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Guideline 12 : Guideline on Security for Costs

1. Security for costs under the 1996 Act

1.1 As a result of the 1996 Act, it has become the norm for an arbitral tribunal to have the power to order a claimant to provide security for the costs of the arbitration. The Act recognises that the parties may agree on the powers exercisable by the tribunal. Consequently the parties may by contract agree upon the circumstances in which a tribunal may order security or they may preclude an order for security. Any rules incorporated into the contract may have a similar effect. An arbitrator should therefore examine the contract and any rules incorporated in it before entertaining an application for security.

1.2 If the parties do not otherwise agree, Section 38(3) of the Act enables a tribunal to order a “claimant”, (which term includes a counterclaimant (Section 82(1))) to provide security for the other party’s costs of the arbitration. The Act does not lay down any principles to govern the circumstances when an order for security should be made. The Departmental Advisory Committee was at one stage in favour of providing that an arbitral tribunal should act on the same principles as the Court in exercising the power but this provision was deleted from the final draft.

1.3 There is one negative provision, namely that the power must not be exercised on the ground that the claimant is an individual ordinarily resident outside the United Kingdom or a corporation or association incorporated, or formed under, the law of a country outside the United Kingdom, or whose central management and control is exercised outside the United Kingdom. This prohibits an order for the provision of security not only where the principal ground for ordering it is that the claimant is ordinarily resident outside the United Kingdom but also where this is one of several stated grounds for ordering it. There is some doubt as to how far the prohibition extends. It was one of the objects of Section 38 to avoid discrimination between the treatment of UK claimants and non-UK claimants. Both should be treated on similar principles.

1.4 The only other restriction, if it can be so called, is that the tribunal must comply with its general duty under Section 33(1) to act fairly and impartially between the parties.

2 Comparative Law Overview

2.1 In the past, the use of security for costs in the major European arbitration centres was broadly unknown. In the English-speaking world, including England, the tendency was to require the parties to apply to court for security for costs. The creation of the arbitrator’s power to order for security for costs in Section 38(3) of the 1996 Act has set off interest in the possible uses of this power in cases outside England.

2.2 There is no great statutory underpinning for such a power. For example, Article 19(2) of the UNCITRAL Model Law just enables the tribunal to “conduct the arbitration in such manner as it considers appropriate”. One finds similar powers in Article 1693 of the Belgian Code Judiciaire, Article 1494(2) of the French NCPC, Article 1036 of the Dutch Burgerlijke Rechtswörderung and Article 182(2) of the Swiss LDIP. Section 38 of the Swedish Act makes it clear that the arbitrator can order a party to provide security for his or her fees.

2.3 An arbitrator’s order published in ASA Bulletin 2001 at p. 745 but rendered in 1997 concludes that the practice of ordering security for costs has been in existence for some years, citing other cases notably ICC cases 6682 and 6692. The tribunal in the 1997 case based its powers on Article 182(2) and 183 of the Swiss LDIP. Article 182(2) seems to be the correct provision. This suggests that these general rules in a number of arbitration statutes giving the arbitrator broad powers to determine the procedure in the absence of the parties’ agreement can be correctly interpreted as enabling the arbitral tribunal to order security for costs. One effect of this is that an arbitrator

operating under a general power to determine procedure may find these guidelines helpful in determining the correct approach. (For an example of Swiss authors using the English approach to frame their view of the arbitrator's duties in this area, see J-F Poudret & S Besson, *Droit compare de l'arbitrage international*, Schulthess, 2002 at pp. 553-554.)

3. Approaching the decision on whether to order security for costs

3.1 As to the proper approach, the arbitral tribunal must necessarily strike a balance between the factors in favour of ordering security (save for those covered by the negative provision referred to in paragraph 1.3 above) and the factors mitigating against an order for security. In so doing an arbitrator must have regard to the evidence and must exercise his discretion in a manner which seems most in accordance with the justice of the case. But it can sometimes be difficult to resolve the matter in a way which avoids injustice to one or other party.

3.2 In most cases, the application will be made on the ground that the claimant will or may be unable to pay the respondent's (ie the applicant's) costs in the event of the respondent being successful in the arbitration. Where the application is made on these grounds it can be useful, as a rule of thumb, to begin by making the initial assumption that the applicant's defence will succeed and that an award of costs will be made in his or her favour (these assumptions can be reviewed later if necessary) and then to consider:

- (1) the likely total amount of the applicant's recoverable costs; and
- (2) whether it is probable on the evidence that the claimant will be unable to pay that amount when the award becomes enforceable.

3.3 If the evidence establishes, at the first stage, that the claimant will be unable, or is unlikely to be able, to pay the applicant's recoverable costs, the arbitral tribunal should go on to the second stage which can involve the consideration of broader factors relevant to the exercise of the discretion. The arbitrator should ask himself the question: Would it be fair and just in all the circumstances of the case to make an order for security for costs and if so, for how much?

3.4 When considering the probable amount of the applicant's recoverable costs, an arbitrator will require the applicant to submit an itemised list of the costs which have been incurred to the date of the application together with an estimate of those likely to be incurred in the future. The arbitrator should also consider whether the total is reasonable and proportionate. At an early stage in the arbitration it may be difficult for the tribunal to estimate what global amount of costs would be proportionate. This can be a reason for ordering security to be provided in stages (see below). In any event arbitrators should view statements of costs with some care as they are not likely to be understated.

3.5 Any dispute as to the ability of the claimant to pay the applicant's costs at the time when the award will become enforceable will normally give rise to an examination of the claimant's most recently published accounts. An arbitrator is at liberty to draw inferences from those accounts, as well as from any failure on the part of the claimant to file or produce accounts.

3.6 In some cases, the dispute centres on the question whether a successful respondent would be able to enforce an award of costs against any assets belonging to the claimant. If the claimant has reachable assets in the United Kingdom the question can hardly arise. If the claimant is resident in a country which has acceded to the New York Convention and has assets in that jurisdiction, it should be possible under the Convention to enforce the award against those assets.

3.7 However, not all states which are parties to the Convention have provided adequate remedies to enforce Convention awards. Where there is no adequate legal regime enabling a party to enforce an award of costs, (whether the state has acceded to the Convention or not) this may be a powerful factor in favour of granting security. It is thought that an order in such circumstances would not fall within the prohibition referred to in paragraph 1.3 albeit that difficulties of enforcement were traditionally the justification for making orders for security against claimants resident outside the United Kingdom.

3.8 In some cases, a claimant will assert positively, as a reason why security should not be ordered, that it has no assets or insufficient assets to meet the applicant's costs and that consequently if it were ordered to provide security this would deprive it of an opportunity to pursue a meritorious claim. In such cases it can be difficult to find an equitable solution. A point to

bear in mind is that even if the claimant cannot provide the security itself, the shareholders or backers of the company may be able to provide it and an arbitrator should be wary about accepting a plea that the claimant cannot provide security unless evidence is produced as to whether security can be provided by any shareholders or backers. It may turn out that, even if security can be provided, this could only be done at the price of unduly fettering the working capital of the claimant but once again some caution may need to be exercised against accepting such an argument without proper evidence to support it.

3.9 In all such cases a balance needs to be struck between any injustice which an order for security may cause to the claimant against the injustice which may be caused to the applicant by refusing an order for security in circumstances where the claimant will be unable to pay its costs at the end of the day. It may be possible to strike this balance by reducing the quantum of the security ordered so that the applicant will be partially secured. Such an order will achieve no purpose however unless the claimant is able to provide the security ordered. At best such an order can be justified on the grounds that the provision of some, albeit insufficient, security is a test of the bona fides of the claimant. In this area there can be no hard and fast rules and in some cases an order for partial security will constitute an unsatisfactory and illogical compromise.

3.10 An order for security should not be allowed to become an instrument of oppression. Arbitrators should be vigilant to guard against the use of an application for security as a tactical device by which a respondent may be seeking to intimidate a weaker party or to delay the time when it has to address the substance of the dispute.

3.11 A claimant may assert that its want of means to pay the respondent's costs has been brought about by the conduct of the applicant. Such assertions will carry little weight unless supported by evidence but may if justified be a ground for refusing to order security.

3.12 It is normally unproductive to examine the merits of the claim or the probability of the respondent being successful in the course of an application for security. However, one or other party may advance arguments based on the merits of the claim. In such circumstances an arbitrator should be willing to go some way towards making an assessment of the cases of each party since it may become evident for example, that the chances of the applicant obtaining an order for costs are extremely slim or even non-existent. Since the arbitrator will ultimately have to decide the case on its merits, he should be wary of going into the merits in more detail than is absolutely necessary, should decline to do so whenever the examination is likely to be detailed or prolonged and should express his conclusions with some caution to avoid giving the impression that he has formed a final view on the merits without giving the party affected a reasonable opportunity of putting his case.

3.13 It is not uncommon for parties to refer to settlement offers as a ground for ordering or refusing to order security. A reference to a sealed offer may cause difficulty to an arbitrator since he may anticipate that one or other party will consider itself prejudiced if the offer is known to the arbitrator before questions of liability and quantum have been determined. However the Departmental Advisory Committee considered this point and was not persuaded either that the tribunal would be influenced by the offer if the case proceeded to a hearing on the merits or that the disclosure of the offer could somehow disqualify the tribunal from acting. It is however wise to avoid references to sealed offers whenever possible.

3.14 Where the applicant has a counterclaim which raises the same or similar issues to the claim, an order for security on its own may serve no purpose since if security is ordered and not provided the arbitration may continue on the counterclaim. The arbitrator may in such circumstances require as a condition for ordering security that the applicant undertakes not to pursue the counterclaim if the claimant fails to provide the security ordered.

4 The Form of the Order

4.1 In order not to stifle a bona fide claim it is sensible for an arbitrator (if persuaded that security should be provided) to order that it be provided in stages. The first order might be for security up to and including the close of pleadings or the disclosure of documents. The next might be up to the hearing or some point shortly before it, such as a pre-trial review. The final stage might include the hearing. The object is to avoid injustice and to try to resolve the dispute without a hearing.

4.2 Should the arbitrator be minded to order security he should ensure that his order makes provision for the following:

- (1) the amount of security to be provided.
- (2) the form in which it is to be provided (this might be by payment to a stakeholder or by the provision of a bank guarantee in terms acceptable to the applicant or in default of agreement to be settled by the arbitrator, by a parent company guarantee, by a director's personal guarantee, by a floating charge on assets, etc).
- (3) the stage of the arbitral proceedings which it is to cover.
- (4) the time within which the security is to be provided.

4.3 Arbitrators are commonly asked to include in the order a provision that, if the security be not provided within the specified time, the claim will be stayed. There is usually no need for such a provision and orders for the automatic staying of arbitral proceedings are not sanctioned either by the Act or by the reports of the Departmental Advisory Committee.

4.4 If an order for security is not complied with, the sanction available to the applicant is first to apply for a peremptory order within Section 41(5). A peremptory order must prescribe a time for compliance. If the claimant fails to comply with a peremptory order for the provision of security the applicant may apply to the tribunal for an award dismissing the claim (Section 41(6)).

4.5 Finally it should be mentioned that Section 38(3) is not confined to a situation where a respondent seeks an order that the claimant is to provide security for its costs. The section is so worded that it confers jurisdiction on a tribunal to order a claimant to provide security for the arbitrators' fees and expenses. But arbitrators should, whenever practicable, agree with the parties the basis of their remuneration, including any arrangements for security for their own fees and expenses, on or before acceptance of their appointment. In addition, under English law arbitrators have a statutory lien on the award until such time as they are in receipt of full payment of their fees and expenses (Section 56(1)). Only very rarely, therefore, if ever, is it justified for arbitrators to order a claimant to provide security for their own fees and expenses.