AWARDING COSTS IN ARBITRATION

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I INTRODUCTION

In a domestic arbitration conducted in New Zealand, unless the parties agree otherwise, the arbitral tribunal is required by clause 6(1) of Schedule 2 of the Arbitration Act 1996 to fix and allocate the costs and expenses of the arbitration in its award made under Article 31 of Schedule 1 of the Act or any additional award made under Article 33(3) of Schedule 1.

The same rule applies to international arbitrations conducted in New Zealand if the parties so agree.

Clause 6 defines the costs and expenses of the arbitration as the legal and other expenses of the parties, the fees and expenses of the arbitral tribunal and any other expenses related to the arbitration.

Unless the parties agree otherwise the parties are taken as having agreed that, if a party makes an offer to another party to settle a dispute or part of the dispute and the offer is not accepted and the award of the arbitral tribunal is no more favourable to the other party than was the offer, the arbitral tribunal, in fixing and allocating the costs and expenses of the arbitration, may take the fact of the offer into account in awarding costs and expenses in respect of the period from the making of the offer to the making of the award.[1]

Clause 6(3) of Schedule 2 empowers the High Court to vary the amount or allocation of the costs and expenses fixed and allocated by the arbitral tribunal if satisfied that the amount or allocation or both is unreasonable in all the circumstances.

We can take it therefore that any award fixing and allocating the costs and expenses of the arbitration must be reasonable in all the circumstances, but the Act provides no explicit guidance as to what constitutes a reasonable award.

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1 Clause 6(2)(a).

The aim of this session is to generate a discussion about the way arbitrators generally fix and allocate costs in arbitrations. To get the ball rolling I propose to examine three questions:

(1) A reasonable contribution to the successful party's costs and expenses or to fully compensate the successful party for the costs and expenses it has incurred in relation to the arbitration?

(2) If the aim is to provide a reasonable contribution, what guidance should be taken from the High Court Rules dealing with costs awards and in particular the daily rates and time allocations deemed to be reasonable for the purposes of party and party costs in the High Court?

(3) If the aim is to provide an indemnity what, if any, limits should be imposed in fixing the quantum of the successful party's costs and expenses?

II CONTRIBUTION OR INDEMNITY

A Reasonable Contribution

There is a respectable body of literature and judicial authority in support of the reasonable contribution approach.

In *Arbitration* by Anthony Willy (Brookers Ltd 2010) the author refers to the "threshold rule" that, for public policy reasons, costs will be a reasonable contribution and not a total recovery; the award of indemnity costs being reserved for exceptional cases.

Similarly in *Brookers Arbitration* by Green & Hunt the authors refer to the general rules that (a) costs follow the event; and (b) that the successful party is entitled to a reasonable contribution towards costs unless there are special circumstances making it fair to depart from that principle: *Marx v A-G* [1974] 2 NZLR 372.

In *Rosser v Rosser* (CIV-2004-404-2564, High Court Auckland 10 August 2004) Randerson J held that an arbitrator has a broad discretion in fixing costs and that the discretion must be exercised judicially and in accordance with established principle: *Angus Group Limited v Lincoln Industries Limited* [1990] 3 NZLR 82.

At paragraph [29] he said that:

> Ordinarily a successful party is entitled to a reasonable contribution towards costs unless there are special circumstances making it fair to depart from this principle: Marx v Attorney General [1974] 2 NZLR 372.

This approach is consistent with other judgments of the High Court including *Ambler Homes Ltd v Powell* (HC Auckland M 618-SW99, 30 November 1999) in which Nicholson J found that unsuccessful parties to an arbitration, involving a building dispute, should pay a reasonable contribution to the costs which their actions put the builder to. He took into account aspects of balance, proportionality and equity and found it was just and appropriate to order the owners to pay costs of approximately half of the builder's actual expenditure together with the arbitrator's full costs.

The reasonable contributions approach seemed to be the norm in 2006 when Stephen Mills QC presented his findings to the First New Zealand Arbitration Day Seminar in June 2006. Stephen sent a questionnaire to selected leading arbitrators posing four questions including one about the percentage of actual costs they would consider reasonable for a successful litigant to receive where there was no prior agreement as to the approach to costs and no particular factors that would justify an uplift or a decrease.

The question proved difficult to answer with any finality but the answers indicated that a range of 75% to 85% of actual costs would not be unusual.

B Full Indemnity

On the other hand in *Marble & Granite Centre Ltd v R & Y Emery* (M 1384/98, High Court Auckland 30 September 1998), after referring to the Court system, which is predicated on the basis of reasonable contribution towards the costs of a party which is successful, Robertson J said:

> There are other approaches to costs awards and in an arbitral setting the exact approach of the courts need not be replicated.

The authors of *Williams & Kawharu on Arbitration* refer to the developing trend in domestic commercial arbitration and in international commercial arbitration to award a successful party the whole of its costs and at para 16.8 they say it is becoming common to require the parties to share equally the costs of the arbitration but to award the successful party the whole of its own legal and other costs and expenses.

The authority cited for the latter statement is *Ronke v Meyer* (HC Hamilton CP198/91 27 October 1992). This case involved an application to set aside the final award of an arbitrator insofar as it related to costs. In his award the arbitrator said that, in arbitration proceedings, it was usual for the successful party to be awarded claimed that he thereby fettered his discretion as to costs.

Doogue J started his analysis by recording that an arbitrator must exercise his discretion as to costs judicially and that paragraph 9 of the Second Schedule

of the Arbitration Act 1908 authorised the arbitrator to award costs to be paid as between solicitor and client. Doogue J acknowledged that, in saying it was usual for the successful party to be awarded its entire costs, the arbitrator may have been overstating the matter but, if read in the sense that in the ordinary way costs follow the event and that the arbitrator was acknowledging his entitlement to award full costs, there was nothing wrong about the statement.

While this judgment confirms that an arbitrator may award a party full costs it does not seem to me to establish that it is usual to do so.

There is no doubt that an arbitrator has power to award full costs. The rationale for doing so is said by the authors of *Williams & Kawharu* to be that a person who brings a claim in order to recover what they are already entitled to should not have to pay for the cost of pursuing that claim. Equally, a person who has been forced to defend himself or herself against an unwarranted claim should not have to pay to do so.

This rationale seems to be logical and reasonable. The question is whether it now represents an established principle which arbitrators can apply. It has not been recognised as such by judges in New Zealand but it may be time for them to reconsider the traditional approach. After all the rationale for limiting costs to a reasonable contibution may not be relevant to arbitrations.

The authors of *McGechan on Procedure* say that the less than full costs recovery principle attempts to balance the following objectives:

(a) Access to justice;

(b) Avoiding the successful party ending up seriously out of pocket in terms of its litigation costs;

(c) Encouraging attempts to resolve disputes short of litigation, or during litigation, i.e. some disincentive to resort to litigation or to pursue it; and

(d) Encouraging engagement of a solicitor and counsel of the appropriate level of skill and experience, and encouraging them to conduct the litigation efficiently. Conversely to discourage inefficiency and overcharging and also "overkill", i.e. an unjustified Rolls Royce approach to the case.

In *Bradbury v Westpac Banking Corporation* [2009] 3 NZLR 400 the Court of appeal described access to justice – the principle that the citizen is entitled to access to the courts, as a significant although not dominant factor supporting the New Zealand position in limiting the losing party's liability for costs.

Access to justice is clearly an issue for the public court system. But I question whether access to justice is a relevant consideration for arbitrators who are dealing with disputes which the parties have agreed, and are usually contractually bound, to refer to arbitration.

If you discount access to justice as a reason for limiting costs awards do the other objectives identified in *McGechan* justify an approach which usually denies the successful party its full costs? That is a question on which I expect opinion will be divided.

III HIGH COURT RULES

In *O v S M* [2000] 3 NZLR 114 Nicholson J said:[2]

> [44] The question whether the amount for allocation of costs and expenses is unreasonable in all the circumstances is to be decided by applying the principles on which the discretion to award costs is exercised in the High Court and District Courts ... .

At paragraph [45] he identified the appropriate considerations as being:

> … the relative degrees of success of outcome, the importance of the amounts in issue to the parties, attitude to settlement, the lengthening of the hearing by conduct and a reasonable contribution in all the circumstances to the costs which the more successful party actually and reasonably incurred.

Rules 14.1 to 14.10 of the High Court Rules now contain a comprehensive set of principles governing costs in the High Court. The District Court Rules contain an equivalent regime for that court.

A General Principles

While rule 14.1 leaves all matters relating to costs of or incidental to a proceeding or a step in a proceeding to the discretion of the Court the discretion is not unfettered. Since 2000 it has been qualified by rules 14.2-14.10, the first of which contains the following general principles applicable to the determination of costs:

(a) the party who fails with respect to a proceeding or an interlocutory application should pay costs to the party who succeeds;

(b) an award of costs should reflect the complexity and significance of the proceeding;

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2 Adopted as correct by Paterson J in *Young v Kerr Construction* 16 PRNZ 311 who said that the High Court had said the same thing on several occasions.

(c) costs should be assessed by applying the appropriate daily recovery rate to the time considered reasonable for each step reasonably required in relation to the proceeding or interlocutory application, the rates and time allocation being defined in rules 14.3 – 14.5;

(d) an appropriate daily recovery rate should normally be two-thirds of the daily rate considered reasonable in relation to the proceeding or interlocutory application;

(e) what is an appropriate daily recovery rate and what is a reasonable time should not depend on the skill or experience of the solicitor or counsel involved or on the time actually spent by the solicitor or counsel involved or on the costs actually incurred by the party claiming costs;

(f) an award of costs should not exceed the costs incurred by the party claiming costs; and

(g) so far as possible the determination of costs should be predictable and expeditious.

B Time Bands

A determination of what is a reasonable step must be made by reference to:

(a) band A if a comparatively small amount of time is considered reasonable; or

(b) band B if a normal amount of time is considered reasonable; or

(c) band C if a comparatively large amount of time for the particular step is considered reasonable.

For the purposes of rule 14.2(c) a reasonable time for a step is the time specified for it in Schedule 3 (attached) or a time determined by analogy with that schedule if Schedule 3 does not apply or the time assessed as likely to be required for the particular step if no analogy can usefully be made.

C Daily Recovery Rates

The current daily recovery rates, which are fixed by the High Court Rules Committee in consultation with the New Zealand Law Society, the New Zealand Bar Association and the Legal Services Agency, are:

- Category 1 proceedings - $1,320.00;
- Category 2 proceedings - $1,990.00;
- Category 3 proceedings - $2,940.00.

The aim of rules 14.2(d) and (e) is to allow two-thirds of costs considered or deemed to be reasonable for the proceeding or the particular step in the proceeding. Actual time spent and costs incurred are irrelevant.

In practice these rates have not proved to be sufficient. In November 2008 Sir Rupert Jackson was appointed to carry out a fundamental review of the rules and principles governing the costs of civil litigation in the UK and to make recommendations in order to promote access to justice at proportionate cost. His final report was published in January 2010 and the recommendations are being taken forward in a variety of ways.

In the course of his review Sir Rupert consulted extensively including with the judiciary and practitioners in New Zealand. At page 603 of the preliminary report, in his discussion of the New Zealand civil cost regime Sir Rupert stated [at 4.5]:

> As stated in rule 14.2(d) [of the High Court Rules] above, the scale fees were originally intended to approximate to two-thirds of actual costs. It is clear however from talking to your practitioners that in practice scale fees generally fall far short of that. The width of that gap depends upon the type of litigation and the location of the lawyers. The scales constitute uniform rates across the whole of New Zealand, even though the overheads and charging rates of lawyers in, say, Auckland will be very different from those of lawyers in more remote areas. Some practitioners told me that recovery in their cases was in the region of 30-40%. Others quoted higher or lower percentages than that. One commercial litigator informed me that recovery in his cases was about 10% of actual costs.

The numerous applications in recent years for increased costs and indemnity costs probably reflect litigants' continuing dissatisfaction with the costs available in the High Court.

This costs regime was not in force when Nicholson J delivered his judgment in *O v SM*, and there is no suggestion in that or later judgments that arbitrators are bound by the two thirds rule or the time allowances and daily recovery rates deemed to be reasonable for the purposes of costs awards in the Courts.

Under clause 6(1) of Schedule 2 the arbitrator's focus should be on the actual legal and other expenses of the parties not the expenses deemed to be reasonable for the purposes of High Court litigation.

Nevertheless some of the general principles in rule 14.2 (a, b, f, and g in particular) seem to me to be relevant and the time allowances may be a

useful guide where there is a dispute about the reasonableness of the successful party's costs.

D Increased Costs

Under r 14.6 (1) the court may order a party to pay increased costs if:

(a) the nature of the proceeding or the step in it is such that the time required by the party claiming costs would substantially exceed the time allocated under band C; or

(b) the party opposing costs has contributed unnecessarily to the time or expense of the proceeding or step in it by—

  (i) failing to comply with the rules or with a direction of the court; or

  (ii) taking or pursuing an unnecessary step or an argument that lacks merit; or

  (iii) failing, without reasonable justification, to admit facts, evidence, documents, or accept a legal argument; or

  (iv) interrogatories, or other similar requirement under these rules; or

  (v) failing, without reasonable justification, to accept an offer of settlement whether in the form of an offer under rule 14.10 or some other offer to settle or dispose of the proceeding; or

(c) the proceeding is of general importance to persons other than just the parties and it was reasonably necessary for the party claiming costs to bring it or participate in it in the interests of those affected; or

(d) some other reason exists which justifies the court making an order for increased costs despite the principle that the determination of costs should be predictable and expeditious.

This rule does not allow the court to award a percentage of actual costs, just an uplift of up to 50% of scale costs – *Holdfast NZ Ltd v Selleys Pty Ltd* (2005) 17 PRNZ 897.

E Indemnity Costs

The court may order a party to pay indemnity costs if:

(a) the party has acted vexatiously, frivolously, improperly, or unnecessarily in commencing, continuing, or defending a proceeding or a step in a proceeding; or

(b) the party has ignored or disobeyed an order or direction of the court or reached an undertaking given to the court or another party; or

(c) n.a.

(d) n.a.

(e) the party claiming costs is entitled to indemnity costs under a contract or deed; or

(f) some other reason exists which justifies the court making an order for indemnity costs despite the principle that the determination of costs should be predictable and expeditious.

In *Bradbury v Westpac Banking Corporation* [2009] 3 NZLR 400 (CA) at [27] the Court of Appeal recognised the following circumstances in which indemnity costs had been ordered:

(a) the making of allegations of fraud knowing them to be false and the making of irrelevant allegations of fraud;

(b) particular misconduct that causes loss of time to the Court and to other parties;

(c) commencing or continuing proceedings for some ulterior motive;

(d) doing so in wilful disregard of known facts or clearly established law;

(e) making allegations which ought never to have been made or unduly prolonging a case by groundless contentions … the "hopeless case".

The Court also summarised the difference between standard costs, increased costs and indemnity costs as follows:

(a) Standard scale applies by default where cause is not shown to depart from it;

(b) Increased costs may be ordered where there is failure by the paying party to act reasonably; and

(c) Indemnity costs may be ordered where that party has behaved either badly or very unreasonably.

F Contractual Right to Indemnity Costs

Where a claimant is entitled to indemnity costs under a contract or deed the Court, and I would suggest arbitrators, are required to decide what tasks attract a costs indemnity on a proper construction of the contract; whether the task undertaken was one of those contemplated in the contract; whether the steps

taken were reasonably necessary in pursuance of that task; whether the rate at which they were then charged was reasonable having regard to the principles normally applicable to solicitor/client costs; and whether any other principles drawn from the general law of contract would in whole or in part deny the claimant its prima face right to judgment.

These are all matters of objective assessment, not discretion - *Frater Williams & Co Limited v Australian Guarantee Corporation (NZ) Ltd* (1994) 2 NZ Conv 191, 873 per Honey Assn [2009] NZCA 595 at [20].

IV LIMITS ON QUANTUM

Bearing in mind that costs awards must be reasonable in all the circumstances, and that they should reflect balance, proportionality and equity there are limits to an award of indemnity costs.

The arbitrator has to assess whether whether the steps taken in the proceeding were reasonably necessary; the time taken was reasonable and; the hourly or other rates charged were reasonable. This will normally involve an examination of the invoices containing details of the work carried out and the rates charged.

As Harrison J put it in *Bradbury v Westpac* (2008) 18 PRNZ 859 (HC) the appropriate course for assessing what actual costs were reasonably incurred is to (1) determine whether a particular item of expenditure is reasonably incurred - for example, preparation of a statement of defence; (2) fix what would be a reasonable allocation of actual costs, measured by reference to an appropriate time taken and allowing for the significance and complexity of the category of work; and (3) quantify the costs by reference to a median hourly rate reasonably applicable to it.

At paragraph [210] His Honour said:

> In assessing what is reasonable I have been greatly assisted by Mr Kos' provision of schedules of scale costs, a breakdown and analysis of actual costs and witnesses expenses and a thorough chronology of steps taken. All give some indication of the intensity of this proceeding ... Mr Kos has also provided a breakdown of the hourly rates charged for senior counsel and partners and solicitors within Chapman Tripp. While the rates may seem high to a layman, I am satisfied that they are reasonable based upon my own knowledge of rates charged by leading counsel and leading commercial law firms.

If the arbitrator is unfamiliar with the going rates charged by lawyers he or she could refer the invoices to an independent lawyer for assessment or could ask for evidence about the matter.

SCHEDULE 3 OF HIGH COURT RULES

	General civil proceedings	Allocated days or part days		
		A	**B**	**C**
	Commencement			
1	Commencement of proceeding by plaintiff	1.6	3	10
2	Commencement of defence by defandant	1	2	6
	Other pleadings and notices			
3	Reply	0.4	0.8	2.4
4	Counterclaim	0.8	1.6	4.8
5	Cross-notice between defendants	0.6	1.2	4
6	Third party notice and statement of claim	1.2	2.4	7
7	Notice of appearance	0.2	0.2	0.2
8	Notice of appearance with protest to jurisdiction	0.3	0.6	2
9	Pleading in response to amended pleading (payable regardless of outcome except when formal or consented to)	0.3	0.6	2
	Case management			
10	Preparation for first case management conference (including discussion about discovery)	0.2	0.4	1
11	Filing memorandum for first or subsequent case management conference or mentions hearing	0.2	0.4	1
12	Appearance at mentions hearing or callover	0.2	0.2	0.2
13	Appearance at first or subsequent case management conference	0.3	0.3	0.7
14	Preparation for and appearance at issues conference	-	0.5	1
15	Preparation for and appearance at pre-trial conference	-	0.5	1
	Interrogatories, discovery and inspection			
16	Notice to answer interrogatories	0.4	1	4
17	Answer to interrogatories	0.4	1	4
18	Notice to admit facts	0.4	0.8	2.4
19	Admissions of facts	0.4	0.8	2.4
20	List of documents on discovery	0.7	2.5	7
21	Inspection of documents	0.5	1.5	6
	Interlocutory applications (including applications for summary judgment and for review of interlocutory decisions)			
22	Filing interlocutory application	0.3	0.6	2
23	Filing opposition to interlocutory application	0.3	0.6	2
24	Preparation of written submissions	0.5	1.5	3
25	Preparation by applicant of bundle for hearing	0.4	0.6	1

26	Appearance at hearing of defended application for sole or principal counsel	The time occupied by the hearing measured in quarter days		
27	Second and subsequent counsel if allowed by court	50% of allowance for appearance for principal counsel		
28	Obtaining judgment without appearance	0.3	0.3	0.5
29	Sealing order or judgment	0.2	0.2	0.2
	Trial preparation and appearance			
30	Plaintiff's or defendant's preparation of briefs or affidavits	1.5	2.5	5
31	Plaintiff's preparation of list of issues, authorities, and common bundle	1.5	2.5	5
32	Defendant's preparation of list of issues, authorities, and common bundle	1	2	4
33	Preparation for hearing	2	3	5
34	Appearance at hearing for sole or principal counsel	The time occupied by the hearing measured in quarter days		
35	Second and subsequent counsel if allowed by court	50% of allowance for appearance for principal counsel		
36	Other steps in proceeding not specifically mentioned	As allowed by the court		