Notes

FEE SHIFTING IN INVESTOR-STATE ARBITRATION: DOCTRINE AND POLICY JUSTIFYING APPLICATION OF THE ENGLISH RULE

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ABSTRACT

In investor-state arbitration, tribunals can and should apply the English rule on legal costs and abandon the two alternatives, the American rule and the pro-claimant rule. Under the English rule, the unsuccessful party in a dispute must indemnify the prevailing party for the costs of dispute resolution. Both doctrine and public policy support the application of the English rule, particularly in light of the much-publicized backlash against the investor-state arbitration system. Most importantly, the English rule would help to mitigate the two most commonly identified causes of the backlash—the system’s alleged pro-investor bias and its chilling effect on host states’ legitimate use of police power. Though a slowly growing number of tribunals have either followed or purported to follow the English rule, the doctrine and policies that justify applying it have so far been either poorly articulated or ignored. This Note presents those justifications in detail for the first time.

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INTRODUCTION

This Note addresses the treatment of legal costs in investor-state arbitration. Amid the chaos of praise, scorn, and proposals for redesigning the investor-state arbitration system’s most fundamental mechanics, the question of how lawyers and arbitrators are paid may seem peripheral. But the treatment of legal costs plays an important role in the investor-state arbitration system. Certainly, the sums of money paid out in legal cost awards are vast. More importantly, as Judge Richard Posner and many other writers have observed, the allocation of legal costs in any dispute-settlement system influences the character of that system, including the types of claims brought, the claimants who bring them, and the manner in which they are resolved. If the investor-state arbitration system needs reworking or


2. See generally THE BACKLASH AGAINST INVESTMENT ARBITRATION: PERCEPTIONS AND REALITY (Michael Waibel et al. eds., 2010) (cataloguing the criticisms of investor-state arbitration, including institutional biases, the “legitimacy deficit,” and inconsistent jurisprudence); M. Sornarajah, The Retreat of Neo-Liberalism in Investment Treaty Arbitration, in THE FUTURE OF INVESTMENT ARBITRATION 273 (Catherine A. Rogers & Roger P. Alford eds., 2009) (arguing that overreaching by “neo-liberals” has led to dissatisfaction with investor-state arbitration and the slowing down of treatymaking).


4. See, e.g., EDF (Servs.) Ltd. v. Romania, ICSID Case No. ARB/05/13, Award, ¶ 329 (Oct. 8, 2009), http://icsid.worldbank.org/ICSID/ FrontServlet?requestType=CasesRH&caseId=C57 (ordering the claimant to pay $6 million of Romania’s legal costs); PSEG Global Inc. v. Republic of Turkey, ICSID Case No. ARB/02/05, Award, ¶ 353 (Jan. 19, 2007), http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&caseId=C212 (ordering 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) (ordering the Slovak Republic to pay $10 million of the claimant’s legal costs).

fine-tuning, its rule on legal costs is a promising instrument of reform. Indeed, among the growing literature on redesigning the investor-state arbitration system, there have already been two prominent proposals directed at rethinking the system’s treatment of legal costs.\(^6\) Dean John Gotanda has proposed a more careful and consistent application of the American rule,\(^7\) whereas Professor Stephan Schill has argued that a pro-claimant rule would be more appropriate.\(^8\) As does this Note, both of those proposals draw extensively from the numerous studies\(^9\) of legal costs written in the United States in response to the late twentieth-century “litigation boom.”\(^10\)

Unlike Gotanda and Schill, however, this Note argues for the application of the English rule. Under the English rule, the unsuccessful party in a dispute must indemnify the prevailing party for its legal costs. Though investor-state tribunals seem to apply either the American rule or a de facto version of the pro-claimant rule in the majority of cases, tribunals have unambiguously followed the English rule in several decisions and have at least appeared to do

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\(^{7}\) Gotanda, *supra* note 6, at 17–19. Under the American rule, both parties pay their own legal costs regardless of which party prevails on the merits. See *infra* Part II.A.

\(^{8}\) Schill, *supra* note 6, at 690. Under the pro-claimant rule, the respondent pays its own legal costs regardless of which party prevails on the merits. A claimant may recover its legal costs, however, if it prevails on the merits. See *infra* Part II.B.


so in many more.\textsuperscript{11} Unfortunately, these tribunals have failed to articulate adequately their reasons for applying the English rule. This lack of explanation is curious given the strong doctrinal and public policy justifications for the English rule’s application, particularly in light of the backlash that currently threatens the investor-state arbitration system—a backlash manifested in the form of states’ withdrawals from investment treaties, refusals to honor awards, and the reemergence of the “toothless” investment treaty.\textsuperscript{12}

Indeed, application of the English rule would help investor-state tribunals mitigate the two most commonly cited causes of this troubling backlash: the system’s alleged proinvestor bias and its chilling effect on host states’ legitimate use of police power.\textsuperscript{13} Much like the tribunals themselves, the academic literature has so far failed to identify this connection. This Note clarifies both the doctrinal and public policy justifications for the English rule’s application. Parts I and II provide the necessary background. Part I describes the mechanics of investor-state arbitration and details the system’s short history, including the explosion of claims since 1998, the much-publicized backlash since 2007, and the allegations of bias and regulatory chill. Part II then describes the inconsistent and unpredictable treatment of legal costs in investor-state arbitration.

Thereafter, Parts III and IV explain the arguments in favor of the English rule. Part III addresses doctrine. When advocating for the application of the American rule or the pro-claimant rule, writers and tribunals primarily emphasize case law\textsuperscript{14}—although both concede that this approach is inadequate. Because the investor-state arbitration system lacks a formal rule of stare decisis, case law is not binding upon tribunals in subsequent cases.\textsuperscript{15} Therefore, Part III looks beyond case law and addresses all of the sources of substantive and procedural law applicable in the investor-state arbitration system: the

\textsuperscript{11} See infra Part II.C.

\textsuperscript{12} See infra Part I.B.2.

\textsuperscript{13} See infra Parts III–IV.

\textsuperscript{14} This is consistent with legal reasoning in investor-state arbitration generally. See Ole Kristian Fauchald, \textit{The Legal Reasoning of ICSID Tribunals: An Empirical Analysis}, 19 EUR. J. INT’L L. 301, 356–59 (2008) (reviewing almost one hundred investor-state arbitral awards and demonstrating empirically that investor-state tribunals rely on “precedent” in roughly 90 percent of decisions, more than any other means of determining the law).

\textsuperscript{15} August Reinisch, \textit{The Role of Precedent in ICSID Arbitration}, 2008 AUSTRIAN ARB. Y.B. 495, 501.
host state’s domestic law,\textsuperscript{16} “general principles of law as recognized by civilized nations,”\textsuperscript{17} and the texts of investment treaties and other ex ante agreements.\textsuperscript{18} Though these sources do not necessarily require tribunals to apply the English rule, they provide substantial support for its application.

Finally, Part IV presents public policy justifications for applying the English rule. Considerations of public policy frequently play a role in the decisionmaking of investor-state tribunals.\textsuperscript{19} Academic commentaries—including proposals encouraging tribunals to apply the American rule or the pro-claimant rule—often have the same emphasis.\textsuperscript{20} After reexamining the financial incentives that these two rules create, however, this Note demonstrates that both the American rule and the pro-claimant rule exacerbate the most commonly identified causes of the backlash against investor-state arbitration. Therefore, because the continued application of the American rule or the pro-claimant rule would be harmful to the ongoing viability of investor-state arbitration, tribunals should use their discretion to apply the English rule.

I. THE INVESTOR-STATE ARBITRATION SYSTEM: BACKGROUND AND BACKLASH

The investor-state arbitration system is a network of approximately three thousand bilateral and multilateral investment treaties that first emerged in 1957 and proliferated rapidly from 1980 to 2001.\textsuperscript{21} To Americans, the most famous of these investment treaties is probably the North American Free Trade Agreement (NAFTA)\textsuperscript{22}—though NAFTA is better known in the context of the free trade debate. In addition to creating a broad framework for

\textsuperscript{16} See infra Part III.B.
\textsuperscript{17} See infra Part III.C.
\textsuperscript{18} See infra Part III.A.
\textsuperscript{19} See Fauchald, supra note 14, at 356 (demonstrating empirically that investor-state tribunals rely on public policy or “reasonable results” in just under 40 percent of decisions).
\textsuperscript{20} See, e.g., Schill, supra note 6, at 690–91 (arguing that the pro-claimant rule would incentivize compliance with international investment law); Gotanda, supra note 6, at 17–18 (arguing that the consistent application of the American rule would improve predictability).
multilateral trade liberalization, Chapter 11 of NAFTA includes the two standard obligations of any ordinary investment treaty. The first of these is substantive, whereas the second is procedural. By acceding to a multilateral or bilateral investment treaty, the signatory states undertake, first, to provide foreign investors with substantive rights and protections and, second, to give ex ante consent to binding arbitration of any disputes based on the state’s future violations of investors’ rights and protections.

A. The Structure and Mechanics of Investor-State Arbitration

1. Substantive Rights and Protections. Most investment treaties contain a standard set of substantive protections for foreign investors, including protection from expropriation, protection from discriminatory treatment, and a guarantee of fair and equitable treatment. American writers have frequently compared these treaty protections to the Fifth and Fourteenth Amendments’ restraints on government action: protection from expropriation resembles the Takings Clause, protection from discriminatory treatment resembles the Equal Protection Clause, and guarantees of fair and equitable treatment resemble elements of the Due Process Clause. These

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25. Id. at 267.


29. The fair and equitable treatment standard includes a guarantee to provide investors with due process of law in administrative and judicial proceedings. A second major component

treaty benefits, however, are not made available to everyone—only to foreign investors from other treaty states and only in disputes arising from foreign investment. Neither the host state’s nationals nor the average foreign tourists receive similar assurances.\footnote{30}

2. Binding Dispute Resolution. By acceding to an investment treaty, a state gives ex ante consent to binding arbitration of any investor’s claim that arises from the state’s breach of the treaty’s substantive protections. Investors bring their claims against host state governments before tribunals of neutral arbitrators, selected either by an appointing authority such as the International Centre for Settlement of Investment Disputes (ICSID) or ad hoc by the parties themselves.\footnote{31} Unlike most litigation under international law, private investors can initiate investor-state arbitration without the need for any legal or diplomatic action by their home states’ governments.\footnote{32}

For example, in PSEG Global Inc. v. Republic of Turkey,\footnote{33} an American power plant developer brought its claim directly against the Turkish government for negligently failing to disclose key information during the implementation of a power plant project.\footnote{34} The U.S. government did not intervene or have any role in the dispute. The parties—the power plant developer and the Turkish government—jointly appointed a tribunal of three arbitrators pursuant to the ICSID arbitration provisions of a bilateral investment treaty between the United States and Turkey.\footnote{35} The tribunal ultimately found that Turkey’s failure to disclose certain key information constituted a breach of the fair-and-equitable-treatment of the standard, unrelated to due process of law, includes the protection of investors’ legitimate expectations at the time the investment was made, whether created by contractual arrangements, legislative commitments, or specific assurances. For a summary and analysis of the jurisprudence in this area, see Rudolf Dolzer, Fair and Equitable Treatment: A Key Standard in Investment Treaties, 39 Int’l L. & Pol’y 87, 94–106 (2005).


\footnote{31} Schwebel, supra note 1, at 267.

\footnote{32} Id.

\footnote{33} PSEG Global Inc. v. Republic of Turkey, ICSID Case No. ARB/02/05, Award (Jan. 19, 2007), http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC630_E&caselid=C212.

\footnote{34} Id. ¶¶ 246–256.

\footnote{35} Id. ¶ 2.
standard of this investment treaty, and it awarded compensation to the power plant developer. Similarly, in Československá Obchodní Banka A.S. v. Slovak Republic, a Czech commercial bank won a claim directly against the Slovak government for its failure to repay a loan. There, too, the Czech government had no role in the proceeding, which remained the claimant’s to pursue from initiation to conclusion.

After arbitration has concluded, a successful claimant may enforce the tribunal’s award against the host states’ assets under one of two multilateral treaties—the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention) or the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States (Washington Convention)—in the domestic courts of any nation that is party to those conventions. Enforcement of these arbitration awards is considered “automatic” because courts may only set aside these awards on very narrow grounds such as fraud, corruption, or ultra vires action on the part of the arbitrator.
B. Historical Background of Investor-State Arbitration

1. 1998 to 2007: Overwhelming Praise. Although these two complementary obligations unavoidably restrict states’ freedom of action in dealing with foreign investors, states were for several decades quite willing to undertake these obligations by ratifying investment treaties. During the 1990s, as the number of effective investment treaties grew into the thousands, international law scholars reacted euphorically. They called the investor-state arbitration system “a revolution,”
45 a “transformation,”
46 and a “sea change.”
47 Its merits were “overwhelming”
48 and its success was “unmitigated.”
50 After twentieth-century experiences with the International Court of Justice (ICJ), the emergence of this new and effective international legal process was a significant change. Since its founding seventy years ago, the ICJ has decided fewer than 150 cases
51 and has awarded monetary damages only once
52—in its very first case.
53 That award was paid in full, but not until fifty-seven years

48. Ian A. Laird, A Community of Destiny—The Barcelona Traction Case and the Development of Shareholder Rights to Bring Investment Claims, in INTERNATIONAL INVESTMENT LAW AND ARBITRATION: LEADING CASES FROM THE ICSID, NAFTA, BILATERAL TREATIES AND CUSTOMARY INTERNATIONAL LAW 77, 94 (Todd Weiler ed., 2005) (observing that, “[w]ith respect to international investment instruments, there is no doubt that there has been a sea change away” from previous international law).
49. Schwebel, supra note 1, at 263 (“The merits of bilateral investment treaties are substantial, indeed, overwhelming.”).
50. Thomas W. Wälde, Improving the Mechanisms for Treaty Negotiation and Investment Disputes: Competition and Choice as the Path to Quality and Legitimacy, in YEARBOOK ON INTERNATIONAL INVESTMENT LAW & POLICY, supra note 3, at 505, 506 (calling “the unexpected, rapid, and extensive development of investment arbitration over the past fifteen years” an “unmitigated success”).
52. See Corfu Channel (U.K. v. Alb.), 1949 I.C.J. 244, 250 (Dec. 15) (awarding damages to the United Kingdom for damage done to one of its vessels from a minefield in Albanian waters).
after the ruling. The ICJ has not awarded damages since. By contrast, in investor-state arbitration, claims are heard, damages are awarded, and awards are enforced. Since 1998 investor-state tribunals have decided more than 150 cases, awarding damages in nearly half of them. These awards are paid in full in an estimated 90 percent of cases. At the time of writing, more than 100 new disputes were pending.

2. From 2007 to the Present: Signs of Backlash. Since 2007, however, the system has suffered a crisis of confidence, suggesting that states’ interests are not being adequately protected under international investment law. A small but growing number of national governments have begun to reject and denounce investor-state arbitration, “voting with their feet and leaving the system.” For example, Bolivia withdrew from the Washington Convention. Ecuador terminated nine of its investment treaties. The Russian Federation withdrew from the multilateral Energy Charter Treaty.

54. Laurence W. Maher, Half Light Between War and Peace: Herbert Vere Evatt, the Rule of International Law, and the Corfu Channel Case, 9 AUSTRALIAN J. LEGAL HIST. 47, 80 (2005).
56. See Susan D. Franck, Empirically Evaluating Claims About Investment Treaty Arbitration, 86 N.C. L. REV. 1, 49 (2007) (surveying fifty-two investor-state arbitral awards and finding that investors had won compensation in 38.5 percent of them).
57. DUGAN ET AL., supra note 42, at 675 n.1.
58. List of Pending Cases, INT’L CENTRE FOR SETTLEMENT OF INV. DISPUTES, http://icsid.worldbank.org (follow “Cases” hyperlink; then follow “List of Cases” hyperlink; then follow “Pending Cases” hyperlink) (last visited Nov. 24, 2010). This figure does not include non-ICSID treaty claims pending before non-ICSID tribunals.
Argentina refuses to honor certain categories of arbitral awards. Even among developed economies such as the United States, Australia, and Japan, toothless treaties containing the standard substantive protections but lacking ex ante consent to arbitration have resurfaced.

This apparent backlash against international investment law has become the subject of tremendous attention and debate. Writers attempting to identify the causes of the backlash frequently point to two defects in the investor-state arbitration system: first, the system is allegedly afflicted by a proinvestor bias; second, the system causes “regulatory chill.” Neither of these criticisms has been simple to prove or disprove, but both have been pervasive.

The proinvestor bias theory of investor-state arbitration arises from several different underlying concerns. First, some scholars have criticized the treaty-negotiation process as “lopsided” because office.com/newsletters/detail.aspx?g=17675c7c-c55c-4f1d-81cd-e5610fd3b3d8 (noting “Russia’s reluctance to provide investment protections on its own territory”).


64. See Anne van Aaken, Perils of Success? The Case of International Investment Protection, 9 EUR. BUS. ORG. L. REV. 1, 2 (2008) (observing that the rate of new investment treaties concluded has dropped off since the explosion of investor-state claims).


66. See generally Gus Van Harten, Perceived Bias in Investment Treaty Arbitration, in THE BACKLASH AGAINST INVESTMENT ARBITRATION, supra note 2, at 433 (finding that a key problem is not that persons involved in investment treaty arbitration are biased, but that issues of structure cast doubt on the system).

67. See, e.g., SARAH ANDERSON & SARA GRUSKY, CHALLENGING CORPORATE INVESTOR RULE: HOW THE WORLD BANK’S INVESTMENT COURT, FREE TRADE AGREEMENTS, AND BILATERAL INVESTMENT TREATIES HAVE UNLEASHED A NEW ERA OF CORPORATE POWER AND WHAT TO DO ABOUT IT 4 (2007), available at http://www.ipsdc.org/reports/challenging_corporate_investor_rule (“[T]he threat of massive damages awards can put a ‘chilling effect’ on responsible policy-making.”); AARON COSBEY, HOWARD MANN, LUKE ERIC PETERSON & KONRAD VON MOLTKE, INVESTMENT AND SUSTAINABLE DEVELOPMENT: A GUIDE TO THE USE AND POTENTIAL OF INTERNATIONAL INVESTMENT AGREEMENTS 20 (2004) (“A secondary concern is that regulators who are held liable for their impacts on investors will not regulate to the extent that they should (the regulatory chill argument).”).
“[d]eveloping countries are pressured to give up their interests and concerns in exchange for greater incentives to investors.” 68 Second, commentators have criticized the substantive treaty rights themselves as “vague” and “open-ended,” and therefore subject to being construed in ways that the host states could not possibly have expected at the time they entered into the treaties. 69 Third, and most troublingly, the president of Bolivia and others have accused the dispute-settlement process itself of being biased in favor of investors, alleging that “[g]overnments in Latin America . . . never win the cases” and that the investors “always win.” 70 Empirical studies suggest that this last accusation is unfounded, 71 but the overall perception has, nonetheless, been difficult to shed. 72

Similarly, the regulatory chill theory is also difficult to prove or disprove. According to some commentators, the threat of an investment dispute has rendered traditional governmental protection of health, safety, and human rights prohibitively expensive. One writer has argued that investor-state arbitration “has gone from being a protective shield for defending investors against unfair and discriminatory treatment to a sword used by those investors to attack legitimate government regulation pursued in the public interest.” 73 Another reports that “practicing lawyers do admit that they hear rumours of investors applying informal pressure upon host states—while brandishing an investment treaty as a potential legal stick.” 74


69. Id. at 960.


71. See Franck, supra note 56, at 50 (surveying fifty-two awards and concluding that “[t]he percentage of ultimate winners does not appear to be meaningfully different for investors and governments.”).

72. See, e.g., Van Harten, supra note 66, at 433 (“Investment treaty arbitration is characterized by an apparent bias in favor of claimants and against respondent states.”).


Though little empirical evidence exists to confirm the regulatory chill theory, it is nonetheless a favorite of the system’s critics.\footnote{75}{See supra note 67 and accompanying text.}

Informed by these criticisms, an extensive literature has emerged over the last few years addressing how the much-beloved and much-maligned system can be fixed.\footnote{76}{See, e.g., Juillard, supra note 3, at 168 (proposing that the “entire development of international law should at some point come under reappraisal”).}

Many proposals, such as a global investment court of appeals with a tenured judiciary,\footnote{77}{Michael D. Goldhaber, \textit{Wanted: A World Investment Court}, \textit{AM. LAW.}, Summer 2004, at 26.} seem too ambitious to be politically feasible at present. Multilateral trade treaties and the World Trade Organization (WTO) dispute-settlement mechanism may provide some hope for the establishment of global, “top-down” solutions in the future, but attempts at drafting multilateral treaties have experienced a gloomy “eight decades of failure” in the investment law context.\footnote{78}{See Charles H. Brower, II, \textit{Reflections on the Road Ahead: Living with Decentralization in Investment Treaty Arbitration}, in \textit{THE FUTURE OF INVESTMENT ARBITRATION}, supra note 2, at 339, 348 (calling “simple, top-down solutions” unfeasible and drawing on “eight decades of failure to negotiate comprehensive multilateral treaties on foreign investment” as proof).} For now, it appears that effective changes to international investment law can only be brought about in a piecemeal, case-by-case fashion by the tribunals themselves.

\section{II. The Current Treatment of Legal Costs}

As Part I explains, the two most commonly identified causes of the backlash against investor-state arbitration are the system’s alleged pro-investor bias and its chilling effect on host states’ legitimate use of police power. As Part IV ultimately shows, the English rule on legal costs can help to mitigate both of these factors. But before this can be explained, it is necessary to examine and understand the system’s inconsistent treatment of legal costs.

Whether domestic or international, dispute settlement systems allocate “legal costs”—court costs, attorneys’ fees, experts’ fees, and arbitrators’ fees—according to three distinct practices: the American rule, the English rule, and the pro-claimant rule. Under the American rule, “the costs lie where they fall.”\footnote{79}{Arthur R. Miller, \textit{The Adversary System: Dinosaur or Phoenix}, 69 MINN. L. REV. 1, 10 (1984).} That is, both the respondent and claimant pay their own legal costs, regardless of which party is
successful on the merits. There is no shifting of legal costs, except when one of the two parties is penalized for litigating in bad faith. By contrast, under the English rule, “the costs follow the event.” That is, the party that is unsuccessful on the merits must always indemnify the prevailing party for part or all of its legal costs, even when both sides litigate in good faith. Finally, under the hybridized pro-claimant rule, prevailing claimants always recover their legal costs, as under the English rule, but prevailing respondents must always bear their own legal costs, as under the American rule.

In domestic litigation, the prospect of having to pay one’s own legal costs or an opponent’s legal costs can have a material effect on the decision to pursue, contest, or settle a claim. In investor-state arbitration, the sheer expense of the system likely amplifies this effect. On average, respondents incur annual legal costs ranging from one to two million dollars for a single dispute, though costs can far exceed this average. In one case, the claimant and the respondent

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81. The common law exceptions to this general rule, such as the common benefit doctrine, are applied very rarely. For the U.S. Supreme Court’s description of the common benefit doctrine, see Alyeska Pipeline Serv. Co. v. Wilderness Soc’y, 421 U.S. 240, 245–46 (1975).

82. Id. The practice of awarding costs to punish bad-faith litigation has also been incorporated into Rule 11 of the Federal Rules of Civil Procedure. See Fed. R. Civ. P. 11 (permitting U.S. federal courts to sanction litigants for pleadings, motions, or other papers that are “presented for any improper purpose, such as to harass, cause unnecessary delay, or needlessly increase the cost of litigation,” or that are based on frivolous facts or legal theories).

83. MICHAEL ZANDER, CASES AND MATERIALS ON THE ENGLISH LEGAL SYSTEM 573 (10th ed. 2007).


85. This is not the generally applicable rule in any domestic jurisdiction, but several jurisdictions—including the United States—apply it in certain exceptional cases. See Harold J. Krent, Explaining One-Way Fee Shifting, 79 VA. L. REV. 2039, 2041 (1993).

each reported incurring more than $14 million in legal costs. In another case, the parties reported a shared total of $21 million.

Regardless of the relative merits of each party’s case, it is difficult to predict with certainty which party will ultimately bear these costs. Arbitration rules accord arbitrators broad discretion in allocating legal costs, and tribunals exercise this discretion inconsistently. Both tribunals and commentators agree that the practice is “arbitrary and unpredictable.”

A. Application of the American Rule

In 2007, an empirical study showed that investor-state tribunals had followed the American rule and ordered parties to pay their own legal fees in about four-fifths of disputes. Tribunals have noticed this general trend, but they have not yet explained the reasons for it. Respected arbitrator and advocate Arthur Rovine wrote simply in his dissent to *EDF (Services) Ltd. v. Romania* that “[e]ach side bearing its own costs has been an ICSID tradition.” Likewise, in his dissent to *International Thunderbird Gaming Corp. v. United Mexican States*, Professor Thomas Wälde recognized a principle of “established NAFTA and ICSID jurisprudence” requiring that “each party, winning or losing, bear its own legal expenses and share the

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88. PSEG Global Inc. v. Republic of Turkey, ICSID Case No. ARB/02/05, Award, ¶ 353 (Jan. 19, 2007), http://icsid.worldbank.org/ICSID/FromServlet?requestType=CasesRH&actionVal=showDoc&docId=DC630_En&caseId=C212.


90. Franck, supra note 56, at 69.

91. *EDF (Servs.) Ltd. v. Romania*, ICSID Case No ARB/05/13, Award (Oct. 8, 2009), http://icsid.worldbank.org/ICSID/FromServlet?requestType=CasesRH&actionVal=showDoc&docId=DC1215_En&caseId=C57.

92. *EDF (Servs.) Ltd. v. Romania*, ICSID Case No ARB/05/13, Dissent Regarding Costs, ¶ 4 (Oct. 8, 2009), http://icsid.worldbank.org/ICSID/FromServlet?requestType=CasesRH&actionVal=showDoc&docId=DC1216_En&caseId=C57.

costs of arbitration,” unless arbitrators find “either gross professional misconduct” or “a manifestly spurious claim.”

B. Application of the Pro-Claimant Rule

In an attempt to explain the 20 percent of cases in which the costs do not simply “lie where they fall,” a second line of analysis suggests that tribunals do not actually follow the American rule, but rather the pro-claimant rule—without ever saying so explicitly. Professor Schill makes this argument in a 2006 article. Analyzing what tribunals do, rather than what they say, Schill asserts that tribunals consistently award legal costs to prevailing claimants but not to prevailing respondents, resulting in a “one-way, pro-investor cost-shifting approach.”

Schill acknowledges that a number of cases do not immediately appear to support his theory, but he argues that these cases are nevertheless more compatible with a pro-claimant rule than it would first appear. Schill argues that the majority of legal cost awards requiring unsuccessful claimants to pay prevailing respondents’ legal costs have not resulted solely from the merits of the case, as would happen under the English rule. Rather, such awards have been made with the intention of punishing claimants’ “frivolous and spurious claims or, more generally, bad faith litigation.” Put simply, Schill proposes that tribunals have actually adopted a de facto pro-claimant rule and that other commentators have simply misinterpreted a traditional penalty for bad faith—awarding legal costs—as sporadic application of the English rule.

Moreover, Schill argues that the de facto pro-claimant rule is a normatively appropriate rule for the investor-state arbitration system, and that this rule should be made de jure. He envisions the investor-state arbitration system as “a mechanism for the enforcement of
obligations,”

which is well suited by a legal-costs rule that contributes “additional deterrence of potential defendants” and “induces compliance” by incentivizing investors to bring more claims for larger amounts. Schill’s proinvestor proposal was likely very convincing in 2006, one year before Bolivia withdrew from the Washington Convention, when the legal regime seemed to be on firmer footing. Today, however, the backlash against investor-state arbitration provides sufficient reason to rethink Schill’s normative arguments. Because a uniquely proinvestor procedural advantage disincentivizes host states from participating in the investment arbitration regime, the overall aim of investment protection would be better served by a more balanced approach. After all, investor-state arbitration cannot protect any foreign investments if states simply withdraw from the system.

C. Application of the English Rule

Even disregarding cases in which legal cost awards may be used implicitly as a penalty for bad faith, tribunals do not apply Schill’s proposed de facto pro-claimant rule universally. Cases such as EDF and Thunderbird provide unmistakable proof that arbitrators follow the authentic English rule in some circumstances. In EDF, the unsuccessful claimant—who failed to show that the Romanian government had taken the claimant’s profitable duty-free business and other commercial properties on an arbitrary and discriminatory basis—was ordered to indemnify Romania for $6 million of its legal costs. In Thunderbird, the unsuccessful claimant—who failed to show that the Mexican government had closed the claimant’s gaming facilities for unfair and inequitable reasons—was ordered to indemnify Mexico for $1.1 million. In both of these cases, the tribunals explicitly found that there had been no bad faith or

100. Id. at 679.
101. Id. at 690–92.
102. See Press Release, Int’l Centre for Settlement of Inv. Disputes, supra note 60 (noting Bolivia’s “denunciation of the ICSID Convention”).
103. EDF (Servs.) Ltd. v. Romania, ICSID Case No. ARB/05/13, Award, ¶ 329 (Oct. 8, 2009), http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC1215_En&caseId=C57.
misconduct by the claimants during arbitration. Nevertheless, both tribunals awarded legal costs to the respondents based on the merits of the dispute. In doing so, both tribunals observed that it is the practice in international commercial arbitration to award costs based on the merits of the dispute.

There are also a large number of ambiguous cases, such as *Link- Trading Joint Stock Co. v. Department for Customs Control of the Republic of Moldova* and *Methanex Corp. v. United States*, in which legal costs are awarded to respondents but there is no explicit mention of bad faith. In these cases, however, Schill is convinced by the “general tone” of the decisions that the claimants' misconduct had a material influence on the result. Nevertheless, the tribunals at least purported to base their decisions on the respondents’ success on the merits. Moreover, in numerous cases in which tribunals award costs in favor of prevailing claimants, they generally declare in neutral terms that “the successful party should receive reimbursement from the unsuccessful party.” If these tribunals realize that they are applying this rule only to the detriment of the states, they do not say so explicitly.

105. See EDF, Award, ¶ 328 (“In the Tribunal’s judgment, the instant dispute was fairly brought by Claimant and good faith was evidenced by each side.”); *Int’l Thunderbird*, Arbitral Award, ¶ 218 (“[T]he Parties here presented their case in an efficient and professional manner.”).

106. See EDF, Award, ¶ 327 (“In the instant case, and generally, the Tribunal’s preferred approach to costs is that of international commercial arbitration and its growing application to investment arbitration. That is, there should be an allocation of costs that reflects in some measure the principle that the losing party pays, but not necessarily all of the costs of the arbitration or of the prevailing party.”); *Int’l Thunderbird*, Arbitral Award, ¶ 214 (noting that “the same rules should apply to international investment arbitration as apply in other international arbitration proceedings”).


110. See id. at 659–63 (“[C]ost shifting against the losing investor can be seen as a reaction to frivolous claims or bad faith litigation.”).

111. *Methanex*, Final Award of the Tribunal on Jurisdiction and Merits, pt. V., ¶ 10; *Link- Trading*, Final Award, ¶ 93.

112. See, e.g., ADC Affiliate Ltd. v. Hungary, ICSID Case No. ARB/03/16, Award, ¶ 533 (Sept. 27, 2006), http://ita.law.uvic.ca/documents/ADCvHungaryAward.pdf (“In the present case, the Tribunal can find no reason to depart from the starting point that the successful party should receive reimbursement from the unsuccessful party.”).
In *EDF* and *Thunderbird*, when the majorities unambiguously applied the English Rule, they provoked vigorous dissents by arbitrators Rovine\textsuperscript{113} and Wälde,\textsuperscript{114} respectively. Strikingly, both of them directed their dissents at the respective majorities’ deliberative methodology, rather than at their final decisions to award legal costs. Neither dissent defended the American rule or the pro-claimant rule on the basis of any particular benefits conferred by either rule. Rather, the dissents observed that following the American rule was the usual practice in investor-state arbitration and objected to the majorities’ “departure”\textsuperscript{115} from “ICSID tradition”\textsuperscript{116} and “established NAFTA and ICSID jurisprudence”\textsuperscript{117} without articulating adequate reasons for such a departure. Indeed, Rovine acknowledged the possibility that there may be “good underlying reasons” for applying the English rule but argued forcefully that the majorities should either identify and evaluate these hypothetical reasons or else adhere to the standard practice.\textsuperscript{118}

### III. DOCTRINAL JUSTIFICATIONS FOR APPLYING THE ENGLISH RULE

This Note follows Rovine and Wälde’s prompting and identifies the “good underlying reasons” found in doctrine and public policy that support application of the English rule. From a doctrinal standpoint, it is not obvious how legal costs should be awarded in investor-state arbitration, but there are persuasive reasons for applying the English rule.

Rovine and Wälde’s dissents in *EDF* and *Thunderbird* are based on a presumption that ICSID tradition should control unless adequate reasons can support departure from it. Even in the absence

\textsuperscript{113} EDF (Servs.) Ltd. v. Romania, ICSID Case No. ARB/05/13, Dissent Regarding Costs, ¶ 4 (Oct. 8, 2009), http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC1216_En&casId=C57.


\textsuperscript{115} Id. ¶ 126; see also *EDF*, Dissent Regarding Costs, ¶ 6 (“In light of the determinations made by the Tribunal . . . there is a question whether there is a sufficient or any reason in this case to depart from the approach of each side bearing its own costs.” (emphasis added)).

\textsuperscript{116} *EDF*, Dissent Regarding Costs, ¶ 4.

\textsuperscript{117} *Int’l Thunderbird*, Separate Opinion, ¶ 124.

\textsuperscript{118} *EDF*, Dissent Regarding Costs, ¶ 12 (“There may well be good underlying reasons for applying the loser pays doctrine . . . .”).
of a formal rule of stare decisis, the existence of settled legal doctrine might demonstrate that previous tribunals have already identified, evaluated, and reconciled the issues worthy of consideration in resolving a specific type of legal problem. Economist and philosopher F.A. Hayek argued that judicial precedent safeguards “the experience gained by the experimentation of generations,” which “embodies more knowledge than [is] possessed by anyone.”

In Rovine and Wälde’s view, because the EDF and Thunderbird majorities did not support their decisions with precedent, the decisions were presumptively contrary to established law. Departure from the American rule, therefore, came with the methodological burden of providing a rationale for the departure. Had the majorities simply followed the American rule, there would have been no such burden and no need for additional justifications.

But it is unfair to give such emphasis to nonbinding precedent, because investor-state arbitration recognizes other sources of law and gives them equal or greater doctrinal weight. Under Article 42(1) of the Washington Convention, tribunals are to apply two sources of law when the Convention, the investment treaty, and parties’ choice-of-law agreements leave a question unsettled. First, arbitrators “shall apply the law of the Contracting State party to the dispute.” Second, arbitrators shall apply “rules of international law.” This second source, “rules of international law,” is the window through which investor-state arbitral precedents may affect future disputes. As Wälde himself observed in Thunderbird, precedent properly applies in an investor-state dispute only because it is a traditionally recognized subcomponent of public international law.

But precedent is not the only component of international law, nor is it given the most deference. In fact, both the EDF and Thunderbird majorities also based their use of the English rule on an equally valid subcomponent of public international law, “general

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121. EDF, Dissent Regarding Costs, ¶¶ 6, 10; Int’l Thunderbird, Separate Opinion, ¶¶ 126, 129.


123. Id.

principles of law recognized by civilized nations.” The EDF tribunal, for example, announced that “[i]n the instant case, and generally, the Tribunal’s preferred approach to costs is that of international commercial arbitration and its growing application to investment arbitration.” Though the majorities did not make this doctrinal link explicit, such a statement about international commercial arbitration can only be interpreted as a reference to a “general principle of law.” That is the only basis on which a reference to international commercial arbitration, an entirely distinct form of dispute settlement, could be meaningful in an investor-state arbitration. Indeed, at least one writer on legal costs has concluded that commercial arbitral practice is evidence of a “general principle” supporting application of the English rule. “General principles of law recognized by civilized nations” are also a component of public international law and are doctrinally granted more weight than precedent.

Therefore, because the majorities identified a suitable doctrinal basis for their decisions—a general principle of law as evidenced by international commercial arbitration—Rovine and Wälde were wrong to insist that the burden rested squarely with the majorities to identify additional reasons supporting application of the English rule. The majorities likely could have articulated the link between commercial arbitration and investor-state arbitration more clearly, if only to insulate their decisions from dissent. Likewise, the majorities could have drawn on several other applicable sources of law that would have unambiguously supported application of the English rule. An examination of these sources follows.

126. EDF (Servs.) Ltd. v. Romania, ICSID Case No. ARB/05/13, Award, ¶ 327 (Oct. 8, 2009), http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC1215_En&caseId=C57.
127. See infra Part III.C.
128. See John Yukio Gotanda, Awarding Costs and Attorneys’ Fees in International Commercial Arbitrations, 21 Mich. J. Int’l L. 1, 34 & n.160 (1999) (“[T]he principle that costs follow the event is almost universally recognized. Indeed, it is so well-accepted that it may be viewed as a general principle of international law.” (footnote omitted)).
129. See infra Part III.C.
A. Ex Ante Agreements Are Generally Silent as to How Legal Costs Should Be Awarded

As a preliminary matter, it is important to recognize that the sources of investment law specified in Article 42(1) of the Washington Convention are not all of equal weight. Taking its basic structure from commercial arbitration, the investor-state arbitration system gives priority to sources of law chosen by the parties to the dispute.\(^{130}\) Therefore, tribunals first look to the Washington Convention, the investment treaty, and any other choice-of-law rules selected ex ante by the parties. It is only in the absence of ex ante agreement that tribunals are obliged to consider the two gap-fillers—that is, “the law of the Contracting State party to the dispute . . . and such rules of international law as may be applicable.”\(^{131}\)

Unfortunately, ex ante agreements rarely provide guidance on the distribution of legal costs. The Washington Convention, which governs the procedure of ICSID-appointed tribunals, gives arbitrators complete discretion under Article 61(2) to determine how legal costs should be awarded: “[T]he Tribunal shall, except as the parties otherwise agree . . . decide how and by whom those expenses . . . shall be paid.”\(^{132}\) Other sets of commonly selected procedural rules grant equally broad discretion. For example, though the rules authored by the United Nations Commission on International Trade Law (UNCITRAL) hint at a presumption that arbitrators should apply the English rule to a portion of the costs, arbitrators may apparently reject this presumption for whatever reasons they wish.\(^{133}\)

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130. See ALAN REDFERN, MARTIN HUNTER, NIGEL BLACKABY & CONSTANTINE PARTASIDES, LAW AND PRACTICE OF INTERNATIONAL COMMERCIAL ARBITRATION 94 (4th ed. 2004) (“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)).


132. Id. art. 61(2), 17 U.S.T. at 1294, 575 U.N.T.S at 198.


The current Article 42 was originally Article 40 when the UNCITRAL rules were first adopted, Arbitration Rules of the United Nations Commission on International Trade Law, G.A. Res. 31/98, U.N. Doc. A/RES/31/98 (Dec. 15, 1976), but was renumbered when the rules
Likewise, investment treaties and choice-of-law agreements are almost invariably silent on legal costs, leaving arbitrators with an “unfettered and arbitrary” discretion that makes both tribunals and commentators acutely uncomfortable.\textsuperscript{134} Professor Schill has pointed out the irony of this broad discretion, given that any discretionary exercise of power without a reasoned basis seems somewhat contrary to the spirit of international investment law.\textsuperscript{135} After all, investment law does not permit states to treat foreign investors in an arbitrary manner. Rather, investor-state tribunals require judicial and administrative organs of state governments to base all of their decisionmaking on adequate and articulated reasoning,\textsuperscript{136} and they unanimously agree that arbitrary treatment constitutes a breach of investment treaties’ substantive protections.\textsuperscript{137} Admitting that their own decisionmaking with regard to legal costs is arbitrary or unfettered would place an investor-state tribunal in a position of hypocrisy.

To dispel the discomfort surrounding their “unfettered and arbitrary” discretion as to legal costs, tribunals frequently go beyond the ex ante texts in search of legal principles on which to base their decisions. This search draws tribunals to examine the law of the domestic jurisdiction and public international law. Indeed, tribunals


\textsuperscript{135}. See \textit{supra} note 6, at 664–65 (“[T]he assumption of an unfettered discretion that would allow tribunals to decide the issue of costs without regard to prior practice in investment treaty arbitration comes close to arbitrary and inconsistent decision-making of administrative agencies, a practice that can constitute a violation of fair and equitable treatment under international investment treaties if entertained by domestic administrators.”) (footnote omitted).

\textsuperscript{136}. See, e.g., Técnicas Medioambientales Tecmed SA \textit{v.} United Mexican States, ICSID Case No. ARB(AF)/00/2, Award, ¶ 154 (May 29, 2003), 10 ICSID Rep. 134 (2004) (emphasizing the need for consistency in the decisionmaking of a national agency under the guarantee of fair and equitable treatment).

\textsuperscript{137}. See, e.g., Glamis Gold, Ltd. \textit{v.} United States of America, Award, ¶¶ 625–626 (NAFTA Ch. 11 Arb. Trib. June 8, 2009), http://ita.law.uvic.ca/documents/Glamis_Award_001.pdf (“Previous tribunals have indeed found a certain level of arbitrariness to violate the obligations of a State under the fair and equitable treatment standard. Indeed, arbitrariness that contravenes the rule of law, rather than a rule of law, would occasion surprise not only from investors, but also from tribunals.”).
may even be obligated to do so. After all, if tribunals’ discretion on legal costs were actually unfettered, then Rovine and Wälde would have had no basis for their objections in EDF and Thunderbird. Despite the confidence with which the dissenters defended the doctrinal correctness of the American rule, an examination of the additional sources of applicable law—domestic law and public international law—reveals substantial authority favoring application of the English rule.

B. Domestic Law Supports the English Rule in All Disputes in which the United States Is Not a Party

In nearly every investor-state dispute, application of “the law of the Contracting State party” supports application of the English rule. The term “English rule” is a misnomer made in America. Nearly every domestic legal system in the world, whether belonging to the common law or civil law tradition, follows a variation of the rule that “costs follow the event.” The single obvious exception is the United States, which follows the American rule.

Some jurisdictions codify the English rule in statutes or regulations. In others, the English rule is a judge-made practice. Some jurisdictions follow the Welamson doctrine, which awards legal costs to the prevailing party based on the proportion of its successful claims to its unsuccessful claims. Despite these variations, in the overwhelming majority of jurisdictions worldwide, courts award reasonable legal costs to the prevailing party. Though several

138. See 1 LORD JUSTICE JACKSON, REVIEW OF CIVIL LITIGATION COSTS: PRELIMINARY REPORT 21–22 (analyzing the rules on costs in the United Kingdom); 2 id. at 545–639 (2009) (analyzing the rules on costs of other major common law jurisdictions in the world, including Australia, Canada, New Zealand, and Scotland, and observing that only the United States follows the American rule).

139. See MERRYMAN ET AL., supra note 84, at 1026–27 (observing that all civil law jurisdictions follow some version of the English rule, though five civil law jurisdictions only apply the English Rule to the costs that the court or administrative tribunal incurs, rather than to both the tribunal’s costs and the parties’ attorneys’ costs).


141. See Gotanda, supra note 128, at 6–7 (citing the legislation of France, Germany, Sweden, and Brazil).

142. See id. (citing judge-made law in Canada and Australia).

theoretical justifications for this practice exist, domestic courts most widely adhere to the rationale that a claimant should be made financially whole for a legal wrong suffered and should not be satisfied with a lesser amount because of the necessity of suing. Likewise, one who successfully defends himself against an unjustified claim should come out of the experience without financial loss.

In at least three cases before investor-state tribunals, arbitrators have looked to a host state’s law either to support a decision on legal costs or to dissent from one. This demonstrates that Article 42(1) of the Washington Convention is not a dead letter rendered irrelevant by arbitrators’ preference for case law. Therefore, because the United States is the sole jurisdiction that does not follow the English rule, the law of “the Contracting State party” should consistently support applying the English rule whenever the respondent is not the United States.

C. The English Rule in Public International Law

Though arbitrators have looked to domestic law in certain decisions about legal costs, they have referred to public international law in many more. Indeed, as Wälde recognized in Thunderbird,
public international law is the only channel through which precedent may enter a tribunal’s deliberative process under Article 42(1).  

The content of public international law is not defined in the Washington Convention, but it is well understood to consist of the five components described in Article 38(1) of the Statute of the International Court of Justice. A two-tiered hierarchy exists within these five components. The three sources of public international law include “international conventions,” “international custom,” and “general principles of law recognized by civilized nations.” The two subsidiary means of determining international law include “judicial decisions,” such as the awards rendered by investor-state tribunals, and “the teachings of the most highly qualified publicists,” a phrase which refers generally to academic commentary on international law. Doctrinally, when precedent or academic commentary is in conflict with any of the primary sources of international law, courts and tribunals should follow the primary sources. In public international law, precedent and academic commentary “do not create rules of law, but only serve as means for determining such rules.”

Considering the almost universal acceptance of the English rule on legal costs in domestic law, Dean Gotanda has proposed that the rule “constitutes a general principle of international law” recognized by civilized nations. General principles of law may be identified when the national laws of many domestic systems converge, though unanimous worldwide convergence is not required. In particular, these principles frequently help international courts settle questions of procedure.

149. *Int'l Thunderbird*, Separate Opinion, ¶ 129.  
152. *Id.* at 19, 24.  
154. Gotanda, *supra* note 128, 34 n.160. *But see* Gotanda, *supra* note 6, at 17 (citing the policy rationale of predictability, rather than doctrine, as the basis for adopting the American rule on legal costs).  
Not all commentators and tribunals agree, however, that comparative domestic practice is the only factor in identifying a general principle of law. Some writers insist that examination of comparative international practice is also a necessary step.\textsuperscript{157} Sharing this view, the Thunderbird and EDF tribunals based part of their respective decisions on a review of the treatment of legal costs in various forms of international litigation. Both majorities looked to international commercial arbitration, which in a sense is an international practice, though it governs private legal relationships rather than public ones.\textsuperscript{158} The EDF tribunal also considered what it ambiguously called “the public international rule,” which, from the context, most likely referred to cases before the ICJ.\textsuperscript{159} Professor Walde’s dissent in Thunderbird broadly surveyed the practices of the WTO dispute-settlement body, the European Court of Human Rights (ECHR), and the Iran-U.S. Claims Tribunal.\textsuperscript{160}

As a whole, international litigation presents a more divided and complicated picture than does domestic law. Although permitted under its statute to award legal costs to litigating states at its discretion,\textsuperscript{161} the ICJ has always followed the American rule—which is unsurprising given the ICJ’s difficulties with enforcing awards of ordinary monetary damages.\textsuperscript{162} The WTO dispute-settlement body likewise follows the American rule—which is even less surprising because the WTO’s remedies are entirely nonmonetary.\textsuperscript{163} By contrast, the ECHR and its analogue, the Inter-American Court of Human Rights (IACHR), both follow the pro-claimant rule to

\begin{footnotesize}
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\item \textsuperscript{157} CHENG, \textit{supra} note 153, at 2–3.
\item \textsuperscript{158} EDF (Servs.) Ltd. v. Romania, ICSID Case No. ARB/05/13, Award, ¶ 326 (Oct. 8, 2009), \url{http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC1215_En&caseId=C57}; Int’l Thunderbird Gaming Corp. v. United Mexican States, Arbitral Award, ¶ 218 (NAFTA Ch. 11 Arb. Trib. Jan. 26, 2006), \url{http://ita.law.uvic.ca/documents/ThunderbirdAward.pdf}.
\item \textsuperscript{159} EDF, Award, ¶ 322.
\item \textsuperscript{160} See Int’l Thunderbird Gaming Corp. v. United Mexican States, Separate Opinion, ¶¶ 140–141 (NAFTA Ch. 11 Arb. Trib. Jan. 26, 2006), \url{http://ita.law.uvic.ca/documents/ThunderbirdSeparateOpinion.pdf} (observing that in the WTO and under the European Convention on Human Rights, prevailing parties are not awarded costs, whereas in the Iran-U.S. Claims Tribunal, costs have been awarded in only a fraction of the cases).
\item \textsuperscript{161} Statute of the International Court of Justice, \textit{supra} note 150, art. 64, 59 Stat. at 1063 (“Unless otherwise decided by the Court, each party shall bear its own costs.”).
\item \textsuperscript{162} BROWN, \textit{supra} note 53, at 193–94.
\item \textsuperscript{163} \textit{Id.} at 216.
\end{itemize}
\end{footnotesize}
accommodate claimants who may be “indigent, social outcasts, or marginalized.”\textsuperscript{164}

Nevertheless, international legal practice sometimes follows the English rule. International commercial arbitration, in particular, follows the English rule, as the \textit{Thunderbird} and \textit{EDF} tribunals observed.\textsuperscript{165} So does the Iran-U.S. Claims Tribunal in most of its cases.\textsuperscript{166} Therefore, though far from unanimous, international legal practice still provides an adequate doctrinal basis for the application of the English rule on legal costs.

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From a doctrinal standpoint, it is not obvious how legal costs should be awarded in investor-state arbitration, but there is at least as much support for the English rule as for either alternative. Though ICSID case law tends to support either the pro-claimant rule or the American rule, tribunals have applied or purported to apply the English rule in many cases. Domestic law almost always supports the English rule, except when the United States is a party to the dispute. Domestic litigation provides evidence that the English rule is a general principle of law, but the practice in international litigation is more mixed.

Therefore, because doctrine does not settle the question entirely, tribunals are justified in moving past doctrine to consider public policy and practical realities.

IV. POLICY JUSTIFICATIONS FOR APPLYING THE ENGLISH RULE

Though the legal doctrine presents a somewhat divided picture, public policy considerations support application of the English rule. This is particularly true in the post-2007 political environment. Today, the investor-state arbitration system is regularly accused of both

\textsuperscript{164} Dinah Shelton, Remedies in International Human Rights Law 368 (2d ed. 2005). \textit{But see id.} (noting, however, that the IACHR had followed the American rule until 1998).

\textsuperscript{165} See Gotanda, \textit{supra} note 128, at 34 n.160 (explaining that most countries award costs and attorneys’ fees, which suggests that the practice is a “general principle of international law”).

\textsuperscript{166} Stephen J. Toope, \textit{Mixed International Arbitration} 380 (1990) (noting that the Iran-U.S. Claims Tribunal, in \textit{Sylvania Technical Systems, Inc. v. Government of the Islamic Republic of Iran}, 8 Iran-U.S. Cl. Trib. Rep. 298 (1985), observed that the tribunal could award costs only if they were reasonable).
showing a proinvestor bias and of producing a chilling effect on host states’ legitimate use of police power. The pro-claimant rule and the American rule only exacerbate these harmful effects by virtue of the financial incentives they provide to claimants and respondents. By comparison, the financial incentives the English rule creates are fairer and more sensible.

This Part first describes the various financial incentives each rule creates. Then it notes the connections between the pro-claimant rule and the alleged “pro-investor bias,” with reference to Schill’s argument that this bias is a positive feature of the investor-state arbitration system. Finally, this Part analyzes the connection between application of the American rule and the regulatory chill that critics of the system have observed, and explains why the American rule encourages high-value, low-merit nuisance suits against host states.

A. The Financial Incentives That Each Rule Creates

Each rule on legal costs produces a unique set of incentives for prospective parties. The English rule encourages claimants to bring stronger, smaller claims. By contrast, the American rule encourages claimants to bring weaker, larger claims. The pro-claimant rule encourages the bringing of all claims, no matter how small or weak.

Under the American rule, because even a successful claimant is required to bear its own costs, the rational claimant is discouraged from bringing a claim for an amount less than the cost of litigating,

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167. See supra notes 73–75 and accompanying text.
168. Schill, supra note 6, at 657.
169. In this discussion, the strength or weakness of a claim is defined as the probability of its success at trial. A claim may be made weak or strong by virtue of its factual or legal basis. The size of a claim, by contrast, refers to the monetary amount sought by the claimant in damages. See, e.g., Avery Katz, Measuring the Demand for Litigation: Is the English Rule Really Cheaper?, 3 J.L. ECON. & ORG. 143, 156 (1987) (“[A] plaintiff with a low estimate of her chances will give a relatively high weight to the prospect of indemnifying her opponent and will be less inclined to sue. For analogous reasons, however, the English rule encourages plaintiffs with relatively low ratios of total stakes to total cost and relatively high probabilities of victory.” (footnote omitted)).
170. See, e.g., Prichard, supra note 5, at 460–61 (noting that the American cost rules allowing group and class action litigation, expanding the scope of litigation, and providing minimal fee shifting do not create institutional barriers to litigating novel legal theories).
171. See, e.g., Hylton, supra note 5, at 445 (“The incentive to bring suit is greater under the Pro-plaintiff rule than under either the American or British rule.”).
even if the probability of recovering on the claim is 100 percent. On the other hand, the rational claimant is encouraged to bring a claim if the amount of the claim discounted by the probability of losing is greater than the claimant’s own legal costs, even if the probability of losing is very high. Therefore, a claimant under the American rule is encouraged to bring a weak, large claim but discouraged from bringing a strong, small claim.

By contrast, under the English rule, the rational claimant is encouraged to bring a small claim, provided the claim is strong enough that the claimant is satisfied with its probability of winning, because a prevailing claimant will not bear its own legal costs. On the other hand, the rational claimant is discouraged from bringing a low-probability claim, even if the amount of the claim is very great, because a failed claim comes with the additional burden of bearing the respondent’s legal costs.

Finally, the pro-claimant rule creates a financial incentive for the bringing of any claim, no matter how small or how weak, without any corresponding disincentives. No matter how small the claim may be, success on the merits will protect the claimant from losing any of its recovered damages to legal costs. No matter how weak the claim, no possible result will require the claimant to pay the respondent’s legal costs. Unlike the English rule or the American rule, the pro-claimant rule tilts the playing field plainly in favor of one party, as its name indicates.

172. See Steven Shavell, Suit, Settlement, and Trial: A Theoretical Analysis Under Alternative Methods for the Allocation of Legal Costs, 11 J. LEGAL STUD. 55, 58 (1982) (“[U]nder the American system, the plaintiff will bring suit if and only if his expected judgment would be at least as large as his legal costs.” (emphasis omitted)).

173. See id. at 58–59 (explaining that, assuming the claimant is risk neutral and no fee shifting is involved, under the American rule a claimant calculates whether to bring an action simply by discounting the probability of winning by the expected legal costs).

174. See id. at 59 (“[I]t is apparent that the frequency of suit will be greater under the British system when the plaintiff believes the likelihood of prevailing is sufficiently high . . . because when the plaintiff is relatively optimistic about prevailing . . . he will be thinking about the possibility of not having to pay any . . . costs . . . .”).

175. See id. at 59–60 (explaining that suits with a low probability of success in the British system are, on average, more costly than in the American system because an unsuccessful claimant is responsible for opposing legal costs).

176. See id. at 60 (noting that the only factors a claimant considers in a pro-claimant system are the expected legal costs and the probability of success).
B. The Pro-Claimant Rule and Proinvestor Bias

Tilting the playing field is exactly what motivates jurisdictions to deploy the pro-claimant rule. That is, when a jurisdiction perceives a preexisting power imbalance between certain classes of potential claimants and respondents, the jurisdiction may adopt the pro-claimant rule for certain types of litigation to correct this imbalance. For example, because employers almost always have greater access to financial resources than do their employees, numerous American statutes allow employees to recover attorneys’ fees if they prevail in suits against their employers. Likewise, the ECHR follows the pro-claimant rule because the victims of human rights abuses are “often indigent, social outcasts, or marginalized.”

In his 2006 article endorsing the pro-claimant rule, Schill argues that the investor-state context is analogous. According to Schill, the “equality paradigm” followed in ordinary litigation and commercial arbitration should be discarded in disputes between states and investors because the states and investors are in a “hierarchical relationship,” rather than on equal footing. States may “unilaterally impose binding obligations on a foreign investor in the form of administrative orders or legislation.” Further, “under general international law, a State is even entitled . . . to change the national law that governs investor-State contracts.”

But Schill is wrong to imply that the state is therefore always in a position of power over the investor during dispute settlement. Though Schill correctly points out that the investor-state relationship is not like a commercial relationship, none of the sovereign powers Schill identifies has any effect on the outcome of arbitration. It is unclear why sovereign powers necessarily create a dispute-settlement environment that does not fit an equality paradigm, especially when...

177. Rowe, supra note 144, at 663–65.
178. See, e.g., Fair Labor Standards Act of 1938 § 16(b), 29 U.S.C. § 216(b) (2006) (“The court in such action shall, in addition to any judgment awarded to the plaintiff or plaintiffs, allow a reasonable attorney’s fee to be paid by the defendant, and costs of the action.”).
179. SHELTON, supra note 164, at 368 (“Attorneys who bring human rights cases need to be paid because fee awards encourage them to represent victims who are often indigent, social outcasts, or marginalized. . . . Without financial recompense, attorneys in repressive states have little incentive to provide services for those most in need.”).
180. Schill, supra note 6, at 679.
181. Id.
182. Id. at 678.
183. Id.
abusing sovereign powers is how states incur liability. The only sovereign power that would be useful in this context, immunity from suit, is already waived by accession to an investment treaty. None of the host state’s other sovereign powers can assist it during investor-state arbitration.

Actual power imbalances during investor-state arbitration are more likely to arise from another source of power, unrelated to national sovereignty: financial resources. The party with greater financial resources can hire superior legal representation, conduct factual research in greater depth, and present its case in a more effective fashion.\footnote{See Kate M. Supnik, Note, Making Amends: Amending the ICSID Convention to Reconcile Competing Interests in International Investment Law, 59 DUKE L.J. 343, 366 (2009) (observing that “developing . . . states . . . often lack sufficient resources to adequately represent themselves in proceedings”).} Though in some cases the host state may have greater access to financial resources than does the claimant,\footnote{For example, the United States is one of the more frequent respondents. See Franck, supra note 56, at 86–87 (illustrating that only Argentina and Mexico were more frequent respondents than was the United States, although Canada, the Czech Republic, and Egypt were respondents in an equal number of cases as the United States). With an annual federal budget estimated between $3 and $4 trillion, the United States is also the wealthiest frequent respondent. OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT OF THE U.S., BUDGET OF THE U.S. GOVERNMENT, FISCAL YEAR 2011, at 146 tbl.S-1 (2010).} this is not always the case. The vast majority of claimants are transnational corporations with substantial budgets.\footnote{Anderson & Grusky, supra note 67, app. at 31–32.} A 2007 study found that 20 percent of investor-state arbitration was initiated by corporations that ranked in Fortune’s Global 500.\footnote{Id. at ix.} In fact, in seven of those cases, the claimant’s corporate revenues exceeded the GDP of the defending country.\footnote{Id. at 5.}

The most notorious example of a claimant outspending and out-lawyering a respondent is the case of \textit{CDC Group PLC v. Republic of the Seychelles}.\footnote{CDC Grp. PLC v. Republic of the Seychelles, ICSID Case No. ARB/02/14, Award (Dec. 17, 2003), 11 ICSID Rep. 211 (2007).} The Republic of Seychelles, an island country of approximately eighty thousand people, “many of them illiterate,”\footnote{Wälde, supra note 50, at 559.} was represented solely by its attorney general, whose office had an unreliable Internet connection, no access to Westlaw or Lexis, and
only two outdated English treatises on contract law. The claimant, the Commonwealth Development Corporation, though technically “an investor” covered under the treaty, was not purely a private party, but an instrumentality of the British government. Represented by a major international law firm based in London with a specialty practice in investor-state arbitration, the claimant routed the respondent and recovered a total of $4.6 million.

Following a de facto pro-claimant rule in such lopsided contexts only provides fuel for critics and uncooperative governments, who already protest that “the rules are rigged” in favor of investors. A system in which an arm of the British government can mobilize the Magic Circle to retrieve millions of dollars from a tiny island republic can hardly be characterized as structurally imbalanced in favor of the respondent. Such a system is not at all like employment litigation in the United States or human rights disputes before the ECHR, in which the claimants are frequently at a financial disadvantage. Thus, the investor-state arbitration system seems like a bad candidate for the pro-claimant rule.

C. The American Rule and Regulatory Chill

The investor-state arbitration system is also a bad candidate for the American rule because of its particular vulnerability to nuisance suits. “Nuisance suits” are suits that may have little chance of success but that would still be cheaper for respondents to settle than to litigate. Economists have shown that a respondent is most likely to settle a nuisance suit under the American rule and least likely to settle a nuisance suit under the English rule. In the investor-state context, nuisance suits could force a host state to spend part of its budget to needlessly settle low-merit claims, rather than to promote

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192. Wälde, supra note 50, at 564.
194. CDC Grp., Award, ¶ 62.
197. See id. at 5 (explaining that nuisance suits succeed when the defendant’s litigation costs exceed the cost of settling but that “under the British system the willingness of the plaintiff to litigate and to file a claim will be less than under the American system if the likelihood of prevailing [on the merits] is low” (emphasis omitted)).
the health, welfare, and safety of its citizens. They might also force a state’s government to refrain from legitimate uses of its police power that could give a potential claimant an opportunity to bring a nuisance suit. To limit this avenue for “legalized blackmail” of host states, investor-state tribunals should apply the English rule on legal costs, rather than the American rule.

Theoretically, the investor-state arbitration system is already particularly vulnerable to nuisance suits, regardless of which legal cost award rule it applies. Economists have demonstrated that respondents are most vulnerable to nuisance suits when they are uncertain as to whether a claim is credible or when the cost of responding to a claim is higher than the cost of settling. Unfortunately, uncertainty and expense are two hallmarks of investor-state arbitration. Though using awards of legal costs as a penalty for frivolous claims and bad faith is likely to lessen the threat of nuisance suits, this will not be a sufficient deterrent in all instances. A respondent must spend a great deal of money determining for itself whether the claim is frivolous before it can even begin to prove as much to the tribunal. Unlike sanctions for bad-faith litigation in some domestic systems, with which judges may punish misconduct at any time after the filing of a claim, investor-state tribunals cannot award costs to either party except as “part of the award”—that is, after the tribunal makes a final decision on all the issues of the dispute.

Effectively, unless a respondent is certain that a claim is frivolous, it must be careful at the outset to research, analyze, and argue all potential legal and factual issues or lose its opportunity to address those issues during arbitration. Consequently, before the tribunal ever has the opportunity to punish a claimant for bringing a

198. See, e.g., ANDERSON & GRUSKY, supra note 67, at 4 (“[T]he threat of massive damages awards can put a ‘chilling effect’ on responsible policy-making.”).
199. See, e.g., COSBEY ET AL., supra note 67, at 20 (“A secondary concern is that regulators who are held liable for their impacts on investors will not regulate to the extent that they should (the regulatory chill argument).”).
204. E.g., FED. R. CIV. P. 11.
205. SCHREUER ET AL., supra note 89, at 1241.
nuisance claim, the respondent must first pay counsel to guide it through at least the following phases: constitution of the arbitral panel, \(^{206}\) assessment of the arbitrators' conflicts and disqualification proceedings, \(^{207}\) memorials and hearings on provisional measures, \(^{208}\) memorials and hearings on jurisdiction and admissibility, \(^{209}\) memorials and hearings on ancillary claims, \(^{210}\) production and review of documents, \(^{211}\) and memorials and hearings on core issues. \(^{212}\) During this lengthy process, the respondent spends on average between one and two million dollars per year, and potentially far more. \(^{213}\)

Because investor-state arbitration is already particularly vulnerable to nuisance suits, the American rule serves this regime very poorly. The American rule exacerbates the threat of nuisance suits and encourages settlement even when a claim is frivolous or, at least, unlikely to succeed. Continued application of the American rule only confirms the perception that investor-state arbitration is a mechanism for the legalized blackmail of host states, impeding the ability of governments to protect the health, safety, and human rights of their citizens. \(^{214}\) To correct this, investor-state tribunals should abandon the American rule and apply the English rule instead.

**CONCLUSION**

In the last several years, investor-state tribunals and commentators have cautioned with increasing frequency that “a balanced approach” is the best way of interpreting an investment

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206. Since private parties are unlikely to have worked with international arbitrators in the past, they often need legal counsel to help them make a good selection of arbitrators. United Nations Conference on Trade & Dev., *Dispute Settlement: International Centre for Settlement of Investment Disputes: 2.7 Procedural Issues*, at 11–12, U.N. Doc. UNCTAD/EDM/Misc.232/Add.6 (Mar. 11, 2003) (noting that parties retain freedom to choose their own arbitrators to sit on the tribunal).  
207. *Id.* at 15–18.  
208. *Id.* at 27.  
209. LUCY REED, JAN PAULSSON & NIGEL BLACKABY, *GUIDE TO ICSID ARBITRATION* 85 (2004) (noting that parties must object as soon as possible to jurisdiction or lose the ability to address the issue).  
211. *Id.* at 22.  
212. *Id.* at 21–22.  
213. See Secretariat, United Nations Conference on Trade & Dev., *supra* note 86, ¶ 14 (noting that “[a] cursory review of cost decisions in recent awards suggests that the average legal costs incurred by Governments are $1 to $2 million”).  
treaty’s substantive protections, and that tribunals should “temper” their “pro-investor inclination.” This is because “an interpretation which exaggerates the protection to be accorded to foreign investments may serve to dissuade host States from admitting foreign investments and so undermine the overall aim” of the investor-state arbitration system. Though these cautionary statements refer generally to the textual interpretation of investment treaties’ substantive protections, rather than to the exercise of discretion under Article 61(2) of the Washington Convention with regard to legal costs, these statements share a common spirit with the arguments advanced in this Note. Professor Schill was able to argue viably in 2006 that conferring a special advantage on claimants was appropriate, given that the object and purpose of investment treaties seemed primarily to be protection of these claimants. Today, however, Schill’s argument seems dangerous. After all, the investor-state arbitration system will be unable to protect anyone unless it can first ensure states’ willingness to participate in it. The growing array of proposed quasi-legislative solutions might help to save the system, but only if they can be politically implemented.

In the meantime, the best safeguard of the system is the wisdom of the tribunals themselves. When text is silent, as text typically is with respect to legal costs in investor-state arbitration, tribunals’ principled application of law relies on their consideration of two

215. Andrew Newcombe & Lluís Paradell, Law and Practice of Investment Treaties: Standards of Treatment 115 (2009); see also Azurix Corp. v. Argentine Republic, ICSID Case No. ARB/01/12, Award, ¶ 307 (June 14, 2006), 14 ICSID Rep. 374 (2009) (“[T]he [Bilateral Investment Treaty] itself is a document that requires certain treatment of investment which the parties have considered necessary to stimulate the flow of private capital. . . . [Therefore] the Tribunal in interpreting the [agreement] must be mindful of the objective the parties intended to pursue by concluding it.” (internal quotation marks omitted)); Saluka Invs. BV (Neth.) v. Czech Republic, Partial Award, ¶ 300 (Perm. Ct. Arb. Mar. 17 2006), 15 ICSID Rep. 274 (2010) (“The protection of foreign investments is not the sole aim of the Treaty, but rather a necessary element alongside the overall aim of encouraging foreign investment and extending and identifying the parties’ economic relations. That in turn calls for a balanced approach to the interpretation of the Treaty’s substantive provisions for the protection of investments, since an interpretation which exaggerates the protection to be accorded to foreign investments may serve to dissuade host States from admitting foreign investments and so undermine the overall aim of extending and intensifying the parties’ mutual economic relations.”).

217. Schill, supra note 6, at 695–96.
218. See Brower, supra note 78, at 348 (calling “simple, top-down solutions” unfeasible and drawing on “eight decades of failure to negotiate comprehensive multilateral treaties on foreign investment” as proof).
essential factors—first doctrine, then policy. Because the English rule on legal costs is supported by doctrine and would serve essential policy goals, the English rule is a promising instrument for fine-tuning the investor-state arbitration system. Doctrinally, the English rule on legal costs is available because ex ante agreements do not forbid it, the respondent’s domestic law almost invariably requires it, and its near universality in domestic litigation and commercial arbitration may give rise to a general principle of law under public international law.

From a public policy perspective, the English rule possesses two advantages over the alternatives. First, the pro-claimant rule is openly and deliberately biased against states, which is bound to discourage states’ participation in dispute settlement. Second, the American rule creates financial incentives that promote low-merit, high-value claims, including nuisance suits that deter host states from legitimately using their police power. By contrast, application of the English rule on legal costs reduces these economic and political burdens on host states and helps to ensure their continued participation in investor-state arbitration. This, in turn, protects and promotes foreign investment. Therefore, by applying the English rule on legal costs in investor-state arbitration, tribunals can reach the wisest and most reasonable results.