Kluwer Arbitration Blog

Security for Costs Against (Non-Sanctioned) Russian Claimants? – An Overview Under the Vienna Rules

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Security for costs can be an effective tool to protect the respondent from an arbitration in which a potential costs claim against the claimant is irrecoverable. While the specific requirements for a security for costs order are determined by the applicable institutional rules or arbitration laws, the respondent applying for security for costs will generally have to prove the existence of a risk of irrecoverable costs. The risk of irrecoverable costs exists typically when the claimant lacks funds to pay an adverse costs award or has started to hide assets from the respondent. Since the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 10 June 1958) ("NYC") has been ratified by over 170 states, little has been written on the question of whether a tribunal may order security for costs when the recognition and enforcement of a potential costs award itself is at risk. Since the NYC obliges its contracting states to recognize and enforce foreign arbitral awards, arbitral tribunals will usually refrain from questioning compliance with the NYC.

However, at least in relation to the Russian Federation, this view may now change. Given the Russian Federation's current stance towards "unfriendly states" and the recent Russian court practice prohibiting foreign claimants from initiating or continuing with arbitration outside of Russia, there is a conceivable risk that Russian courts will refuse to enforce foreign arbitral awards rendered in "unfriendly states" based on Russian state interests and fair trial considerations.

In this blog post, the authors argue that where the seat of arbitration is in an "unfriendly state", the broad language of the Vienna Rules 2021 ("Vienna Rules") allows the respondent to request security for costs against any Russian claimant, whether or not it has been sanctioned. The risk that a costs award is not enforceable in Russia may be displayed by recent decisions of the Russian state commercial courts (so-called *arbitrazh* courts).

Requirements Under Art 33(6) Vienna Rules

Art 33(6) Vienna Rules contains an express provision on security for costs. Its wording is straightforward and reads as follows:

> *The arbitral tribunal may, at the request of a party, order any party asserting a*

> *claim or counterclaim to provide security for costs, if the requesting party shows cause that the recoverability of a potential claim for costs is, with a sufficient degree of probability, at risk.* […].

Under Art 33(6) Vienna Rules, three requirements must thus be met: (1) a request from the respondent/counter-respondent, (2) a potential costs claim, and (3) the showing of a risk of non-recoverability of the potential costs claim.

Security for costs under the Vienna Rules may only be requested by the respondent or counter-respondent. Moreover, it goes without saying that the respondent/counter-respondent must have a potential claim for costs against the opponent. This means that security for costs cannot be ordered if no adverse costs award can be rendered, since, e.g., the parties have agreed that everyone bears their own arbitration costs or a defense is manifestly groundless.

Most importantly, the broad wording of Art 33(6) Vienna Rules does not limit security for costs to certain risks or to a showing of "exceptional circumstances" (regarding the latter, see e.g., Art 38 SCC 2023). In this vein, also the authoritative Vienna International Arbitral Center's ("VIAC") Handbook confirms that "[p]*ara 6 does not specify the nature of the risk to respondent's claim for recovery of costs. Every conceivable type of risk is covered* […]"[1] While the literature might suggest that the purpose of security for costs is to protect the respondent from an impecunious claimant only, this is a risk that perhaps typically, but not exclusively, occurs. Therefore, also other risks, if conceivable and sufficiently proven, are covered.

The respondent bears the burden of proof to show such conceivable risk. The standard of proof under Art 33(6) Vienna Rules is a "*sufficient degree of probability*", which is an autonomous and reduced standard of proof compared to, e.g., a "*high degree of probability*" or a "*preponderance of evidence*". Since every conceivable risk is covered under Art 33(6) Vienna Rules, a tribunal may order security for costs if the respondent shows with a sufficient degree of probability that the state, in which the assets are located, will not comply with the NYC.

The risk of Russian courts not complying with the NYC can be demonstrated by the decisions of the Russian *arbitrazh* courts since February 2022.

Recent Russian Court Practice

At the outset, the Russian Federation has introduced amendments to the Russian Arbitrazh (Commercial) Procedure Code by Federal Law No. 171-FZ of 08 June 2020, whereby the Russian *arbitrazh* courts were granted exclusive jurisdiction over disputes involving a sanctioned Russian party or disputes arising out of foreign sanctions. Moreover, the introduced amendments expressly grant Russian parties the right to request anti-suit injunctions preventing the foreign opponent from initiating or continuing with arbitration or state court litigation outside of Russia. As a result, Russian *arbitrazh* courts may disregard validly concluded arbitration agreements based on the (presumed) ground that access to justice is restricted for sanctioned Russian parties (or for disputes arising out of foreign sanctions) in foreign states that apply restrictive measures.

The amendments have increased, or at least, created the risk that Russian courts will not enforce foreign arbitral awards, in particular, if the sanctioned party has opposed arbitration outside of

Russia.

Following the military invasion of Ukraine on 24 February 2022, this risk now certainly also exists for parties having to enforce a foreign arbitral award rendered in an "unfriendly state" against a non-sanctioned Russian party. As a response to Russia's invasion, several states have imposed sanctions upon the Russian Federation. By Government Directive No. 430-r of 05 March 2022, the Russian Federation has classified those states (including, amongst others, the US, the UK, and all members of the EU) as "unfriendly states" and has launched countermeasures against them by several presidential decrees (see, e.g., Russian Presidential Decree No. 79 of 28 February 2022 and Russian Presidential Decree No. 95 of 05 March 2022).

The Russian *arbitrazh* courts explicitly base their decisions on questioning the impartiality of arbitral tribunals and institutions outside Russia when issuing arbitration-related interim injunctions on the above-mentioned state measures. For instance, in August 2022, the Moscow *Arbitrazh* Court granted Russian Railways' application for an injunction against Siemens AG to initiate arbitral proceedings administered by the VIAC. In reliance on the above-mentioned decrees, it held that a dispute involving a person located in an "unfriendly state" (here: Austria) will be considered a dispute on the territory of a foreign state without a fair trial. In general terms, the Moscow *Arbitrazh* Court also held that an objective and impartial judicial defense of a Russian legal entity can currently only be exercised within the territory and jurisdiction of the Russian Federation. In February 2023, the Moscow District Federal Arbitrazh Court upheld the decision to grant the application for an injunction to initiate VIAC arbitration of Russian Railways against Siemens Mobility GmbH. In this case, the appellate court stated with greater clarity that given the "unfriendly" actions by EU member states, there are no possibilities to protect the rights and economic interests of Russian Railways at VIAC. Strikingly, the decision shows that the Russian *arbitrazh* courts even doubt foreign arbitral institutions that have received the status of permanent arbitral institutions from the Russian government (here: VIAC).

Most importantly, the Russian *arbitrazh* courts are also competent to enforce and recognize foreign arbitral awards. This can only but show a risk that that Russian *arbitrazh* courts may also refuse recognition and enforcement of arbitral awards rendered in "unfriendly states" based on Art V(1)(b) NYC (*fair trial considerations*) and Art V(2)(b) NYC (*Russian public policy*) in favour of any Russian party, being sanctioned or not. The willingness of the *arbitrazh* courts to interpret the public policy exception broadly is displayed by a decision of the Stavropol Arbitrazh Court of November 2022. In this case, the court refused recognition and enforcement of a London Court of International Arbitration ("LCIA") award, amongst others, on the basis that the withdrawal of funds of persons controlled by "unfriendly states" violates Russian public interests, citing several Russian presidential decrees on countermeasures.

Moreover, the enforcement risk is exemplified by Russia's breaches of the most fundamental international law rules (the prohibition to use force – Art 2(4) UN Charter) in the context of Ukraine. Consequently, there is a risk that Russia will disregard its other international law obligations too, including the NYC.

Arbitration Agreements Concluded After 2022

The question arises as to whether the respondent may request security for costs if it has concluded

an arbitration agreement with a Russian claimant following Russia's military invasion and the development of the Russian court practice mentioned above.

For instance, in the context of impecuniosity, it is often mentioned that tribunals may require that the claimant's lack of funds was not known to the respondent when entering into the arbitration agreement. While the wording of Art 33(6) Vienna Rules does not require a change of circumstances since the conclusion of the arbitration agreement, the VIAC Handbook itself mentions the knowledge of the financial situation of the claimant as a factor to be taken into account when ordering security for costs.[2)] When it comes to impecuniosity, this consideration in the claimant's favor seems legitimate, as ordering an impecunious claimant to pay security for costs will often prevent the claimant from pursuing the claim further. However, this consideration cannot apply to a claimant with enough funds who may continue with the arbitration through payment of the security. Moreover, it should always be borne in mind that security for costs merely serves to secure the respondent's expected arbitration costs. In case the respondent is not awarded a reimbursement of costs, the security for costs is to be returned to the claimant.

In sum, it will be fair to argue that the right to request security for costs against Russian parties exists in the present situation irrespective of when the arbitration agreement was concluded. However, arbitrators may, within their discretion (and also under different arbitration rules), take the view that the knowledge of certain risks at the time of the conclusion of the arbitration agreement prevents the respondent from requesting security for costs.

Practical Considerations

Art 33(6) Vienna Rules provides for a reduced standard of proof since it (only) requires a sufficient degree of probability that the recoverability of a potential claim for costs is at risk. The broad language of Art 33(6) Vienna Rules allows respondent/counter-respondent to request security for costs against any Russian claimant. The current Russian court practice questioning the impartiality of foreign arbitral tribunals and institutions seated in "unfriendly states" demonstrates such a degree of probability.

References

?1 Gabriel/Haugeneder/Pörnbacher, Art 33 in VIAC Handbook (2019) mn 29.

?2 Gabriel/Haugeneder/Pörnbacher, Art 33 in VIAC Handbook (2019) mn 31.

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