New Vienna Rules: Where do you stand on Security for Costs?

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Since their inception in 1975, the Vienna Rules (Rules of Arbitration and Mediation of the Vienna International Arbitral Centre) have undergone a number of major reforms keeping them abreast of the fast-moving tides of legal development in international arbitration. The latest revision of the Rules as from 1 January 2018 (previously covered in this blog) also introduced an explicit regulation of the tribunal's power to order security for costs. By acknowledging such power, the Vienna Rules take an innovative and truly international stand, however stipulating a strict standard for security for costs orders which must be reserved to exceptional cases.

Clarification: Security for costs in exceptional circumstances

The new rule comes at a time when there is still little consensus[fn] Whilst some reject the tribunal's power to order security for costs altogether, other scholars base such orders on the tribunal's procedural power to conduct the arbitral proceedings within its discretion or – and this is the prevailing opinion – frame them as interim measures. The drafters of the Vienna Rules sided with this last approach.[/fn] on the admissibility and preconditions under Austrian law of this legal instrument. Unsurprisingly, the new provisions sparked a lively debate when officially presented to the Austrian arbitration community at the sixth ArbAut Forum on 19 February 2018. Considering the absence of statutory provisions and case law on security for costs in arbitration in Austria and (as it appears) in many other civil law jurisdictions,[fn] Whereas institutional rules in common law jurisdictions have traditionally included express rules (e.g. LCIA, SIAC, HKIAC), those in civil law jurisdictions were hesitant to address the issue (see, however, Article 38 of the new SCC Rules as of 1 January 2017; whilst the Belgian CEPANI Rules set out that security for costs may be ordered as an interim measure, they stop short of providing further guidance; the new DIS-Rules – as of 1 March 2018 – refrain from expressly regulating security for costs).[/fn] the new Vienna Rules 2018 bring valuable clarification and legal certainty. The Vienna Rules working group responded to what they felt was a practical need for security for costs orders in exceptional cases, not least in view of the recent rise of third party funding.[fn] Third party funding, too, was amongst the topics discussed by the Vienna Rules working group but eventually did not make its way into the new Rules.[/fn] The good news upfront: Parties arbitrating under the Vienna Rules will now spare the time and costs which are often lost in debating the tribunal's authority to order security for costs. Let's look at some of the details:

Interim Measure

As from 1 January 2018, Article 33(6) and (7) Vienna Rules authorize tribunals to order security for

costs as an interim measure, they read as follows:

> (6) The arbitral tribunal may, at the request of the respondent, order the claimant to provide security for costs, if the respondent shows cause that the recoverability of a potential claim for costs is, with a sufficient degree of probability, at risk. When deciding on a request for security for costs, the arbitral tribunal shall give all parties the opportunity to present their views.
> (7) If a party fails to comply with an order by the arbitral tribunal for security for costs, the arbitral tribunal may, upon request, suspend in whole or in part, or terminate, the proceedings (Article 34 paragraph 2.4).

Under Article 33(6) Vienna Rules, security for costs orders can be imposed on the **claimant** (including on the counter-claimant) at the request of respondent (including counter-respondent). The wording of the Vienna Rules excludes – in line with the intention of its drafters – security for costs orders against the respondent. Before deciding on the request for security for costs, the tribunal is required to grant all parties *"the opportunity to present their views"* (para 6): This general principle that interim relief may not be granted ex-parte (Article 33(1)) thus also extends to security for costs. Also, although not explicitly mentioned in Article 33(6) Vienna Rules, the tribunal first must ascertain its jurisdiction prima-facie based on the information before it. Requests for security for costs will typically be raised at the outset of the arbitration or, subsequently, after respondent becomes aware of circumstances giving rise to an enforceability risk. Whilst Article 33(6) Vienna Rules does not stipulate a strict period for making the request, the tribunal may consider any "delays" in the exercise of its discretion to grant the order.

Substantive requirements

Under Article 33(6) Vienna Rules, the respondent needs to demonstrate that, first, there is a possibility of an adverse costs award, and, second, that the enforceability of this award is at risk. The Vienna Rules do not spell out further requirements. The second prerequisite will be the real test in practice:

Potential costs claim

As envisaged by the working group, the first prerequisite ("*potential claim for costs*") will hardly ever present an obstacle in practice. It will operate to exclude security for costs where, based on the **parties' agreement on costs allocation**, an adverse costs award is not conceivable in the first place, e.g. where the arbitration clause provides for the "American rule" to govern the costs decision. In most cases, respondent will be able to show that the costs-follow-the-event rule may (amongst other principles) be applied in a prospective costs decision. The reference to a "*potential claim for costs*" also includes an additional requirement, namely that respondent has a (potential) defence case on the merits at all so that the loser pays rule could be applied in the first place. However, the procedural arguments on security for costs are not the place to engage the tribunal in (and for the tribunal to prejudge) the merits of the case. This requirement will therefore only strike out requests in such exceptionally rare cases where claimant can demonstrate that based on the limited information available on file **respondent's case is manifestly groundless**, which would exclude even the remote possibility of a claim for costs.

Recoverability risk

In practice, the parties' arguments will concentrate on the second requirement stipulated by the

Vienna Rules: Respondent must *"show cause that the [potential costs claim's] recoverability is, with a sufficient degree of probability, at risk"*, which is the case where claimant will have no funds to pay the costs award and where his assets will not be readily available for an effective enforcement. Such risk may materialize e.g. where claimant takes steps to frustrate a costs award, or where claimant is impecunious (e.g. a special purpose vehicle with no sizeable assets). Amongst other things, as was envisaged by the working group, the involvement of a third party funder may play a role in assessing the recoverability risk, but only if the third party funding indicates the impecuniosity of the party.

The language *"show cause"* is the English translation of the German *"glaubhaft machen"* ("show credibly"), which is defined in Austrian civil procedural law as reducing the standard of proof (Section 274 Austrian Code on Civil Procedure) to that of preponderant probability. Thus Article 33(6) three times refers to the probability of the enforcement of a costs award, namely by introducing the standard of preponderant probability as implied in *"glaubhaft machen"*, by referring to a *"sufficient degree of probability"* and by the use of the term *"risk"*, which again connotes a likelihood, namely that of an undesirable event materializing. Tribunals likely will focus on the requirement of "a sufficient degree of probability", which works to increase the threshold for a security for costs order: Security for costs presupposes a **high risk** of non-recoverability. Not in every case of a preponderant probability of non-enforceability, but only where such probability is sufficiently high may security for costs be ordered.

Tribunal's discretion

The Vienna Rules do not set out further express prerequisites. If the tribunal concludes that the requirements of Article 33(6) are met, it **"may" grant the order within its discretion**. Conversely, respondent has no procedural right to a security for costs order. Tribunals will exercise their discretion diligently and restrictively and limit security for costs orders to **exceptional circumstances** which manifestly call for such orders. This does not only flow from the current arbitral practice to limit security for costs to "very particular circumstances" (CIArb Guidelines on Applications for Security for Costs, Preamble, item 2) but will typically be corroborated by the reasonable expectations of the parties who agree on the Vienna Rules expecting a civil law style arbitration. Usually, the general rule that claimant needs to substitute respondent's share on the advance on costs will suffice to deter futile claims.

In this vein, tribunals will typically treat the express substantive requirements for a security for costs order set out in Article 33(6) as a **minimum threshold**. Whilst a request may pass this – high – minimum threshold, the tribunal may still deem it inappropriate (or: "unfair") to order security for costs. This may e.g. be the case where based on the information on file security for costs is **unaffordable**, i.e. where both claimant as well as any third parties holding a material economic interest in the proceedings on claimant's side (including the main shareholders) are impecunious. In such case, the tribunal may wish to respond to concerns that ordering security for costs would unjustly stifle a genuine claim. Security for costs orders would then likely be restricted to manifestly abusive claims. Typically, this will also follow from an *in favorem validitatis* interpretation of the underlying arbitration clause: Imposing security for costs where it is unaffordable may – at least under Austrian law – entitle claimant to terminate the arbitration agreement for due cause.

It has also been submitted that if respondent was responsible for claimant's impecuniosity this should militate against a security for costs order. However, this goes a far way into the merits of the case. Tribunals under the Vienna Rules may therefore be reluctant to open the interlocutory proceedings on security for costs to such arguments. Another factor which is sometimes mentioned as relevant is Respondent's failure to pay its share on the advance on costs. In the author's view, however, such failure must not exclude a security for costs order; rather, its legal consequences are spelled out in Article 42 Vienna Rules.

To recap: Whilst a preliminary and prima facie assessment of (certain aspects of) the merits of the case cannot always be avoided (most importantly: no stifling of legitimate claims), under the Vienna Rules there is no room for assessing the prospects of success of the parties' claims and defences on the merits as a standard step in assessing a security for costs request.

Scope and legal consequence

According to Article 33(7) Vienna Rules, a failure of claimant to comply with a security for costs order entitles the tribunal to (wholly or partially) suspend or even terminate the proceedings (Articles 33(7) and 34 para 2.4 Vienna Rules) upon request of respondent. Again, as for the issuance of the order, the tribunal enjoys discretion as to the suspension or termination of the proceedings where claimant fails to provide security. Tribunals will have due regard to claimant's right to (effective) access to (arbitral) justice, also considering claimant's reasons for non-provision of the security.

Overall, under the new Vienna Rules security for costs orders are admissible but will be the exception rather than the rule. Tribunals will be called upon to act diligently and robustly, discouraging belligerent respondents from any attempts to misuse security for costs applications for prolonging proceedings and increasing costs.