Kluwer Arbitration Blog

SCC Arbitration Institute Explores Security for Costs in International Arbitration

Raoul Sievers · Sunday, November 17th, 2024

On 7 November 2024, the SCC Arbitration Institute ("SCC") hosted a discussion on security for costs in international arbitration, with Anna Joubin-Bret, Secretary of UNCITRAL; Dr. Faris Nasrallah, Head of Arbitration at Crescent Petroleum; Dr. Monique Sasson, Partner DeliSasson and arbitrator with ARBITRA; Jake Lowther, Specialist Counsel, SCC Arbitration Institute, and moderated by Dr Crina Baltag, Professor Assoc. Stockholm University and member of the Board of the SCC.

Security for costs — a balancing act

Following welcome remarks from Caroline Falconer, Secretary General of the SCC, Dr Baltag introduced the topic of security of costs as being one of the timely topics currently addressed in international arbitration. Security for costs is only one of several tools available to the parties to impact the costs of arbitration. It provides the responding party with the security of being able to recover incurred costs once the claim brought by the opposing party is dismissed. At the same time, where the alleged breach has left the claimant in a financially vulnerable situation, an application for security for costs goes to the root of a party's ability to pursue its claims. Thereby, an application for security for costs entails a balancing act between the respondent's interest in securing recoverability of adverse costs and the claimant's access to arbitral justice. This is perceived by arbitral tribunals as a balancing act which lacks uniform standards, and therefore, a good time to reflect on the current state of security for costs in international arbitration.

A deep dive into costs and reflections on security

Dr. Nasrallah highlighted the numerous effects of costs on the initiation and conduct of arbitral proceedings, which cut to the heart of the most sensitive conceptual components and professional junctures in international arbitration. Cost incentives often drive the participation in arbitral proceedings. Equally, costs competition exists between institutions, legislators and courts for the most cost-efficient process guides the parties' decision on the forum of dispute resolution. The parties' "war chests" and ever escalating party costs raise questions of equality of arms in the proceedings and affect their willingness to enter into settlement negotiations as well as the terms of such settlement. Costs can also act as a deterrent in arbitral proceedings for sanctioning unwarranted delays. An application for security for costs might have a calibrating effect encouraging parties to stay within the boundaries of reasonableness and preventing costs from spiraling out of control.

It is therefore remarkable that many national laws remain silent with regard to a party's entitlement to recover costs, let alone security for costs. This finding extends to a number of national laws of countries that frequently provide the procedural framework for arbitral proceedings such as France and Switzerland. Similarly, the arbitration community is yet to find common ground as to which costs should be recoverable. Should the prevailing party be allowed to recover in-house legal costs, internal staff costs, costs for ancillary court actions, witness evidence costs and expenses, costs incurred for asset tracing and dispute-related public relations? Which considerations should guide the tribunal in using its broad discretion regarding the allocation of costs? Faris Nasrallah observes a tendency of institutional rules to "marry up" to the national laws in the institutions' country of origin in what may be perceived as "costs nationalism". The silence and sparsity of costs coverage in arbitral laws and institutional rules affords wide discretion that result in reliance on customary arbitral norms and practices influenced by national legal cultures and training.

Proposals of UNCITRAL's Working Group III on security for costs

An observation of "costs nationalism" calls for an international perspective. Ms. Joubin-Bret continued the discussion, providing commentary on the proposals of UNCITRAL's Working Group III, currently mandated with reforming Investor-State Dispute Settlement ("ISDS"). One of the issues identified by the working group are costs and duration of ISDS. Ms. Joubin-Bret notes a

shift from the practice of each party paying its own costs to both investors and states, requesting the tribunal to allocate incurred costs. In ISDS, security for costs can play a vital role as investors' claims are often brought by investment vehicles at the host state, commonly mere letter box companies. 2022 saw a reform of the arbitration rules of the International Center for Settlement of Investment Disputes ("ICSID" and "ICSID Rules") and the introduction of a provision on security for costs in Rule 53 ICSID Rules. Yet, the need for uniformity in the relevant circumstances to be considered by the tribunal in deciding on security for costs remains. Draft Provision 5 subsection 4 of UNCITRAL's Working Paper 244 aims to address this need. As pointed out by Anna Joubin-Bret, one of the rather contentious issues in this regard is item e) which directs the tribunal to take into account the existence of third-party funding when assessing an application for security for costs. While the questions of legitimacy and limitations of third-party funding are rigorously fought out, the drafters seek to link the existence of such funding and the application for security for costs in an effort to prevent investors from being able to make an investment on a claim and not being held accountable for the risks of an adverse decision. A provision that, as Ms. Joubin-Bret recognizes, "will be hotly debated".

Security for costs under the SCC Rules

The event accompanied the recent launch of the SCC's report on costs of arbitration and apportionment of costs under the SCC Rules. Earlier this year, the SCC released a practice note on security for costs, a thorough analysis of 23 applications for security for costs and their prospects of success in commercial cases administered by the SCC between 2017 and 2022. While the scope of the report is limited to commercial disputes, the SCC has also seen numerous applications in investment cases in the same timeframe. The report observes that only two of the 23 applications for security for costs yielded success. This finding reflects the exceptional nature of a grant of security for costs and the high threshold applied by tribunals. As Mr. Lowther emphasized, the report nevertheless seeks to provide parties considering applying for security for costs further insight into where it may be appropriate, e.g., in cases of insolvency of one of the parties during the course of the proceedings. This year alone, the SCC has counted eight applications for security for costs, many of which have been granted indicating that the propositions of Art. 38 SCC Rules start to gain traction. Yet, the SCC also notes that most applications are made in international disputes given the historical lack of tools providing security for costs in Sweden, and for that matter in most civil law jurisdictions.

Security for costs: the civil law and common law divide

Monique Sasson equally observed a divide in the way civil law and common law jurisdictions handle security for costs. Notably, Art. 98 of the Italian Codice di Procedura Civile recognized a claim for security for costs. However, this provision was declared unconstitutional by the Italian Constitutional Court in December 1960. The court held that the provision imposed an unwarranted burden on the claimant's access to justice. As Monique Sasson points out, the decision was met with criticism and to date does not preclude arbitrators from granting security for costs in proceedings seated in Italy. However, the Italian Constitutional Court's assessment reflects the skepticism towards security for costs in civil law jurisdictions. In contrast, in Monique Sasson's experience as counsel and arbitrator in common law systems that provide for cost-shifting (*i.e.*,

"loser pays"), rules of arbitral institutions based in these jurisdictions often expressly provide the tribunal with broad discretion to grant security for costs (*e.g.*, Sec. 38(3) of the English Arbitration Act). In the United States, where application of the cost shifting principle in court proceedings is relatively rare, even though institutional rules may not preclude security for costs, the procedure is less well known (the disparity between practices regarding allocation of costs in international arbitration and United States litigation was also discussed in a report by the New York Bar Association earlier this year).

Concluding remarks

An application for security for costs entails a balancing act between the respondent's interest in securing recoverability of incurred costs and the claimant's access to justice. While security for costs remains only one of several tools to impact the costs of the proceedings, many national laws and institutional rules lack uniform standards to rely upon in the application. For ISDS, the need for uniformity is addressed by UNCITRAL Working Group III while parties in commercial disputes may seek guidance from the report published by the SCC. While the surge for uniform standards promotes the popularity of security for costs in international arbitration, its rise entails another balancing act. The future will have to show how institutions and tribunals strike the balance between encouraging applications for security for costs in appropriate circumstances while maintaining its exceptional nature to safeguard the claimant's access to justice.
