Costs awards – who pays?

In a sequel to a previous GAR article on the costs of investment treaty arbitration, Judith Gill QC and Matthew Hodgson of Allen & Overy present research on how many costs awards get paid in practice, by whom and in what circumstances. Could security for costs orders or costs orders immediately following procedural skirmishes alleviate the continuing problem of non-payment?

Investment treaty arbitration is expensive. Typically the stakes are high and the process is characterised by large numbers of documents, substantial submissions addressing complex jurisdictional, merits and quantum issues, witness and expert evidence, and a week or two of oral hearings followed by further written briefs.

An earlier study by one of the authors of this piece (Matthew Hodgson, “Counting the costs of investment treaty arbitration”, Global Arbitration Review, Volume 9 Issue 2, from which this article incorporates various findings) found that average party costs were in the region of US$4.5 million and average ICSID tribunal costs around US$770,000.

Where a state succeeds in its defence, a costs award may at least provide financial compensation for its expense in defending a meritless claim. Conversely, a successful investor may feel it has not been made “whole” for the breach of international law if it does not recover its reasonable costs.

While investment treaty practice is far from consistent, there has been a discernible trend in recent years towards some adjustment of costs in favour of the successful party. Almost half of investment arbitration tribunals (49 per cent) made some form of costs adjustment in awards published since 2006 compared with just 35 per cent prior to that. But of course, receiving a costs award is not the end of the story. Indeed, it is a common complaint from states that they are not on a level playing field since investors are often “shell” companies with neither the intention nor the means to make good on an adverse costs decision.

This article presents the findings of a study by the authors of how many costs awards get paid in practice. It also considers how those results inform the current debate over security for costs.

The findings
The authors contacted counsel representing the successful party in 80 investment treaty cases where a costs award was made in the period to 31 December 2013. The survey was conducted on a strictly anonymous basis, and references in this article to specific cases are based on publicly available sources. We asked whether the costs award had been paid (in full or in part) and whether steps were taken to enforce the award or reach a settlement.

Responses were received in relation to 58 cases. Three cases are subject to ongoing annulment proceedings. In one of these, a bank guarantee was posted for the costs payable in the event that annulment is denied. This case was therefore treated as a case where the costs award was paid in full. The other two were excluded on the basis that the costs awards are not “ripe”, resulting in a final pool of 56 cases in total.

Of the 56 cases, costs awards were made in favour of the claimants in 21 cases and the respondents in 35 cases. We asked whether they had been paid in full, paid
in part or not paid. We also asked whether there are ongoing or completed enforcement proceedings or settlement discussions or a concluded settlement.

The breakdown of the results in respect of awards in favour of claimants and respondents can be seen in Chart 1 and Chart 2.

In Chart 3, a closer look at the statistics reveals further nuances.

As regards costs awards in favour of claimants, in 10 per cent of the cases considered (2 of 21) enforcement proceedings have already been completed, resulting in payment, in full or in part. None of the costs awards in favour of claimants was subject to ongoing enforcement proceedings.

Some 43 per cent of cases (9 of 21) were settled. However, in two of those cases the settlements did not cover costs. Adjusting for this, payment of costs awards, in full or in part, was made through settlement in some 33 per cent of all cases (7 out of 21). There was a further case where settlement discussions were still ongoing several years after the award; this was treated as a case where the costs award was not paid.

In one case, the claimant ultimately recovered part of its costs award through settlement after unsuccessful attempts at enforcement. This case was treated as a case where payment resulted from settlement.

As regards costs awards in favour of respondents, enforcement proceedings were more common (see Chart 4). They were completed resulting in payment, in full or in part, in 17 per cent of cases or 6 out of 35. There were four further cases where enforcement proceedings were ongoing, which were treated as cases where the costs award was not paid.

Settlement was far less common, however, with just 6 per cent of cases (2 of 35) resolved in this way. Both these settlements covered costs. None of the costs awards in favour of respondents was subject to ongoing settlement discussions.

In one case, the respondent ultimately recovered part of its costs award through settlement after unsuccessful attempts at enforcement. This case was treated as a case where payment resulted from settlement.

A breakdown of how payment, in full or in part, was actually procured can be seen overleaf in Chart 5 and Chart 6.

In cases where the respondents were paid, enforcement proceedings were common. In 27 per cent of the cases where the respondents were paid in full or in part (6 out of 22), such amounts were recovered only through enforcement proceedings, often in more than one jurisdiction and sometimes taking several years to complete.

In a further case, the respondent in question took enforcement actions in three jurisdictions before settlement (including partial payment of the costs award) was finally reached.

In contrast, for the claimants, only 12 per cent of costs awards were realised in full or in part through enforcement proceedings (2 out of 17). In the recent (13 August 2014) decision on security for costs in RSM v St Lucia, the majority referred to the previous ICSID case of Grynberg and RSM v Grenada, in which the costs award was satisfied only after enforcement proceedings in the United States, as evidence of the claimant’s unwillingness or inability to pay and thus a factor in favour of granting security for costs.

The counsel for the respondents in four of the 13 cases where they were not paid their costs awards commented that their clients specifically chose not to pursue any enforcement proceedings because of the claimants’ apparent lack of assets.

In cases where the claimants obtained an award of costs, settlements were far more common – made in 43 per cent of such cases (9 out of 21). However, in two of those cases the settlements did not cover costs.

Adjusting for this, the level of settlements including payment of costs was 33 per cent of all cases (7 out of 21), or 41 per cent of those cases where the claimants were paid their costs awards, in full or in part (7 out of 17).

In contrast, there were only two cases of settlements being reached where costs awards were made in favour of the respondents (6 per cent of all cases or 9 per cent of cases where the respondents were paid their costs awards in full or part). The settlements in both those cases covered costs – but, in one case, following years of enforcement proceedings.

This trend of settlements being more common in respect of claimants’ awards of costs accounts for the significant number of partly paid costs awards in favour of the claimants (29 per cent), while the respondents were usually either paid in full or not paid at all. Presumably, claimants are willing to settle for partial payment due to the legal and practical difficulties associated with enforcing against state assets.

Summary
The key statistical findings in relation to these 56 cases can be summarised as follows:

• 37 per cent of successful respondents were paid nothing at all, despite obtaining a costs award in their favour, whereas only 19 per cent of successful claimants suffered the same fate.

• Only 40 per cent of claimants and 38 per cent of respondents paid costs awards against them voluntarily.

• Where some payment was made, respondents paid 65 per cent of costs awards against them in full and 35 per cent in part only, whereas claimants paid 77 per cent in full and 23 per cent in part only.

• Claimants are more likely to secure payment through settlement (7 out of 17 cases or 41 per cent) than respondents (2 out of 22 cases or 9 per cent).

• Respondents are more likely to secure payment through enforcement proceedings (6 out of 22 cases or 27 per cent) than claimants (2 out of 17 cases or 12 per cent).

• In the investment treaty context at least, the suggestion that most awards are complied with voluntarily is not well founded, at least so far as costs awards are concerned. Only 52 per cent of costs awards in favour claimants and 49 per cent in favour of respondents were paid in full. Moreover, out of these fully paid costs awards, 18 per cent (2 of 11) of those in favour of claimants and 18 per cent (3 of 17) of those in favour of respondents were satisfied only after enforcement proceedings.

• Even taking account of settlements reached (almost all of which involved only partial payment), only 46 per cent...
 Costs awards – a hollow victory?
While the majority of costs awards are paid, at least in part, a substantial minority are not satisfied at all. In these cases, the awardee is left with a hollow victory. Indeed, prospective parties to investment treaty claims may be discouraged to hear that only around half of costs awards are fully paid.

As already noted, it is a common complaint on the part of states and their counsel that claimants are frequently special purpose vehicles (SPVs) with no significant assets, placing the parties in an asymmetric position. These concerns were reflected in responses to our survey.

Several state representatives complained at the number of what they deemed “frivolous” claims being started. While they were confident that those claims would ultimately fail, in the meantime they said they lead to substantial costs and an administrative burden. The head of treaty claims for one state which currently faces a large number of claims volunteered that increased availability of security for costs is the “single change” they would propose to the investment arbitration regime precisely to discourage frivolous claims.

Counsel to another state complained that a subsidiary of one of the claimant companies was transferred (in potentially fraudulent circumstances) during the course of the proceeding and without disclosure to the tribunal. This ultimately prevented enforcement of the costs award since the claimants were left without substantial assets.

To add to states’ list of grievances, successful claimants are more likely to receive a costs award in the first place than successful respondents. In a slight majority of cases (53 per cent), tribunals made an adjusted costs award upon finding for the claimant.

By comparison, tribunals make an adjusted costs award in favour of a successful respondent in only 38 per cent of cases (see Chart 7, overleaf).

However, the study makes clear that this is not an entirely one-sided picture. Investors, too, face the problem of non-payment by states. Whereas the main problem for states is the lack of resources of the claimant, investors frequently face the challenge of the state’s unwillingness to pay backed up by the twin administrative and financial regulation 14(3)(d), after both parties discontinue the proceeding under ICSID and others v Argentina non-payment without commencing enforcement proceedings.

However, the decision in RSM v St Lucia leaves a number of unresolved questions in relation to security for costs in ICSID arbitration.

First, unlike some other arbitral rules (for example, Article 25.2 of the LCIA rules), the ICSID Convention does not provide an explicit power to award security for costs. This leads to uncertainty as to the scope of this power.

The RSM v St Lucia tribunal relied on its broad power to recommend provisional measures to preserve the rights of a party under Article 47 of the ICSID Convention and Rule 39 of the ICSID Arbitration Rules. Most national regimes typically allow security for costs to be made only against a claimant (although a claim for security may be made against a respondent seeking to pursue a counterclaim). The rationale is that presumably the claimant has taken the risk of non-payment into account when commencing its claim. However, it is conceivable that an investor with a claim against a respondent with a track record of non-payment of awards may seek security for costs and the terms of Rule 39 and Article 47 do not exclude this possibility.

This question was also left open, intentionally or otherwise, by the tribunal in the ICSID case of Libananco v Turkey, which, in rejecting the respondent’s application for security for costs in 2008, stated “it would only be in the most extreme case – one in which an essential interest of either party stood in danger of
Chart 5: Breakdown of cases where the claimants were paid their costs awards in full or in part

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<th>No. of cases</th>
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<td>Settlement</td>
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<td><strong>Total</strong></td>
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<td>100%</td>
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<td>19%</td>
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<tr>
<td>Settlement</td>
<td>11</td>
<td>52%</td>
</tr>
<tr>
<td>Enforcement</td>
<td>6</td>
<td>29%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>21</td>
<td>100%</td>
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Chart 6: Breakdown of cases where the respondents were paid their costs awards in full or in part

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<tr>
<td>Settlement</td>
<td>2</td>
<td>9%</td>
</tr>
<tr>
<td>Enforcement</td>
<td>6</td>
<td>27%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>22</td>
<td>100%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>No. of cases</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Voluntary payment</td>
<td>13</td>
<td>37%</td>
</tr>
<tr>
<td>Settlement</td>
<td>17</td>
<td>49%</td>
</tr>
<tr>
<td>Enforcement</td>
<td>5</td>
<td>14%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>35</td>
<td>100%</td>
</tr>
</tbody>
</table>
irreparable damage — that the possibility of granting security for costs should be entertained at all” (emphasis added).

In practice, and consistent with most national regimes for security for costs, it seems likely that security for costs would only be available against a respondent state that advances counterclaims or is the applicant in an annulment proceeding.

Second, and for obvious reasons, orders of security for costs are typical in legal regimes that employ a “costs follow the event” rule. There is no such rule in ICSID cases. Indeed, the majority of ICSID tribunals (64 per cent) have declined to adjust costs as the previous article of one of the authors showed.

This contrasts with the usual position in commercial arbitration and under the UNCITRAL rules. In arbitration conducted under those rules, tribunals declined to adjust costs in less than one-third of cases (31 per cent).

Security for costs is undoubtedly a somewhat uncomfortable fit in the ICSID context, where there is no general rule or even practice of costs adjustment in the first place. This point has been noted by the Libananco tribunal (“Nor, moreover, is it in fact standard practice for ICSID tribunals invariably to make an award of costs against a losing party”), as well as a number of claimants who successfully resisted security for costs applications (including the claimant in the recent case of Eurogas Inc. v Slovakia, who drew the tribunal’s attention to the fact that “the trend in investment arbitration is not to automatically shift costs to an unsuccessful claimant”), and may be one reason why ICSID tribunals have generally been reluctant to make security for costs awards. The tribunal is effectively invited at a very early stage to prejudge how it will exercise an extremely broad discretion in relation to costs much later in the proceedings, or at least to put in place safeguards which will only have any relevance if its discretion is exercised in a particular way.

Third, the president of the tribunal in RSM v St Lucia left open the question whether a tribunal needs to have subject matter jurisdiction (which was undisputed between the parties) to order provisional measures. Gavin Griffiths QC was strongly (and persuasively) of the view that this would be illogical given that the state may well be seeking security for costs on the basis of the lack of such jurisdiction. It would indeed seem odd to require a state to establish jurisdiction in order to avail itself of provisional measures to protect its rights.

Finally, the central and most controversial division among the majority in RSM v St Lucia related to the relevance of “third-party funding” to security for costs decisions. Griffiths was of the view that in most treaty cases, an investor’s lack of funds will not be sufficient to justify an order for security for costs. He reasoned that a state should take the investor as it finds it and, moreover, the lack of funds will often arise from the underlying subject
matter of the claim. The risk that the investor’s ability to avail itself of its treaty rights will be undermined by such an order means a tribunal should be reluctant to require security for costs.

This reasoning has persuaded other tribunals. In the ICSID case of Commerce Group Corp and San Sebastian Gold Mines, Inc v El Salvador, the ad hoc committee dismissed an application for security in 2012, stating that “the respondent’s request, if granted, might seriously affect the applicant’s right to seek annulment of the award”. The tribunal in Libananco also observed that “it is in practice closer to the norm that the entity appearing as an ICSID claimant is an investment vehicle created or adapted specifically for the purpose of the investment transaction.”

However, Griffiths considered that third-party funding would normally provide such exceptional grounds since otherwise the funder would enjoy the upside of the case but not the downside (an outcome he described colourfully as the “gambler’s nirvana”).

For the president, the use of third-party funding was merely a relevant factor increasing doubts as to whether a costs award would be paid.

The award and Griffiths’ opinion in particular drew a sharp response, especially from litigation financiers, who pointed out that parties may choose to fund their claims in a variety of ways (including a capital injection from their owners or by loan or mortgage), and emphasised the careful due diligence conducted by litigation funders to avoid weak claims as well as the importance of the industry in promoting access to justice. Griffiths’ opinion also did not persuade the tribunal in Eurogas Inc v Slovakia, which recently declined to be the second ICSID tribunal to order security for costs (23 June 2015). In its brief reasoning, the Eurogas tribunal followed the view of the president in RSM v St Lucia that financial difficulties and third-party funding (which the tribunal noted has become “a common practice”) were relevant but not decisive factors in favour of a security for costs order. RSM v St Lucia was distinguished on the facts since the Eurogas claimants did not have a “proven history of not complying with cost orders”.

It is surely only a matter of time before the relevance of third-party funding is tested again in an application for security for costs, at which time the debate may well broaden to consider the way in which other fora have grappled with the issue.

One forum that might be considered is England, where the courts employ the “costs follow the event” rules, and rule 25.14 of the Civil Procedure Rules and Practice Directions allows the courts to order security for costs from a third party who has agreed to contribute to the claimant’s costs in exchange for a share of the potential proceeds of the litigation.

It has been held by the English courts that once the existence of third-party funding is admitted or proved, they may order the disclosure of information about the funder and what it stands to gain but not the terms of the funding agreement itself. Further, English courts have the power to make costs orders against third parties, although capped at the amount of the funder’s investment where the funder has not assumed active control over the litigation.

In fact, the recent procedural order in Muhammet Çap & Sehil İnşaat Endüstri ve Ticaret Ltd Sti v Turkmenistan (12 June 2015) suggests that another ICSID tribunal may soon consider the issue.

The tribunal ordered the disclosure of the existence and identity of any third-party funder as well as the terms of the funding arrangements, on the basis that this was relevant to the integrity of the process (in case of a relationship between an arbitrator and the funder) and potentially relevant to an application for security for costs.

A factor of additional relevance was that the claimants had recently changed their legal counsel to be represented by the same counsel as the claimants in Kılıç İnşaat İthalat İhracat Sanayi ve Ticaret Anonim Şirketi v Turkmenistan, where a costs order in favour of the respondent was unpaid notwithstanding that the claimant was funding annulment proceedings. The inference appears to be that a similar third-party funding arrangement may have been put in place in both proceedings, leading to an increased risk of non-payment.

As the law of investment arbitration stands, however, security for costs will be available only in exceptional situations. The facts of RSM v St Lucia were, on any view, highly unusual. Security for costs is not a silver bullet to eliminate the risk of non-payment of costs awards by impecunious claimants, even if backed by third-party funders.

**Why tribunals should make greater use of costs orders**

Another way in which tribunals can respond to the risk of non-payment of costs awards is to be more willing to make costs orders immediately following procedural skirmishes.

At present, it is extremely unusual for a tribunal to make a costs order while the proceedings are pending. Tribunals almost invariably reserve the question of costs until the final award. As an anecdotal example, the authors were involved in a case where one party introduced a large volume of new evidence, including half a dozen new witnesses, immediately before the hearing when at least one member of the tribunal had already arrived at the venue. This necessitated the vacation of the hearing and caused substantial delay. Nonetheless, the tribunal deferred the decision on costs associated with the delay, including wasted hearing preparation costs, until its final award (which remains unpaid).

After the award, of course, the tribunal is functus officio and unable to exert any influence over payment. In contrast, in the event of non-payment of a costs order made during the reference (as with any provisional measure), a tribunal is free to consider what further steps should be taken, including, potentially, suspension of the proceedings.

This is now the situation in RSM v St Lucia, where the claimant failed to provide the required security. In April 2015, the tribunal stayed the proceedings and granted St Lucia leave to apply for final dismissal of the claims in the event that the claimant fails to put up the funds within a further six months. While it seems likely that orders for security for costs as granted in St Lucia will remain exceptional, if tribunals were prepared to make interim costs orders following procedural battles that may to some degree redress the problem with unpaid costs decisions highlighted by the study.

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