Journal of International Arbitration
Keeping the Golden Goose Alive: Could Alternative Fee Arrangements Reduce the Cost of International Arbitration?

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The spiralling cost of conducting international arbitrations has been extensively debated in recent years. Most of the cost of pursuing or defending an international arbitration is attributable to the cost of legal representation. In this article the author considers the use of alternative fee arrangements in international arbitration. The author discusses the use of innovative procurement processes by parties which are intended to drive down the cost of legal services. Although the reason for using such processes is to reduce the cost to the client, the author argues that alternative fee arrangements could result in arbitrations being conducted more efficiently and proactively. Accepting alternative fee arrangements will require law firms to review not only their billing practices, but also to revisit the manner in which they approach the conduct of international arbitrations in order to increase efficiency whilst maintaining profitability.

1 INTRODUCTION

A former legal director of Royal Dutch Shell, Beat Hess, told the ICCA fiftieth anniversary conference that the length of international arbitration proceedings and the increasing use of US-style discovery procedures were issues that kept him awake at night.1 By speaking up, Mr Hess joins a number of other users of international arbitration who have complained about the increased time and cost of international arbitration. As in-house legal teams come under increasing pressure to trim budgets and reduce legal spend, could a radically different approach to procuring legal services have a knock-on effect on the cost (and therefore the time) of international arbitration?

There has been a certain degree of general hand wringing over the cost of international arbitration in recent years (although criticism of the process is not new; back in 1989 Lord Mustill lamented ‘Are the [arbitration] proceedings any longer imbued by informality, or do they not have all the elephantine laboriousness of an

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action in court, without the saving grace of the exasperated judges’ power to bang together the heads of recalcitrant parties. Four years ago, the 2007 Fulbright & Jaworski Litigation Trends Survey concluded ‘the overall trend among the survey respondents seems to be that international arbitration is not seen as offering significant cost benefits over litigation’. The survey also found that the percentage of respondents who believed that arbitration was quicker than litigation fell from 43% in 2006 to 11% in 2007. Back in 2000, Fali S. Nariman stated: ‘Arbitration has lost that lightness of touch that characterized its early manifestations: motivated or reasoned decisions – majority, concurring and dissenting – are now increasingly long and turgid, and too full of legal learning.’ A study of the Corporate Counsel International Arbitration Group (CCIAG) found that 100% of the corporate counsel participants believed that international arbitration ‘takes too long’ (with 56% of those surveyed strongly agreeing) and ‘costs too much’ (with 69% strongly agreeing).

Criticism notwithstanding, there have been significant increases in the number of arbitration matters reported by the arbitral institutions. Statistics published by the Hong Kong International Arbitration Centre show quite staggering increases for various arbitration institutions since 2004. Yet, is the reason for this increase only because, in the words of one corporate counsel ‘the alternatives are so much worse’?

There is considerable anecdotal evidence that the parties’ dissatisfaction with the arbitration process is fuelling an increase in other forms of dispute resolution, notably mediation. Although the ICC reports a general increase in arbitrations across the board (and has consistently done so for a number of years), it is significant that in 2009 it reported a 100% increase in its caseload for mediations, compared with a more modest 10%–30% annual increase in its caseload for arbitrations. The golden goose of international arbitration is likely to go on laying for the foreseeable future but dissatisfaction with the manner in which arbitrations are conducted is evident. Consumers such as Mr Hess and the CCIAG will not continue to tolerate protracted proceedings when other options such as mediation, or even, in some jurisdictions, national court proceedings are, in fact, not so very much worse after all.

8 See the post by Michael McIlwrath, *ICC Mediation, Interesting Data*, on Young OGEMID forum, Mar. 23, 2010.
2 PARTIES’ COSTS MAKE-UP THE MAJORITY OF THE EXPENSE

Despite the numerous articles and conferences which have addressed the perception that arbitration is no longer quick or cheap, and the various suggestions and initiatives asserted to remedy the problem, there has been little change in the past five years in the way that international arbitrations are handled. It is notable that the first solution proposed by a team of in-house counsel during a round table organized by Global Arbitration Review to debate the issue of increased time and cost of international arbitration was to ‘switch to ADR’, rather than try to streamline arbitration procedure or otherwise tackle the perceived problems with arbitration proceedings.\(^9\)

In 2007, the ICC Report on Techniques for Controlling Time and Costs in Arbitration\(^10\) placed the blame squarely on the parties and their counsel. Using statistics based on ICC cases that resulted in a final award in 2003 and 2004, the ICC showed that the costs incurred by the parties in presenting their cases constituted the largest part of the total cost of ICC arbitration proceedings. On average, the costs in these ICC arbitration cases were apportioned as follows:

- costs incurred by the parties to present their cases: 82%;
- arbitrators’ fees and expenses: 16%;
- administrative expenses of the ICC: 2%.

The Report stated ‘It follows that if the overall cost of the arbitral proceedings is to be minimized, special emphasis needs to be placed on steps aimed at reducing the costs connected with the parties’ presentation of their cases.’\(^11\) The manner in which cases are conducted has been made a scapegoat by others with, often, U.S. counsel being castigated for allegedly importing expensive techniques which are more suitable to U.S. domestic litigation into the international arbitration arena.\(^12\)

Others have blamed the parties, on the basis that ‘they’re the ones picking counsel and deciding how the arbitration is to be run’.\(^13\) Yet, this seems slightly unfair:

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\(^13\) Seidenberg, supra n. 12: ‘It’s the parties who are causing the problem’, says one expert who spoke on the condition that he not be identified. ‘They’re the ones picking counsel and deciding how the arbitration is to be run. They’re asking the arbitral associations to stop the parties from bringing the problems on themselves.’ ‘If arbitration is to commit suicide, it will do so of its own choosing, because the parties have chosen to make it more expensive, time-consuming and more like litigation.’
parties select and pay international arbitration counsel in order to be advised how an arbitration should be managed. In the author’s experience, it is rare to find a client with strong views on arbitration procedure. Questions of timetable, disclosure, witness selection and the use of experts are more likely to be left to counsel to opine on. On an assumption that the majority of expenses incurred by the parties are in the form of legal expenses, then (and this may be rather like a turkey voting for Christmas) a solution to reducing the cost (and of course the time) taken by international arbitration becomes obvious: drive down the cost of the parties’ representation. If counsel are forced by parties to reduce the price of their services, then, arguably this will force counsel to rethink the way in which they approach an arbitration.

3 HOURS-BASED BILLING VERSUS FEE-BASED BILLING

Most, if not all, practising lawyers will have grown up with hours-based billing. To quote Thomas Jefferson ‘It is the trade of lawyers to question everything, yield nothing, and to talk by the hour.’ The notion of chargeable hours drives almost every practice in a law firm, from the profit model to the bonus structure. Clients are comfortable with the practice and, frequently, when a firm makes attempts to move to a different pricing model, clients are the ones who are reluctant to depart from the status quo. However, there are signs that companies are becoming more comfortable with alternative fee arrangements (AFAs) and more creative in the manner in which they recruit and retain external counsel. A lawyer may think his or her first and only priority is to provide excellent legal advice. When you consider it from a different angle, you may conclude that this is not necessarily an in-house counsel’s top priority at all.

The 2011 Fulbright & Jaworski Litigation Trends Survey asked respondents how various aspects of their litigation management had been affected by the economic

14 Thomas Jefferson, Third President of the United States (1743–1826).
15 Although some clients would clearly welcome a more creative approach to billing emanating from the law firm. See Michael McIlwrath’s blog post, Kluwer Arbitration Blog, http://kluwerarbitrationblog.com/blog/2011/04/12/anti-arbitration-feedback-on-your-recent-pitch/ (accessed Nov 14, 2011), ‘claiming competitive hourly rates and right-sized teams is, well, apparently part of every law firm pitch. Maybe you could be the firm that will propose something truly different to get our attention on costs? If not, then maybe just say in passing that you’re as competitive on fees as your competitors and leave it at that.’
16 AFA is often used to refer to fee arrangements where payment is dependent on the result of the litigation or arbitration; however, in this article, AFA is used to refer to any fee arrangement which is not based on hourly rates.
17 ‘Question: We asked our law firm for a cost estimate if the dispute goes to arbitration. They said the issues are complex, so an estimate is impossible to provide; they gave their hourly rates instead. How can we get a better handle on the likely cost of the arbitration? Answer: You may want to change your law firm. Now.’ Michael Mcilwrath & John Savage, International Arbitration and Mediation: A Practical Guide 3–112 (2010).
downturn. The survey concluded ‘Generally, the net effect is that areas receiving significantly more emphasis as a result of the economic downtown are: readiness/planning review, use of alternative fees, work kept in-house and willingness to change law firms’ (emphasis added).  

Half of the UK companies surveyed by Fulbright & Jaworski in 2011 used AFAs, compared to 38% in 2009. The larger the company, the more likely it was to use AFAs (61% of companies with a gross revenue of USD 1 billion or more used AFAs compared with 37% of companies with less than USD 100 million in revenue). One respondent to the survey, a US health care company, felt that AFAs would become the ‘norm’ not the exception, and half of the largest companies surveyed planned to increase their use of AFAs in the future.

In the past decade, practices at law firms have changed enormously: from the use of Blackberries, to exchanging submissions by email, to the use of e-disclosure platforms and familiarity with metadata. However, one system that is unlikely to look significantly different from that used ten years ago is the billing system. At its very basic, this captures the time spent by a lawyer on a matter and a narrative to describe the work done. There may additionally be segments available, to which the lawyer can attribute some of his or her time, but these are unlikely to provide any degree of detail. In its present form, the system does not properly equip a lawyer to address a client’s request for an AFA. Historic billing figures generated by these billing systems will not be a reliable source of information on which to base a fee proposal, mainly because historical billing figures will not provide a sufficiently detailed analysis of the time spent on each phase of the matter. When responding to a request for an AFA (or offering an AFA to a client), the law firm has to be in a position to adequately estimate the cost to it of the representation. Only then will it be in a position to move from a ‘cost plus’ (hourly-based billing) to a profit margin (fees-based billing) model.

4 WHO IS BUYING, WHO IS SELLING?

The client is buying a product: the lawyer is selling his or her services. It is difficult to price a product objectively when you are that product. Most lawyers hate discussing fees with clients for this very reason. From the client’s point of view, it is also difficult to negotiate a competitive price for a product when you are facing a long-term relationship with that product. Clients are addressing this issue by using their procurement department, rather than their in-house legal team, to negotiate AFAs with law firms. Distancing the in-house legal department from the procurement process allows the client to use techniques to drive down the cost of the legal services.
they are purchasing. In such a situation, the client typically requests a capped, staged-fee proposal based on a number of assumptions, which it can then compare with proposals solicited from other law firms. In rare (but likely to become more common) instances, the law firm may be asked to participate in a reverse auction, which will have the effect of driving the bids down even further. It is the author’s experience that the larger the company, the more likely it is to have involved its procurement department, and the more likely it is to have requested an AFA.

Law firms need to equip themselves to be able to respond to these demands. If they do not do so already, law firms should distance the product from the sales team by using managers, rather than the lawyers who will be doing the work, to negotiate the fees. It is very difficult for a product to actively sell itself: it is preferable for the selling to be done by a manager who is aware of the actual cost to the firm of doing the work and the potential upside for the firm in agreeing to an AFA. Similarly, the client can drive a significant bargain by using procurement to drive down the cost of the services without being tied by old loyalties to particular firms or particular individual lawyers.

5 COULD FORCING COSTS DOWN INCREASE EFFICIENCY?

Operating under fee constraints could lead to more creative approaches to managing arbitrations, with lawyers looking to reduce costs in phases of the arbitration which are traditionally cost intensive. For example: the conventional wisdom is that having three arbitrators is generally preferable to having one. As Jennifer Kirby noted ‘First, it is said that having three arbitrators improves the quality of the arbitral process and the award. Second, having three arbitrators is said to increase party confidence in the process principally because it allows each side to nominate a co-arbitrator – to have ‘its’ arbitrator as one of the three people who will decide the dispute.’ In fact, clients may feel that including a reference to having three arbitrators runs the risk of doubling the time of the arbitration and trebling the cost (of arbitrators’ fees). Three arbitrators rather than one means that there are more likely to be challenges to the tribunal: firms will spend time researching the background of each arbitrator in order either to appoint the arbitrator or to challenge him or her. Operating under a strict fee constraint would mean that a firm would be loath to incur costs on this stage of proceedings and would prefer to be lobbying for a sole arbitrator. Similarly, firms would be arguing for a restricted pleading schedule and limited or no disclosure. The use of experts would be dramatically curtailed.

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An ICC arbitration conducted under a significant fee cap (imposed on both parties) would be run in a very different way to one billed to the client by the hour. The question for both the client and the lawyers is what product the client wants. In his article, *Can a World Exist Where Expedited Arbitration Becomes the Default Procedure?* Peter Morton likened the parties’ choice to attending a car showroom looking for a functional car and being persuaded to opt for a luxury model. If the law firm is already operating under previously determined fiscal constraints then it is much less likely to dismiss Morton’s Mini Cooper arbitration out of hand. Or, to put it a more palatable way, the firm is more likely to consider alternative ways of conducting the arbitration from the outset. As ever, the flexibility of arbitration procedure permits a flexible approach. Clients have begun thinking creatively by using innovative procurement concepts, it may be time for law firms to respond with innovative ways of managing the arbitrations in question. However, where there is dissonance between the parties, namely, where one is operating under a fee cap and the other is not, this will have a major impact on the arbitration and it is possible to foresee situations in which the party which is fiscally constrained is tactically swamped by the party which is not operating under such constraints.

There are other major issues. The disconnect between a client’s procurement department and the in-house legal team who will live and breathe the arbitration process is problematic. The only role for procurement is to drive down the cost of legal services, with, arguably, a resulting impact on quality. Little or no account will be taken of the personalities, the experience and the qualifications of the individual law firm, apart from ensuring that it meets basic threshold requirements and, most importantly, competes on cost. The ‘success’ of procurement’s involvement will be measured instantaneously (by virtue of the amount the department ‘saved’ the client by driving down the bids). Any ‘success’ of the ultimate arbitration is far harder to

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21 ‘In a recent survey of the expectations as to how long an arbitration of medium complexity with U.S.$5 to 10 million at stake should take, many of the business executives surveyed replied two to three months, and many corporate counsel felt that such an arbitration should be concluded in less than a year . . . Yet, what the consumers are receiving in arbitration is a process which, as a “norm,” will take two to three years from commencement of the arbitration to delivery of the award, with costs per party (counsel only) frequently in excess of U.S.$1 million. One questions how long this apparent mis-match between the needs and expectations of the business community and the product that is being delivered by the arbitration community can continue. To draw an analogy, in terms of the process, many clients walk into the car dealership looking for a Mini Cooper, or equivalent – a nimble, reasonably priced car, of sound quality. Arbitration counsel, on the other hand, like selling clients the luxury saloon, a Rolls Royce or Maybach equivalent. Counsel (and arbitrators) are very familiar with the luxury saloon and, of course, the cynic would point out that it reflects well on the dealership bottom line. Counsel are more inclined to keep the Mini Cooper equivalent parked in the garage at the back, and perhaps reluctantly wheel it out from time to time if a customer must or circumstances clearly require it.’ Peter Morton, *Can a World Exist Where Expedited Arbitration Becomes the Default Procedure?,* 26 Arb. Int’l 103 (2010).

22 As my former supervisor used to say ‘if you think good lawyers are expensive, you should try bad ones’.
measure and clearly will arise, if at all, much further down the track. If clients continue to put pressure on law firms to reduce their prices, then it is very likely that we will see a knock-on effect on the way in which arbitrations are conducted. However, the result may be that the arbitration costs less, but the award comes at a higher price.
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1. Articles must be presented in their final form, in English. They should be double spaced with wide margins for ease of editing. Please provide the text in Microsoft Word or Word Perfect, and deliver to the General Editor at editorjoia@kluwerlaw.com

2. Special attention should be given to quotations, footnotes and references which should be accurate, complete and in accordance with the Journal style sheet, which is available online at www.kluwerlawonline.com/JournalofInternationalArbitration.

3. Tables should be self-explanatory and their content should not be repeated in the text. Do not tabulate unnecessarily. Keep column headings as brief as possible and avoid descriptive matter in narrow columns.

4. Please ensure a brief biographical note giving details of the professional/academic status of the author(s) is provided.

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