Kluwer Arbitration Blog

International Arbitration in Italy: Is the American Rule the Solution?

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In my last post, I pointed out the inconsistencies of the Italian judicial system. Italy has a court system that is indisputedly overloaded (and, as a consequence, inefficient); yet the most obvious solution to this problem, International Arbitration, is rarely used by companies or private individuals to resolve their disputes. In my view this happens mainly because the advantages of Arbitration are not adequately known by potential litigants in Italy.

A few much appreciated comments to my post noted the need of a shift in teaching in law schools and the power of education to increase awareness of International Arbitration. Most important, it has been highlighted that one key reason which keeps most Italian businesses away from Arbitration is its high costs, especially as compared to the Italian court system.

It is undeniable that costs of International Arbitration can be considerable, and certainly far greater than any domestic litigation proceedings in Italy. A first component of the costs is represented by the "costs of the proceedings", which includes the arbitrator's fees and the administrative fees. The appointment of the arbitrator(s) is a peculiarity of International Arbitration and the parties to the dispute, in all likelihood, will select one (or more) highly specialized practitioner(s) or professor(s) to decide the dispute. The administrative fees relate essentially to the fees of the arbitration institution which will handle the case, according to the parties' agreement (unless, of course, the parties decide to opt for an *ad hoc* Arbitration, in which case the administration fees might be lower, but the arbitrators' fees accordingly higher). From this perspective, it is meaningful to note that the Chamber of Arbitration of Milan (CAM) has recently applied an average reduction of 15% to administrative and arbitrators' fees with reference to middle-value and high-value arbitrations starting from January 1, 2016 and administered according to its rules.

Nonetheless, the "costs of the proceedings" generally represent only a minor (but not trivial) section of the overall costs. By way of example, a recent ICC Commission Report on costs allocation in International Arbitration, has disclosed that, based on a review of 221 ICC awards from 2012, arbitration costs represent on average 17% of the parties' entire costs.

Conversely, the main component of the costs is represented by the "costs of the parties", and especially by counsels' fees. On the one side, International Arbitration still remains a specialist practice area, where only skilled and experienced counsels/law firms are able to provide adequate legal assistance, especially in Italy. On the other side, International Arbitration is highly demanding, the timelines are usually tight (a valuable element for the parties) and, hence, a

considerable amount of work is required to counsels.

Most relevant, the parties have to deal with the prospect of losing the dispute and the risk of having to pay the fees of the counterparty's counsel, according to the English Rule, also known as "losers pays" or "costs follow the event" (CFTE). Originally derived from Roman Law, the English Rule is conceptually based on the principles of fairness, equity and fair economic allocation of costs. The rationale behind it is clear: to indemnify the winning party; i.e., a party should be no worse off as a result of vindicating its rights. Nowadays, the English Rule is generally adopted by the court systems of most countries, including Italy, and as default rule in commercial arbitration.

A traditional alternative to the English rule is the American Rule, according to which each party shall bear its own costs (normally, when the American Rule is adopted, the "costs of the proceedings" are equally split between the parties). The American Rule has been in place for many years, supposedly established by the U.S. Supreme Court in *Arcambel v Wiseman*, 3 U.S. (3 Dall.) 306 (1796).

In this blog piece I propose that the Italian arbitral institutions should adopt a novel approach in seeking to win over Italy to the idea of International Arbitration. They should adopt the American Rule as their default rule on costs.

On what do I base my proposal? First, and most crucially, the American Rule would provide the parties with certainty throughout the process in terms of costs. Each party will be able to understand and manage the costs of the Arbitration as they will only be paying their own legal fees, and will not be concerned about paying more legal fees following an arbitral award. I believe that certainty of fixed costs under the American Rule will make Arbitration more attractive to Italian parties than the potential risk of indefinite costs under the English Rule.

Furthermore, the American Rule would allow greater certainty by reducing inconsistencies in costs awards. It is certainly arguable that awards of costs and fees in International Arbitration are not as consistent or predictable as they could be. Parties in very similar situations receive different costs results and this, I would argue, undermines the legitimacy of the entire arbitral process. An example of this inconsistency of practices adopted by arbitral institutions often takes place when a party wins only partially its claim. Some tribunals will award costs in proportion to the party's level of success (if the claimant is successful on 75% of its claim, they are awarded 75% of its costs). Other tribunals will set off the successful party's award of costs against the reimbursement claims (the claimant is successful on 75% of its claim, so it receives 75% of their costs minus the costs of the other side of 25%).

Second, the American Rule would eliminate the (sometimes) hard process of establishing which party actually prevailed in a claim. Establishing the "winner" is often not straightforward. For instance, suppose that a corporation and its directors are sued by its shareholders for a questionable transaction. Since the defendants are worried about the consequences of the claim, they decide to rescind the transaction and the action by the shareholders is subsequently dismissed. In this case, I would suggest it would be unfair to have the claimants pay the fees of the corporation's counsel, even if the claimants technically lost the case.

Third, the American Rule would eliminate the injustice of having the claimant-loser pay the counterparty's costs when a claim, which is meritorious and brought in good faith, fails for reasons unrelated to the claim (e.g., novel interpretations of the law, refusal of witnesses to testify, tribunal

error, etc). Also in these cases, in my view, it would be extremely unfair to impose a costs penalty on a claimant who lost the case on an unforeseeable event.

Fourth, it is an arguable proposition that the American Rule would encourage settlements better than the English Rule. A number of interesting and thought-provoking studies were conducted in the early 1970s by William Landes, Richard Posner and John Gould, and suggest that, by adopting the American Rule, the initial gap between the parties would be lower and it would be easier to bridge it, the counsel's fees not being "mingled" with the amount in dispute.

Lastly, the American Rule would protect financially weaker parties and encourage them to defend their rights. When the U.S. Supreme Court first adopted the American Rule in 1976 a key policy reason was the access to justice: less financially capable parties may be deterred from the prospect of claiming or defending through Arbitration if they fear a large costs award against them if they lose.

As mentioned above, the application of the American Rule as the default rule within the Italian arbitral institutions (along with a certain degree of flexibility of the Tribunals, of course) might be a solution to the issue of costs, by raising the degree of certainty and lowering (or, better, distributing) the overall costs since the outset. From this perspective, Italy not only might be regarded as one of the few worldwide countries adopting a different method of allocating costs between the parties in International Arbitration (thus representing a viable and unique alternative to many foreign courts/arbitration institutions), but it might introduce an alternative to its own court system, where the English Rule governs costs allocation.

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