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edited by

Marianne Roth
Michael Geistlinger

with the assistance of

Marianne Stegner

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Joe TIRADO/Max STEIN/Mumuksha SINGH

Security for costs in international arbitration

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Abstract
This paper provides an overview on security for costs and tells the reader about what it is, who can request it and when and why it is helpful in arbitration proceedings. Other aspects of this paper address the procedure for seeking such an order, the provisions available under certain institutional rules and the criteria an arbitral tribunal will bear in mind before granting such an order. In the penultimate paragraphs we have discussed an overview about the current market practice and the UK law position with reference to Jackson’s reforms. It can be concluded that going forward, more predictability on cost issues would become a necessity in the arbitration world for both lawyers and clients alike.
Keywords
Arbitration, costs, ICC, ICDR, ICSID, Jackson, LCIA, SCC, security, SIAC, third party funding, UNCITRAL Model Law

I Introduction
The costs of an international arbitration can be quite substantial. This can place a respondent faced with an unmeritorious claim by an impecunious party into a catch-22-situation. If the respondent does not defend the claim, it runs the risk of a default judgment. If the respondent does defend the claim, there is the risk having to pick up all the costs of the arbitration. An order for security for costs seeks to resolve this problem.

II What is an order for security for costs?
An order for security for costs is an order by a competent tribunal that is granted as an interim measure. The tribunal will require the claimant to provide this security before the respondent incurs costs to defend the claim. It is thus a method by which a respondent can gain security for its own costs in the event that it ultimately prevails in the arbitration and the claimant is unable or unwilling to pay the costs ordered. The security will only relate to the legal fees and expenses arising from the defence of the relevant claims in the proceedings. An interim order for security for costs is different from other interim reliefs direct approach, as it is implemented or enforced without state assistance, which is usually, due to its process, used to stall or dismiss arbitral proceedings.\(^1\)

Some national laws also allow for courts to issue an order for security for costs. This has been generally understood as a common law concept, although it is not completely unheard of in civil law jurisdictions (usually described as cautio judicatum solvi).\(^2\)

III Who can request it?
Generally, only a respondent can request an order for security for costs. Having said this, there are instances where a claimant may ask for security, i.e. when counterclaims are filed by a respondent. Other examples include third parties

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seeking security in joint proceedings or costs applications in a proceeding that seeks a different form of interim measure all together.3

IV Why request it?

An order for security for costs can be a very powerful tool for a respondent. In practice, it will generally be accompanied by a request for a stay of the proceedings until the security has been provided and for dismissal of the claim if the security is not provided within the prescribed time. It is therefore an unusual interim measure in that the arbitral tribunal can easily enforce it itself. Naturally, this can create tensions and also give rise to interesting tactical considerations. The respondent is able to prevent the claimant from pursuing its claim without providing for sufficient security for the respondent to recover its costs in defending a possibly spurious or frivolous claim. An order for security may also be used to put pressure on the claimant (or counterclaimant) to settle.

V How is it done?

Usually, the respondent will first ask the claimant to voluntarily provide payment of security into court, provide another form of security such as a letter of guarantee from a reputable bank, or provide financial documents in order to prove its solvency. If this is denied, the request for an order from the tribunal will then have a better prospect of success.

Security can be provided in a number of ways. A common order is to require a claimant to make payment into court (for English courts this is done by completing a Court Fund Office Form 100). Other Forms of Security include a solicitor’s undertaking, a banker’s bond, a deed of indemnity, an after-the-event provision of insurance payout, a payment into an escrow account and bank guarantees.

VI Institutional rules

Whether an order for security for costs is admissible at all is firstly a question for the arbitration agreement to decide. Although arbitration agreements are usually silent on issues such as security for costs, they often refer to institutional rules which may encompass such an order.

Some arbitration rules specifically confirm the arbitral tribunal’s authority to order security for costs, for example the LCIA rules (Article 25.2) and the SIAC rules (Rule 24.1(k)). Others do not specifically deal with security for costs, but instead grant the tribunal a right to order any interim measure it deems appropriate. This can be seen under Article 28.1 of the ICC 2012 Rules, Article 23.1 of the ICC Rules (1998) and Article 47 of the International Convention on the Settlement of Investment Disputes. The ICDR Rules grant tribunals a similarly wide power to order “whatever interim measures it deems necessary” which include security for costs (Article 21(1) and 21(2)).

There has been some debate on whether the UNCITRAL Rules 1976 provide for this discretion as the wording reads that the tribunal may take “any interim measures it deems necessary in respect of the subject matter of the dispute” (Article 26). It has been suggested that this may not directly address or include security for costs.\(^4\) In spite of the ambiguous wording, the UNCITRAL Rules 1976 have been used for the settlement of a broad range of disputes such as those between private commercial parties where no arbitral institution is involved, investor-state disputes, state-to-state disputes and commercial disputes administered by arbitral institutions. In 2006, the United Nations Commission on International Trade Law decided that the 1976 Rules should be revised in order to meet changes in arbitral practice. This revision aimed at enhancing the overall efficiency of arbitration. The revision considered the wording of Article 26 and added paragraph 2(c) under the UNCITRAL Arbitration Rules 2010 which state that interim measures may be awarded if they provide the means for “preserving assets out of which a subsequent award may be satisfied”. Some commentators suggested including the words ‘or securing funds’ after the word ‘assets’ but the Working Group disagreed. The reasoning was that security for costs was considered to be encompassed under paragraph 2(c) and additional wording would suggest that the identical provision on interim measures under the UNCITRAL Arbitration Model Law (adopted in 2006) was insufficient to provide for security for costs because it did not have the additional textual drafting.\(^5\)

**VII Lex arbitri**

Even where the arbitration rules are silent on the issue, the *lex arbitri* may allow arbitral tribunals to make an order on security for costs. In England and Wales, Section 38 of the Arbitration Act 1996 provides that, unless otherwise agreed by the parties, the tribunal has the power to “order a claimant to provide security for the costs of the arbitration”. Similar rules apply in certain common law jurisdictions like Singapore and Hong Kong but many other countries may not be as supportive for the same.

**VIII Criteria for granting the order**

Since an order for security for costs is such a powerful tool that could be used by respondents to torpedo a legitimate claim by a cash-strapped counterparty, it is common ground that it will only be granted in exceptional cases. Hence, even where orders for security for costs are generally admissible, their intention should not be to stifle a legitimate claim.\(^6\) While there is no internationally ac-

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\(^5\) Ibid.

cepted legal test, certain factors have been taken into consideration, as dis-
cussed below:

A  Foreign residence

It is generally accepted that the tribunal may not render the order solely on the
grounds of foreign residence.7 This is based on the rationale that the respondent
was aware of the jurisdictional risks involved when first dealing with the counter-
party and cannot now mitigate those by seeking security for costs as an alterna-
tive option. Although foreignness of the claimant is not accepted as a ground, it
is not unknown for respondents to cite jurisdictional difficulty in enforcement of
the award or foreign location of assets as a gloss for obtaining a costs award.8

B  Financial situation of the claimant

The financial situation of the claimant is the most obvious and most often applied
criterion by the tribunal to determine whether to make an order for security. The
tribunal may grant the order only where there is a clear risk that a defeated
claimant will not comply with his obligation to pay the respondent’s costs. In this
instance it is important for the respondent to bring to light credible evidence
about the claimant’s poor liquidity (such as statutory returns, audited annual
accounts, low valuation of operating assets or previous history of entering into
voluntary arrangements, receivership or liquidation). If the respondent can show
that the claimant lacks the means to pay up it may simultaneously be able to
support its argument that an eventual award of costs is likely to go unpaid there-
by winning the tribunal’s favour to order a security for costs award. However,
where the claimant has sufficient assets to satisfy any costs award, it has been
held that in such situations an order for security for costs should not be made.9

If there has been a recent change in the claimant’s financial circumstances
such as a disposal of valuable assets prior to commencing a claim or not making
a full or frank disclosure of assets and financial arrangements that can be in-
furred as evasive, it may be considered appropriate in such circumstances that
the claimant pay security for costs.10

C  Fundamental change of circumstances

Many arbitral tribunals have not been satisfied with the impecuniosity of the
claimant alone and have instead demanded a fundamental change of circum-

7  This can be seen under English law in section 38(3)(a), Arbitration Act 1996; CPR
r.25.13(2)(a) for the award of security for costs by an English court against residents
of countries outside the Brussels regime.

8  High Court of Justice (Chancery Division), Somerset-Leeke v. Kay Trustees, Deci-
sion of 1 May 2003, [2004] 3 All E.R. 406 (there was doubt about the location of the
claimant’s assets and it was argued that “it was incumbent upon Mr. Somerset-
Leeke to disclose where his assets were”).

9  Queen’s Bench Division (Commercial Court), Azov Shipping Co. v. Baltic Shipping

10 High Court of Justice (Chancery Division), Ackerman v. Ackerman, Decision of
stances be shown.\textsuperscript{11} The idea behind this requirement is that a respondent may be said to have accepted the financial strength or weakness of a claimant with whom it has voluntarily concluded a business relationship. An order for security for costs would disturb the equilibrium of the contract and create an uneven playing field for the claimant.\textsuperscript{12}

D  Risk of non-enforcement

The risk of non-enforcement plays a rather minor role, given the geographical spread of the New York Convention. It may be a viable argument where the enforcing state is not a member to the New York Convention or if it may be argued that the state would not enforce a cost award even though it is a member state. The latter may be the case if ordering security for costs would, for example, be against the public policy of the enforcing state.

There may be circumstances in which the tribunal is prepared to take notice of enforcement difficulties, particularly where these amount to impossibility. English courts have already identified such considerations in the cases involving, for example, Sudan\textsuperscript{13} and Russia\textsuperscript{14}. Political difficulties may also be persuasive factors in cases where countries like Afghanistan, Somalia and the Democratic Republic of the Congo are involved.\textsuperscript{15}

E  Merits

The merits of the case are unlikely to play a major role because orders for security for costs are usually requested at an early stage of the proceedings. The merits have, however, been considered by arbitral tribunals in cases in which a partial final award had already been rendered.\textsuperscript{16}

F  Conduct of the parties

The arbitral tribunal will be reluctant to grant an order for security for costs if the respondent’s conduct suggests that it merely seeks to stifle a meritorious claim. An indication for this may be the timing for such a request. Tribunals are also likely to question how far the claimant’s impecuniosity is due to the respondent’s behaviour.\textsuperscript{17} Likewise, the claimant’s conduct can also be important too and it should exercise care when responding to a request from the respondent to dis-

\textsuperscript{12} Ibid.
\textsuperscript{13} High Court of Justice (Queen’s Bench Division), Abdel Mahmoud Al-Koronky, Hanan Ibrahim Mohammed v. Time Life Entertainment Group Ltd, Damien Lewis, Decision of 29 July 2005, [2005] EWHC 1688 (QB).
\textsuperscript{14} Court of Appeal (Civil Division), Dumford Trading AG v. OAO Atlanticruflot, Decision of 17 September 2004, [2004] EWCA Civ 1265.
\textsuperscript{15} See Al-Koronoky v. Time-Life Entertainment Group Ltd, supra note 13, which discusses the difficulties of enforcement of politically sensitive awards.
\textsuperscript{17} Ibid.
close relevant financial documents. It should, however, be well noted by a claimant that a refusal to disclose these documents might permit the tribunal to draw an adverse inference and the refusal may be seen as evasive behaviour.

IX Practice

Orders for security for costs may become more relevant as cases of third party funding are on the rise, it may also be one of the few solutions for respondents in a lose-lose situation who are more vulnerable to extortionate settlements. They are also very relevant in cases in which the project company itself (which is often an empty shell) brings a claim with little to lose.

X Jackson reforms

The Jackson reforms on controlling escalating litigation costs are expected to be in place by April 2013 and this is going to have an effect on upcoming cases in England. The reforms, in principle, suggest that the payment of the successful party's costs would still lie at the feet of the unsuccessful party. However, such costs would need to be proportionate to the matters in issue and the amount in dispute.

The reforms will only apply to disputes governed by English law and procedure. Although they are not international per se, they may have a considerable impact given the popularity of English law as governing law for much ongoing arbitration, and particularly in tribunals comprised of common law counsel, there may be a difficulty in disengaging thought processes on issues regarding case budgeting and proportionate costing. For certain claims such as personal injury or clinical negligence, Jackson LJ will abolish the “loser pays” principle altogether i.e. under which the losing party paid the bulk of the winner’s legal costs. Jackson LJ suggests that this be replaced with one way cost shifting under which the respondent would still pay the claimant’s costs if the claim succeeded but would not be able to recover their own costs if it fails.

Although arbitral tribunals are not bound by these reforms, they usually follow the High Court when considering such issues. Many complexities can arise, such as instances where a claimant to an arbitration proceeding obtains third party funding and the respondent has made a security for costs application. Tribunals may need to consider whether they should order the claimant to produce proof of the funding so as to suffice as security for costs. It will be a source of debate whether funding documents should be disclosed as they are sensitive and give an insight into how the party and their counsel perceive their chances of winning. Further, there is no guarantee that external funders will make the entire payment for the costs awarded by the tribunal as their liability is usually bespoke and varies case by case. If the funding agreement is subject to a maximum cap,
should the tribunal seek to order for security beyond that cap limit? These are grey areas even for active litigations and certainly English court decisions following the Jackson reforms can shed light on this issue.

Mindful of these expected changes, we are yet to see if and how they will affect arbitral tribunals when deciding on security for costs orders. It can be said at this stage, however, that all issues regarding cost estimates would be scrutinised harder than they have previously been. The arbitral tribunal is not bound by the strict rules of the court and therefore the reforms would not be mandatory for arbitral proceedings. If the arbitration clause and institutional rules (as applicable) which grant the tribunal power for awarding security for costs are wide enough in their textual drafting, seeking such interim measures may be more straightforward in arbitration as compared to court litigation, as long as the tribunal adheres to its duty to act fairly and impartially.  

**XI Conclusion**

Respondents should always consider requesting an order for security for costs if they fear that a claimant may not be able to pay an eventual order for costs. In exceptional cases, this may save them from having to arbitrate at all. Likewise, before bringing a claim, every party should consider that it may be ordered to pay security for costs. Given the possibly grave consequences, whether or not an order security for costs is permissible is an issue worth investigating before deciding on arbitration rules. Every tribunal will eventually decide on the award of a security for costs on a case by case basis but the major problem remains the lack of internationally accepted rules which makes it difficult for both sides to assess their prospects of success.

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20 Section 33 (1) (a), Arbitration Act 1996.