

Security for costs in international arbitration – emerging consensus or continuing difference?



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The scope and nature of the interim relief that a tribunal may grant in international arbitration proceedings has been a matter of some controversy. The extent of this controversy was recently underscored by the difficulties that the United Nations Commission on International Trade Law (UNCITRAL) faced in reaching consensus on proposed changes to article 17 of the UNCITRAL Model Law on International Commercial Arbitration. Article 17 deals with the interim measures that may be granted by an arbitral tribunal. A revised version of article 17 was adopted in July 2006, but only after debate for more than four years. The representatives of a number of nations, including the United Kingdom and France, expressed significant reservations about the ultimate wording.

Within the range of interim measures that can be granted, one that has generated considerable debate and differences in approach between various European jurisdictions is an arbitral tribunal's power to order security for costs.

In general terms, an order for security for costs is an order by a competent court or tribunal requiring (usually) a claimant to provide security for the costs of its counterparty in the event that its claim is ultimately unsuccessful. Although by nature security for costs is ordinarily for the benefit of the defendant in proceedings, claimants may seek its protection in response to counterclaims in certain circumstances.

Security for costs relates only to legal fees and expenses arising from the defence of the relevant claims in the proceedings. This interim remedy does not extend to security for any ultimate damages award. In effect, it is a form of collateral that the claimant (or counterclaimant) must provide in respect of its counterparty's costs in the proceedings as a condition to the claimant (or counterclaimant) continuing with its claim. This is typically provided by way of a bank guarantee, a payment into escrow, or similar form of security.

Clearly, security for costs is only appropriate where the principle of cost-shifting applies to the proceedings. Thus, in circumstances where a party may recover its costs if successful, and there is a risk that the counterparty will be unable to meet any costs order at the time of the award, then it could be appropriate to put costs protection in place.

The grant of security for costs involves a sensitive balancing exercise. On the one hand, security serves a valuable role in complementing cost-shifting rules and acts as a deterrent against spurious or frivolous claims. On the other hand, it may impose considerable practical constraints on the ability of a claimant to proceed with its legitimate claims. For this reason, security for costs is sometimes perceived as a limitation on the right to a fair hearing. Different national arbitration laws and different procedural laws strike a balance between these two, often competing, considerations in different ways.

Given that an order for security for costs can be a powerful weapon in a defendant's arsenal (when faced with an unmeritorious claim or counterclaim), the availability of security may be a material consideration in a party's choice of a particular seat or set of institutional rules. We address below the differences between

various national arbitration regimes and the rules of leading arbitral institutions and offer some observations as to the practical ramifications arising from these differences.

The English position

Security for costs has often been regarded as a very English concept and it is still true to say that this form of interim relief is given broader recognition in both English statutory and case law than in the laws of other jurisdictions.

England's Arbitration Act 1996 is one of relatively few national arbitration statutes that expressly empowers an arbitral tribunal to make an order for security for costs. Prior to the 1996 Act, such an order could not be sought directly from an arbitral tribunal but, rather, had to be sought from an English court in support of arbitral proceedings in England. That was expressly changed by section 38(3) of the Act, which provides that:

The tribunal may order a claimant to provide security for the costs of the arbitration.

This power shall not be exercised on the grounds that the claimant is-

- (a) an individual ordinarily resident outside the United Kingdom, or*
- (b) a corporation or association incorporated or formed under the law of a country outside the United Kingdom, or whose central management or control is exercised outside the United Kingdom.*

In some respects, the power of a tribunal to make an order for security for costs is more limited than the power that an English court would have in similar circumstances. Notably, section 38(3)(a) and (b) contains an express limitation that the power to grant security for costs shall not be exercised on the grounds that the claimant is resident in or incorporated in a country other than the United Kingdom. In contrast, rule 25.13 of the English Rules of Civil Procedure (CPR) expressly provides that in deciding whether to grant an order for security the court may take account of a claimant or company being ordinarily resident out of the jurisdiction in a country that is not party to EU Regulation 44/2000 or the Lugano Convention.

This additional express limitation imposed by section 38(3) of the English Arbitration Act 1996 recognises the cross-border character of international arbitration. In such arbitration, it would be inappropriately broad for security for costs to be granted on the basis that one party was not based in the jurisdiction: the very nature of international arbitration is that the parties typically will be from different jurisdictions. Moreover, many of the enforcement risks that might apply in respect of a costs award against a foreign claimant in English High Court litigation are reduced in the context of international arbitration by the application of the New York Convention. The possibility of enforcing any costs award under the Convention provides an additional reason why an arbitral tribunal might exercise restraint in the application of section 38(3).

Despite these limitations, English case law has adopted a relatively broad view of section 38(3) of the Arbitration Act. In the seminal case, *Azov Shipping Co v Baltic Shipping Co*,¹ Mr Justice

Longmore, as he then was, in the English Commercial Court held that the arbitrator's discretion to make an order for security for costs was not subject to any formal fetter beyond the two express limitations in paragraphs (a) and (b) of section 38(3). In that case, Longmore J upheld the decision of an arbitral tribunal seated in London to require that the claimant provide security for costs as a precondition for continuing with its claim.

Longmore J recognised that “cases will be rare in which...an arbitrator would think it right to order security for costs if an applicant for relief has sufficient assets to meet any order for costs and if those assets are available for satisfaction of any such order for costs.” However, Longmore J went on to state that “if [the party] does not have such assets or if such assets are not readily available to satisfy any Court order, I would be inclined to make an order for security.”

In determining whether to grant security for costs in an English seated arbitration, there is an established body of precedent to which an arbitral tribunal could have regard. Cases such as *Re Unisoft Group (No. 2)*² recognise that, in determining both whether to grant an order for security for costs, and the quantum of any order granted, a balance must be struck between protecting the ability of the defendant to recover costs and not preventing the claimant from proceeding with a meritorious claim. This balancing act – and the specific factors that need to be considered in applying it (such as the relative difficulty of enforcing a costs award against the claimant in its place of residence) – has been considered in some detail in a number of recent cases including *Nasser v United Bank of Kuwait*.³

Inevitably, jurisprudence developed in the context of English High Court proceedings will have to be moulded to reflect both the differences that exist between the English Arbitration Act 1996 and the CPR (including section 38(3)(a) and (b) of the Act discussed above) and the provisions of any applicable institutional rules. However, the established body of precedent that exists under English law does at least provide a useful reference point as to how an arbitral tribunal seated in London could approach the question of security.

England compared with other European jurisdictions

Traditionally, courts and tribunals in other European jurisdictions have been more reluctant than English courts or tribunals to grant orders for security for costs. Although recently there have been signs of an increasing willingness in some continental European jurisdictions to permit security for costs in arbitral proceedings, in practice it remains rare (even though most continental jurisdictions provide for some form of cost shifting).

One exception is the newly revised German arbitration statute which expressly confers authority upon an arbitral tribunal to order security for costs (German Code of Civil Procedure (1998), section 1041(1)).

Other continental jurisdictions remain more circumspect. In Switzerland, for example, article 183(1) of the Private International Law Act 1987 confers upon an arbitral tribunal the authority to grant provisional or interim measures. Although there is no express statutory recognition of security for costs in the context of international arbitration, article 183(1) has been relied upon to make such an order in certain circumstances (such as where the claimant appears to be insolvent). However, the scope for security for costs based on article 183(1) is significantly more limited than it would be under English statute in respect of proceedings sited in England. Similar principles apply in France. Pursuant to articles 808-9 and articles 827-73 of the New French Code of Civil Procedure, in arbitration proceedings sited in France, the tribunal enjoys concurrent jurisdiction with the national courts to order provisional or

interim measures. As in Switzerland, however, there is no specific statutory jurisdiction conferred upon an arbitral tribunal to make an order for security for costs.

Distinctions between the rules of leading arbitral institutions

The rules of the leading arbitral institutions also adopt different approaches to the issue of security for costs.

The Rules of the London Court of International Arbitration (LCIA Rules) do expressly empower an arbitral tribunal to make an order for security for costs. This mirrors the express jurisdiction conferred upon tribunals seated in England pursuant to section 38(3) of the English Arbitration Act 1996, as well as the relatively expansive approach of the English courts towards security for costs. In particular, article 25.2 of the LCIA Rules provides:

The Arbitral Tribunal shall have the power, upon the application of a party, to order any claiming or counterclaiming party to provide security for the legal or other costs of any other party by way of deposit or bank guarantee or in any other manner and upon such terms as the Arbitral Tribunal considers appropriate.

Article 11.1 of the Arbitration Rules of the Hong Kong International Arbitration Center (HKIAC) make similar express provision for arbitrators to make an order of security for costs. In contrast, the rules of other leading arbitral institutions do not make any specific provision.

Article 23(1) of the Rules of the International Chamber of Commerce (ICC Rules) provides that:

Unless the parties have agreed otherwise, as soon as the file has been transmitted to it, the Arbitral Tribunal may, at the request of a party, order any interim or conservatory measure it deems appropriate.

This broad language has been interpreted as empowering an arbitral tribunal to grant an order for security for costs in appropriate circumstances. However, in practice such orders pursuant to article 23(1) remain relatively uncommon, and are only justified in exceptional circumstances.

Article 30 of the ICC Rules is sometimes cited as a countervailing reason against security in ICC proceedings. Article 30 provides for advances on costs to cover the fees and expenses of the arbitrators and the ICC administrative costs, payable by the parties in equal shares. Article 30 requires a claimant to put up substantial sums of money to pursue its claims, which in itself may provide an adequate safeguard against frivolous or vexatious claims. By way of enforcement, if a party fails to pay its share of the advance, the ICC Court of Arbitration may deem its claims (or, in the event of a defendant, its counterclaims) withdrawn. This has a similar effect to a security for costs order, at least in some respects.⁴ However, the benefits of article 30 are limited. In particular, it provides no protection in relation to a successful defending party's own legal fees and costs, as usually contemplated by a security for costs order.

In a similar vein, none of the other major arbitral institutions' rules expressly and specifically addresses the issue of security for costs, including the new Swiss Rules of International Arbitration (enacted in January 2006), the DIS Arbitration Rules of the German Institution of Arbitration, the Rules of the Arbitration Institute of the Stockholm Chamber of Commerce and the UNCITRAL Arbitration Rules.

Article 17 of the Model Law – failure to reach consensus

Recent amendments to article 17 of the UNCITRAL Model Law have highlighted the lack of real international consensus on interim measures in general and security for costs in particular.

After extended discussions over a number of years, a revised

version of article 17 of the Model Law was adopted by the 39th session of UNCITRAL on 14 July 2006. The new version contained a number of revisions defining, among other things, specific conditions to be taken into account in granting interim measures. However, the wording ultimately chosen was very much a product of compromise between divergent national viewpoints. Moreover, the revised version has been the subject of considerable criticism (among other things, the provisions of article 17 addressing ex parte applications for interim relief were particularly controversial). The United Kingdom, for example, issued a statement that the revised article “has the weakness of any hard fought compromise”.⁵

It is notable that the UNCITRAL working group – in attempting to reach consensus – ultimately decided not to address the issue of security for costs. Unlike the English Arbitration Act 1996, the revised version of article 17 does not expressly confer the power upon the arbitral tribunal to make an order for security.

A report prepared by the working group stated that further consideration could be given to the issue.⁶ However, the report also highlighted that any such further consideration would have to take account of the Hague Conventions on Civil Procedure of 1905 and 1954, which prohibit security for costs being required from nationals of signatory states.⁷

The fact that the amendments to article 17 ultimately adopted do not expressly address the issue of security for costs highlights the continuing lack of international consensus in this area.

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As described above, security for costs is an established and accepted aspect of procedure in dispute resolution proceedings sited in England, including both litigation and international arbitration. However, despite convergence of many other aspects of procedure in international arbitrations, relatively significant differences remain between the English position and other European national arbitration regimes in this respect. Moreover, the lack of any express provision providing powers to an arbitral tribunal to order security for costs under most leading institutional arbitration rules (except those of the London-based LCIA) reflects the lack of any real international consensus in this area.

The English experience is that, properly exercised, the power to order security for costs can be extremely valuable in protecting innocent defendants, both from vexatious and unmeritorious claims and from costs incurred in the successful defence of proceedings commenced by an impecunious claimant. The power is discretionary and, properly exercised, should not cause any genuine claim to be stifled. In practice, the lack of certainty as to the avail-

ability (and scope or application) of security for costs orders under various other national arbitration regimes may become a relevant consideration in the parties’ choice of seat (and even its choice of arbitrator). An arbitral tribunal sited in London, for example, would be more inclined to grant security for costs, than an arbitral tribunal seated in Geneva or Paris. Parties may consider it appropriate to take that into account when selecting the seat (and arbitrators) for their proceedings.

Alternatively, parties may expressly grant certain powers to a tribunal. Parties to arbitration are free, subject to mandatory rules of the forum, to make specific provision for security for costs or to exclude the possibility altogether. Such specific provision may be appropriate in cases where the law of the seat or the applicable procedural rules do not expressly provide such powers. Alternatively, the parties may wish (again subject to mandatory rules of the forum) to alter by contract the provisions concerning security for costs that might otherwise apply under the law of their chosen seat or the procedural rules of their chosen arbitral institution. This route, however, requires consensus from the parties which is rarely achievable once dispute resolution proceedings have been commenced.

Notes

- 1 [1999] 2 Lloyd’s Rep 39.
- 2 [1993] BCLC 532.
- 3 [2002] EWCA Civ 556.
- 4 The issue of whether security should be granted becomes more complex when a defendant advances counterclaims, particularly if these are based on the same facts as the original claims. Article 30(3) of the ICC Rules permits separate advances on costs to be fixed in relation to counterclaims. Failure to pay by one party can result in the deemed withdrawal of its claims (or counterclaims) but continuation of the remaining counterclaims (or claims). In practice, this may be a useful alternative to an application for security for costs.
- 5 See Comments Received from United Kingdom at the 39th session of the United Nations Commission on International Trade Law in New York between 19 June and 7 July 2006, published as A/CN.9/609/Add. 4.
- 6 See Note by the Secretariat of the meeting of Working Group II (Arbitration) of UNCITRAL in Vienna on 13 – 17 September 2004 as published in 740 PLI/Lit 1181.
- 7 In particular, article 17 of the 1954 Hague Convention on Civil Procedure provides:
No bond, nor deposit, under any denomination whatsoever, may be imposed on the ground, whether of their foreign character or of absence of domicile or residence in the country, upon nationals of one of the contracting States, having their domicile within one of such States, who are plaintiffs or intervene in the tribunals of another of such States.

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