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Security for Costs in Investment Arbitration: Who Should Bear the Risk of an Impecunious Claimant?

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When allocating costs, investment arbitration tribunals apply two principles: a "pay your own way" principle which provides that each party pays its own legal costs and they effectively share the costs of the proceedings, and secondly a "costs follow the event" or "loser pays" principle which provides that the losing party bears the costs of the proceedings including the legal costs of the successful party. The latter is more frequently applied in its "adjusted" form, i.e. the costs are allocated in proportion to the relative success of the parties on different issues.

The "pay your own way" principle, applied by the majority of tribunals, was perceived as the traditional approach in investment arbitration. However, this no longer seems to be the case as the "(adjusted) costs follow the event" principle becomes more frequently endorsed.

As the application of the "costs follow the event" principle increases, so do the number of issues to be dealt with by the tribunals in investment arbitration. In the context where the successful respondent state can expect to be awarded (at least some of) the costs, security for costs comes under the spotlight.

The award, naturally, has value for the parties as long as it is not just a dead letter, but an effective enforceable decision. From the aspect of the respondent state, it means that at the end of the day, if it wins the arbitration it will be able to recover at least some of the taxpayers' money spent on the defence from the groundless claim(s).

However, if an impecunious claimant is on the opposite side, recovery of the awarded costs becomes mission impossible. And although the tribunal may have recognised and acknowledged the respondent's right to recover the costs, the award becomes of no value to the respondent. Arbitration disputes are not equally burdensome in respect of various states world-wide, and while the consequences of some "worthless" awards may pass unnoticed in certain states, they can have significant adverse effects on others.

The respondent state's only recourse to prevent these situations (and indirectly protect integrity of the proceeding and the award) is to request security for costs early

in the arbitral proceedings. Such request would also be a strong defence tool against arbitral "hit and run" (claims funded by a third-party funder that cannot be subject to any costs awards).

But, the tribunal confronted with such request faces another concern: would an order for security for costs prevent the claimant from pursuing a meritorious claim? To order the claimant, who may indeed be facing some financial difficulties, to post a security equivalent to the respondent's expected costs, may well be equal to depriving it of its right to access the arbitral justice. Should the claimant's financial position affect its right of access to arbitral justice in the first place? And, moreover, what if the very reason the claimant found itself in financial difficulties is as a result of the actions/omissions of the respondent state, which forms the subject matter of the claim?

Clearly, two conflicting, yet legitimate interests exist: the right of access to arbitral justice and the right to recover awarded costs. Yet, someone has to bear the risk of the impecunious claimant.

There are no set rules on this topic. The overall impression gleaned from the still very scarce cases that deal with the issue is that the tribunals were cautious and even reluctant to order security of costs save under some exceptional circumstances (claimant's track-record of failing to comply with the arbitral tribunal's order, claimants stripping itself of the assets, abuse or serious misconduct, etc.)

The first obvious step for the tribunal is to determine whether it indeed is dealing with the case of an impecunious claimant. In some existing decisions security for costs was denied as the respondent was unable to meet the burden of proof and substantiate its allegations that the claimants will not be able to pay the costs at the end of the arbitration.

However, there are other cases where this is not an issue: empty shell companies, insolvent companies, companies already involved in bankruptcy proceedings, etc. In situations where the respondent is only concerned that the claimant will not be able to pay its costs at the end of the arbitration, and it becomes clear to the tribunal that the claimant has no assets (and, therefore, that it will not be able to pay the costs of the arbitration), is it indeed necessary and justified to request existence of additional, extraordinary circumstances to order security for costs? Is it indeed necessary for some kind of bad faith to be evident on the claimant's side? From the respondent's perspective, inability to recover the awarded costs is equally harmful, regardless of whether the claimant was acting in bad faith or not.

Wouldn't it be justified for the tribunal to ensure only that it were not the respondent's actions/omissions that caused the claimants' lack of assets in such cases? However, this test is not a simple exercise either. In fact, it will likely require the tribunal to analyse and take a position on certain issues on the merits very early in the process (to determine relevant actions/omissions, attribution, consequences, etc.). Additionally, it also begs the question, what if the tribunal determines that the respondent's actions/omission only contributed to the claimant's poor financial position, but did not exclusively or even predominantly cause it? What would the

threshold then be when this contribution prevents ordering security for costs?

Moreover, the heated third-party funding debate pending in investment arbitration community just adds more controversy to the issue of security for costs.

It has become the increasingly adopted view (also recommended by ICCA-QMUL TPF Task Force in their Report on Security of Costs) that the mere existence of the third-party funding agreement should not automatically and on its own indicate that the claimant is impecunious. Yet, it does stir up the debate as to what it does indicate.

Is it necessary to order disclosure of third party funding agreements when analysing securing for costs requests in this setting? How is a tribunal supposed to analyse the third party funder's influence without reviewing the terms of its engagement?

There are views that the existence of a third-party funding agreement can actually be an indication that the claim is not frivolous. This follows from the fact that third-party funders conduct their own due diligence and are arguably not willing to fund meritless claims. Prior to drawing any conclusions in this respect, it would be necessary to analyse who the third party funder is (institution or individual with interests of its own), its background and portfolio. Further, if the third-party funder finds the claim meritorious and is willing to fund it why would it not be appropriate to shift the risk to the third-party funder and request it to advance the respondent's costs?

Concerning this topic, it seems that the only undisputed facts are the following: the parties and their counsel will have a tough job making a prediction of how successful a request for security for costs will be, and we are yet to see what standards will be developed by the tribunals for this issue in arbitrations to come.

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