my judgment the plaintiff cannot rely on his own inability to carry out his part of the arbitration agreement [...]. The arbitration agreement remains an agreement which is *perfectly capable of being performed* if the parties are themselves capable of performing it [...]” [emphasis added].⁴⁵⁵

The English court, therefore, took a clearly opposite stance on this matter than the one taken, for example, by German courts. Notwithstanding the harsh consequences which this decision imposed on the impecunious party and its access to justice, the English court provided a reasonable justification by elaborating in detail what it finds to meet the threshold for an arbitration agreement to become incapable of being performed by comparing an arbitration agreement with a sales contract. In this regard, the court stated:

“The incapacity of one party to that agreement to implement his obligations under the agreement does not [...] render the agreement one which is incapable of performance [...] any more than the inability of a purchaser under a contract for purchase of land to find the purchase price when the time comes to complete the sale could be said to render the contract for sale incapable of performance. The agreement only becomes incapable of performance in my view if the circumstances are such that it could no longer be performed, even if both parties were ready, able and willing to perform it. Impecuniosity is not [...] a circumstance of that kind.”⁴⁵⁶

⁴⁵⁵ *Haendler & Natermann GmbH v Janos Paczy*, 1 Lloyd’s Law Reports 302 (Court of Appeal 1980).

⁴⁵⁶ *Ibid.*

The *Paczy decision* has established firm grounds in both the doctrine and judicial practice. It is oft-cited both by English courts and by the commentators⁴⁵⁷, but it is also accepted in other jurisdictions⁴⁵⁸. In England and Wales, the *Paczy decision* had a significant impact on a decision rendered in the case of *Amr Amin Hamza El Nasharty v. J Sainsbury Plc* [“Nasharty decision”], where Mr. Nasharty, an impecunious claimant, submitted his inability to pay the advance on costs as an argument to oppose the stay of the court proceedings, and he invoked his right of access to courts under Article 6 of the ECHR.⁴⁵⁹ The English High Court found no violation of such a right. It stated that the claimant validly waived this right and that its impecuniosity “*adds nothing because inherent in any finding of waiver will be a finding that the Claimant freely and voluntarily entered into an arbitration agreement which imported a transparent published costs regime [...].*”⁴⁶⁰

The English High Court directly invoked the *Paczy decision* to support its finding in this regard by stating:

“[I]nability of one party to meet his financial obligations under the ICC or comparable Rules or procedures does not render the arbitration agreement inoperative or incapable of being performed – see *Janos Paczy v Haendler and*

⁴⁵⁷ Aron Broches, “UNCITRAL - Commentary On The Model Law,” in *International Handbook on Commercial Arbitration*, vol. Supplement No. 11 (Kluwer Law International, 1990), 47.

⁴⁵⁸ The **Uganda** Supreme Court, while dealing with the impecunious claimant, agreed with the *Paczy decision*. This is what the Supreme Court concluded: “*The Court duly considered the law and facts and came to the right conclusion that poverty of the appellant was not a sufficient reason for exercising discretion to refuse to stay proceedings on the ground that the agreement has been rendered incapable of being performed.*” Interestingly enough the Court continued by entering a new condition to the equation: “*In order to justify the exercise of the discretion in favour of the appellant, it had to be established that the appellant's impecuniosity was caused by the respondent. In this case there was no sufficient evidence to prove this*”. See in: Uganda No. 1, Fulgensius Mungereza v. PricewaterhouseCoopers Africa Central, Volume XXXV Yearbook Commercial Arbitration, Kluwer Law International 2010 (Supreme Court of Uganda 2004); Furthermore, the **Australian** Federal Court cited the *Paczy decision* in regard to the definition of the phrase “incapable of being performed”. See: Australia No. 8, Bakri Navigation Co. Ltd. v. Ship Golden Glory, Glorious Shipping S.A., Volume XIX Yearbook Commercial Arbitration, Kluwer Law International 1994 (Federal Court of Australia, New South Wales District Registry, General Division in Admiralty 1991); For more cases see: Robert Hunter, “Impecuniosity of the Parties and Its Effect on Arbitration – An English Perspective,” in *Financial Capacity of the Parties: A Condition for the Validity of Arbitration Agreements?*, Schriftenreihe Der August-Maria-Berges-Stiftung Für Arbitrales Recht 16 (Frankfurt am Main: Peter Lang, 2004), n. 18.

⁴⁵⁹ *Amr Amin Hamza El Nasharty v. J Sainsbury Plc*, [2007] EWHC 2618 (Comm) 2007 WL 3389508.

⁴⁶⁰ *Ibid.*

Natermann [...], concerned with the materially identical section 1 of the Arbitration Act 1975. Brightman LJ in that case indicated that in his view it cannot have been intended by Parliament that the court should on an application such as this attempt to assess the financial resources of a party.”⁴⁶¹

Hence, the court saw no reason to disregard the arbitration agreement since the party freely agreed to the costs schedule, for which the court stated to be “*the legitimate aim of ensuring that arbitrators are properly remunerated and that the administrative expenses of the ICC are paid.*”⁴⁶²

The question that can be addressed to the English courts which decided that the agreement is still perfectly performable and operative despite the party’s impecuniosity which immobilized the arbitration proceedings is as follows: Is there any way for an impecunious party to free itself from the arbitration agreement when it is obvious that it cannot afford it? Under the adopted approach, the answer would be “no”.

The *Paczy decision* takes the following perspective: “*The agreement only becomes incapable of performance [...] if the circumstances are such that it could no longer be performed, even if both parties were ready, able and willing to perform it.*”⁴⁶³ If the claimant is impecunious, it will still be ready and willing to perform the arbitration agreement and pay the costs. It will, however, not be able to do so due to lack of funds. Hence, it is clear from the definition that the impecuniosity of one party cannot reach this threshold and that is why the court followed it with saying that “[i]mpecuniosity is not [...] a circumstance of that kind”.⁴⁶⁴

⁴⁶¹ Ibid.

⁴⁶² Ibid.

⁴⁶³ Haendler & Natermann GmbH v Janos Paczy, 1 Lloyd’s Law Reports 302 (Court of Appeal 1980).

⁴⁶⁴ Ibid.

Section 1(1) of the 1975 EAA (now Section 9(4) of the 1996 EAA) has the same origin in Article II (3) of the New York Convention, just as Section 1032(1) of the German CCP, which was discussed under the previous section [see **IV.2.2**]. The 1975 EAA, including Section 1(1), was enacted to give the effect to the provisions of the New York Convention.⁴⁶⁵ As it followed from the analysis of the phrase “incapable of being performed” under the New York Convention and the UNCITRAL Model Law under the previous section, the state of impecuniosity does not seem to be a proper basis for declaring an arbitration agreement incapable of being performed. It would be advisable to opt out of using this legal basis as a proper test for the validity of an arbitration agreement when cases involve an impecunious claimant. In that sense, the English court was, indeed, right when stating that “[*Mr. Paczy’s*] misfortune, as it seems to me, really stems from two facts. First that legal aid unfortunately is not available in arbitration proceedings, and secondly that subsection (1) of Section 1 is mandatory and not discretionary.”⁴⁶⁶ However, the “misfortune” of not having the funds to finance its claim was not addressed under all grounds provided in this mandatory section.

Section 1(1) of the 1975 EAA (now Section 9(4) of the 1996 EAA) provides that an arbitration agreement can be set aside on one of three grounds: if it is null and void, inoperative or incapable of being performed. The English court in the *Paczy decision* dealt only with one of these grounds – whether the arbitration agreement became incapable of being performed. On the other hand, in the *Nasharty decision*, the English High Court declined the possibility for the arbitration agreement to be either incapable of being performed *or* inoperative due to the impecuniosity of a claimant.

It remains to be seen whether the rendered decision in the *BDMS case* in 2014 changes anything in this area, especially regarding the possibility to terminate an arbitration

⁴⁶⁵ Juliam D.M. Lew and Melissa Holm, “Development of the Arbitral System in England,” in *Arbitration in England, with Chapters on Scotland and Ireland* (Kluwer Law International, 2013), 6.

⁴⁶⁶ *Haendler & Natermann GmbH v Janos Paczy*, 1 Lloyd’s Law Reports 302 (Court of Appeal 1980).

agreement when the claimant is impecunious. The *BDMS case* involved a respondent who failed to pay its share of the advance, and the court found this to be a breach of its contractual obligation undertaken by concluding the arbitration agreement, but it found no repudiation on the respondent's side and the claimant was not entitled to terminate the arbitration agreement [see **IV.1**]. The question is whether termination based on repudiation would be possible if an impecunious claimant initiated the proceedings and then respondent refused to pay the respondent's share of the advance, for if the respondent paid its share, there would be no breach of obligation to pay in first place. The issue is whether such non-payment is to be considered repudiatory breach. In this regard, unless the respondent made its payment conditioned on, for example, the payment of security for costs, one can consider the refusal to participate to be the absolute one, i.e. it should be considered as a part of "wider pattern of repudiatory conduct", which was the first requirement under the *BDMS decision*. Secondly, if the claimant is impecunious, it could not make substitute payment which would prevent it from avoiding the procedural consequences of non-payment and protecting itself from being deprived of benefits under the arbitration agreement, and this would satisfy three other requirements under the *BDMS decision*.

Finally, the court in the *BDMS decision* stated that "*even if a claim is deemed withdrawn as a result of default in payment of the advance on costs, there is no restriction on the same claim being brought to arbitration again at a future time.*"⁴⁶⁷ In the case involving an impecunious claimant, this requirement for repudiation of the arbitration agreement leaves the following questions open: Is the claimant expected to abstain from arbitration until a better "financial climate" arrives? Or when it is clear that the claimant will not be able to substitute both shares and continue with arbitration is this enough for the court to conclude that the respondent repudiated the whole agreement to arbitrate, and not just the reference to

⁴⁶⁷ *BDMS Ltd v Rafael Advance Defence Systems* [2014] EWHC 451 (Comm) (High Court 2014).

arbitration in that particular case? In other words, although the subsequent submission of claim is possible, one needs to see whether the respondent's failure to pay made with the knowledge of claimant's impecuniosity reaches the *proportion of the failure to perform* which leads to repudiation.

When explaining what is the *proportion of failure to perform* that allows termination, Treitel gave the example of the case in which the buyer refused to accept one of two deliveries without any explanation and the court held that the seller was entitled to terminate the contract.⁴⁶⁸ A similar conclusion should be reached by the court in the case involving impecunious claimant. Non-payment by the respondent in a case referred to an arbitral tribunal without any justification should be considered severe enough to reach the *proportion of failure* that will allow the claimant to terminate the agreement to arbitrate. Otherwise, if the threshold requires the repetition of non-payment in a subsequent arbitration proceeding, this practically imposes the duty on the claimant not only to recover from its impecuniosity in order to cover its *own share* of advance, but also to be able to cover *respondent's share* as well. Since the substitute payment is not the claimant's obligation at all, the one-time respondent's refusal to pay its share should be enough to enable an impecunious claimant to terminate the contract. However, it remains to see whether English courts will be ready to overrule the precedent established in the *Paczy case* and confirmed in the *Nasharty case* in light of this new development under which the non-payment is considered to be breach of a contractual obligation.

There are possible drawbacks to this solution as well. The impecunious claimant will be able to terminate the arbitration agreement only if the respondent refuses to pay its share. If the respondent pays its share of the advance, this would preclude the claimant of available remedy and deny its access to justice. Moreover, once the court reaches the conclusion that

⁴⁶⁸ Edwin Peel and G. H Treitel, *Treitel on the Law of Contract*. (London: Sweet & Maxwell, 2011), 869.

the respondent's breach is repudiatory, it will be confronted with one more consideration before it allows the claimant to terminate the arbitration agreement. Since the impecunious claimant will not be able to pay its share of advance, it will be in breach as well. The court then needs to inquire what happens with the parties' right to terminate the contract in a case of simultaneous breaches. According to Treitel the general rule should be that where both parties breached a contract, each of them should preserve its right to terminate it and "[t]he justification for that general rule is that [...] that no good purpose is served by holding parties to a contract after each of them has committed a breach justifying its termination".⁴⁶⁹ Therefore, an impecunious claimant, who did not pay its share of advance, should still be entitled to terminate an arbitration agreement where the respondent refuses to pay as well. It depends, of course, on the policy of English courts which they will adopt in this type of a situation – whether they will decide to re-enforce the already established pro-arbitration approach, or if they will decide to be more sensitive to the party's unavailability of access to arbitral forum.

France is another jurisdiction in which an impecunious claimant will not be allowed to disregard an arbitration agreement due to its impecuniosity. French courts adopted a position that is contrary to the position adopted by the German Federal Court of Justice. This was correctly predicted by Gaillard in 2000, in the collection of papers on impecunious parties that was mentioned in the introduction to this Chapter.⁴⁷⁰ In 2013, the plaintiff in the *Lola Fleurs* case filed a claim before a French court, which referred it to arbitration.⁴⁷¹ The plaintiff appealed the decision, and claimed that the arbitration clause should be considered manifestly inapplicable since it cannot afford the costs of arbitration. The Paris Court of Appeal confirmed the first instance court's decision, and it reasoned by stating that the

⁴⁶⁹ Ibid., 912–13.

⁴⁷⁰ Gaillard, "Impecuniosity of Parties and Its Effects on Arbitration: A French View," 81.

⁴⁷¹ *Lola Fleurs* Case, No. 12/12953 (Paris Court of Appeal 2013).

inapplicability of an arbitration agreement cannot be incurred from the impecuniosity of a plaintiff, and that it is up to the arbitral tribunal to allow access to justice – any failure of granting such access can be sanctioned later.⁴⁷² In 2015, the Paris Court of Appeal restated this position in its decision rendered in a case no. 15/00512 [“Airbus case”], decided on 7 April 2015.⁴⁷³ According to the court, the arbitration agreement was not manifestly inapplicable due to the impecuniosity of a party, and it was once again re-affirmed that the denial of justice which could result from this financial state of a party is the arbitral tribunal’s responsibility, as it should ensure access to justice.⁴⁷⁴ The scrutiny of whether there was denial of justice can be, according to the French court, addressed *ex post*.⁴⁷⁵

This approach is described by scholars as a re-affirmation of a negative effect of the competence-competence principle with an *a posteriori* court scrutiny.⁴⁷⁶ It is difficult to perceive, however, which decision could be later scrutinized by courts since, as explained above, the file most often in the cases of an impecunious claimant does not even reach the tribunal. If the courts opt for the preservation of the binding force of an arbitration agreement, and insist on the arbitrators’ responsibility for providing access to justice, some practical aspects should be taken into account and resolved in the future. Namely, if the file does not even reach the arbitral tribunal at all, it is questionable then in which way the tribunals are expected to provide access to justice. Insisting on this approach would also mean that the arbitrators impliedly agreed in their *receptum arbitri* to act without any payment of the advance, which will often not be true or there will be no provision in this regard in their acceptance of an appointment. As mentioned above, it is too optimistic to expect that

⁴⁷² Ibid.

⁴⁷³ SELAFA MJA v S.A.S. AIRBUS HELICOPTERS AND Societe AIRBUS HELICOPTERS DEUTSCHLAND GMBH (Paris Court of Appeal 2015). The author would like to thank Ioana Stupariu, who translated the decision to English and made it possible to be included in this overview.

⁴⁷⁴ Ibid.

⁴⁷⁵ Ibid.

⁴⁷⁶ Kühner, “The Impact of Party Impecuniosity on Arbitration Agreements,” 809.

arbitrators will conduct the proceedings without the advanced payment, or that arbitration institutions will allow it.

However, the biggest criticism that this approach can receive is certainly the fact that, by enforcing arbitration agreements in these situations, the national courts are evidently placing a price on justice. One might argue that it was the parties who put it there in the first place. However, it might be difficult, especially in situations where there is an alternative in referring the parties to litigation as a cheaper option, to defend this position.

A similar *ex post* review, which is related to the final allocation of costs, was considered and criticized in the U.S. jurisprudence due to the violation of the principle of judicial economy. In the dissenting opinion to the *Green Tree* decision, Justice Ginsburg, who wrote the opinion, stated that the majority opinion

“does not prevent [the respondent] from returning to court, post-arbitration, if she then has a complaint about cost allocation. If that is so, the issue reduces to when, not whether, she can be spared from payment of excessive costs. Neither certainty nor judicial economy is served by leaving that issue unsettled until the end of the line.”⁴⁷⁷

The same principle can be applied when the issue is not the complaint related as to the allocation of excessive costs, but when the discussion is led as to whether the tribunal guaranteed access to justice to an impecunious party. Besides, the narrowness of the grounds on which judicial review of international arbitral awards is conducted was also pointed out as one of the weaknesses of the *ex post* scrutiny.⁴⁷⁸ This argument, however, could be easily

⁴⁷⁷ *Green Tree Financial Corp. - Alabama et al. v Randolph* (Supreme Court of the United States 2000).

⁴⁷⁸ Bales and Gerano, “Determining the Proper Standard for Invalidating Arbitration Agreement Based on High Prohibitive Costs: A Discussion on the Varying Applications of the Case-by-Case Rule,” 71.

overturned as the access to justice could be claimed to be part of international public policy, and therefore, it would be covered by otherwise narrow judicial review.

IV.3 Impecuniosity of the Respondent (Counterclaimant): Prohibitive Procedural and Party Costs and the Party's Right of Access to Justice

The situation involving an impecunious respondent implies certain differences in comparison to claimant's impecuniosity. The impecuniosity of the claimant, unless it is overcome by respondent's substitute payment, or by the court's finding of the arbitration agreement incapable of being performed or inoperative, blocks the commencement or continuation of arbitration proceedings. Similarly, the claimant may be interested in this case to disregard the arbitration agreement. The difference is that in this case it is the solvent party that wishes to extinguish the arbitration agreement. There are general solutions based on the waiver theory and the termination due to the non-payment, which were discussed under Part I of this Chapter. However, it remains to see whether there are additional remedies or a wider application of these remedies when the impecuniosity of a party is the basis for the solvent's party request to disregard the arbitration agreement. Hence, the first sections analyses the grounds based on which the solvent party, i.e. claimant, may disregard the arbitration agreement if the respondent is impecunious and fails to pay its share of the advance [IV.3.1]

Another difference stems out from the claimant's readiness to pay the whole advance on costs. For this reason, the proceedings are conducted and the award rendered, unlike in the cases of impecunious claimants, when proceedings are usually terminated. Since the proceedings are conducted despite one party's lack of funds, different issues might arise

eventually. Two aspects of the financial incapacity of a respondent and their consequences will be addressed here: a possible violation of respondent's procedural rights if it is not in a financial position to submit counterclaims [IV.3.2] and a violation of respondent's procedural rights when it cannot pay the costs for effective defence (notwithstanding the submission of counterclaims) [IV.3.3].

IV.3.1 Non-Payment by the Impecunious Respondent as a Basis for Termination by the Claimant and “Inoperativeness” of the Agreement to Arbitrate

The contract law based solutions, as discussed under Part I of this Chapter, have little bearing on the situations involving impecunious claimants, as this is the party interested in the commencement of arbitration, but also in breach of its obligation due to lack of funds. They, however, have more importance for solvent claimants who are not ready to provide substitute payment for an impecunious respondent, and who wish to disregard the arbitration agreement. Section 5 of the Swedish AA provides a remedy for such claimants. Since it states that “[a] party shall forfeit his right to invoke the arbitration agreement as a bar to court proceedings where the party: (...) fails [...] to provide his share of the requested security for compensation to the arbitrators”, this ground encompasses the non-payment of any of the parties, including respondents, with or without any underlying reason for such non-payment. In case of an impecunious respondent failing to provide its share of the advance, the solvent

claimant will obtain the right of having recourse to national courts again, at least in regard to that specific reference to arbitration.⁴⁷⁹

Furthermore, while in the *BDMS* case, the English High Court clarified the nature of the obligation to pay the advance, it found no repudiation on the side of the non-paying respondent. The *BDMS* decision provided grounds for the impecunious claimants to terminate the arbitration agreement, as discussed under **IV.2.3**, but this will highly depend on the policy which will be adopted by courts. It remains to see whether there is any ground to find repudiation by the respondent who defaulted due to lack of funds. This *BDMS* decision will be analysed in comparison to another decision rendered in Canada, another common law jurisdiction. This is the decision rendered in the case of *Resin Systems Inc. v Industrial Service & Machine Inc.* [“Resin case” or “Resin decision”].⁴⁸⁰ In both cases addressed here, the courts dealt with issue of whether the agreement to arbitrate became *inoperative*. However, the courts came to different conclusions.

In the *BDMS* case, the English High Court found the respondent’s non-payment to be a breach of a substantive obligation under the arbitration agreement. However, as noted before, the English High Court laid down five reasons due to which the breach was not found to be repudiatory and, consequently, left the claimant without the right to terminate the agreement to arbitrate. Regarding the finding whether the arbitration agreement was operative, it concluded that

“[t]here is a possible further argument available to the Claimant that even if there had been no accepted repudiation the arbitration agreement had been rendered unworkable and thereby inoperative. [...] Nevertheless, my reasons

⁴⁷⁹ Swedish Supreme Court, Case no. Ö 2289-05 (12 May 2008); The reasoning adopted in the *Pre-Paid* case, where the respondent invoked the arbitration agreement and then failed to pay its share of the advance, may also have an impact on the case involving an impecunious respondent.

⁴⁸⁰ *Resin Systems Inc. v Industrial Service & Machine Inc.* (Court of Appeal of Alberta 2007).

for finding that the breach did not go to the root of the contract are equally reasons for finding the arbitration agreement was not made unworkable and thereby inoperative in this case.”

Therefore, the English High Court addressed the right to terminate the arbitration agreement and a claim that it became inoperative as two different and valid grounds that claimant can invoke in cases like this. The final result was, under both grounds, that the claimant was still bound by arbitration agreement and, consequently, not able to turn with its claim to a national court.

In order to determine whether the breach was repudiatory, the following requirements were analysed in the *BDMS decision*: (1) the defendant’s refusal to participate needs to be *absolute*, and not conditioned (a so-called “wider pattern of repudiatory conduct”); (2) the breach *should deprive the claimant to arbitrate*, which will not happen if the claimant can pay the respondent’s part of the advance; (3) in that regard, although substitute payment is not the claimant’s obligation, it is a “*machinery for dealing with this situation*”; (4) the non-payment will substantially deprive the claimant of the benefits, if it could not have *avoided the consequence*; (5) it has to be proven that *the arbitration agreement was repudiated*, not merely the reference to arbitration in that case.⁴⁸¹ The impecuniosity as underlying reason for the respondent’s default may have a significant impact on some of the court’s findings, which were made when the respondent conditioned the payment of its share on the payment of the security for costs.

Firstly, an impecunious respondent would show much “wider pattern of repudiatory conduct”, as its non-payment would not be conditioned upon any security and it would, therefore, be absolute. Of course, other behaviour, such as active participation in other phases

⁴⁸¹ Paragraph 57 of the *BDMS decision*.

of the arbitration, an “involvement in the settling of the TOR” or “in exchanges as to the scope of the preliminary issue hearing”, may be taken into account as well.⁴⁸² Furthermore, it is clear from the *BDMS* decision that substitute payment is considered a proper “machinery for dealing with this situation”. However, in case of an impecunious respondent the issue of the claimant’s reimbursement, either during the arbitration or in the last award, is uncertain. The claimant will surely have an opportunity to arbitrate subject to the payment of the whole advance, but the English High Court emphasized the possibility of the reimbursement as one of the reasons why claimant was not deprived of its right to arbitrate.⁴⁸³ It will, again, depend on the policy of a court whether the claimant will be found to be deprived of such a right, once it would be expected from it to cover the costs wholly on its own, without a reasonable possibility to expect the reimbursement. The requirements, as set in the *BDMS* decision, are difficult to rebut, and they will highly depend on the circumstances of a particular case.

While discussing the issue brought before it, the English High Court mentioned the Alberta Court of Appeal decision in the *Resin* case, where the circumstances very much mirrored the *BDMS* case, but the Alberta Court of Appeal court reached the opposite conclusion.⁴⁸⁴ The case involved an impecunious respondent who failed to pay its part of the share of the advance. The claimant was not ready to make substitute payment and it commenced court proceedings. The Alberta Court of Appeal court, as well as the English High Court, found that the non-payment of the share of the advance is a breach of the arbitration agreement due to the textual interpretation of the applicable rule from the ICC rules which state that “the advance costs *shall* be payable in equal shares by each of the parties” [emphasis added].⁴⁸⁵

⁴⁸² *BDMS Ltd v Rafael Advance Defence Systems* [2014] EWHC 451 (Comm) (High Court 2014).

⁴⁸³ *Ibid.*

⁴⁸⁴ *Resin Systems Inc. v Industrial Service & Machine Inc.* (Court of Appeal of Alberta 2007).

⁴⁸⁵ *Ibid.*

The Alberta Court of Appeal court then focused solely on the discussion whether the arbitration clause is operative, without any reference to the termination of the agreement to arbitrate. It concluded that “*the refusal to pay the costs makes the arbitration unworkable, and thereby inoperative, as there is no obligation on the other party to fund the defaulting party’s share.*”⁴⁸⁶ As illustrated by the decisions analysed above, the Canadian and English courts rendered the opposite decisions under similar circumstances.

Comparing these decisions might shed more light on whether the non-defaulting party from the *Resin* case would be successful in claiming that the breach was repudiatory or that the agreement was inoperative under the five requirements listed above in the *BDMS* decision. First requirement was that the breach was absolute. In the *Resin* case, the court established that the respondent stated that it had not intended to make the payment.⁴⁸⁷ However, the refusal was not completely resolute, and the respondent was actively participating in the proceedings until that point. The respondent also provided a justification for the refusal, submitting that the claim exceeded the contractual limits. The Alberta Court of Appeal rejected this argument, stating that it is a justification of the substantive nature which would have been an issue, had the arbitration continued.⁴⁸⁸ In the *BDMS decision*, the English High Court dealt with the respondent’s refusal to pay conditioned upon the claimant’s payment of the ordered security for costs. This condition was of procedural nature, so it would be interesting to see how an English court would decide, if the reason for the non-payment would be of substantive nature.

The second requirement was the one on the availability of substitute payment, which was one more reason why the English High Court decided the breach not to be repudiatory and the agreement to be still operative. In this respect, the Alberta Court of Appeal simply

⁴⁸⁶ *Ibid.*, para. 16.

⁴⁸⁷ *Ibid.*, para. 8.

⁴⁸⁸ *Ibid.*, para. 15.

stated that the agreement to arbitrate was unworkable and, therefore, inoperative “*as there is no obligation on the other party to fund the defaulting party’s share*”.⁴⁸⁹

Lastly, the Alberta Court of Appeal did not address the last requirement of the English approach – that repudiation should not be limited to the single reference to arbitration. The reason why it did not make any conclusions on this point might be that, as mentioned before, the court in the *Resin case* focused solely on the inoperativeness, while this requirement focuses on the scope of repudiation. Since the applicable arbitration rules in both cases were the same, i.e. the ICC Rules, the withdrawal of the claim in this case would provide no prejudice to any subsequent submission as well. Therefore, the English court might probably conclude the repudiation was only regarding the specific reference, and not the whole agreement to arbitrate.

To summarize, the solutions at the disposal of a solvent claimant in the case involving impecunious respondent is not internationally uniform. The national courts might adopt similar legal grounds based on which they will characterize the issue – either as an issue of repudiation or inoperativeness or a waiver – but they will render opposite decisions. Therefore, in the case of impecunious respondent, claimant’s chances to have recourse to a national court will depend from jurisdiction to jurisdiction. However, if the claimant is ready to make substitute payment, the respondent might be the party which is interested in disregarding the arbitration agreement, especially if it is unable to finance the counterclaim [see **IV.3.2**] or it lacks funds for a proper defence [see **IV.3.3**].

⁴⁸⁹ Ibid., para. 16. In this regard, the Canadian court also cited the *Paczy* decision, in which the court held the claimant’s argument that respondent should pay also its share of advance to be a “fantastic assertion”. The Court in the *Resin* decision, dealing now with the same argument from the respondent’s side, continued in the same direction by addressing such an argument as “audacious”. However, the interesting fact is that the latter court did not comment the fact that in the *Paczy* decision the claimant was in the end left without the forum, since the English court stated that the claimant’s impecuniosity did not render the agreement “incapable of being performed”.

IV.3.2 Prohibitive Procedural Costs for Submitting a Counterclaim: The Respondent's (Counterclaimant's) Right to Disregard the Arbitration Agreement

The set of circumstances involving an impecunious respondent which will be discussed under this section is the one in which the respondent lacks funds to cover the advance for its counterclaims. The submission of counterclaims in institutional arbitration usually leads to the payment of separate advances.⁴⁹⁰ When a respondent is impecunious, this is usually followed by payment made only on by claimant for its own claims, while respondent's counterclaims are considered withdrawn. The position of the respondent, i.e. the counterclaimant, in these situations, resembles very much the position of an impecunious claimant described above. The respondent (counterclaimant) is not prevented from defending itself against the claims submitted by claimant, but it is prevented from raising new claims.

The differences between the positions of a claimant and counterclaimant stem from the fact that in arbitration proceedings involving an impecunious counterclaimant, the proceedings still can, and usually do, take place. For this reason, the discussion related to an issue of impecuniosity is postponed for a later stage - the stage of the recognition and enforcement (or setting aside) of an award. It will be shown whether this offers an impecunious party any new remedies. Portuguese and French courts came to similar conclusions, but with different reservations.

On November 9, 2003, the Portuguese Supreme Court in the case No. 1647/02 confirmed the enforcement of an award, which was initially granted by the first and second

⁴⁹⁰ For example, under article 36(3) of the 2012 ICC Rules: "Where counterclaims are submitted by the respondent under Article 5 or otherwise, the Court may fix separate advances on costs for the claims and the counterclaims. When the Court has fixed separate advances on costs, each of the parties shall pay the advance on costs corresponding to its claims."

instance courts.⁴⁹¹ One of the grounds on which the appellants (respondents in arbitration) challenged the enforcement of the award was the violation of public policy under the New York Convention, as they were impecunious at the time of arbitration and consequently their counterclaims were not heard by the arbitral tribunal. The invoked legal basis for such claim was article 20 (1) of the Portuguese Constitution which provides that

“[e]veryone shall be guaranteed access to the law and the courts in order to defend those of his rights and interests that are protected by law, and justice shall not be denied to anyone due to lack of financial means.”

The court agreed that the right guaranteed under Article 20(1) of the Portuguese Constitution is part of international public policy.⁴⁹² However, this right, according to the Portuguese Supreme Court, is not absolute. The Court stated that it is allowed for

“anyone to resort to other measures than the state courts, such as arbitration, and to submit to a foreign law and/or jurisdiction in respect of right which one can freely dispose, *paying what is necessary to guarantee that measure’s functioning*” [emphasis added].⁴⁹³

The decision is, in this regard, comparable with the *Nasharty decision*, where the court also emphasized the parties’ awareness of the cost schedules to which they were agreeing. Hence, the Portuguese Supreme Court re-affirmed that the waiver of the right of access to court also encompasses the waiver of any state’s obligation to protect the parties with lack of funds. While Article 20(1) of the Portuguese Constitution guarantees access to courts despite the financial incapacity of a party, the moment the parties step out of its realm by waiving it in favour of arbitration or foreign court’s jurisdiction, they are solely liable for financing the

⁴⁹¹ Portugal No. 1, A (Netherlands) v. B & Cia. Ltda., C and others, Volume XXXII Yearbook Commercial Arbitration 2007, Kluwer Law International 474 (Supremo Tribunal de Justiça [Supreme Court of Justice] 2003).

⁴⁹² Ibid.

⁴⁹³ Ibid.

chosen forum. In other words, they are leaving the “protective umbrella of the state” by accepting the decision to be rendered by an arbitral tribunal or a foreign court.⁴⁹⁴

In this particular case, the appellants were impecunious, and were unable to submit their counterclaims in the arbitration. The Portuguese Supreme Court found no denial of justice. In accordance with what was mentioned above, the court stated that, while international public policy encompasses the right under article 20(1) of the Constitution, it does not include “*a principle which would provide for complementing the insufficient [financial] means of [an entity] that by nature only exists because and to extent that it has the economic means necessary for its existence.*”⁴⁹⁵ Also, it was emphasized that neither the domestic law nor any act which Portugal is bound by guarantees legal aid to companies. Taking that into account and also the fact that the parties to the arbitration agreement should have been aware of the future costs which these proceedings might entail, according to the Portuguese Supreme Court, international public policy was not violated and the award was enforced.

The Portuguese Supreme Court, nevertheless, provided for a possible exception to the established rule. This is the situation in which the party *subsequently* found itself *without fault* in financial difficulties “*that makes access to justice totally impossible where the obligation to submit to the arbitral tribunal still exists*”, but, according to the court, no allegations as to prove that “*the obligation is extinguished because performance thereunder has become impossible through no fault on its own*” were made by appellants in this case.⁴⁹⁶

In 2008 the Portuguese Constitutional Court rendered a decision in which it dealt with an impecunious party to an arbitration agreement. It stated that if an impecunious party is eligible for legal aid in accordance with the relevant law, it is not obliged to respect an

⁴⁹⁴ Ibid.

⁴⁹⁵ Ibid.

⁴⁹⁶ Ibid.

arbitration agreement.⁴⁹⁷ The stance of the Portuguese Constitutional Court seems not to conflict with the position taken by the Portuguese Supreme Court, since the latter emphasized the unavailability of legal aid for companies under Portuguese law in its reasoning. Literal reading of these decisions would lead to a conclusion that there is a possibility for an impecunious counterclaimant to successfully claim denial of justice if it proves that the financial difficulties emerged subsequently and without its own fault, and/or that it would qualify for legal aid in court proceedings.

This is in line with some of the comments given in the previous parts of this study. The question is then what should be done with such counterclaims which are submitted in arbitration, but the advance was not paid, which would lead to denial of justice. Should the tribunal continue with its services irrespective of such payment, or should the party be referred and allowed to approach national courts in this regard? Perhaps more can be concluded on this matter from the decisions of French courts.

The issue of impecuniosity was address in the *Pirelli case* by the Paris Court of Appeal and the French Supreme Court.⁴⁹⁸ Although the latter overruled the decision of the former, it is interesting to examine and compare both of these decisions.

The *Pirelli case* involved a respondent submitting the counterclaims in ICC arbitration, who later, due to its bankruptcy, could not pay the advance due upon these submissions. The counterclaims were withdrawn and the arbitral tribunal decided only on the claims submitted by the claimant. The respondent sought the annulment of the award based

⁴⁹⁷ José Miguel Júdece and Joaquim Shearman de Macedo, “Right to Plead Case versus Enforcement of Arbitration Agreement” (International Law Office, February 5, 2009), <http://www.internationallawoffice.com/Newsletters/Arbitration-ADR/Portugal/AM-Pereira-Sragga-Leal-Oliveira-Martins-Jdice-e-Associados-Sociedade-De-Advogados/Right-to-Plead-Case-versus-Enforcement-of-Arbitration-Agreement#decision>.

⁴⁹⁸ *Société Licensing Projects (LP) et autres v Société Pirelli & C. SPA et autres*, Volume 2012 Issue 2 *Revue de l’Arbitrage*, Comité Français de l’Arbitrage 2012 387 (Court of Appeal of Paris 2011); *Pirelli & Co. v. Licensing Projects and other*, A contribution by the ITA Board of Reporters, *Kluwer Law International* (First Civil Law Chamber 2013).

on the violation of Article 1502 (4) and (5) of the French Code of Civil Procedure [“French CCP”], which provided for the annulment if due process has not been respected, or if the recognition or enforcement is contrary to international public policy. The particular legal issues which the Paris Court of Appeal addressed were the violation of the principle of equality as part of due process, and the violation of the right of access to courts.

Regarding the principle of equality, the Paris Court of Appeal decided that the parties were not on equal footing before the tribunal since respondent’s defence was restricted only to reply to the claims. Since it was deprived from submitting its counterclaims, which were sufficiently connected with the claims, it was deprived of a possibility to offset the claimant’s successful claims.⁴⁹⁹ As to the possibility to submit the counterclaims again in the future without any prejudice, the opinion of the Court of Appeal was that such a possibility is only theoretical.⁵⁰⁰ Regarding the violation of the right of access to courts, the Court of Appeal stated that if there are restrictions imposed on this right, they must be proportionate to the proper administration of justice, and the tribunals are also due to apply this principle.⁵⁰¹

The French Supreme Court annulled the Court of Appeal’s decision due to the lack of legal basis.⁵⁰² The French Supreme Court stated that submissions of counterclaims are not to be guaranteed, unless they are inseparable from the main claims, and the Court of Appeal failed to examine this.⁵⁰³ While the theory of inseparability was conceived as to prevent denial of justice, scholars rightly pointed out that the French Supreme Court provided no criteria for the determination on whether claims and counterclaims are separable or not.⁵⁰⁴ It

⁴⁹⁹ *Société Licensing Projects (LP) et autres v Société Pirelli & C. SPA et autres*, Volume 2012 Issue 2 *Revue de l’Arbitrage*, Comité Français de l’Arbitrage 2012 387 (Court of Appeal of Paris 2011).

⁵⁰⁰ *Ibid.*

⁵⁰¹ *Ibid.*

⁵⁰² *Pirelli & Co. v. Licensing Projects and other*, A contribution by the ITA Board of Reporters, *Kluwer Law International* (First Civil Law Chamber 2013).

⁵⁰³ *Ibid.*; Kühner, “The Impact of Party Impecuniosity on Arbitration Agreements,” 810–11.

⁵⁰⁴ Kühner, “The Impact of Party Impecuniosity on Arbitration Agreements,” 812.

is up to the arbitral tribunal to decide on this issue, on a case-by-case basis.⁵⁰⁵ At the same time, the question whether the parties whose counterclaims were withdrawn due to the inability to pay the costs can bring those counterclaims before a national court has not yet been answered by the French Supreme Court.⁵⁰⁶ However, in light of the decisions of the Paris Court of Appeal in the *Lola Fleurs* and the *Airbus* cases, it seems that it is highly unlikely that the French courts, which did not find an arbitration clause manifestly inapplicable due to the impecuniosity of the claimant, would conclude any differently in cases involving impecunious counterclaimants.

If we compare the outcome of the *Pirelli case* and the reasoning of the French Supreme Court with the decision of the Portuguese Supreme Court, we can conclude that both courts emphasized the significance of party autonomy, which is the sole ground for waiving the state protection when concluding the arbitration agreement. Consequently, both supreme courts found no legal basis to guarantee the parties the access to arbitral tribunal. However, both courts provided for certain exceptions to this rule, although the exceptions were of a different nature. The French Supreme Court stated that submissions of counterclaims are not to be guaranteed, unless they are inseparable from the main claims.⁵⁰⁷ On the other hand, the Portuguese Supreme Court provided for a possibility for courts to take the impecuniosity into account as a plausible argument, but only when the party proves that it was caused subsequently and without its own fault.

⁵⁰⁵ Ibid.

⁵⁰⁶ Ibid., 813.

⁵⁰⁷ *Pirelli & Co. v. Licensing Projects and other*, A contribution by the ITA Board of Reporters, Kluwer Law International (First Civil Law Chamber 2013).

IV.3.3 Prohibitive Party Costs: Violation of the Respondent's Right to be Heard

The second scenario involving impecunious respondents is the one in which the respondent has enough funds to cover its share of advance, but it lacks funds to finance its defence. The costs which are necessary for respondent's defence include, but are not limited to, attorney's fees, other expenses, and the readjustment of the advance on costs. It is considered that there is no obligation for the parties to be represented by an attorney in arbitration, but the complexity of cases as well as the principle of equal treatment might impose the need for the party to be professionally represented.⁵⁰⁸ Even if the party is not represented by an attorney, the travel costs necessary for it to participate in hearings, but also other expenses might be high enough to prevent the respondent in effectively presenting its case. These other expenses might involve, for example, the fees and expenses of witnesses of fact, expert witnesses, technical advisers, interpreters etc. Without available funding for these costs, the respondent will not have an opportunity to present evidence supporting its arguments, or its defence will at least not be as effective as it could be. All these situations show how the lack of financial funds on the respondent's side can impair its effective defence, and consequently violate the right to present the case and the right to equal treatment.

The treatment of respondent's impecuniosity in regard to the effective defence should be treated differently than when it is not in a position to finance its counterclaims since the latter situation does not touch upon the respondent's right to reply to the claim raised by the claimant. This can also be deduced from the opinion of the French Supreme Court in the *Pirelli case* where it was stated that the submissions of counterclaims are not to be

⁵⁰⁸ Reiner, "Impecuniosity of Parties and Its Effects on Arbitration – From the Perspectives of Austrian Law," 46.

guaranteed, unless they are inseparable from the main claims.⁵⁰⁹ Therefore, the conclusion would be that any impairment of a respondent to answer to a claim caused by financial distress would lead to the violation of due process.

It remains to see whether the respondent would have a claim under Article 6 of the ECHR. Article 6 of the ECHR covers not only the right of access to courts, but also the right of access to justice of certain quality. The ECtHR took a position that the right to fair hearing was violated due to the denial of legal aid which deprived the applicants “*to present their case effectively before the court and contributed to an unacceptable inequality of arms*”.⁵¹⁰

Although it cannot be claimed that the violation of the ECHR is a separate ground for challenging the award, the grounds usually provided for that purpose can be a basis for pursuing the guarantees of rights under Article 6(1) of the ECHR. Hence, lack of funds on the respondent’s side to finance defence might trigger much more serious consequences for the award, which need to be taken into account by arbitral tribunals.

It is, however, difficult to suggest any solution on how to obtain necessary funds for a respondent. The claimant cannot be forced to finance it on any other but voluntary basis, while legal aid is not guaranteed in arbitral proceedings. It is also questionable whether the tribunal could insist on the respondent’s application for third-party funding. Besides these three solutions, the question is whether the tribunal can continue the proceedings with knowing that there is a great possibility that it will render an award which is tainted by a conceivable violation of due process.

To conclude, when we talk about the right of equality of arms, much more can be deducted from the ECtHR practice. The issue here is whether the state should be found in

⁵⁰⁹ *Pirelli & Co. v. Licensing Projects and other*, A contribution by the ITA Board of Reporters, Kluwer Law International (First Civil Law Chamber 2013).

⁵¹⁰ *Steel and Morris v UK* (2005) see in: Mowbray, *Cases, Materials, and Commentary on the European Convention on Human Rights*, 411.

violation of Article 6(1) of the ECHR if it does not set aside or it enforces an award or arbitration agreement in cases where this right was or if it is threatened to be jeopardized. The ECtHR clearly stated that right to a fair trial is not absolute. This should be the leading thought in solving the issue of impecunious parties in arbitration which cannot afford defence. Firstly, courts should give due attention and effort in proving whether party is impecunious. Secondly, they should always observe whether impecunious party would be better off in litigation. If an impecunious party does not qualify for legal aid, or defence before the state court would not be any cheaper, a state cannot be subsequently accused of not ensuring a right to a fair trial. The means through which this right is guaranteed in litigation are left to the state's discretion and parties to arbitration agreement should not be in more favourable position than the litigants before a court of law.

Another option that impecunious parties have is to obtain funds from an external funder. Third party funding is a recently developed industry, whose impact on arbitration is yet to be evaluated. However, due to its emerging availability, this study will analyse the main legal issues related to the funding of impecunious parties.

IV.4 Third Party Funding: Panacea or Menace for an Impecunious Party and Its Right of Access to Justice

IV.4.1 Theoretical Foundation and Definitions

Third party funding, which initially started as a litigation related industry, spread its net in the last decade over arbitration field as well. Arbitration, as a privately funded adjudicative process, has certain benefits from this new industry. For example, one of the possibilities for impecunious parties in arbitration is to seek out for the external funding. The

discussion, therefore, should not be placed on the necessity of such funding in arbitration, but on the necessity of more detailed regulation, and the avoidance of drawbacks. The need for such regulation, and a proper way of conducting it, was also stressed in the Consultation Paper on Third Party Funding for Arbitration [“2015 Consultation Paper”] released by the Third Party Funding for Arbitration Sub-committee of the Law Reform Commission in October 2015.⁵¹¹ This Chapter introduces and elaborates on the most important concerns related to third party funding in international commercial arbitration. While this type of funding is widely welcomed, as any new industry, it may bring more drawbacks and obstruct the legitimacy and efficiency of arbitration proceedings more than one would be ready to admit at first.

The 2015 Consultation Paper mentions as reasons for opting for third party funding the management of the risks of arbitration by sharing the risk of non-recovery and the lack of its own financial resources.⁵¹² Impecunious parties are, therefore, not the only beneficiaries of this type of funding, but they will be in focus for the purposes of this part of the Chapter. The issue of necessary regulation rises when the self-regulation within the industry does not suffice anymore to achieve the underlying policy.

Third party funding offers a solution for impecunious parties to cover the necessary procedural and party costs, and in that way it supports the pro-arbitration approach, i.e. the enforcement of arbitration agreements. Hence, tribunals and/or national courts, when confronted with the impecuniosity of a party to international commercial arbitration, might as well start to take into account the availability of third party funding in order to decide on the validity of an arbitration agreement. However, this should be approached with caution.

⁵¹¹ “Consultation Paper on Third Party Funding for Arbitration” (Third Party Funding for Arbitration Sub-committee of the Law Reform Commission of Hong Kong, 2015), http://www.hkreform.gov.hk/en/docs/tpf_e.pdf.

⁵¹² *Ibid.*, 9.

There is a newly developed trend in international commercial arbitration: the need for efficient proceedings. The need for efficient proceedings is exactly the reason why one should have in mind that, although third party funders certainly deserve to be at the “arbitration table”, their participation should not be taken for granted by arbitration participants, including the parties to arbitration agreements, their representatives, the arbitrators, and arbitration institutions. Taking it for granted can easily violate the right of access to justice and the highly appreciated principle of efficiency of proceedings.

In that regard, this part of the Chapter will cover several non-resolved legal issues which often arise when a party is funded by an external funder. Given the wide scope of issues related to the third party funding, this part, as mentioned above, will focus on third party funding when provided to *impecunious* parties, i.e. parties without sufficient funds to cover arbitration-related costs by themselves. There is a wide diversity of the types of third party funding. This part deals with the so-called “classic third party funding”, i.e. non-recourse financing with repayment contingent on success.⁵¹³

In order to establish whether third party funding serves, and to which extent, the protection of a party’s access to justice, the following will be analysed: the availability of third party funding depending on the procedural position in the proceedings, how funders decide whether to fund the claim or not, how much control they take over the funded proceedings, the usual scope of coverage of funding, the possible conflicts of interest. These legal issues are not novelties by themselves. There is already an established stream of thought which states that these should be regulated in one or another way. However, observing them through the lenses of an impecunious party might shed some new light on them. If access to justice is to be protected through this financial device, then the regulators should take into account this perspective as well.

⁵¹³ Nieuwveld and Shannon, *Third-Party Funding in International Arbitration*, 8.

IV.4.2 The Availability of Third Party Funding: Is It Indeed Levelling the Field?

Third party funding might be a leeway for impecunious parties who are trying to level their playing field. This claim can be based on the following: arbitration does not fall under the financial support of the state in which it is conducted since one of the main differences between bringing a claim before a national court and before an arbitral tribunal is that the parties are the ones paying the fees of the tribunal, while in judicial proceedings the judges are paid by the states. Also, by bringing a claim to the arbitration forum, parties leave one of the biggest benefits of national courts systems – legal aid.⁵¹⁴ Without such aid, impecunious parties may be left without access to arbitral justice when in financial distress. Third party funding can fill in this gap.

As an example, one author, when discussing the settlement dynamics between two parties, one of which became impecunious, said the following:

“In those circumstances, even if the weaker of the two parties has a very strong case on the merits, it would have a difficult time turning down a low settlement offer that would free it of the burdens of ongoing dispute resolution. [...] Without a credible threat of taking the case through arbitration (and enforcement proceedings) – and lacking the resources needed to take full advantage of the process available to it – the weaker of the parties could not extract a settlement for the amount to which it is lawfully entitled.”⁵¹⁵

⁵¹⁴ Wagner, “Poor Parties and German Forums: Placing Arbitration under the Sword of Damocles?,” 13.

⁵¹⁵ Christopher Bogart, “Overview of Arbitration Finance,” in *Third-Party Funding in International Arbitration*, Dossiers ICC Institute of World Business Law (International Chamber of Commerce (ICC), 2012), 52.

Referring to arbitration finance, i.e. third party funding, as a solution, the author concludes that “anything that levels the playing field and enhances the ability of the adjudicative system to fulfil its goal of providing justice is desirable”.⁵¹⁶

However, welcoming third party funding in arbitration should come with certain reservations as well. As already mentioned, the availability of third party funding for impecunious parties is available subject to certain conditions, restraints, and considerations. Hence, national courts should, when deciding upon whether access to justice was effectively guaranteed in situations involving an impecunious party, take these circumstances into account as well.

The availability of third party funding will depend on the procedural position of an impecunious party, the types of costs which could be covered, and other terms as imposed by a third party funder. Third party funders set out the terms of funding, and the funding is mainly available for claimants or counterclaimants, but rarely for respondent’s defence due to the difficulties in defining the success upon which the payment is contingent.⁵¹⁷ That already means that some impecunious parties will have less success in finding financial assistance from an external funder than others. Moreover, the funders discussed here are those with no legal interest in dispute. However, they maintain economic interest in winning the case, and their main motivations to fund a proceeding are the reimbursement of their costs uplifted with a significant share of a claim.⁵¹⁸

This also means that third party funding and its availability depends heavily on due diligence made by a third party funder and its judgement of the likelihood of the success in

⁵¹⁶ Ibid.

⁵¹⁷ “Consultation Paper on Third Party Funding for Arbitration,” 35.

⁵¹⁸ Margareta Habazin, “Third-Party Funding Implications on Arbitrator Independence: The 2014 IBA Guidelines on Conflicts of Interest Cannot Prevent Potential Conflicts of Interest Arising from Third-Party Funding in International Investment Arbitration,” *Croatian Arbitration Yearbook 21/22 (2015 2014)*: 186.

the arbitration.⁵¹⁹ The process of such due diligence depends on the model adopted by each of the funders, but the factors taken into account are more or less publicly known and similar.⁵²⁰ The likelihood of a success of a claim is one of the most important factors, and such likelihood should usually be quantified somewhere between 60-75% for funders to have interest in funding a claim.⁵²¹

The case assessment as the basis for the decision on whether to grant funding, as well as case monitoring, which is conducted once the funding is granted, are grounds which raise multiple confidentiality concerns since the funded party is required to disclose dispute related facts. This presupposes the question of what the scope of the confidentiality obligation under the arbitration agreement is. Unless explicitly regulated within the agreement, the existence and the scope of the confidentiality obligation between the parties will depend usually on the chosen arbitration rules. Almost all analysed arbitration rules contain the so-called “wide-ranging confidentiality obligations” which extend to a broad scope of category of information: the existence of the arbitration, the nature and quantum of the claim, the counterparty, the arbitrators, the documents submitted throughout the arbitration, the arbitral hearings, and the tribunal’s decisions.⁵²² The usual disclosure duties of the funded parties would violate the entire scope of their confidentiality obligation under the arbitration agreement.⁵²³ For that reason, the first consideration which needs to be made is to observe whether there is a plausible exception to this obligation.

⁵¹⁹ Nieuwveld and Shannon, *Third-Party Funding in International Arbitration*, 62.

⁵²⁰ “Consultation Paper on Third Party Funding for Arbitration,” 36–37.

⁵²¹ Selvyn Seidel, “Third-Party Investing in International Arbitration Claims - To Invest or Not to Invest? A Daunting Question,” in *Third-Party Funding in International Arbitration*, Dossiers ICC Institute of World Business Law (International Chamber of Commerce (ICC), 2012), 25; “Consultation Paper on Third Party Funding for Arbitration,” 36–37.

⁵²² von Goeler, *Third-Party Funding in International Arbitration and Its Impact on Procedure*, 35:295, 299.

⁵²³ *Ibid.*, 35:299.

One scholar has summed up the available exceptions related to the following two: disclosure to protect the funded party's rights and disclosure to advisors.⁵²⁴ The former exception encompasses directly the situation analysed in this part of the chapter. The protection of the funded party's rights includes the situation where the funded party needs to make a necessary disclosure in order to obtain access to arbitral justice.⁵²⁵ Some of the arbitration rules regulate such an exception more clearly, such the 2014 LCIA Rules and 2012 Swiss Rules. Under Article 30(1) of the 2014 LCIA Rules, the party is bound by confidentiality obligation "*to the extent that disclosure may be required of a party [...] to protect or pursue a legal right.*" The same exception is provided under Article 44(1) of the 2012 Swiss Rules. The impecunious party's right to obtain capital from a funder is considered to be a legitimate business interest, and as long as the third party funding is not objected to, the party should be allowed to make necessary disclosures in this regard.⁵²⁶ The latter exception, which relates to the disclosure to advisors, can be read into the rules with the "wide range confidentiality obligations". Therefore, successfully defend the funded party's legitimate interest to disclose information to funders as persons who perform advisory and monitoring functions in relation to the arbitration proceedings.⁵²⁷

Even if an exception to the party's obligation under the arbitration agreement applies, and the party is free to disclose the necessary information to the potential or current funder, the further issue is what the scope of the funder's confidentiality obligation is, if there is any at all. The funder, as a non-signatory to the arbitration agreement, is not bound by any confidentiality requirement provided in such an agreement.⁵²⁸ The non-funded party's interests are in jeopardy, notwithstanding whether the funded party is allowed to disclosure to

⁵²⁴ Ibid., 35:302–5.

⁵²⁵ Ibid., 35:303.

⁵²⁶ Ibid., 35:304.

⁵²⁷ Ibid., 35:304–5.

⁵²⁸ Ibid., 35:300, 307.

the funder or not. If the funded party falls under one of the applicable exceptions, the question is whether there is an obligation for the funded party to guarantee that the funder will respect the confidentiality threshold, which is imposed between the parties by the arbitration agreement.

As mentioned above, the arbitration agreement does not oblige the third party funder. This can be overcome by including such a confidentiality obligation into the funding agreement.⁵²⁹ The breach of this obligation would, however, be a breach against the funded party. The non-funded party would have no basis to sue for damages based on the breach of the funding agreement which is concluded between the funder and the funded party. It is, however, possible to construe the legal basis upon which the non-funded party may sue the funded party for the breach of confidentiality made by its funder. Section 43(1) of the 1998 DIS Rules provide that “[p]ersons acting on behalf of any person involved in the arbitral proceedings shall be obligated to maintain confidentiality.” This section would oblige a funded party to secure the confidentiality within its legal relationship with the funder, and if the funder breaches it, the opposing party may sue the funded party for appropriate damages.⁵³⁰ However, such an obligation on the funded party’s side cannot be implied under an arbitration agreement when not explicitly regulated in arbitration laws or rules.⁵³¹

Furthermore, given that funders entirely have discretion to decide whether to fund the claim, the process of the scrutiny of the claims is somewhat moved to an earlier stage and into the hands of the funders since in a case of an impecunious party the proceedings will not commence unless there is an external funding. The question is whether one can claim then that this guarantees access to justice at all. It might be so, but it may cause severe injustice as well. It is also fair to state that national courts might be less inclined to find a violation of a

⁵²⁹ Ibid., 35:300.

⁵³⁰ Ibid., 35:307.

⁵³¹ Ibid.

right of access to justice if the solution, such as third party funding, is offered within the arbitration realm. At the same time, the commencement of the arbitration proceedings will depend on the results of the funder's due diligence. For that reason, the status and availability of such funding should be approached with caution and not taken for granted by national courts.

One thing that should be considered when deciding on the relevance of third party funding in cases involving an impecunious party is whether such a party would be at all better off if the case was brought before a national court. As third party funding is not always available, the same can be said for legal aid. It is questionable, and worth of research, whether legal aid is available for commercial parties and under which conditions. According to the National Reports contained and analysed in the synthesis "Costs and Fee in Allocation in Civil Procedure" a somewhat general conclusion is that legal aid is usually subject to two main, and strict, conditions: (1) only parties who fall below an income or wealth threshold are eligible, which makes public legal aid unavailable to the middle class, and (2) the case needs to pass so-called merits test, under which states do not fund long shot litigation.⁵³² While first condition might not be necessary for obtaining third party funding in international arbitration since, as mentioned above, the party may want to obtain it to manage its financial risks rather than to cover its lack of funds, the second condition is highly important.

However, the measurement whether the claim has merits or not can be conducted under the different thresholds in arbitration and litigation. For example, according to paragraph 17 of the Recital of the EU Council Directive on legal aid "*Member States should be allowed to reject applications for legal aid in respect of manifestly unfounded actions or on grounds related to the merits of the case in so far as pre-litigation advice is offered and*

⁵³² Mathias Reimann, "Cost and Fee Allocation in Civil Procedure: A Synthesis," in *Cost and Fee Allocation in Civil Procedure*, ed. Mathias Reimann, Ius Gentium: Comparative Perspectives on Law and Justice 11 (Springer Netherlands, 2012), 37–38, http://link.springer.com/chapter/10.1007/978-94-007-2263-7_1.

access to justice is guaranteed” [emphasis added].⁵³³ Hence, the EU Council sets as a threshold for rejection to provide legal aid a “manifestly unfounded action”, which seems to be much lower merits test than the likelihood of 60-75% for a claim to be successful, which is a test applied by third party funders in international arbitration. It is, however, true that limited number of parties would be eligible to receive legal aid. Although the EU Directive on legal aid, for example, applies to civil and commercial matters, under Article 3(1) only natural person may apply. Therefore, it will depend on particular jurisdiction whether corporate entities may apply as well. Third party funding in international commercial arbitration is oriented towards such entities in the first place.

The main purpose of this discussion is not to identify third party funding with public legal aid, but just the opposite – to clearly distinguish it from it. The purpose is also not, under any circumstances, to state that legal aid should be available in international commercial arbitration.

Third party funding, as the type of funding available based on a privately concluded agreement, seems to fit well in the frame of international commercial arbitration which is as well contract based dispute settlement mechanism. However, as a newly developed industry, it deserves special attention, especially when it is claimed that it may preserve impecunious party’s access to justice. Third party funders, however, lay down a high economic interest in the success of the claim due to the fact that their fee is contingent on it.

When the court is deciding whether an impecunious party would be better off before a national court, several other considerations need to be made. For example, the impecuniosity of a party might not qualify for legal aid, but perhaps the fees which initially are to be paid to a court or an arbitral award might differ from jurisdiction to jurisdiction. In national courts’

⁵³³ Council Directive 2002/8/EC of 27 January 2003 to improve access to justice in cross-border disputes by establishing minimum common rules relating to legal aid for such disputes, Official Journal L 026 , 31/01/2003 P. 0041 – 0047.

proceedings, only filing fees are charged, while national judges are paid by the states. In some countries, court charges, however, may be of high amounts. Quite the opposite, in arbitration, arbitrators' fees and expenses, and other administrative charges are paid in advance by the parties. The relation between these two is also something that should be taken into account when deciding whether the right of a party to access justice needs protection.

Arbitrators' fees are not even the highest fees paid in international commercial proceedings – the highest amounts are paid for party costs, including legal fees. According to the 2015 ICC Report on Costs, party costs make usually 83% on average of the overall costs of arbitration.⁵³⁴ This introduces a new issue – what do funders require in exchange for paying such high fees, and what is the usual coverage of funding.

In respect of the funders' demands, there are two distinct features of third party funding agreement: different levels of control over proceedings which they require and a high percentage of a successfully claimed amount. The percentage usually sought by the funders falls somewhere in between 15% and 50%.⁵³⁵ This, and many other features, may be justified by a generalized statement that “funding a claim in the expectation of earning a return from it is an expensive, risky and protracted undertaking.”⁵³⁶ At the same time, the economic power of a funder (and possibly the need to protect its interests) can also put it in a position to negotiate the terms of a funding agreement which will be unfair for a funded party.⁵³⁷ The level of control which a funder takes over arbitration is one of the terms which can, on one hand, be justified by the risk undertaken by a funder and the fact that it is also interested in the outcome of the case, while on the other hand, it may be pushed further than it would be agreed on if the parties were on equal economical footing.

⁵³⁴ “ICC Arbitration and ADR Commission Report - Decisions on Costs in International Arbitration,” 3.

⁵³⁵ Susanna Khouri, Kate Hurford, and Clive Bowman, “Third Party Funding in International Commercial and Treaty Arbitration - a Panacea or a Plague? A Discussion of the Risks and Benefits of Third Party Funding,” *Transnational Dispute Management (TDM)* 8, no. 4 (October 2011): 3.

⁵³⁶ *Ibid.*, 6.

⁵³⁷ *Ibid.*

Some examples of such control over the proceedings are: control over the choice of the party's lawyer or the nomination of an arbitrator, control of how the claim is managed by the lawyers, including any settlement prospects.⁵³⁸ The funder may even go so far to as to negotiate a term under which it has a right to terminate funding if the funded party does not act according to its wishes, or if there is a material breach of a contractual term, or even if the likelihood of success of the claim changes during the proceedings.⁵³⁹ This all shows a high level of involvement which funders may acquire during the negotiations of a funding agreement, and which can seriously jeopardize or prevent a party to freely conduct its proceedings. It was perfectly valid, therefore, to ask, as some authors did, "whose claim is this anyway?"⁵⁴⁰

The reply to this question may seem simple as the third party funder never becomes, unless explicitly agreed, a party to an arbitration agreement.⁵⁴¹ But the question is set much broader – it is not about who the party in arbitration is, but who is controlling and, in a way, "owning" a claim and the proceedings. Depending on the terms, in a case where the funded party is impecunious, this might indeed be the third party funder since in case it decides to withdraw its funding, such a party will not have access to arbitral justice anymore. However, this does not necessarily mean that such terms are not valid, or that they invalidate the funding agreement. This is to be decided under the law applicable to such contract. Also,

⁵³⁸ Habazin, "Third-Party Funding Implications on Arbitrator Independence: The 2014 IBA Guidelines on Conflicts of Interest Cannot Prevent Potential Conflicts of Interest Arising from Third-Party Funding in International Investment Arbitration," 188; Georges Affaki, "A Financing Is a Financing Is a Financing..." in *Third-Party Funding in International Arbitration*, Dossiers ICC Institute of World Business Law (International Chamber of Commerce (ICC), 2012), 11; For control over proceedings in litigation see in: Maya Steinitz, "Whose Claim Is This Anyway? Third Party Litigation Funding," *Minnesota Law Review* 95, no. 4 (2011): 1296.

⁵³⁹ Habazin, "Third-Party Funding Implications on Arbitrator Independence: The 2014 IBA Guidelines on Conflicts of Interest Cannot Prevent Potential Conflicts of Interest Arising from Third-Party Funding in International Investment Arbitration," 188; "Consultation Paper on Third Party Funding for Arbitration," 41.

⁵⁴⁰ Steinitz, "Whose Claim Is This Anyway? Third Party Litigation Funding."

⁵⁴¹ Habazin, "Third-Party Funding Implications on Arbitrator Independence: The 2014 IBA Guidelines on Conflicts of Interest Cannot Prevent Potential Conflicts of Interest Arising from Third-Party Funding in International Investment Arbitration," 187.

although other terms might be disruptive to conducting the proceedings, funder's control may also lead to more effective case management, as it is in its interest for arbitration to be cost and time-efficient.⁵⁴²

At this point, it can be concluded that, when it comes to levelling the field for the impecunious party, it can be done through third party funding, but it all depends on several circumstances. National courts, as well as arbitral tribunals, should take these circumstances into account when deciding whether the party is provided with effective access to justice, and whether the party should be allowed to have recourse to national courts as discussed in other Parts of this Chapter [see **IV.2 and IV.3**]. The first observation should be whether the impecunious party would be better off before a national court, taking into account the difference between the costs which would likely be incurred in arbitration and comparing them with those which would be incurred in litigation. Also, the likelihood of granting legal aid to a party who lacks funds may be of relevance, depending on the impecunious party's eligibility. Finally, the terms of a funding agreement, if the impecunious party opted for third party funding, might be of utmost importance because they might be disruptive for party's control over proceedings, and consequently deprive it of *effective* access to justice. For example, some of the terms, such as the possibility to terminate the funding, might deprive the impecunious party from access to justice in the end. Hence, all these issues related to the funding of the impecunious party call for the development and supervision of the standards of this funding industry.

Even if third party funding effectively supports party's access to justice, there are other unresolved legal issues which can jeopardize the award in the end or disrupt the proceedings. Some of them, such as the scope of coverage of third party funding and conflicts of interest, are discussed in the following subsections.

⁵⁴² "Consultation Paper on Third Party Funding for Arbitration," 133.

IV.4.3 The Scope of Coverage of Third Party Funding: The Security for Costs as Another Side of the Same Coin

Third party funding may cover different types of costs and expenses incurred in arbitration, e.g., arbitrators' fees and expenses, legal costs and other party costs, costs of experts, but this coverage will depend on the funding agreement. There are two cost liabilities for which third party funders in arbitration are rarely ready to take responsibility. One of them is the payment of security for costs, and the other is the payment of adverse costs order, which is due upon the final allocation of costs at the end of the arbitration proceedings. Regarding the latter, at this point, it will only be stated that it is currently not possible for an arbitral tribunal to make an adverse costs award against the third party funder.⁵⁴³ This means that, while the funder will cover the procedural costs of the arbitration, as required through the advance on costs, any shifting of party costs or decision on damages will not be enforceable against the funder. If a case involves an impecunious party who is supported by a third party funder, its opponent may recognize this as a strong incentive to protect its interest to get paid at the end of proceedings.

When focusing on a situation involving a third party funder, there are two possible ways in which the respondent may obtain protection: the respondent can either ask the arbitral tribunal or the court to take into account the third party funding when deciding on granting the security for costs, or even successfully obtain and enforce an order for security for costs against the funder.⁵⁴⁴ In any case – the funded, impecunious party's right of access

⁵⁴³ von Goeler, *Third-Party Funding in International Arbitration and Its Impact on Procedure*.

⁵⁴⁴ Galagan and Živković, "If They Finance Your Claim, Will They Pay Me If I Win: Implications of Third Party Funding on Adverse Costs Awards in International Arbitration," 177.

to justice will be jeopardized to a certain extent if it is ordered to pay such security, but not able to cover it. Hence, the main question is: which right shall prevail – the funded party’s right of access to arbitral justice or the other party’s right on secured payment of cost award? The answer to the question whether the funder is responsible for the payment of security for costs ordered by an arbitral tribunal, without such an explicit term in a funding agreement, is negative.⁵⁴⁵

Third party funding may still, however, be a relevant circumstance which can be taken into account when deciding upon whether security for costs should be ordered or not. Security for costs is an interim measure which is sought to ensure that the likely amounts which would be awarded to the party, if it prevails in the arbitration, will be covered.⁵⁴⁶ The power of a tribunal to order the payment of security for costs is considered to be recognized in the countries which adopted the Model Law.⁵⁴⁷

Being an interim measure, in order to grant the security for costs, the requirements for interim measures should be fulfilled.⁵⁴⁸ The requirements usually are: (i) *prima facie* establishment of jurisdiction, (ii) *prima facie* establishment of the case, (iii) urgency, (iv) threatening harm, and (v) proportionality.⁵⁴⁹ The *prima facie* establishment of jurisdiction and of the case are less relevant when deciding on the security for costs.⁵⁵⁰ Third party funding can, however, be a significant circumstance when it comes to determining the requirement of the urgency, harm, and proportionality. The requirement of urgency is satisfied when the losses of a party seeking security are likely to increase over time, and

⁵⁴⁵ Ali Yesilirmak, *Provisional Measures in International Commercial Arbitration* (Kluwer Law International, 2005), 72.

⁵⁴⁶ Born, *International Commercial Arbitration*, 2495.

⁵⁴⁷ *Ibid.*

⁵⁴⁸ Berger, “Arbitration Practice: Security for Costs: Trends and Developments in Swiss Arbitral Case Law,” 9.

⁵⁴⁹ Yesilirmak, *Provisional Measures in International Commercial Arbitration*, 175.

⁵⁵⁰ Born, *International Commercial Arbitration*, 2496; Yesilirmak, *Provisional Measures in International Commercial Arbitration*, 175–76.

when it is unreasonable to make that party wait till the end of proceedings.⁵⁵¹ Since the party is incurring legal and other costs throughout the proceedings, and these costs are potential losses, third party funding in cases where the funder is not responsible for the payment of adverse costs can undermine the reasonability for a respondent to wait till the last award.⁵⁵²

Threatening harm, as another condition for granting the security for costs, is treated in different ways by arbitral tribunals. The weight that third party funding should bring on their decision regarding the security for costs can range from being irrelevant, to giving it relevance to a certain extent next to other circumstances of a case, and finally to find it crucially important to rendering a decision. The tribunals were overall more often confronted with bankrupt state of a party, and it was not always clarified whether this also included the state of impecuniosity. However, some of the tribunals would take into account financial situation of a party, and some of them even observed whether it opted for an external funding.

One of the tribunals found this to be a crucial point, and important enough to subject the right of access to justice to the funder's readiness to pay the costs. In particular, the tribunal stated that

“[i]f a party has become manifestly insolvent and therefore is likely relying on funds from third parties in order to finance its own costs of the arbitration, the right to have access to arbitral justice can only be granted under the condition that those third parties are also ready and willing to secure the other party's reasonable costs to be incurred.”⁵⁵³

⁵⁵¹ Yesilirmak, *Provisional Measures in International Commercial Arbitration*, 149.

⁵⁵² Galagan and Živković, “If They Finance Your Claim, Will They Pay Me If I Win: Implications of Third Party Funding on Adverse Costs Awards in International Arbitration,” 178.

⁵⁵³ Berger, “Arbitration Practice: Security for Costs: Trends and Developments in Swiss Arbitral Case Law,” 11.

In this case the tribunal clearly found the threatening harm, as it is sometimes defined, to be a potential non-enforceability of an adverse costs award due to claimant's insolvency.⁵⁵⁴ Similarly, another tribunal found the bankruptcy of a party to be a relevant circumstance to grant security for costs; however, although party acquired external funding, the tribunal did not invoke this fact as relevant.⁵⁵⁵ One should, however, be careful when taking this circumstance into account not to contradict the exceptional nature of this relief.⁵⁵⁶

This nature was emphasized by an arbitral tribunal sitting in Switzerland which decided in the end that “[g]iven the cash available to Claimant about a month ago [...] there is some likelihood that any claims for costs of Respondent [...] are not at risk”.⁵⁵⁷ The conclusion which can be made is that the financial state of a party, as well as third party funding, can be indicators that security for costs is indeed needed to prevent the harm of non-reimbursement, but they will heavily depend on the circumstances of a case. One should not lose the exceptional nature of this remedy from the sight, and the fact that ordering the payment of security to an impecunious party can lead to preventing such party to access justice.

The relation of such access and the opponent's right to have its payment secured lies at the heart of the proportionality requirement. Under that requirement, “*the possible injury caused by the requested interim measure must not be out of proportion with the advantage which the claimant hopes to derive from it*”.⁵⁵⁸ There is an opinion that third party funders will make the payment for security for costs in order not to lose the investment already made

⁵⁵⁴ Otto Sandrock, “The Cautio Judicatum Solvi in Arbitration Proceedings or The Duty of an Alien Claimant to Provide Security for the Costs of the Defendant,” *Journal of International Arbitration* 14, no. 2 (1997): 34; Markus Wirth, “Interim or Preventive Measures in Support of International Arbitration in Switzerland,” *ASA Bulletin* 18, no. 1 (2000): 36.

⁵⁵⁵ Swiss entity v Dutch entity, Award, HKZ Case No. 415, 20 November 2001, 20 *ASA Bulletin* 467 (n.d.); Kirtley and Wietrzykowski, “Should an Arbitral Tribunal Order Security for Costs When an Impecunious Claimant Is Relying upon Third-Party Funding?,” 25.

⁵⁵⁶ Galagan and Živković, “If They Finance Your Claim, Will They Pay Me If I Win: Implications of Third Party Funding on Adverse Costs Awards in International Arbitration,” 178.

⁵⁵⁷ ABC AG v Mr X., Procedural Order, 27 November 2002, 23 *ASA Bulletin* 108, 114 (2002).

⁵⁵⁸ Yesilirmak, *Provisional Measures in International Commercial Arbitration*, 182.

even if they did not initially agreed to it.⁵⁵⁹ If they do not do so, there are three issues which may arise if third party funding is taken into account anyways, and these are: (1) otherwise meritorious claim may be stifled, (2) arbitration proceedings may be delayed, and/or (3) funded claimant may complain that it is threatened worse than those parties who are using other forms of financing, for example, bank loan.⁵⁶⁰ Furthermore, it was said that the respondent's right on security as a reaction to the claimant's external funding

“seems contrary to essence of an arbitration agreement where the possibility of a third party funder of either side's legal costs is not contemplated at the moment of consent to the arbitration, at which point each side accepts the risks around the other party being able to pay the costs or damages, or provide security for costs, associated with any future arbitration under the relevant contractual jurisdiction clause”.⁵⁶¹

In the light of everything stated above, it is advisable to look at third party funding only as an additional, but not the crucial or the only justification for making an order for security for costs, and to give force to all relevant circumstances of each case.⁵⁶² In order to take it into account, however, a funded party should disclose it first. Disclosure of third party funding is so far not regulated as mandatory, but there is certainly a lot of pressure made by the arbitration community in this direction.⁵⁶³ Disclosure is relevant not only when security for costs is discussed, but in general. As it will be discussed in the next subsection, the lack of

⁵⁵⁹ Kirtley and Wietrzykowski, “Should an Arbitral Tribunal Order Security for Costs When an Impecunious Claimant Is Relying upon Third-Party Funding?,” 27.

⁵⁶⁰ *Ibid.*, 23–25.

⁵⁶¹ Nieuwveld and Shannon, *Third-Party Funding in International Arbitration*, 27 ft. 8.

⁵⁶² Galagan and Živković, “If They Finance Your Claim, Will They Pay Me If I Win: Implications of Third Party Funding on Adverse Costs Awards in International Arbitration,” 179.

⁵⁶³ Habazin, “Third-Party Funding Implications on Arbitrator Independence: The 2014 IBA Guidelines on Conflicts of Interest Cannot Prevent Potential Conflicts of Interest Arising from Third-Party Funding in International Investment Arbitration”; Jennifer A. Trusz, “Full Disclosure? Conflicts of Interest Arising from Third-Party Funding in International Commercial Arbitration,” *Georgetown Law Journal* 101, no. 6 (n.d.); “Consultation Paper on Third Party Funding for Arbitration.”

disclosure can seriously jeopardize the destiny of an award and/or disrupt the arbitration proceedings.

IV.4.4 The Consequences of Lack of Disclosure of Third Party Funding: Closer Look at the Independence of Arbitrators

Lack of disclosure of third party funding in arbitration may cause the disruption of proceedings or the plausible ground for setting aside or objecting to the recognition and enforcement of an arbitral award. In this regards, one of the most probable grounds for disrupting the proceedings or jeopardizing the award is the lack of independence of an arbitrator due her or his relations with the third party funder.⁵⁶⁴

The examples of possible conflicts of interest which can appear with the involvement of third party funders can be best presented in comparison to the lists provided in the IBA Guidelines on Conflicts of Interest in International Arbitration [“IBA Guidelines on Conflicts”]. For example, conceivable situation can be that an arbitrator is holding shares in either a privately or publicly held third party funding company.⁵⁶⁵ This can be qualified as a situation worth of disclosure either under the 2.2.1. or 3.5.1. of the IBA Guidelines on Conflicts. Situation 3.5.1. is provided under the Orange list, and it describes a conflict of interest in which “[t]he arbitrator holds shares, either directly or indirectly, that by reason of number or denomination constitute a material holding in [...] an affiliate of one of the parties, [...] being publicly listed.” Situation under 2.2.1. is part of a Waivable Red List, and it defines a conflict of interest as a case in which “[t]he arbitrator holds shares, either directly or

⁵⁶⁴ Trusz, “Full Disclosure? Conflicts of Interest Arising from Third-Party Funding in International Commercial Arbitration,” 1652.

⁵⁶⁵ Ibid., 1670–71; Habazin, “Third-Party Funding Implications on Arbitrator Independence: The 2014 IBA Guidelines on Conflicts of Interest Cannot Prevent Potential Conflicts of Interest Arising from Third-Party Funding in International Investment Arbitration,” 190.

indirectly, in [...] an affiliate of one of the parties, [...] being privately held.” The main difference between these two situations will be the way in which waiver can be made. As to the latter situation, when a conflict of interest is on the Waivable Red List, such person will be able to serve as an arbitrator only if “all parties, all arbitrators and the arbitration institution, or other appointing authority (if any), have full knowledge of the conflict of interest and [...] all parties expressly agree that such a person may serve as an arbitrator, despite the conflict of interest” [General Standard 4(c)]. The conflict of interest listed on the Orange List can be waived by a simple lack of any objection after disclosure was made [General Standard 4(a)].

The shareholding is not the only plausible ground for conflicts of interest in cases involving third party funders. As mentioned above, a third party funder may have a significant influence on the appointment of the arbitrators, and if an arbitrator was appointed by the same third party funder on two or more occasions, this requires disclosure under Situation 3.1.3. on the Orange List.⁵⁶⁶ Moreover, a case where the third party funder is funding a client of an arbitrator’s law firm in another case is another situation that can be found under those listed on the Waivable Red List, according to which it needs to be disclosed if “[t]he arbitrator’s law firm currently has a significant commercial relationship with [...] an affiliate of one of the parties.”⁵⁶⁷

Due to these possible situations which can provide grounds for a successful challenge of an arbitrator, third party funding is better to be disclosed as early as possible. Otherwise, if

⁵⁶⁶ Situation 3.1.3. under the IBA Guidelines on Conflicts: “The arbitrator has, within the past three years, been appointed as arbitrator on two or more occasions by one of the parties, or an affiliate of one of the parties.” Trusz, “Full Disclosure? Conflicts of Interest Arising from Third-Party Funding in International Commercial Arbitration,” 1670–71; Habazin, “Third-Party Funding Implications on Arbitrator Independence: The 2014 IBA Guidelines on Conflicts of Interest Cannot Prevent Potential Conflicts of Interest Arising from Third-Party Funding in International Investment Arbitration,” 190.

⁵⁶⁷ Trusz, “Full Disclosure? Conflicts of Interest Arising from Third-Party Funding in International Commercial Arbitration,” 1670; Habazin, “Third-Party Funding Implications on Arbitrator Independence: The 2014 IBA Guidelines on Conflicts of Interest Cannot Prevent Potential Conflicts of Interest Arising from Third-Party Funding in International Investment Arbitration,” 189.

discovered during the proceedings or even at the stage when a last award is rendered, this can make either the whole or part of the arbitration useless. That is why it is recommendable for an impecunious party, who opted for such funding, to disclose it at the beginning, and to avoid unnecessary costs of such non-disclosure in advance.

IV.5 Conclusion on Chapter IV

The analysis of European national courts' decisions, and others, presented in this Chapter shows that there is no harmonisation of the solutions on the matter of impecunious parties in arbitration. The involvement of an impecunious party in arbitration proceedings involves a conflict between two public policy principles: *pacta sunt servanda* and access to justice. National courts are equally divided in their findings on which of these principles should prevail. Due to this unresolved conflict, the courts of jurisdictions mentioned in this Chapter opted for one of these options: they either insisted on the enforceability of the arbitration agreement despite the party's financial incapacity or they disregarded the arbitration agreement and allowed an impecunious party to have recourse to courts.

Until a uniform approach on this matter evolves, when confronted with an impecunious party in arbitration, the choice evidently falls between these two solutions. Since the main advantage of each of these solutions is strengthening one of the principles mentioned above, this Chapter served as a reminder of the pitfalls of each of these approaches. Moreover, there are several arbitration-specific features which may seem as confusing, depending on the stance taken. For example, the substitute payment may be equally used by those who are *pro* termination of the arbitration agreement in a case of impecuniosity, as it is only an option left for the other party. At the same time, termination of

the arbitration agreement can be unavailable exactly due to the availability of making substitute payment, as it was stressed by English courts.

The approaches of national courts heavily depend on the circumstances of the case, such as who the impecunious party is, which grounds for the termination are invoked and analysed, whether only the reference to that particular arbitration is considered forfeited or the whole arbitration agreement is to be terminated, and/or whether the parties' fault for the financial is to be observed or not. Discrepancies among the approaches are visible regarding each of these circumstances.

For example, what is often left out from the discussion is what the proper ground for deciding legal issues related to the impecuniosity of the parties in arbitration is. For example, whether the impecuniosity of the claimant (counterclaimant) renders the arbitration agreement "incapable of being performed" or "inoperative"? Harmonization at the level of proper qualification of an issue could be a good start at least. Although this seems to be a rather theoretical distinction, there is a reasonable expectation that a uniform qualification of an issue will lead to more harmonized results.

Harmonization at the other stages of decision-making will require more effort since the doctrinal debate on this issue is primarily based on the policy that is adopted. On one hand, the preference may be given to the policy based on commercial reasonableness of preserving the arbitration agreement to which the parties feely consented. On the other hand, courts may opt for the policy of being more concerned regarding the party's right of access to justice, of which a party is deprived in case of the impecuniosity in arbitration. This Chapter aimed to show how both of these policies can be equally well defended. However, the juxtaposition of these two approaches creates legal uncertainty as to the question of what is the destiny of arbitration agreement once one of the parties becomes impecunious.

Finally, the last Part of Chapter IV analysed third party funding agreements as a plausible solution for impecunious parties and stressed the inconclusiveness regarding several legal issues due to the lack of regulation of this new industry. For this reason, the funded parties might not always gain from third party funding, but may also be harmed if this type of funding is taken for granted.

The most important and concluding remark at the end of this Chapter is directed to the parties: the provided analysis inevitably results in advice to keep in mind when concluding an arbitration agreement the possible impecuniosity of either of the parties, and the unavailability of a forum due to such financial state. If drafted properly, arbitration clauses might supersede some aspects of the discussion presented here.

CHAPTER V

PRACTICE ON THE ALLOCATION OF COSTS IN INTERNATIONAL COMMERCIAL ARBITRATION

When the allocation of costs in arbitration is compared with the allocation of costs in civil litigation, it is interesting to notice how the regulation of the former is often not regulated in great detail. In litigation states prefer a detailed regulation of which costs can be recovered (often based on tariffs for the calculation of attorney fees), and in what manner. On the other hand, it is a general rule that arbitrators have much wider discretion as to the allocation of costs.

As any other dispute resolution mechanism, arbitration is also changing through time in accordance with legal and economic realities that surround it. More complex cases have changed the comparative advantages of arbitration, as low costs and speedy proceedings are no longer considered to be the main factors attracting the parties.⁵⁶⁸ These advantages do not always stand today. As a response to that, the allocation of costs which is based on the rationality of procedural steps is now promoted as a means that can yield time and cost-efficiency of arbitration proceedings. Such promotion and achievement of efficiency of arbitration is possibly due to the flexibility and wide discretion that still remain the main features of an arbitration process.

As a side effect of such flexibility, there is intensified lack of predictability for stakeholders in arbitration, most importantly for the parties to an arbitration agreement. It is acknowledged as a premise of this Chapter that both the flexibility and discretion of arbitrators' decision-making in both procedural and substantive matters are among the most

⁵⁶⁸ Várady, "What Is Pro-Arbitration Today?," 9–10.

important features of international commercial arbitration. The predictability of an outcome of such decision-making and legal certainty might, however, on certain occasions, outweigh such advantages. Therefore, in order to optimize the use of arbitration as a dispute resolution mechanism, these two need to be balanced against each other. This means that any new law, arbitration rules, guideline, or arbitral decision that modifies or expands or directs the use of flexibility when deciding on the allocation of costs needs to have its counterpart in steps taken in a way to make such decisions more predictable for the parties in arbitration.

Predictability, however, is not a negative number in an equation of achieving efficiency of arbitration proceedings – it actually contributes to efficiency since it allows the parties to anticipate and avoid those actions which would be taken against their benefit when allocating the costs. Also, nothing in this Chapter suggests that flexibility and discretion of arbitrators' decision-making should be generally restrained.

Quite the opposite, the underlying idea of this Chapter is that the most successful means of preserving the flexibility and of achieving efficiency in arbitration is harmonisation. Therefore, in this Chapter, it will be analysed whether there is a harmonised approach as to the allocation of costs. In those instances where such harmonisation has not yet been achieved, this Chapter offers legal analysis of plausible issues, and suggests the solutions.

In order to provide a basis for the analysis of the regulation of tribunal's power to allocate the costs, the first part of this Chapter will briefly address the legal theory regarding the allocation of costs in civil litigation and the rules on allocation in some of the jurisdictions [V.1]. Although, in the author's opinion, the arbitral legal order is of transnational nature, the author is also aware that solutions adopted in arbitration were initially developed in civil litigation, and the analysis of the latter can be used as a platform to assess the costs allocation system in arbitration. These rules will also form the parties' expectations and they may as

well shape the arbitrators' decision-making on the allocation because they might be influenced by the rules on allocation stemming from their legal background.

Afterwards, the analysis will be focused on the rules under which the tribunals allocate the costs. Firstly, in order to establish the basis for tribunal's wide discretion, arbitrator's power to allocate the cost will be analysed, its sources, and its relation to party autonomy [V.2]. Thereafter, the rules on and methods of allocation in international commercial arbitration will be discussed, with emphasis on the moderated "costs follow the event" approach as the prevailing approach in international commercial arbitration, which preserves tribunal's wide discretion and flexibility in decision-making [V.3]. In order to assess and improve the harmonisation of such cost allocation, the next two parts will analyse the factors that are most often taken into account [V.4], and which costs can be recovered and/or allocated [V.5].

V.1 Allocation of Costs in Civil Litigation: A Prelude to the Parties' Expectations and Arbitrators' Background Knowledge regarding the Standard of Allocation

In a simplified way, it can be stated that the costs incurred before the courts are court's costs, attorney fees and evidence-related costs.⁵⁶⁹ The treatment of these costs in civil litigation is often divided into two main approaches: the American Rule (non-shifting rule) and the "costs follow the event" rule, often also called the "loser pays" rule or the English rule, despite the fact that England and Wales is not a representative of its strictest

⁵⁶⁹ Reimann, "Cost and Fee Allocation in Civil Procedure," 9.

application.⁵⁷⁰ However, by stating only this, the issue would be oversimplified. As will be shown, civil litigation does not enjoy the benefits of harmonisation in this area. Quite the opposite, costs are treated differently from jurisdiction to jurisdiction. The mentioned rules, although sometimes seem not to be rules at all, but mere guidelines, are a good starting point for the analysis.

V.1.1 Allocation of Costs in Litigation

The American Rule⁵⁷¹, as the name suggests, is applied mainly by the courts in the United States [U.S.]. The U.S. is known for *not proclaiming* the loser pays rule, and that within this jurisdiction, the cost shifting is almost unknown.⁵⁷² In other words, under the American Rule each party bears its own costs incurred during litigation.⁵⁷³ Besides in the U.S., the American Rule is applied also in Japan.⁵⁷⁴ The rule is, however, not absolute. Its application depends on the type of costs which are claimed, and like almost every other existing legal rule it has exceptions. For example, in both of these jurisdictions, the rule applies only to attorney fees, while court costs, such as the filing fee and the costs of taking evidence, are regularly shifted to the losing party.⁵⁷⁵ Regarding the court costs, the strict “loser pays” approach is regularly applied, and the reductions of court costs are rare.⁵⁷⁶

⁵⁷⁰ Ibid., 9–10.

⁵⁷¹ James R. Maxeiner, “The American ‘Rule’: Assuring the Lion His Share,” in *Cost and Fee Allocation in Civil Procedure*, ed. Mathias Reimann, *Ius Gentium: Comparative Perspectives on Law and Justice* 11 (Springer Netherlands, 2012), 288, http://link.springer.com/chapter/10.1007/978-94-007-2263-7_26. The author is aware that this can hardly be called a rule since it is not provided in a statute or precedent. However, the term is chosen in order to simplify the terminology, and also to confirm the usual practice of using this term in this regard in scholarly work.

⁵⁷² Reimann, “Cost and Fee Allocation in Civil Procedure,” 15.

⁵⁷³ Maxeiner, “The American ‘Rule,’” 288.

⁵⁷⁴ Manabu Wagatsuma, “Recent Issues of Cost and Fee Allocation in Japanese Civil Procedure,” in *Cost and Fee Allocation in Civil Procedure*, ed. Mathias Reimann, *Ius Gentium: Comparative Perspectives on Law and Justice* 11 (Springer Netherlands, 2012), 196, http://link.springer.com/chapter/10.1007/978-94-007-2263-7_16.

⁵⁷⁵ Ibid., 195; Maxeiner, “The American ‘Rule,’” 288, 295; H. Patrick Glenn, “The Irrelevance of Costs Rules to Litigation Rates: The Experience of Quebec and Common Law Canada,” in *Cost and Fee Allocation in Civil*

In order to promote access to justice, in parallel with this rule on allocation, the U.S. practice lawyers started to charge contingency fees. Under contingency fees arrangements, the party pays to its lawyer certain percentage of claimed amount but only in case of success.⁵⁷⁷ The American Rule is subject to further exceptions. For example, one of the exceptions is that the fees can be shifted when a party “litigated in bad faith, abused the litigation process, or violated court orders.”⁵⁷⁸ As will be shown below, this is an exception that cannot be overturned by the parties’ agreement in international arbitration. Some forms of the party’s behaviour which can be used as grounds to shift the attorney fees are the failure to appear in court on time, the failure to cooperate with discovery, the filing of moot appeals, concealing or failing to produce documents, the filing of unnecessary or groundless petitions or defenses, the assertion of “specious” objections, just to name a few.⁵⁷⁹ The shifting of attorney fees in these cases is considered by courts both to be punitive as well as compensatory, as will be explained in more detail below.⁵⁸⁰

This brief overview of the application of the American Rule shows that the rule is not as strict as sometimes perceived by lawyers coming from countries where the “costs follow

Procedure, ed. Mathias Reimann, *Ius Gentium: Comparative Perspectives on Law and Justice* 11 (Springer Netherlands, 2012), 100, http://link.springer.com/chapter/10.1007/978-94-007-2263-7_6.

⁵⁷⁶ James R. Maxeiner, “Cost and Fee Allocation in Civil Procedure: United States of America National Report,” *American Journal of Comparative Law*, 58 (2010): 3, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1482843&download=yes.

⁵⁷⁷ Maxeiner, “The American ‘Rule,’” 297.

⁵⁷⁸ Alba Conte, *Attorney Fee Awards*, vol. 2 ([St. Paul, Minn.]: Thomson/West, 2004), 125; Markus Jäger, *Reimbursement for Attorney’s Fees: A Comparative Study of the Laws of Switzerland, Germany, France, England, and the United States of America; International Arbitration Rules and the United Nations Conventions on Contracts for the International Sale of Goods (CISG)*, *International Commerce and Arbitration*, v. 4 (The Hague, The Netherlands: Eleven International Pub, 2010), 40.

⁵⁷⁹ Jäger, *Reimbursement for Attorney’s Fees*, 49.

⁵⁸⁰ *Ibid.*, 47. The list of procedure-related examples usually cited is the following: 1) the failure to appear in court on time, 2) the failure to cooperate with discovery, 3) submission of falsified records, 4) attempting to threaten to bribe a witness, 5) misrepresenting evidence, 6) the failure to adhere to stipulations, 7) repeated failure to meet filing deadlines, 8) the filing of moot appeals, 9) concealing or failing to produce documents or witnesses, 10) the destruction of evidence, 11) the repeated assertion of time-barred claims. The conduct related to substantive aspects of litigation was: 1) the filing of unnecessary, groundless, or vexatious motions or petitions, 2) the continued pursuit of a groundless claim, 3) the assertion of patently frivolous defenses, 4) the assertion of “specious” objections, 5) the failure to withdraw an action, 6) the continuation of a defense after it is clear it is meritless, 7) the refusal to concede an issue about which there can be no dispute. See in: Conte, *Attorney Fee Awards*, 2:168.

the event” rule is applied. At this point, without going to further details, one should be introduced to the system of the allocation of costs at the entirely opposite end of spectrum. Under the strict application of the “costs follow the event” rule, all the costs, including court fees, attorney fees, and expert fees, are shifted to the losing party.⁵⁸¹ The “costs follow the event” rule and the “loser pays” rule are usually used interchangeably in legal writing and practice because they, indeed, share as starting point the idea of shifting the costs to the losing party. There might be some nuances between them, but they will not be discussed in this thesis.

The “costs follow the event” principle is widely applicable, including Germany, Switzerland, and Sweden. In Switzerland, the “costs follow the event” rule is applicable, and the costs are apportioned in accordance with the degree of success in litigation.⁵⁸² It is similar in Sweden, where the winner has a right to be reimbursed for the costs for preparation and performance of the litigation, while the amount reimbursable is limited to the “reasonably required [costs] for the protection of the party’s rights”.⁵⁸³ This clearly shows that this rule, which is based on the idea of indemnifying the winner in litigation, does not lead to *full* indemnity.

In Germany, under the “costs follow the event” principle, a loser bears statutory costs in civil litigation, which includes the opponent’s courts costs, attorney fees, and costs incurred for the remuneration of experts whose appointments was necessary.⁵⁸⁴ However, just as in Switzerland, these costs will be apportioned in accordance with the success of the

⁵⁸¹ Reimann, “Cost and Fee Allocation in Civil Procedure,” 10.

⁵⁸² Caspar Zellweger, “Pricey But Predictable: Civil Litigation Costs and Their Allocation in Switzerland,” in *Cost and Fee Allocation in Civil Procedure*, ed. Mathias Reimann, *Ius Gentium: Comparative Perspectives on Law and Justice* 11 (Springer Netherlands, 2012), 277–78, http://link.springer.com/chapter/10.1007/978-94-007-2263-7_25.

⁵⁸³ Martin Sunnqvist, “Loser Pays – But Only a Reasonable Amount,” in *Cost and Fee Allocation in Civil Procedure*, ed. Mathias Reimann, *Ius Gentium: Comparative Perspectives on Law and Justice* 11 (Springer Netherlands, 2012), 267, http://link.springer.com/chapter/10.1007/978-94-007-2263-7_24.

⁵⁸⁴ Burkhard Hess and Rudolf Huebner, “Cost and Fee Allocation in German Civil Procedure,” in *Cost and Fee Allocation in Civil Procedure*, ed. Mathias Reimann, *Ius Gentium: Comparative Perspectives on Law and Justice* 11 (Springer Netherlands, 2012), 151, http://link.springer.com/chapter/10.1007/978-94-007-2263-7_11.

parties in litigation, and, in any case, they will be limited to so-called *necessary* costs.⁵⁸⁵ That means, for example, the attorney fees are recoverable only in the amount as set in statutory provided tariffs, and any additional fees that were agreed upon, the winning party will have to cover on its own.⁵⁸⁶ There are exceptions to this rule which are, similarly as under the American Rule, designed in order to discourage procedural misbehaviour. Some examples of such misbehaviour under the German law are the party's failure to observe a time limit, or unsuccessful or unnecessary motions, in which case the party who caused additional costs must compensate the other side for those costs.⁵⁸⁷ However, the court's discretion will be limited in this regard.⁵⁸⁸ In Switzerland, similar exceptions of procedural and substantive nature can be applicable and the court's discretion in this regard is wider.⁵⁸⁹

These exceptions are interesting to compare with the "costs follow the event" approach as applied in England and Wales. In that jurisdiction, while recognizing the "loser pays" principle, the legislator provided the courts with wide discretion with special emphasis on the conduct of the parties, which needs to be taken into account by the courts. Firstly, under the English Civil Procedure Rule 44.3(1), a court will have discretion as to whether there should be any shifting, and if yes, then what amount of these costs is recoverable and when it should be paid. If the court decides to make an order about costs, the Rules provide that "the general rule is that the unsuccessful party will be ordered to pay the costs of the successful party; but the court may make a different order". When the court is deciding on these issues, it will take into account the conduct of the parties which under Rule 44.4(3) includes: conduct before, as well as during, the proceedings, whether it was reasonable for a party to raise, pursue or contest a particular allegation or issue, the manner in which a party

⁵⁸⁵ Ibid.

⁵⁸⁶ Ibid.

⁵⁸⁷ Ibid., 153.

⁵⁸⁸ Ibid.

⁵⁸⁹ Zellweger, "Pricey But Predictable," 279–80.

has pursued or defended her/his case or a particular allegation or issue, and whether a claimant who has succeeded in her/his claim, in whole or in part, exaggerated her/his claim. The difference between this approach and the American Rule, and the German approach to the “loser pays” principle is that the procedural behaviour of the parties is not an exception to the rule of allocation, but it is interwoven with a decision on whether to allocate and how to allocate the costs.

The discretion of the English courts does not stop at this stage. When deciding on the amount of recoverable costs, the courts can decide on it on two bases – standard basis or indemnity basis – again, taking all the circumstances of litigation into account.⁵⁹⁰ The standard basis allows recovery only of the costs which are proportionate to the matters in issue, and reasonably incurred.⁵⁹¹ The proportionality is assessed on the basis of: the amount of money involved, the importance of the case, the complexity of the issue, and the financial situation of each party.⁵⁹²

The indemnity basis requires the courts to only take into account the reasonability of the costs incurred and their amounts into account.⁵⁹³ When deciding either on the standard or indemnity basis, the court will take into account the following aspects of the party’s conduct and other circumstances: the conduct of before, as well as during, the proceedings, the efforts made, if any, before and during the proceedings in order to try to resolve the dispute, the amount or value of any money or property involved, the importance of the matter to all the parties, the particular complexity of the matter or the difficulty or novelty of the questions raised, the skill, effort, specialised knowledge and responsibility involved, the time spent on

⁵⁹⁰ Reimann, “Cost and Fee Allocation in Civil Procedure,” 13.

⁵⁹¹ Rule 44.4(2)

⁵⁹² Jäger, *Reimbursement for Attorney’s Fees*, 25.

⁵⁹³ Rule 44.4(3).

the case, and the place where and the circumstances in which work or any part of it was done.⁵⁹⁴

The exercise of this wide discretion usually leads English courts to the shifting of costs on the standard basis more often, and for that reason it was stated by some authors that this method of allocation leads to a partial shifting because the prevailing party will often bear a significant amount of the costs incurred during litigation.⁵⁹⁵ It does not come as a surprise then that in England there are no fee schedules or tariffs for the calculation of attorney fees, similarly to the United States.⁵⁹⁶

V.1.2 Differences, Similarities and Policies behind the National Approaches to the Allocation of Costs in Civil Litigation

Differences among the above mentioned approaches are justified by underlying policies. The policies behind those approaches that allow cost-shifting (e.g., England and Germany) can be summed up as: the punishment to a losing party, the indemnification of the winning party, and the discouragement of the frivolous and bad faith procedural behaviour.⁵⁹⁷ Interestingly, the same policies lie behind the justification of the bad faith exception to the American Rule.⁵⁹⁸ As to the deterring effect of the “costs follow the event” rule, the opponents of the American Rule would state that litigation is always uncertain – for that

⁵⁹⁴ Rule 44.5(3).

⁵⁹⁵ Reimann, “Cost and Fee Allocation in Civil Procedure,” 13.

⁵⁹⁶ *Ibid.*, 24.

⁵⁹⁷ John Y. Gotanda, “Awarding Costs and Attorneys’ Fees in International Commercial Arbitrations,” SSRN Scholarly Paper (Rochester, NY: Social Science Research Network, January 1, 2000), 6, <http://papers.ssrn.com/abstract=208672>; Thomas Rowe, “The Legal Theory of Attorney Fee Shifting: A Critical Overview,” *Duke Law Journal* 31 (January 1, 1982): 653; Hess and Huebner, “Cost and Fee Allocation in German Civil Procedure,” 152.

⁵⁹⁸ Jacob Singer, “Bad Faith Fee-Shifting in Federal Courts: What Conduct Qualifies,” *St. John’s Law Review* 84, no. 2 (2010): 720.

reason one should not be penalized for pursuing the vindication of its right.⁵⁹⁹ Another policy behind cost-shifting is to provide free access to justice, at least to those with a valid claim or defense.⁶⁰⁰ On the other hand, the policy behind the American Rule would suggest that in this way the “costs follow the event” approach discourages the poor from instituting claims since they might need to pay the other party’s fees in the end.⁶⁰¹ The same could perhaps be said for the American rule under which the poor would not be able to cover their attorney fees, but as mentioned above, this deterring effect is avoided by contingency fee arrangements where attorneys pair up with parties in pursuing a claim.

Similarities among these systems are more important for international arbitration. The first similarity is that the punishment of the procedural misconduct of parties is common for all the approaches, but at different stages of the allocation of costs. Under the American Rule, the misconduct is punished by shifting the attorney fees incurred to the party who misbehaved, while under the “costs follow the event” rule, this misconduct will usually lead to declining to shift the prevailing party’s fees. As it will be discussed below, the international arbitration practice developed an approach similar to the latter one – a so-called moderated “costs follow the event”. However, the fact that there is a similarity in this regard between the approaches applied in litigation reveals that there should not be much surprise on the side of the parties in international commercial arbitration who come from jurisdictions where the American Rule is applied.

The second similarity that the systems share is that both the American Rule and the “costs follow the event” rule promote pre-trial settlements in civil disputes.⁶⁰² This can be best achieved through the predictability of the final allocation of the costs. Of course, both

⁵⁹⁹ Jäger, *Reimbursement for Attorney’s Fees*, 39.

⁶⁰⁰ Reimann, “Cost and Fee Allocation in Civil Procedure,” 21.

⁶⁰¹ Jäger, *Reimbursement for Attorney’s Fees*, 39.

⁶⁰² Brian G. M. Main and Andrew Park, “The British and American Rules: An Experimental Examination of Pre-Trial Bargaining in the Shadow of the Law,” SSRN Scholarly Paper (Rochester, NY: Social Science Research Network, August 14, 2000), <http://papers.ssrn.com/abstract=234998>.

rules also received some criticism. The “costs follow the event” rule seems not to be fair to charge the party who merely was trying to vindicate its rights, or defend itself. On the other hand, the lack of indemnification for the party who was drawn into litigation to protect itself against the other party’s behaviour, or to defend itself against the unsuccessful claims, is rather unfair as well under the American Rule.

The goal of this thesis is not to offer an answer as to which of these approaches provide the best solution. Given that the regulation of each of these approaches influences the way the attorney fees are regulated, the answer might as well be that each of them serves the purpose it is supposed to serve within its own jurisdiction. So how do we then translate these policies and rules into international arbitration which involves parties coming from different jurisdictions, with different expectations as to the cost allocation, and different fee arrangements with their counsels? The answer is simple and it lies in the discretion given to the tribunals and the flexibility of arbitration proceedings. These two features are rooted deeply in the regulation of arbitration, but they do not come without any legal issues, as will be explained in the next part of this Chapter.

V.2 Arbitral Tribunal’s Power to Allocate the Costs

The tribunal’s power to allocate the costs is provided in most national arbitration laws, i.e. the procedural law of arbitration. For example, national laws that provide for such a power are the German CCP in Section 1057(1), the Swedish AA in Section 42, and the 1996 EAA in section 63, the Austrian Code of Civil Procedure [“ACCP”] in Section 609(1) and Croatian AA in Article 35(1).⁶⁰³ As to the nature of the power to allocate the costs and the

⁶⁰³ Section 1057(1) of the German Arbitration Act provides: “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.” Section 42 of

final decision on costs, there is no uniform opinion in scholarly work as to whether these are of substantive or procedural nature. The most convincing argument in this regard is that the power to allocate the costs is a procedural matter, while the international standard under which costs are allocated is of substantive nature.⁶⁰⁴ This power is, however, subject to party autonomy, which can be exercised either through parties' agreement on the application of particular arbitration rules, or by drafting the rules on allocation by themselves. This raises two issues: (1) is the allocation power inherent to the tribunal's authority even when there is no *explicit* provision on it, or is it entirely subject to party autonomy, and (2) which costs in arbitration are subject to such power.

As to the definition of costs, national laws as well as arbitration rules provide for their own notions under which they address different types of costs. The "costs of the proceedings"⁶⁰⁵, "costs of the arbitration"⁶⁰⁶ or "costs of the arbitration proceedings"⁶⁰⁷ might all look the same at the first sight. However, the differences are revealed after examining what they refer to, and more often than it seems these notions are used for different groups of costs. To demonstrate such a difference we can refer to definitions of the costs provided in the ICC Rules, the LCIA Rules and the SCC Rules. All these rules use the same term "costs

the Swedish Arbitration Act: "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." Section 61 of the English Arbitration Act: "(1) The tribunal may make an award allocating the costs of the arbitration as between the parties, subject to any agreement of the parties. (2) Unless the parties otherwise agree, the tribunal shall award costs on the general principle that costs should follow the event except where it appears to the tribunal that in the circumstances this is not appropriate in relation to the whole or part of the costs." Section 609(1) of the Austrian Arbitration Act provides: "Where the arbitral proceedings are terminated, the arbitral tribunal shall decide upon the obligation to reimburse the costs of the proceedings, provided the parties have not agreed otherwise." Article 35(1) of the Croatian AA: "(1) Upon a request by a party, the arbitral tribunal shall determine in the award or an order for the termination of the arbitral proceedings which party and in which proportion has to reimburse the other party the necessary costs of arbitration, including expenses of party representation and the fees of arbitrators, and/or has to bear its own expenses."

⁶⁰⁴ Waincymer, *Procedure and Evidence in International Arbitration*, 1194; Greenberg, "Law Applicable to Costs Claims in International Arbitration: Why Does It Matter?," 171, 175.

⁶⁰⁵ For example, Sec. 609. para.1 Austrian Code of Civil Procedure.

⁶⁰⁶ For example, Sec. 59. para.1 of English Arbitration Act; Art. 37. para.1 of ICC Rules; Art. 31. para.1 of AAA Rules; Art. 28. para.1 of LCIA Rules, Art. 38 of SWISS Rules; Art. 43. para. 1 of SCC Rules;

⁶⁰⁷ For example, Sec. 1051 para.1 of German Code of Civil Procedure; Art. 35 para.1 of DIS Rules.

of the arbitration”. However, under Article 37(1) of the ICC Rules this term refers both to the costs required for the proceedings itself, such as arbitrators’ fees and institution fees, as well as to the costs incurred by the parties. On the other hand, under Article 28(1) of the LCIA Rules and Article 43(1) of the SCC Rules use this term only to address the first type of the costs, while the costs of the parties are not covered by this term.

In this thesis, the “costs of the arbitration” will be used as an “umbrella” term for both the costs paid to an arbitral tribunal and an arbitration institution, and for party costs, including attorney fees and other expenses related to the arbitration proceedings [see more under **I.5**]. The costs of the arbitration will be divided into procedural costs and party costs. The *procedural costs* are the costs required either by the tribunal or the institution. These include, but are not limited to, institution related fees, such as a filing fee and administrative fee, and the costs of the tribunal, such as arbitrators’ fees and expenses, the costs of the experts appointed by the tribunal, and the administrative secretary’s fees and expenses. The costs of the parties will contain legal costs, i.e. the costs for representation, and other costs incurred during the arbitration proceedings by the parties. Therefore, one of the issues is whether both procedural costs (tribunal’s fees and expenses, the costs of experts appointed by the tribunal, and institutional fees) and party costs (legal fees and other expenses) are subject to arbitrator’s power to allocate.

International arbitration is a forum which involves parties, arbitrators, and attorneys from different jurisdictions, and usually seat of arbitration is in a jurisdiction different from theirs. It is reasonable to assume that each of the participants involved will bring a certain set of expectations based on their home jurisdiction’s rules on costs, as it was explained above. If the parties are not able to predict how the costs will be allocated, this might also undermine the transparency and the legitimacy of arbitration as such. This concern was raised by Gotanda in 2000 – it remains to be seen whether arbitral practice offers a basis for

another conclusion today.⁶⁰⁸ This can be overcome by the parties' agreement on the method of allocation. However, although the parties are allowed to set their own rules, but they rarely do so.⁶⁰⁹ Even if they do, a question arises whether the tribunal is obliged to follow them. In order to find an answer to this question, the source of tribunal's authority to allocate costs needs to be observed as well.

In international arbitration, some authors consider the power to allocate the costs to be an inherent aspect of the tribunal's authority, even when it is not explicitly provided for.⁶¹⁰ For example, in England and Wales, the EAA states in Section 61 that "[t]he tribunal *may* make an award allocating the costs of the arbitration as between the parties, subject to any agreement of the parties" [emphasis added]. However, in *Re Becker, Shillan & Co and Barry Bros*, the Court, under the EAA 1950, considered that the arbitrator does not have discretion to choose whether to deal with the costs in the award or not, but "he must exercise his discretion upon them."⁶¹¹ Similarly, in *Casata Limited v General Distributors Limited*, the Supreme Court of New Zealand concluded that

"[t]here is nothing in the legislative history of the new Act to indicate any intention to depart from the pre-existing position that costs are **always** in issue **where not excluded by agreement of the parties** and that **the arbitrator has an obligation** to fix and determine them, even if they have not been raised as an issue before publication (*sic*) of an award" [emphasis added].⁶¹²

This decision also confirmed that the costs decisions are inherent to the tribunal's mandate, but it also provided for a possibility for the parties to completely exclude this task. The

⁶⁰⁸ Gotanda, "Awarding Costs and Attorneys' Fees in International Commercial Arbitrations," 4.

⁶⁰⁹ Ibid.

⁶¹⁰ Gary Born, *International Arbitration: Law and Practice*, 2012, 176.

⁶¹¹ Ong and O'Reilly, *Costs in International Arbitration*, 27.

⁶¹² *Casata Limited v General Distributors Limited* (The Supreme Court of New Zealand 2006).

question is how far party autonomy can go in this regard, and whether there are any criteria subject to which the validity of a parties' agreement on the costs exist.

In civil litigation, parties' agreements regarding costs are rare, and most of the times they would not be considered enforceable, or the enforceability of such an agreement would at least be questionable.⁶¹³ The arbitrators' power to allocate the costs is comparable to the same power of national judges. At the same time, their mandate is based on the parties' agreement, unlike the mandate of national judges. For that reason, the conclusion regarding the parties' agreement on the allocation of costs as set in civil litigation may not be valid for international arbitration. While the power to allocate the costs may be considered inherent to the tribunal's mandate, the parties reserve their right to shape it as they wish. This is confirmed in the ACCP and the GPPC which specifically provide that the tribunal will have the power to allocate the costs as long as "the parties have not agreed otherwise".⁶¹⁴ What are the limits of such an agreement: can the parties limit such arbitrators' power, or completely exclude it, or only provide for a method of allocation? Although it seems to be a technical issue, and it is not raised often in practice, this dilemma involves a philosophical question that deals with the source and scope of party autonomy. The issue comes down to the

⁶¹³ Marianne Roth, "Litigating in Austria – Are Costs and Fees Worth It?," in *Cost and Fee Allocation in Civil Procedure*, ed. Mathias Reimann, *Ius Gentium: Comparative Perspectives on Law and Justice* 11 (Springer Netherlands, 2012), 71, http://link.springer.com/chapter/10.1007/978-94-007-2263-7_3; Jarkko Männistö, "Cost and Fee Allocation in Finland," in *Cost and Fee Allocation in Civil Procedure*, ed. Mathias Reimann, *Ius Gentium: Comparative Perspectives on Law and Justice* 11 (Springer Netherlands, 2012), 130, http://link.springer.com/chapter/10.1007/978-94-007-2263-7_9; Hess and Huebner, "Cost and Fee Allocation in German Civil Procedure," 154; Marco B. M. Loos, "Cost and Fee Allocation in the Netherlands," in *Cost and Fee Allocation in Civil Procedure*, ed. Mathias Reimann, *Ius Gentium: Comparative Perspectives on Law and Justice* 11 (Springer Netherlands, 2012), 220, http://link.springer.com/chapter/10.1007/978-94-007-2263-7_19; Greg Gordon, "Rigidity, Discretion and Potential Reform: Cost and Fee Allocation in Scotland," in *Cost and Fee Allocation in Civil Procedure*, ed. Mathias Reimann, *Ius Gentium: Comparative Perspectives on Law and Justice* 11 (Springer Netherlands, 2012), 244, http://link.springer.com/chapter/10.1007/978-94-007-2263-7_21; Nina Betetto, "Cost and Fee Allocation in Slovenia – From Major to Partial Shifting?," in *Cost and Fee Allocation in Civil Procedure*, ed. Mathias Reimann, *Ius Gentium: Comparative Perspectives on Law and Justice* 11 (Springer Netherlands, 2012), 253, http://link.springer.com/chapter/10.1007/978-94-007-2263-7_22.

⁶¹⁴ Section 609(1) of the ACCP provides: "(1) Where the arbitral proceedings are terminated, the arbitral tribunal shall decide upon the obligation to reimburse the costs of the proceedings, provided the parties have not agreed otherwise."; Section 1057(1) of the GPPC provides: "(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."

following: is party autonomy a basis for the tribunal's power, the limitations of which are exceptions that need to be justified, or is party autonomy provided only by the legal order, and it is allowed if and to the extent as recognized by such an order? The answer differs from jurisdiction to jurisdiction.

In civil law countries, for example, under the ACCP and the GPPC, party autonomy as to the decision on allocation of costs is conceptualized in very broad terms. Section 609(1) of the ACCP provides: “*Where the arbitral proceedings are terminated, the arbitral tribunal shall decide upon the obligation to reimburse the costs of the proceedings, provided the parties have not agreed otherwise*”, while Section 1057(1) of the GPPC provides: “*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.*” Regarding the former, some authors find that this provision allows the parties to *completely exclude* tribunal's decision on the allocation of costs.⁶¹⁵ They can also condition it upon a request of one of the parties by agreeing to 2014 Vienna Rules. This position is defended to be in line with the adversarial nature of the cost claim, and in that case rendering a decision on costs without the request of a party would provide a possible *ultra petita* decision rendered by the tribunal.⁶¹⁶ The Austrian system also allows, as mentioned, the parties to exclude the tribunal's decision on costs overall. In that regard, this approach substantiates the first philosophical view, which is that the parties' autonomy is a basis for the tribunal's power, the limitations of which are exceptions that need to be justified.

Parties' agreement as to the *method* of allocation is a narrower exercise of the parties' autonomy in this regard. It excludes the tribunal's power *to determine the same rule*, but it

⁶¹⁵ Vienna International Arbitral Centre, *Handbook Vienna Rules*, 216.

⁶¹⁶ *Ibid.*, 217.

does not exclude the tribunal's power to *allocate* the costs *per se*. Nevertheless, it can be argued that by agreeing that each of the parties will bear its own costs, the parties are *effectively* removing the power to allocate the costs from the tribunal. The tribunal will still, however, state the costs allocation in its award. The EAA contains a separate provision on the parties' agreement as to the allocation of costs, which imposes certain restrictions as to the exercise of such autonomy. Section 60 of the EAA determines that “[a]n agreement which has the effect that a party is to pay the whole or part of the costs of the arbitration in any event is only valid if made after the dispute in question has arisen.” Again - these agreements are not often seen in practice, but the philosophical background of such a provision is more in line with the opinion that party autonomy may be exercised only to the extent defined by the legal order. The fact that this provision is considered mandatory speaks in favour of such a conclusion.⁶¹⁷

Although these issues can rarely be seen in practice, there are certain contracts in which the allocation of costs is usually set by the parties, such as managing director agreements or shareholders' agreements.⁶¹⁸ In one such managing director agreement, upon which a dispute regarding the unlawful termination by the director arose, the parties agreed that “[t]he Company shall pay the fee of the arbitrator.”⁶¹⁹ When the dispute arose, the sole arbitrator found no reason to invalidate such a clause, and it ordered the company to pay the arbitrator's fees in total.⁶²⁰ The claimant – director in question – alleged that the same method of allocation should apply to administrative fees charged by the Finnish Arbitration Institute. The sole arbitrator disagreed as the arbitration clause contained no reference to these fees, and decided on the allocation based on the outcome of the case: since both parties partly lost

⁶¹⁷ Martin Hunter and Toby Landau, *The English Arbitration Act 1996: Text and Notes*, vol. 1 (Kluwer Law International), 51, accessed July 6, 2015, <https://unov.tind.io/record/7509>.

⁶¹⁸ Anna-Maria Tamminen and Mika Savola, Cost allocation award, Case Date 21 August 2015, ITA Board of Reporters, Kluwer Law International (n.d.).

⁶¹⁹ *Ibid.*

⁶²⁰ *Ibid.*

on their claims, the arbitrator allocated the administrative fees to be paid by both parties in half.⁶²¹

Another example from practice was a *Productos la Saban vs Tampico* case before the Chilean Court of Appeal of Santiago, in which one of the parties sought a partial annulment of an award based on the ground that the arbitral tribunal exceeded its mandate by allocating the costs.⁶²² The facts of the case reveal that the parties initially agreed that all the costs of arbitration would be equally shared by both parties. The court concluded that the parties overturned this agreement by agreeing in the terms of reference that the tribunal has a power to allocate the costs, and a party requesting the appeal also contradicted its claim for setting aside by requesting the costs. It is not known whether the court, had the parties not renounced their agreement, would find any limitations to such an agreement based on public policy. There is such a limitation in Austria, where it was held, for instance, that providing that only the party instituting the proceedings will bear all the costs notwithstanding the outcome of the case is against public policy.⁶²³

The second issue that was raised above was: is the allocation of both procedural costs (tribunal's fees and expenses, the costs of experts appointed by the tribunal, and institutional fees) and party costs (legal fees and other expenses) regulated in the same way? In civil litigation, the legal families differ when it comes to the allocation of attorney fees, while court costs are usually awardable under both the American and the "costs follow the event" rule. The ACCP, the GCCP, the EAA and the SAA make no difference between these costs when it comes to an issue whether the tribunal can allocate them in the last award.

⁶²¹ Ibid.

⁶²² Cristian Conejero-Roos, *Productos la Sabana vs Tampico*, ITA Board of Reporters, Kluwer Law International (Court of Appeal of Santiago 2014).

⁶²³ Vienna International Arbitral Centre, *Handbook Vienna Rules*, 216.

However, the power to allocate party costs, in particular legal fees, was widely discussed in doctrine and practice, especially in the United States, the home jurisdiction of the American Rule. In *In re General Security National Insurance Co.*, the court confirmed that the power to allocate legal fees was inherent to the arbitrator's mandate, even when no specific institutional or *ad hoc* rules are agreed upon.⁶²⁴ The parties in that case provided for a place of arbitration in New York and for New York law as an applicable law. New York's arbitration statute provided for arbitrator's fees to be allocated in the last award, but not for the allocation of the legal fees. The Court, however, held that New York's arbitration statute did not govern the proceedings, because the contract's choice of law clause called only for application of *substantive* New York law.⁶²⁵ The Second Circuit went even further in *Reliastar Life v EMC* case⁶²⁶ by reversing a decision to vacate an award, and confirming that the bad faith exception to the American Rule is preserved even if the parties agreed in the arbitration agreement that each party is to bear its own attorney's and arbitrator's fees. In other words, the tribunal has an inherent power to award attorney's and arbitrator's fees if they are incurred due to the other party's failure to arbitrate in good faith, even if the parties agreed to exclude such a power. Both decisions, and especially the one of the Second Circuit, defend the position that the parties' autonomy is provided by the legal order, and it is allowed if and to the extent as recognized by such an order. In other words, the tribunal's power to award the costs is not solely based on a parties' agreement – it is inherent to its mandate to a certain extent.

This approach, however, poses another question when it comes to the recognition and enforcement of tribunal's decisions on costs. Namely, by recognizing the possibility for

⁶²⁴ *In re General Security National Insurance Co.* 2011 U.S. Dist. LEXIS 49518 (S.D.N.Y. April 29, 2011).

⁶²⁵ "Marc J. Goldstein Litigation & Arbitration Chambers » Arbitral Award of Legal Fees Upheld Despite No Specific Grant of Power in the Arbitration Clause," accessed July 14, 2015, <http://arblog.lexmarc.us/2011/05/arbitral-award-of-legal-fees-upheld-despite-no-specific-grant-of-power-in-the-arbitration-clause/>.

⁶²⁶ *Reliastar Life Ins. Co. v EMC Nat'l Life Co.* (564 F.3d 81 (2nd Cir. 2009) 2009).

tribunals to derogate the parties' agreement as to the allocation of costs, such a possibility may jeopardize the award under Article V(1)(d) of the New York Convention, which provides that the recognition and enforcement may be refused if "the arbitral procedure was not in accordance with the agreement of the parties." If such an objection was raised by a party at the stage of recognition and enforcement, the tribunal's first task would be to analyse whether the allocation on costs falls under the arbitral procedure or merits.

The term "arbitral procedure" encompasses the period beginning with the filing of an action and ending when the award is rendered.⁶²⁷ The decision on the allocation of costs can be qualified as of mixed nature. Although the costs of arbitration are a consequence of procedural acts and accessory to the vindication of a party's right, and the decision on their allocation often takes procedural behaviour of a party into account, the decision is based on material requests of the parties for reimbursement of the costs incurred and some circumstances taken into account are of substantive nature as well. This brings discrepancies as to the defining the legal nature of such decision in different jurisdictions, and national courts might fall into the trap of homeward trend by "borrowing" the understanding of the legal nature of decisions on costs in litigation in their home jurisdictions. The above mentioned U.S. decision *In re General Security National Insurance Co.*, for example, shows such trend since the court found New York law as non-applicable to costs since it was the applicable *substantive* law. This is an application of the U.S. position according to which the costs of litigation are considered to be an issue of procedural nature.⁶²⁸ In Germany, on the

⁶²⁷ Borris Christian and Henneke Rudolf, "Article V(1)(d)," in *New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards: A Commentary* (R. Wolff, 2012), 344; Patricia Nacimiento, "Article V(1)(d)," in *Recognition and Enforcement of Foreign Arbitral Awards: A Global Commentary on the New York Convention*, 2010, 292.

⁶²⁸ Harry M. Flechtner, "Recovering Attorneys' Fees as Damages under the U.N. Sales Convention: A Case Study on the New International Commercial Practice and the Role of Case Law in CISG Jurisprudence, with

other hand, the decision on costs in an arbitral award was considered to be part of the merits of the award and thus not reviewable by the court.⁶²⁹

When raising an objection under Article V(1)(d) of the New York Convention, the parties should be aware of these discrepancies. It is important to mention, however, that notwithstanding whether the costs are considered to be of procedural or of substantive nature, the challenge based on public policy shall be possible. Namely, even if the costs are found to be a matter of procedure and, consequently, the parties' agreement on it is considered to be an agreement on procedure, the arbitral procedure is still subject to the fundamental requirements of due process and refusal of recognition and enforcement is still possible under Article V(2)(b) of the New York Convention.⁶³⁰

Having this issue in mind and continuing on the effect of parties' agreement on tribunals' discretionary power, another representative of a position that the tribunal's power to award the costs is not solely based on the parties' agreement, but it is inherent to its mandate to a certain extent, is the Singaporean jurisdiction. The Singapore International Arbitration Act does not expressly provide for the tribunal's power to allocate the costs – either procedural or party costs. Scholars have, however, concluded that “the Singapore legislature and courts have considered it a trite point and have implicitly presumed a power to award costs.”⁶³¹ This can be taken as a reflection of “judicialization” of arbitration, a theoretical concept which emphasizes the similarities between the roles of arbitrators and those of

Comments on *Zapata Hermanos Sucesores, S.A. v. Hearthside Baking Co.*,” *Northwestern Journal of International Law & Business* 22 (2002): 155.

⁶²⁹ Germany No. 148, German seller v. German guarantor, Oberlandesgericht, Munich, 34 Sch 21/11, 11 April 2012 (n.d.).

⁶³⁰ Berg, *The New York Arbitration Convention of 1958*, 324.

⁶³¹ Ong and O'Reilly, *Costs in International Arbitration*, 23.

national judges through the formalization of arbitration procedure.⁶³² The main purpose of it is to prevent uncertainty and surprise in arbitration procedure.⁶³³

Other contributing factors to the process of judicialization are expectations and knowledge as to which decisions the arbitrators will undertake, that all the participants in arbitration, especially arbitrators and parties, bring from their home jurisdictions. Consequently, the expectations to rule on the allocation of costs are also transferred in the arena of international arbitration. As mentioned above, parties' agreements on whether to rule or how to rule on costs are rare, and their enforceability is questionable in civil litigation. It seems from the analysis above that such an approach is not transferred in international arbitration. Nevertheless, such a conclusion deserves a certain critical review. Namely, although the role of arbitrators resembles the role of national judges, it is often pointed out that the sources of their powers are of a rather different nature. Judges derive their authority from a state, while arbitrators base their power on a parties' agreement to subject their disputes to arbitration.⁶³⁴ Considering this difference of the sources of authority, the fact that costs claims should be subject to settlement, and the fact that the flexibility of arbitration procedure is one of the reasons why commercial parties prefer it over litigation, it is plausible to claim that the parties to arbitration agreement have wider autonomy and discretion to decide on whether the tribunals will have a power to allocate the costs or not.

The discussion on relation between party autonomy and the allocation is even more important when it comes to the method as to how the costs are to be allocated. The two U.S. cases analysed in this part showed that the courts, even in a case where parties agreed on the

⁶³² See in: Arthur W. Rovine, "Fast-Track Arbitration: A Step Away from Judicialization of International Arbitration," in *International Arbitration in the 21st Century: Towards "judicialization" and Uniformity? : Twelfth Sokol Colloquium*, ed. Richard B Lillich and Charles N Brower (Irvington, N.Y.: Transnational Publishers, 1994), 45–60.

⁶³³ *Ibid.*, 47.

⁶³⁴ Susan Franck, "The Role of International Arbitrators," *ILSA J. Int'l & Comp. L.* 12 (2005): 11, http://heinonlinebackup.com/hol/cgi-bin/get_pdf.cgi?handle=hein.journals/ilsaic12§ion=24.

method, found the tribunals' power to allocate so inherent to their role as adjudicators that it had overridden the parties' agreement in that regard. Again, although parties, tribunals, and courts are often transferring what they already know from their own jurisdictions in arbitration realm, the autonomy of the parties in international arbitration should not be easily restricted.

National courts enjoy their discretion to decide on setting aside, and on the recognition and enforcement of arbitral awards. The judicial review will often contain a stance on whether an award is against public policy, and at that stage it may check whether parties' agreement as to allocation violated it. It is, however, an established position in the arbitral practice and doctrine that this ground should be interpreted narrowly. The question is whether the circumstances, which are taken into account when deciding on the allocation are of such significance as to conclude that they form a part of public policy.

However, since parties will rarely agree on the method of allocation, the following section will serve the purpose of showing how flexibility of tribunal's decision-making was preserved through providing them with wide discretion as to the allocation of costs, which resulted in the harmonised international approach of moderated "costs follow the event" rule.

V.3 Moderated "Costs Follow the Event" as a Prevailing Standard of Allocation of Costs in Arbitration, and Its Limitations

Although often chosen due to its procedural flexibility, there is only a certain level until which parties are ready to go into unknown in international arbitration, and after which the main consequence of flexibility – unpredictability - turns the procedure into "chaos".⁶³⁵

⁶³⁵ Howard M. Holtzmann, "Balancing the Need for Certainty and Flexibility in International Arbitration Procedures," in *International Arbitration in the 21st Century: Towards "judicialization" and Uniformity?* :

Consequently, through its development, international arbitration became a battlefield between the need for legal certainty and the flexibility of a procedure.⁶³⁶ The parties to arbitration certainly do not prefer to be surprised by solutions adopted by an arbitral tribunal, either in procedural or substantive matters. These matters, especially procedural ones, are left to the wide discretion of a tribunal. In order to make them more predictable, “soft law” guidelines are often provided, which parties can choose in order to be able to predict better the procedural actions of a tribunal.⁶³⁷ This, of course, does not come without any criticism. It was pointed out that these rules, although not binding unless agreed upon by the parties, might overburden arbitration by overregulating it, and take away probably the most distinct feature of it, i.e. its flexibility.⁶³⁸ Therefore, a right balance of these two principles needs to be achieved. When it comes to the allocation of costs, such balance is still not achieved. This part will provide an analysis of a current situation in practice.

While the justification and the need for the flexibility stems from the procedural nature of the arbitrator’s power to decide upon the allocation of costs, the standard that the arbitrators apply can be qualified as of either procedural or substantive nature.⁶³⁹

A discussion regarding the rules of allocation of the costs took place between the two diametrically opposite approaches that were initially developed in litigation: the American Rule and the “costs follow the event” rule. For obvious reasons, the dichotomy of these two approaches made it difficult to achieve a uniform treatment of costs in the last award to be achieved in the arbitration community. Although the regulation of allocation of costs was left

Twelfth Sokol Colloquium, ed. Richard B. Lillich and Charles N. Brower (Irvington, N.Y.: Transnational Publishers, 1994), 16.

⁶³⁶ Holtzmann, “Balancing the Need for Certainty and Flexibility in International Arbitration Procedures.”

⁶³⁷ Ugo Draetta, “The Transnational Procedural Rules for Arbitration and the Risks of Overregulation and Bureaucratization,” *ASA Bulletin* 33, no. 2 (June 1, 2015): 331.

⁶³⁸ *Ibid.*, 333.

⁶³⁹ Greenberg, “Law Applicable to Costs Claims in International Arbitration: Why Does It Matter?,” 175.

to national legislators and arbitration institutions, arbitral practice has developed a harmonised approach of the moderated “costs follow the event” rule.⁶⁴⁰

The rules on allocation, which were initially developed in civil litigation, are not any more applied in their strict form either in litigation or in arbitration. As shown above, there are many differences between jurisdictions even if they apply the same rule of allocation – the “costs follow the event” rule. Recoverable costs, circumstances taken into account when deciding on allocation, and the starting point may differ between jurisdictions that are technically adopting the same rule. On the other hand, under some of the exceptions under the American Rule, the courts are readily taking into account some of the procedural behaviour of the parties in order to depart from the rule and shift the fees.

Taking into account the parties’ procedural acts is exactly what brings all the systems together. On one hand, it is clear that no party shall be reimbursed for its actions which it undertook in bad faith. The counterpart can be found under the American Rule, according to which no party shall bear its own costs the costs incurred due to bad faith actions of its opponent. What is taken into account in all mentioned systems is the conduct of a party before and during a proceeding, in particular, observing a time limit, and bringing unnecessary, unreasonable, or groundless claims or defences. Also, fee shifting based on these circumstances is justified as the punishment of a losing party, the indemnification of a winning party, and/or the discouragement of a frivolous and bad faith procedural behaviour in all three mentioned jurisdictions.

Notwithstanding the similarity of the two main systems on allocation - “costs follow the event” rule and the American Rule - to take into account the procedural behaviour of the parties, the distinction between them still exists. Namely, in jurisdictions which follow “costs

⁶⁴⁰ Ong and O’Reilly, *Costs in International Arbitration*, 20.

follow the event” rule, the outcome of the case is an initial circumstance taken into account when allocating the costs. Under the American Rule, however, the rule of non-shifting is an initial position. The circumstance of who the winner is matters only regarding the allocation of the court’s costs, which are allocated based on the “loser pays” approach, as discussed above under **V.1.1**.

The issue is whether these national approaches in any way influence, or should influence, the approaches of arbitral tribunals. Once we leave the frame of litigation, and of national procedural laws regulating allocation of costs that bind the national courts, arbitral tribunals are generally found not to be bound by the procedural rules of national laws. The legal framework for the allocation of costs in international arbitration can be found in arbitration acts, arbitration rules, and in a parties’ agreement. International arbitrators are confronted with a challenge since these rules are rather simple, and provide them with wide discretion, while the parties will usually have certain expectations based on the rules of their background jurisdictions. Such expectations form, of course, only one part of the basis on which predictability is to be built. It is the main thesis of this study that although arbitral tribunals are not bound by these expectations, when they are developing an approach to the allocation of costs, they should take the parties’ expectations into account to a certain extent, and create a fair playing field for everyone. That is a rather difficult task to do given that the limits of the arbitration arena are rather broad and as wide as the borders of the 156 state-parties to the New York Convention. The first building block of this harmonised approach is the rules on the allocation provided in arbitration laws and arbitration rules.

In order to illustrate the overall rules on the allocation provided in the legal framework, the analysis of eight arbitration rules is provided. Out of these eight arbitration rules, none of them provides for a clear-cut application of the American Rule. Four of them provide for an application of the “costs follow the event” rule, subject to other circumstances

besides the outcome.⁶⁴¹ Finally, four of them provide for neither the American Rule nor for the “costs follow the event” rule, but for allocation in accordance with the circumstances of the case.⁶⁴² This clearly shows that the American Rule has almost no relevance in international arbitration, at least as a starting point for the allocation. Nevertheless, that does not mean that arbitral tribunals do not reach decisions in which they decide that each party should bear its own costs. A recent study shows that out of 53 international awards in 15 of them (i.e. 28%) the arbitrator(s) decided that each party shall bear its own procedural costs, while in 25 (i.e. 47%) cases arbitrator(s) left each party to bear its own legal costs, i.e. attorney fees.⁶⁴³ It is not, however, known from this study whether the arbitrators applied the American Rule initially, or they decided not to shift the fees after considering the circumstances of the case. If the latter is correct, then the “costs follow the event” rule was applied. Eventually, the arbitrators found no “event” to be “followed”.

According to another study, conducted by the author, out of 18 international awards, only in five the arbitrators decided not to shift any costs, although they acknowledged their authority to do so. Moreover, all the arbitration rules analysed in this thesis, which are also rules of the most prominent arbitration institutions, provide for allocation (shifting) of costs, only with a slightly different initial point of view. Therefore, it is hard to imagine the application of the American Rule in international arbitration on any other basis but the parties’ agreement, and it may be concluded that the American Rule is of little importance in international arbitration. This is the first derogation of the expectations of the parties who come from “non-shifting jurisdictions”, such as the U.S. and Japan. However, since this derogation from their home jurisdiction’s system is made in the arbitration laws, or rules, one

⁶⁴¹ Article 28.4 of the LCIA Rules; Article 35.2 of the DIS Rules; Article 43(5) and Article 44 of the SCC Rules; Article 40 of the Swiss Rules.

⁶⁴² Article 37(4) and (5) of the ICC Rules; Article 34 of the ICDR Rules; Article 37 of the Vienna Rules, Article 31.1 of the SIAC Rules (no rule as to how to allocate the costs).

⁶⁴³ Christopher Koch, “Is There a Default Principle of Cost Allocation in International Arbitration?,” *Journal of International Arbitration* 31, no. 4 (81/01 2014): 496.

cannot object to an argument that the parties explicitly agreed on such a change. However, not everything on the allocation is written in the rules, and there is plenty that can surprise the parties.

Several conclusions follow from this short analysis. Firstly, there is no dichotomy of the rules on allocation in arbitration. Secondly, the prevailing approach, which is applicable under the arbitration rules, is the “costs follow the event” rule, but never in its strict form. Thirdly, this approach is modified when it applies as a default solution. In that case, the “event” is no longer only the outcome of the case, as other circumstances are also taken into account. Therefore, one may say that the “event” is no longer subject only to the determination of a “winner” and a “loser” in the case. This is not a surprise given that such a strict approach is not applied in civil litigation either. It follows that under those rules which provide for an allocation in accordance with the circumstances of the case, they apply the modified version of the “costs follow the event” approach as well, but in which the “event” encompasses various circumstances, and the outcome of a dispute is not to be considered to be the first one on the list of such circumstances. For that reason, the terminology which will be used in this Chapter will distinguish the “costs follow the event” approach as an umbrella term for all the approaches which in one or the other way provide for an allocation in accordance with the circumstances of the case, notwithstanding what the circumstances are. On the other hand, the “loser pays it all” will be a term used when the circumstance of an outcome is discussed. A shift in terminology is suggested by some other authors as well, for example, *Colin and O’Reilly* recognize that there is a clear tendency towards a “moderated costs follow the event”.⁶⁴⁴ Under moderated version of this approach “the principle that *costs follow the event* is merely the starting point and may be adjusted or even eclipsed by other

⁶⁴⁴ Ong and O’Reilly, *Costs in International Arbitration*, 20.

factors [...]and] the recoverable costs are subject to a test of reasonableness and possibly proportionality also.”⁶⁴⁵

The Article 4.3.2 of the Chartered Institute of Arbitrators’ Guideline for Arbitrators on Making Orders Relating to the Costs of the Arbitration provides that:

“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 the relevant “event” was. 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.”

The guideline introduces two main questions which will be discussed below. Firstly, what is the “event” that costs are supposed to follow in today’s arbitration realm and does it encompass the outcome of the case. Secondly, what is a proper way to determine who the winner of a case is. Therefore, the following section will deal with the circumstances which are provided by arbitration rules and taken into account by tribunals when allocating the costs. The analysis will refer to circumstances taken into account by courts in civil litigation when appropriate.

⁶⁴⁵ Ibid.

V.4 Factors Relevant for the Costs Allocation

The notion of the “event”, under the “costs follow the event”, developed throughout the arbitral practice. For that reason, as mentioned above, some of the authors advocate for a change in terminology by addressing this approach as a “moderated costs follow the event”, under which the arbitrators’ starting point is the “loser pays” principle, which is then modified by taking other circumstances into account as well.⁶⁴⁶ Other rules go even further by providing for the tribunal to decide on costs by taking the circumstances of a case into account, and making the “outcome of the case” only one of those circumstances. Examples of the former solution can be found in the LCIA Rules, the DIS Rules, the SCC Rules and the Swiss Rules. The examples of the latter approach are the ICC Rules and the ICDR Rules. Finally, more thorough analysis brings to light a third approach – an approach under which the arbitrators are given discretion to its full extent when deciding on costs. For example, Article 37 of the Vienna Rules provides that “*the arbitral tribunal shall decide on the allocation of costs in the manner it deems appropriate.*” No further guidelines besides the “appropriateness” of the allocated costs are given as to how such decision should be made. The SIAC Rules are another example of the rules that provide even broader discretion to the tribunal when allocating the costs. Article 31.1 provides only that “*the Tribunal shall determine in the award the apportionment of the costs of the arbitration among the parties.*” Therefore, three approaches may be deduced instead of only two:

- 1) A “moderated costs follow the event”, or adapted “loser pays” approach: approach that provides for an outcome of the case as a starting point, moderated afterwards with other circumstances,

⁶⁴⁶ Ibid.

- 2) An approach under which the allocation is to be made in accordance with the circumstances of the case, one of which is usually the outcome of the case,⁶⁴⁷
- 3) An approach under which no starting point is made, and the allocation is entirely in discretion of the tribunal.

It remains to be seen whether the circumstances which are taken into account by the tribunals under these approaches differ. Also, it is investigated whether there are any practical differences which stem from these approaches. Finally, and most importantly, the focus will be on the examination how predictable for the parties the circumstances taken into account by arbitral tribunals are. The last issue is especially interesting to observe when the parties' expectations formed under the rules of their home jurisdictions are taken into account and compared to the expectations that are shaped through arbitral practice.

V.4.1 Who is the Winner?

The first “event” that comes to one’s mind is the outcome of the case. However, as shown above, according to the arbitration rules this approach is no longer to be applied in its strict version, as other circumstances are also to be taken into account. The arbitral practice, nevertheless, shows sometimes an opposite development by taking the outcome into account, even if it is not set as the starting point. Under the 1998 ICC Rules, the tribunals had a broad discretion as to the allocation of costs. Article 31(3) provided that “[t]he final Award shall fix the costs of the arbitration and decide which of the parties shall bear them or in what proportion they shall be borne by the parties.”

⁶⁴⁷ In the author’s opinion, this approach is a pure “costs follow the event” approach.

The ICC tribunal in the Case No. 11509 read this rule in a way that the “loser” in the case should bear all the costs, as long as there are no “factors to the contrary”.⁶⁴⁸ In another ICC case, No. 13756, a sole arbitrator stated:

“[u]nder [...] the ICC Rules, I have discretion as to the allocation of cost. Agent has won on all its major claims. It is thus the winning party in this arbitration. Against this background I find that the arbitration costs are to be paid by Principal. [...] Principal must also bear the costs of the arbitration, as fixed by the ICC Court.”⁶⁴⁹

In both of these cases, the first issue the arbitral panel and the sole arbitrator addressed was a determination of a “winner” in the case. In the former case, the tribunal concluded that the claimant was a winner by simply stating that it “succeeded in recovering almost the entire amount of its claim”.⁶⁵⁰ No further explanation was given in the last award. Similarly, the sole arbitrator in the latter case stated that “Agent won on all its major claims”.

These two awards show how strong influence the allocation in relation to success has in international arbitration, since they were decided under the rules that do not put such a principle in the first place. There are authors who support such approach by claiming that “the circumstance of winning and losing form the most important factor of allocating the attorney’s [fees] so that it is justified to set it as starting point also in the [...] group of international arbitration rules [which do not focus on party’s success].”⁶⁵¹ This approach, which adopts the party’s success in the case as a starting point for allocation under the rules that do not set it as such, might be criticised as the homeward trend from the arbitrators’ side. However, since the parties’ agreed on the rules that allow arbitrators such wide discretion,

⁶⁴⁸ Company A (Singapore) v. Company B (Austria), Final Award, ICC Case No. 11509.

⁶⁴⁹ Ibid.

⁶⁵⁰ Ibid.

⁶⁵¹ Jäger, *Reimbursement for Attorney’s Fees*, 81.

little can be said against their decision to take the outcome of the case as the most important circumstance.

At this point, these two awards present the situation that might occur at the end of the proceedings: one of the parties will entirely (or “almost entirely”) win the case. The other possibility is that they will partly achieve success in their claims and counterclaims. This means that the “costs follow the event” approach should not only be modified in regard of the determining *who* the winner is, but also in regard of the *manner* in which the costs are apportioned or shifted – strictly or proportionately.

Measuring party’s success in arbitration and calculating the amount of costs to be shifted in accordance with the success can be a difficult and complex task. The ICC ADR Commission’s Report on Decisions on Costs in International Arbitration [“2015 ICC Report on Costs”] listed three approaches so far made by arbitral tribunals: 1) they either concluded that a party succeeded in all its claims (or most of them) and ordered the other party to pay all of the successful party’s costs, or 2) they awarded costs in proportion to the degree of success, or 3) they apportioned the costs in proportion to the relative success and failure of the parties.⁶⁵²

The ICC Case No. 14792 is a perfect example of the first approach, where the tribunal concluded that the “Claimant, for the most part, is successful with its claims”, and consequently the Respondent was ordered to pay 100% of the Claimant’s procedural and party costs. The success of the Claimant in this case when measured against the amounts it sought was 100% under the First Contract, 100% under the Second Contract and 96% under the Third Contract. Another ICC tribunal in a Case No. 11869 applied the second approach, and since the claimant won the vast majority of its claims it ordered the respondent to pay

⁶⁵² “ICC Arbitration and ADR Commission Report - Decisions on Costs in International Arbitration,” 20.

85% of the procedural costs and 85% of the claimant's legal costs. Finally, in the ICC Case No. 14020, the sole arbitrator established that "each party's claim have succeeded in part and failed in part", so it apportioned the procedural and party costs equally, as it would be done under the third approach listed in the ICC Report on Costs.

Although it seems that all three approaches adopt the *proportional* manner of allocation, nuances are possible. So, it might happen that, for example, the claimant who won 100% of the claimed amount is awarded 100% of its recoverable costs, or depending on other circumstances, as will be discussed below, it may be awarded less than 100% of its recoverable costs. On the other hand, the tribunals might be inclined to award the claimant 100% of its recoverable costs, even if the claimant won only 51% or 80% of the amount claimed. Under such an application, the "success is defined by winning more than 50% of what was claimed."⁶⁵³

There are examples of awards in which the tribunal reimbursed the amount of costs which corresponded *exactly* with the percentage of the party's success. In one of such cases, the tribunal awarded 6.2% of the procedural costs to the claimant, which was the exact percentage of the success in the claims it submitted.⁶⁵⁴

As already explained, the outcome of the case is no longer the only circumstance taken into account by the tribunals. For example, one ICC Sole Arbitrator applied the same approach in exercising his discretionary power in the Case No. 14630 by stating that "*the Sole Arbitrator will nevertheless follow the rule 'the costs follow the event' and examine whether certain arguments or procedural requests made by the Parties revealed unfounded.*" The sole arbitrator offered a bit more comprehensive discussion on the circumstances that were taken into account in order to determine who the winner was:

⁶⁵³ Koch, "Is There a Default Principle of Cost Allocation in International Arbitration?," 492.

⁶⁵⁴ An arbitral award rendered in 2012 under the ICC Rules, with which I am familiar due to conducting the tasks of a research assistant.

“[73] In the present case, Claimant has only partly prevailed in its claims and has, in particular, not successfully demonstrated that Respondent was wrong, as a matter of principle, when it withheld certain amounts in order to acquire missing spare parts. Claimant also made procedural requests, which were denied (challenge of the arbitrator; difficulties related to the testimony of two witnesses).

[74] Respondent was not entirely successful in its defence. Furthermore, it raised arguments in relation to the standing of Claimant and of the statute of limitation, which revealed unfounded. Admittedly, such defence[s] were raised in the initial brief of Respondent at a point in time when Claimant had not yet fully exposed its claims and arguments.”⁶⁵⁵

As it can be seen from the cited part of the award, the sole arbitrator did not take into account only the outcome, i.e. the success of the parties on substance, but also their success in procedural requests that they made. This will be discussed, however, in the next subsections.

Especially interesting case might arise if the claimant is successful in proving the jurisdiction of the tribunal, when contested, but the respondent succeeds or prevails on the merits. These two stages of proceedings are often treated as two “merits” stage, where the claimant’s success at the jurisdictional stage (of course, only when it was contested) will be highly appreciated when the allocation of costs is decided. The tribunals in those cases will take into account the outcome in both phases of the proceedings and they will allocate the costs accordingly. This usually results with each of the parties covering its own costs.⁶⁵⁶

⁶⁵⁵ Consortium member (Italy) v. Consortium leader (Netherlands), Final Award, ICC Case No. 14630.

⁶⁵⁶ ICC Case No. 13009; An arbitral award rendered in 2013 under the UNCITRAL Rules, with which I am familiar due to conducting the tasks of a research assistant.

However, sometimes, the tribunals will take the award on jurisdiction into account, but “*with more weight attributed to the final award*”, i.e. the decision on the merits.⁶⁵⁷

The circumstances of a case which tribunal takes into account can benefit a party who was not fully successful with its claims. On the other hand, they usually work as a disadvantage for a party who was entirely or almost entirely successful in a case. The overview of tribunals’ decisions on costs, which follows in this section, will show that there are multiple circumstances that can be taken into account. It will also confirm broad tribunals’ discretion in this regard and, consequently, the lack of predictability.

V.4.2 Success of Procedural Requests Made by the Parties and Procedural Conduct in General

Some tribunals not only take into account success of the parties on the merits, but also their respective success in procedural matters. For example, the ICC Sole Arbitrator in the Case No. 14630 stated that “[...] *Claimant has only partly prevailed in its claims [...]. Claimant also made procedural requests, which were denied (challenge of the arbitrator; difficulties related to the testimony of two witnesses).*”⁶⁵⁸ For all these reasons, the sole arbitrator exercised its discretion by ordering the claimant to bear two thirds of the costs of the arbitration, two thirds of its party’s costs, and two thirds of Respondent’s legal costs, while the respondent had to bear one third of the mentioned costs.

Whether respondent failed to comply or not with the tribunal’s order during the proceedings is another factor taken into account. In the ICC Case No. 15248, despite the fact

⁶⁵⁷ An arbitral award rendered in 2012 under the ICC Rules, with which I am familiar due to conducting the tasks of a research assistant.

⁶⁵⁸ Consortium member (Italy) v. Consortium leader (Netherlands), Final Award, ICC Case No. 14630.

that the claimant was not entirely successful, the tribunal ordered the respondent to bear the full burden of the procedural costs and legal costs. The reasoning that the tribunal offered was that, “the Respondent has seriously failed to comply with the Arbitral Tribunal's orders and directions regarding the production of evidence.”⁶⁵⁹ The procedural conduct of the parties, especially failure to appear or to respect time limits, failure to produce documents, or filing groundless objections, is taken into account, as shown above, by national courts in all three systems presented. For that reason, procedural conduct should be anticipated as a circumstance that will be taken into account by arbitral tribunals when allocating the costs.

It also needs to be mentioned that IBA 2013 Guidelines on Party Representation in International Arbitration provide in Guideline 26(c) that

“[i]f the Arbitral Tribunal, after giving the Parties notice and a reasonable opportunity to be heard, finds that a Party Representative has committed Misconduct, the Arbitral Tribunal, as appropriate, may [...] consider the Party Representative’s Misconduct in apportioning the costs of the arbitration, indicating, if appropriate, how and in what amount the Party Representative’s Misconduct leads the Tribunal to a different apportionment of costs.”

Although the Guidelines are a “soft law” instrument and they are far from being mandatory in arbitration, this solution received criticism from certain scholars who stated that they lead to the overregulation and bureaucratization of arbitration.⁶⁶⁰ As a main disadvantage it was pointed out that such regulation added nothing new to tribunal’s arsenal, while at the same time it made it more burdensome for a tribunal to use the allocation of costs as an effective means against such misconduct.⁶⁶¹ In particular, a tribunal should now not only give a notice to the parties and an opportunity to comment, but also to state how and in what amount the

⁶⁵⁹Final Award, ICC Case No. 13730, para 163.

⁶⁶⁰Ugo Draetta, *Counsel as Client’s First Enemy in Arbitration?* (Juris Publishing, Inc., 2014), 124.

⁶⁶¹Ibid.

misconduct led to a different allocation of costs.⁶⁶² In the opinion of this author, the claim of unnecessary overregulation is true and the requirement of reasoning such a decision is making tribunal's mandate more burdensome to a certain extent. However, giving a notice to the parties and an opportunity to be heard just confirms the adversarial nature of the costs claims. Giving such notice in advance is also in accordance with the ICC Techniques for Controlling Time and Costs in Arbitration which suggest that “[i]t may be helpful to specify at the outset of the proceedings that in exercising its discretion in allocating costs the arbitral tribunal will take into account any unreasonable behaviour by a party.”

Interestingly, the ICC Techniques talks about the “unreasonable behaviour by a party”, while the IBA Guidelines are mentioning the misconduct of a party representative. Given that party's representative is, as the name indicates, representing party's interests in arbitration, and it is the party that will bear the monetary consequences of an allocation, the former term is more accurate. However, commentaries on these two provisions show that the same conduct is considered under both of them. They cover unreasonable and bad faith conduct, delays, and dilatory tactics, such as those named in the ICC Techniques: excessive document requests, excessive legal argument, excessive cross-examination, dilatory tactics, exaggerated claims, failure to comply with procedural orders, unjustified interim applications, and unjustified failure to comply with the procedural calendar.⁶⁶³

The success on another procedural request which is often taken into consideration when allocating the costs is the success at the jurisdictional stage of the proceedings. As mentioned above, an especially interesting case might arise if the claimant is successful in establishing the jurisdiction of the tribunal, when contested, but the respondent succeeds or prevails on the merits. The tribunals in those cases will take into account the outcome in both

⁶⁶² Ibid.

⁶⁶³ Ibid., 122–23.

phases of the proceedings, and will allocate the costs accordingly, with the result usually being close to 50-50 allocation.⁶⁶⁴ However, sometimes, the tribunals will take the award on jurisdiction into account, but “*with more weight attributed to the final award*”, i.e. the decision on the merits.⁶⁶⁵ This usually depends on the length of each of these stages and the complexity of the issues involved.

In conclusion, right after the outcome of the case, the second most important circumstance taken into account by arbitral tribunals when allocating costs is the procedural behaviour of the parties. This makes this consideration predictable for the parties. However, predicting that arbitral tribunals will take into account procedural conduct, is a rather vast prediction. There are many types of behaviour that can be qualified as unreasonable, or malicious, that one can hardly speak of predictability in that regard. Nevertheless, procedural acts are party’s rights. Hence, the Guidelines and the ICC Techniques are going in a right direction when insisting on a tribunal giving the parties early indications that certain procedural conduct will be taken into account in the final allocation of costs.

V.4.3 Necessity of the Costs

In ICC Case No. 12877, the tribunal noted that “[*a]lthough I have awarded Respondent five eighths of the costs of the counterclaim, some of the costs of the arbitration would have been incurred in connection with the claim in any event, and Claimant’s claim was successful*” [emphasis added].⁶⁶⁶ Consequently, the sole arbitrator lowered the share of the costs to be reimbursed to the respondent due to the fact that some of the costs of the

⁶⁶⁴ ICC Case No. 13009; An arbitral award rendered in 2013 under the UNCITRAL Rules, with which I am familiar due to conducting the tasks of a research assistant.

⁶⁶⁵ An arbitral award rendered in 2012 under the ICC Rules, with which I am familiar due to conducting the tasks of a research assistant.

⁶⁶⁶ Seller (UK) v. Buyer (Australia), Final Award, ICC Case No. 12877.

counterclaim would be incurred as a reply to the claim in any case, i.e. they were not necessary for pursuing the counterclaim. The necessity of the costs was previously mentioned as a measurement for the recoverable costs in the German civil litigation, where it practically leads to the recoverability of only statutory costs. There are no tariffs established in international arbitration, but necessity, reasonability, and appropriateness as a measure of the recoverability of the costs incurred are well-known. They should, however, be addressed only at the stage of recoverability, rather than as a basis for the determination of the rule, i.e. the proportions, of allocation.

V.4.4 Parties' Contribution to the Adoption of a Pathological Clause

The ICC tribunal in Case No. 14581, despite the respondent's success at the jurisdictional stage, decided to apportion only its procedural costs to the claimant, while only a part of the legal costs was shifted. The tribunal reasoned by stating that "there are circumstances in this case that mitigate against a full award of costs to the successful party, most notably **the joint responsibility of the Parties** for the adoption of a pathological arbitration clause that has necessitated these complex jurisdictional proceedings" (emphasis added).⁶⁶⁷ Consequently, the tribunal ordered the claimant to bear only US\$ 400,000.00 out of US\$ 1,247,079.06, which was claimed by the respondents, i.e. only 32% of the amount claimed.

This case depicts one of the pre-arbitration factors that are taken into account when deciding on costs. This circumstance was also of substantive and not purely procedural nature. It is questionable whether these factors should be taken into account by arbitral tribunals

⁶⁶⁷ Lessor (Ireland) v. (1) Ministry A (State X), (2) Ministry B (State X), (3) State Enterprise (State X), (4) State X, Final Award on Jurisdiction, ICC Case No. 14581 (n.d.).

when deciding on costs. This discussion was led under the bad faith exception in the U.S., where the question was whether the timeline of such an exception should encompass also pre-litigation conduct or not, and the persuasive arguments for both positions were forwarded in different circuits.⁶⁶⁸ In England, as mentioned above, the procedural rules allow to take into account the conduct during, as well as before the proceedings, when deciding on the allocation. Therefore, under both the American Rule, as well under the “cost follows the event” rule, it is possible to invoke pre-litigation or pre-arbitration behaviour as one of the circumstances determining the allocation.

In this particular case, the fact that the respondent contributed to the pathology of the arbitration clause, led to the non-recoverability of its costs incurred at the jurisdictional stage. Taking into account the fact that respondent concluded such a clause with the claimant shows the mixed nature of costs, which, although usually awarded under procedural laws, have a component of substantive nature as well. Having in mind the compensatory nature of the costs, the mitigation aspect, as invoked in this case, should not come as a surprise. The basis might be found in the rule on contributory fault, under which, when the party’s fault has materially contributed to the damage which it suffered due to the conduct of the counterparty, the compensation must be reduced accordingly.⁶⁶⁹ Due to this generally accepted principle, such arbitral tribunals’ practices should not violate the principles of legal certainty and predictability in international arbitration.

⁶⁶⁸ Singer, “Bad Faith Fee-Shifting in Federal Courts,” 714–17.

⁶⁶⁹ Sergey Ripinsky, “Assessing Damages in Investment Disputes: Practice in Search of Perfect,” SSRN Scholarly Paper (Rochester, NY: Social Science Research Network, January 16, 2009), 15, <http://papers.ssrn.com/abstract=1547089>.

V.4.5 Commencement of Arbitration Proceedings in Good Faith

A very interesting circumstance was taken into account by the ICC tribunal in the Case No. 13730. Although the tribunal dismissed the claimant's claims, it stated that

“it was not unreasonable for Claimants, given the uncertainties of Japanese law and a certain level of ambiguity of Respondents in their conduct – which we have considered not sufficient to amount to a breach of good faith and fair dealing – to initiate the present arbitration. This is what they did in good faith.”⁶⁷⁰

Therefore, since the claims were submitted in good faith, although unfounded, the tribunal provided for equal allocation of all the costs.

Similarly, the SCC tribunal in Case No. 73/2011 stated that “it is clear that Claimant, if it was to obtain payments due to it upon Agreement termination, was obliged to begin and prosecute arbitration.”⁶⁷¹ The tribunal allocated claimant's procedural and legal costs to the respondent.

V.4.6 Reasonableness and Proportionality Tests

The standard of the reasonableness, or necessity, or appropriateness of costs is often invoked factor when assessing which *amount* of costs should be recovered, and it almost exclusively refers to the party costs. For example, Article 44 of the SCC Rules and Article 37(1) of the ICC Rules provide for tribunal's power to shift party's *reasonable* costs,

⁶⁷⁰ Distributor (Poland) and Daughter Company of Distributor (Isle of Man) v. Manufacturer (Japan) and Manufacturer Europe (European country), Final Award, ICC Case No. 13730.

⁶⁷¹ Final Award, SCC Case No. 73/2011, para. 62.

including legal costs.⁶⁷² A similar test can be found in Article 34(d) of the ICDR Rules, Article 38(e) of the Swiss Rules, and Article 28.1 of the LCIA Rules.⁶⁷³ Article 35.1 of the DIS Rules provides for the possibility to reimburse party costs “which were necessary for the proper pursuit of their claims or defence.” An exception can be found in the SIAC Rules, which provide the test of reasonability in Article 32.2 for the tribunal’s expenses:

The Tribunal’s reasonable out-of-pocket expenses necessarily incurred and other allowances shall be reimbursed in accordance with the Practice Notes for the time being in force.

The reason why reasonability or necessity test applies prevailing on party costs, particularly legal fees, is quite easy to identify. In institutional arbitration, arbitrators’ fees are set by an institution’s body in accordance with a cost schedule, which is known in advance, so there is a presumption that such costs are reasonable. Also, in both institutional and *ad hoc* setting, the advance on costs is paid at the beginning of the proceedings. The advance can be suggestive as to the amount of the fees which are to be paid in the end of the proceedings. In any case, the final amount of arbitrators’ fees is fixed in their agreement with the parties, and any dispute as to their amount is to be resolved before a last award, which contains the decision on the allocation of costs.

⁶⁷² Article 44 of the SCC Rules: “Costs incurred by a party Unless otherwise agreed by the parties, the Arbitral Tribunal may in the final award upon the request of a party, order one party to pay any reasonable costs incurred by another party, including costs for legal representation, having regard to the outcome of the case and other relevant circumstances.”; Article 37(4) of the ICC Rules: “The costs of the arbitration shall include the fees and expenses of the arbitrators and the ICC administrative expenses fixed by the Court, in accordance with the scale in force at the time of the commencement of the arbitration, as well as the fees and expenses of any experts appointed by the arbitral tribunal and the reasonable legal and other costs incurred by the parties for the arbitration.”

⁶⁷³ Article 34 of the ICDR Rules: “The arbitral tribunal shall fix the costs of arbitration in its award(s). The tribunal may allocate such costs among the parties if it determines that allocation is reasonable, taking into account the circumstances of the case. Such costs may include: [...] d. the reasonable legal and other costs incurred by the parties [...]”; Article 38(e) of the Swiss Rules: “The costs for legal representation and assistance, if such costs were claimed during the arbitral proceedings, and only to the extent that the arbitral tribunal determines that the amount of such costs is reasonable.”; Article 28.3 of the LCIA Rules: “The Arbitral Tribunal shall also have the power to decide by an award that all or part of the legal or other expenses incurred by a party (the “Legal Costs”) be paid by another party. The Arbitral Tribunal shall decide the amount of such Legal Costs on such reasonable basis as it thinks appropriate. The Arbitral Tribunal shall not be required to apply the rates or procedures for assessing such costs practised by any state court or other legal authority.”

The same cannot be said for party costs. Party costs are incurred during the proceedings. They are not fixed in advance, and even if they are, they are communicated only between the party and its counsel, and not to the other party. Hence, one cannot presume any consent to the amount in question. The amount of party costs can be significantly high, and it is usually higher than the amount of procedural costs. It does not come as surprise why parties may object to the reasonableness of such costs claimed for reimbursement by their opponent. According to the 2015 ICC Report on Costs, party costs, which include lawyer's fees and expenses, expenses related to witness and expert evidence, and other costs incurred by a party, make on an average 83% of the overall costs.⁶⁷⁴ Since shifting of party costs is allowed under all of the analysed arbitration rules, and the reasonableness/necessity of party costs is a condition for their recoverability, tribunals also often provide their reasoning when assessing this condition.

Sometimes the reasonableness test overlaps with other factors listed above. For example, the joint responsibility of the parties for the adoption of a pathological arbitration clause that led to the complex jurisdictional proceedings in the ICC Case 14581 was not explicitly discussed as part of the reasonableness test, but it led to reducing the amount of the winning party costs to 32% of the amount claimed.⁶⁷⁵

In other instances, tribunals have more explicitly discussed whether party costs were reasonably incurred. The 2015 ICC Report on Costs acknowledged several circumstances which can be considered under the reasonableness test: the rates number and level of fee-earners, the specialist knowledge of team members, the amount spent at different phases of the arbitration proceedings, and the disparity (if any) between the parties' costs.⁶⁷⁶ The last

⁶⁷⁴ "ICC Arbitration and ADR Commission Report - Decisions on Costs in International Arbitration," 3.

⁶⁷⁵ *Lessor (Ireland) v. (1) Ministry A (State X), (2) Ministry B (State X), (3) State Enterprise (State X), (4) State X*, Final Award on Jurisdiction, ICC Case No. 14581 (n.d.).

⁶⁷⁶ "ICC Arbitration and ADR Commission Report - Decisions on Costs in International Arbitration," 12.

mentioned circumstance of disparity between the parties' costs also falls under the three-fold test of proportionality, which falls under the broader concept of reasonableness. In particular, tribunals may consider the proportionality of party costs to (1) the costs of its opponent, (2) the amount in dispute, and (3) the work done.⁶⁷⁷

For example, in the ICC Case No. 14792, the tribunal stated that legal and other costs are reasonable "considering the amount in dispute", among other circumstances.⁶⁷⁸ Another ICC tribunal found "party costs broadly similar", as one of the circumstances confirming their reasonableness.⁶⁷⁹

The reasonableness of party costs based on their proportionality to the work done and to the procedural behaviour of a party is more often emphasized and elaborated in detail. In any case, tribunals may then either find the amount of claimed costs to be of a reasonable amount or they may reduce it, depending upon the circumstances. The considerations made by tribunals when reasoning on the reasonableness of party costs are assessed on case by case basis. Certain factors can be identified as being taken into account by different tribunals. One of them is the complexity of the matter, and the justification of undertaken procedural actions which were a product of such complexity. For example, the ICC Tribunal in the Case No. 14108 recognized, considering the quantification of party costs to be allocated, that "this was a very large, complex and difficult case for many reasons, requiring extensive expenditure on legal specialists and other experts."⁶⁸⁰ In even more detailed reasoning in the ICC Case No. 11509, the tribunal explained:

⁶⁷⁷ Ibid., 12–13, 26.

⁶⁷⁸ Seller (Italy) v (1) Buyer (US) & (2) Consignee and guarantor (Ukraine), Final Award, ICC Case No. 14792.

⁶⁷⁹ Joint Venture (US) v State W, Final Award, ICC Case No, 14108, XXXVI Yearbook Commercial Arbitration (n.d.).

⁶⁸⁰ Joint Venture (US) v State W, Final Award, ICC Case No, 14108, XXXVI Yearbook Commercial Arbitration.

“The case was not very complicated, but there is no doubt that substantial amount of time and effort had to be, and was, expended in its preparation and presentation. This can be gleaned from the final product in the volume of case statements, witnesses’ evidence statements and written submissions which have been filed by both sides, in addition to the terms of reference which had to be prepared.”

Tribunals often judge the reasonableness of party costs in relation to the necessity of a procedural action for which they were charged. Hence, the parties could be much better prepared to anticipate whether they will be reimbursed if this is explained at the beginning of the proceedings or when the particular action is to be undertaken. This can, for example, be achieved in regard of the fees and expenses of experts. Tribunals may warn the party requesting such an examination that, unless the tribunal finds such report relevant and reliable for its decision, the costs of it will not be reimbursable in all or in part. In the ICDR Case No. 526-04, the tribunal stated that since it “did not accept the portions of the [...] [expert] report”, it reimbursed only 73% of the costs claimed for the experts’ charges.⁶⁸¹

The tribunals’ introduction of any of the factors listed above, including the reasonableness/proportionality test, can only be that much effective as it meets its counterpart on the parties’ side – a detailed breakdown of the claimed party costs. In order to be able to decide on the shifting of the party costs in an efficient and fair way, the tribunals should insist on this cooperation from the parties’ side. Detailed listing of the costs incurred and their amounts are important, not only when it comes to the differentiation of the costs depending on the procedural action for which they were incurred, but also for the differentiation based on a timeline of the proceedings or the type of the costs. In the already above mentioned ICDR Case No. 526-04, the tribunal noted that there was “[n]o break down that would allow the

⁶⁸¹ Grant Hanessian, ed., *ICDR Awards and Commentaries* (Huntington, NY: JurisNet, LLC, 2012), 262.

Panel to differentiate between fees for arbitration and other fees [incurred for the work preceding arbitration]”.⁶⁸² The same tribunal pointed out the same fact in relation to an unsuccessful motion for injunctive relief – since no breakdown was made, a precise differentiation of the fees for that motion was not possible.⁶⁸³ In both instances, the tribunal had no other choice but to estimate the adjustment itself, as it found it appropriate.⁶⁸⁴

Tribunals should encourage the parties and their counsels early in the proceedings to record the fees and expenses in detail. When a breakdown of the invoices is provided, tribunal will be able to more easily assess the reasonableness, and consequently the recoverability, of particular fees. An example can be found in the SCC Case No. 73/2011, in which the tribunal found the provided breakdown useful for differentiating the fees paid to English solicitors who did not appear in the arbitration at all and, therefore, it was not reasonable to reimburse the party for them.⁶⁸⁵ At the same time, the tribunal was able to differentiate and assess the travel expenses and find them reasonable and recoverable.⁶⁸⁶ The breakdown of party costs can, therefore, be useful for arbitrators, but also not only for the parties who can expect more predictable results in the decision on costs.

Certain types of party costs, i.e. certain types of legal fees, cause more issues as to the assessment of their reasonableness, and consequently of their recoverability, than others. These are outcome-based fees, in-house attorney fees, and pre-arbitration attorney fees. Since these can be easily identified, and their recoverability was more widely discussed in the legal writing and practice, they will be discussed in more detail under the next part.

⁶⁸² Ibid., 261.

⁶⁸³ Ibid.

⁶⁸⁴ Ibid.

⁶⁸⁵ Exclusive Distributor (EU country) v Manufacturer GmbH (EU country, Final Award, SCC Case No. 73/2011.

⁶⁸⁶ Ibid.

V.5 Which Costs Can Be Allocated

When the tribunal is deciding on costs in the last award under any of the applicable rules of allocation, not all of the costs will be subjected to its decision. Besides defining the rule of allocation, the tribunal is also required to determine the recoverability of the particular types of costs.

V.5.1 Procedural Costs

V.5.1.1 Arbitrators' Fees and Expenses, and Institutional Fees

Arbitrators' fees and institutional fees, as the main and often prevailing part of procedural costs, are regularly considered subject to the tribunal's power to allocate them. All the analysed arbitration laws and rules provide for such tribunal's power. While the tribunal's power to allocate these types of costs is not disputed, the amount of these costs might still be challenged before national courts, as discussed in Chapter **II**, and the allocation of the costs, while perfectly acceptable from the standpoint of lack of arbitrators' power to do so, can still be subject to the challenge, as presented throughout this Chapter and in Chapter **II**.

V.5.1.2 Tribunal's Administrative Secretary's and the Court Reporter's Fees

The Yukos awards, which were rendered on July 18, 2014, admittedly dealt with an investment dispute.⁶⁸⁷ These decisions and the subsequent setting aside proceedings, which were initiated by the Russian Federation under the Dutch Code of Civil Procedure, brought to light an interesting issue of the relation of a tribunal's mandate and the role of administrative secretaries or assistants. In the press release given by the Ministry of Finance of the Russian Federation, one of the grounds on which the award was challenged was:

“the arbitrators did not personally fulfil their mandate, in violation of Dutch law; in particular, the assistant to the arbitrators, who the tribunal had previously stated would be responsible only for administrative tasks, in fact **billed the parties for more hours than did any of the arbitrators**; the tribunal must therefore have impermissibly delegated to the assistant certain of the arbitrators' personal responsibilities, including analyzing the evidence and applicable law, participating in deliberations, and preparing the arbitral awards” [emphasis added].⁶⁸⁸

Hence, the violation of tribunal's mandate through disallowed delegation of its task is primarily based on the calculation of the assistant's fees, which showed to be quite high given that he was in charge of only administrative tasks. The assistant's fees, which amounted to EUR 970,562, when divided with his hourly rate of 250-325 EUR, and compared with the arbitrators' fees divided by the hourly rate applicable to them led to a disparity of 40% to 70% of hours of work between the assistant and arbitrators.⁶⁸⁹ Without going into more details of

⁶⁸⁷ *Hulley Enterprises Limited (Cyprus) v The Russian Federation, Veteran Petroleum Limited (Cyprus) v the Russian Federation, and Yukos Universal Limited (Isle of Man) v the Russian Federation.*

⁶⁸⁸ See here: http://old.minfin.ru/en/news/index.php?id_4=24358.

⁶⁸⁹ Dmytro Galagan and Patricia Živković, “The Challenge of the Yukos Award: An Award Written by Someone Else – a Violation of the Tribunal's Mandate?,” February 27, 2015, <http://kluwerarbitrationblog.com/2015/02/27/the-challenge-of-the-yukos-award-an-award-written-by-someone-else-a-violation-of-the-tribunals-mandate/>.

this particular case, a following issue can be raised: given that the role of administrative secretaries or assistants may be significant, but also taking into account that a secretary or assistant performs administrative tasks for a tribunal, who should bear their fees – the tribunal or the parties?

The arbitration rules analysed in this thesis do not explicitly deal with the remuneration of arbitral secretaries and assistants, or sometimes not even with their role. Nevertheless, a uniform standard as to their remuneration can be established as the following:

“The parties are responsible for the reasonable expenses of the secretary, while the tribunal is responsible for any fees of the secretary.”⁶⁹⁰

This standard is in accordance not only with Article 4(1) of the Young ICCA Guide on Arbitral Secretaries which introduces a general principle that “the use of an arbitral secretary should reduce rather than increase the overall costs of the arbitration”, but also with the relevant ICC’s, SCC’s and Swiss Chambers’ Arbitration Institution’s guidelines. The ICC Note on the Appointment, Duties and Remuneration of Administrative Secretaries [“ICC Note on Administrative Secretaries”] provides a detailed standard for the remuneration:

“Any remuneration payable to the Administrative Secretary shall be paid by the Arbitral Tribunal out of the total funds available for the fees of all arbitrators, such that the fees of the Administrative Secretary will not increase the total costs of the arbitration.

In no circumstances should the Arbitral Tribunal seek from the parties any form of compensation for the Administrative Secretary’s activity. Direct arrangements between the Arbitral Tribunal and the parties on the Administrative Secretary’s

⁶⁹⁰ Michael Polkinghorne and Charles B Rosenberg, “The Role of the Tribunal Secretary in International Arbitration: A Call for a Uniform Standard,” *Dispute Resolution International*, no. October 2014, accessed January 16, 2016, <http://www.ibanet.org/Article/Detail.aspx?ArticleUid=987d1cfc-3bc2-48d3-959e-e18d7935f542>.

fees are prohibited. Since the fees of the Arbitral Tribunal are established on an ad valorem basis, any compensation to be paid to the Administrative Secretary is deemed to be included in the Arbitral Tribunal's fees.”

This provision clearly sets the rule that the arbitral secretary's fees are part of the tribunals' fees, and it explicitly excludes the possibility for parties to agree to a different arrangement. It is a somewhat different issue whether parties could agree on a different arrangement with the arbitral secretary herself/himself.

A similar guideline is adopted in the Swiss Chambers' Arbitration Institution's Guidelines for Arbitrators and in the SCC Arbitrator's Guidelines. The later one also explicitly provides that “[a]ny *expenses* that the secretary incurs are borne by the parties” [emphasis added]. These include, not exhaustively, secretary's travel and lodging expenses.⁶⁹¹

Such an apportionment of liability for administrative secretary's or assistant's costs (fees covered by the tribunal and expenses by the parties) seems rather reasonable given that secretaries are performing the administrative tasks *for* the tribunal. It comes then as a surprise that the survey conducted by the Young ICCA shows that majority of respondents to the survey had a different point of view. In answer to the question “who should bear the costs of the secretary in an arbitration”, 62.1 % of participants stated it should be the parties who bear the costs of the arbitral secretary, while 30.5 % and 22.1 % thought it should be the arbitral tribunal and president of the arbitral tribunal respectively.⁶⁹²

Court reporter's fees are another type of fees that might be entailed during the proceedings, but without a clear rule on whose responsibility they are. The 2014 Swiss Guidelines for Arbitrators might be helpful in this regard as they provide for court reporter's

⁶⁹¹ Ibid.

⁶⁹² International Council for Commercial Arbitration, “Young ICCA Guide on Arbitral Secretaries - The ICCA Reports No. 1,” 2014, 32, ft. 15, http://www.arbitration-icca.org/media/3/14235574857310/aa_arbitral_sec_guide_composite_10_feb_2015.pdf.

costs as the tribunal's expenses and qualifies them as “*actual costs shall only be reimbursable against receipts or other proper substantiation if receipts are unavailable*”.

V.5.2 Party Costs

V.5.2.1 Attorney Fees

The allocation of attorney fees generally requires special attention, and specifically the allocation of those that are paid based on the outcome (success) of the case. Attorney fees, in majority of jurisdictions, are set freely by an agreement between a party and its counsel.⁶⁹³ That does not mean that the amount that was set in their agreement will be fully recovered. In jurisdictions in which the “costs follow the event” rule or “loser pays it all” rule is followed, the recoverability of attorney fees is usually determined through the application of specific tariffs or rates.⁶⁹⁴ The combination of the freedom to negotiate the price for legal service, and the application of rather low tariffs for the reimbursement leads to a recoverability gap, which is in some jurisdictions higher and in some lower – depending on the applicable tariffs.⁶⁹⁵ In any case, the application of tariffs prevents full indemnity of the legal fees for the winning party. Hence, the conclusion is that although indemnification is one of the main underlying reasons for the allocation of costs, full compensation is not a principle under which this is conducted.

In international arbitration, unless the parties would agree to, no tribunal is bound by the tariffs of any jurisdiction. The measurement for recoverable costs, as will be shown

⁶⁹³ For example of Belgium, Denmark, France, Germany, The Netherlands see in: Christopher J. S Hodges, Stefan Vogenauer, and Magdalena Tulibacka, *The Costs and Funding of Civil Litigation: A Comparative Perspective* (Oxford; Portland, Or.: Hart Pub., 2010), 228, 282, 343, 364–65, 424.

⁶⁹⁴ Reimann, “Cost and Fee Allocation in Civil Procedure,” 11.

⁶⁹⁵ Hodges, Vogenauer, and Tulibacka, *The Costs and Funding of Civil Litigation*, 415; Reimann, “Cost and Fee Allocation in Civil Procedure,” 12.

below, is quite broad term of reasonableness. Therefore, allows the tribunal to award the legal fees with much lower recoverability gap. Some authors stated that in domestic arbitration, the tribunal may pay due attention to the local tariffs, and in international disputes that they may rely on the tariffs of the party's jurisdiction.⁶⁹⁶ However, the same authors agree that this is not mandatory for the arbitral tribunals. While the reasonability (necessity) of these costs will be discussed below, at this point, two issues shall be discussed: are outcome-based fees recoverable at all, and can the fees that falls in the recoverability gap, i.e. which are not awarded as costs, be awarded as damages.

Regarding the outcome based fees, these fees are referred as contingency fees, success fees, and “no win, no fee” agreements.⁶⁹⁷ The reimbursement of these fees is controversial not only in arbitration, but also in civil litigation. In that regard, it is difficult to reach an international consensus. Agreements on contingency fees are a hallmark of the U.S. system, and under these agreements the fees of a counsel are payable as a percentage of the recovered amount under the claim, and only in the case of the success in the proceedings.⁶⁹⁸ Contingency fees are still a controversy and illegal in most European jurisdictions: France⁶⁹⁹, Belgium⁷⁰⁰, the Netherlands⁷⁰¹, Poland⁷⁰². Interestingly, in Germany, outcome-based fees are allowed on a limited basis since 2006, after the Federal Constitutional Court found that a ban on contingency fees is unconstitutional as it prevents claimants from exercising their right of access to justice, when they are able to agree only on outcome-based fees.⁷⁰³ Contingency

⁶⁹⁶ Karl-Heinz Bockstiegel, Stefan Kröll, and Patricia Nacimiento, *Arbitration in Germany: The Model Law in Practice*, 1st ed., Kluwer Law International (Wolters Kluwer Law & Business, 2007), 701.

⁶⁹⁷ Cremades A. and Mazuranic A., Costs in Arbitration in Geisinger E. and Voser N. (eds), *International Arbitration in Switzerland: A Handbook for Practitioners*, Second edition (Kluwer Law International 2013), p. 195.

⁶⁹⁸ Maxeiner, “The American ‘Rule,’” 297.

⁶⁹⁹ Hodges, Vogenauer, and Tulibacka, *The Costs and Funding of Civil Litigation*, 343.

⁷⁰⁰ *Ibid.*, 228.

⁷⁰¹ *Ibid.*, 413.

⁷⁰² Hess and Huebner, “Cost and Fee Allocation in German Civil Procedure,” 156–57.

⁷⁰³ *Ibid.*, 156.

fees are also allowed in England and Wales since 2013.⁷⁰⁴ Hence, in Germany and England, under certain criteria, one can contract for all the types of outcome-based fees. It would be wrong, however, to say that no outcome-based fees are allowed in other European countries. Most of the jurisdictions mentioned above allow contingency-like fees, i.e. so-called success fees, which are divided on a basic fee paid in any case and a premium in a case of success.⁷⁰⁵ Both contingency and success fees result in a higher amount than fees calculated on other basis.⁷⁰⁶

Since this arrangement is not agreed upon by the losing party, the controversy arises on two levels: first, can contingency/success fees be at all admitted as reimbursable costs in international arbitration, and second, can they be fully reimbursed. The question whether contingency/success fees can be reimbursed at all can be raised from three different perspectives, and governed by three different national laws: (1) law of the country where the success fee arrangement was made, (2) the law of the seat of the arbitration, and (3) the law of the of the country of enforcement.⁷⁰⁷ The first of these laws influences the agreement on the arrangement itself, and may be as such a basis for debarring an attorney who illegally concluded such an agreement.⁷⁰⁸ In author's opinion, this does not directly influence the award in which success fees are considered for reimbursement. However, it might still have an effect as a part of one of the laws under (2) or (3), since the award in which tribunal observed and shifted the contingency/success fees can be challenged either in the proceedings for setting aside or in enforcement proceedings. It still remains a question that on which ground can such a challenge be submitted?

⁷⁰⁴ "Contingency Fees in England after April 2013 | Lexology," accessed October 27, 2015, <http://www.lexology.com/library/detail.aspx?g=f053e1a5-6992-4ef0-a9d8-9bef404a85e6>.

⁷⁰⁵ Ian Meredith and Sarah Aspinall, "Do Alternative Fee Arrangements Have a Place in International Arbitration?," *Arbitration* 72, no. 1 (2006): 22; Similarly in: Waincymer, *Procedure and Evidence in International Arbitration*, 1241; Cremades and Mazuranc, "Costs in Arbitration," 195.

⁷⁰⁶ Waincymer, *Procedure and Evidence in International Arbitration*, 1241.

⁷⁰⁷ Meredith and Aspinall, "Do Alternative Fee Arrangements Have a Place in International Arbitration?," 22; Similarly in: Waincymer, *Procedure and Evidence in International Arbitration*, 1242.

⁷⁰⁸ Hodges, Vogenauer, and Tulibacka, *The Costs and Funding of Civil Litigation*, 343.

In some jurisdictions, these fee arrangements are considered to be against public policy.⁷⁰⁹ Previously in Germany, when the outcome-based fees were forbidden, its arrangement could be claimed to be a violation of public policy.⁷¹⁰ A similar argument could have been plausible under the English law at the time when success fees, but not contingency fees, were allowed.⁷¹¹

Swedish courts have enforced the awards in which decision on costs contained success fees, if found to be reasonable.⁷¹² This might be a middle approach which would fall between two opposite approaches. First one would be the one not allowing the tribunal to assess the contingency/success fees when they would be illegal under one of the mentioned applicable laws. The second one would allow the tribunal full discretion regarding the assessment of the fees. A similar situation was presented in an English case *Protect Projects v Al-Kharafi* in 2005, before the new regulation was passed. Arbitrator, when deciding on costs, took into consideration the fees incurred on the basis of success fee arrangement. It allowed, however, reimbursement only of the fee he found reasonable, without any uplifts. The losing party challenged the award claiming “substantial injustice” under Section 68(2d) of EAA. It claimed that the agreement on success fees was not enforceable under English law and, therefore, it was not supposed to reimburse any of these fees. The court disagreed. It stated in its decision:

“Kharafi must have anticipated, if it lost, that at least such costs would have been recoverable from it. To be deprived of an unexpected and unearned bonus is not readily seen as a substantial injustice. Any unenforceability of the claims for costs derives from the regulations as they apply to success fees, yet no success fees

⁷⁰⁹ Waincymer, *Procedure and Evidence in International Arbitration*, 1242.

⁷¹⁰ Meredith and Aspinall, “Do Alternative Fee Arrangements Have a Place in International Arbitration?,” 25.

⁷¹¹ *Ibid.*, 24.

⁷¹² *Ibid.*, 26.

were awarded. It could reasonably be thought that the stringent all or nothing consequences of the English law applicable to CFAs could work injustice.”

In other words, if only reasonable amount of the success fees is being reimbursed (and no uplifts), this decision should not be influenced by the enforceability or non-enforceability of the agreement on the success fees itself. This leads us to the second controversy regarding contingency/success fees that was introduced at the beginning of this subsection – can such fees ever be fully reimbursed?

Since contingency fees are a hallmark of the U.S. legal system, it does not come as a surprise that there they are not against public policy. However, it is surprising that a U.S. court allowed the *full* shifting of such fees in case of *Johnson Controls, Inc. v Edman Controls, Inc.*, as long as the shifting is done based on a contract, and not provided by the statute. Namely, in international arbitration between *Johnson Controls, Inc. and Edman Controls, Inc.*, the Seventh Circuit confirmed the lower court’s decision not to vacate the award in which the arbitrator shifted the contingency fees in their entirety, amounting to 33.3 per cent of the sum awarded.⁷¹³ When addressing the reasonableness of the contingency fees, the Seventh Circuit turned to the law of the seat of the arbitration in order to confirm its conclusion on the reasonableness of the awarded amount, and stated that “*Edman submitted affidavits from two experts stating that a one-third contingent fee is common for commercial arbitration cases in Florida, where the arbitration took place.*”⁷¹⁴ However, the court distinguished between the fees which are shifted on the basis of a statutory rule and those, as it happens in arbitration, which are shifted based on the parties’ contract. According to the Seventh Circuit court,

⁷¹³ *Johnson Controls, Incorporated v. Edman Controls, Incorporated*, XXXVIII Yearbook Commercial Arbitration 514 (United States Court of Appeals, Seventh Circuit 2013).

⁷¹⁴ *Ibid.*

“[t]here is less need to police the reasonableness of fees shifted pursuant to a contract because the parties to a contract expressly consent to and define the terms of the fee shifting. If the parties do not want to pay an opposing party's contingent fee, they are free to write an agreement under which the prevailing party will be obliged only to pay fees calculated in accordance with the lodestar method. [...] We see no reason to curtail parties' ability to define the terms of their fee arrangements with lawyers. This is quite different from a statutory obligation to pay the opponent's fees, where the party responsible for the fees does not consent to the arrangement and has no say in determining how fees will be calculated.”⁷¹⁵

The message of the Seventh Circuit is quite clear – contingency fees are fully reimbursable in international arbitration, and if the opposing party wants to prevent the allocation of such fees, it needs to insist on such a rule during negotiations. The reasoning of the U.S. court is fair to a certain extent. Namely, as long as the contingency fees are foreseeable, and the amount of it is predictable, one could not simply deny their reimbursement based on the fact that they were not accepted by the opposing party, as no attorney fee ever is, since it depends on the agreement between a counsel and a client. The test of reasonableness used by the Seventh Circuit, which it based on the local rules regarding contingency fees, might be a bit more problematic to justify since the other party never consented to this amount of fees. The fees were unilaterally imposed by the party claiming the reimbursement and its counsel, and such reimbursement could hardly meet the standard of reasonableness. When awarded in full and in an unreasonable amount, contingency fees may seriously jeopardize the enforcement of the decision on costs based on the violation of public policy.

⁷¹⁵ Johnson Controls, Incorporated v. Edman Controls, Incorporated, XXXVIII Yearbook Commercial Arbitration 514 (United States Court of Appeals, Seventh Circuit 2013).

This solution, however, should not be considered as widely acceptable, especially in jurisdictions which still forbid outcome-based fees, or which allow them, but only on a restricted basis. In those jurisdictions, the issue might be, in a case when contingency fees are not awarded, or they are only partially awarded, can the party claim them alternatively (or initially) as damages? The same question can be posed for any recoverability gap that exists between any attorney fees which are reimbursed, and those which were actually paid by the party based on its agreement with the attorney.

V.5.2.2 Recoverability of Attorney Fees under National Substantive Law

Germany is known as a jurisdiction where the idea of the recoverability of costs under substantive law originated. In that jurisdiction a party may claim costs incurred before or during litigation, either in a special procedure *or* as damages claim based on one of the relevant tort or contract law provisions.⁷¹⁶ A similar system for costs claims is adopted in Switzerland, but only if the Cantonal laws on civil procedure do not deal with the reimbursement of pre-trial attorney fees.⁷¹⁷ The Belgian Supreme Court found attorney fees to recoverable as damages in 2004, “as far as they are a necessary effect of the [contractual] non-compliance.”⁷¹⁸ In 2007, the Belgian legislator passed new legislation providing for a minimum and maximum of recoverable attorney fees, depending on the amount in dispute.⁷¹⁹ After this legislation was passed, claiming costs as damages, in excess to those that are awarded based on this act, on contractual or extra-contractual basis was no longer possible.⁷²⁰

⁷¹⁶ Jäger, *Reimbursement for Attorney’s Fees*, 148.

⁷¹⁷ *Ibid.*, 149.

⁷¹⁸ Hodges, Vogenauer, and Tulibacka, *The Costs and Funding of Civil Litigation*, 220.

⁷¹⁹ Ilse Samoy and Vincent Sagaert, “‘Everything Costs Its Own Cost, and One of Our Best Virtues Is a Just Desire To Pay It.’ An Analysis of Belgian Law,” in *Cost and Fee Allocation in Civil Procedure*, ed. Mathias Reimann, *Ius Gentium: Comparative Perspectives on Law and Justice* 11 (Springer Netherlands, 2012), 83, http://link.springer.com/chapter/10.1007/978-94-007-2263-7_4.

⁷²⁰ *Ibid.*

The issue is still existent in regard of additional amounts paid to a lawyer for a defence against a vexatious or completely non-meritorious claim, or which are incurred for redundant proceeding.⁷²¹ In other words, the two-track recovery is still an open possibility: a party may recover attorney fees as costs under the provided rates, and claim the rest as damages for procedural misconduct. The authors base such a plausible claim on the provisions of fault liability, or on those for civil penalty, which is also available under the Belgian law.⁷²² A two-track claim for costs, both on procedural and substantive grounds, is available according to some authors in Germany as well to a certain extent.⁷²³ Even in in the U.S., jurisdiction in which attorney fees as a rule are not shifted, a majority of the states have held that attorney fees may be sought as an element of damages in tort action for malicious civil prosecution.⁷²⁴

It may be concluded that a claim for costs under national substantive law is not absolutely unusual, and moreover that sometimes it may be sought parallel with the claim for costs based on procedural laws. The possibility for such cost claims based on substantive law will depend from jurisdiction to jurisdiction. Besides the jurisdictions mentioned above, to the author's knowledge, claiming costs as damages is not a usual way of recovering, and even less so - an additional way of recovering. In any case, these issues might be less doubtful for national courts, while they are still troublesome for arbitral tribunals which do not have *lex fori*.

A small caveat needs to be made at this point – the recoverability of costs as damages in international arbitration will logically arise only as an issue if these expenditures were not initially qualified as recoverable costs. In other words, it may be claimed that these expenditures are not “costs” in their true meaning, especially if they are incurred *prior* to the

⁷²¹ Ibid.

⁷²² Ibid.

⁷²³ Jäger, *Reimbursement for Attorney's Fees*, 148.

⁷²⁴ John W. Wade, “Frivolous Litigation: On Frivolous Litigation: A Study of Tort Liability and Procedural Sanctions,” *14 Hofstra L. Rev.* 433, Spring 1986, 443.

proceedings. For example, these may be expenditures incurred *prior to the proceedings* due to the breach of arbitration agreement by submitting the claim to a national court or expenditures incurred in litigation related to an underlying agreement which took place *prior to the arbitration*, e.g., in the process of granting interim measures. In the latter group of expenditures, one can distinguish those which were subject to allocation in litigation and those which were not. In any case, it is questionable whether attorney fees, incurred before the arbitration proceedings in which their allocation is sought, can be qualified as costs under arbitration rules. For example, Article 37(1) of the 2012 ICC Rules states that costs must be “incurred by the parties *for the arbitration*” [emphasis added]. Hence, a party will have to prove that those expenditures are incurred *for the arbitration*.

It is possible to make two submissions as to the allocation of these expenditures in international arbitration under national substantive law. If they are qualified as “costs”, then a party needs to prove that costs are recoverable under national substantive law, in addition to the general rules on allocation. If they are not qualified as costs, these expenditures ought to be treated as “pure” damages claim, with due consideration given to their relation with a cost claim in order to avoid double recovery. An example of the expenditures that can qualify as “costs”, but are often not fully recovered, are contingency fees. Therefore, a party may be interested in recovering the non-reimbursed part of these fees as damages. Without going into further discussion on this issue, it must be emphasized that the focus in this part of the thesis is on the recoverability of any expenditures which were not recovered under the general rules on allocation of costs in arbitration. Some authors argued that such non-recoverability should be a condition to seek the costs under national substantive law, while others are of opinion that costs should be recoverable under national substantive law without any prior

condition.⁷²⁵ This depends on several issues discussed below, starting with the qualification of the costs as either procedural or substantive matter.

Procedural rules for arbitration, be it either national arbitration acts or the applicable arbitration rules, provide rules for the allocation of costs which are equivalent for the similar rules provided for allocation of costs in civil litigation in the procedural laws of each country. The fact that allocation of costs in international arbitration is governed by procedural rules is probably not sufficient to conclude that a claim based on substantive laws is excluded.⁷²⁶ In case when one of the parties wishes to file such a claim, the first question is which substantive national law should they invoke: the substantive law of the seat, the substantive law applicable to the arbitration agreement, or the substantive law applicable to the underlying contractual obligations? It is only the law applicable to the arbitration agreement that could be found applicable to such costs claims, if they are allowed at all. The reason is simple: the damages claimed are a consequence of an arbitration procedure, and not of, e.g., the breach of an underlying contract. However, the mixed procedural-substantive nature of the costs, the wide discretion of the tribunal, and certain specificities of the costs claims speak against the possibility to file such a claim overall.

Costs claims are of both procedural and substantive nature. This mixed nature does not stem from the fact that the recoverability of costs is provided in the procedural or substantive laws. It actually stems from the fact that the costs claims are monetary claims for the amounts incurred as a consequence of procedural actions, but they are awarded by taking into account not only procedural, but also substantive circumstances. Moreover, it is argued that international standards for allocation of costs in international arbitration are of

⁷²⁵ Waincymer, *Procedure and Evidence in International Arbitration*, 1195.

⁷²⁶ For an opposite opinion see in: Flechtner, "Recovering Attorneys' Fees as Damages under the U.N. Sales Convention: A Case Study on the New International Commercial Practice and the Role of Case Law in CISG Jurisprudence, with Comments on *Zapata Hermanos Sucesores, S.A. v. Hearthside Baking Co.*," 153–54.

substantive nature, while the power to allocate the costs is procedural.⁷²⁷ For that reason and due to their compensatory nature, the costs claims are a special type of damages already. These claims are based on the responsibility without guilt.⁷²⁸ However, due to the tariff system in civil litigation and the factor of reasonableness in international arbitration, the damages claimed under costs claims, as shown above, do not lead to *full* indemnification of attorney fees. The partial indemnification protects the right of access to justice. Otherwise, if party was expected to cover *all* the costs of its opponent, this might deter its will to file a claim in the first place.⁷²⁹ Since partial indemnification is inherent to the cost allocation, it would be unfair to let a party submit a claim for full indemnification in another claim for damages based on substantive laws. In that sense, recoverability of those expenditures which were not recovered in the first place seems not to be in accordance with the basic principles behind the allocation of cost rules.

Such forbearance of the circumvention of the rules on allocation of costs is supported also by wide discretion given to arbitral tribunals when deciding on the allocation. Namely, arbitral tribunals, as shown above, besides the outcome of the case, take many other circumstances into account, which are both of procedural and substantive nature. Moreover, tribunals are not bound by tariffs or rates, and for that reason the recoverability gap is more flexible in international arbitration. This allows the parties to bring before the tribunal, when deciding on the allocation based on procedural law, all the circumstances which would be relevant for claiming the costs as damages under substantive laws. Any invocation of these circumstances afterwards would mean that a mere re-characterization of a legal basis of a claim can supersede the substance of the claim, which is neither procedurally efficient nor it

⁷²⁷ Waincymer, *Procedure and Evidence in International Arbitration*, 1194–95.

⁷²⁸ Hodges, Vogenauer, and Tulibacka, *The Costs and Funding of Civil Litigation*, 275.

⁷²⁹ *Ibid.*, 424.

guarantees legal certainty. The authors, however, support such a possibility as long as there is no double recovery under these claims.⁷³⁰

Finally, it is the main thesis of this chapter that costs claims represent a *special* type of damages or at least that they are decided under substantive standard. If they were not regulated, they might not have been recoverable at all. One of the most persuasive arguments for that is the fact that attorney fees are *accessory* to the main claim for damages, and as such they cannot be themselves considered as damages.⁷³¹ Even if they are considered to be damages, there is the lack of causality for the same reason – they are a product of procedural acts and the party’s will to hire a lawyer, and not of the breach.⁷³² One might argue that in some legal systems these two grounds could be combined as long as there is a need for relief, i.e. “additional costs”⁷³³ can be sought on different circumstances than those based on which the costs are usually allocated. Perhaps such a combination should be available in international arbitration as well. However, as stated before, due to wide discretion of arbitrators when rendering decisions on costs, no such “additional costs” could actually be incurred, and parties should be encouraged to raise all such damages-related circumstances before the tribunal in the procedure related to the allocation. This is also a command of the transnational nature of these arbitral decisions, which should not be influenced by the peculiarities of several legal systems that allow such costs claims based on substantive national law. Finally, as per a latin maxim – *neminem laedit qui jure suo utitur* - such damages would miss a civil wrong, i.e. illegality, from the equation. The liability of the party which is to reimburse attorney fees would be based on the fact that that party draw the winning party in the adjudication procedure by its behaviour. Hence, one might face a

⁷³⁰ Waincymer, *Procedure and Evidence in International Arbitration*, 1195.

⁷³¹ Hodges, Vogenauer, and Tulibacka, *The Costs and Funding of Civil Litigation*, 220; Jäger, *Reimbursement for Attorney’s Fees*, 149.

⁷³² Hodges, Vogenauer, and Tulibacka, *The Costs and Funding of Civil Litigation*, 220.

⁷³³ Samoy and Sagaert, “‘Everything Costs Its Own Cost, and One of Our Best Virtues Is a Just Desire To Pay It.’ An Analysis of Belgian Law,” 83.

problem that there is nothing illegal with a party vindicating its rights, or defending them. Consequently, once again the costs claims do not meet the threshold necessary for a damages claim.

V.5.2.3 In-house lawyer's fees

The legal costs include the fees and expenses of party's external lawyers.⁷³⁴ Some authors include also the hidden costs that consist of "executive" or "management" time spent on the case, which includes time of senior officials, directors or in-house counsel.⁷³⁵ These costs are usually considered to be a part of the normal course of business and not awarded in the arbitration proceedings.⁷³⁶ Nevertheless, some arbitration rules, such as ICC Rules ("the reasonable legal and other costs incurred by the parties") opened the possibility for them to be claimed.⁷³⁷ The Secretariat's Guide to ICC Arbitration 2012 even expressly states that tribunals are free to consider and grant the costs of in-house counsels, management or other staff of the parties.⁷³⁸ The decision will, in the end, be completely at tribunal's discretion.

The most controversial among hidden costs are costs of in-house counsel. The solutions regarding their recoverability are not unified. Costs of in-house counsel are usually not recognized as legal costs and, consequently, most of the times they are not reimbursed.⁷³⁹

One of the reasons why the tribunals are reluctant to reimburse them is difficulty to provide

⁷³⁴ A. Sheppard, ed., "English Arbitration Act, Costs of the Arbitration," in *Concise International Arbitration* (Kluwer Law International, 2010), 809.

⁷³⁵ Nigel Blackaby et al., *Redfern and Hunter on International Arbitration*, Fifth Edition (Also available as: Paperback, 2009), para. 9.91.

⁷³⁶ *Ibid.*, para. 9.92.

⁷³⁷ *Ibid.*, para. 9.93.

⁷³⁸ Fry, Greenberg, and Mazza, *The Secretariat's Guide to ICC Arbitration*, 409.

⁷³⁹ Sheppard, "English Arbitration Act, Costs of the Arbitration," 809; von Schlabrendorff and Sessler, "Part II – Commentary on the German Arbitration Law (10th Book of the German Code of Civil Procedure), Chapter VI Making of the Award and Termination of the Proceedings, § 1057 – Decision on Costs," 2007, 424.

proof of their amount.⁷⁴⁰ Another reason may be that they are sometimes considered to be part of party's normal operating expenses.⁷⁴¹ However, opposite opinions exist and their basic argument is that parties are free to choose between the in-house and external counsel, and the one that chooses the second option should not be privileged.⁷⁴² Arbitral tribunals have denied the reimbursement of these costs when they are incurred next to the costs of the external counsel⁷⁴³, but allowed them when they are incurred as of the external counsel⁷⁴⁴.

The Massachusetts Appeals Court came to a similar conclusion when deciding on shifting in-house lawyer's costs to the losing party. It concluded that "having in-house counsel engaged in the present suit had a concrete financial impact on [the prevailing party], which we conclude 'incurred' a cost".⁷⁴⁵

V.6 Conclusion on Chapter V

The allocation of costs in international commercial arbitration is an area in which the opinions, approaches, and principles are somewhat diametrically positioned. The rule that the tribunal has power to allocate costs of the arbitration has been firmly established and widely recognized, and the arbitral practice has developed a standard applicable to the allocation of costs. At the same time, when dissecting this standard of the "moderated costs follow the event" principle, scholars and practitioners often criticize the unpredictability of the factors which will be taken into account eventually. This suggests that harmonization is not

⁷⁴⁰ Fry, Greenberg, and Mazza, *The Secretariat's Guide to ICC Arbitration*, 409.

⁷⁴¹ *Ibid.*

⁷⁴² Zuberbühler, Müller, and Habegger, *Swiss Rules of International Arbitration: Commentary*, 328.

⁷⁴³ Cremades and Mazuranc, "Costs in Arbitration," 191.

⁷⁴⁴ von Schlabrendorff and Sessler, "Part II – Commentary on the German Arbitration Law (10th Book of the German Code of Civil Procedure), Chapter VI Making of the Award and Termination of the Proceedings, § 1057 – Decision on Costs," 2007, 424.

⁷⁴⁵ *Holland v. Jachmann*, Mass. App. Ct. No. 13-P-0280 (2014).

completed in this area of arbitration law, mostly due to the juxtaposition of the principle of the flexibility of the arbitrators' decision-making and the principle of the predictability for the parties.

Moreover, the parties' expectations as to the allocation of costs in arbitration are often influenced by the rules on allocation of costs in litigation in their home jurisdictions. This, however, does not mean that reconciliation of their expectations is not possible. This Chapter has introduced two main systems adopted in jurisdictions – the American Rule and the “costs follow the event” rule. Besides introducing the main differences between them, this Chapter also explained that often the same procedural parties' behaviour is taken into account under both of these rules.

This procedural behaviour is taken into account by arbitral tribunals as well, such as: the success of procedural requests, the necessity of the costs, the parties' contribution to the adoption of the pathological clause, the commencement of arbitration proceedings in good faith and other. These circumstances are observed under the so-called moderated “costs follow the event” rule as well, which is a prevailing standard as to the allocation of costs in arbitration.

Furthermore, the shifting of the party costs raises peculiar issues, which are hardly harmonized. The reimbursement of contingency fees and in-house fees, and the recoverability of the legal costs under substantive law still remains approached on a case-by-case basis. This is not at all satisfactory for the arbitration field in which efficiency of the procedural steps is gaining more and more importance.

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