Arbitration News:  
Security for Costs in Arbitration - Is it likely to be ordered?

This article outlines what security costs is, why a party may want to seek security for costs, what arbitration rules provide for security for costs, the common grounds for seeking security for costs and the potential difficulties in obtaining an order for security for costs in arbitration proceedings.

What is security for costs?

Security for costs is an interim measure sought by a party (usually the Respondent) to protect against the potential scenario that it is eventually successful in the arbitration and is awarded its costs to be paid by the claiming party but the claiming party has insufficient money to pay the adverse costs order made against it.

If security for costs is ordered in arbitration proceedings, the arbitral tribunal will require the party against whom it is ordered (usually the claimant or counterclaimant) to set aside a sum of money (usually on account or by bank guarantee) to provide security for the applicant’s costs.

Why seek security for costs?

If a party is ultimately successful in an arbitration, a tribunal will likely order that the unsuccessful party pays some or all of the reasonable legal costs and expenses incurred by the winning party. The risk of a party being liable to pay the other party’s costs in the event it is unsuccessful with its claim, can be an effective measure for discouraging parties from advancing unmeritorious claims or counterclaims. However, the risk of a potential adverse costs order against a party is worthless if the party against whom it is made has no money to pay those costs or no assets against which the order can be enforced. Accordingly, a party may want to make, as an interim measure in appropriate circumstances, an application to require a party bringing a claim or a counterclaim to provide security for the applicant’s costs.

The power to order security for costs

Most institutional rules provide the tribunal with the power to award security for costs. However, not all institutional rules provide an express provision to do so. For example, there is no express provision in the International Chamber of Commerce (ICC) Rules but Article 28(1) provides that ‘the arbitral tribunal may, at the request of a party, order any interim or conservatory measure it deems appropriate’. Likewise, Article 26 of the United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules provides that the ‘arbitral tribunal may, at the request of a party, grant interim measures’, which includes applications for security for costs. See also Article 31(1) of the Dubai International Arbitration Centre (DIAC) Rules.

Other institutional rules provides express provisions for the tribunal to award security for costs. For example, Article 25.2 of the London Court of International Arbitration (LCIA)
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Rules 1998 and 2004 provides that ‘the Arbitral Tribunal shall have the power upon the application of a party… to order any claiming or cross-claiming party to provide or procure security for Legal Costs and Arbitration Costs’.

In addition, for arbitrations in England and Wales, section 38 of the Arbitration Act (AA) 1996 provides that ‘the tribunal may order a claimant to provide security for the costs of the arbitration’.

Grounds for awarding security for costs

There is no strict test for the tribunal to follow in relation to ordering security for costs in arbitration proceedings and they are able to take into account any considerations it deems appropriate.

The 2015 Guidelines by the Chartered Institute of Arbitrators issued helpful guidance for tribunals to consider when deciding whether to make an order for security for costs. These include:

- the prospects of success of the claims and defences;
- the claimant’s ability to satisfy an adverse costs award and the availability of the claimant’s assets for enforcement of an adverse costs award; and
- whether it is fair in all of the circumstances to require one party to provide security for the other party’s costs.

Difficulties for obtaining security for costs

When considering an application for security for costs, tribunals may make a preliminary assessment of the merits of the case to consider the prospects of success of the claims and defences. However, such assessments raise concerns that the case may be prejudged without the tribunal reviewing all the evidence and without hearing a full discussion between the parties on that evidence.

In relation to the claimant’s potential impecuniosity, it is essential that the applicant is able to evidence that the other party does not have sufficient finances to pay an adverse costs order against it. This could be in the form of company accounts or evidence of creditors etc. If the applicant does not have sufficient evidence, it should ask the other party to provide evidence that it has sufficient funds and if this is not provided, this can be used to help justify why security should be ordered. Difficulties however may arise if the other party’s financial situation has been caused from the actions or inactions of the applicant and this is often used to argue why security should not be ordered.

Furthermore, the impecuniosity of the other party may have already existed at the time the arbitration agreement was entered into between the parties. Tribunals have used this reason to refuse to order security for costs on the basis that the risk of not being able to recover costs of the arbitration should have been known by the applicant at the time it entered into the arbitration agreement. If an applicant can show that there has been a change in the other party’s financial position, which was unforeseeable at the time of entering into the arbitration agreement, this may help to support an application for security for costs.

The ICC issued a bulletin on security for costs (published in Vol 25 Supplement 2014) and noted that ‘the consensual basis of arbitration and the assumption that when entering into an arbitration agreement, parties freely choose their contractual partner and they accept the risk that they might one day be involved in arbitration proceedings, calls for a restrictive approach to the ordering of security for costs in arbitration’. The ICC suggests that the power of the tribunal to order security for costs will only be in exceptional circumstances, such as a change of circumstances so severe as to jeopardise the enforceability of a future award of costs and the deliberate alienation of funds to avoid liability.
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The mere fact that a party is resident outside the jurisdiction of the arbitration is unlikely to be a sufficient for a tribunal to order security for costs. This is usually considered a part of the risk that a party took when entering into an agreement with a party outside the jurisdiction. As such, section 38(3) of the AA 1996 provides that the tribunal’s power to order security for costs ‘shall not be exercised on the ground that the claimant is an individual ordinarily resident outside the United Kingdom, or a corporation or association incorporated or formed under the law of a country outside the United Kingdom, or whose central management and control is exercised outside the United Kingdom’.

It is unlikely that the fact that the claiming party is relying on third party funding to fund its claim will be a determinative factor in ordering security. However, it is likely to be a relevant factor that the tribunal will take into account.

In considering whether it would be fair to require one party to pay security for the other party’s costs, the Tribunal will consider the specific circumstances of the case and weigh up the unfairness to the claimant (or counterclaimant) of the security of costs order potentially stifling the claim, against the unfairness to the applicant of potentially being unable to recover its costs from the claimant in the event that it successfully defends the claim.

Considerations

A party should carefully consider whether to make an application for security for costs in arbitration as despite the institutional rules providing tribunals with the power to award security for costs, the power is used rarely and in only exceptional circumstances. However, given the potential benefits that security for costs orders can bring, if sufficient evidence is available, applications for security for costs in arbitration should not be discounted.

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