ARTICLE

Contextualizing Cost Shifting: A Multimethod Approach

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Legal scholars devote a great deal of energy to understanding how judges allocate expenses in litigation — rules designed to encourage lawyers to bring cases, to discourage socially excessive litigation, or to sanction undesirable behavior by litigants or their legal counsels. In recent years, the scholarly debate has narrowly focused on empirically evaluating and comparing the American rule ("the costs lie where they fall") and the English rule ("the loser pays the costs"). What the debate has missed, however, is a conceptual understanding of the broader factors that influence the choice between them. In other words, scholars have focused on the "seed" (rule) and not on the "soil" (context).

In this Article, I use a discrete area of litigation as an entry point into this debate. Focusing on the uniquely discretionary (or "judge-centered") litigation system of investment arbitration panels, I explore the practice of cost shifting when dealing with manifestly unmeritorious claims — a setting where the theory unambiguously predicts cost shifting. What makes this narrow domain particularly interesting is that the theoretical prediction of the application of the English rule sharply contrasts with the actual practice in the field, where the American rule dominates. The contrast between theory and practice can be used to help understand the factors that may constrain discretion beyond formal rules.

Based on empirical data obtained through descriptive statistics, interviews with arbitrators, case studies, and two survey experiments, I argue against the increasingly narrow debate on litigation costs and for the contextualization of cost shifting. As I explain, part of the problem is that the current debate over optimal fee-shifting rules very often presumes that adjudicators have no affiliation with the litigating parties, that the rules operate in systems unaffected by social pressures, and a symmetrical scheme in which both parties can bring legal claims. However, many systems of litigation operate outside of this narrow construction, opening the door to a wide variety of context-specific factors that affect the independence, accountability, and transparency of the process of rule application. In investment arbitration — the case at issue — each party nominates one of the adjudicators, who face strong social pressures in a context where only investors are generally entitled to bring claims. These factors, I argue, interact with the current discretionary rule, which could be improved in clear ways to incentivize a more robust case law. At a

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theoretical level, I advance the argument that optimal fee rules should account for the settings in which the adjudication processes operate and propose a way to think about these factors for future research. In other words, to focus more on the "soil" and less on the "seed."

I. INTRODUCTION

Litigation costs are of near universal concern.[1] This attention is not meritless; the way courts allocate legal costs can dictate the entire litigation strategy of a party before they even get to court. Cost allocation has the positive potential to encourage lawyers to bring cases, discourage inappropriate behaviour by litigating parties and their legal counsels, or punish losers who bring bad claims.[2] In fact, some argue that the question of how costs are allocated may be so influential that litigation cost rules can provide a basis on which countries compete internationally for the business of legal services — giving some nations with optimal rules a comparative advantage over others.[3]

In recent years, the debate has become narrower, focusing almost exclusively on assessing and comparing the two main approaches to addressing litigation costs — the English Rule and the American Rule.[4] Under the English rule, the loser pays litigation costs; under the American rule, each party pays its own way.[5] While this focus has generated a number of important insights applicable across legal contexts and institutions, the increasingly narrow debate also overlooks the fact that many legal arenas blur the lines between these two and other methods of allocating litigation costs.[6] Moreover, the particular focus on the effects of cost-shifting rules is

1. *See, e.g.*, RICHARD A. POSNER, LAW AND LEGAL THEORY IN ENGLAND AND AMERICA 70–73 (1996); *see also*, Mathias Reimann, *Cost and Fee Allocation in Civil Procedure: A Synthesis*, in COST AND FEE ALLOCATION IN CIVIL PROCEDURE 3, 5–6 (Mathias Reimann ed., 2012); Werner Pfennigstorf, *The European Experience with Attorney Fee Shifting*, 47 L. & CONTEMP. PROBS. 37, 39 (1984).

2. Theodore Eisenberg et al., *When Courts Determine Fees in a System With a Loser Pays Norm: Fee Award Denials to Winning Plaintiffs and Defendants*, 60 UCLA L. REV. 1452, 1456–57 (2013); Keith N. Hylton, *Fee Shifting and Predictability of Law*, 71 CHI.-KENT L. REV. 427, 444–45 (1995); J. Robert S. Prichard, *A Systemic Approach to Comparative Law: The Effect of Cost, Fee, and Financing Rules on the Development of the Substantive Law,* 17 J. LEGAL STUD. 451, 463–64 (1988); Mitchell A. Polinsky & Daniel L. Rubinfeld, *Sanctioning Frivolous Suits: An Economic Analysis*, 82 GEO. L.J. 397 (1993).

3. ALL FOR GERMAN LAW, LAW — MADE IN GERMANY 29 (2012), http://www.lawmadeingermany.de/Law-Made_in_Germany.pdf.

4. *See* Eisenberg et al., *supra* note 2; *see also* Theodore Eisenberg & Geoffrey P. Miller, *The English Versus the American Rule on Attorney Fees: An Empirical Study of Public Company Contracts*, 98 CORNELL L. REV. 327, 328–29 (2013); James W. Hughes & Edward A. Snyder, *Litigation and Settlement Under the English and American Rules: Theory and Evidence*, 38 J.L. & ECON. 225 (1995); Brian G. M. Main & Andrew Park, *The British and American Rules: An Experimental Examination of Pre-Trial Bargaining in the Shadow of the Law*, 47 SCOTTISH J. POL. ECON. 37 (2000); A. Mitchell Polinsky & Daniel L. Rubinfeld, *Does the English Rule Discourage Low-Probability-of-Prevailing Plaintiffs?*, 27 J. LEGAL STUD 519 (1998); Avery Katz, *Measuring the Demand for Litigation: Is the English Rule Really Cheaper?*, 3 J.L. ECON. & ORG. 143 (1987); Charles R. Plott, *Legal Fees: A Comparison of the American and English Rules*, 3 J.L. ECON. & ORG. 185, 185–92 (1987).

5. *See generally* John Leubsdorf, *Toward a History of the American Rule on Attorney Fee Recovery*, 47 L. & CONTEMP. PROBS. 9 (1984) (discussing the American Rule); Issachar Rosen-Zvi, *Just Fee Shifting*, 37 FLA. ST. U. L. REV. 717, 731–34 (2010) (discussing the English Rule). *See also* Dan Slater, *The Debate Over Who Pays Fees When Litigants Mount Attacks,* WALL ST. J., Dec. 23, 2008, at A8.

6. See Avery Katz & Chris W. Sanchirico, *Fee Shifting, in* PROCEDURAL LAW AND ECONOMICS (Chris William Sanchirico ed., 2012), for a general survey of the literature. See Reimann, *supra* note 1,

drifting away from a contextual understanding of litigation costs and the institutional conditions that favour one rule over another. To reorient the literature, this Article uses a discrete area of legal adjudication as the entry point into the debate.

In contrast to most domestic legal systems, international arbitration rules generally grant adjudicators broad authority to allocate costs, including the costs of lawyers for both sides as well as fees and expenses.[7] This discretionary approach is known as a "judge-centered" system and gives the adjudicators the ability to adopt the "loser pays," the "costs lie where they fall," or any other possible method and combination depending on the circumstances and merits of the case.[8] In theory, a judge-centered system could effectively address many practical problems arising from the rigidities associated with the English and American rules. For instance, it may avoid overwhelming parties with reasonable but losing claims with the full litigation costs of their opponents — a concern present under the English rule. Alternatively, arbitrators may use their discretion to deter certain claims by awarding costs to prevailing defendants against unreasonable, frivolous, or groundless claims — an option unavailable under the American rule. In fact, the theory suggests that deterring frivolous litigation and allowing reasonable yet losing claims makes the judge-centered system more equitable than the English and American rules.[9] Of course, the actual practice can be much more complicated than the theory, in part because the application of rules is affected by a multiplicity of extra-legal factors beyond the background rules.[10]

Generally, it is hard to assess how such a variety of factors — institutional, psychological, social, or otherwise — can affect the application of the rules. This limitation affects the understanding of the proper conditions under which a particular rule could be more or less effective, preventing scholars and adjudicators alike from determining optimal levels of litigation. However, investor-state arbitration (known formally as Investor-State Dispute Settlement, or ISDS) under the International Centre for Settlement of Investment Disputes (ICSID) is an interesting case study. This controversial form of international dispute settlement is an example of

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for a critique on the state of the field (characterizing the dichotomy between the respective systems as "hopelessly simplistic").

7. *See* Francis Gurry, *Fees and Costs*, 6 WORLD ARB. & MEDIATION REP. 227, 233 (1995); ALAN REDFERN & MARTIN HUNTER, LAW AND PRACTICE OF INTERNATIONAL COMMERCIAL ARBITRATION 469 (4th ed. 2004). There are many exceptions to this general principle. *See, e.g.*, JOHN YUKIO GOTANDA, SUPPLEMENTAL DAMAGES IN PRIVATE INTERNATIONAL LAW 153–73 (1998) (surveying national laws on the awarding of costs and fees in arbitration).

8. Talia Fisher & Issi Rosen-Zvi, *It's for the Judges to Decide: Allocation of Trial Costs in Israel Report on Israel, in* COST AND FEE ALLOCATION IN CIVIL PROCEDURE, *supra* note 1, at 177–78.

9. Eisenberg et al., *supra* note 2, at 1456.

10. *See generally* Roscoe Pound, *Law in Books and Law in Action,* 44 AM. L. REV. 12 (1910); JOHN HENRY SCHLEGEL, AMERICAN LEGAL REALISM AND EMPIRICAL SOCIAL SCIENCE (1995).

an arbitration system that confronts the pressure to deter litigation with a number of incentives created by the adjudicatory setting.[11] In particular, ISDS provides a formal mechanism that allows corporations, most often large and well-financed litigants, to file claims for damages against governments for alleged harmful expropriation, discrimination based on nationality, or other unfair treatment.[12] The litigation is often based on vague standards — such as the obligation to afford "fair and equitable treatment" — incorporated into treaties.[13] The cases are heard by arbitrators, many of whom also act as counsels in other cases, and who are paid considerable fees. In these proceedings, legal costs can be relatively high — the median legal costs for a claimant is around US $3.3 million, one third of the median award of roughly US $10.5 million.[14] Therefore, adjudicators have a particularly high stake in the system.

The academic treatment of costs in investment arbitration is also timely. For one, controversial cases have given rise to a growing concern about socially excessive litigation, including two highly visible cases against Uruguay and Australia for their governments' efforts to impose tobacco labelling requirements.[15] In both cases, arbitrators reacted to the public

11. Emilie M. Hafner-Burton, Zachary C. Steinert-Threlkeld & David G. Victor, *Predictability Versus Flexibility: Secrecy in International Investment Arbitration*, 68 WORLD POL. 413 (2016); Sergio Puig, *Emergence & Dynamism in International Organizations: ICSID, Investor-State Arbitration & International Investment Law*, 44 GEO. J. INT'L L. 531 (2013); Susan D. Franck, *The ICSID Effect? Considering Potential Variations in Arbitration Awards*, 51 VA. J. INT'L L. 825 (2011); Detlev Vagts, *Foreword to* THE BACKLASH AGAINST INVESTMENT ARBITRATION, at xxiii, xxv–xxvi (Michael Waibel et al. eds., 2010).

12. Among other causes of action, the ICSID Convention gives the Centre jurisdiction over "any legal dispute arising directly out of an investment, between a Contracting State . . . and a national of another Contracting State." Convention on the Settlement of Investment Disputes Between States and Nationals of Other States art. 36, Mar. 18, 1965, 575 U.N.T.S. 159 [hereinafter ICSID Convention].

13. See CAMPBELL MCLACHLAN ET AL., INTERNATIONAL INVESTMENT ARBITRATION 226–47 (2007), for a take on what this standard encompasses. See Técnicas Medioambientales Tecmed S.A. v. United Mexican States, ICSID Case No. ARB(AF)/00/2, Award, ¶ 154 (May 29, 2003), http://www.italaw.com/sites/default/files/case-documents/ita0854.pdf, for an expansive interpretation of FET clauses ("The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently . . . State actions conforming to such criteria should relate not only to the guidelines, directives or requirements issued, or the resolutions approved thereunder, but also to the goals underlying such regulations.").

14. Jeffrey P. Commission, *How Much Does an ICSID Arbitration Cost? A Snapshot of the Last Five Years*, VANNIN CAPITAL (Feb. 29, 2016), http://arbitrationblog.kluwerarbitration.com/2016/02/29/how-much-does-an-icsid-arbitration-cost-a-snapshot-of-the-last-five-years/; *See, e.g.*, EDF (Servs.) Ltd. v. Rom., ICSID Case No. ARB/05/13, Award, ¶ 329 (Oct. 8, 2009) (claimant to pay $6 million of legal costs); PSEG Global Inc. v. Republic of Turk., ICSID Case No. ARB/02/05, Award, ¶ 353 (Jan. 19, 2007) (requiring Turkey to pay almost $14 million in legal costs); Československá Obchodní Banka A.S. v. Slovak Republic, ICSID Case No. ARB/97/4, Award, ¶ 374 (Dec. 29, 2004), 13 ICSID Rep. 181 (2008) (requiring the Slovak Republic to pay $10 million of the claimant's legal costs); Diane Desierto, *Rising Legal Costs Claimed by States in Investor-State Arbitrations: The Test of "Reasonableness," in* Philip Morris v. Australia, EJIL-TALK! (July 12, 2017), https://www.ejiltalk.org/rising-legal-costs-claimed-by-states-in-investor-state-arbitrations-the-case-of-philip-morris-v-australia/ (discussing recent decisions).

15. In a highly-visible arbitration involving tobacco labelling requirements, the tribunal chose to order Phillip Morris to bear the burden of the full costs incurred. This came after the initiation of an arbitration against Australia was labelled as an abuse of rights, as the corporate restructuring to access

uproar by imposing costs on Phillip Morris International and, in doing so, signalling a general discontent with claims that many perceived as audacious.[16] Additionally, in 2006, ICSID modified its Arbitration Rules[17] — the rules applicable to almost 70 percent of investor-state proceedings.[18] These provisions are now being reviewed, and while they have generated sufficient legal practice, no clear assessment of their effect exists.[19] In relevant part, the Arbitration Rules provide both a rule that the award of costs is left to the discretion of the tribunal[20] and a procedure for the efficient disposal of claims deemed to be "manifestly without legal merit."[21] The combination of these two mechanisms permits a systematic treatment both of the use of cost shifting as a deterrent tool in a judge-centered system of litigation and of investor-state arbitration cost practices on unmeritorious claims.

One of the primary methodological hurdles in analysing the debate over the use of discretion in cost shifting is the lack of sufficient data. To overcome this challenge, I rely on a multimethod approach. I use the available ISDS decisions as a foundation, supplementing them with additional evidence from case studies, semi-structured interviews with arbitrators in the field, and two survey experiments designed to observe the role of discretionary allocation rules in arbitration. By using this approach,

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the tribunal "was carried out for the principal, if not sole, purpose of gaining Treaty protection." Philip Morris Asia Ltd. v. Commonwealth of Austl., PCA Case No. 2012-12, Final Award Regarding Costs, ¶ 6 (July 8, 2017), https://www.italaw.com/cases/851 [hereinafter *PM – Tobacco Australia*]. In the Uruguayan case, the tribunal ordered the reimbursement of Uruguay's costs in the amount of $7,000,000.00 (about 67 percent of the total), in addition to ordering the Claimants to pay all fees and expenses of the tribunal and ICSID. Philip Morris Brands SARL v. Oriental Republic of Uru., ICSID Case No. ARB/10/7, Award, ¶¶ 588–90 (July 27, 2016), http://www.italaw.com/sites/default/files/case-documents/italaw7417.pdf [hereinafter *PM – Tobacco Uruguay*].

16. *See PM – Tobacco Australia,* PCA Case No. 2012-12, ¶ 108*; PM – Tobacco Uruguay*, ICSID Case No. ARB/10/7, ¶¶ 588–90.

17. ICSID Convention, *supra* note 12.; Antonio R. Parra, *The Development of the Regulations and Rules of the International Centre for Settlement of Investment Disputes*, 22 ICSID REV. – FOREIGN INV. L.J. 55, 65–67 (2007).

18. There is no reliable universe for arbitrations. Therefore, this number is based on the most reliable estimates from ICSID. INT'L CTR. FOR SETTLEMENT OF INV. DISPUTES, THE ICSID CASELOAD – STATISTICS (ISSUE 2017-2) (2017), https://www.icsid.worldbank.org.

19. On October 7, 2016, ICSID advised its 153 member States that it was beginning the process to further update the ICSID rules and regulations. Amendments to the ICSID rules require approval of two-thirds of the member States. *See* ICSID Convention, *supra* note 12; *see also* Lacey Yong, *ICSID to Target 16 Areas for Rule Reform*, GLOBAL ARB. REV., May 8, 2017, https://globalarbitrationreview.com/article/1141282/icsid-to-target-16-areas-for-rule-reform.

20. ICSID Convention, *supra* note 12, at art. 61(2) ("In the case of arbitration proceedings the Tribunal shall, except as the parties otherwise agree, assess the expenses incurred by the parties in connection with the proceedings, and shall decide how and by whom those expenses, the fees and expenses of the members of the Tribunal and the charges for the use of the facilities of the Centre shall be paid. Such decision shall form part of the award.").

21. ICSID Convention, *supra* note 12, at Arb. Rules, r. 41(5) ("Unless the parties have agreed to another expedited procedure for making preliminary objections, a party may, no later than 30 days after the constitution of the Tribunal, and in any event before the first session of the Tribunal, file an objection that a claim is manifestly without legal merit.").

it is possible to provide additional insights as to the use of discretion in cost allocation and the factors that constrain the application of the rules. As I show in this Article, many intervening factors affect the formal rule, including the nomination system of arbitrators, the compact social structure of arbitration practice, and the asymmetrical nature of investor-state arbitration (i.e., only investors may bring claims). To organize and understand the effect of these factors, I propose a theory — based on the *independence, accountability,* and *transparency* of the process of rule application — to refine the role of rule and other factors in cost shifting.[22]

At a normative level, the empirical findings and theory support the view that ICSID's current default rule giving complete discretion to arbitrators to allocate cost is suboptimal. As I explain, the limitation of arbitrators' independence and accountability — resulting from different institutional factors — interacts with the arbitrator's interest in deterring unmeritorious claims. Hence, I argue against the current system and instead propose a qualified presumption in favour of the English rule in cases where the tribunal upholds objections that a claim is "manifestly without legal merit." Though minor, this proposed amendment has the potential to encourage rule transparency, as adjudicators will be forced to explain the reasoning they used in departing from a rule. In effect, the proposed change could serve to counterbalance the pressures — created by the adjudicatory system itself — to follow the American rule. This can help to address some of the lavish concerns over the use of arbitration and will help to create a more consistent case-law by forcing adjudicators to justify their use of discretion in departing from a rule. More generally, I argue for expanding the debate on litigation costs and for contextualizing the operation of cost-shifting rules.

The Article is divided in six Sections. After this introduction, Section II reviews the literature and explains the working hypotheses. Section III discusses all the cases of cost shifting in investor-state arbitration in the context of spurious claims. Section IV discusses the alternative empirical evidence. Section V focuses on the normative and theoretical arguments. Section VI concludes.

22. For excellent works applying these criteria, *see, e.g.*, Jeffrey Dunoff & Mark Pollack, *The Judicial Trilemma*, 111 AM. J. INT'L L. 225 (2017); LEE EPSTEIN & JACK KNIGHT, THE CHOICES JUSTICES MAKE (1998); LEE EPSTEIN, WILLIAM M. LANDES & RICHARD A. POSNER, THE BEHAVIOR OF FEDERAL JUDGES (2013); JEFFREY A. SEGAL & HAROLD J. SPAETH, THE SUPREME COURT AND THE ATTITUDINAL MODEL REVISITED (2002); G. ALAN TARR, WITHOUT FEAR OR FAVOR: JUDICIAL INDEPENDENCE AND JUDICIAL ACCOUNTABILITY IN THE STATES (2012).

II. DETERRENCE AND COST SHIFTING

A. Cost Shifting in Judge-Centered Systems

The literature on litigation costs can be characterized as oceanic. However, the studies reach "few consistent predictions or prescriptions."[23] Most analyses examine litigation cost award amounts and the legal factors that determine them. Within these factors, the study of and comparison between the English and American rules has resulted in one of those classic debates in American legal scholarship: a black-letter choice between dichotomies despite the existence of other approaches within different jurisdictions, including discretionary rules and a "halfway rule" ("only a fraction of the costs is borne by the losing party") (*see* Table 1).[24]

	Fee-Allocation Rules Across Jurisdictions				
Country	**British Rule**	**"Halfway Rule"**	**American Rule**	**Discretion of the Judge**	**Usual Practice**
Austria	X				
Belgium		X		X	Halfway
Czech Rep.	X			X	British
Denmark				X	
Estonia		X			
Finland	X				
France		X		X	Halfway
Germany	X				
Greece	X				
Hungary	X			X	British
Ireland				X	
Italy		X		X	Halfway
Luxembourg		X			
Netherlands		X	X	X	Halfway or American
Poland	X			X	
Portugal			X		
Slovak Rep.	X			X	British
Slovenia	X				
Spain	X				
Sweden	X		X		British
England	X	X			British
Wales	X	X			British
Scotland				X	
Switzerland	X				
Australia				X	
Japan			X		
Korea				X	
Mexico				X	
New Zealand				X	

Table 1: Fee Shifting Rules Across Jurisdictions[25]

23. Some of the seminal works include: Steven Shavell, *Suit, Settlement and Trial: A Theoretical Analysis Under Alternative Methods for the Allocation of Legal Costs*, 11 J. LEGAL STUD. 55 (1982); A. Mitchell Polinsky & Daniel L. Rubinfeld, *Does the English Rule Discourage Low-Probability-of-Prevailing Plaintiffs?*, 27 J. LEGAL STUD. 519 (1998); Lucian Bebchuk & Howard Chang, *An Analysis of Fee Shifting Based on the Margin of Victory: On Frivolous Suits, Meritorious Suits, and the Role of Rule 11*, 25 J. LEGAL STUD. 371 (1996); Bruce Hay, *Optimal Contingent Fees in a World of Settlement*, 26 J. LEGAL STUD. 259 (1997) (providing an excellent literature review on this theory).

24. *See, e.g.*, Eisenberg et al., *supra* note 2, at 1454–55.

25. ORG. FOR ECON. COOPERATION & DEV., JUDICIAL PERFORMANCE AND ITS DETERMINANTS: A CROSS-COUNTRY PERSPECTIVE 31–32 (2013).

Partly as a result of the focus on the background rules, the analysis of cost shifting in judge-centered systems has been partially relegated to an analysis of lesser importance. With some notable exceptions, existing studies do not focus on understanding the use of, and the factors that constrain, the grant of discretion to shift litigation costs and what its use says about adjudicatory decision-making. [26] This scholarly void needs filling, considering that a thorough examination of discretion can allow scholars and practitioners alike to understand alternatives to the rigidities often associated with the English and American rules, as well as factors that impact their operation.[27]

A dissection of the factors begins with the use of discretion in the most obvious cases. If there is an area where adjudicators would be the most enthusiastic about using their discretion, it is when faced with clearly unreasonable, frivolous, or groundless claims.[28] In those cases, especially in settings that are perceived as encouraging socially excessive litigation, most theories suggest that adjudicators will typically support a fee award to a prevailing defendant — either to discourage similar cases or to "sanction" the losing party — unless special circumstances apply.[29] What seems to be missing is a deeper understanding of the factors or conditions that constrain the use of cost shifting as a form of "sanction."

To rationalize these special factors, Professor Reimann reviewed several legal systems and concluded that one reason against full shifting rules is the perceived negative effect on potential low-income litigants. [30] Leading scholars Theodore Eisenberg et al. note that "[f]ull recovery is often regarded as unjust and as imposing too great a risk of stifling justified litigation by persons of limited means."[31] Consequently, rules or judicial discretion "often temper the negative effects of a pure loser pays system."[32] The obvious implication of such a finding is that some concept of fairness is clearly a consideration in cost determinations.

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26. *See, e.g.*, Eisenberg et al., *supra* note 2.

27. *See* Pfennigstorf, s*upra* note 1, at 67 (explaining that discretion is likely used in cases where the loser's legal or factual position appears weak). Additionally, see the CONTRACT WITH AMERICA: THE BOLD PLAN BY REP. NEWT GINGRICH, REP. DICK ARMEY AND THE HOUSE REPUBLICANS TO CHANGE THE NATION 143, 145–46 (Ed Gillespie & Bob Schellhas eds., 1994), for the implementation of this logic (claiming that cost shifting "penalizes frivolous lawsuits by making the loser pick up the winner's legal fees").

28. *See generally* Lucian Arye Bebchuk & Howard F. Chang, *An Analysis of Fee Shifting Based on the Margin of Victory: On Frivolous Suits, Meritorious Suits, and the Role of Rule 11*, 25 J. LEGAL STUD. 371 (1996); Amy Farmer & Paul Pecorino, *A Reputation for Being a Nuisance: Frivolous Lawsuits and Fee Shifting in a Repeated Play Game*, 18 INT'L REV. L. & ECON. 147 (1998).

29. John J. Donohue III, Commentary, *Opting for the British Rule: Or, If Posner and Shavell Can't Remember the Coase Theorem, Who Will?*, 104 HARV. L. REV. 1093 (1991).

30. Reimann, *supra* note 1, at 3.

31. Eisenberg et al., *supra* note 2, at 1461.

32. *Id.*

To operationalize this consideration, adjudicators often seem to rely on the perceived legal capacity of litigants as a proxy for assessing material means.[33] For instance, research suggests that individual plaintiffs are protected against costs more than corporations.[34] A plausible explanation is that individuals are more often perceived as poorly endowed litigants when compared to corporate actors.[35] However, it is unclear and little research exists on how this logic translates when governments or governmental agencies are part of the litigation or when only one type of actor is on the receiving end of legal claims.[36]

There are certainly other factors that constrain discretion beyond fairness considerations. For instance, one can think of factors that affect impartiality as factors that may also temper or exacerbate the exercise of discretion.[37] Among the most consequential of these factors may be the adjudicatory system or institutional setting itself, especially the methodology for selecting the adjudicators and the institutions surrounding the particular area of legal practice.[38] As elaborated by Posner and de Figueiredo, the method used to select judges may result in explicit strategic decisions on the part of those judges, or in implicit influences or biases that are hard to constrain.[39] For example, a judge may decide a case strategically to obtain a promotion to a more prominent court. At the same time, judges are subject to various implicit biases that have been extensively documented in social sciences literature.[40]

In addition, litigation and the resulting judicial activity often take place in a larger social context, where rules, procedures, rituals, or norms are relevant.[41] In some areas of litigation, social pressures or the prospect of further interactions with other legal actors may constrain an arbitrator's

33. Albert Yoon and Tom Baker, *Offer-of-Judgment Rules and Civil Litigation: An Empirical Study of Automobile Insurance Litigation in the East*, 59 VAND. L. REV. 155 (2006).

34. Eisenberg et al., *supra* note 2, at 1457.

35. However, there is almost no literature on how these factors play when governments take on the role of a litigating party, since they are often assumed to enjoy the ability to pay litigation fees.

36. Richard L. Schmalbeck & Gary Myers, *A Policy Analysis of Fee-Shifting Rules Under the Internal Revenue Code*, 6 DUKE L.J. 970 (1986).

37. John J. Donohue, III, *The Effects of Fee Shifting on the Settlement Rate: Theoretical Observations on Costs, Conflicts, and Contingency Fees*, 54 L. & CONTEMP. PROBS. 195, 202–03 (1991).

38. Georg Vanberg, *Establishing and Maintaining Judicial Independence, in* THE OXFORD HANDBOOK OF LAW AND POLITICS 99 (Keith E. Whittington et al. eds., 2008). See, for example, John Ferejohn, *Independent Judges, Dependent Judiciary: Explaining Judicial Independence*, 72 S. CAL. L. REV. 353 (1999), for an influential work on independence.

39. Eric A. Posner & Miguel F. P. de Figueiredo, *Is the International Court of Justice Biased?,* 34 J. LEGAL STUD. 599 (2005).

40, See D. Michael Risinger et al., *The* Daubert/Kumho *Implications of Observer Effects in Forensic Science: Hidden Problems of Expectation and Suggestion*, 90 CALIF. L. REV. 1 (2002), for a review. See Christopher Tarver Robertson, *Blind Expertise,* 85 N.Y.U. L. REV. 174 (2010), for an application.

41. See Marc Galanter, *Why the "Haves" Come Out Ahead: Speculations on the Limits of Legal Change*, 9 LAW & SOC'Y REV. 95 (1974), for a classical explanation. See Carrie Menkel-Meadow, *Do the "Haves" Come Out Ahead in Alternative Judicial Systems?: Repeat Players in ADR,* 15 OHIO ST. J. ON DISP. RESOL. 19, 33–34 (1999), for a discussion of contextual factors outside of court settings.

impulse to shift costs, as it may signal a sanction against the counsel or may discourage future cases — in many ways making background legal rules less relevant.[42] In some sense, even impartial adjudicators who are able to resist pressures are part of the culture, social structure, and political economy of a particular legal field and respond to the system in different ways.[43]

In short, factors associated with the design of the adjudicatory system along with human elements such as biases or social and professional interactions among the lawyers may be factors of relevance that affect discretion when allocating cost. Before discussing how these factors inform this Article's working hypotheses, I first briefly discuss international arbitration as an example of a judge-centered system — a system that, in theory, grants discretion to decision-makers.

B. International Arbitration as a Judge-Centered System

A silent but steady trend has eliminated formal courts from hearing disputes that affect many aspects of social, economic, and even political life.[44] Arbitration clauses are now ubiquitous in all types of contracts. While the U.S. Supreme Court maintains a permissive trend on the enforcement of arbitration agreements according to their terms, many scholars consider this to be a "lamentable" state of legal affairs.[45] Chief among their concerns is the ability of corporations to steer cases in the direction of arbitrators who may be more sympathetic than traditional tenured judges. Arbitrators, like judges, are driven by many different incentives, but unlike judges who often have long tenures and are supervised and heavily scrutinized, arbitrators are more acutely sensitive to the pressures of re-appointment as they are selected to hear only a single dispute at a time.[46]

This trend is global.[47] Not only are other countries showing similar growth in the acceptance of arbitration as a method of domestic dispute

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42. *See, e.g.*, Farmer & Pecorino, *supra* note 28.

43. *See* Ryan C. Black & Christina L. Boyd, *U.S. Supreme Court Agenda Setting and the Role of Litigant Status,* 28 J.L. ECON. & ORG. 286, 287–88 (2012); *see generally* Joost Pauwelyn, *The Rule of Law Without the Rule of Lawyers? Why Investment Arbitrators Are From Mars, Trade Panelists Are From Venus*, 109 AM. J. INT'L L. 761 (2015); Tom Ginsburg, *The Culture of Arbitration*, 36 VAND. J. TRANSNAT'L L. 1335, 1340 (2003) (discussing international adjudication).

44. Myrian E. Gilles, *The End of Doctrine: Private Arbitration, Public Law and the Anti-Lawsuit Movement* (Cardozo Legal Stuies Research Paper No. 436, 2014), http://ssrn.com/abstract=2488575 or http://dx.doi.org/10.2139/ssrn.2488575.

45. Am. Express Co. v. Italian Colors Rest., 570 U.S. 228 (2013); Kristine Bergman, *An Impossible Reconciliation? — Understanding Class-Action Waivers and Arbitration After* American Express v. Italian Colors*,* 5 RESOLVED 58 (2015).

46. *See* Sergio Puig, *Social Capital in the Arbitration Market*, 25 EUR. J. INT'L L. 387 (2014).

47. *See, e.g.*, YVES DEZALAY & BRYANT G. GARTH, DEALING IN VIRTUE: INTERNATIONAL COMMERCIAL ARBITRATION AND THE CONSTRUCTION OF A TRANSNATIONAL LEGAL ORDER (1996); Christopher R. Drahozal, *Private Ordering and International Commercial Arbitration*, 113 PENN ST. L. REV. 1031 (2009).

settlement, but "international" arbitration has also become the preferred adjudicatory process in transnational business transactions between corporations.[48] Despite this expansion, most international arbitrations are decided by a still relatively small number of self-regulated arbitrators. In commercial arbitration, many of these international arbitrators serve as decision-makers in multiple cases as well as counsels in other arbitral proceedings — a controversial, yet permissible, practice in a field with relatively tolerant ethical standards.[49]

The expansion of arbitration is not only a matter of volume but also one of depth. Traditionally, the principal function of arbitration was to provide an independent forum to assist merchants in settling private disputes.[50] With the increasing number, variety, and relevance of international treaties that constrain governmental action, the role of arbitration has expanded.[51] Through a vast network of Bilateral Investment Treaties (BIT's), many states have granted private foreign investors the right to pursue arbitration against states in an international forum for alleged violations of investment protections.[52] Arbitration tribunals have the power to find states in violation of their treaty or contractual commitments, and furthermore to obligate that state to pay damages to the investor. Investors have used this type of arbitration to challenge not only cases of direct expropriation or nationalization, but also domestic laws and regulatory decisions seen as unfavourable under broad standards of protection.[53]

In all three settings — domestic, transnational, and international — concerns have focused on the social cost of a system that operates outside of the formal state apparatus.[54] Yet, if there is a field of arbitration where socially excessive litigation is of utmost concern, it is investor-state arbitration. A recent commentator described the system as a kind of

48. Drahozal, *supra* note 47.

49. Michael P. Reynolds, *Arbitration and Ethical Code*s, 17 LEGAL ETHICS 458 (2015).

50. Drahozal, *supra* note 47, at 1037 (touching on the history of international arbitration).

51. In the growth of international litigation. *See* Cesare P.R. Romano, *The Proliferation of International Judicial Bodies: The Pieces of the Puzzle*, 31 N.Y.U. J. INT'L L. & POL. 709, 709 (1999) (stating further that the enormous expansion of the international judiciary will probably be seen by future international lawyers and scholars as the single most significant post-cold war development in international law).

52. Anthea Roberts, *Clash of Paradigms: Actors and Analogies Shaping the Investment Treaty System,* 107 AM. J. INT'L. L. 45, 75–93 (2013) (discussing the changing nature of investment arbitration and the evolution of debates).

53. *See, e.g.*, Vattenfall AB v. Fed. Republic of Ger., ICSID Case No. ARB/12/12 (a dispute resulting from a decision of the German Parliament to abandon the use of nuclear energy by the year 2022); *see also* Vattenfall AB v. Fed. Republic of Ger., ICSID Case No. ARB/09/6, Claimant's Request for Arbitration (Mar. 30, 2009).

54. *See, e.g.*, Judith Resnik, *Migrating, Morphing,* and *Vanishing: The Empirical and Normative Puzzles of Declining Trial Rates in Courts,* 1 J. EMPIRICAL LEGAL STUD. 783 (2004) (discussing domestic arbitration); Bryant G. Garth, *Tilting the Justice System: From ADR as Idealistic Movement to a Segmented Market in Dispute Resolution*, 18 GA. ST. U. L. REV. 927 (2002) (discussing international arbitration). *See also* George Kahale, *Is Investor-State Arbitration Broken?,* TRANSNATIONAL DISPUTE MANAGEMENT, Dec. 2012, at 7, https://www.transnational-dispute-management.com/article.asp?key=1918.

"private, global super court that empowers corporations to bend [poor] countries to their will."[55] Examples of controversial cases include two very high-profile cases in which tobacco giant Phillip Morris International sought damages for Australia and Uruguay's anti-smoking legislation, casting the efforts as a form of unlawful expropriation of its brand.[56] More recently, TransCanada filed notice to submit a claim against the U.S. government's decision to stop the Keystone XL pipeline for a "lack of fair-and-equitable-treatment."[57]

Despite this criticism, one of the most interesting aspects of investor-state arbitration rules is that they often follow a judge-centered system of cost allocation that has the potential to help moderate these exact concerns over socially excessive litigation. By shifting costs, arbitrators can deter highly controversial cases or discourage other behaviours considered outside of the spectrum of permissible litigation or beyond the norm of legitimate cases. Importantly, such discretionary systems of cost allocation are often described as transferring authority to the institutional actor with: (1) case-specific expertise, (2) no affiliation with the litigating sides, and (3) a presumed interest in promoting justice as each individual case requires.[58] Nevertheless, different factors — applicable in arbitration more generally and investor-state arbitration specifically — may relax such hefty assumptions based on an idealized model of adjudication.

With respect to case-specific expertise, different fields of arbitration call for different considerations. In commercial arbitration, where both parties are often presumed similarly endowed and may share similar legal capacity, Gotonda reports that arbitrators very often render decisions in accordance with the "costs follow the event principle."[59] However, an analysis by the International Chamber of Commerce — the premier arbitral institution for commercial arbitration — revealed that tribunals awarded costs to the respondents 33 percent of the time that the claimants were found partially or completely unsuccessful, and the respondent only received some or all of its legal fees as part of the final award in 20 percent of the cases.[60] This contrast, and further anecdotal evidence discussed below, both suggest that case-specific considerations affect a decision to shift cost.

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55. Chris Hamby, *The Court That Rules the World*, BUZZFEED NEWS (Aug. 28, 2016), www.buzzfeed.com/chrishamby/super-court.

56. *See PM – Tobacco Australia,* PCA Case No. 2012-12*; PM – Tobacco Uruguay*, ICSID Case No. ARB/10/7.

57. TransCanada Corp. v. United States, ICSID Case No. ARB/16/21, Request for Arbitration, (June 24, 2016). The arbitration is currently suspended.

58. *See* Fisher & Issi Rosen-Zvi, *It's for the Judges to Decide: Allocation of Trial Costs in Israel Report on Israel, in* COST AND FEE ALLOCATION IN CIVIL PROCEDURE, *supra* note 1, at 177–78.

59. John Gotanda, *Awarding Costs and Attorneys' Fees in International Commercial Arbitrations,* 21 MICH. J. INT'L L. 1, 6–10 (1999).

60. *Decisions on Costs in International Arbitration — ICC Arbitration and ADR Commission Report*, ICC DISP. RESOLUTION BULLETIN (Int'l Chamber of Commerce, Paris), no. 2, 2015.

With respect to the non-affiliation assumption, arbitration may be radically different to other areas of legal adjudication. While arbitrators, like judges, are supposed to be neutral and impartial, arbitration practitioners suggest that arbitrators tend to lean in favor of the nominating party.[61] This may be the result of the incentives created to appoint arbitrators with favorable views towards the litigant's case (selection effect) or incentives for re-appointment, as arbitrators do not have tenure and their income may depend on it (compensation effect). [62] In addition to these material incentives, prior research has found that arbitrators are susceptible to implicit biases including affiliation effects — the bias to favor the nominating party.[63] To be sure, arbitration decisions are often collective, involve an arbitrator brought by each of the parties to the proceedings, and require deliberation. Hence, such biases may or may not be reflected in the final outcome of the decision. Nevertheless, they interact in complex ways and affect the decision not to allocate cost to an unsuccessful respondent.

Even the assumption that arbitrators in a judge-centered system decide in a way that promotes justice may be incorrect in the face of other factors. According to Professor Franck, who has produced the most comprehensive analysis of cost shifting in investor-state arbitration, arbitrators generally prefer "parties to be responsible for their own costs, [as] there was neither a universal approach to cost allocation nor a reliable relationship between cost shifts and losing."[64] In contrast, Noah Rubins — an insider to this legal field — argues that arbitrators appear especially reluctant to award attorneys' fees where the applicable law is unclear, where the *bona fides* of unsuccessful claims are clear, or where the issues of law are novel.[65] One can understand this proclivity to find factors that justify a "pay your own way" approach as the possible result of different perceptions of what is fair and just, which can be affected by the norms of each field. This is particularly relevant in some areas of arbitration that rely heavily on individual reputation and social capital.[66]

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61. Jan Paulsson, *Are Unilateral Appointments Defensible?*, KLUWER ARB. BLOG (Apr. 2, 2009), http://kluwerarbitrationblog.com/blog/2009/04/02/are-unilateral-appointments-defensible/ (criticizing the mechanism of appointment of arbitrators by party).

62. Sergio Puig, *Blinding International Justice*, 56 VA. J. INT'L L. 647 (2017).

63. Sergio Puig & Anton Strezhnev, *Affiliation Bias in Arbitration: An Experimental Approach*, 46 J. LEGAL STUD. 371 (2017).

64. Susan D. Franck, *Rationalizing Costs in Investment Treaty Arbitration*, 88 WASH. U. L. REV. 769 (2011).

65. Noah Rubins, *The Allocation of Costs and Attorney's Fees in Investor-State Arbitration*, 18 ICSID REV. – FOREIGN INV. L.J. 109 (2003).

66 . JOSHUA KARTON, THE CULTURE OF INTERNATIONAL ARBITRATION AND THE EVOLUTION OF CONTRACT LAW 55 (2013).

C. *Bounded Discretion: Factors Constraining Deterrence*

One can expect arbitrators to use their discretion in allocating litigation costs in some instances, especially in light of the concerns over the social cost of this form of legal adjudication. At the very least, a finding that a claim is patently unmeritorious — the most decisive finding against a litigant — should, less controversially, result in an award on cost against the losing party.[67] On the other hand, one can expect that such impulses may be tempered by a variety of factors, including any special circumstances in the cases, the institutional setting, and possibly the social context of the legal actors involved. The literature described in Section II(A) is particularly illuminative in this regard, as it provides some ways of assessing factors that limit discretion.[68]

One hypothesis is that arbitrators may use their discretion to grant differential treatment based on the losing party's case strength, capacity, and perceived ability to pay.[69] For instance, arbitrators may shift costs against rich companies bringing bad cases more often than less wealthy parties with meritorious cases, especially when facing relatively poor countries which are typically on the receiving end of such claims.

A second hypothesis is that arbitrators may be affected by the adjudicatory system, especially the biases resulting from the methods by which adjudicators are nominated and the security of tenure.[70] Legal scholars and political scientists agree that an important source of bias, ideology, and state control is the method of appointing adjudicators.[71] This function is performed in many different fashions, depending on a series of factors, including the type of tribunal, the jurisdictional mandate, and the enforceability of the decisions.[72] In arbitration, one could posit that individual arbitrators who are appointed by the parties may use their discretion either to sanction the non-appointing party more aggressively, or to limit the negative effects on the appointing party of an award on costs.

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67. *See, e.g.*, Avery Wiener Katz, *Indemnity of Legal Fees*, *in* ENCYCLOPEDIA OF LAW AND ECONOMICS: THE ECONOMICS OF CRIME AND LITIGATION 63, 64–65 (Boudewijn Bouckaert & Gerrit De Geest eds., 2000).

68. *See supra* Section II(A).

69. *See* Keith N. Hylton, *Fee Shifting and Incentives to Comply With the Law*, 46 VAND. L. REV. 1069, 1106–09 (1993).

70. *See supra* Section II(A).

71. Erik Voeten, *The Politics of International Judicial Appointments. Evidence from the European Court of Human Rights,* 61 INT'L ORG. 669 (2007); Manfred Elsig & Mark A. Pollack, *Agents, Trustees, and International Courts: The Politics of Judicial Appointment at the World Trade Organization*, 20 EUR. J. INT'L REL. 391, 393 *(*2014).

72 . Ruth Mackenzie, Kate Malleson, Penny Martin & Philippe Sands, SELECTING INTERNATIONAL JUDGES: PRINCIPLE, PROCESS, AND POLITICS (2010).

Finally, one can hypothesize that social and professional norms act as a moderating force on the impulse to shift costs.[73] For instance, the role and influence of different court actors like clerks, the embeddedness (or lack thereof) of the court in a particular regime or legal community, or the norms and professional interests of decision-makers can all affect such outputs.[74] In particular, one could see how, in fields of legal practice that rely heavily on reputation in the reappointments of adjudicators and are structured around ubiquitous professional norms, adjudicators would be reluctant to shift costs to avoid embarrassing another professional. Adjudicators may want to discourage some cases, but as their income depends on being nominated to more cases, arbitrators may not want to impose sanctions that are perceived as too high and risk damaging their image as an attractive candidate.[75]

In the next two Sections, I explore how these factors may play out. Since not all factors can be assessed with observational data, I complement data on the proceedings with case studies, relevant experimental data, and interviews with professional arbitrators in the field of investor-state arbitration.

III. CLASSIC EVIDENCE: STATISTICS AND CASE STUDIES

A. Background

i. ICSID and Investor-State Arbitration

Among the most immediate challenges with research in arbitration is that proceedings are typically private. The ICSID system, however, provides an unprecedented opportunity for a more robust empirical analysis. As part of the World Bank, this international organization was designed to facilitate the settlement of disputes between states and foreign investors as a "step toward promoting an atmosphere of mutual confidence and thus stimulating a larger flow of private international capital."[76] Under its rules, the ICSID Secretariat must make significant information concerning the proceedings available to the public, including the general outcomes of every dispute.[77]

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73. *See supra* Section II(A).

74. Jacob Katz Cogan, *Competition and Control in International Adjudication*, 48 VA. J. INT'L L. 411, 416 (2008) (describing mechanisms of state control over international adjudicatory bodies); Tom Ginsburg, *Bounded Discretion in International Judicial Lawmaking*, 45 VA. J. INT'L L. 631 (2005); Laurence R. Helfer, *Why States Create International Tribunals: A Theory of Constrained Independence*, *in* INT'L CONFLICT RESOL. 253 (Stefan Voigt, Max Albert & Dieter Schmidtchen eds., 2006); Pauwelyn, *supra* note 43.

75. Puig, *supra* note 46; GUS VAN HARTEN, INVESTMENT TREATY ARBITRATION AND PUBLIC LAW (2007) (arguing that only the security of tenure can adequately ensure that judges properly apply international investment law and proposing the creation of an international investment court).

76. ICSID Convention, *supra* note 12, at Report of the Executive Directors, ¶ 9.

77. *See* ICSID Convention, *supra* note 12, at Administrative and Financial Regulations, reg. 23.

Before turning to the main discussion, some context on the ICSID and investor-state arbitration is needed.

ICSID tribunals hear claims brought by foreign investors seeking compensatory damages under foreign investment protection instruments (BITs, concession contracts, or foreign direct investment promotion legislation) when affected by the excessive intervention of a host state.[78] On very rare occasions, states have also brought claims against investors under contractual provisions.[79] However, ICSID is considered an "asymmetrical" dispute settlement system, as states are (almost) always in the position of the respondent defending a measure taken by a governmental authority.[80]

With some exceptions, the tribunals deciding these cases are typically composed of three members — one arbitrator appointed by each party in the litigation, and a third arbitrator appointed by an independent designating authority or by agreement of the parties.[81] The third arbitrator usually acts as the chair. The parties are free to appoint any individual who exhibits "high moral character and recognized competence in the fields of law, commerce, industry or finance" and can "exercise independent judgment."[82] The role of an arbitrator can be fundamental in the process as well as the outcome of arbitration. In fact, litigants often seek "a party-appointed arbitrator who has a maximum predisposition towards his client with the minimum appearance of bias."[83] Moreover, both the economic incentives as well as the profile of investment arbitration cases are high, which can potentially trigger arbitrators to make strategic decisions to ensure a steady stream of income or to advance particular ideological commitments in this very contested field of transnational governance.[84]

Among the most important concerns of this system of adjudication is the delegation of crucial decision-making authority in relevant policy areas.[85] In addition, concerns over what some perceive as socially excessive litigation has resulted in calls for the removal of this form of dispute settlement

78. *See* CHRISTOPHER F. DUGAN, DON WALLACE, JR., NOAH D. RUBINS & BORZU SABAHI, INVESTOR-STATE ARBITRATION 675–700 (2008) (describing the investment law enforcement mechanism); Aron Broches, *Development of International Law by the International Bank for Reconstruction and Development*, *in* SELECTED ESSAYS: WORLD BANK, ICSID, AND OTHER SUBJECTS OF PUBLIC AND PRIVATE INTERNATIONAL LAW 79, 80–84 (1995).

79. *See, e.g.*, Mar. Int'l Nominees Establishment v. Republic of Guinea, ICSID Case No. ARB/84/4, Award, January 6, 1988, 4 ICSID Rep. 61 (1997).

80. Jan Paulsson, *Arbitration Without Privity*, 10 ICSID REV. — FOREIGN INV. L.J. 232 (1995).

81. ICSID Convention, *supra* note 12, at art. 37.

82. ICSID Convention, *supra* note 12, at art. 14. Unless waived, arbitrators cannot have the nationality of the State of the investor or the Defendant State. *Id.* at art. 39.

83. *See* Martin Hunter, *Ethics of the International Arbitrator*, 53 ARB. 219, 223 (1987).

84. *See* Jason Webb Yackee, Pacta Sunt Servanda *and State Promises to Foreign Investors Before Bilateral Investment Treaties: Myth and Reality*, 32 FORDHAM INT'L L.J. 1550, 1611 (2009); Kahale, *supra* note 54; Gus Van Harten, *The (Lack of) Women Arbitrators in Investment Treaty Arbitration*, 59 COLUM. FDI PERSP. (2012).

85. *See* Markus Wagner, *Regulatory Space in International Trade Law and International Investment Law*, 36 U. PA. J. INT'L L. 1, 14 (2014).

altogether from international commercial treaties.[86] As explained below, the scope of cost liability may contribute to concerns about this system.

ii. The Current Treatment of Legal Costs under the ICSID

As Section II explains, the two most common approaches to cost allocation are the American and the English Rule.[87] Under the American rule, "the costs lie where they fall." This typically means that there is no shifting of legal costs, except in very rare instances, e.g., when one of the parties litigates in bad faith. By contrast, the English rule means that "the costs follow the event": an unsuccessful party must indemnify the prevailing party for part or all of its legal costs.

Unless the instrument that establishes jurisdiction provides otherwise, ICSID arbitration rules accord arbitrators broad discretion in allocating costs.[88] Tribunals tend to exercise this discretion inconsistently or, as put by one of the most cited decisions in investor-state arbitration, have yet to establish "a uniform practice in respect of the award of costs and expenses."[89] In fact, the question of costs has been a major part of the discontent over the fairness of this form of legal adjudication.[90]

One of the most common criticisms is that tribunals consistently award costs to prevailing claimants but not to prevailing respondents. This, Professor Shill notes, is especially troubling because (with very limited exceptions) only investors can be claimants.[91] He explains that this results

86. *See* Letter from Law and Economics Professors Urging Congress to Reject ISDS in TPP (Sept. 7, 2016), https://www.citizen.org/documents/isds-law-economics-professors-letter-Sept-2016.pdf.

87. *See supra* Section II(A).

88. ICSID Convention, *supra* note 12, at art. 61(2). *See* REDFERN & HUNTER., *supra* note 7, at 94 ("It is generally recognized that parties to an international commercial agreement are free to choose for themselves the law (or the legal rules) applicable to that agreement." (footnote omitted)). The scope for cost liability generally includes: (1) the expenses of both parties' lawyers, (2) the costs of the tribunal and administrative expenses, and (3) which party will bear these two expenses given the possibility of cost shifting. *See* Kateryna Bondar, *Allocation of Costs in Investor-State and Commercial Arbitration: Towards a Harmonized Approach*, 32 ARB. INT'L 45, 45–46 (2016), https://doi.org/10.1093/arbint/aiv080 ("The costs in the arbitration proceedings can take the form of fees and expenses of the institution and the arbitral tribunal ('tribunal costs' or 'arbitration costs'), and fees and expenses of counsel, experts, and witnesses ('party costs' or 'legal fees') . . . Arbitral tribunals can adopt different approaches to allocation of cost.").

89. Mondev Int'l Ltd. v. United States, ICSID Case No. ARB(AF)/99/2, Award, ¶ 159 (Oct. 11, 2002), 6 ICSID Rep. 192 (2004); *see also* CHRISTOPH H. SCHREUER, LORETTA MALINTOPPI, AUGUST REINISCH & ANTHONY SINCLAIR, THE ICSID CONVENTION: A COMMENTARY 1229 (2d ed. 2009) ("The practice of ICSID tribunals in apportioning costs is neither clear nor uniform.").

90. John Y. Gotanda, *Attorneys' Fees Agonistes: The Implications of Inconsistency in the Awarding of Fees and Costs in International Arbitrations* 2 (Villanova Univ. Sch. of Law Pub. Law & Legal Theory Working Paper Series, Paper No. 2010-01, 2009), http://ssrn.com/abstract=1491755; Matthew Hodgson, *Costs in Investment Treaty Arbitration: The Case for Reform*, *in* RESHAPING THE INVESTOR-STATE DISPUTE SETTLEMENT SYSTEM: JOURNEYS FOR THE 21ST CENTURY (Jean E. Kalicki & Anna Joubin-Bret eds., 2014).

91. Stephan W. Schill, *Arbitration Risk and Effective Compliance: Cost-Shifting in Investment Treaty Arbitration*, 7 J. WORLD INV. & TRADE 653, 654–55 (2006).

in a "one-way, pro-investor cost-shifting approach," adding to the concerns over the demanding features of investor-state arbitration, especially for poor states that are often in the respondent seat of these claims.[92] Moreover, the extent and range of expenses in the system likely amplify its importance. While costs can be massive (e.g., more than $80 million in a recent dispute involving Yukos and Russia), parties incur legal costs ranging from three to four million dollars for a single dispute.[93] Regardless of the relative merits of each party's case, it is generally very difficult to predict who will ultimately bear legal costs in investor-state arbitration.

In relevant part, the ICSID Convention establishes a general rule for all arbitration proceedings. Article 61(2) of the Convention establishes:

> In the case of arbitration proceedings, the Tribunal shall, *except as the parties otherwise agree*, assess the expenses incurred by the parties in connection with the proceedings, and shall decide how and by whom those expenses, the fees and expenses of the members of the Tribunal and the charges for the use of the facilities of the Centre shall be paid. Such decision shall form part of the award.[94]

Regarding the added emphasis, commentators agree that this provision establishes that, if there is no agreement between the parties on the allocation of costs, the tribunal is given broad discretion to make the decision itself.[95] According to ICSID, a tribunal may allocate costs with regard to the proceeding as a whole or with regard to a particular part of the proceeding. Its decision in the award becomes binding and enforceable.

Because of the complexity of the topic, I will begin the analysis from the perspective of the most outrageous claims — cases where most reasonable people could expect an award on costs in favour of the prevailing party. In such cases, the general rule also applies; in other words, ICSID provides no specific rules addressing costs in cases of manifestly unmeritorious claims. Nevertheless, given the concerns over socially excessive litigation and the hefty bar to dismiss a claim summarily (as I further explain below), one would expect cost shifting to be prevalent in such cases. Moreover, one could learn something from the patterns of litigation as well as the reasons given to avoid cost shifting in such cases.

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92. *Id.*

93. JOHNATHAN BONNITCHA ET AL., THE POLITICAL ECONOMY OF THE INVESTMENT TREATY REGIME 88 (2017).

94. ICSID Convention, *supra* note 12, at art. 61(2) (emphasis added).

95. Lucy Reed, *Allocation of Costs in International Arbitration*, 26 ICSID REV. — FOREIGN INV. L.J. 76 (2011).

B. Cost Shifting and Unmeritorious Investment Claims

i. The Proceeding to Dismiss Claims Summarily

The mechanism to dismiss unmeritorious claims summarily is relatively new.[96] In April of 2006, several amendments to the ICSID Arbitration Rules came into effect.[97] One of the amendments provided a textual basis for ICSID tribunals to dismiss spurious claims. Rule 41(5), as amended, "allows a party to request the tribunal, at an early stage in the proceeding, to dismiss all or part of a claim on an expedited basis," on the grounds that the claim is "manifestly lacking in legal merit," even though it has been registered by the ICSID Secretary-General.[98]

In his assessment of the new rule the then Deputy Secretary-General of ICSID, Antonio Parra, suggested that this amendment relates to the early dismissal of "frivolous" or "patently unmeritorious claims."[99] A party may raise an objection and in doing so trigger the expedited procedure under Rule 41, as adopted, "[u]nless the parties have agreed to another expedited procedure for making preliminary objections."[100] This caveat comes from investment treaties or BITs which include provisions that permit such objections to be made on an expedited basis with similar language.[101]

The new rule came in response to different concerns, including the criticism of excessive litigation against poor governments. Although there have only been a few cases in which ICSID tribunals have made rulings on the new Rule 41(5), there is a great degree of consistency in the way upon which the objections (but not the cost allocation) under this provision are being ruled.[102] Four relevant issues are worth mentioning here before addressing how arbitrators have dealt with the issue of costs in these cases.

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96. ICSID Convention, *supra* note 12, at Arb. Rules, r. 41(5).

97. See Aurelia Antonietti, *The 2006 Amendments to the ICSID Rules and Regulations and the Additional Facility Rules*, 21 ICSID REV. — FOREIGN INV. L.J. 427, 430 (2006), for a detailed review of the amendments.

98. *Id.* at 439–40.

99. Parra, *supra* note 17, at 65.

100. ICSID Convention, *supra* note 12, at Arb. Rules, r. 41(5).

101. *See, e.g.*, Free Trade Agreement, Chile-U.S., art. 10.19(4), June 6, 2003, 42 U.S.T. 1026 [hereinafter CLFTA]; Free Trade Agreement, Oman-U.S., art. 10.19(4), Jan. 19. 2006, Hein's No. KAV 8673 [hereinafter OMFTA]; Free Trade Agreement, Morocco-U.S., art. 10.19(4), June 15, 2004, 44 I.L.M. 544 [hereinafter MAFTA]; Trade Promotion Agreement, Peru-U.S., art. 10.20(4), Apr. 12, 2006, Hein's No. KAV 9736 [hereinafter PTPA]; Dominican Republic-Central America-United States Free Trade Agreement, art 10.20(4), Aug. 5, 2004, 119 Stat. 462, 43 I.L.M. 514 [hereinafter CAFTA-DR].

102. *See* Michele Potestà & Marija Sobat, *Frivolous Claims in International Adjudication: A Study of ICSID Rule 41(5) and of Procedures of Other Courts and Tribunals to Dismiss Claims Summarily*, 3 J. INT'L DISP. SETTLEMENT 137, 139–145 (2012); Chester Brown & Sergio Puig, *The Power of ICSID Tribunals to Dismiss Proceedings Summarily: An Analysis of Rule 41(5) of the ICSID Arbitration Rules*, 10 THE LAW AND PRACTICE OF INTERNATIONAL COURTS AND TRIBUNALS 227, 256–57 (2011); Aïssatou Diop, *Objection Under Rule 41(5) of the ICSID Arbitration Rules*, 25 ICSID REV. — FOREIGN INV. L.J. 312, 333 (2010) (discussing the first four cases applying Rule 41(5)).

First, the objection under Rule 41(5) can be made either with respect to the jurisdiction of the tribunal or the merits of the claim. The Tribunal in *Brandes Investment Partners LP v. Venezuela* first decided this issue.[103] Although Rule 41(5) was, at least in part, introduced at the urging of states who lamented that there was no procedure to provide for summary dismissal of cases which were "frivolous as to the merits,"[104] the scope of application for Rule 41(5) is in fact broader, covering both objections to the jurisdiction of the tribunal and objections based on the merits.

Second, ICSID tribunals are in unusual agreement that the bar for success on a Rule 41(5) objection that a claim that the case "manifestly without legal merit" is high. The term "manifestly" requires the party filing the objection to "establish its objection clearly and obviously, with relative ease and dispatch."[105] In this sense, both the factual and legal premises of the objection under Rule 41(5) must be established unequivocally by the party advancing the objection(s). This is important, as a finding of this nature means that the hefty standard involved in its determination has been established without uncertainty or factors that would oblige minimum hesitation.

Third, in determining whether a claim is "without legal merit, the objection must raise a "legal impediment to a claim," rather than a factual one.[106] As I explained with Professor Brown, this is because claimants do not typically extensively detail the facts of the case in their request for arbitration, nor do they append documentary exhibits or witness testimony to such requests.[107]

Finally, a recent tribunal has confirmed that claimants can also rely on access to a Rule 41(5) objection. In *Elsamex v. Honduras*, the claimant initiated the 41(5) proceeding after Honduras moved to annul the award, seeking a remedy against an arbitration award available to Honduras under the ICSID Convention.[108] There, the Annulment Committee determined

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103. Brandes Inv. Partners, LP v. Bolivarian Republic of Venez., ICSID Case No. ARB/08/3, Decision on the Respondent's Objection Pursuant to Rule 41(5) of the ICSID Arbitration Rules, ¶¶ 50–55 (Feb. 2, 2009) [hereinafter Brandes].

104. Parra, *supra* note 17, at 65; Antonietti, *supra* note 97, at 440.

105. Trans-Global Petroleum, Inc. v. Hashemite Kingdom of Jordan, ICSID Case No. ARB/07/25, Decision on the Respondent's Objection Pursuant to Rule 41(5) of the ICSID Arbitration Rules, ¶ 88 (May 12, 2008) [hereinafter Trans-Global]; Brandes, ICSID Case No. ARB/08/3, ¶ 63; Glob. Trading Res. Corp. v. Ukr., ICSID Case No. ARB/09/11, Award, ¶ 35 (Dec. 1, 2010) [hereinafter Global Trading]; Grynberg v. Grenada, ICSID Case No. ARB/10/6, Award, ¶ 6.1.2 (Dec. 10, 2010) [hereinafter Grynberg].

106. Brandes, ICSID Case No. ARB/08/3, ¶ 59; PNG Sustainable Dev. Program Ltd. v. Independent State of Papua N.G., ICSID Case No. ARB/13/33, Decision on the Respondent's Preliminary Objections Pursuant to ICSID Arbitration Rule 41(5), ¶ 90 (Oct. 28, 2014).

107. It is not expected that they do this under the ICSID Institutional Rules, which provide guidance on the form in which such requests are to be submitted. *See* Brown & Puig, *supra* note 102.

108. Elsamex, S.A. v. Republic of Hond., ICSID Case No. ARB/09/4, Annulment Proceeding Decision on Elsamex S.A.'s Preliminary Objections, ¶¶ 90–109 (Jan. 7, 2014).

that the procedure is also applicable in annulment applications — the most commonly used control mechanism limited to narrow circumstances.[109]

ii. Data on Cases Addressing 41(5) Objections

As of the end of 2017, there have been twenty-four applications to dismiss cases summarily under the ICSID Rules. Two of these have settled out of arbitration, and eight are either pending or have remained silent on the issue of cost. The remaining fourteen, all brought against developing or emerging economies, have made the matter of cost shifting visible and therefore can be subjected to relevant analysis. This is an admittedly very low number for a robust statistical analysis. Without more information, there are limited empirical methods that can be utilized with this data.

Nevertheless, one must start somewhere, and descriptive statics is an acceptable avenue. In nine of the fourteen cases (65 percent), ICSID tribunals fully rejected the Rule 41(5) objections raised by the respondent state. In five cases (35 percent), the tribunal sustained the objections: two partially and three completely. Contrary to what the theory may suggest, in principle, the tribunals seem to treat the allocation of costs in sustained objections similarly to the way it treats fully rejected ones. In fact, tribunals assigned costs at about the same rate (around 40 percent) in both fully rejected and accepted objections. Interestingly, in both situations the tribunals had a tendency to apply the American rule at a similar rate (around 60 percent).

This initial finding is surprising. One might expect tribunals to assign costs in successful Rule 41(5) objections instead of splitting them. At the very least, one can expect different distributions between the separate groups of fully rejected and accepted applications. Moreover, this distribution of outcomes sharply contrasts with the treatment of costs under the CAFTA-DR, a trade treaty with an investment chapter including a similar procedure for summary judgments but with a different rule on cost allocation. CAFTA-DR partially constrains the discretion of arbitrators, indicating that "the tribunal may, if warranted, award to the prevailing disputing party reasonable costs and attorney's fees incurred in submitting or opposing the objection."[110] In Section V(B), I return to this point regarding the comparison between the two different rules.

109. *Id. See also* ICSID Convention, *supra* note 12, at art. 52. In addition, a party may ask a tribunal that neglected to decide a submitted question to supplement its award and may request interpretation of the award. ICSID Convention, *supra* note 12, at arts. 49(2), 50.

110. CAFTA-DR, *supra* note 101, at ¶ 10.20(6).

	Rule 41(5) Applications ***N=14***		**DR-CAFTA Rule Applications** ***N=4***	
	Split Cost	**Assigned Cost**	**Split Cost**	**Assigned Cost**
Fully Rejected	5	4	2	0
Accepted	3	2	0	2

Table 2: Treatment of Cost Summary Dismissal Proceedings in Investor-State

To understand why tribunals have been so historically unpredictable, I start by dissecting the tribunal's reasoning in the cases sustaining (partially or fully) the application. In the three successful cases that followed the American rule to split costs, two tribunals referred to considerations of fairness and justice as their reasoning for not imposing costs on the claimant investors.[111] Similarly, in the third case, the tribunal implied that the host state had mistreated the investor, but the treaty relied on was of a very narrow scope.[112] In a fourth dispute — one of the case studies of this Article — the tribunal cited the novelty of the 41(5) proceeding as a reason not to

111. In Trans-Global, ICSID Case No. ARB/06/25, only one claim was considered manifestly without legal merit. In the consent award, parties agreed to "each bear their own legal costs and expenses and pay in equal shares the fees and expenses of the Tribunal and ICSID." In Rafat Ali Rizvi v. Republic of Indonesia, ICSID Case No. ARB/11/13, Decision on the Respondent's Objection Pursuant to Rule 41(5) of the ICSID Arbitration Rules (Apr. 4, 2012) (not publicly available) the Tribunal accepted the Respondent's objections. However, after rejecting all the surviving claims in a decision on jurisdiction of July 13, 2013, the tribunal concluded that "[a]s the Claimant was put to not inconsiderable extra expenses of this prior application, including the Auckland Hearing in February 2012, the Tribunal regards it as appropriate on finality to allocate the costs between the Parties equally with each Party bearing its own costs and legal representation." In Grynberg, ICSID Case No. ARB/10/6, the Tribunal decided: "Having regard to its conclusions that Claimants present claims are manifestly without legal merit, and that, it was impermissible for Claimants to advance them in new ICSID proceedings, the Tribunal considers it appropriate that Respondent should be fully indemnified for all of its costs, reasonably incurred or borne, in this proceeding." Finally, in Ansung Hous. Co. Ltd. v. People's Republic of China, ICSID Case No. ARB/14/25, Award (Mar. 9, 2017), the Tribunal completely accepted Respondent's Objections. The Tribunal decided to assess all of the direct costs of the proceeding and 75 percent of Respondent's legal fees and expenses against the Claimant. According to the Tribunal, China should not bear the reasonable costs for successfully defending the claim at the Rule 41(5) stage. The Tribunal dismissed arguments of regarding the size of investor, and the novelty of claims (in contrast to Global Trading). It found, however, the lawyer's fees were disproportionate to the extent of the Rule 41(5) Objection submissions and one-day hearing, hence the partial award.

112. Accession Mezzanine Capital L.P. v. Hung., ICSID Case No. ARB/12/3, Award, ¶¶ 200–01 (Apr. 17, 2005), https://www.italaw.com/sites/default/files/case-documents/italaw4353.pdf (concluding to split costs because "there was no possibility for the Claimants to obtain justice in Hungary and it was natural for them to look to an international tribunal. This Tribunal is, however, a judicial body with a limited jurisdiction that is carefully prescribed in the international instruments that are binding upon it. The Tribunal has no discretion to depart from the rules applicable to its jurisdiction, but it does have the discretion to take into account broader considerations of fairness and justice in exercising its power to award costs under Article 61 of the ICSID Convention.").

shift costs.[113] Finally, in a case where the respondent's objections were only partially sustained, but the case was ultimately dismissed in a later procedural stage, the tribunal split the costs of the entire proceeding.[114] In that case, the tribunal effectively penalized the respondent because of the added hardship of a partially unsuccessful 41(5) proceeding, "and because the favorable decision was no 'vindication of Respondent's position on the merits.'"[115] Hence, each party had to bear its own costs.

The observed reluctance to shift costs in cases of successful Rule 41(5) application coincides with a proclivity to assign the costs of the 41(5) proceedings where applications were considered unsuccessful — cases where one may expect to see tribunals splitting the costs. For instance, one tribunal reasoned that the rationale of "Rule 41(5) was to spare respondent States the wasted trouble and expense of having to defend wholly unmeritorious claims, [though] it must follow per contra that a Respondent invoking the procedure under the Rule takes on itself the risk of adverse cost consequences should its application fail."[116] Another tribunal held in the merits stage that the respondent was liable and awarded costs to the claimant by applying the English rule to both the preliminary and merits stages.[117] Finally, in two cases in which the tribunal awarded costs to a successful Respondent, it discounted the expenses incurred in connection with the unsuccessful preliminary objections phase — as exemplified with the second of the case studies below.[118]

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113. Global Trading, ICSID Case No. ARB/09/11, ¶ 59 (The Tribunal completely accepted Respondent's Objections. However, it decided "the appropriate outcome is for the costs of the procedure to lie where they fall." This is because of "the newness of the Rule 41(5) procedure" and "the reasonable nature of the arguments concisely presented.").

114. Emmis Int'l Holding, B.V. v. Hung., ICSID Case No. ARB/12/2, Award, ¶ 259 (Apr. 1, 2014), https://www.italaw.com/sites/default/files/case-documents/italaw3143.pdf (deciding that "Claimants acted in good faith in bringing and prosecuting their claim," and that "Respondent could have consented to submit the wider dispute encompassing Claimants' non-expropriation claims to ICSID arbitration, [but] decided not to give its consent, as it was entitled to do.").

115. *Id.* at ¶ 261 (holding that the "[a]ward [was no] vindication of Respondent's position on the merits.").

116. MOL Hungarian Oil & Gas Co. Plc v. Republic of Croat., ICSID Case No. ARB/13/32, Decision on the Respondent's Objection Pursuant to Rule 41(5) of the ICSID Arbitration Rules, ¶ 54 (Dec. 2, 2014) (concluding "Rule 41(5) was to spare respondent States the wasted trouble and expense of having to defend wholly unmeritorious claims, [yet] it must follow per contra that a Respondent invoking the procedure under the Rule takes on itself the risk of adverse cost consequences should its application fail.").

117. Edenred S.A. v. Hung., ICSID Case No. ARB/13/21. See Luke Eric Peterson, *French Investor Wins 23 Million Euro Under France-Hungary BIT*, INVESTMENT ARBITRATION REPORTER (Dec. 16, 2016), https://www.iareporter.com/articles/french-investor-wins-23-million-eur-under-france-hungary-bit, for a report on this unpublished case.

118. Transglobal Green Energy, LLC v. Republic of Pan., ICSID Case No. ARB/13/28, Decision on the Admissibility of Respondent's Preliminary Objection to Jurisdiction of the Tribunal under Rule 41(5) of the Arbitration Rules, ¶¶ 23–37 (Mar. 14, 2015) [hereinafter Transglobal Green, Jurisdictional Order] (The Tribunal considered the cavalier attitude of Claimants and the submission of multiple suspension requests. Notably, it also considered that the Preliminary Objection under Rule 41(5) was clearly out of time nonetheless accepted as a jurisdictional objection to except related costs). In Cent.

Two patterns emerge from the early treatment of costs in proceedings to dismiss unmeritorious claims summarily: tribunals are more willing to discourage abusive uses of 41(5) proceedings by respondent states than they are to sanction claimant investors bringing unmeritorious cases. Moreover, if a case advances to a further stage, the decision to bring a Rule 41(5) proceeding is relevant to the final allocations of costs, especially if the claimant is ultimately unsuccessful in the merits stage. In such cases, tribunals are more likely to apply the English rule to the portion of the cost of the summary dismissal proceedings. In the next Section, I provide some plausible explanations to these trends. Before such analysis, I complement this Section with two case studies that are illustrative of these trends.

Claimant	Respondent	Application Accepted?	Costs of Arbitration	Cost of 41(5) Stage	Rule in 41(5) Stage
Rafat Ali Rizvi	Indonesia	No	Split	Respondent	English
Brandes Investment Partners LP	Venezuela	No	Split	Split	American
Venoklim Holding B.V.	Venezuela	No	Split	Split	American
PNG Sustainable Development Program Ltd.	Papua New Guinea	No	Split	Split	American
Lundin Tunisia B.V.	Tunisia	No	Split	Split	American
Edenred S.A.	Hungary	No	Respondent	Respondent	English
Transglobal Green Energy, LLC and Transglobal Green Panama, S.A.	Panama	No	Claimant	Split	American
MOL Hungarian Oil and Gas Company Plc	Croatia	No	Split	Respondent	English
Central European Aluminium Company	Montenegro	No	Claimant	Split	American
Trans-Global Petroleum, Inc	Jordan	Yes*	Split	Split	American (agreed)
Global Trading Resource Corporation and Globex International, Inc	Ukraine	Yes	Split	Split	American
Rachel S. Grynberg, Stephen M. Grynberg, Miriam Z. Grynberg, and RSM Production Corporation	Grenada	Yes	Claimant	Claimant	English
Ansung Housing Co., Ltd.	China	Yes	Claimant	Claimant	English
Emmis International Holding, B.V., Emmis Radio Operating, B.V., MEM Magyar Electronic Media Kereskedelmi és Szolgáltató Kft.	Hungary	Yes	Split	Split	American
Accession Mezzanine Capital L.P. and Danubius Kereskedöház Vagyonkezelö Zrt.	Hungary	Yes	Split	Split	American

Table 3: Allocation of Costs in Rule 41(5) Proceedings under ICSID

European Aluminium Co. (CEAC) v. Montenegro, the Tribunal completely rejected the Respondent's objections. The majority of the Tribunal declined to find jurisdiction to hear the matter and, in relation to the costs, the Tribunal applied the "costs follow the event" rule. Therefore, the Tribunal awarded costs to the Respondent, minus the costs and expenses incurred in connection with the Preliminary Objections phase (each party to bear equal share). *See* Cent. European Aluminium Co. (CEAC) v. Montenegro, ICSID Case No. ARB/14/8, Award, ¶ 226 (July 26, 2016).

iii. Case Studies on Cost Allocation in Tribunals Addressing 41(5) Objections

Global Trading Resource Corporation et al. v. Ukraine: This case is a good example of the application of the provisions of Rule 41(5) and the general reluctance to shift costs or sanction spurious claims.[119] This claim was brought against the Ukraine on the basis of the US-Ukraine BIT. The investors, Global Trading and Globelex, alleged that they had agreed to "sale and purchase" contracts with the Ukrainian State Committee for State Material Reserve — contracts which were solicited by the Ukraine in order to break "anti-competitive and inflationary conditions in the Ukrainian poultry industry."[120] The claimants sought to enforce "the right to be paid for performance of the contractual obligations" as a treaty breach.[121]

Soon after the registration of the case by ICSID, the Ukraine noted that it intended to raise an objection under Rule 41(5).[122] The Ukraine argued that the claims were "nothing more than claims to payment under trading contracts, and [did] not therefore amount, in law, to 'investments.'"[123] The Ukraine submitted that this type of cross-border trade transaction had been excluded from the definition of "investment" under the US–Ukraine BIT and that such transactions were outside the scope of the concept of "investment" under Article 25(1) of the ICSID Convention.[124] In response, the claimants argued that the "substantial resources" they had devoted to "procuring, shipping and delivering the goods and the purposes for which they were being purchased . . . constituted, on a property interpretation . . . 'investments.'"[125]

In addressing the objection under Rule 41(5), the Tribunal agreed with prior case law that the term "manifestly without legal merit" required "the respondent to establish its objection clearly and obviously, with relative ease and dispatch. The standard was set high."[126] The Tribunal then turned to the substance of the Ukraine's objection, raised on the argument that Global Trading and Globelex had not made an "investment" within the meaning of the US-Ukraine BIT or Article 25(1) of the ICSID Convention. The Tribunal did not need to come to a definitive view on whether the contracts fell within the meaning of the BIT due to its finding that the sale and purchase contracts were purely commercial transactions, and *clearly* not an "investment" for the purposes of Article 25(1) of the ICSID Convention.[127]

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119. Global Trading, ICSID Case No. ARB/09/11, at ¶ 105.
120. *Id.* at ¶¶ 37-38.
121. *Id.* at ¶ 40.
122. *Id.* at ¶ 16.
123. *Id.* at ¶ 41.
124. *Id.*
125. *Id.* at ¶ 42.
126. Trans-Global, ICSID Case No. ARB/06/25, at ¶ 88 (cited in Global Trading, *supra* note 105, at ¶ 35).
127. *Id.* at ¶¶ 54–57.

The Tribunal therefore decided that the claims brought by Global Trading and Globelex were "manifestly without legal merit."[128]

Notwithstanding the fact that commercial transactions of this nature are considered the textbook example of business transactions that cannot qualify as an investment for the purposes of Article 25 of the Convention,[129] or the dismissal of the claimants' claims in the broadest possible terms, the Tribunal refused to cost-shift and decided instead as follows:

> [T]he Tribunal [decides according to] Article 47 of the Arbitration Rules . . . given the newness of the Rule 41(5) procedure and given the reasonable nature of the arguments concisely presented to it by both parties, that the appropriate outcome is for the costs of the procedure to lie where they fall. It therefore makes no order as to costs.[130]

Transglobal Green Energy, LLC et al. v. Panama exemplifies how arbitrators are usually uneasy about the use of Rule 41(5) proceedings for tactical reasons, or otherwise. Tribunals may be more willing to assign the costs of unsuccessful cases to respondents bringing summary dismissal proceedings even when they succeed on a later stage of the case. The case concerned a dispute submitted on the basis of the US-Panama BIT, [131] which involved a hydro-electric power generation concession in Panama named "Bajo de Mina."[132] The Claimants were two companies that failed to comply with the starting time of a concession contract for the construction of a hydroelectric power utility.[133] The state had the right to terminate the contract if the concessionaire failed to meet the deadlines, and accordingly did so.[134] Domestic litigation ensued and was pending when the arbitration started.

In the arbitration proceedings, Panama failed to submit objections within the 30-day period after the constitution of the Tribunal. Nevertheless, Panama submitted a Rule 41(5) objection, arguing that "the balance of harm or injury should the Tribunal decline to address the 41(5) objection on timeliness grounds would be against Panama, which would be forced to defend against claims manifestly lacking a legal basis."[135] The Tribunal completely rejected the Respondent's objections for not meeting "the 30-day limit from the constitution of the Tribunal for filing a preliminary

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128. *Id.* at ¶¶ 58–59.

129. ICSID Convention, *supra* note 172, at art. 25. *See also* SCHREUER ET AL., *supra* note 89; Julian Davis Mortenson, *The Meaning of "Investment": ICSID's* Travaux *and The Domain of International Investment Law*, 51 HARV. J. INT'L L. 257 (2010).

130. Global Trading, ICSID Case No. ARB/09/11, at ¶ 59.

131. Transglobal Green Energy, LLC v. Republic of Pan., ICSID Case No. ARB/13/28, Request for Arbitration, ¶ 2 (Sept. 19, 2013) [Hereinafter Transglobal Green, Request for Arb.].

132. *Id.* at ¶ 3.

133. *Id.* at ¶ 2.

134. *Id.* at ¶ 15.

135. Transglobal Green, Jurisdictional Order, ICSID Case No. ARB/13/28, at ¶ 10.

objection under Rule 41(5)."[136] Panama persisted in the jurisdictional stage, arguing objections similar to those raised in the Rule 41(5) proceeding but under the doctrine of abuse of process accusing the Claimants of attempting to create artificial international jurisdiction over a pre-existing domestic dispute.[137]

The Tribunal was receptive to this later objection. After completely accepting the Respondent's objection against abuse of process, the Tribunal awarded partial costs to the Respondent. The Tribunal considered both the cavalier attitude of the Claimants and the submission of multiple suspension requests. Notably, in considering that the Preliminary objection under Rule 41(5) was clearly out of time, the Tribunal placed the burden of attorney's fees and expenses for bringing the untimely objection on the Respondent. In its decision, the tribunal reasoned:

> The Preliminary Objection to Jurisdiction under Arbitration Rule 41(5) was clearly out of time and therefore rejected as such by the Tribunal, but the Tribunal nonetheless accepted it as a notice of future jurisdictional objections. After taking all these circumstances into account, the Tribunal concludes that Claimants should bear the attorneys' fees and expenses of Respondent except for those claimed by Respondent for [the Rule 41(5) proceeding].[138]

IV. SUPPLEMENTAL CONSIDERATIONS: EXPERIMENTS AND INTERVIEWS

The prior Section highlights some of the challenges of conducting research in international litigation, especially in arbitration. Though the quantity of arbitral proceedings continues to grow, the full body of proceedings is still admittedly small and consists mainly of settled cases and unpublished decisions. On top of this, selection issues limit the results of relevant analysis. In addition to forum shopping and the variety of challenges in comparing materially distinct disputes, non-random selection of arbitrators and consensus decision-making processes, among others, affect the analysis.

The pitfalls inherent in these finite avenues of analysis can be supplemented and overcome with semi-structured interviews and, more especially, experiments — the "gold standard" of social science research.[139]

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136. *Id.* at ¶ 38.

137. Transglobal Green Energy, LLC v. Republic of Pan., ICSID Case No. ARB/13/28, Award, ¶ 85 (June 2, 2016) [hereinafter Transglobal Green, Award].

138. *Id.* at ¶ 127.

139. *See generally* James N. Druckman, Donald P. Green, James H. Kuklinski & Arthur Lupia, *The Growth and Development of Experimental Research in Political Science*, 100 AM. POL. SCI. REV. 627 (2006);

In particular, this multimethod approach can yield important evidence for the assessment of debates, such as the use of discretion to allocate costs. Before engaging in the final analysis, in this section I explain the approach to obtaining alternative evidence as well as the main findings from it.

A. Experiment Survey on Cost Allocation

i. Design

To understand the role of discretion and the factors that may affect cost allocation, I worked alongside a social scientist to design an experimental survey with embedded manipulations.[140] We asked actual arbitrators to imagine that they were appointed to an investment arbitration tribunal, briefly outlined the hypothetical dispute, and provided the tribunal's decision on the case. We then asked the arbitrators to decide the question of legal costs. We replicated the experiment with a slightly different setting, but confirmed the results outlined below.[141]

Four elements of the vignette were randomly and independently manipulated for every participant: the party that appointed the arbitrator, the income level of the respondent state and of the home country of the claimant investor, and the outcome of the dispute. Figure 1 shows an example vignette (one of 64 possibilities), highlighting the areas where the vignette texts differed across respondents.

> Imagine an investor-state dispute being conducted under the 2006 Arbitration Rules of the International Centre for Settlement of Investment Disputes (ICSID). The claimant is a firm headquartered in a [**high income economy]**. The respondent is a country classified by the World Bank as a [**middle income economy]**.
>
> The claimant alleged that the respondent violated the provisions of a bilateral investment treaty to which the respondent is a party. Among other arguments, the claimant argued that the investor and its investments had been treated unfairly and that ultimately the respondent expropriated the claimant's investment located within the respondent's territory. The underlying dispute concerns an infrastructure project undertaken by the claimant under a concession contract with a governmental agency. The respondent argued in response that the claimant had violated provisions of the contract and that the investors received all compensation to which they were entitled.
>
> You were appointed to the tribunal **[by the respondent].** After careful consideration of the facts of the case, the tribunal unanimously decided that [**all the claimant's claims are manifestly without legal merit].**
>
> In their submissions on costs, both parties have requested that the other party bear the costs of the proceedings in full, including legal fees and expenses. The counsels for both parties behaved professionally and ethically during the proceedings.

Figure 1: Sample experimental vignette showing manipulated elements.

Adam S. Chilton & Dustin Tingley, *Why the Study of International Law Needs Experiments*, 52 COLUM. J. TRANSNAT'L L. 173 (2013).

140. For the results and design, see Puig & Strezhnev, *supra* note 63.

141. *Id.*

This experiment was designed to capture the plausible operation of the factors detailed above in Section II(C), which we hypothesized could impact the use of discretion in allocating costs. For instance, to assess the impact of a litigant's perceived capacity on an arbitrator's discretion, the vignette included a claimant who was either headquartered in a high income or middle-income economy, while the respondent state could be a middle-income or a low-income country.[142] To assess the role of independence, survey participants could also be told that they were appointed in four ways: (1) by the respondent, (2) by the claimant, (3) by agreement of the litigating parties, or (4) by an unknown party — the different methods in which arbitrators can be appointed.[143] Moreover, to assess the strength of a case and to create a meaningful benchmark, the tribunal's ruling could take on four different conditions: (1) respondent expropriated the claimant's property (claimant wins dispute), (2) respondent did not expropriate the claimant's property (respondent wins dispute), (3) the dispute is outside of the tribunal's jurisdiction (respondent wins on technical grounds), and (4) the claimant's claims are manifestly without merit (respondent wins decisively).

After presenting the survey participants with the vignette, they were asked a simple question: how should legal costs be apportioned in the dispute? Survey respondents could choose to have the one party reimburse all (English Rule) or part of the costs, or have each party pay their own costs (American Rule).

As an integral part of the experimental design, each of the 64 unique combinations (4x4x4) of the four treatment variables had an equal probability of appearing and each treatment vignette was generated independently of the others. This category of experiments, which assign multiple randomized treatment conditions to each subject, are known as "factorial" design experiments.[144] With this design, researchers can make comparisons across any two unique profiles — a strong fit for researchers interested in testing hypotheses relating to a *single attribute* of the vignette (e.g., the effect of being appointed by the respondent rather than the claimant). Moreover, conjoint analysis techniques provide a way of analyzing a factorial experiment in order to estimate separate effects for each "attribute" of a vignette. This strategy, originally developed in the field of

142. Since investment arbitration claimants tend to be from wealthier capital exporters and respondents tend to be developing countries, we omitted the "low income claimant" and "high income respondent" conditions in order to keep the total number of treatments reasonable given our sample size. *See* Thomas Schultz & Cedric Dupont, *Investment Arbitration: Promoting the Rule of Law or Over-empowering Investors? A Quantitative Empirical Study,* 25 EUR. J. INT'L L. 1147, 1154–56 (2015).

143. In the last case, the treatment condition simply read "You were appointed to the tribunal." This is what some authors call "blind appointment." *See* Puig & Strezhnev *supra* note 63, at 394–95.

144. ROGER E. KIRK, EXPERIMENTAL DESIGN: PROCEDURES FOR BEHAVIORAL SCIENCES (1982).

market research, has broader use within the social sciences for researchers studying how individuals make decisions when presented with a choice among multiple attributes.[145]

For practical purposes, this means that as long as each element of the vignette is manipulated independently, the general intuition behind experimentation and randomization still holds.[146] One can obtain unbiased estimates of the average effect of a change in a single attribute by taking the difference-in-means of the outcome between the individuals receiving a vignette with one level of the attribute and individuals receiving the other (control) level.[147] Higher-order interactions with the other treatments can be safely ignored (in terms of bias) since by design, those treatments are independently assigned.

Focusing on a single narrow decision (outcome variable) like cost allocation exploits one advantage of experimental designs by isolating a discrete choice between the English or American rules. However, the decision to have arbitrators rule on costs was also made for practical purposes. Any experimental vignette has to strike a balance between detail and length. Participants need enough detail in order to give realistic and reasonable responses. But if the vignette is too long, respondents will simply not have the time to participate in the experiment. It is important to note that the survey was conducted online after collecting publicly available information on international arbitrators from a variety of internet sources. Because investor-state arbitration inherits much of its structure from private commercial arbitration, commercial arbitrators participated in the survey.[148] Nevertheless, it was found that survey participants were a reasonably fair representation of the overall community of investor-state arbitrators, and much better than a non-expert sample. The experiment was conducted during the fall of 2015 and replicated in the spring of 2017, after obtaining all the relevant approvals by the review boards of the two institutions involved.

ii. Results

A total of 257 valid responses were received in the original experiment (plus a few responses that appeared to have a mistaken click and that were considered in the analysis to avoid inducing bias). Figure 2 plots the

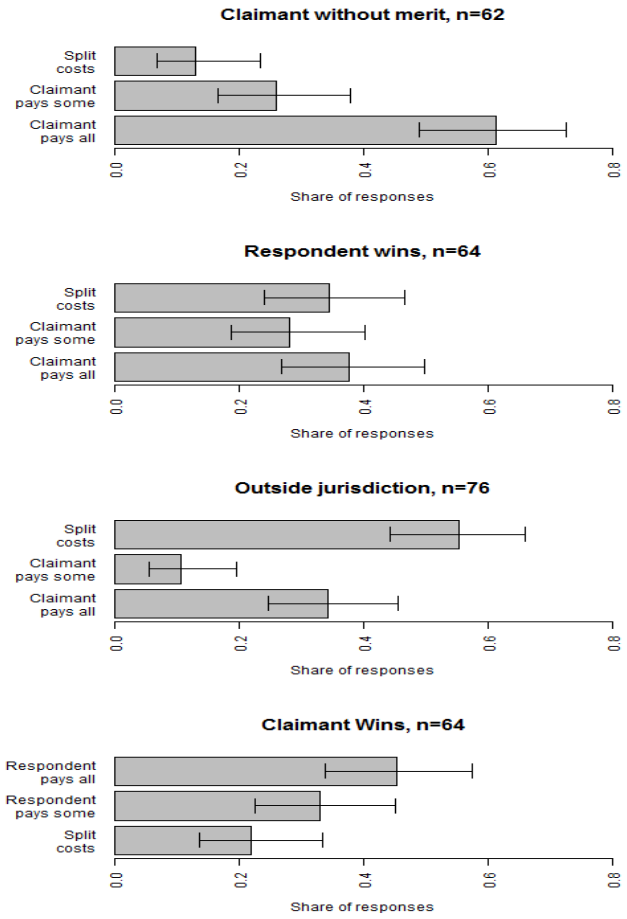
145. *See generally* Paul E. Green, Abba M. Krieger, & Yoram J. Wind, *Thirty Years of Conjoint Analysis: Reflections and Prospects*, 31 INTERFACES 56 (2001) (giving an overview of conjoint methods in market research); Jens Hainmueller, Daniel J. Hopkins & Teppei Yamamoto, *Causal Inference in Conjoint Analysis: Understanding Multidimensional Choices via Stated Preference Experiments*, 22 POL. ANALYSIS 1 (2013)

146. Hainmueller et al., *supra* note 145, at 11–12.

147. *Id.*

148. *See* DEZALAY & GARTH, *supra* note 47; Susan Franck et al., *The Diversity Challenge: Exploring the "Invisible College" of International Arbitration*, 53 COLUM. J. TRANSNAT'L L. 429 (2015).

distribution of cost allocations across the four dispute outcome conditions — the only treatment that fully relates to legal attributes. From the first visualization, it appears quite clear that surveyed arbitrators were more punitive towards the claimant's claims ruled spurious and were more likely to have the parties pay their own way when the dispute was ruled outside of the jurisdiction — a finding that may suggest that, despite misconduct by the government, a technicality barred the investor's claim. Moreover, when the respondent and the claimant respectively win the case on the merits, arbitrators tend to assign cost at a similar rate, with arbitrators being slightly more punitive on respondents that loose. Finally, arbitrators treat victories on jurisdiction or on the actual merits to be less deserving of reimbursement than victories under the manifestly without legal merit standard.



Lines denote 95% binomial confidence intervals.

Figure 2: Empirical distribution of survey respondents' cost allocations across dispute outcome

In principle, these findings seem to be consistent with the general theory. Individual arbitrators appear to respond rationally to the *magnitude* of a victory when assigning costs.[149] The question however, is how strong the differences in treatment are.

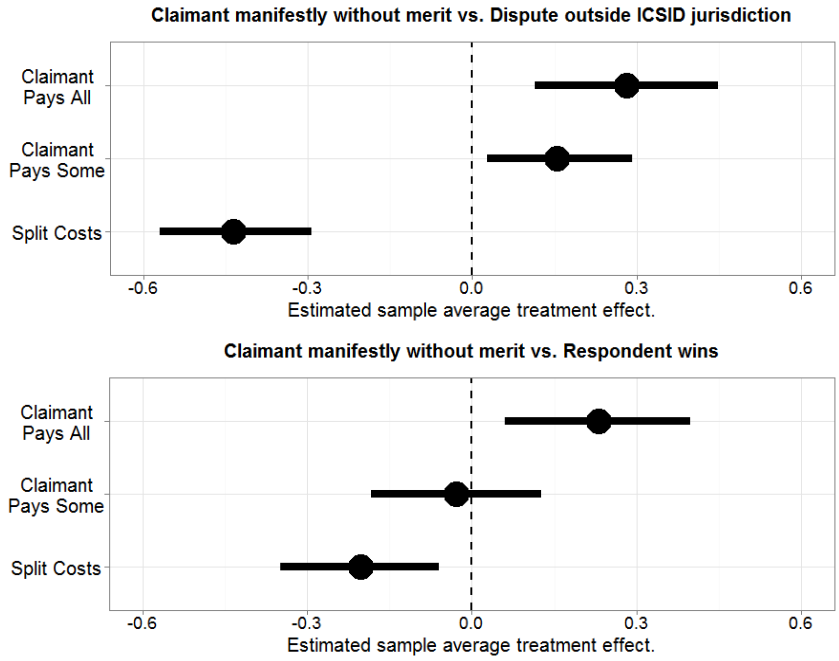
To assess the degree to which the arbitrators react to the different outcomes, Figure 3 plots the estimated average treatment effects[150] of dispute outcomes on survey participants who received a treatment where the respondent won. The findings are telling: compared to a simple loss for the claimant, a ruling that the claim is "manifestly without merit" increases the probability that the arbitrator will have the claimant reimburse all of the respondent's legal costs by about twenty percent. Moreover, the difference between winning on jurisdictional grounds and a ruling that the claim is "manifestly without merit" is comparable; in that case, however, arbitrators are trading off between splitting the costs and having the claimant pay *some* of the costs. Hence, losing summarily rather than on jurisdiction increases the probability of paying some of the respondent's costs by about the same percentage.[151]

Overall, the results indicate that arbitrators exercise their discretion in assigning costs as a way of compensating for the magnitude of a victory, absent any other relevant factors. In particular, there is evidence that arbitrators seek to deter frivolous litigation by punishing claimants who are "manifestly without merit." Hence, the probable explanation for the discrepancy observed between the experiment and the actual case is likely related to other factors, independent of the strength of the case.

149. *See* Puig & Strezhnev, *supra* note 63.

150. The "average treatment effect" measures the difference in mean outcomes between units assigned to the treatment and units assigned to the control. *See generally* STEVEN L. MORGAN & CHRISTOPHER WINSHIP, COUNTERFACTUALS AND CAUSAL INFERENCE: METHODS AND PRINCIPLES FOR SOCIAL RESEARCH (2007).

151. *See* Puig & Strezhnev, *supra* note 63.



Lines denote 95% bootstrapped confidence intervals. N = 257

Figure 3: Estimated average treatment effects of dispute outcome.

The design of the experiment also provides a test for the role of other factors on how arbitrators make decisions, especially the factors that the literature has identified as constraining discretion.

First, I examine whether arbitrators' decisions are affected by the party that appointed them. As discussed, a number of prominent scholars have raised their concerns about the impartiality of party-appointed arbitrators in investor-state proceedings.[152] While arbitrators are supposed to be impartial regardless of the appointing party, there is a concern that career incentives or implicit biases drive arbitrators to favor the side that appointed them.

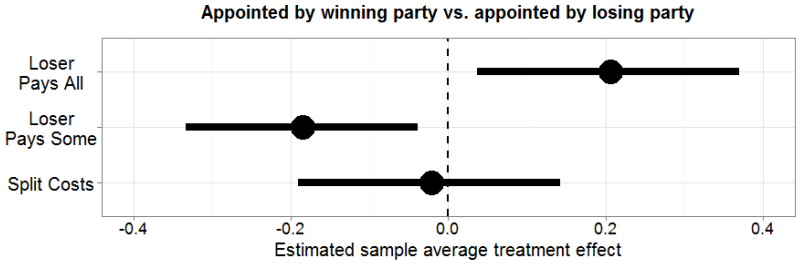
The specific effect of personal interest is the difference in cost allocation between arbitrators who are appointed by the winning party and those appointed by the loser.[153] Figure 4 plots the estimated effect of being

152. *See generally* Jan Paulsson, *Moral Hazard in International Dispute Resolution*, 25 ICSID REV. — FOREIGN INV. L.J. 339 (2010); Albert Jan van den Berg, *Dissenting Opinions by Party — Appointed Arbitrators in Investment Arbitration, in* LOOKING TO THE FUTURE: ESSAYS ON INTERNATIONAL LAW IN HONOR OF W. MICHAEL REISMAN 821 (Mahnoush Arsanjani et al. eds., 2011).

153. In the experiment, we pooled respondent- and claimant-appointee effects into a single "winner" effect to improve power. Note that we find no statistically significant heterogeneity in the winner-loser effect depending on whether the winner was the claimant compared to the respondent. *See* Puig & Strezhnev, *supra* note 63.

appointed by the winner relative to the loser of the dispute. Overall, the results suggest that arbitrators tend to render more favorable cost decisions to the party that appointed them. Being appointed by the winning party causes a statistically significant ($p < .05$) increase of approximately eighteen percent in the probability that the arbitrator will have the loser pay all of the costs of the dispute.[154] The magnitude of this effect is comparable to the effect of a claimant being ruled "manifestly without merit" rather than simply losing the dispute.

Notably, there is no statistically significant difference between the two groups in the probability that the arbitrator chooses to have the parties split the costs of the dispute. This result suggests that arbitrators tend to have a predisposition towards the party that appointed them, but their bias operates within the constraints of legal norms. Arbitrators who would have adopted the American rule do not appear more likely to cost shift when appointed by a party that would benefit from reimbursement. However, given that an arbitrator chooses to have the losing party pay part of the winner's legal costs, the winning party's appointee will tend to have the loser reimburse a greater amount.



Lines denote 95% bootstrapped confidence intervals. N = 257

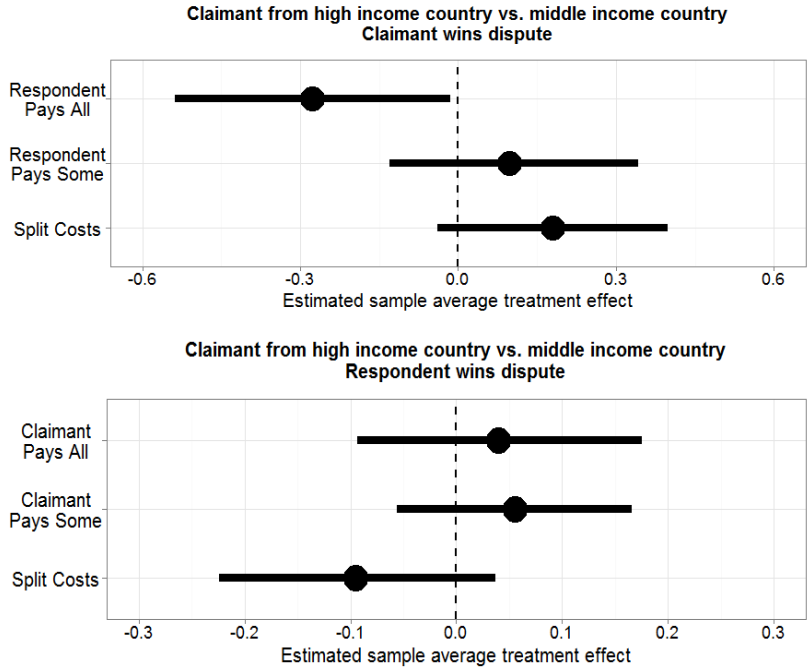
Figure 4: Average treatment effect on costs of being appointed by the winning party vs. losing party

In addition to appointer's effect, prior research suggests that the perceived capacity of an advantage by one actor over another can result in the tailoring of discretion. This may be the result of equality perception bias — a predisposition against perceived unequal distribution of resources.[155] To assess this factor, Figure 5 plots the average effects of assigning a different respondent or claimant home country income level on cost allocation. Among claimants that win the dispute, claimants with higher

154. See Puig & Strezhnev, *supra* note 63, for other implications of this result.

155. Alex Shaw & Kristina R. Olson, *Children Discard a Resource to Avoid Inequity*, 141 J. EXPERIMENTAL PSYCHOL.: GEN. 382 (2012); Sarah F. Brosnan & Frans B. M. de Waal, *Monkeys Reject Unequal Pay*, 425 NATURE 297 (2003).

expected resources (those from high income rather than middle income countries) are less likely to have their full costs reimbursed. Likewise, when the respondent wins the dispute, low income respondents are more likely to have at least part of their costs reimbursed. Interestingly, we found null effects on average for the losing party. Arbitrators tend to allocate costs in a way that attempts to counterbalance the perceived resource disparities among the parties, but in a way that tends to compensate the winning rather than losing party. This may explain why claimants that win after also successfully navigating a Rule 41(5) objection tend to get higher awards on costs.[156]



Lines denote 95% bootstrapped confidence intervals. N = 257

Figure 5: Estimated effects of claimant/respondent country development conditional on outcome

In short, the experimental survey suggests that the observed reluctance to shift costs in investor-state arbitration may not be driven by a misperception of the role of discretion to deter bad cases. Rather, arbitrators seem to be very aware of the possibility of using their discretion to allocate costs depending on the magnitude of the victory — and for that matter to

156. For the implications of this finding, see Sergio Puig & Anton Strezhnev, *The David Effect and ISDS*, 28 EUR. J. INT'L L. 731 (2017).

deter spurious claims brought by investors. However, arbitrators seem constrained by other factors — including their perception of the capabilities of the parties — as well as affected by their relative independence.

In this context, ICSID tribunals' preference for the American rule in their exercise of discretion is understandable in most cases: it protects against over-punishing respondents and limits suboptimal deterrence of future cases. However, it has the potential to result in leniency towards claimants bringing bad cases as a consequence of arbitrators affected by affiliation bias bargaining within the tribunal and arbitrators making judgements on legal capacity and deservingness. In the next Section, I explore how arbitrators perceive their own use of discretion and to what extent other factors like professional norms may by implicated in the allocation of costs.

To be sure, there are many obvious limitations to survey experiments. Some are general and others more specific to the field of investor-state arbitration. Regardless of the field of study, it is obvious that the real world can be much more complex than the discrete controlled environment of surveys. While randomizing actual proceedings to replicate an experiment would be ideal, it is complicated without assistance from adjudicatory institutions. Moreover, unless researchers use a more realistic setting that replicates the deliberation and discussion of the tribunal, this experiment is unable to assess how exactly preferences of individual arbitrators affect the outcomes of the arbitration tribunal — a collective and collaborative body. This is not only a limitation of survey experiments, but a general concern with experiments on individual actors who act within organizations that have their own norms, rituals, and tacit procedures.[157]

B. Semi-structured Interviews of Arbitrators

The profession of arbitration is a textbook example of how socialization among professionals may change their incentives and affect their decision-making. In essence, international arbitration takes place in a close-knit community of legal actors and strong professional norms. Hence, arbitrators rely on different signals and respond to complex incentives that drive their careers and the field more generally. Anecdotally, some experts claim that this feature often results in compromises or "barters," which are reflected in many complicated aspects of the proceedings and decision. For instance,

157. See Alexander Coppock & Donald P. Green, *Assessing the Correspondence Between Experimental Results Obtained in the Lab and Field: A Review of Recent Social Science Research*, 3 POL. SCI. RES. & METHODS 113 (2015), for general limitations on survey experiments. See Kevin J. Mullinix, Thomas J. Leeper, James N. Druckman, & Jeremy Freese, *The Generalizability of Survey Experiments*, 2 J. EXPERIMENTAL POL. SCI. 109 (2015), for general limitations on internet experiments.

this can manifest in the wording of decisions, the nature of the violations identified, or the amount of damages awarded.[158]

To understand what other factors constrain the allocation of costs, especially professional norms and other incentives, I conducted semi-structured interviews with international arbitrators in Mexico City, Barcelona, and Washington, D.C., during the summer of 2017.[159] Most described the process of deciding on costs as a difficult one — despite the complete grant of discretion — and remarked that parties rarely, if ever, challenge that section of the decision. In particular, the interviewees noted that being on a Tribunal can be contentious, especially for less experienced arbitrators who tend to show bias in favor of their appointing party. One arbitrator recalled a recent case in which, despite a clear victory by the claimant, another arbitrator "adamantly" tried to protect the respondent (his/her appointer). This is consistent with the appointer's bias identified above. [160]

The arbitrators interviewed also admitted that decisions are often the product of "compromises" between arbitrators.[161] An arbitrator recounted an instance where a colleague decided to go along with the majority, without expressing their concern for a rather technical point that would make the legality of a measure adopted by a state look less apparent. In "exchange" for the unanimous decision in favor of the state, the arbitrators were to split the costs evenly. In another interesting insight, one arbitrator referred to a case which ended with an award on cost *against* a successful defendant.[162] Their reasoning was that the state won as a result of an incident of bribery (exorbitant fees promised to consultants on the eve of the tender process) that disqualified the investor from legal protection, and some evidence existed to suggest that state officials were also implicated.[163] The tribunal imposed costs that were to be paid to a trust fund for anti-corruption matters, signaling the tribunal's concern with that country's corruption.

158. Mark Kelman, Yuval Rottenstreich & Amos Tversky, *Context-Dependence in Legal Decision Making*, 25 J. LEGAL STUD. 287 (1996) (describing effects of "compromise" and "contrast" behavior on jury decision-making); Paulsson, *supra* note 152.

159. Given that the questions included general aspects of decision-making (but not on individual cases), the arbitrators consented to discussing the topic.

160. Interview Notes, Arbitrator 3 (June–Aug. 2017) (on file with author).

161. Interview Notes, Arbitrator 12 (June–Aug. 2017) (on file with author).

162. Interview Notes, Arbitrator 6 (June–Aug. 2017) (on file with author). The case referred to is Spentex Netherlands, B.V. v. Republic of Uzb., ICSID Case No. ARB/13/26. The case is unpublished, but reported in Vladislav Djanic, *In Newly Unearthed Uzbekistan Ruling, Exorbitant Fees Promised to Consultants On Eve of Tender Process Are Viewed by Tribunal As Evidence of Corruption, Leading To Dismissal of All Claims Under Dutch BIT,* INVESTMENT ARBITRATION REPORTER (June 22, 2017), https://www.iareporter.com/articles/in-newly-unearthed-uzbekistan-ruling-exorbitant-fees-promised-to-consultants-on-eve-of-tender-process-are-viewed-by-tribunal-as-evidence-of-corruption-leading-to-dismissal-of-all-claims-under-dutch/.

163. Djanic, *supra* note 162.

Accordingly, both cases show that this area of arbitrator's discretion is frequently used to bargain over more substantive aspects of the decision.

Finally, when asked specifically about spurious claims, most arbitrators were in agreement on two aspects. First, that it was a complicated standard because misconduct and legal violations are significantly different. Hence, a claim can be "manifestly without legal merit," but still attract the sympathy of arbitrators, who in turn can reflect this sympathy in their decision not to shift costs without needing to offer much justification.[164] Second, arbitrators suggested that professional pressures can play a major role. Such professional pressures — often reflected in the specialized press — can affect an arbitrator's decision on costs.[165] At least four arbitrators used the example of the recent cases against Australia and Uruguay brought by Philip Morris.[166] These arbitrators believed that the decision to impose costs on the tobacco company had to do, at least partially, with the negative effects that these cases were having on ISDS and the community of arbitrators more generally. The arbitrators did not believe these cases were unreasonable.

* * *

To summarize: the multimethod approach discussed in Sections III and IV shows a more refined view of the way in which legal adjudicators use discretion to allocate costs; it reveals some of the main factors that interact with background legal norms. For one, the data on cases confirm a general reluctance to shift costs and a tendency to confound legal findings and legal standards with the actual quality of the case and lawyering. The experimental survey works as an alternative research strategy and confirms that individual arbitrators are responsive to the magnitude of a victory, especially when a claim is found to be spurious. Yet, this impulse is clearly mitigated by different biases, including biases against a party with a perceived advantage in legal capacity. The interviews confirmed that arbitrators within tribunals tend to protect the nominating party from hefty awards on cost, that they bargain over question of resources allocation with substantive issues of the case and, more importantly, that if the legal standard is bogus, a case's impact on the perception of the system of adjudication may be a large incentive to impose costs.

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164. Interview Notes, Arbitrator 2 (June–Aug. 2017); Interview Notes, Arbitrator 4 (June–Aug. 2017).

165. Interview Notes, Arbitrator 3, *supra* note 160; Interview Notes, Arbitrator 6, *supra* note 162; Interview Notes, Arbitrator 7 (June–Aug. 2017).

166. Interview Notes, Arbitrator 6, *supra* note 162; Interview Notes, Arbitrator 12 (June–Aug. 2017); Interview Notes, Arbitrator 2, *supra* note 164; Interview Notes, Arbitrator 9 (June–Aug. 2017).

V. CONTEXT, LEGAL INSTITUTIONS AND OPTIMAL FEE RULES

In this Section, I explore the theoretical and normative implications of this Article's empirical findings. Conceptually, I propose a way to think about cost-shifting rules in context — to change the exclusive locus of attention from the rules to the legal environment in which they operate. In other words, I argue for a more systematic treatment of the institutional settings (and not only the formal rules) in which costs shifting operates. This argument serves as the basis for the proposal that, in the context of successful 41(5) proceedings, a qualified presumption for the application of the English rule is a sensible approach.

A. Optimal Fee Rules and Discretion: A Proposal

Legal scholars are passionate about fee-shifting, a debate which has now found its way to international law and arbitration scholarship. As noted above, this interest is not without merit. However, the debate has focused mostly on the contrast between the English and the American rules — in part because this sets a perfect stage for a binary debate framed as a competition between two approaches.[167] Little advancement has been made in recent years, despite the existence of other approaches — including the discretionary approach analyzed here — and prior scholarship noting that "models should account for real-world factors associated with fee clauses."[168] Few conceptual works, informed by empirical evidence, have developed the operationalization of these real-world factors associated with the application of fee allocation rules.

While studying formal rules is inarguably a relevant approach to legal and policy analysis, the evidence presented in this Article offers valuable insights as to the operation of law in action — in its real-world context. Multiple factors may explain the fee-shifting patterns, none of which can be easily ruled in or out. The multimethod approach, however, confirms that background legal norms are, in practice, highly constrained by different factors — many of which affect discretion in particular ways. How to generalize these factors is the task at hand in this Section.

No simple taxonomy can fully capture and reflect how context-specific factors affect cost shifting. Nevertheless, a good start is the traditional framework of *independence, accountability,* and *transparency* — three concepts that aggregate the desirable virtues of most legal adjudicatory processes, all of which interact with discretion in different ways.[169] This framework has

167. *See supra* Section II(A).
168. Eisenberg et al., *supra* note 2, at 327.
169. Dunoff & Pollack, *supra* note 22, at 226.

only recently been applied to international adjudication, but has a long pedigree in understanding and assessing the application of rules within domestic court systems.[170]

In essence, *independence* refers to the ability of adjudicators to be separated from the parties involved in the litigation, achieved through mechanisms that remove biases such as fixed terms and salary protection, among other institutional features.[171] *Accountability,* on the other hand, refers to structural checks on the exercise of judicial authority. In domestic courts, this manifests most prominently with appeal processes, rules of precedent, and rules that establish coordination and hierarchies among judges.[172] In international courts, this is most often done via the reappointment or reelection processes of judges. However, like in domestic courts, this can also be done through rules and procedures to police the misconduct of adjudicators.[173] Finally, *transparency* refers to many aspects of law and legal process. It generally denotes clear and binding legal obligations that publicly convey unambiguous commitment to a particular principle and certain policy goals established during the legitimate process of creation or policy implementation.[174]

We can imagine these three ideal features of most adjudicatory legal settings as affected by a multiplicity of factors. For instance, they can be impacted by a lack of clarity regarding the applicable legal standard, the biases (implicit or otherwise) introduced by institutional features, or material incentives in the form of prospective sanctions — all of which may result in a preference, overtly or not, for a particular outcome. If the adjudicatory setting is maximally transparent, maximally independent, and maximally accountable we should expect that the rule on costs is maximally relevant, hence influential on the actual practice (in this case, the decision on cost allocation). If, on the other hand, the setting is minimally transparent, minimally independent, and minimally accountable, the rule would be a bad predictor of the cost practice and therefore would be minimally influential, opening the door to other extra-legal factors — social, institutional, psychological, or otherwise.

170. *Id.* at 230

171. *Id.* at 231.

172. *Id.* at 233–35.

173. *Id* at 236. Some level of accountability can also take place through other members of the court, whose buy-in is required for a decision — a unanimous or majority opinion — or, more broadly, by other members of the legal profession. Such members of the profession may use diffuse forms of pressure — from overt challenges to legal reasoning to other reputation sanction.

174. *Id. See also* Andrew K. Woods, *The Transparency Tax,* 71 VAND. L. REV. 1, 6-7 (2017). According to Woods, the law is maximally transparent when it is clearly defined (what does the rule require?); clearly justified (why this rule?); public (who knows about the rule?); and specifically attributable (who is implicated in the rule?).

Here, I have demonstrated several ways in which different factors can interact with and potentially alter the use of discretion.[175] These factors can help to identify variables and instruments of control, as well as to calibrate the potential role of different elements in cost-shifting rules. First, institutional norms and practices can be internalized even in the absence of a formal rule, generally *constraining* discretion. Hence, if transparency is limited, i.e., the formal rule is undefined, unjustified, relatively unknown or not attributable to a particular authority, other elements should certainly be taken into consideration by researchers trying to understand cost outcomes. These elements include practices intrinsic to a particular legal environment and attitudes that may result from distinct legal traditions. These usually result in the dodging of formal rules and the constraint of discretion in favor of a particular practice — a practice that can be partially or completely disconnected from the actual formal rule.

Second, cost-shifting decisions can be affected by a lack of independence, generally *expanding* discretion.[176] Limited independence can arise when the system of appointing decision-makers introduces biases, where the form of litigation (symmetrical or not) creates attitudes against a particular set of litigants, or when there are other institutional factors such as economic incentives. As the evidence presented in this Article shows, these factors have frequently resulted in expansion of discretion. More importantly, this expansion of discretion in the allocation of costs would typically be to the favor of the party that introduces the bias (think of the affiliation bias). Nevertheless, this outcome can very well be context-dependent.

Finally, the emphasis on accountability in an adjudicatory system and its decision-makers can have a material impact on cost-shifting decisions. In general, accountability systems tend to *limit* discretion.[177] It naturally follows that a lack of accountability will generally lead to expanded discretion and fewer constraints. Nevertheless, the effects of varying degrees of accountability tend to be more complex and difficult to predict, unlike the other previously noted elements. Not only does the spectrum of accountability include formal accountability processes that would typically constrain discretion, it also includes collective decision-making processes and bargains. These latter elements are more difficult to model and to generalize for, as they may be the result of features within the litigation setting. As a result, scholars should take special consideration of the existence (or lack thereof) of an appeals process, the role and influence of

175. *See supra* Section IV.

176. See Adrian Vermeule, *Conventions of Agency Independence*, 113 COLUM. L. REV. 1163, 1165–68 (2013), for a version of this argument in the context of agency discretion.

177. *See generally* JOHN HART ELY, DEMOCRACY AND DISTRUST: A THEORY OF JUDICIAL REVIEW 75–77, 172–73 (1980).

clerks, or the mechanisms used to filter out cases (standing rules, budget, etc.).[178]

Put against the backdrop of an institutional setting, this trifurcated approach highlights potential ways that researchers can start theorizing about the particular differences in institutional settings and their impact on cost shifting. Empirical surveys can establish baselines of preference and test for the role of legal factors as well as non-legal factors applicable to a particular setting. With this type of analysis, comparative studies on the role of rules could be more robust and theoretical models more exact as to the actual effect of rules and the role of discretion.

B. Towards a Qualified English Approach for Rule 41(5) Proceedings

When it comes to Rule 41(5) proceedings under ICSID, it is easy to see why there is a disconnect between the ideal use of a discretionary rule and its actual application. The discretionary rule should, in principle, be used to deter spurious claims. Yet, the use of discretion in this way is rare. Part of the problem is that fee-shifting rules very often presume that adjudicators have no affiliation with the litigating parties, that the rules operate in a system unaffected by social pressures, and that the arbitration presents a symmetrical scheme in which both parties have equal opportunity to bring legal claims. However, like many systems of litigation, ISDS fails to meet this ideal type. This opens the door to a large number of context-specific factors that affect the independence, accountability, and transparency of the process and hence the substance of cost rules.

In this context, the current discretionary rule would not sufficiently deter socially excessive litigation, which is a critical consideration in today's field of investor-state arbitration for two main reasons.[179] First, Rule 41(5)'s procedures impose a high bar on (mostly) host state respondents attempting to summarily dispose of the claims brought against them; utilizing this procedure means facing steep burdens to dismiss claims summarily. Ideally, a summary dismissal standard in this arena should, at the very least, create a presumption that the claimant (or her lawyers) had a reason to know about some of the defective aspects of the claim before setting in motion the expensive (and expansive) international litigation machinery against a state. Recognizing this would be the first step in balancing a general duty to refrain from spurious litigation against the fiscal and social costs of the litigation against states itself. In fact, part of the general dissatisfaction with current investor-state arbitration is that it is often perceived as unfair by developing

178. See Andrew B. Coan, *Judicial Capacity and the Substance of Constitutional Law*, 122 YALE L.J. 422 (2012), for a more refined version of this argument.

179. *See supra* Section IV.

host nations who very frequently end up subjected to these claims.[180] Critics argue that investor-state arbitration seems to deliver minute gains as a mechanism to attract foreign direct investment while exposing developing host nations to international claims, including potentially overzealous cases or spurious claims.[181]

Second, the lack of specificity regarding the application of Rule 41(5) seems to combine with the lack of accountability mechanisms in the system and the constrained independence of arbitrators to create incentives for arbitrators to bargain across various dimensions within each case. Scholars and practitioners have noted that bargaining dynamics often establish informal rules for cooperation among international arbitrators.[182] Incentives to bargain come from the desire to achieve compliance with and the successful enforcement of arbitral awards. Equally impactful is the fact that arbitrators, in their role as administrators of a process within a system, need to ensure that the system's reliant actors (states or investors) do not exit the system, whether that be through not participating in cases or avoiding bringing new claims.[183] Driven by these considerations, arbitrators strive for compromise and typically broker "deals." Such bargaining results in only awards on cost in "outrageous" cases. But, if only investors bring cases and satisfying the "manifestly without legal merit" standard is already difficult, should not litigants bringing claims be the ones to face the added procedural burden to contribute to a fairer system?

Because other features of arbitration that contribute to this problem are complex and would be difficult to change, I argue that the answer is the introduction of an amendment that modifies how Rule 41(5) proceedings and the discretionary rule on costs interact. Changing the default rule that currently gives arbitrators full discretion could add more transparency by connecting the tribunal's justification for how they shift costs to the goal of the practice of cost shifting. Hence, I propose a rule amendment in favor of an award on costs when a party meets the high bar of Rule 41(5), a rule which also ideally limits the effect of bargaining done by arbitrators within the tribunal. The proposal to reform cost allocation in Rule 41(5),

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180. *See*, *e.g.*, Hamby, *supra* note 55 (describing ISDS as a system that serves as "a private, global super court that empowers corporations to bend [poor] countries to their will.").

181. *See* Leon E. Trakman, *The ICSID Under Siege*, 45 CORNELL INTL L.J. 603 (2012); *see also* LAUGE POULSEN, JONATHAN BONNITCHA & JASON YACKEE, TRANSATLANTIC INVESTMENT TREATY PROTECTION, PAPER NO. 3 IN THE CEPS-CTR PROJECT ON "TTIP IN THE BALANCE" AND CEPS SPECIAL REPORT NO. 102 (2015) (containing a cost benefit analysis of ISDS in the context of TTIP).

182. *See*, *e.g.*, Daphna Kapeliuk, *The Repeat Appointment Factor: Exploring Decision Patterns of Elite Investment Arbitrators*, 96 CORNELL L. REV. 47 (2010).

183. See ALBERT O. HIRSCHMAN, EXIT, VOICE AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES (1970), for a version of this argument. See Anna T. Katselas, *Exit, Voice, and Loyalty in Investment Treaty Arbitration*, 93 NEB. L. REV. 313 (2014), for its relevance on ISDS.

proceedings directly by changing the ICSID Arbitration Rules or through a BIT, does not necessarily mean an unqualified adoption of the English rule. In fact, it is rarely the case that the English rule is adopted without any caveats. Instead, I argue for a new rule that clearly establishes a presumption of an award on costs for successful litigants in Rule 41(5) proceedings. The newly amended rule should allow a tribunal the discretion to depart from the English approach in special circumstances, which need not be defined in the rule itself. This would allow the tribunal instead to use its discretion and further expound upon its actual considerations in the assessment, an approach that over time can help to build a more robust case law. This solution can force future tribunals to indicate their specific considerations and provide persuasive reasoning as to the motivations behind their decision to depart from the rule, enhancing rule transparency. Not only is this proposed approach easier to implement, but it also can lead to a better understanding of the considerations relevant to cost allocation in arbitration more generally — a practice currently considered "arbitrary and unpredictable."[184] Such arbitrariness and unpredictability is a product of lamentably limited accountability and independence, yet addressable through increased transparency.

This approach has an additional advantage. As noted above, it is not uncommon for arbitrators to bargain within the tribunal. In some circumstances, given the broad margin of discretion that tribunals have to declare that a particular claim is "manifestly without merit," they may be tempted to bargain around the margins, especially given that they are left to decide by their own means and rationale whether the objecting party has proven their case clearly, obviously, and with relative ease. In other words, a third arbitrator with the responsibility of casting the swing vote could be convinced, given the particular circumstances of the case and bargaining by the other arbitrators, to decide in a specific direction, provided that the losing party does not get penalized. If implemented, the suggested approach would permit a tribunal to make such a decision, but require that arbitrators face the additional burden of justifying why, despite the finding that a claim is manifestly without merit, the litigant should not be *sanctioned* with any costs.

Finally, this qualified English rule could add needed transparency to the assessment of costs in investment arbitration. Consider for a moment the example set by CAFTA-DR, a treaty that has developed a more robust case law by making the factors considered in the allocation of costs more transparent.[185] It has also led to the elaboration of the reasons to consider

184. Gotanda, *supra* note 90, at 1.

185. CAFTA-DR, *supra* note 101, at ¶ 10.20(6).

in the allocation of costs.[186] Moreover, the proposed rule would not completely constrain discretion. It allows the tribunal to make a determination, but with justification. The tribunal in *Accession Mezzanine Capital L.P. and Danubius Kereskedöház Vagyonkezelö Zrt. v. Hungary,* an ICSID arbitration case under the Hungary-UK BIT, provides a good final example of how discretion, however limited, can be properly utilized to avoid over-penalizing a litigant while still being mindful of the magnitude of the loss. After rejecting all claimants' claims in the jurisdictional phase (not in the actual Rule 41(5) proceeding), the tribunal felt the need to justify its decision not to impose costs on the claimants, concluding that:

> [T]here was no possibility for the Claimants to obtain justice in Hungary and it was natural for them to look to an international tribunal. This Tribunal is, however, a judicial body with a limited jurisdiction that is carefully prescribed in the international instruments that are binding upon it. The Tribunal has no discretion to depart from the rules applicable to its jurisdiction, but it does have the discretion to take into account broader considerations of fairness and justice in exercising its power to award costs under Article 61 of the ICSID Convention.[187]

There, as in the application of this new proposed rule, the tribunal showcased both the benefits of mindful discretion and the advantages of increased transparency in decision-making. A new rule requiring tribunals to take this additional step in every successful Rule 41(5) objection would cultivate a more robust investor-state arbitration case-law and promote a transparency-driven, more equitable use of discretion. In short, the approach can be justified on the grounds of both justice and fairness, as well as on considerations of efficiency. It makes the asymmetrical reality of Rule

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186. *See*, *e.g.*, Pac Rum Cayman LLC v. Republic of El Sal., ICSID Case No. ARB/09/12, Award, ¶ 11.7 (Oct. 14, 2016) (The Tribunal completely rejected Respondent's Objections. After dismissing all the claimant's claims, the Tribunal awarded $8 million, a portion of the lawyer's fees, to the Respondent. The tribunal reasoned that the Preliminary Objections where "not frivolous," and the case narrowly moved to the merits, in which Respondent prevailed. As to the administrative costs, the Tribunal each party to bear equal share.); R.R. Dev. Corp. v. Republic of Guat., ICSID Case No. ARB/07/23, Award, ¶¶ 282–83 (June 29, 2012) (The Tribunal completely rejected Respondent's Objections. In the final award, after finding Respondent liable, the Tribunal determined that Respondent shall pay $192,427.00 to cover the Claimant's portion of administrative fees during the jurisdictional phase mainly because Respondent's objections to jurisdiction were twice rejected.); Corona Materials, LLC v. Dom. Rep., ICSID. Case No. ARB(AF)/14/3, Award, ¶ 277 (May 31, 2016) (The Tribunal completely accepted Respondent's Objections. Considering that the Claimants "had a *bona fide* claim" and not a "frivolous" one and that both parties' counsel acted professionally and efficiently, the Tribunal decided that each party should bear its own legal costs.); Commerce Grp. Corp. v. Republic of El Sal., ICSID Case No. ARB/09/17, Award, ¶¶ 135–140 (Mar. 14, 2011) (The Tribunal completely accepted Respondent's Objections. Considering that the Claimants claims was not a "frivolous," the Tribunal decided that each party should bear its own legal costs.).

187. Accession Mezzanine Capital L.P. v. Hung., ICSID Case No. ARB/12/3, Award, ¶¶ 200–01 (Apr. 17, 2005), https://www.italaw.com/sites/default/files/case-documents/italaw4353.pdf.

41(5) more effective and legitimate by recalibrating the incentives against socially excessive litigation, but still leaving tribunals discretion. This proposed approach can make the practice of cost allocation more transparent by increasing clarity and determinacy incentivizing reasoning.

VI. CONCLUSION

Litigation costs are of near universal concern. Legal scholars devote a great deal of energy to the issue and to understanding how judges allocate expenses in litigation. This study of attorney fees in investor-state arbitration joins the ranks of this vast subset of legal literature. In particular, it demonstrates that when given unbounded discretion to shift costs arbitrators tend to exhibit a remarkable aptitude for the English rule. This contrasts with the actual practice, where factors such as limited independence, institutional constraints and extra-legal factors such as heuristics affect the actual application of the Tribunal's grant of discretion.

With this context and disconnect in mind, this Article calls for a carefully tailored bounding of discretion for arbitrators allocating fees in successful Rule 41(5) applications. The proposed amendment to the ICSID rules may help to promote transparency, clarity, and precision in the process of cost allocation, and may improve the legitimacy of investor-state arbitration on the whole. The normative approach suggested in this Article offers an opportunity to provide the stability and rationalization necessary while dissuading spurious or unmeritorious claims that may burden developing states.

Finally, I offer insights to theoretical and public policy debates about optimal-fee provisions. The ongoing, unnecessarily curtailed debate between the two dominant approaches to cost shifting provides too narrow of a field of analysis for international arbitration systems to grow. The variance between the individual preferences and collective decisions of arbitrators highlights exactly how much this narrow view of the field fails to consider. While this Article provides some factors that may affect the role of discretion in international arbitration systems, further research into specific cases and systems with an appropriately broad scope may reveal other reasons for applying a particular type of rule.

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