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# **Do Alternative Fee Arrangements Have a Place in International Arbitration?**

**By**

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# Do Alternative Fee Arrangements Have a Place in International Arbitration?

by IAN MEREDITH and SARAH ASPINALL

## 1. INTRODUCTION

Research by *The Lawyer* reveals that some of London's leading solicitors undertook up to 450 per cent more "no win, no fee" cases in 2003–2004 than in the previous 12 months. As parties with experience of alternative fee arrangements become increasingly drawn into international arbitral disputes, the question arises whether such innovative arrangements can validly be utilised, both to regulate the relationship between the party and its legal advisers and to operate as the measure of the costs recoverable by the successful party. This article examines the public policy objections in different jurisdictions and the applicable professional conduct rules and other regulatory provisions that may render alternative fee arrangements unenforceable. It also explores the conflict of laws and the difficulties facing an arbitral tribunal in assessing alternative fee arrangements as a measure of costs.

## 2. GENERAL PRINCIPLES

"Alternative fee arrangement" is the generic term used to describe fee arrangements between solicitors and clients, where payment of the solicitors' fees is dependant upon the result of the litigation or arbitration. Sometimes, the term "no win, no fee" is used. One type of fee arrangement is traditionally called a conditional fee agreement (CFA). Under a CFA solicitors can charge the client the usual charge out rate plus an uplift (or "success fee") if they have pursued their client's case successfully. In England and Wales, the uplift or success fee may be as high as 100 per cent of the usual charging rate. The content of CFAs must comply with the provisions of the Conditional Fee Agreements Regulations 2000. Another type of fee arrangement whereby the solicitors are paid only if they have pursued the client's case successfully is traditionally called a contingency fee agreement. If the case is lost, no fee is payable to the solicitors but if won the solicitors recover a percentage of the winnings. This system (common in the United States) is prohibited in England and Wales in contentious proceedings by r.8 of the Solicitors Practice Rules 1990.

None of the main institutional rules (UNCITRAL, ICC, LCIA and AAA) make express reference to success fees or other alternative fee arrangements, which is interesting. Therefore, when looking at the enforceability of fee agreements, it is necessary to look at: the law of the country in which the arrangement is entered into; the law of the seat (i.e. the place of the arbitration); and the law of the country where the arbitral award will be enforced.

Clearly, if a party and its lawyers enter into a fee arrangement in a country which has a public policy objection to forms of remuneration which connect the outcome to the level of payment for legal services, the agreement is likely to be unenforceable and the law firm may contravene applicable professional conduct rules or other relevant regulatory provisions. If the tribunal is asked by a successful party to utilise a success fee or alternative fee payable by that successful party to its legal advisers as the measure of costs to be awarded against the unsuccessful party, in order to ensure the enforceability of the award, consideration ought to be given to the public policy under the law of the seat (affecting the tribunal's ability to make the award) and the public policy in the country or countries of likely enforcement, which are likely to have an impact on the tribunal's view on what constitutes international public policy. If an award offends the public policy of the seat, it may be set aside on challenge; if it offends public policy in the country of enforcement, it may not be upheld by a state court operating under the New York Convention, or any applicable reciprocal enforcement treaty.

### 3. RECOVERABILITY OF COSTS GENERALLY

When determining the recoverability of costs in general, the tribunal must have regard to the level of those costs and whether they should, as an essential requirement of fairness, limit those costs in some way. To ascertain whether the tribunal has power to award the successful party its costs, the parties must first see whether their arbitration agreement has any express provision, which is unlikely. However, it may specify that a set of institutional rules will govern the arbitration. These rules leave a broad discretion to the arbitral tribunal as to how it should exercise its powers to award costs but do not provide it with much guidance. For example, the rules of UNCITRAL, the American Arbitration Association (AAA), the ICC, the LCIA, the Stockholm Chamber of Commerce (SCC) and WIPO each make it clear that the tribunal has power to award the successful party its representational costs.

The ICC Rules state that the arbitral tribunal shall decide which parties should bear the costs and in what proportion (Art.31(3)). The UNCITRAL Rules state that costs shall, in principle, be borne by the unsuccessful party but the tribunal may apportion each of such costs between the parties as it is considered reasonable taking into account the circumstances of the case (Art.40). The LCIA Rules state that, unless otherwise agreed in writing, the tribunal shall award costs on the general principle that costs should reflect the parties' relative success and failure, except where it appears that this general approach is inappropriate (Art.28(3)). The AAA Rules take the same approach as the UNCITRAL Rules (Art.31). The Singapore International Arbitration Centre Rules state that the tribunal shall have the authority to award that all or a part of the legal or other costs of the parties be paid by another party (Art.30(3)). The SCC Rules provide that, unless the parties agree otherwise, the tribunal may, at the request of a party, order the losing party to compensate the other party for legal representation and other expenses for representing its case (Art.41). The International Centre for Settlement of Investment Disputes (ICSID) Convention/Rules state that the tribunal may decide that the costs shall be borne entirely, or in particular shares, by the parties (Art.28(1)(b)). The China International Economic and Trade Arbitration Commission (CIETAC) Arbitration Rules provide that the arbitral tribunal has the power to decide in the arbitral award that the losing party shall pay the winning party as compensation a proportion of the expenses reasonably incurred by the winning party in dealing with the case (Art.46).

The practice under which the unsuccessful party is expected to pay or contribute towards the other party's legal costs is by no means a universal practice, either in international arbitrations, or in national systems of law. Even where a tribunal decides that some contribution towards the winning party's costs should be ordered, there is the problem of deciding upon what basis, and when, this contribution should be assessed. Practical problems of this kind lead many international tribunals to refrain from ordering the unsuccessful party to pay the legal costs of the winning party, or simply to order the losing party to pay an arbitrarily chosen fixed sum towards the winner's legal costs. Most international tribunals that decide to make an award of costs in favour of the winning party tend to adopt a "broad-brush" approach in assessing the amounts to be paid. Any specific provisions of the law of the seat must be taken into account. The practice varies from place to place. In Austria and Germany, for example, it is normal for the reasonable costs of legal representation to be ordered against the losing party. In the United States, by contrast, each party usually pays the fees of its own lawyer and, unless otherwise provided in the arbitration agreement (or in any relevant arbitration rules), lawyers' fees are not considered part of the expenses of the arbitration.

The costs which are recoverable, from an objective point of view should be "reasonable" or "necessary". In essence, were the activities for which the costs were incurred necessary and, if so, are the amounts claimed reasonable? The tribunal should make its assessment without the benefit of hindsight. It should be assessed as at the time the lawyer was instructed, on the basis that a party paid its costs at a time when it did not know whether those costs would

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be recovered and so must have considered those costs to be reasonable at the time. This was the view Judge Holtzmann took in a case before the Iran-US Claims Tribunal<sup>1</sup>:

“Nor should the tribunal neglect to consider the reality that legal bills are usually first submitted to businessmen. The pragmatic fact that a businessman has agreed to pay a bill, not knowing whether or not the tribunal would reimburse the expenses, is a strong indication that the amount billed was considered reasonable by a reasonable man spending his own money, or the money of the corporation he serves. That is a classic test of reasonableness.”

In ICC Case No.8786 of 1997, it was decided that the arbitrator is not bound by any local procedural law or practice and it is therefore not relevant what lawyers' fees would be customary, or provided for. It is in the free discretion of the arbitrator to decide what lawyer's fees are “reasonable” pursuant to Art.31(1) of the ICC Rules of Arbitration. However, when applying the test of reasonableness, arbitrators may take into account the fees customary in a particular jurisdiction. For example, in ICC Case No.6962 (decided under the old Art.20 of the ICC Rules, now Art.31(1)), the application of an official fee schedule to a party's statement of legal costs was regarded as representative of the amount of fees which the claimant would have to pay and it was held that such a statement of costs fitted the concept of “normal” (now “reasonable” under Art.31(1)) legal fees pursuant to the ICC Rules of Arbitration. The costs of the parties can vary dramatically (as shown in ICC Case No.8786). This poses a difficulty for the tribunal, who will ordinarily compare the costs of both parties and, provided there is no significant discrepancy, will not intervene.<sup>2</sup> The tribunal has a wide discretion. But how should the tribunal exercise its discretion when the costs to be awarded are calculated on the basis of a contingency, or conditional fee arrangement? This may depend on the law of the country in which the arrangement is entered into, the law of the seat of the arbitration, or the law applicable in the country of enforcement.

### 4. THE APPROACH OF PARTICULAR COUNTRIES

The general principle of English law is that success fees are unenforceable, save where the arrangement meets the criteria of allowable CFAs. Allowable CFAs are set out in the Courts and Legal Services Act 1990, s.58, as amended by the Access to Justice Act 1999. The CFA must be in writing and must not relate to proceedings which cannot be the subject of an enforceable CFA (s.58(3)(a) and (b)) and it must state the percentage by which the amount of the fees which would be payable if it were not a CFA is to be increased (s.58(4)(b)). Therefore, CFAs are permitted under English law but not contingency fee agreements. By s.58A(4), CFAs are not limited to contentious business in the courts but include “any sort of proceedings for resolving disputes, whether commenced or contemplated”. Therefore, the CFA is also permitted in arbitration proceedings.<sup>3</sup>

Provided the CFA complies with the provisions of the Courts and Legal Services Act 1990 and the Conditional Fee Agreements Regulations 2000, it is lawful and enforceable under English law. If the CFA is governed by English law (i.e. was entered into by a solicitor practising in England and Wales) and the seat of the arbitration is in England or Wales, the Arbitration Act 1996 applies. It has no express provisions dealing with CFAs but tribunals have a wide discretion to award such costs as they think fit (s.63(3)). Unless the parties have agreed, in an arbitration agreement entered into *after* the dispute has arisen, what costs of the arbitration are recoverable, the tribunal may determine the recoverable costs “on the basis that there shall be allowed a reasonable amount in respect of all costs reasonably incurred”

<sup>1</sup> 8 Iran—US C.T.R 329.

<sup>2</sup> *Protech Projects v Al-Kharafi* [2005] EWHC 2165 (Comm), October 14, 2005.

<sup>3</sup> However, it may be argued that the Arbitration Act 1966 is a standalone statute—see *Lesotho Highlands Development Authority v Impregilo Spa* [2005] UKHL 43 and *Fence Gate Ltd v NEL Construction Ltd* [2001] 82 Con.L.R. 41.

and “any doubt as to whether costs were reasonably incurred or were reasonable in amount shall be resolved in favour of the paying party” (s.63(5)(a) and (b)).

There are practical problems in assessing awards of costs. Should the tribunal award them on a conditional fee basis, or assess them on an *ad valorem* basis related to the amount claimed (rather than the amount awarded), in the same way as the ICC’s own administrative charges are assessed (Art.31(1))? In the leading work on the practice of international commercial arbitration, Redfern and Hunter observe that one author was involved in two separate cases in 1998 when contingency fees were expressly claimed as an element of the claim for costs,<sup>4</sup> but currently there is almost no detailed commentary on the consideration applied by the tribunal. This is undoubtedly a developing area of international arbitral practice.

*Benaim UK Ltd v Davies Middleton & Davies Ltd*<sup>5</sup> upheld the decision of the arbitrator that a conditional fee agreement with contingent uplift (determined in part by the amount of the client’s winnings) was valid. The definition of success fee varied the percentage uplift by stages from 40 per cent for recovery up to £200,000, to 100 per cent for recovery over £1 million, subject to the success fee so calculated not exceeding 25 per cent of the amount recovered. Such a capping provision is expressly contemplated by the Conditional Fee Regulations and satisfied the requirements of s.58 of the Act. This decision would seem to be a natural progression in public policy in England and Wales in this area of funding.

There are no express provisions relating to success or alternative fees in the legislation of the following countries: Australia, Austria, Canada, China, Federal Republic of Nigeria, France, Hong Kong, India, Indonesia, Italy, Kenya, Malaysia, Malta, Mexico, Netherlands, New Zealand, Singapore, South Africa, Spain, Sri Lanka, Sweden, Switzerland, Thailand, United States and Zimbabwe. In Germany success fees are expressly forbidden by s.49b(2) of the Rules governing lawyers in the Federal Republic of Germany (*Bundesrechtsanwaltsordnung*):

“Agreements under which remuneration or the amount of fees depend on the outcome of the case or on the success of the *Rechtsanwalt*’s work (no win, no fee) or under which the *Rechtsanwalt* keeps a part of the award made by the Court as a fee (*quota litis*) are not permitted.”

A recent reform of the Federal Attorneys Fees Act, which came into force in 2004, prohibits contingency or conditional fee arrangements. Therefore, a German party may raise a public policy defence against an award for payment by it of costs based on a conditional fee arrangement if enforcement proceedings are brought in Germany. However, the *lex arbitri* or the *lex causae* may allow this kind of agreement.

CFAs are strictly limited in the domestic French context. However, the issue is not of such importance as to constitute a matter of “international public policy”. For international arbitral awards to be unenforceable they must be manifestly contrary to international public policy. Although the concept of international policy is vague, the French Supreme Court in civil matters has defined it as “those principles of universal justice which are considered in French opinion as possessing absolute international value.” In Egypt CFAs are recognised and legal, provided the uplift on lawyers’ fees does not exceed between 5 and 20 per cent.

In Mexico, the Commercial Code was amended in 1989 to incorporate a new title on arbitration, which was replaced by a wholly new arbitration chapter in 1993. The reforms enacted the UNCITRAL Model Law on arbitration with minor modifications. Mexico also ratified the New York Convention. CFAs are legal in Mexico but it is not considered common and ethical to work on a pure contingency basis. However, a mixed fee arrangement is quite

<sup>4</sup> Alan Redfern and Martin Hunter, *Law and Practice of International Commercial Arbitration* (Thomson, London, student edn, 2003), 8–89.

<sup>5</sup> [2004] EWHC 737 (TCC).

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common. There is no objection to the so-called *cuota litis* but the fee should be “reasonable”. The tribunal is free to determine which party shall bear such costs and the proportion of those costs as it deems reasonable.

In Turkey, enforcement of an arbitral award is governed by Arts 43–45 of the International Private Procedural Law and the New York Convention. Pursuant to Art.164 of the Law of Attorneys, a CFA needs to incorporate details of the time to be spent by the lawyer and the fees payable for the time spent. A percentage of the value of the amount claimed in the action can be agreed, provided this percentage does not exceed 25 per cent.

In Sweden conditional fee arrangements are generally not recognised by the courts. A successful party will be awarded their reasonable costs in an arbitration. However, the courts are likely to enforce an award as to costs incorporating a CFA, if the tribunal making the award had decided such fees were reasonable in the circumstances.

Contingency fees are forbidden in Switzerland, being deemed unethical.

In Argentina, the amount of all legal fees are fixed by state courts (National Code of Civil and Commercial Procedure, Art.772). Despite this, the enactment of Law 22432 in 1995 meant parties to arbitration proceedings are free to negotiate fees with arbitrators and lawyers, thereby liberalising the procedure of fixing the professional fees of lawyers. Parties may also give the power to the tribunal to fix the lawyers’ fees. Before the enactment of Law 22432, the Argentine Supreme Court had consistently ensured that legal fees fixed by lower courts to lawyers participating in arbitrations were reasonable. In applying a standard of reasonableness, the court disregarded Law 21838 under which the amount of lawyers’ fees is calculated in accordance with the amounts claimed in the dispute.

### 5. THE ROAD AHEAD

There seems little doubt that there is an appetite for alternative fee arrangements in international arbitration, particularly among major conglomerates well used to such arrangements in US court proceedings. Parties are, however, less familiar with principles of cost recovery and so tend to view contingency fee arrangements as exercises in risk sharing between client and legal adviser. There seems little doubt that in the coming years the arbitration world will see more and more alternative fee arrangements and law and practice will evolve further. For parties considering such arrangements, consideration ought to be taken of the current state of the law of the seat and any potential countries in which an award may be enforceable. It is one thing to regulate the relationship between client and lawyer by an alternative fee arrangement, legal and compliant with professional conduct rules in the country in which it will be enforced as between client and lawyer, and quite another to seek to use that alternative fee arrangement as the measure for cost recovery. In such circumstances, there are many jurisdictions around the world in which material issues will arise on enforcement: and there are many arbitrators, schooled in the law and professional conduct rules of such countries, who are likely to be reluctant to adopt such a measure.