

Judgment 25/2013

**Tostevin & Tostevin and Newhouse &
Newhouse
Royal Court
9th August, 2013**

Appeal against Arbitrator's final award.

**IN THE ROYAL COURT OF GUERNSEY
(ORDINARY DIVISION)**

Between:

**DAVID DANIEL ALFRED TOSTEVIN
PAMELA NORA TOSTEVIN**

Appellants

-and-

**CRAIG NEWHOUSE
ANN NEWHOUSE**

Respondents

Appeal against Arbitrator's Final Award

Hearing date: 9th April 2013

Judgment handed down: 9th August 2013

Before: Richard James McMahon, Esq., Deputy Bailiff

Advocate for the Appellants: Advocate N J Barnes

Advocate for the Respondents: Advocate F J Haskins

Cases, texts & legislation referred to:

The Arbitration (Guernsey) Law, 1982

The Royal Court Civil Rules, 2007

Zermalt Holdings SA v Nu-Life Upholstery Repairs Limited [1985] 2 EGLR 14

Schwebel v Schwebel [2010] EWHC 3280 (TCC)

Mustill and Boyd, *Commercial Arbitration: 2001 Companion Volume to the Second Edition*

President of India v Jadranska Slobodna Plovidba [1991] 2 Lloyd's Rep 274

Everglade Maritime Inc v Schiffahrtsgesellschaft Detlef Von Appen mbH [1993] QB 780

Excelsior Commercial & Industrial Holdings Ltd v Salisbury Hamer Aspden & Johnson (a firm)
[2002] EWCA Civ 879

Olcott Investments Limited v Mark Amy Limited 1998 JLR 62

Chartered Institute of Arbitrators, Channel Islands Branch, *Rules of the Arbitration Scheme for the Resolution of Disputes in the Construction Industry* (May 2009)

Chartered Institute of Arbitrators, *Practice Guideline 9: Guideline for Arbitrators on Making Orders Relating to the Costs of the Arbitration*

Thompson and Le Noury v Masterton and Bourne [2003-04] GLR 332

Hulme v Matheson Securities (Channel Islands) Limited (1997) 24.GLJ.80

The Royal Court Civil Rules, 1989

Woodbourne Trustees Limited v Generali Worldwide Insurance Company Limited [2011-12] GLR Note 6

Shaina Investment Corporation v Standard Bank London Limited [2001] EWHC Ch 472

Re Elgindata Ltd (No. 2) [1993] 1 All ER 232

Noorani v Calver (No. 2) [2009] EWHC 592 (QB)

Bank of Credit and Commerce International SA v Ali [2002] 1 AC 251

Introduction

On 28 January 2013, pursuant to section 19 of the Arbitration (Guernsey) Law, 1982, I granted leave to appeal to David and Pamela Tostevin against the Final Award made by the arbitrator, Gary Naftel, in favour of Craig and Ann Newhouse, which he had issued on 11 July 2012. This judgment deals with the Appellants' substantive appeal in respect of the costs element only of that Final Award, the grounds of which are set out in paragraph 7 of their Application of 31 July 2012. The further allegation that the arbitrator wrongly ordered the Appellants to register the Interim and Final Awards at the Greffe when the arbitrator had no jurisdiction to make such an order has been resolved by agreement between the parties. Advocate Barnes appeared on behalf of the Appellants and Advocate Haskins on behalf of the Respondents and I am grateful to them both for their assistance.

Background

Because the Appellants have confined their challenge to the arbitrator's Final Award to the costs order he made, I will not set out in any great detail the nature of the complaints made by both sides in the arbitration. Their dispute arose because they own and live in neighbouring properties in Torteval. The Applicants occupy a first floor apartment, which is directly above the Respondents' ground floor apartment. The Applicants have lived in their apartment since 1991. The Respondents moved in much later after they purchased their apartment in early 2009. The conveyances through which they purchased their apartments provide that any dispute or difference arising between them as apartment owners must be referred to a single arbitrator.

The parties agreed in October 2009 to the appointment of Mr Naftel as arbitrator to resolve the disputed matters that had arisen between them. Each of the disputed matters amounted to an alleged breach of one or more of the covenants contained in their conveyances by which the parties are bound. The Respondents' complaints related *inter alia* to noise and pollution, including the use of a washing machine, wrongful use of common parts through maiming, injuring or defacing the roof and roof space, as well as trespass and interference with access and/or a right of way resulting from the planting of flowerbeds. These complaints were set out in a document entitled "POINTS OF CLAIM" dated May 2010. The relief sought in para. 34 was a declaration that the breaches alleged by them had occurred and an order that they cease forthwith. In particular, the Respondents also sought an order that the Appellants be required to undertake and pay for remedial works required to remedy the breaches found and that, if the remedial works were not completed within three months, payment of daily damages in the sum of £100 thereafter (para. 36). The document concluded with a claim for

“*general damages for nuisance, annoyance, inconvenience and loss of enjoyment*” in the sum of £100 per day to run from 26 May 2009, plus general damages for injury to psychological health in the sum of £20,000, representing £10,000 for each of them. Accordingly, by the time the claim was served on the Appellants, the damages element of the Respondents’ claim was already in excess of £50,000.

The Applicants filed a full Defence and Counterclaim dated 7 June 2010. The Counterclaim complained that the Respondents had engaged in aggressive behaviour, had banged loudly on the ceilings and that the noise transference problems had been exacerbated by the sound proofing system installed on behalf of the Respondents. The relief sought was similarly for declarations relating to the alleged breaches and orders that the Respondents carry out and pay for remedial works. There was also an unquantified claim for damages for nuisance, annoyance, inconvenience, discomfort and loss of enjoyment of their land. The Respondents joined issue on the Appellants’ Counterclaim in an undated Statement of Reply to the Defence.

The arbitration hearing eventually took place in May and June 2011. It was a six-day hearing, during which evidence was adduced from two experts and 11 other witnesses and submissions were made. Scott Schedules had been prepared showing that the parties were still poles apart. By the time of the hearing, the damages element of the Respondents’ claim had, therefore, increased to something approaching £100,000.

The arbitrator’s findings on the substance of the parties’ disputes were set out in his Interim Award dated 5 September 2011. The arbitrator found in favour of the Respondents on the vast majority of the issues raised by them and ordered relief. That relief came in the form of sums of money, aggregating to a little under £4,000, which were to be paid by the Appellants to the Respondents. He found that permission had not been obtained for the installation of the multi-fuel stove, but he was against any decision to direct its removal (para. 42). Accordingly, he made an award of £500 for the failure to obtain permission, in return for which the Respondents would give their consent to its installation. Noting that the Appellants would be the only party ever able to benefit from use of the available space within the roof structures, the arbitrator found a further breach of covenant for failing to obtain approval from adjoining owners, but was not persuaded that reinstatement of those common parts should be ordered (para. 74). Accordingly, he awarded damages of £2,000 to the Respondents. In respect of the Appellants’ washing line restricting the Respondents’ use of the communal area, which he described as a “*serious obstruction*” (para. 86(f)), the arbitrator assessed the damages at £2 per day from 22 August 2009 until the date of his award, which totalled £1,488 (para. 85).

The arbitrator also gave directions as to the times at which the Respondents’ washing machine could be used, to take immediate effect from the date of his award. He ordered that the hours during which the washing machine was permitted to be used were 8 am to 8 pm on weekdays (ie, 12 hours each day) and 10 am to 6 pm at the weekends (ie, 8 hours each day) (para. 86(c)). In respect of the flowerbed, the arbitrator declared it to be owned by the Respondents and permitted them to reinstate the area, albeit at their own expense. In other words, he did not make any financial award against the Appellants. The arbitrator agreed with the Appellants that the soundproofing system installed on behalf of the Respondents had exacerbated the level of noise disruption, but left it to the Respondents as to what steps, if any, to take (para. 86(d)). The arbitrator found both sides to be jointly responsible for the

frayed relationship that existed between them (para. 86(j)). The arbitrator rejected the claims made by the Appellants in their Counterclaim. Because of insufficient time at the hearing, he did not attempt to resolve the Respondents' claim for injury to psychological health (para. 86(i)).

Following the issuing of the arbitrator's Interim Award, both sides withdrew their claims for damages for physical injuries, but pursued claims for costs. The costs applications were dealt with by the arbitrator on written submissions. The documentation supplied to the arbitrator has been copied to the Court. Having considered both sides' submissions, the arbitrator handed down his Final Award dated 11 July 2012. Paragraph 57 summarises his decision and provides that the Respondents were being awarded their legal costs on a partial indemnity basis in the amount of £66,832. In addition, the arbitrator awarded them the fees they incurred in respect of the experts in the disciplines of surveying and engineering in the sum of £9,455.70. He also awarded the Respondents their share of the arbitration fees and related expenses that they had already paid in the amount of £11,374.55. He ordered that the total sum of £87,662.25 be paid by the Appellants to the Respondents within 60 days of him issuing his Final Award and that, from the date of award until payment, interest at 8% per annum would be applied, being a daily rate of £19.21. Finally, he ordered that the damages of £3,988 referred to in his Interim Award were to be paid within 14 days of his Final Award, namely by 25 July 2012.

The arbitrator's costs award

The approach taken by the arbitrator to the question of how to resolve the parties' costs applications is shown by various passages in his Final Award. By way of preliminaries, at para. 6, he explained that he had "*made an attempt to provide a just and fair award for costs*". He acknowledged at para. 8 that the arbitration had been conducted under the *Scheme for the Resolution of Disputes in the Construction Industry*, May 2009 and that he had been invited to exercise his powers in accordance with paragraph 5.5 of those Rules, to which I will turn in more detail shortly. (Although the arbitrator has referred to the sub-division in the Rules as "*paragraphs*", I will refer in this judgment to each as a "*Rule*".) At the outset, the arbitrator had noted (at para. 2) that his Interim Award had contained statements about "*various issues being distributed between the parties*", which he would not repeat but which "*may be referred to within this final award*". In his Interim Award, the arbitrator had intimated the way he was thinking about certain aspects of the costs. For example, he stated (at para. 65) that "*I further hold that Mr and Mrs Tostevin's apparent reluctance to consider alternatives without reasonable justification holds them more accountable when considering allocation of costs*" and (at para. 66):

"It is also a concern that attempts to find a suitable resolution between Mr Julian Hunt and Mr Andrew Ozanne conducted in December 2010 on a 'without prejudice' basis also failed to be considered acceptable by Mr and Mrs Tostevin. I am not aware of the details of those without prejudice negotiations however it has become clear that any attempt to find a suitable resolution and avoid arbitration proceedings has been distinctly discarded by Mr and Mrs Tostevin. The absolute reasoning or level of acceptance / rejection of previous solutions have not been presented before me due to the 'without prejudice' basis however this will have to be considered in detail whilst apportioning costs in the final award."

Once the arbitrator begins his analysis of the submissions made, there is a sentence in para. 12 that I am afraid I just do not understand:

“... the question of whether the Claimants [ie, the Respondents to the appeal] were successful, should not give reference to costs incurred whilst searching for justice but merely whether their claims were wholly or partially successful.”

However, in accordance with generally accepted principles applicable to costs awards, the arbitrator then proceeded in the next paragraph to state that *“As the Claimants have been successful in the majority of the claim, I am persuaded that they should receive a fair proportion of their claim for costs”*. At para. 15, the arbitrator drew attention to the fact that the Appellants had been unsuccessful in their Counterclaim and stated *“I am persuaded that any time expended defending the counterclaim should be awarded to the Claimants”*. He continued (at para. 17):

“Part of the Respondents’ [ie, now the Appellants’] counterclaim was also to assert that the soundproofing works had affected the stability of the separating floor structure. This allegation had resulted in occurring additional expert fees and time delays which was proven to be unnecessary and therefore on this basis I am persuaded that the Respondents shall be responsible for full costs of the experts involved and the time delays incurred on this part.

The arbitrator rejected the Respondents’ submission that some of the legal argument advanced by the Appellants had been unreasonable: *“The Respondents has [sic] the right of defence in any form and I am not persuaded that they used such legal arguments unreasonably”* (para. 18). However, in relation to whether or not some mutually acceptable terms of settlement might have been reached, he stated (at para. 19) *“I find the Claimants have a more active and persistent history of attempting to find way of settling the dispute without proceeding to arbitration”*. After referring to the involvement of PC Barham, he moved on to consider the parties’ joint instruction of Andrew Dunnell. This is a matter to which I will have to return but, in relation to a comment written on behalf of the Appellants by their Advocate at the time following receipt of Mr Dunnell’s draft report that they *“were not in a position to replace their kitchen and/or carry out any sort of works to their apartment”*, the arbitrator ruled (at para. 21):

“I find this statement and refusal to accept the proposals stated within Mr Dunnell’s draft report conflicting to the intentions of his appointment and I’m not aware of any reasonable conclusion as to why the Respondents should reject his proposals. In fact, I find that failing to accept the proposals presented in the draft report was an act of unreasonable behaviour and contradicted the very purpose of his appointment. The Respondents’ refusal to accept Mr Dunnell’s proposals has led to legal, expert and arbitration costs far in excess of the proposed construction remedies. At this point, I believe it was wrong for the Respondents to continue with the arbitration proceedings and they should have accepted the reasonable proposals that would have resolved matters.”

In the following paragraphs, the arbitrator went into further detail about why Mr Dunnell’s recommendations should have been accepted by the Appellants, finding himself satisfied that the Respondents had *“taken all necessary steps to resolve the dispute and have on several occasions made reasonable offers which have been rejected”* (para. 26). In short, the Appellants’ *“rejection of these proposals led them towards incurring substantial legal costs that could have simply been put towards the costs required to satisfy the proposals within Mr*

Dunnell's report. Therefore, I am persuaded that the decision to decline these proposals on the grounds of lacking funds was fundamentally wrong" (para. 27).

By way of contrast, the Arbitrator then dealt with a proposal advanced on behalf of the Appellants, which had been rejected by the Respondents because they were not consistent with Mr Dunnell's recommendations: "*I am persuaded that the rejection of this proposal should not affect their [ie, the present Respondents] claim for costs because the proposals were not in accordance with Mr Dunnell's proposals and that any expenditure would have been put to proper use*" (para. 28).

Having made "*an assessment on a balance*" (para. 29), the arbitrator "*reached the firm opinion that the Claimants have conducted themselves with reasonable behavior [sic]*", adding "*On balance, the Claimants have been more reasonable than unreasonable in the process of this dispute and I am persuaded that they shall receive a high percentage on their costs claim*" (para. 30). He continued: "*I am also aware the full cost claim include time expended for the psychiatric claim which was later withdrawn by the Claimants, thus this part of their claim will not be accepted and I am not willing to award the cost claim in full*". Turning to the Appellants' behaviour, the arbitrator had "*the firm opinion that they have conducted themselves with a high degree of **unreasonable** behavior [sic]. The use of the washing machine at unreasonable time periods has been proven to me and the unwillingness to share the washing line when the Claimants has equal rights to the drying area was an example of acting unreasonably.*"

In the light of his findings, the arbitrator proceeded to remind himself to consider the whole of Rule 5 in the 2009 Scheme (para. 33) and referred himself to the guidance contained in *Practice Guideline 9: Guideline for Arbitrators on Making Awards* (para. 34), to which I will also return. The arbitrator was critical of what he perceived to be confusing submissions made on behalf of the Appellants, describing them as "*poorly structured*". The final section of his Final Award sets out more directly the reasoning he applied in reaching his determination.

On behalf of the present Respondents, ie, the Claimants in the arbitration, Advocate Haskins sought legal costs and disbursements on the indemnity basis in the sum of £83,540.50 or, in the alternative, on a recoverable basis in the amount of £41,861, as well as the experts' fees of £9,455.72, witness fees and the arbitrator's fees and related expenses. On the initial question of whether he should award costs on the indemnity or recoverable basis, the arbitrator concluded (at para. 42):

"I am persuaded that the Respondents have acted with a high degree of unreasonableness during the course of this arbitration. I also believe it was wrong of the Respondents to have let this dispute be put before me and they should have given greater consideration to the reasonable proposals presented to them in Mr Dunnell's draft report. For this reason, I find the Respondents liable for the costs claimed on an indemnity basis."

He added (at para. 43) that "*rejecting the proposals detailed in Mr Dunnell's report and offering inadequate alternatives is the main outstanding incident*" of the Appellants' unreasonable behaviour, before continuing (at para. 44):

“I find the Respondents’ blunt refusal to properly consider Mr Dunnell’s proposals to have been unreasonable. During the course of the arbitration, the Respondents have put forward a series of applications before me which have incurred legal costs with no specific outcome. The most recent example of this is their appeal against my interim award which was subsequently withdrawn after legal costs have been expended. I fully accept those costs may have been dealt with in another forum.”

The Arbitrator then explained his approach as to the discount to be applied to the indemnity costs to be awarded: *“I shall apply a percentage of the full indemnity claim based on my understanding of the degree of reasonable / unreasonable behaviour of both parties to this arbitration”* (para. 45). Having taken into account the *“time expended by both parties in relation to the initial claims for psychiatric damages which were later withdrawn”*, for which reason he was deducting a proportion of time for the Respondents’ costs, he awarded the Respondents 80% of their legal costs on an indemnity basis, which he calculated to be £66,832.40.

In relation to the amounts claimed in respect of experts’ fees, which the Respondents asserted were expenses incurred because the Appellants rejected Mr Dunnell’s proposals, the arbitrator took a different approach to each. At para. 48, he ruled:

“The Claimants asserted that the fees incurred for their engineer was a result of the Respondents’ claim that the soundproofing works had affected the separating floors stability. As this was proven not to be the case, I shall order the Respondents to pay the full engineers fee of £1,700.72 to the Claimants.”

However, in relation to the fees for the Respondents’ surveyor, he stated (para. 49):

“Ordinarily, I would find the Claimants responsible for their own expert fees on the basis that his discovery and reporting would have been required not only for the arbitration purposes but to identify the constructional issues and propose various improvements. As the parties have already jointly incurred costs for the independent expert who has carried out this inspection and report with proposals, it is clear that the surveyor fees were an unnecessary additional cost incurred through this arbitration process. The Claimants’ surveyor was therefore necessary as a result of the Respondents’ decision to reject Mr Dunnell’s proposals, and on that basis I order the Respondents to pay the full surveying expert fees of £7,755.00 to the Claimants.”

Although he rejected any claims in respect of witness costs (para. 50), in respect of the general costs of the arbitration itself, at para. 51 the arbitrator ruled as follows:

“The Claimants have asserted that the Respondents failure to accept Mr Dunnell’s proposals was a main reason for incurring costs through this arbitration process and that there was no alternative for them to pursue. Whilst the arbitration proceedings have incurred costs on both parties, I believe the Respondents were wrong in bringing this arbitration process before me and should have given greater consideration to the proposals outlined in Mr Dunnell’s report. On this basis, I shall find the Respondents responsible for the full arbitration fees and related expenses.”

The arbitrator rejected the Appellants' claim that they should get their costs from the Respondents. A particular submission made was that the Respondents' refusal to entertain a suggestion that the matter be referred for mediation constituted unreasonable behaviour, in relation to which the arbitrator decided (at para. 54):

“Having read the without prejudice correspondence I’m not of the opinion that this amounts to unreasonable behavior [sic] on the Claimants’ part. The fact that mediation and various other settlement offers were given by the Respondents after Mr Dunnell’s report does not demonstrate the Claimants’ unreasonable behavior.”

The Final Award continued (at para. 55):

“On this basis, and on the fact that I find the Respondents’ behavior [sic] to have been unreasonable in various circumstances although mainly refusing to accept Mr Dunnell’s proposals, I am not accepting the Respondents claim for recovery of costs.”

Grounds of appeal

The first ground pursued by Advocate Barnes on behalf of the Appellants is that *“The arbitrator misdirected himself in his application of rule 5.5 of the arbitration rules in deciding the Appellants’ conduct was unreasonable such that the rule in 5.1 should be dis-applied and that they should be ruled to pay the Respondents’ costs”*. In support of that ground, Advocate Barnes has submitted that the approach in an arbitration to what is *“unreasonable”* should be the same, or at least a similar, approach as the Royal Court would take when considering indemnity costs under rule 83 of the Royal Court Civil Rules, 2007. If so, he suggests that the conduct of the Appellants in the arbitration proceedings was not such that it would attract an award of indemnity costs by the Court, adding that the effect of the arbitrator’s approach to this question would effectively mean that any unsuccessful party to such an arbitration would be condemned to pay costs on the indemnity basis.

The second ground of appeal relates to the way in which the arbitrator focused on the Appellants’ decision not to give effect to the recommendations made by Mr Dunnell. Advocate Barnes points out that what Mr Dunnell proposed was not what was ordered by the arbitrator. Accordingly, the arbitrator has erred in law by taking into account an irrelevant consideration. The arbitrator should have been comparing what he awarded with what the parties sought as a measure of which party was successful and to what extent. Then, the arbitrator should have been comparing whether what he awarded matched what either party had offered during the course of any negotiations, including without prejudice offers. Following the usual practice in that regard, if the outcome of the arbitration was one that could be treated as having matched or bettered an offer made, then adverse costs consequences could flow from the point of that offer against the party choosing not to accept what would have been shown to be a reasonable offer.

The other grounds advanced on behalf of the Appellants collectively amount to a general complaint that the arbitrator failed to exercise his discretion properly. It is tantamount to arguing that he reached a decision that is perverse and so cannot be sustained as a matter of law. In particular, Advocate Barnes submits that the order for costs made by the arbitrator was disproportionate to the limited relief he awarded to the Respondents as a result of his Interim Award.

Principles on appeals from arbitrators

Before turning to each of the grounds raised on behalf of the Appellants, I need to be mindful of the approach that the Court should take on an appeal from an arbitrator's award pursuant to section 19 of the 1982 Law. Advocate Haskins was particularly keen that I should recognise that an arbitrator's award should not be picked over with the same level of scrutiny as might be appropriate in respect of a legally-qualified professional judge's judgment and that, in general, costs awards are often less closely reasoned than judgments on substantive matters. I have, therefore, reminded myself of a number of general propositions when considering the submissions of Counsel on each of the grounds of appeal.

As I noted in my judgment granting leave, the opening general comments of Bingham J in *Zermalt Holdings SA v Nu-Life Upholstery Repairs Limited* [1985] 2 EGLR 14 offer a general statement of the law that is equally applicable in Guernsey:

"... as a matter of general approach, the courts strive to uphold arbitration awards. They do not approach them with a meticulous legal eye endeavouring to pick holes, inconsistencies and faults in awards and with the objective of upsetting or frustrating the process of arbitration. Far from it. The approach is to read an arbitration award in a reasonable and commercial way, expecting, as is usually the case, that there will be no substantial fault that can be found with it."

Advocate Haskins also referred to para. 23 of the judgment of Akenhead J in *Schwebel v Schwebel* [2010] EWHC 3280 (TCC), which serves to remind me that I should not be overly critical of the arbitrator's approach to the questions of where the costs associated with the arbitration he conducted fell:

"(a) Arbitrators and awards cannot be criticised simply because they do not address each and every item of contentious or even non-contentious evidence. Omission to address particular items of evidence is not necessarily in itself a serious irregularity, let alone one which will give rise to serious injustice.

(b) Arbitrators who are required to give reasons in their awards do not have to list all the arguments or items of evidence as advanced which they accept and which they reject. They should identify usually the primary evidence which they do find compelling where the case depends upon factual findings because that will be part of the reasoning.

(c) Great care and circumspection should be exercised by the Court to identify cases which genuinely give rise to a serious irregularity and those which essentially reflect a losing party's upset that its evidence was not accepted or that inferences were made against it or for the other party. There will be no serious irregularity simply because the Claimant in the Court proceedings considers that the tribunal failed to arrive at the right decision, factual or legal."

Recognising that the current appeal is about the costs award rather than the determination of the dispute, I have read the references to "evidence" generously to extend to material placed before the arbitrator before he reached his costs decision.

The need for the Appellants to demonstrate unlawfulness, which has been accepted by Advocate Barnes as being the test applicable in this appeal, is also clear by reference to para.

398 of Mustill and Boyd, Commercial Arbitration: 2001 Companion Volume to the Second Edition:

“In order to demonstrate an appealable error of law it is not sufficient to allege that the arbitrator has made an award which a judge would not have made: it has to be shown from the reasons given by the arbitrator that the award of costs was unlawful, in the sense that there were no grounds on which the arbitrator could properly in law have made the order which he did, or that he made the order on grounds which he could not properly in law have taken into account, or failed to exercise the discretion at all.”

In President of India v Jadranska Slobodna Plovidba [1991] 2 Lloyd’s Rep 274, Hobhouse J further explained that *“the awarding of costs involves an exercise of a judicial discretion not the recognition of a legal right”* and continued (at page 282):

“... the appellants will have to satisfy the Court, on the reasons, that the arbitrator misdirected himself on what was involved in the judicial exercise of his discretion or that, although there was no express misdirection, it must be inferred that he did misdirect himself because that is the only explanation of his award.”

In Everglade Maritime Inc v Schiffahrtsgesellschaft Detlef Von Appen mbH [1993] QB 780, Sir Thomas Bingham MR made comments of a similar nature (at page 790):

“... while the court can review an arbitrator’s exercise of discretion on costs it ... is not enough to show that the arbitrator’s order is one which a judge would not have made or would not be likely to have made. The parties chose an arbitrator, not a judge. It must be shown that the arbitrator’s order was one which was not lawfully made.”

Advocate Haskins also drew my attention to a general comment about appeals relating to costs taken from the judgment of Lord Woolf CJ in Excelsior Commercial & Industrial Holdings Ltd v Salisbury Hamer Aspden & Johnson (a firm) [2002] EWCA Civ 879 (at para. [20]):

“As is to be expected, the decision of the judge in relation to costs was expressed succinctly. A judge is not expected to give a detailed decision as to why he is making an order. However, if he is going to make an order for costs which is not the normal order expected under the particular provisions of the CPR, then the parties are entitled to know the basis of that order and the judge is required to explain that so far as necessary to do so.”

Whilst I recognise that this is a principle that can properly be applied to a costs decision, I am also faced with what might be regarded as a closely reasoned costs decision as set out in the arbitrator’s Final Award. I believe he has set out his reasoning in the detail he has because he recognised that he was reaching a decision that went further than what might normally have been expected.

Finally, I have also reminded myself of what the Jersey Court of Appeal had to say about the different regime relating to arbitrations in that jurisdiction in Olcott Investments Limited v Mark Amy Limited [1998] JLR 62, 66:

“It is common ground between the parties in this court that as a matter of Jersey law, the court only has the right to interfere with the arbitrator’s exercise of his discretion in relation to costs, if that

decision “were wrong in law or so unreasonable that no sensible arbitrator could have reached the decision””

In my judgment, the basic test stated in that case reflects the position under English law and, because of the similarities between Guernsey’s 1982 Law and the previous legislation in England and Wales, is the test that I should apply in relation to this appeal. On behalf of the Appellants, Advocate Barnes has to persuade me that the decision of the arbitrator was, in whole or in part, wrong in law or, which is an aspect of that same test, one so far outside the band of reasonableness available to him that the arbitrator could not lawfully have reached it.

Costs Rules relating to arbitration

The joint application for the appointment of an arbitrator signed on behalf of the parties in October 2009 provided (at clause 7.2) that they “*agreed to be bound by the Rules of the Scheme and bound by the Award*”. The Rules of the Scheme are those of the Chartered Institute of Arbitrators, Channel Islands Branch, *Rules of the Arbitration Scheme for the Resolution of Disputes in the Construction Industry* dated May 2009 (hereafter referred to as “the 2009 Rules”). Rule 5, headed “COSTS”, provides:

“5.1 Each Party shall bear its own costs of preparing and submitting its case and of attending any meeting or hearing.

5.2 The recoverable costs of the reference shall be the Arbitrator’s fees and expenses, the appointment fee, the costs of hiring rooms for meetings and/or hearings and any other costs determined by the Arbitrator to be costs in the reference.

5.3 The Arbitrator shall determine by Award the recoverable costs of the reference and shall direct to and by whom and in what manner those costs or any part thereof shall be paid.

5.4 The Arbitrator shall determine the recoverable costs of the Arbitration on the general principle that the costs should follow the event, except where it appears to the Arbitrator that in the circumstances this is not appropriate in relation to the whole or any part of the costs.

5.5 The Arbitrator may also order one Party to pay any part of the other’s costs where the former has acted unreasonably and caused the opposing party unnecessary expense.

5.6 The Arbitrators [sic] fees, as set out on the application form or as otherwise agreed with the Parties and any additional fees as may become payable, shall be paid on demand as the Arbitrator shall direct.

5.7 Each Party shall be jointly and severally liable for payment of the Arbitrator’s fees.”

The Advocates agreed that the construction of this provision, and in particular Rule 5.5, was central to the question of whether the arbitrator misdirected himself as alleged in the Appellants’ first ground of appeal.

Towards the end of the hearing, I raised with Counsel the question of whether there was any known guidance provided to Channel Islands arbitrators as to how they should approach their task pursuant to Rule 5 of the 2009 Rules and, if not, whether there was merit in inviting the Channel Islands Branch of the Chartered Institute of Arbitrators to make any written submissions to assist the Court. Neither Advocate was aware of any guidance and felt it was too late to consider inviting any representations from that professional body. Accordingly, I am left with the responsibility of reaching my conclusions on the construction to be given to Rule 5 without any such input. If my conclusions produce any unforeseen and unwelcome consequences for arbitrators, the Institute’s remedy will be to re-write the Rules so that they accurately reflect the arrangements they wish to apply thereafter.

Rule 5 of the 2009 Rules contains a self-contained and comprehensive set of provisions that the parties agreed were to be taken into account by the arbitrator. As such, their agreement displaces the default position set out in section 16 of the 1982 Law that “*the costs of the reference and award shall be in the discretion of the arbitrator or umpire, who may direct to and by whom and in what manner those costs or any part thereof shall be paid, and shall tax the amount of costs to be paid*”. That said, the Advocates were agreed that the role of the arbitrator under Rule 5 is that he must exercise any discretion remaining to him judicially.

Advocate Barnes submitted that the basic position in the parties’ agreement is that set out in Rule 5.1, namely that the each agreed to “*bear its own costs*”. Accordingly, he suggested that the starting point was that neither party was exposed to any risk of having to pay the legal and experts’ costs of the other side unless and until there was a finding of unreasonableness and unnecessary expense under Rule 5.5. He added that the arbitrator was obliged to make such a double finding in respect of each and every aspect of the Respondents’ costs that he was minded to order the Appellants to pay. As regards the costs of the arbitrator, etc. he submitted that they were dealt with by Rule 5.2 to Rule 5.4 inclusive.

Advocate Haskins submitted that Rule 5 fell to be construed differently. Rule 5.1 deals with the position prior to the outcome of the arbitration being determined. Rule 5.2 contains a definition of what costs are comprised in “*the costs of the reference*”. Rule 5.3 then covers the fact that the arbitrator must deal with the costs of the reference. Rule 5.4 stands alone because it deals with “*the recoverable costs of the Arbitration*”. By referring to “*Arbitration*” rather than “*reference*”, Advocate Haskins submitted that these Rules must relate to something different, although in his reply Advocate Barnes contended that the terms are interchangeable. Advocate Haskins pointed out that this provision contains the general rule to be applied when considering the costs, namely that they will usually “*follow the event*”. Rule 5.4 also gives the arbitrator the discretion to determine that it would not be appropriate to award a successful party some or all of its costs. Rule 5.5 then enables the arbitrator to penalise a party in costs where its conduct has been unreasonable and that has resulted in the other party incurring unnecessary expense. This might involve a successful party being denied some or all of its costs and required to pay some of the other party’s costs and for those costs to be awarded on the fullest basis possible. She further noted that Rule 5.7 provides that each Party undertook to be jointly and severally liable for the arbitrator’s fees, yet Rule 5.3 provides that the arbitrator can determine by whom his fees are payable and must apply the normal principle of such costs following the event. For that reason, Rule 5.1 is not of general application but is a statement of how the parties will approach the issue of costs from the outset, which will then be dealt with by the arbitrator in accordance with the powers conferred on him by other parts of Rule 5.

Guidance on costs

Both Advocates also referred to the guidance in respect of arbitrations conducted under English law, which had been referred to by the arbitrator in his Final Award. This is the document produced by the Chartered Institute of Arbitrators entitled *Practice Guideline 9: Guideline for Arbitrators on Making Orders Relating to the Costs of the Arbitration* (hereafter referred to as “the Guideline”). The fact that para. 1.1 begins with the following cautionary words speaks volumes: “*One of the most difficult and important functions which an arbitrator has to perform relates to the making of awards of costs.*” Whilst the Guideline is specifically designed to support the UK Arbitration Act 1996, it offers useful material for how a

Guernsey-based arbitrator might exercise the discretion left to him or her. The importance of examining the contract between the parties to see if there is any provision relating to costs is emphasised at para. 4.2.1. Accordingly, the guidance itself is no substitute for the way in which the terms of any such contract fall to be construed.

In the absence of any contrary position in the contract, the general principle under the guidance is that costs awards follow the event. An arbitrator is reminded that any decision not to award the successful party its costs needs to be justified (para. 4.3.4). The Guideline continues (at para. 4.4.1):

“If a claimant recovers a monetary award, he is normally to be regarded as successful since he had to bring the arbitration in order to recover the sum in question. The “event” is the recovery of money. It is normally no ground for depriving the claimant of his costs that the amount recovered is less than that claimed unless the recovery is so small that it can be regarded as nominal or derisory.”

In respect of the conduct of the parties, para. 4.5.1 of the Guideline states:

“Generally an arbitrator should exclude from consideration any matter not strictly connected with the arbitration or with the claims made in it. A general disapproval of a claimant’s conduct is still no ground for refusing to apply the general principle. The question whether it was reasonable for a party to raise pursue or contest a particular allegation is, on the other hand, a relevant matter and if the arbitrator considers that the hearing has been prolonged by unreasonable conduct of this kind he is fully entitled to make an order which reflects this view (eg by depriving the successful party of a proportion of its costs).”

The Guideline deals with the position where there has been partial success in section 4.6. As noted in para. 4.6.1, *“In many instances it would not be fair to penalise a successful party for having raised issues or made claims which have ultimately been held to be unsustainable. If it was reasonable to raise these issues or claims and if they have not led to a substantial extra expenditure of time or money, then it may be fair to award the claimant the whole of his costs on the basis of the principle that “costs follow the event”.”* In para. 4.6.2, the Guideline then sets out a slightly different approach where the issues on which the successful party has failed engaged substantial amounts of time and money: *“In such circumstances it may be appropriate to award the successful party the general costs of the arbitration (to include the cost of issues on which he has succeeded) but to award to the party who has been unsuccessful overall the costs of the issues on which that party has succeeded”.*

The question of the approach to take to settlement offers is covered in section 4.8 of the Guideline: *“if the respondent has offered to settle in the course of the arbitration and the claimant eventually recovers less than the sum which was offered, it will have been a waste of time and money to pursue the arbitration for the period after the time when the settlement offer was made and could have been accepted”* (para. 4.8.1), explaining further that *“it would not be appropriate to allocate costs on the principle that costs should follow the event in relation to the period following the offer”* (para. 4.8.2). Amongst the principles to consider is that *“the overriding question will be whether the claimant has achieved more by going on with the arbitration and obtaining an award than he would have done by accepting the offer”* (para. 4.8.4.2) and *“in deciding whether the claimant has done better by going on with the arbitration, it is necessary to make a precise comparison of the benefit to the claimant in accepting the offer as compared with the eventual award, so that if the claimant “beats” the*

offer, even by a small margin, the offer will have no effect, unless of course there are special circumstances which affect the matter” (para. 4.8.4.3).

The overall question of the reasonableness of the costs is summarised in the section on the scope of the arbitrator’s powers. The arbitrator is reminded at para. 5.6.5 that *“If the costs as a whole appear disproportionate, the arbitrator will seek to limit the recoverable costs to the amount which would have been incurred if the arbitration had been conducted in a proportionate manner”*. Further, *“indemnity costs are not awarded just to penalise a party for advancing a case which it has lost but are usually reserved the situations where the arbitrator is indicating his disapproval of the conduct in the arbitration of the party against whom the costs are awarded. ... If the eventual award is more advantageous to the claimant than the proposals contained in his offer to settle would have been, it may be reasonable to award the claimant indemnity costs from the time when the respondent could have accepted the offer to settle”* (para. 5.6.6).

The approach that this Guideline suggests taking in arbitrations is a familiar one because it very closely reflects the types of consideration which the Court is called upon to bear in mind when considering how to deal with costs in civil proceedings under its broad discretionary powers in rules 82 and 83 of the Royal Court Civil Rules, 2007. Both Advocates readily acknowledged that any discretion vested in the arbitrator in respect of costs had to be exercised judicially.

Principles on indemnity costs

The approach to the awarding of indemnity costs in proceedings before the Royal Court was helpfully summarised by Lieutenant-Bailiff Day in *Thompson and Le Noury v Masterton and Bourne* [2003-04] GLR 332, distilling the principles from previous Guernsey cases, including the Court of Appeal decision in *Hulme v Matheson Securities (Channel Islands) Limited* (1997) 24.GLJ.80 (in which the references to rule 48 of the previous Royal Court Civil Rules, 1989 can now be read as references to rule 82 or, specifically on indemnity costs, rule 83 of the 2007 Rules):

- “12. ... (a) *the discretion of the court under r.48 is unfettered, though it must be exercised judicially.*
- (b) *Rule 48(4) is to be read disjunctively, namely, (a) separately from (b) (though there may be a conceptual overlap in some cases, per Talbot, Lieut. Bailiff in Moed v Cockram), and, similarly, the five circumstances identified under para. (b).*
- (c) *Unreasonableness under sub-para. (4)(b) does not have to amount to an abuse of process, nor is it to be qualified in any way, such as “totally” or “wholly”, etc. (see also Saromaje, in which the matter is dealt with more fully).*
- (d) *The inadequacy of recoverable costs is not essentially a “special circumstance” for the purpose of r.48(4)(a).*
- (e) *Sums of money paid into court by a defendant which are seriously inadequate may constitute a “special circumstance” (see Carey, Deputy Bailiff in Le Moigne, with which decision I would respectfully agree), as also a factor to be taken into account in assessing unreasonableness in any particular circumstances.*
- (f) *The substantive determination of any particular action or issue is not in itself determinative of the question of whether indemnity costs should be awarded, though it may be of some significance.*

13. *I would add two further principles – two sides of the same coin:*

(g) *It will sometimes be the case that the various stages of, or matters in, the proceedings may need to be separately analysed, and thereafter separately assessed as meriting indemnity costs or not – as, for example, in Silver Falcon. So also different issues may require separate analysis.*

(h) *However, in other cases it may be inappropriate for a judge to concentrate so assiduously on all the detail of what has transpired over a period of years as to lose sight of the wider perspective, the overall general feel as to how the parties, their counsel and their advisors have conducted themselves.”*

The relevance of having regard to the parties’ approach to the making of offers and whether accepting or rejecting offers was justifiable and so warranted an order for some or all of the costs to be paid on an indemnity basis, as dealt with in Woodbourne Trustees Limited v Generali Worldwide Insurance Company Limited [2011-12] GLR Note 6, was also relied on by Advocate Haskins.

In turn, Advocate Barnes also referred to the way that the approach to indemnity costs in the courts of England and Wales had been summarised at first instance in Shaina Investment Corporation v Standard Bank London Limited [2001] EWHC Ch 472 (at para. [12]):

- “(i) the Court has a discretion to award costs on an indemnity basis;*
- (ii) it is not possible to define the exact circumstances in which an indemnity costs order might be ordered; in each case it is a matter for the individual discretion of the judge on the facts before him;*
- (iii) where the conduct of the litigation was deserving of moral condemnation an order for indemnity costs was appropriate;*
- (iv) where a party has continued with litigation in circumstances where the Court concluded that to do so was unreasonable conduct of litigation it was appropriate to make an order for an indemnity costs after a particular date or in relation to particular issues;*
- (v) where cross-examination of a party took the form of a totally uncalled for personal attack the Court could make an order in favour of the other party for that portion of the trial;*
- (vi) where a party to litigation acted in a way that could be described as disgraceful or deserving of moral condemnation an order for costs in the indemnity basis could be made;*
- (vii) where a party had not acted improperly it will be wrong to make an order for costs on an indemnity basis; the proper order should be on the standard basis;*
- (viii) where a party had acted unreasonably in breach of a Court order it might be appropriate to make an order for costs on an indemnity basis against that party;*
- (ix) where a claim was considered by the Court not to be bona fides it will be appropriate to make an order for costs against that party on the indemnity basis.”*

Advocate Barnes also relied on a further passage from para. [24] of that case: “*Advancing a case which is difficult, unlikely to succeed or which in fact fails is not a sufficient reason for such an award [of costs on an indemnity basis].”*

There are plenty of other authorities on the principles applicable to awarding costs, some of which were referred to by Counsel. For example, in Re Elgindata Ltd (No. 2) [1993] 1 All ER 232, the principles were crystallised into four propositions:

“(1) Costs are in the discretion of the court. (2) They should follow the event, except where it appears to the court that in the circumstances of the case some other order should be made. (3) The general rule does not cease to apply simply because the successful party raises issues or makes allegations on which he fails, but where that has caused a significant increase in the length or cost of the proceedings he may be deprived of the whole or a part of his costs. (4) Where the successful party raises issues or makes allegations improperly or unreasonably, the court may not only deprive him of his costs but order him to pay the whole or a part of the unsuccessful party’s costs.”

In Excelsior Commercial & Industrial Holdings Ltd v Salisbury Hamer Aspden & Johnson (*supra*), Lord Woolf CJ re-emphasised that “before an indemnity order can be made, there must be some conduct or some circumstance which takes the case out of the norm” and in Noorani v Calver (No. 2) [2009] EWHC 592 (QB), Coulson J stated (at para. [8]):

“Indemnity costs are no longer limited to cases where the court wishes to express disapproval of the way in which litigation has been conducted. An order for indemnity costs can be made even where the conduct could not properly be regarded as lacking in moral probity or deserving of moral condemnation: see Reid Minty v Taylor [2002] 1 WLR 2800). However, such conduct must be unreasonable “to a high degree. ‘Unreasonable’ in this context does not mean merely wrong or misguided in hindsight”: see Simon Brown LJ (as he then was) in Kiam v MGN Limited No 2 [2002] 1 WLR 2810.”

All of these principles relating to what considerations that can properly be had before deciding whether or not to award full or partial indemnity costs will inevitably be in the mind of a judge in the Royal Court. Subject to how they fit into the specific rules under which the arbitrator was obliged to reach his costs decision, they are also principles of general application that have been incorporated into the Guideline, to which the arbitrator referred when making his award. Although para. 5.4.1 of the Guideline highlights that “*There is no need for the arbitrator to follow court procedures when determining the costs of the arbitration*”, further noting that “*The procedure is in his discretion and should be tailored to suit the circumstances of the case*”, these comments relate to procedure rather than principle. The fact that the arbitrator commented (at para. 38 of his Final Award) that he found that the submissions made on these costs-related principles on behalf of the Appellants have “*not only been confusing but also conflicting*” is troubling and perhaps indicative of him not fully appreciating every aspect of the difficult task he was required to undertake. As is apparent from the detailed analysis contained in this judgment, I do appreciate that the costs consequences of these proceedings were far from easy to resolve and the cautionary words at para. 1.1 of the Guideline about the difficult task the arbitrator faced could not be more accurate.

Construction of Rule 5

The central question in this appeal involves deciding how the arbitrator was bound to approach his function under Rule 5 of the 1989 Rules, which was incorporated into the parties’ arbitration agreement. Construction of a contractual document is a question of law. For present purposes, rather than set out extensively the principles to be followed, I will simply quote the summary from the speech of Lord Bingham of Cornhill in Bank of Credit and Commerce International SA v Ali [2002] 1 AC 251 (at para. 8):

“... the object of the court is to give effect to what the contracting parties intended. To ascertain the intention of the parties the court reads the terms of the contract as a whole, giving the words their natural and ordinary meaning in the context of the agreement, the parties’ relationship and all the relevant facts surrounding the transaction so far as known to the parties. To ascertain the parties’ intentions the court does not of course inquire into the parties’ subjective states of mind but makes an objective judgment ...”.

Rule 5.2 makes clear that the words “*recoverable costs of the reference*” are being used as a term of art. The recoverable costs of the reference are defined. At para. 51 of his Final Award, the arbitrator found “*the Respondents [ie, now the Appellants] responsible for the full arbitration fees and related expenses*”. Although the arbitrator may not have expressly referred to the “*recoverable costs of the reference*” when determining what these were, as arguably he should have done to fulfil his obligation under Rule 5.3, I understand him to have been referring to costs and expenses that fell within Rule 5.2 and so the “*recoverable costs of the reference*”, ie, “*the Arbitrator’s fees and expenses, the appointment fee, the costs of hiring rooms for meetings and/or hearings*”. Rule 5.2 also enables the arbitrator to determine that any other costs are to be regarded as “*costs in the reference*”. In the absence of anything explicit on the face of the Final Award determining any other costs to fall into that category, I am proceeding on the basis that the arbitrator chose not to bring any other costs or expenses within this category. In passing, whether there is any distinction between “*costs in the reference*” and “*costs of the reference*” does not, therefore, need to be decided in this appeal but the use of two different phrases is not particularly helpful in understanding precisely what is meant.

The obligation of the arbitrator under Rule 5.3 is to “*direct to and by whom and in what manner those costs or any part thereof shall be paid*”. In ordering the Appellants to pay the portion of the arbitration fees already paid by the Respondents in accordance with the joint and several liability for the payment of the arbitrator’s fees under Rule 5.7, the arbitrator has complied with this. Rule 5.2 and Rule 5.3 both refer to the “*recoverable costs of the reference*” and are, in my view, clearly inter-linked.

Rule 5.4, however, uses the term “*the recoverable costs of the Arbitration*”. This rule contains a principle of general application that “*the costs should follow the event*”, which is then made subject to an exception if the arbitrator considers that “*in the circumstances this is not appropriate in relation to the whole or any part of the costs*”. There is no definition of what is meant by “*the recoverable costs of the Arbitration*”. Whilst I have considerable sympathy with Advocate Barnes’ submission that the two terms used are intended to be interchangeable, I am afraid that I cannot reach that conclusion. This is because the terms used differ and I consider that I should pay due regard to the principle that where different words are used they must be intended to have different meanings. If that were not the case, it would have been very simple for Rule 5.4 to have continued to have referred to the term used in the preceding sub-rules.

From the material placed before me, I cannot tell whether the underlying intention of the Channel Islands Branch of the Chartered Institute of Arbitrators was that Rule 5.4 should set out the general principle and exception applicable to an arbitrator’s obligation to determine the “*recoverable costs of the reference*” and that the reference to “*the recoverable costs of the Arbitration*” is, therefore, an error. All I can do is to construe the words that actually appear in the parties’ arbitration agreement and, in my view, the use of two different phrases, one of

which is defined and so used as a term of art, must be treated as referring to different things. Accordingly, the “*recoverable costs of the Arbitration*” must refer to costs that are not defined as “*the recoverable costs of the reference*” in Rule 5.2. In the context of the parties’ arbitration proceedings, although he did not express himself in precisely this way, I take the view that the arbitrator was right to treat the legal costs and disbursements on experts’ fees as falling within Rule 5.4, despite Rule 5.1 providing that “*Each Party shall bear its own costs of preparing and submitting its case and of attending any meeting or hearing*”.

In the context of Rule 5 when read as a whole, the interpretation I have given to Rule 5.4 means that Rule 5.1, as submitted by Advocate Haskins, sets out the position of the parties from the outset, prior to the arbitrator determining the question of costs by his Award. I therefore expressly reject Advocate Barnes’ contention, as set out in para. 7.1 of the Appellants’ Application, that Rule 5.1 needs to be dis-applied. In my judgment, it does not because it does not bind the arbitrator when reaching his conclusions under the operative sub-rules in Rule 5. That said, if my conclusion that Rule 5.4 is distinct from Rule 5.2 and Rule 5.3 were to be wrong, then I can see force in Advocate Barnes’ submission that the agreement between the parties in respect of their own costs is set out in Rule 5.1, subject only to the ability of the arbitrator to make an order that one party pay some or all of the other party’s costs in accordance with Rule 5.5. However, because of the different wording, having first decided on where “*the recoverable costs of the reference*” fall, the arbitrator was then required to determine “*the recoverable costs of the Arbitration*”, using the general principle that they follow the event, unless there is any reason not to apply that general principle to all those costs, before moving on to consider whether a party “*has acted unreasonably and caused the opposing party unnecessary expense*” and, if so, what the costs consequences of that behaviour should be (Rule 5.5). I take comfort from the fact that such an approach to the various questions associated with awarding costs at the conclusion of an arbitration is consistent with the overall terms of the Guideline.

I further take the view that Rule 5.5 can be applied in respect of any costs that would otherwise be awarded, be they the recoverable costs of the reference or the recoverable costs of the Arbitration. Before costs can be awarded under Rule 5.5, the arbitrator needs to make a double finding, first of unreasonableness in respect of the paying party’s behaviour or conduct and secondly of that behaviour or conduct leading to unnecessary expense being incurred by the receiving party. When referring to “*the paying party*” and “*the receiving party*”, I am adopting terminology used by the Court to mean respectively the person against whom any element of a costs order and the person in whose favour that element is made.

One other aspect of Rule 5 is also not entirely clear to me. Costs in proceedings before the Royal Court may be awarded on a standard recoverable basis or an indemnity basis. As is apparent from the Guideline, in England and Wales the distinction between standard costs and costs on the indemnity basis is not quite as stark as it often is in Guernsey. The rate of recovery of Advocates’ fees in Court proceedings is fixed by Rules of the Court at a level that is generally below what the client will pay his or her Advocate. That is one of the incentives for seeking and obtaining costs on the indemnity basis. There is also the shifting of the burden of establishing that the costs incurred were reasonably incurred, which is the principal distinction, as I understand it, of the different awards in England and Wales. This begs the question of what is meant in Rule 5 when referring to “*recoverable costs*”. Before the arbitrator, Counsel proceeded on the basis that the Court rates could usefully be used. Because they both did so, I will not interfere with that approach in respect of this appeal.

However, if that is not the way in which the Chartered Institute of Arbitrators intended the 2009 Rules to be construed then some further clarification of what is meant by the term would probably be useful.

Analysis of Final Award

Having given Rule 5 the construction I have, in the light of the general principles relating to costs in arbitrations to which I have referred, I will turn to consider whether the arbitrator's order on costs was one which was not lawfully made, reminding myself that something more than deciding that it is not an order I would have made in equivalent Court proceedings is required. Although I will return to the arbitrator's approach to the recoverable costs of the reference in due course, I will first considering how Rule 5.4 applies.

The successful party

Because of the general principle that "*costs should follow the event*", the arbitrator was required to decide which of the parties had won the arbitration. He concluded that "*the Claimants have been successful in the majority of the claim*" (see para. 13 of the Final Award) and, in respect of the Appellants' unsuccessful counterclaim, that he was "*persuaded that any time expended defending the counterclaim should be awarded to the Claimants*" (para. 17). What is not spelt out explicitly is whether this conclusion related only to the question of success, meaning that the costs associated therewith would normally follow the event, or whether this also purported to be a conclusion about unreasonable conduct incurring unnecessary expense. The way the paragraph continues implies the latter, although there is no express reference to the making of findings pursuant to Rule 5.5.

As a basic premise, I find that the conclusion reached by the arbitrator that the Respondents to this appeal succeeded in the majority of their claims is a conclusion he was clearly entitled to reach. In simple terms, the Respondents sought various forms of relief from the arbitration process. Whilst they may not have succeeded in getting everything they sought, the Respondents came out victorious and the Appellants can properly be regarded as having lost. That conclusion applies to the Respondents' claim and the way in which they also beat the Appellants in relation to the latter's counterclaim. As the Guideline points out, success equates to obtaining a monetary award, even in a smaller sum than claimed. The fact that a smaller amount is awarded is not in itself a ground for not awarding the successful party its costs. The arbitrator did not, therefore, act unlawfully in reaching a conclusion that he should, through applying the general principle, award the Respondents some or all of "*the recoverable costs of the Arbitration*" pursuant to Rule 5.4. In reaching that conclusion, I will disregard the rather odd comment in para. 12 of the Final Award to which I have already referred because it also appears to be inconsistent with the remainder of the arbitrator's approach to determining where the costs fell.

Unreasonable behaviour

Although it is sometimes difficult to ascertain precisely what thought processes were being followed by the arbitrator, the fact that he moves seamlessly from considering which party has been successful (para. 15) to the assertion from the Respondents that the Appellants had been unreasonable and their conduct led to the incurring of unnecessary costs (para. 16) strongly suggests that the arbitrator immediately proceeded to consider how to make a costs order under Rule 5.5 rather than first completing what he really should have done under Rule

5.4. Put another way, the arbitrator failed to consider whether there might have been any circumstances meaning that it was not appropriate for the successful party to be awarded their recoverable costs of the Arbitration. That failure in itself would not, in my view, be sufficient to find that the arbitrator reached a decision that is unlawful if, viewing the Final Award in the round, the overall outcome fell within the terms of Rule 5. However, the mixing of approaches between Rule 5.4 and Rule 5.5 that pervades the remainder of the Final Award is indicative of muddled thinking and, in the event, an unlawful approach to the arbitrator's task.

The arbitrator appears to have become fixated on the proposals made by Mr Dunnell to the extent that he found the "*blunt refusal*" of the Appellants "*to properly consider Mr Dunnell's proposals to have been unreasonable*" (para. 44). The reference to "*unreasonable*" must, in my view, be treated as a finding under Rule 5.5, especially when the passage continues through reference to legal costs being incurred "*with no specific outcome*", which is as close to saying they were "*unnecessary*" as the arbitrator came. It was unwise of the arbitrator in that context to refer to any costs wasted in appealing his Interim Award, because that really is not relevant to his determination of the parties' conduct of the arbitration proceedings with which he was engaged but, again, that little slip, if taken in isolation, would not justify interfering with the arbitrator's Final Award.

In order to understand fully the implications of the arbitrator's finding about Mr Dunnell's proposals, I need to look carefully and closely at the basis on which Mr Dunnell was instructed by the parties and exactly what he proposed and how that compares with what the arbitrator actually ordered. This was not the approach taken by the arbitrator. As a consequence, he misdirected himself about the proper approach to take on this issue and the real question is whether what he did means that his conclusions cannot be upheld as achieving an outcome open to him.

Mr Dunnell was instructed by the parties by a joint letter from their Advocates dated 6 November 2009, which was headed "Without Prejudice". By way of explanation, the letter stated: "*In an attempt to settle this matter and avoid the need for arbitration, both parties to this dispute have agreed to jointly instruct you with the intention of providing a report based on the details*" that were then set out. The instructions given were:

"We require you to visit 4 and 5 La Belle Cottages, undertake an inspection and evaluate the existing sound insulation/proofing systems in both properties and provide any recommendations.

We would be grateful if you could please prepare a report dealing with the following issues:-

- 1. An evaluation as to the suitability of the existing sound insulation/proofing systems in 4 and 5 La Belle Cottages;*
- 2. Assess any apparent noise issues or noise related effects in the 4 and 5 La Belle Cottages;*
- 3. Asses [sic], whether further sound insulation/proofing works are required/desirable in either 4 or 5 La Belle Cottages in order to minimise any noise issue or noise related effects and if so, recommendations as to the most appropriate solution in this regard;*
- 4. Where any recommendations are appropriate, an indication of the most suitable individual/company to undertake the required works/modifications and an indication of the likely costs; and*

Could you also please provide us with any comments that you may have on the above or on the matter in general.”

Mr Dunnell provided his draft report to the parties on 5 February 2010. As part of the final section, headed “Summary and Conclusion”, Mr Dunnell noted that *“the constructions which have been undertaken in broad terms are likely to have been approved as being acceptable under the Building Regulations which would have been in force at the appropriate times”*. The most notable aspect of the sound transmission about which the Respondents complained was *“at its worst within the first floor kitchen due to a very basic floor construction”*. The covenants to ensure that sound transmission did not take place were regarded by Mr Dunnell as *“relatively weak and any enforcement would be hard to achieve in a meaningful way”*. He encouraged the parties to reach agreement about what upgrading could sensibly be undertaken to address the issue of sound transfer, acknowledging that some elements might need to await more extensive refurbishment and *“In the interim, we do believe there are some measures which could be put in hand which are likely to have some impact, but it is unlikely that they will be entirely satisfactory”*. Mr Dunnell took the view that the upgrading works on the underside of the floor by the Respondents *“would be deemed as being entirely satisfactory under current Building Regulation standards and, therefore, we do not see any merit in further upgrading or improvement work being put in hand with regard to these matters”*. The final paragraph of the draft report reads:

“It is fully acknowledged that there does not appear to be any grounds which create a legal obligation upon either party to undertake works which will amend the situation which exists, our assessment of the situation which currently exists indicating that there does not appear to have been any breach of Building Regulation standards which may have existed in the past when constructions were put in hand. However, we would be strongly of the opinion that this is a situation which requires resolution by co-operation between the two parties so that the quality of life which is enjoyed by both parties is improved and the value of the investments both parties have are protected and enhanced.”

In short, therefore, the jointly appointed expert acknowledged that what the Respondents sought through bringing their dispute with the Appellants to arbitration was unlikely to be capable of being ordered. The arbitrator agreed, because he did not order any reinstatement of the premises for the technical breaches of covenant he found. Instead, Mr Dunnell concentrated on advising the parties what they might wish to spend their money on through choice and agreement, effectively involving them considering steps that would be outside the arbitration process. That is an important distinction, which seems to have been overlooked by the arbitrator.

The first response to Mr Dunnell’s draft report came from the Appellants’ Advocate in a letter dated 23 February 2010, pointing out that his *“clients are simply not in the financial position to replace their kitchen and/or carry out any sort of work to their apartment”*, whilst indicating that access to the Appellants’ premises would be afforded to the Respondents if they wished to commission and pay for upgrading work to be undertaken. The Respondents’ Advocate replied by letter dated 26 February 2010, referring to her clients having *“entered into this proposed mediated settlement in good faith and on the understanding that action would be taken based on the conclusions reached”*. I do not recall seeing any documentation or other suggestion that this was the basis of the instruction of Mr Dunnell. In particular, there has been nothing produced indicating that Mr Dunnell was performing the role of

mediator to bring the parties to a mutually acceptable settlement. The spectre of a claim for costs on an indemnity basis was raised and an indication given that an arbitration decision would be likely to force works to be undertaken by the Appellants, meaning “*significant costs and inconvenience*”, plus the possibility of damages being awarded. Accordingly, it was stated that the Respondents’ position was “*Either [the Appellants] carry out the works required to ensure that they do not cause any further nuisance, annoyance, damage and inconvenience to [the Respondents], as recommended in the conclusions by Mr Dunnell, or the matter is immediately referred back to the Arbitrator for all matters to be resolved*”.

The Respondents’ proposal was met with a response from the Appellants’ Advocate headed “Without Prejudice Save As To Costs” dated 4 March 2010, in which the option of the Respondents commissioning and paying for upgrading works was re-put, pointing out that Mr Dunnell’s view was that the arbitration proceedings would not result in the outcome for which the Respondents were arguing. A revised proposal was put on a “Without Prejudice” basis by the Respondents’ Advocate in a letter dated 1 April 2010. There were four elements to these proposals for settlement:

- “1. *Your clients remove the fireplace and flue forthwith and reinstate the hole in the roof at their sole cost.*
2. *The soundproofing works recommended by Mr Dunnell to be put in hand forthwith and completed within a reasonable time on condition that the total costs of all soundproofing works (including the works previously carried out by our clients but excluding the cost of consequential decoration and carpeting in each property which shall be borne by the owners individually) shall be paid for equally by our respective clients. The likely total cost to each of our respective clients will be approximately £14,000 per owner.*
3. *Pending these works being carried out, your clients agree to put a strip carpet on the kitchen floor to help with the footfall noise and to only use the washing machine/dryer between the hours of 9.00 am and 5 pm on Monday – Fridays.*
4. *On condition the above matters are agreed, our clients will agree not to pursue the issues referred to in (b) to (d) above [which related to three further removals sought by the Respondents as relief in the arbitration proceedings].”*

Those proposals were rejected by letter dated 20 April 2010 and the Appellants’ original offer repeated.

In the meantime, other avenues for reaching settlement were explored with assistance from Andrew Ozanne. The possibility of mediating the parties’ dispute was raised on behalf of the Appellants once again, the option having been mentioned previously in 2009. A further “without prejudice” offer was put to the Appellants on behalf of the Respondents by Advocate Haskins’ letter dated 3 September 2010. The same settlement terms as before were offered, although mention was also made about the need to resolve some aspects relating to flowerbeds. There was also a proposal that the Appellants should pay the Respondents’ costs on a recoverable basis, with an indication that up to a date towards the end of summer, the running total for these was £7,218.80, whereas the total costs incurred, including non-chargeable time, was said to be in excess of £18,500. That offer was rejected by letter dated 22 September 2010, in which the possibility of mediation was repeated.

The question of timing restrictions on use of the washing machine continued in further correspondence. It was explained that the washing machine is not used in the evenings,

although that would help so as to secure a cheaper rate for electricity consumed and that use in the mornings is such that the machine should not reach its spin cycle before 8.30 am. The suggestion that there should be no permitted use of the washing machine on Saturdays and Sundays was regarded by the Appellants as being an unreasonable restriction.

The Respondents made a final “without prejudice offer” by way of Advocate Haskins’ letter dated 4 February 2011. In the living room and bedroom, the proposal was to lift the carpets and lay down “*the Versilay system*” and in the kitchen to lay Reduc 17 over the existing floor, all such works to be completed within 28 days, or such other reasonable time as might be agreed. The Appellants should use the washing machine on Mondays to Fridays only between the hours of 9 am and 5.30 pm. The parties’ experts would meet to address how to accommodate the use of the hearth in a way that resolved the noise issues, thereby enabling the covenant in that regard to be amended by agreement. The flowerbed would have to be removed and made good. Each party would bear its own costs and be liable for one half of the Arbitrator’s fees to date. That offer was stated to remain open for 14 days. It was rejected by the Appellants’ Advocate’s letter dated 15 March 2011.

I have set out in detail the exchanges between the parties, made with a view to settling the dispute before proceeding further with the arbitration, because one of the principles on costs overlooked by the arbitrator is whether what he awarded matches or beats any offer made. As the Guideline explains, if that is the position, then the costs consequences following that time can be dealt with by penalising the party who failed to accept such an offer. As the Guideline further explains (at para. 4.8.4.3), a “*precise comparison*” is required. The potential difficulty in this case is that none of the offers made by either side directly equates with the outcome ordered by the arbitrator. Equally, however, had the arbitrator conducted the type of more detailed analysis I have just carried out, he would have realised how difficult it was for him to focus in such a particular fashion on what Mr Dunnell recommended. In my judgment, the arbitrator clearly erred in law by concentrating almost exclusively on the Appellants’ unwillingness to embrace the recommendations of Mr Dunnell and, in doing so, did not compare those proposals with the actual outcome of the arbitration he conducted. That error of law is sufficient for the appeal to be allowed.

It is important, in this regard, to consider what it was that both parties offered the other side by way of settlement. The arbitrator did not consider those offers, but confined himself to considering that the refusal of the Appellants even to consider taking the steps recommended by Mr Dunnell was “*wrong*” and so that refusal warranted him penalising them with an award of costs on an indemnity basis. The offers of settlement made on behalf of the Respondents evolved through the negotiations. Those offers also included other matters in dispute. Particular reference was made to the hours at which the Respondents offered to permit the Appellants to use the washing machine. In financial terms, each of the offers of settlement put to the Appellants would have involved them spending money. The difference is that the money was not to be paid directly to the Respondents by way of compensation for breach of a covenant but towards remedial works. In that respect, I appreciate that the arbitrator will have struggled to compare like with like. However, by comparing the total cost of the proceedings, including the costs that had, by that time, been expended, with the likely costs of the recommended remedial work, I take the view that the arbitrator has erred in principle. The choice between accepting a proposal for settlement and proceeding with the arbitration should compare the outcomes without considering the costs incurred in reaching those respective outcomes. The costs fall to be dealt with separately once the offers and outcomes are

compared. On that basis, the comparison should be between what was actually ordered by the arbitrator and what could have been agreed if any offer to settle had been accepted. The purpose of making an offer is to settle the claim being made, in other words it focuses on what is in dispute. Although an offer of settlement might also address the question of costs, such a costs element should, in my view, be disregarded for the purposes of comparison. In this case, although the analogy is not perfect, the Respondents were claiming both monetary compensation for their alleged losses in respect of breach of covenants and a form of injunctive relief restricting the hours of use of the washing machine. I consider that both aspects needed to be looked at by the arbitrator to ascertain whether the award he eventually made was more favourable to the Appellants or the Respondents than any offer made but rejected.

In my view, the dispute about the use of the washing machine can be regarded as having been resolved more favourably than any of the offers advanced on behalf of the Respondents. The permitted hours of use ordered by the arbitrator (see para. 86c of his Interim Award) were 8 am to 8 pm on Mondays to Fridays and 10 am to 6 pm on Saturdays and Sundays. The Respondents had proposed 9 am to 5 pm on Mondays to Fridays only. However one considers the outcome and the offer, the Appellants clearly beat the offer put to them on more than one occasion in respect of this element, both in terms of the permitted hours on Mondays to Fridays and by securing permitted use, as they sought, at weekends. In my judgment, the arbitrator erred in law by failing to have regard to this factor and he should have taken into account in reaching his decision on costs that, by proceeding with the arbitration, the Appellants secured considerably more permitted use of the washing machine than would have been the case had they accepted the settlement terms proposed by the Respondents.

The financial aspects of the Respondents' claims also need to be considered through comparing what they sought, what was ordered and how what they proposed by way of settlement would have impacted on the Appellants. The claim they faced was quite significant because of the daily damages escalating whilst the claim was pursued. The Respondents also sought quite extensive reinstatement works which, if ordered, would have had costs implications for the Appellants. The result, however, was that the Appellants were ordered only to pay an amount of just under £4,000 to the Respondents. They were not ordered to undertake any works at the premises. The direct cost to the Appellants of proceeding with the arbitration proceedings was, therefore, less to the Appellants than would have been the case had they accepted any of the proposals advanced on behalf of the Respondents. As a bare minimum, accepting any of the Respondents' settlement offers would have entailed the Appellants spending more than £4,000 and, on some estimates, in excess of £14,000. Whilst I do not overlook that the arbitrator highlighted that spending money on remedial work would have produced some enhancement of the Appellants' property and so may have added value, which may or may not mean that the overall negative financial outcome for the Appellants was at or below what the arbitrator ordered them to pay, this analysis of what he actually awarded to the Respondents was not undertaken by the arbitrator and, again, I take the view that he erred when concluding without more that he found the Appellants' response to the recommendations of Mr Dunnell to have been "*wrong*" because it meant that a costly arbitration hearing was then needed.

When taken in the round, I am satisfied that the arbitrator did not address his mind to the terms of the settlement offers made on behalf of the Respondents and consider whether, and if so how, the orders he made in his Interim Award reflected or differed from any of those

offers. Further, the arbitrator did not make any comparison with the actual terms of his Interim Award, which I regard as being indicative of him failing to address his mind to the considerations Rule 5 of the 2009 Rules and the Guideline suggest he should have taken into account. Whilst I acknowledge that I do not have the same level of knowledge about the dispute as the arbitrator would have done having heard the witnesses given their evidence and the submissions made on behalf of the parties, looking at the overall position, I struggle to understand how the conclusion could be reached that the Appellants fared worse by continuing with the arbitration than they would have done by accepting any of the offers made on behalf of the Respondents. This was a fundamental consideration in deciding whether or not the Appellants had acted unreasonably for the purposes of Rule 5.5 and, by failing to undertake the exercise as required, the arbitrator has wrongly exercised his powers under Rule 5. For these reasons, the arbitrator has, in my judgment, reached a decision on the costs arising from the arbitration proceedings that is legally flawed and, on this basis, the appeal is allowed.

Outcome of appeal

Rather than proceed to deal with the various other arguments advanced on behalf of the Appellants by Advocate Barnes, I will instead move on to consider how to dispose of this appeal. In doing so, the explanations I offer for what I regard as the correct legal approach will indicate any other areas where I also find that the arbitrator erred.

By virtue of section 19(2) of the 1982 Law, on the determination of an appeal the Court is empowered to confirm, vary or set aside the award or to “*remit the award to the reconsideration of the arbitrator or umpire together with the Court’s opinion on the question of law which was the subject of the appeal*”. At the hearing, both Advocates indicated that, if I allowed the appeal, the parties were content that I should vary the arbitrator’s award rather than remit the award for his reconsideration. Accordingly, I will proceed to explain how the conclusions of the arbitrator with which I will not interfere should be factored into the approach that Rule 5 of the 2009 Rules required in respect of the costs of this arbitration.

The recoverable costs of the reference

Rule 5.3 of the 2009 Rules required the arbitrator to “*determine by Award the recoverable costs of the reference and ... direct to and by whom and in what manner those costs or any part thereof shall be paid*”. The “*recoverable costs of the reference*” are those defined in Rule 5.2 and were dealt with by the arbitrator under his general heading of arbitrator fees and related expenses. At para. 52 of his Final Award, the arbitrator decided that 100% of the arbitration fees, namely £22,749.10, should be paid by the Appellants. Because both sides had already paid equal shares of that amount, he ordered that the Appellants should pay to the Respondents the 50% already paid by the latter.

Whilst acknowledging that the arbitrator was entitled to have regard to which side had largely won and which had largely lost when deciding where these costs fell, I consider that the arbitrator failed to consider whether the Appellants should properly be ordered to pay the entirety of this head of the costs and reached a decision on this element that is inconsistent with his other findings. The overall conclusion of the arbitrator, albeit mistakenly by reference to “*the degree of reasonable / unreasonable behaviour of both parties*” (see para. 45 of his Final Award) was that he discounted his award in respect of legal costs on an indemnity basis to 80% (see para. 46). In doing so, he drew attention to the fact that both parties had

made claims for psychiatric damages which were later withdrawn, so he decided to “*deduct a proportion of time from the costs claimed by the Claimants for this reason*”. In other words, having decided to apply a percentage discount to the legal costs, the arbitrator should, in my view have similarly addressed his mind to the question of whether it was appropriate to apply some discount to the recoverable costs of the reference. The fact that Rule 5.3 concludes with the words “*those costs or any part thereof*” demonstrates that the Rule enables an arbitrator to award a portion only of those costs, or specific aspects of what has been expended, rather than it being a straightforward binary choice between all or nothing.

Although I understand that the arbitrator had more matters in mind when reaching his conclusion that discounting the rate of recovery of costs to 80% was the correct percentage to apply, I am minded to make use of the percentage discount he applied. In other words, bearing in mind the arbitrator’s deeper knowledge and understanding of how the arbitration was conducted on behalf of both sides, his assessment of the balance between the way the parties behaved is, in my view, an appropriate conclusion to make use of when considering how his Final Award should be varied. This is consistent with the guidance of Lieutenant-Bailiff Day in the *Thompson and Le Noury* case not to lose sight of the overall feel of a case.

In respect of the recoverable costs of the reference, I therefore consider that the arbitrator should have discounted the total costs in the same way, meaning that the Respondents were entitled to be awarded 80% of the costs, with the remaining 20% of these costs being shared equally between the parties. Because they had already paid their 50% share of the total costs of £22,749.10, the award against the Appellants should have been for 80% of what they had paid, which equates to 40% of the total amount, or £9,099.64.

Experts’ fees

In some respects, the two sets of fees incurred by the Respondents in respect of instructing experts to report and attend the arbitration on their behalves is the hardest of the heads of costs awarded to resolve on this appeal. The arbitrator’s reasons for allowing both claims for costs in full appear to distinguish between the two experts instructed. The fees for the engineer were incurred in order to rebut the Appellants’ claim that the soundproofing works undertaken by the Respondents and were allowed in full because “*this was proven not to be the case*” (see para. 48 of the Final Award), whereas the fees incurred for an expert surveyor were awarded because his instruction was “*necessary as a result of the ... decision to reject Mr Dunnell;s proposals*” (see para. 49). I have, therefore, similarly considered each separately rather than just treating them as a single head of disbursements.

I take the view that the expenses incurred by the parties when instructing expert witnesses are properly to be treated as part of the recoverable costs of the Arbitration, in much the same way as the costs incurred by them in instructing Advocates to represent them. These are, in effect, the type of disbursements which would form part of the overall costs incurred by a party for the conduct of the arbitration on his or her behalf. Consequently, Rule 5.4 of the 2009 Rules required the arbitrator to apply the general principle that costs follow the event, subject to the principle that there might be circumstances where it is not appropriate to award a party who has succeeded some or all of its costs. Rule 5.5 might also be considered but that is potentially a separate consideration.

It is implicit in the arbitrator's finding that the costs incurred for an expert surveyor were treated by him as falling within his general finding that the Appellants had acted unreasonably and caused the Respondents unnecessary expense because the former rejected Mr Dunnell's recommendations. The same cannot be said about his finding in respect of the engineer's fees. It appears the arbitrator's award of those costs was solely based on the Appellants' arguments that the Respondents' soundproofing works being found by him not to have affected the stability of the separating floors, which formed part, albeit perhaps not exactly in those terms, of the Appellants' counterclaim. In other words, the arbitrator has criticised the Appellants for advancing a case that was then found to be misconceived, but did not expressly find that it was unreasonable to have done so. In the absence of such a finding, I have considered whether I can properly infer that the arbitrator's conclusion falls within Rule 5.5 or remains under the general principle set out in Rule 5.4. Because of the reasoning in para. 48 of his Final Award, I feel I am left with no option other than to decide that Rule 5.5 has not been engaged and so cannot be invoked as the justification for awarding the entirety of the costs associated with the Respondents' expert against the Appellants. At para. 17 of his Final Award, the arbitrator did not expressly state that he found this constituted an unreasonable act and, had he done so, it would potentially have been inconsistent with his approach to the "*lengthy and complex legal arguments*" raised, which he did not consider to have been used unreasonably (para. 18). The consequence of my conclusion is that the engineer's fees fall to be dealt with solely in accordance with Rule 5.4.

In relation to the surveyor's fees, as I have already found that the arbitrator erred by concentrating as much as he did on the Appellants' decision not to give effect to the recommendations made by Mr Dunnell, it follows that his reason for allowing the Respondents' claim for the full amount of the surveyor's fees is similarly flawed. Because of the overall effect of the arbitrator's Interim Award, the Appellants' decision to proceed with the arbitration cannot, in my view, be regarded as the type of unreasonable act covered by Rule 5.5. Equally, the arbitrator's indication that he would ordinarily find a successful party responsible for its own expert fees is not consistent with what Rule 5.4 provides. On the basis that instructing an expert to assist with the evidence adduced before an arbitrator is a disbursement or expense that will, unless there are some circumstances making it inappropriate to do so, fall within "*the recoverable costs of the Arbitration*", Rule 5.4 is once again in principle the applicable costs rule.

Applying a similar approach to the recoverable costs of the reference, I take the view that the arbitrator was correct to discount the overall costs award he made to the Respondents to reflect that, whilst they were successful, in the sense of justifying an award of costs in their favour to "*follow the event*", they made claims that were not ultimately pursued and the overall result and the conduct of their claim was such that it would not be appropriate to award the Respondents the entirety of their costs. Accordingly, I am content to continue to use the 20% discount the arbitrator applied to this costs exercise in respect of the costs that he was required to consider under Rule 5.4. This means that, rather than the Respondents being awarded the entirety of the fees they expended on experts, they should have been awarded 80% of the total. That percentage equates to £7,564.56.

Legal costs

The largest single element of the arbitrator's award on costs related to the legal costs incurred. As I have already indicated, if the wording used in Rule 5.4 had been "*the recoverable costs*

of the reference”, rather than “*the recoverable costs of the Arbitration*”, the only basis on which the Respondents could have benefited from an award of their legal costs, and the fees they incurred in respect of instructing their experts, would have been if Rule 5.5 applied. However, I approach the issue of the legal costs on the basis that they also fall within Rule 5.4 and may also be subject to Rule 5.5, in whole or in part, if the arbitrator could properly have found that the paying party “*has acted unreasonably and caused the opposing party unnecessary expense*”.

Because the starting point in Rule 5.4 is the application of the general principle that these costs follow the event, the arbitrator’s conclusion that the Respondents succeeded justifies him in making an award of costs in their favour. Thereafter, there is a potential overlap between looking at matters generally, eg, having regard to the overall circumstances of how the Respondents succeeded on the majority of their claim and also taking into account the settlement offers made on a “without prejudice” basis by both sides, and the discretion to order one Party to pay the other’s costs under Rule 5.5. Because Rule 5.5 is designed to penalise a party for acting unreasonably, thereby causing the other side to incur unnecessary expense, it is the means by which the unsuccessful party for the purposes of Rule 5.4 can be awarded some elements of the costs it incurred as well as being the means by which the successful party is awarded its costs on what might be a more generous basis than might otherwise be the case. Equally, because of the inter-relationship between Rule 5.4 and Rule 5.5, rather than make an award in favour of the successful party pursuant to Rule 5.4 and an award to the unsuccessful party pursuant to Rule 5.5, the arbitrator can decide to exercise his discretion in relation to costs by looking at the circumstances of the claim and the conduct of the parties and making a deduction of some or all of the costs that would otherwise be awarded to the successful party under Rule 5.4.

The clearest example given in the Guideline of where Rule 5.5 might be applicable is in relation to settlement offers. If only by way of example, had the Appellants conceded the technical breaches of covenants and offered to pay the Respondents £5,000 in respect of them, and offered to curtail their use of the washing machine to no more than the hours subsequently directed by the arbitrator, but the matter had still proceeded to a determination by the arbitrator, the outcome on costs may have been quite different. The Respondents would still have succeeded on the majority of their claims and so the general principle under Rule 5.4 would apply to the recoverable costs of the Arbitration, but the Appellants would have had a strong argument that the conduct of the Respondents in not accepting an offer that they failed to beat meant that the costs incurred by the Appellants after the date at which the offer should reasonably have been accepted should not be awarded to the Respondents but to them, and on a full indemnity basis, pursuant to Rule 5.5. Accordingly, in that situation, the award might well have been that the Respondents were awarded the costs they incurred up to a specified date on a recoverable basis and the costs thereafter, which appear to have been the more significant portion, would be awarded against the Respondents on a full indemnity basis. I have emphasised that point to demonstrate the importance of looking carefully at what offers were made when and comparing the outcome actually ordered with each of them.

As I have already explained, I have formed the view that the terms of the arbitrator’s Final Award show that the Appellants did better than any of the offers of settlement made on behalf of the Respondents. Accordingly, it cannot be said that the Appellants decision to reject those offers was an unreasonable act during the conduct of the arbitration proceedings so as to engage Rule 5.5. Equally, because the Appellants declined to make any offer of payment to

the Respondents, the Respondents are not in the position of being criticised for failing to accept a reasonable offer of settlement so as to engage Rule 5.5 in the Appellants' favour. In reality, the arbitrator's Interim Award was somewhere between the positions adopted by the parties during their negotiations. That in itself may indicate that the choice by both sides to continue through to the conclusion of the hearing was a reasonable choice for both to make.

I have given careful consideration to what the arbitrator has said about the conduct of the arbitration proceedings to ascertain whether there is any other basis on which Rule 5.5 enters into play. It is, of course, the conduct of the proceedings that matters and not the conduct of either party in relation to the matters in dispute in the proceedings, so the arbitrator's comments in para. 31 of his Final Award as examples of unreasonable behaviour are further support for him having misconstrued Rule 5. Whilst it is possible that the Appellants' pursuit of their counterclaim, which was unsuccessful, and both parties' pursuit of their claims for psychiatric damage, which were then withdrawn, could be dealt with in this way and an assessment made of the costs elements associated with each aspect so as to make discrete, or issues-based, rulings, having regard to the general guidance of Coulson J in *Noorani v Calver (No. 2)* (*supra*), I doubt that any of the concerns raised take this arbitration into the realms where any element of the costs should properly be dealt with on an indemnity basis under Rule 5.5 and prefer the approach of dealing with these costs solely under Rule 5.4. I have also considered the argument that the arbitrator failed to place sufficient weight on the Appellants' proposal to put the parties' disputes to mediation, however, I regard his conclusion expressed at paragraphs 25 and 54 of his Final Award that mediation was unlikely to have produced a successful outcome to be a fair assessment for him to have reached having had first-hand experience of the parties during the course of the arbitration. The Respondents' rejection of that proposal was not, therefore, an unreasonable act for the purposes of Rule 5.5.

Adopting similar reasoning to the other heads of costs claimed by the Respondents, in order to reflect that their claim, whilst successful, was not as successful as they had sought and that the arbitrator found that the Respondents should only be entitled to 80% of the costs they claimed, I propose again to apply that level of discount to the legal costs to be awarded to the Respondents on the recoverable basis. At para. 41 of the Final Award, the arbitrator recorded that the full costs claimed by the Respondents on the recoverable basis were in the amount of £41,861.00. 80% of that amount is £33,488.80.

Summary

Putting those three elements of the costs award made by the arbitrator together in the reduced amounts I consider were proper to award pursuant to Rule 5 of the 2009 Rules produces an aggregate of £50,153.

By reference to para. 5.6.5 of the Guideline and para. 7.6 of the grounds of appeal, I have tested that outcome against the principle of proportionality. When compared with the amount of damages actually awarded, this figure obviously still looks high, although if compared with the amounts actually claimed on behalf of the Respondents, as well as taking into account that a significant part of the claim related to the noise nuisance caused by the washing machine, which was to be dealt with by imposing restrictions on its use, it is not an amount outside of what might be expected. However, all those involved in these arbitration proceedings must have realised that the costs associated with a fully contested six-day hearing involving

Advocates and experts would be quite considerable. Unless the award made by the arbitrator dealt with matters in such a way as to lead to a different conclusion, which is not the case here, there was always going to be one party who would be treated as the successful party and so, in accordance with the general principle, entitled to receive some costs from the other party. In my judgment, it would not produce a just result to reduce the costs to be awarded to the Respondents below the figure produced by applying a rate of 80% to each of the elements covered under Rule 5.3 and Rule 5.4. Accordingly, as a result of allowing the Appellants' appeal, I will vary the total amount of costs awarded to the Respondents by substituting £50,153 for £87,662.25.

Conclusion

For the reasons given, I find that the arbitrator erred in law when making his Final Award in respect of the costs he ordered the Appellants to pay to the Respondents. In particular, he misconstrued how to apply Rule 5 to the situation with which he was faced and did not adequately analyse the various offers of settlement made, mistakenly concentrating instead on the recommendations made by Mr Dunnell and the Appellants' wrong decision not to accept them without further ado. In accordance with section 19(2) of the 1982 Law, having allowed the Appellants' appeal, I will vary para. 57 of the arbitrator's Final Award so as to substitute for the figures set out at (A), (B), (C) and (D) the figures of £33,488.80, £7,564.56, £9,099.64 and £50,153 respectively. I will also delete the word "indemnity" from (A).

Ancillary matters

I have not attempted to resolve the question of interest dealt with at para. 57(E) of the arbitrator's Final Award. On the basis that section 18 of the 1982 Law treats any sum to be paid by an award, which must extend to the costs element of an award, as carrying interest "*at the same rate as a judgment debt*", interest should still run from the date of the arbitrator's Final Award, as varied by this appeal, at 8% per annum. Much will depend on whether any monies have been paid by the Appellants towards the costs aspect of the Award as to how the final calculation will be made. The daily rate of interest on £50,153 would be £10.99, rather than the amount of £19.21 referred to by the arbitrator. I therefore invite the Advocates to agree whether that is the figure that should be substituted in para. 57(E) or whether it should be something else and, in default of agreement, to seek a short hearing at which the matter could be aired and resolved.

In relation to the costs of the appeal, I similarly invite the Advocates to agree, if they can, what the costs order should be. In default of any further assistance, I would be minded to treat the costs as also following the event. The Appellants have succeeded on their appeal and would, unless I am persuaded differently, be entitled to have their costs on the standard recoverable basis. I am conscious, however, that I do not know whether the parties have made any offers of settlement to dispense with the need for this appeal or whether either feels that a different conclusion should be ordered. Accordingly, I will formally reserve the question of costs, thereby enabling the parties to attempt to seek to agree what order should be made or, in default of agreement, to re-list the matter at a mutually convenient Interlocutory Court.