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Security for Costs in International Arbitration: What's Missing from the Discussion?

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Security for costs, a measure which is perceived as a savior for those who are forced to arbitrate with (allegedly) impecunious parties, can have several connections with the industry of third party funding. Third party funding, as a new trend in international arbitration, has certainly disturbed many waters, including those related to security for costs. Namely, if a case involves an impecunious, or even bankrupt, claimant who sought the funds from a third party, a respondent may be strongly interested in seeking to protect its adverse costs. Since rendering the final award against the third party funder is initially precluded due to the lack of the funder's involvement in the negotiation and performance of the contract between the parties, the respondent may seek relief of a procedural nature, in particular, an order for security for costs. The interconnection of the security for costs and third party funding was widely discussed: from pointing out the fact that third party funding signalizes the lack of financial means on one side, which could influence a decision as to the requested security for costs, to having a discussion on the possibility to render an adverse costs award against the funder itself. These issues are not easy to solve, either theoretically or practically. Do not despair, there are initiatives which are aimed at fostering deeper understanding of third party funding, security for costs and allocation of costs, and their interrelation.

As authors have pointed out many times, in the heart of the decision-making process regarding security for costs, two main principles conflict: one is the right of the respondent (who is usually the party requesting the security) on the secured payment of a potential adverse costs award and the second one is right of the claimant to access to arbitral justice, which is usually denied when the (impecunious) claimant fails to deposit the security. Any attempt to balance these two is almost an utopian fantasy, as much as to have any grounded discussion on the other requirements necessary for ordering security for costs. The "I will know when I see it" argument seems to be in the background of almost all other requirements which were developed in international arbitration practice: urgency, threatening harm, proportionality, the *prima facie* establishment of the case etc.

The *exceptional* nature of security for costs is also often mentioned in the argumentation of the claimants. An exceptionality of this measure stems from the fact that the security for costs is not a *regular* payment mechanism in international

arbitration. Namely, international arbitration practice has so far established two payment mechanisms which are by now already recognized in arbitration rules of almost all known arbitration institutions, albeit with possible nuances in some aspects. The first payment that takes place in arbitration proceedings is the payment of the registration fee, followed by the payment of an advance on costs by both parties in equal shares. The payment of the registration fee is final, non-reimbursable, and it is supposed to cover initial *current* costs of arbitration proceedings. The payment of the advance has a rather *provisional* nature, and its payment serves future goals – the payment of arbitrators' fees and expenses and administrative charges at the end of the proceedings. So, where does the security for costs fall in this track? In that regard, the security for costs shares many similarities with the advance on costs. They are both payments of *provisional* nature which heavily depend on the final allocation of the costs in the last award.[1)] However, their coverage is rather different. The advance is covering arbitrator's fees and administrative charges, which are shared and paid in advance by the parties. The security for costs can be expected (and calculated based on that expectation) to cover any costs incurred by the respondent during arbitration proceedings. This would include the respondent's share of the advance, but also its *legal costs*. In other words, when security for costs is requested and paid, this leads to the claimant not only paying the registration fee, its share of the advance, and its (claimant's) legal costs, but it is also making a deposit which should cover all these costs and fess (except for the registration fee) incurred on the respondent's side (in the event the arbitrators allocate the respondent's costs to the claimant at the end of the proceedings). When this is observed from a very functional approach, it can be said that the claimant is financing the proceedings, at least *provisionally*.

The *provisional* aspect of security for costs stems from the final allocation of costs in the last award. Once this award is rendered, containing the final allocation of costs, the destiny of security for costs, up to this point functioning as a deposit, is decided as well. It will either be paid back to the claimant, or used to cover the costs of the respondent. While the final allocation of costs is often missing from the discussion on whether security for costs should be granted or not, its importance should be elevated to a higher priority than it is currently in practice. Due to the function that this measure serves, the justification for security for costs can barely be achieved if the party requesting it fails to show at a minimum that it is reasonable to expect for the costs to be allocated to the opposing party. Since arbitrators in international arbitration enjoy wide discretion as to the standard of allocation, which is to a certain point designed by the parties as well, the decision on costs are hardly predictable. The so-called prevailing standard of the "costs follow the event" is for sure recognized in the practice, but it is not set in stone. The rules on allocation are indeed the rules that precede the whole discussion on the security for costs. Justification for such a measure can and should not be achieved in those cases where a clear standard on the allocation of the costs cannot be carved out from the applicable rules and the parties' agreement. Nevertheless, practice shows the opposite trend, as if the allocation is taken for granted and the focus of the discussion transfers to the financial situation and behavior of an (impecunious) party, the probability of non-payment of the adverse cost award, and the reasonability of the success on the merits.

The decision on the merits of the case encompasses the decision on the allocation of

costs, as the standard which arbitral tribunal applies is of a substantive nature. This standard is the standard which the party requesting the security should use as the foundation for its request. In other words, the *prima facie* requirement should be met on this matter as well. It is a completely different issue how this can be done without any pre-judgement regarding the costs. There are many circumstances that are taken into account by arbitral tribunals when rendering decisions on costs and many of them are not known at the very early stages of the proceedings. This reality speaks even more in favor of the *exceptionality* of security for costs as a measure available in international arbitration and the cost allocation standard should definitely receive more attention when such requests are discussed.

When focusing specifically on situations involving a third party funder, as mentioned previously, there are two possible ways in which the respondent may obtain protection. First, the respondent can ask the arbitral tribunal or the court to take into account third party funding when deciding on granting the security for costs. On the other hand, the most effective relief would be achieved if the respondent can successfully obtain and enforce an adverse costs award against the funder. Perhaps, once the latter becomes possible in arbitration (which may come to fruition sooner rather than later given the recent developments regarding third party funding), as it is in civil litigation in some jurisdictions, the need for security for costs will drop tremendously. Until then, caution should be maintained within each and every such case when ordering the security for costs.

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References

↑1 For the purpose of this post, the author has adopted the phrase “last award” instead of “final award” as a term describing an arbitral decision which completes the mission of an arbitral tribunal.

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