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Research Report

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Cost allocation in ICSID arbitration: theory and (mis)application

by

Matthew Hodgson*

In their recent *Perspective*, James Nicholson and John Gaffney argued for the “costs follow the event” (CFTE) cost-allocation approach to investment arbitration, in contrast to the more traditional “pay your own way” (PYOW) approach.¹ They countered an earlier contribution by Baiju Vasani and Anastasiya Ugale,² principally on the basis that a CFTE rule would encourage meritorious claims and discourage weak ones.

This contribution to the debate demonstrates that: (1) there is a third approach to cost allocation, referred to here as the “relative success” approach; (2) “relative success” is the dominant approach, but is frequently misapplied in practice; and (3) there is a need for guidance on costs in the International Centre for Settlement of Investment Disputes (ICSID) arbitration rules.

There is no binary distinction between the CFTE and PYOW approaches. Indeed, neither accurately reflects the reasoning of most ICSID tribunals. The “relative success” approach apportions costs based on the success of the parties on different issues in dispute. In a recent survey of public ICSID awards,³ 38% of tribunals justified their decision by reference to the relative success of the parties on different issues in dispute — far more than the number following a CFTE (17%) or a PYOW approach (5%).

Although special factors (e.g., party misconduct, unreasonable costs) may justify deviation, the approach adopted should correlate with the actual costs outcome: CFTE should normally lead to a fully adjusted costs order, while PYOW should lead to an unadjusted costs order. “Relative success”, conceptually linked to the CFTE approach by applying that approach to each issue in dispute, should lead to a partial costs order, since one party will typically succeed on most, but not all, key issues. The reality, however, is quite different.

The survey results from the application of the CFTE approach are unremarkable. As expected, many tribunals adopting this approach made a fully adjusted costs order (46%), with a slightly smaller number awarding only *some* (42%) or even *no costs* (12%) based on the particular circumstances. Tribunals adopting a PYOW approach also had unsurprising results: an unadjusted costs order was the predominant outcome (88%), followed by a partial adjustment (12%).

However, in a substantial majority (65%) of cases, tribunals using “relative success” made no costs adjustment; only one third (33%) made a partially adjusted costs order. This is counterintuitive and suggests that “relative success” is often employed as a shortcut to an unadjusted costs order. It is tempting to interpret this as a convenient way to justify preserving the status quo at the time of the award. This is supported by the fact that the figure is higher (83%) when relative success is the only reasoning adopted (i.e., without any reference to any special factors). Moreover, tribunals frequently lapse into “relative success” reasoning even when nominally applying the CFTE rule.⁴ However, “relative success” is a distinct approach and, as such, should lead to different costs outcomes from the CFTE approach in most cases.

“Relative success” has the appeal of charting a middle course between the stark alternatives of the CFTE and PYOW approaches. It is open to criticism, however. Aside from the apparent misapplication in practice identified above, it remains a difficult, if not impossible, task to assign particular costs to each issue. Further, it is not obvious that it is fair. Should the appropriate test be whether the tribunal accepted every argument advanced by the successful party, or that the arguments were reasonably made? The CFTE rule already allows tribunals to penalize inefficient conduct, including spurious arguments, since only reasonable costs may be recovered.

Costs in investment arbitration are usually substantial.⁵ The allocation of costs involves policy judgments, especially regarding the types of claims that should be incentivized. There is a stark divergence in UNCITRAL and ICSID tribunal approaches to costs.⁶ The absence of a default rule means that ICSID tribunals adopt conflicting decisions. Some ICSID tribunals have insisted that CFTE is the right approach,⁷ others PYOW⁸ and many others endorse “relative success”. Some 15% offered no reasoning at all.⁹ The case for a default rule, or even guidance, for predictability and consistency is compelling. Further debate as to the appropriate approach should be a priority. The next revisions to the ICSID arbitration rules present a good opportunity to begin this process.

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¹ James Nicholson and John Gaffney, “Cost allocation in investment arbitration: Forward toward incentivization,” *Columbia FDI Perspectives*, No. 123, June 9, 2014.

² Baiju S. Vasani and Anastasiya Ugale, “Cost allocation in investment arbitration: Back toward diversification,” *Columbia FDI Perspectives*, No. 100, July 29, 2013.

³ Matthew Hodgson and Chand Chopra, “ICSID tribunals’ reasoning on costs: A survey of 145 public ICSID awards up to 31 May 2014,” available at [http://www.allenoverly.com/SiteCollectionDocuments/ICSID_Reasoning_on_costs_\(revised\).pdf](http://www.allenoverly.com/SiteCollectionDocuments/ICSID_Reasoning_on_costs_(revised).pdf)

⁴ See e.g. *Rompetrol v. Romania*, ICSID Case No. ARB/06/3, ¶298.

⁵ For average costs in treaty proceedings through 2012, see http://www.allenoverly.com/SiteCollectionDocuments/Counting_the_costs_of_investment_treaty.pdf.

⁶ UNCITRAL tribunals adjusted costs (at least in part) in 69% of cases, compared with just 36% of ICSID tribunals, see *supra* note 5.

⁷ See e.g. *Gemplus v. United Mexican States*, ICSID Case No. ARB/04/3, ¶17-20 – 17-24.

⁸ See e.g. *Alasdair Ross Anderson v. Costa Rica*, ICSID Case No. ARB/07/3, ¶62-64.

⁹ See *supra* note 3, part 2D.

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