

A global perspective on availability of security for costs and claim in international arbitration mirage or oasis?



Security for costs and security for claim are interim protective measures available during an arbitration. They are sought when one side is concerned that the other side may not have enough money to pay an adverse costs order or satisfy an award made against it. They require the party against whom they are ordered to set aside a sum of money to satisfy any eventual award or costs order. In theory, they are available under most arbitral rules but in practice they can be difficult to obtain in international arbitration. In this article, Elaine Wong and Gitta Satryani in Tokyo and Singapore respectively, and Chris Parker and Liz Kantor in London, draw on their recent experiences to consider the "optimum" conditions for seeking and obtaining these interim reliefs.

What is security for costs?

Security for costs is an interim measure that allows an applicant (usually the respondent) to secure an amount representing its arbitration costs, ie legal costs, tribunal's fees, administrative costs etc. This measure is grounded in the common law rule of costs following the event which provides that a successful party in legal proceedings is entitled to recover its legal and other costs incurred in the arbitration from the unsuccessful party.

There must be good reasons for securing such sums in advance, based on the claimant's inability to pay an adverse costs order against it. If security for costs is granted in favour of the applicant, the opposing party will be required to set aside a sum of money, usually an estimate of the applicant's arbitration costs, either in an escrow account or more commonly

by way of a bank guarantee, until the tribunal issues its final award dealing with arbitration costs.

What is security for claim?

Security for claim is an interim measure that allows an applicant (*i.e.* the claimant or the respondent in respect of its counterclaim) to secure the amount that it is claiming against the opposing party before the award is issued.

Like security for costs applications, there must be good grounds for securing the amounts claimed in advance of an award to that effect, based on the opposing party's likely inability to pay.



Arbitration Rules) but it is recognised and accepted that they fall within the ambit of the general power awarded to tribunals to order conservatory or interim measures. Similarly, on the investment arbitration front, Article 47 of the International Centre for Settlement of Investment Disputes (ICSID) Convention and Rule 39 of the ICSID Arbitration Rules, which grant tribunals the power to order provisional measures, have been used by a party seeking security for costs.

Given their wide availability in the commonly used arbitration rules, you might assume that these measures would often be applied for by parties in arbitration proceedings. Yet this is not the case. Applications for either measure are seldom made and many in the arbitral community consider them difficult to obtain. A 2014 ICC publication looking at decisions concerning security for costs in ICC arbitrations noted that of the 9 or 10 applications surveyed, only three were successful. Where granted, they were granted only in part and subject to conditions.

Yet this picture is not mirrored in our own more recent experience. While security for costs or claim applications have arisen in only a small percentage of our global caseload, we have seen more positive outcomes, with some 50% of applications being granted. Furthermore, the arbitrators have been receptive to the idea of granting relief in the particular circumstances in play in each of those cases.

Availability of security for costs and security for claim in international arbitration

Most arbitral rules give a tribunal the power to award security for costs and claim, either expressly or by implication. The London Court of International Arbitration (LCIA) Rules and the Singapore International Arbitration Centre (SIAC) Rules both expressly provide powers to award security for costs (Article 25.2 and Rule 27(j) respectively) and security for claim (Article 25.1(i) and (iii) and Rule 27(k) respectively).

In contrast, the International Chamber of Commerce (ICC) Rules and the United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules do not make specific reference to these forms of relief in Article 28 (ICC Rules) and Article 26 (UNCITRAL

ARBITRAL RULES	SECURITY FOR COSTS	SECURITY FOR CLAIM
UNCITRAL	General power under Article 26 - <i>Interim Measures</i>	
ICC	General power under Article 28 - <i>Conservatory and Interim Measures</i>	
CIETAC ¹	General power under Article 23 - <i>Conservatory and Interim Measures</i>	
ICDR ²	General power under Article 24 - <i>Interim Measures</i>	
ICSID	General power under Article 47 of the ICSID Convention read with Rule 39 - <i>Provisional Measures</i>	
LCIA	Article 25.2	Article 25.1
SIAC	Rule 27(j)	Rule 27(k)
HKIAC ³	Article 24	General power under Article 23 - <i>Interim Measures of Protection and Emergency Relief</i>

Does this indicate a shift amongst arbitration practitioners towards using these forms of relief and amongst arbitrators to granting them? It may well be that parties, counsel and arbitrators have begun to recognise that in the right cases, these are tools which can help protect parties and, used appropriately, assist in bringing about the efficient and effective resolution of disputes. If this is so, what are the "right cases"? When should security for costs and security for claim be sought and what are the criteria needed to obtain them?

Criteria for obtaining security for costs and security for claim

There is no uniform test which applies to an application for security for costs or claim and the rules of arbitral institutions are generally silent as to the exact circumstances that need to exist or conditions that need to be met. The 2015 Guidelines issued by the Chartered Institute of Arbitrators in relation to security for costs applications suggest that tribunals should take into account:

- the prospects of success of the claims and defences;
- the claimant's ability to satisfy a future adverse cost award and the availability of the claimant's assets;
- and whether it is fair in the circumstances to make the orderⁱⁱ.

Our experience suggests that in considering applications of this nature, tribunals are less concerned about what law should be applied and tend instead to focus primarily on the justice of the case – for example, in the context of security for costs, balancing the applicant's interests and the risk that any order granted may prevent the opposing party from pursuing a meritorious claim. Based on our experience, the above table distils factors that have been considered relevant or important for tribunals when considering such an application. It is important to note that which (if any) of these principles will be relevant will depend on the particular facts of a case: as discussed below, some tribunals will disagree about the relevance of, or the weight to be placed on, a number of these criteria.

Clearly, these considerations (and the major arbitration rules) leave the tribunal with a considerable latitude to reach what it considers to be the right outcome – indeed, the balance of convenience and the fairness test are very much dependent on the equities of the case and are often assessed by tribunals at the end of their consideration to justify ruling one way or the other. To use the words of ICC's previous Secretary General, these considerations "exemplify arbitration as an art"ⁱⁱⁱ.

SECURITY FOR COSTS	SECURITY FOR CLAIM
Likelihood that the party who would be subject to the order would satisfy a final costs award	Likelihood that the party who would be subject to the order will satisfy the final award
Whether the tribunal has <i>prima facie</i> jurisdiction over the merits of the claim	
Whether there has been a change in financial circumstances since the parties agreed to arbitrate their disputes (whether the balance of risk allocation under the contract has changed)	
Whether the likely harm prevented (by the order sought) outweighs the likely harm caused by granting the application (the 'balance of convenience')	
Whether it is fair in all the circumstances to make the order (the 'fairness test')	
The prospects of success of the claims and defences in the case (whether the applicant has a <i>prima facie</i> case on the merits)	

Making the case for security for costs or claim: considerations for the applicant

i. Proving the opposing party's inability or unwillingness to pay

It is fundamental for the applicant party to show that the other party does not have the finances to satisfy an adverse costs order or award. The applicant party will invariably need to demonstrate that there is a high risk that the opposing party will not satisfy any final award, on costs or on the claim, as the case may be. The applicant may be faced with the practical problem of producing evidence to this effect. Evidence required may involve the claimant's financial records, evidence of lateness or missed payments and may require evidence from fact witnesses familiar with the opposing party's financial position.

Tactically, a good way of addressing this issue is to write to the party that would be subject to the order (or their lawyers) asking for information regarding their financial status, which, if provided, can then be used to evidence the application. This can often be a win-win tactic. You may obtain the information you need to make the application or, in the event that evidence of financial solvency is provided, save yourself the cost and time of making an application that will likely fail. Equally, if the party refuses to provide such information, that refusal can also be evidenced in the application, and may be a critical factor in the tribunal's decision. In a recent successful application for security for costs, the tribunal listed as a key consideration in its decision to award our client security for costs the fact that the party responding to the application had led insufficient evidence of its financial status, such that the tribunal could not be satisfied that it would be able to meet an award of costs.

Where security for claim is sought, it is very unlikely to be enough to simply show that the opposing party is resident or has assets outside of the jurisdiction of the arbitral seat or is resident or has assets in a jurisdiction where the enforcement record is uneven. As discussed below, these may well be seen as part of the risk the applicant took in choosing to transact with

the opposing party in the first place. More commonly, the applicant needs to show that the opposing party is actively seeking to move or dissipate its assets to avoid paying a future award against it. This information may not be easy to come by. It may require detailed analysis into a company's legal structure and ownership, and the services of local legal advisors or investigators to carry out in-depth analysis into transactions which may evidence such an intention.

In a recent successful security for claim application, the applicant was able to persuade the tribunal by providing evidence that:

- the opposing party was a state-owned enterprise with no significant assets outside of its home state, coupled with evidence that the courts in that state have a poor record of enforcement of arbitral awards, especially arbitral awards against the state and state owned entities;
- the opposing party was actively trying to move assets back into its own jurisdiction and out of reach of the applicant;
- the opposing party's key asset, over which the applicant had security, was in the process of being wound up on suspicious grounds and was subject to a foreign injunction preventing enforcement of that security.

ii. The opposing party's financial circumstances: material change and the role of the applicant party

Once the applicant has demonstrated the respondent's likely inability to pay, further hurdles need to be overcome. For example, it will assist an application if the applicant can demonstrate that the respondent's inability to pay has not been caused by the applicant's actions. In looking at this question, the tribunal will usually focus on whether that "causation" has been in some way intentional or "unfair"; not simply as a result of the commercial terms of the parties' agreement. Equally, tribunals will be unlikely to exercise their discretion in favour of an application for security for costs, however impecunious the opposing party, if they believe it is being used to stifle a genuine claim.

Another common roadblock to an order being granted is the degree or extent of the change in circumstances of the opposing party's financial position between the time the arbitration agreement was entered into and the commencement of the arbitration. The argument here is that the risk of the counterparty's impecuniosity should have been investigated as part of the due diligence carried out before contracting and factored into the parties' commercial terms. The application will therefore be stronger if it can be shown that any change in the other party's financial position was unforeseeable at the time the arbitration agreement was entered into.

In one recent arbitration, the tribunal hearing the application for security for costs noted that the applicant did not seem concerned when it entered into the agreement containing the arbitration clause that the opposing party was a special purpose vehicle with no sizeable assets. On this basis, the tribunal did not think that the opposing party's impecuniosity was sufficient reason to grant security for costs for the applicant.

Conversely, in an application for security for claim where the writers successfully obtained an order securing a portion of the amount in dispute, the tribunal noted that our client (the applicant) was comfortable entering into the arbitration agreement because the opposing party's participation (and financing) was backed by a state party. However, by the time the arbitration was commenced, the opposing party had lost the state-backed financing. This change was considered by the tribunal to swing the balance in favour of granting security for claim.

Of course, the weight attached to arguments such as this may vary from case to case: if, for example, the applicant can show why issues of this nature were not a concern at the time of the contract (or, at least, not a concern that could be addressed), it may be able to persuade the tribunal to attribute limited weight to this criteria.

iii. Relevance of the merits

Whether the prospects of the applicant's claim should be a relevant consideration in granting these protective measures is often debated. Whilst the merits of a claim are usually a key factor in court applications (and indeed are specifically listed in the test under the English Civil Procedure Rules, for example), it is arguable that different considerations apply to arbitration proceedings. This is because the judge hearing the application in court is usually not the judge who will decide the merits of the dispute. Conversely, there is often a concern in an arbitration context that, as the same tribunal hearing the merits of the dispute will also decide interim applications, taking account of the merits could amount to a prejudgment of the merits of the case before any evidence has been heard.

In a recent successful application, the tribunal even noted the paradox that the Chartered Institute of Arbitrators Guidelines refer to both the relevance of the merits of the claims and the need not to prejudge the merits of the case. On that basis, the tribunal stated that it did not consider the merits an appropriate factor in that case.

Nonetheless, where a party believes it has a robust position on the merits, it may still be worth making the most of the merits position, as this could still influence the decision-making process implicitly, even if the tribunal does not wish to be perceived as prejudging the merits of the dispute.



iv. Relevance of third party funding in security for costs applications

Applicants have increasingly tried to rely on the use of third party funding by the opposing party to justify security for costs on the basis that (i) the claimant/opposing party is likely to be impecunious (hence the need for third party funding) and will not be able to satisfy any costs award, and (ii) the third party funder who is not a party to the arbitration has no obligation to satisfy any costs award and will be able to walk away if unsuccessful.

There is currently no consensus as to whether this fact alone is sufficient to order security for costs. In a particular security for costs application in which we were involved, the tribunal considered this to be relevant but not determinative. There had to be other factors, ie exceptional change in circumstances, to persuade the tribunal.

“However like an oasis in the desert, security for costs or claim are not often available and there is certainly a high bar to be met in order to obtain these reliefs.”

The concern over third party funding has been seen most clearly in recent investment treaty cases. In the ICSID case of *RSM v St Lucia*, which was the first known case to grant security for costs in an ICSID matter, the claimant was relying on third party funding to bring the claim against St Lucia. The majority of the tribunal found that the third party funding, coupled with the claimant's proven history of non-compliance with costs orders and awards gave rise to concerns that the claimant would not comply with a costs award against it. Some members of the tribunal had very strong views on the subject, with one arbitrator suggesting that, once third party funding was demonstrated, the onus was placed onto the claimant to make a case as to why a costs order should not be made. Another, however, strongly disagreed and maintained that third party funding should not have been a factor in the decision-making process.

v. Your tribunal's legal approach

Orders for security for costs are part of the civil procedure of many common law systems. They aim to protect respondent parties from bearing the legal costs of an unmeritorious claim by an impecunious claimant. This, in turn, is tied to the underlying principle that a losing party should have to pay the costs incurred by the successful party. While rare, security for claim is also an accepted part of the common law approach, again, seeking to protect the worthy claimant from efforts by the respondent to dissipate assets.

However, whilst this principle is accepted in common law jurisdictions, it is rarely seen in civil law jurisdictions. This is not to say that arbitrators coming from civil law jurisdictions will never grant security for costs. Experienced arbitration practitioners from all backgrounds will be open to the idea of such an application, but some civil law practitioners may be less ideologically inclined towards the idea. Where a party is aware from the outset that they may wish to make such an application, this may be a relevant factor in choosing their arbitrator.

Tactics for making and defending a security for costs or claim application

The discussion here is intended to show that these reliefs are not illusory – they have been made available to applicants who are truly in need of protection. However, like an oasis in the desert, they are not often available. This does not mean that prospective applicants should write them off. They bring very real benefits and under the right circumstances can (and should) be granted.

As discussed above, certain approaches and tactics may assist an applicant in maximising its chances of success. These include creating a paper trail of refusal to provide financial information, collating evidence of bad faith behaviour or the dissipation of assets, and tailoring the application so that it fits with the tribunal's background. Prospective applicants should always consider whether they should make an application early on in the proceedings, carefully considering whether the evidence needed to tip the balance in its favour is available.

On the flipside, the opposing party needs to be alive to the evidence that an applicant will need to provide to convince a tribunal that the balance of convenience and fairness lies with them. For example, it will want to make arguments that will resonate with the tribunal, appear co-operative and dispel any conspiracy theories. It may be worth arguing, for example, that the applicant should have known the position all along and that the position has not changed. In a security for costs context, the claimant will often argue that a genuine claim would risk being stifled by an order. While it might seem counter-intuitive, real consideration should also be given to whether it may be advantageous to co-operate with requests for financial information or evidence of ability to pay or even to provide bank guarantees.

ENDNOTES

1. China International and Economic Trade Arbitration Commission
2. International Centre for Dispute Resolution
3. Hong Kong International Arbitration Centre
 - a. ICC International Court of Arbitration Bulletin Vol 25 Supplement 2014, "Procedural Decisions in ICC Arbitration: Security for Costs"
 - b. The Chartered Institute of Arbitrators, "International Arbitration Practice Guideline: Applications for Security for Costs".
 - c. *Supra note (i)*.
 - d. *RSM Production Corporation v. Saint Lucia*, ICSID Case No. ARB/12/10, Decision on Saint Lucia's Request for Security for Costs (13 August 2014).

ABOUT THE AUTHORS



**Chris Parker,
Partner**

Chris Parker, Partner

Chris is a partner specialising in international arbitration.

Elaine Wong, Partner

Elaine is a dispute resolution specialist and partner in the Tokyo office



**Elaine Wong,
Partner**

Gitta Satryani, Senior Associate

Gitta is a senior associate in the Singapore office

Elizabeth Kantor, Senior Associate

Elizabeth is a senior associate in the London office.



**Gitta Satryani,
Senior Associate**



Herbert Smith Freehills is one of the world's leading professional services businesses, bringing together the best people across our 26 offices, to meet all your legal services needs globally. We can help you realise opportunities while managing risk.



**Elizabeth Kantor,
Senior Associate**