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Security for Costs in International Arbitration
Why, when, and what if ...

by Pierre A. Karrer and Marcus Desax[1]

1. Before the state courts, recovery of party representation costs by the winning party is seen as a consequence of the procedure similar to the allocation of court costs. In many systems, party representation costs are granted as a matter of course, even if no claim for them was made and no amount was specified, let alone documented in any way. The state courts apply a state tariff (ad valorem). Such tariffs are established to guard against overreaching by party representatives on their fees and expenses and to provide some cross-subventioning.

2. In *international arbitration practice* some arbitral tribunals are still reluctant to grant claims for party representation costs. Many, however, grant such claims in certain cases or as a matter of course depending on the outcome; they apply the principle that „costs follow the event". They expect the claim for party representation costs to be specified and sometimes documented. There is a limit: Only reasonable party representation costs may be recovered. But this is enforced only in extreme cases. The view is that in international arbitration party representation costs may vary widely because of a number of factors, including the vastly different conditions under which lawyers work around the world and the varying ability of lawyers used to their domestic civil procedure to adapt to the often unfamiliar ways of international commercial arbitration.

3. For a number of reasons, in international commercial arbitration practice the assessment of party representation costs is made in a rather rough way. These reasons include the following: The amounts are often insignificant compared to the overall amount in dispute. The decision must be made at the end when sometimes one party already feels that it will lose and tends to be less cooperative than at the beginning of the arbitration. Extensive written submissions on costs would have to deal with various possible outcomes on the merits and thus become complicated. Pointing out the inefficiencies in the other party's representation is somewhat awkward, especially when one awaits a decision on the merits. If a decision on the merits is made before costs are assessed, in the English domestic way, this is difficult to handle in a system such as the ICC system and may lead to an additional deliberation meeting between the arbitrators, which is inordinately expensive. Some of these difficulties may be averted by ordering sealed submissions on costs, but this is rarely done.

4. What is the *theoretical basis* of granting party representation costs in international arbitration? *Costs follow the event.* But which event? One reasoning is that if the claimant has suffered damage due to the breach of contract of the respondent, the damage inclu-

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des the costs of obtaining recovery, in other words party representation costs. Costs are then seen as part of damages. Presumably the *lex contractus* applies.

5. But suppose, the respondent wins. The party representation costs of the respondent are compensated because there were incurred to defend against an unjustified attack in the arbitration proceedings themselves. These costs are seen as tied to the arbitral process. Presumably the *lex arbitri* applies.

6. That may be all right from a theoretical viewpoint, but why should it make a difference whether the claimant or the respondent wins? This difficulty carries on into the area of security for costs.

Why security for costs in international arbitration?

7. A respondent in arbitration is in a different position from a creditor whose debtor possibly has no money. Despite what one often hears, arbitration is expensive at least up front[2]. If the debtor has few assets, the creditor may choose not to sue the debtor at all, in which case the creditor will at least not throw good money after bad. By contrast, the respondent sued in arbitration by a claimant who has no money stands to lose in any event. If the respondent ignores the claim in arbitration, it is likely that an adverse award will be rendered. Such an award may become enforceable all over the world pursuant the New York Convention[3]. If the respondent defends the action, this will be expensive. Without security for costs, the cost of defending the action may not be recoverable. Further, a claimant at the brink of bankruptcy may wish to sue in arbitration, and, possibly, capitalize its claim against the respondent as an asset on its balance sheet to prevent having to deposit its balance sheet. There is therefore an in-built incentive to commence an arbitration. To reestablish the balance under these circumstances, security for costs in favor of the respondent is an attractive solution.

8. Against ordering security for costs the defense is frequently raised that granting security for costs puts the respondent's potential creditor for costs at an advantage in comparison with other creditors, whereas the policy of bankruptcy law is to set creditors, at least in the same category, on an equal footing[4].

9. This is not particularly convincing because the claim brought by the claimant in an arbitration will result, if successful, in an increase of the assets of the claimant, and thus works in favor of the other creditors, especially if the claimant has few other assets. It is thus not unfair that the price associated with this potential benefit be secured by all potential creditors. Moreover, the commercial creditors of a bankrupt party have all put

2 For the view that it is worth its price, see *Pierre A. Karrer*, Arbitration saves! – Costs – Poker and Hide-and-seek, Journal of International Arbitration 1986, p. 35 et seq.

3 The counterpart in state court litigation is provided by the Brussels and Lugano Convention, but only within Western Europe.

4 See e.g. *Frances Kirkham*, Security for Costs, unpublished paper presented to the Milennium Conference of the Chartered Institute of Arbitrators, November 18-19, 1999, p. 3.

their trust in the bankrupt in a way that the respondent did not. The respondent in an arbitration commenced by the future bankrupt has no choice but either lose and become an award debtor or then become an unsecured creditor of the bankrupt for costs.

10. Not all, but most of what was said about the situation of a claimant also applies to the situation where an unconnected *setoff defense* and counterclaim is raised by a possibly impecunious respondent. Besides, it happens that an arbitration is started against a particular respondent who has few assets – not in the hope of recovering from that respondent but from some insurance company or guarantor which requires at least the attempt to recover from the original debtor. In such a situation, in any event, the impecunious respondent's counterclaim should be treated the same way as a claim by a claimant who has no money.

11. Before the state courts, lack of money and foreign nationality are usually grounds to impose security for party representation costs on a claimant or a counter-claimant, or both[5]. This rule is justified by the fact (or assumption) that it may be difficult or even impossible for the prevailing party to recover the costs in the foreign country. There are special cases where impecuniosity suffices[6].

12. Some leges arbitri specifically provide for the power of arbitral tribunals to grant orders for security for party representation costs[7], but most are silent.

13. Some mostly older authors believed that this silence means that arbitral tribunals have no power to order security of costs[8].

5 See English case law cited by *D. Mark Cato*, Arbitration Practice and Procedure – Interlocutory and hearing problems, 1997, p 514, and § 110 (1) German Code of Civil Procedure.

6 E.g. Zurich Code of Civil Procedure: Bankruptcy or composition proceedings opened in the last five years (§ 73 (2)); outstanding certificates of loss (§ 73 (3)); company in liquidation or whose bankruptcy has been postponed (§ 73 (5)).

7 Section 38(3) English Arbitration Act 1996: "*The tribunal may order a claimant to provide security for costs of the arbitration.*"
Section 2GA(1)(a) of the Hong Kong Arbitration Ordinance 1997: „*When conducting arbitration proceedings, an arbitral tribunal may make orders or give directions dealing with any of the following matters – (a) requiring a claimant to give security for the costs of the arbitration;*" See thereto *Craig Shepherd*, Security for Costs in Hong Kong Arbitration, Asian Dispute Review 1999, vol. 2, p. 24 et seq.

8 Under the old Zurich cantonal arbitration law *Felix Wiget*, in Sträuli/Messmer, Kommentar zur Zürcherischen Zivilprozessordnung, 2d ed. 1982, p. 490; *Paul Baumgartner*, Die Kosten des Schiedsgerichtsprozesses, 1981, p. 92 et seq.; *Max Guldener*, Schweizerisches Zivilprozessrecht, 3rd ed., 1979, p. 611.
Under the Swiss Intercantonal Concordat (which also governed international arbitration in Switzerland before the PIL Statute came in effect in 1989): *Pierre Lalive/Jean-François Poudret/Claude Reymond*, Le droit de l'arbitrage interne et international en Suisse, 1989, p. 162; *Pierre Jolidon*, Commentaire du Concordat suisse sur l'arbitrage, 1984, p. 422.
Probably also: *Andreas Bucher/Pierre-Yves Tschanz*, International Arbitration in Switzerland, 1988, p. 87.

14. Some arbitral tribunals however said that they have such power if granted by an express agreement of the parties[9].

15. Some mostly more recent authors voiced the same opinion[10].

16. Some recent Arbitration Rules provide expressly for the power to grant security for costs[11].

17. Some authors argue that the power is justified in arbitration according to arbitration rules that do not mention it expressly[12].

9 Award of an Arbitral Tribunal of the Zurich Chamber of Commerce of June 5, 1956, Schweizerische Juristenzeitung, 1958, vol.54, p. 92 et seq.; procedural order of an Arbitral Tribunal of the Zurich Chamber of Commerce of November 12, 1991, ASA Bull. 1995, p. 84 et seq.; ICC Award No 7047 of February 28, 1994 in Yearbook Commercial Arbitration, vol. XXI-1996, p. 79 et seq., = ASA Bull. 1995, p. 301 et seq. = *ICC Bull.*, vol. 8 No. 1., p. 61 et seq.; undated award in ad-hoc arbitration in ASA Bull. 1995, p. 529 et seq.

10 Thomas Rüede/Reimer Hadenfeldt, Schweizerisches Schiedsgerichtsrecht nach Konkordat und IPRG, 2d. ed., 1993, p. 241, state that an order for security for costs can only be rendered by the arbitral tribunal if expressly empowered by agreement of the parties. It is not the role of the arbitrators to provide for the welfare of the parties: *„Eine derartige fürsorgliche Maßnahme neben der Prozessentscheidung zugunsten der einen Partei passt nicht zur Aufgabe des Schiedsgerichts, den Rechtsstreit unter Gleichstellung der Parteien zu entscheiden."*

11 Art. 25 of the Rules of the London Court of International Arbitration (LCIA Rules) effective as of 1998, Yearbook Commercial Arbitration XXIII-1998, p. 369 et seq.; Art 37 of the Arbitration Rules of the Netherlands Arbitration Institute (NAI Rules), effective as of 1998, Yearbook Commercial Arbitration XXIIII-1998, p. 394 et seq.
Art. 46(b) WIPO Rules provides as follows: *„At the request of a party, the Tribunal may, if it considers it to be required by exceptional circumstances, order the other party to provide security in a form to be determined by the Tribunal, for the claim or counter-claim, as well as for costs referred to in Article 72."*

12 See Art. 23(1) of the ICC Arbitration Rules in effect as of 1998, which provides as follows: *Unless the parties have otherwise agreed, as soon as the file has been transmitted to it, the Arbitral Tribunal may, at the request of a party, order any interim or conservatory measure it deems appropriate. The Arbitral Tribunal may make the granting of any such measure subject to appropriate security being furnished by the requesting party. Any such measure shall take the form of an order, giving reasons, or of an award, as the Arbitral Tribunal considers appropriate.*
Marc Blessing, The ICC Arbitral Procedure under the 1998 ICC Rules – What has changed? in: *ICC Bull.*, vol. 84, No. 2, p. 30, by reference to the legislative history of Art. 23 of the 1998 ICC Rules of Arbitration, states that the wording is broad enough to allow the making of the application by a party for, and the issuing of a decision by the Arbitral Tribunal on, security for costs. He also mentions that the consequences of non-observance were discussed by the Working Party but that a sanction did not find its way into the new rules. It was argued that *„arbitrators should retain a wide range of consequences to visit on the defaulting party, to be decided by the arbitrators on a case-by-case basis in the light of the particular facts and applicable law."* See also *Marc Blessing*, Introduction to Arbitration – Swiss and International Perspectives, 1999, p. 114. *Yves Derains/Eric A. Schwartz*, A Guide to the New ICC Rules of Arbitration,

18. Finally, some arbitral tribunals say that they have the power to order security for costs even when the arbitration rules are silent[13].

19. This view is supported by some authors, but they emphasize that the arbitral tribunal should exercise this power with *extreme caution* and only in *exceptional circumstances*[14].

20. We believe that international arbitral tribunals should have that power, but that nationality is irrelevant, and we would like to discuss how and when the power should be exercised.

21. Many difficulties arise – hardly surprising – with setoffs and counterclaims: If the setoff defense is characterized by the *lex arbitri* as a *procedural* one, one can make raising it conditional upon payment of an advance for court costs and possibly security for costs. In some systems, a setoff is possible (and a counterclaim may be filed) only if the receivable that is set off (and for which a counterclaim is placed) is covered by the same arbitration agreement as the original claim. One can say that the possibility of the setoff (and counterclaim) is to be expected by the claimant. Hence, by instituting arbitration proceedings the claimant incurs the risk that a setoff may be declared (and a counterclaim filed). It would not be fair to deprive the respondent of one of its means of defense against the claimant.

22. In some arbitration systems – such as the Swiss one[15] – the jurisdiction of a first arbitral tribunal extends to unconnected setoffs and counterclaims that are not covered by

1998, p. 273/4, state that the wording of Art. 23(1) is broad enough to embrace applications for security for costs. For *W. Laurence Craig/William W. Park/J. Paulson*, Annotated Guide to the 1998 ICC Arbitration Rules, 1998, p. 138, it was clear that Art. 23 was to fill a lacuna contained in the previous rules and that it now gives the arbitrators the power to order a party to put up security for the legal costs that the other party may incur in defending what may be an unmeritorious claim.

13 Newer Swiss international arbitration practice in favor of such power: Procedural order of an Arbitral Tribunal of the Zurich Chamber of Commerce dated August 21, 1995, summarized in ASA Bull. 1997, p. 372 et seq.; undated procedural order in an ICC arbitration, ASA Bull. 1997, p. 363 et seq.; procedural order in an ad-hoc arbitration applying the ICC Rules of December 21, 1998, ASA Bull. 1999, p. 59 et seq.; unpublished procedural order in ICC No. 10032 of November 9, 1999.
In France, ICC arbitration practice also is in favor of the power of the arbitral tribunal to require security for costs: Unpublished ICC Award 6632 of January 27, 1993, summarized by *Fouchard/Gaillard/Goldman* Traité de l'Arbitrage commercial international 1993/ On International Commercial Arbitration, 1999, No. 158; ICC Award No 6697 of December 20, 1990, in Revue de l'Arbitrage, 1992, p. 135 et seq.; procedural order in ICC No. 7489, Journal du droit international, 1993, vol. 120, p. 1078 et seq. (= ICC Bull. vol. 8 No 2, p. 68 et seq.).

14 *Otto Sandrock*, The Judicatum Solvi in Arbitration Proceedings, (unpublished paper presented at the Swiss Arbitration Association on January 31, 1997), p.17 et seq.

15 Zurich Chamber of Commerce, Article 27: *Jean-François Poudret*, Compensation et arbitrage in: Le Droit en Action, Recueil de travaux à l'occasion du Congrès commun de la Fédération Suisse des Avocats et de la Société Suisse des Juristes, ed. Jean-Marc Rapp/Michel Jaccard, 1996, p. 361 et seq.

the arbitration agreement and are possibly covered by another arbitration agreement or by a choice-of-jurisdiction agreement. Extending the arbitral tribunal's jurisdiction to unconnected setoffs (and counterclaims) appears justified because it is in the interest of all participants to have the disputes decided in one single forum. This may lead to abuse by impecunious respondents. The antidote could be an order for security for costs.

23. If however, the setoff defense is a *substantive* defense and the setoff arises as soon as the other party receives notification of it ("empfangsbedürftige Willenserklärung"), then the question arises whether the arbitral tribunal should consider a setoff defense regardless of possible additional or separate advances for costs and possibly having posted security for costs arising out of the defense to the setoff.

24. One would like to say no, but this is possible only where the parties have made a specific agreement to that effect, which in practice means where the arbitration rules and costs schedule chosen by them so provide[16].

25. What is the *legal basis* on which an *arbitral tribunal* could issue orders for party representation costs *pendente lite* if that power is not expressly granted be the *lex arbitri*?

26. It follows from the above that one might argue that party representation costs are an item of *damage*. Thus, where an arbitral tribunal has the power to issue a summary award within the prayers for relief, it might have the power to issue an order for security for costs, at least if one accepts that a prayer for party representation costs to be awarded in the final award includes a prayer for security to be for these party representation costs *in majore minus*.

27. Others may argue that the power to issue orders for security for costs is included in the vast powers to issue *provisional and conservatory* measures which again may be granted either by the lex arbitri[17] outright or by party autonomy authorized by the *lex arbitri*.

28. It could also be said that the power to issue an order for security for costs is included in the *general procedural powers* of an arbitral tribunal.

16 Only the International Arbitration Costs Schedule of the Zurich Chamber of Commerce, point 2.1., mentions setoff, but even it does not provide that a setoff declaration is deemed never to have been made where the required security for costs was not provided by the party declaring setoff.

17 Art. 183 Swiss Federal Private International Law Statute has the following content (translation):
2. Provisional and Conservatory Measures
1. Unless the parties have otherwise agreed, the arbitral tribunal may, on motion of one party, order provisional or conservatory measures.
2. If the party concerned does not voluntarily comply with these measures, the arbitral tribunal may request the assistance of the competent state court; the court shall apply its own law.
3. The arbitral tribunal or the state court may make granting the provisional or conservatory measures subject to appropriate sureties.

When should a request for security for costs be granted?

29. To require a party to an international arbitration to post security for costs for the sole reason that it is a resident of a country other than the country of seat of the arbitration[18] would be tantamount to a violation of the *ordre public international*[19]:

30. In international arbitration we are all „internationals", no-one is a „national", let alone a „foreigner". All parties are equal, all enjoying rights and bearing obligations thus forming a „Rechtsgemeinschaft", a community based on the rule of law. This community of law is universal, at a higher level than a national community of law (a given country) or even a multinational one (such as the European Union). At the national level, non-discrimination of the individuals is usually expressly provided for by constitutional law[20]; the same holds often true in communities at a multinational level[21]. If non-discrimination of the parties is not already provided for by an express provision of applicable international arbitration law[22], the non-discrimination rule is one of international customary law.

31. What are legitimate circumstances?

32. Is fumus boni iuris required which would mean in our case that the claim (or the counter-claim) would have to appear prima facie unjustified?[23] We do not believe that this is a practical requirement.

33. Rather, there must be a fundamental change of the situation since the basic agreement between the parties was entered into.

18 In this sense *K. H. Schwab/G. Walter*, Schiedsgerichtsbarkeit, 6. Aufl. 2000, p. 169, who apply § 110 German ZPO also to international arbitration. *Schütze/Tscherning/Wais*, Schiedsgericht und Schiedsgerichtsverfahren, 2.A., Rd. Nr. 352.

19 See *Fouchard/ Gaillard/ Goldman*, Traité de l'arbitrage international, 1993 / On International Arbitration 1999, no 1256. *Andreas Reiner*, Les mesures provisoires et conservatoires et l'Arbitrage international, notamment l'Arbitrage CCI, Journal du droit international, 1998, vol. 125, p. 892 et seq. English Arbitration Act 1996, Section 38(3): *This power shall not be exercised on the ground that the claimant is – (a) an individual ordinary resident outside the United Kingdom, or (b) a corporation or association incorporated or formed under the law of a country outside the United Kingdom, or where general management and control is exercised outside the United Kingdom*". In the same sense Hong Kong Arbitration Ordinance, Section 2GB(3).

20 E.g., German Grundgesetz, Art. 3, and Swiss Federal Constitution, Art. 8.

21 See Art. 12 (ex 6) EC Treaty. See hereto the judgments of the European Court of Justice outlawing security for costs imposed on foreign (EC) nationals in state court proceedings: Saldanha and MTS Securities Corp. v. Hiross Holding AG, C-122/96, NJW 1997, p. 3299; Data Delecta A and Forsberg v. MSL Dynamics Ltd., C-43/95, IPRax 1998, p. 196; Hubbard v. Hamburger, C-20/92, IPRax 1994, p. 203.

22 Art 182 (3) Swiss Federal Private International Law Statute

23 Netherlands Arbitration Institute, Art. 38. See Interim Award in the case No. 1694 of December 12, 1996, Yearbook Commercial Arbitration, Vol. XXIII-1998, p. 97 et seq.

34. The classical case where an application for security for costs may be granted is *the claimant's or counter-claimant's* lack of money.

35. If a party was already insolvent, or was a mere shell, or was, and still is, a resident of a country that is not a signatory of the New York Convention when the arbitration agreement was made, such circumstance would not be sufficient to warrant an order for security for costs. Actually, by entering into an agreement with such a party, the other party has assumed the risk of not being able to collect an award eventually rendered in its favor.

36. The requesting party may provide specific *accounting data* on its opponent, both with respect to the opponent's condition at the time when the basic agreement was entered into and at the present time to enable the arbitral tribunal to determine whether there has been a substantial impairment of that party's financial situation. The arbitral tribunal may then consider the various ratios that allow to determine a company's liquidity respectively its borrowing power (current ratio, quick assets ratio ["acid test"], profit margin, return on net operating assets, return on equity, ratio of net interest paid to total income, gearing)[24].

37. If such data are unavailable and are withheld when the arbitral tribunal orders a party to discover them (which it will not do routinely), the arbitral tribunal may draw an adverse inference.[25]

38. Interesting questions may be presented in case of international embargoes. In arbitration ICC No. 10032 in Zurich, the issue arose (besides impecuniosity of one of the claimants) whether the European Union's freeze of funds belonging to the Government of the Federal Republic of Yugoslavia and/or the Government of the Republic of Serbia[26] was a ground for ordering security for costs against the Yugoslav Claimants. The arbitral tribunal decided that this was not sufficient. It wrote the following in its order dated November 9, 1999 (No. 82–84):

„Even assuming that the freeze applies to funds belonging to the Claimants held outside the territory of Yugoslavia (which is denied by the Claimants as they deny Government ownership and control), an award for costs eventually rendered in favour of Respondent

24 See thereto *Tony Levitt/Arthur Harverd*, Securing Costs in Arbitration Proceedings, Journal of Chartered Institute of Arbitrators, 1998, vol. 64, p. 182 et seq.

25 Art. 915) IBA Rules of Evidence, 1999.

26 EC Council Regulation No 1294/1999, Official Journal of the European Communities, L 153 of June 19, 1999, p. 63 et seq. Under Art. 3 of the Council Regulation all funds held outside the territory of the Federal Republic of Yugoslavia and belonging to the Government of the Federal Republic of Yugoslavia and/or to the Government of the Republic of Serbia shall be frozen. No funds shall be made available, directly or indirectly, to or for the benefit of, either or both, those governments. The definition of *"Government of the Federal Republic of Yugoslavia"* encompasses companies, undertakings, institutions and entities owned or controlled by the government, including all financial institutions and state-owned and socially-owned entities organised in the Federal Republic of Yugoslavia as of 26 April 1999.

could still be enforced in Yugoslavia. The freeze, provided that it applies to assets of Claimants, may have the effect of rendering impossible, for the time being, the enforcement of an award eventually rendered in favour of Respondent in a Member State of the European Union but it does not affect its enforceability as such. This potential inability to enforce an award elsewhere than in the country of the other party's seat or place of incorporation, however, does not present such a serious detriment to Respondent that the exceptional measure of ordering claimants to put up security for costs would be justified. In any event, Respondent has not substantiated at all where such funds belonging to Claimants are located in the European Union, which, because of the freeze are now beyond its control.
In addition, even if the freeze were to apply to funds of the Claimants specified by Respondent, the freeze is only a temporary measure in the European Union and the enforcement would still be possible once the freeze is lifted. In addition, under Art. 8 (1) (b) of the Council Regulation No. 1994/1999 a request to unfreeze the assets could be filed. Respondent has not indicated that such remedy would not be available to it. The purpose of the freeze is to impose sanctions on the Government of the Federal Republic of Yugoslavia and of the Republic of Serbia, not a Europe-based private company which attempts to collect an award rendered in its favour.
Finally, the freeze by the Council of the European Union has no effect on assets located outside the European Union."

39. Presumably, in that arbitral tribunal's view, the decision might have been different where an international embargo was of unlimited duration and without any possibility of exemption, and where the boycotted country enacted retorsion measures which render it practically impossible to enforce an award eventually rendered against a party resident and with the totality of its assets physically located in the boycotted country. But again, there must be a *fundamental change of circumstances* since the basic agreement was made: Who contracts with a person located in a country already subject to an international embargo does so at his own risk and cannot later invoke such embargo to obtain security for costs.

40. Another case of application for security for costs could be where moneys recovered cannot effectively be transferred out of the country due to exchange control legislation.

41. What about devaluation of the currency of the country of residence of the party against which costs may eventually be awarded? This aspect was also examined in the procedural order in ICC 10032, dated November 9, 1999, but was considered insufficient under the particular circumstances of the case (No. 67/68):

„A degree of currency fluctuation is part of the normal commercial risks attendant upon the making of a contract, and of itself does not justify the making of an order for security for costs. However, devaluation of a currency may, in extreme cases, constitute exceptional circumstances justifying an order for security for costs: as an example, if an award is to be rendered in a foreign currency and the party against which the award is to be rendered, instead of having to find x times a given amount of local currency to pay the award would have to find 100 times such amount of local currency, such party's ability to pay the award could be seriously impaired.

No such extreme facts are shown in the case at hand, however. Respondent merely alleges that the Dinar has lost half of its value against the German Mark from 1997 until May 1998. Such devaluation cannot be said to constitute exceptional circumstances."

42. In the procedural order in ICC No 10032 of November 9, 1999, the Arbitral Tribunal stated that the discretion to order security for costs would be exercized with *considerable restraint*. It described the scope of its power as follows (No. 45):

„Accordingly, the Arbitral Tribunal, in the light of the circumstances of the present case, holds that it would be appropriate for it to exercise its discretion to make an order for security for costs.

(i) if the Respondent, which has requested that such an order be addressed to the Claimants, can show:
  (a) that the factual situation at the present time is substantially different from that which existed at the time the parties entered into their arbitration convention, and
  (b) that the present situation is of such a nature as to render it highly unfair to require it to conduct the arbitration proceedings without the benefit of such security;

(ii) unless the Claimants, which oppose the making of an order for security for costs, can show:
  (a) that the making of such order for security for costs would in effect deny their right of access to arbitration for reasons not attributable to them, and
  (b) that, after having weighed the parties respective interests considering both the subject matter of the dispute and the circumstances giving rise to the request for an order for security for costs, the making of such order would appear to be highly unfair to Claimants."

43. In that case, the prerequisites for an order for security for costs were met and Claimants had made no allegations why no such order should be issued, so the Arbitral Tribunal did not have to examine this aspect. Presumably it might have found such countervailing reasons to be present if there is an international boycott of a country because of its government's or ruler's policy, and the boycott is considered sufficient ground for security by the arbitral tribunal, but the claimant against which security would be ordered is a private party of that country, entirely unconnected with its government.

44. Another instance where security for costs may not be required from claimant which has little money could be the situation where the claimant claims that its lack of money is due to the conduct of the respondent, and *prima facie* this appears to be true.

45. In both these cases an arbitral tribunal may be reluctant to require claimants to put up security for costs since this might deny them the right to arbitrate for a reason not attributable to them.

Security for costs in multi-party arbitration

46. What is the situation in multi-party arbitration when there are several claimants, and the reasons for granting security for costs are present in the case of one of the claimants, but not of the others?

47. The requirement of posting security for costs is not set up to punish an impecunious potential claimant or to deter an impecunious potential claimant from filing suit. Rather, it is to protect a respondent from being sued by such a claimant and, having won, being unable to recover its party representation costs.

48. It is submitted that the answer depends on whether the claimants become jointly liable for party representation costs or not.

49. Where the several claimants who may become *jointly* liable for party representation costs if respondent wins, as in the case where they appear jointly as claimants in an arbitration, and are represented by the same lawyers, there is no reason to grant security for costs against the claimant who has few assets. After all, there is the other claimant that is ready and capable of putting its money where its mouth is. There is no intrinsic justification for departing from the normal situation when there are two debtors, one impecunious, and one with a deep pocket, and any creditor will go after the deep pocket[27].

50. By contrast, if several claimants or counterclaimants appearing separately become severally *individually* liable for part of the winning party's representation costs (e.g., if two parties in an international construction consortium claim their respective damages from the third for alleged negligent management of the consortium), then security for costs can be ordered against the claimant that meets its prerequisites.

How should security for costs be put up?

51. The usual means of posting security for costs are through a deposit with the arbitral tribunal or a bank guarantee.

52. The *deposit* with the Chairman of the arbitral tribunal has the advantage that the arbitral tribunal can dispose of the funds in the award and so see to it that the costs are paid to the party entitled to it (to the respondent if claimant loses or back to claimant if he wins)[28].

27 This is also the rule in state court proceedings in Swiss law. See decision of the Swiss Federal Supreme Court of May 16,1967, ATF 93 II 68, and e.g., § 77 of the Zurich Code of Civil Procedure: *„Bei notwendiger Streitgenossenschaft ist nur dann Kaution zu leisten, wenn die Kautionssgründe bei allen Streitgenossen vorliegen."*

28 In ICC practice, the ICC is of the view that it should not involve itself in the enforcement of its own awards at all. It reimburses advances to whoever made them, even if this forces a winning party to enforce its award for reimbursement of costs in state court.

53. The difficulty, however, is that the arbitral tribunal may not wish to get involved with administration of monies and may be reluctant to accept the risk that the funds could be attached in its hands. In addition, if the party putting up security for costs in the meantime disappears (which is not unlikely if security for costs was ordered for impecuniosity in the first place), then these funds may become the object of litigation in which the arbitral tribunal may not wish to be involved.

54. For all these reasons, the preferable alternative is a *bank guarantee*.

55. However, a bank guarantee also presents problems of its own: As it cannot be predicted with certainty how long the arbitration proceedings may last, the bank guarantee should be of unlimited duration. However, a bank may be unwilling to provide such a guarantee of unlimited duration unless it has an ongoing customer relationship with that party. Besides, even then, given the fact that security for costs is only ordered in the event of exceptional circumstances, the bank may be reluctant to provide the desired guarantee of unlimited duration.

56. In the following example, the guarantee is issued for the amount of USD 100,000 on January 1, 2000. While the Claimant is willing to have the bank guarantee extended for as long as may be necessary, the bank is only prepared to be bound for one year, i.e., until December 31, 2000. The bank guarantee may therefore be provided on an „extend-or-pay" basis.

„To: Respondent
Reference is made to the ICC Arbitration Proceedings No. XYZ between Claimant and yourselves concerning Sales Agreement dated _____ as well as the Arbitral Tribunal's Order for Security for Costs dated December 2, 1999, pursuant to which Claimant is ordered to provide, within 30 days, an irrevocable bank guarantee for USD 100,000 in your favor.
In consideration of the aforesaid and on behalf of Claimant, we, ABC bank, hereby irrevocably undertake to pay you, on your first written demand, waving all rights and objections and defense, any amounts of costs including reimbursement of the advance made by you to the ICC, awarded in your favor against Claimant in the ICC Arbitration Proceedings No. XYZ up to a maximum of

USD 100,000

against presentation of:
FIRST ALTERNATIVE
(1) the Final Award in the ICC Arbitration Proceedings No. XYZ, and
(2) your written confirmation that Claimant has not paid the costs awarded in your favor against Claimant by Final Award in the ICC Arbitration Proceedings No. XYZ within 30 days after notification of such Final Award to Claimant;
SECOND ALTERNATIVE
(1) your written request for payment remitted to us no earlier than November 30, 2000, and no later than December 15, 2000, and
(2) presentation of an irrevocable undertaking by a major international commercial bank to pay to Claimant against Claimant's first demand, waving all rights and

obligations and defense, the following amounts against presentation of the Final Award in the ICC Arbitration Proceedings No. XYZ:

(i) USD 100,000 in the event that the Final Award does not award costs in favor of yourselves, or

(ii) the difference of USD 100,000 and the amount of costs awarded in favor of yourselves in the event that the Arbitral Tribunal awards costs to yourselves in an amount lower than USD 100,000.

No payment obligation arises against presentation of the documents mentioned in this SECOND ALTERNATIVE in the event that we inform you, no later than November 15, 2000, that the present bank guarantee is extended until December 31, 2001, in which case we undertake to pay you against a written request for payment remitted no earlier than November 30, 2001, and no later than December 15, 2001, together with the undertaking as per para. 2 above. The same applies mutandis mutatis if we inform you, prior to November 15, 2001 and every year thereafter, as the case may be, that this bank guarantee is extended for another period of one year."

By the operation of the timing, this bank guarantee provides sufficient time for Claimant to have the bank guarantee extended. If the bank guarantee is called and if, after collection, no costs are awarded against the claimant or in a lesser amount, then the claimant can collect the excess payment paid to the respondent under the counter-guarantee provided by the respondent.

What if the party concerned does not comply with the order to provide security for costs?

57. A distinction must be made between a non-complying claimant and a non-complying counterclaimant:

58. If a claimant fails to comply with an order to provide security for costs, the proper remedy is dismissal of the complaint with prejudice. By filing its claim with the arbitral tribunal the jurisdiction of which has not been challenged by the respondent, or if the arbitral tribunal has decided that it had jurisdiction, the claimant has effected lis pendens, and if the case must be decided either by granting or dismissing the complaint, with prejudice[29].

29 Dismissal with prejudice is the consequence provided for by Section 41(6) of the English Arbitration Act 1996 if an order for security for costs is not complied with: „*If claimant fails to comply with a peremptory order of the tribunal to security for costs, the tribunal may make an award dismissing his claim.*"
In the Report of the Departmental Committee on Arbitration Law, the Committee largely responsible for the formulation of the Act (the „DAC Report"), the reason for this sanction was given as follows (para. 198, cited in *D. Mark Cato*, Arbitration Practice and Procedure – Interlocutory and Hearing Problems, 1997, p. 477):
Whilst the *sanction in court for a failure to provide security for costs is normally a stay of the action,* this is *inappropriate in arbitration:* if an arbitrator stayed proceedings, the arbitration would come to a halt without there necessarily being an award which could be challenged

59. This consequence of punishing the non-compliance with a dismissal having effect of res iudicata may seem harsh, but the other possibilities are unsatisfactory: To dismiss the complaint *without prejudice* when no security for costs was provided would be inappropriate, since the claim could be refiled whenever the claimant deems it suitable. Claimant has one chance, but not two.

60. The remedy provided for by Art. 30 of the Swiss Intercantonal Concordat (which continues to be applicable in domestic arbitrations) for lack of making advances for arbitration costs would also be inappropriate: If one party fails to make the advance, the other party may elect to make the advance of all the costs or to forego the arbitration with the effect that the parties are then no longer bound by the arbitration agreement. A respondent sued by an impecunious claimant would be penalized if the latter fails to provide security for party representation costs and the arbitral tribunal would find that the parties are no longer bound by the arbitration agreement. The claimant could now sue before its own court, and the respondent would be deprived of the benefit, if any, of the arbitration agreement. There cannot be any opting-out of arbitration.

61. There is a difference between the obligation to advance the costs of the arbitral tribunal and the obligation to provide security for costs to one's opponent in arbitration proceedings: In the first case, there is an obligation of the parties *towards the arbitrators* under their contract with them. If the parties decide not to advance the fees and expenses of the arbitrators, they should be relieved from their right and obligation to have their dispute decided by the arbitral tribunal. The obligation to provide security for costs, however, is a *duty owed to the other party* on the basis of the arbitration agreement. A party that fails to discharge that obligation should bear the consequences and should not be allowed to derive benefits from its own wrongdoings (*nemo suam turpitudinem allegans audiatur*).

62. If a counterclaimant fails to provide security for costs with respect to its counterclaim (connected, if that is required), the proper remedy is *dismissal of the counter-claim without prejudice*. If the arbitral tribunal refuses to hear the counter-claim in this arbitration, the respondent incurs the risk that the claim will be granted and that it may have to pay irrespective of what other claims, albeit justified, it may have against the claimant. It will still be in a position to file its own claim before an arbitral tribunal under the same arbitration agreement, or under another arbitration agreement, or before a court having jurisdiction, as the case may be. Its failure to provide security for costs to the claimant only deprives it of the advantage of having the entire relationship considered by the same arbitral tribunal. This is the appropriate sanction.

(e.g., if a party seeks to continue the proceedings). We have therefore included a specific *sanction* with respect to a failure to provide security for costs, which is to be found in clause *[section] 41(6)*. This provision also follows the practice of the English Commercial Court, which changed from the old practice of ordering a stay of proceedings if security was not provided. The disadvantage of the latter course was that it left the proceedings dormant but alive, so that years later they could be revived by the provision of security.

63. As is well-known, the *Ken-Ren* case and the dismay which it caused[30] led to the enactment of a specific provision on security for costs in the English Arbitration Act 1996. The subject is of universal interest and far from solved elsewhere.

Security for costs is but one of the areas where Anglo-American and Mainland European arbitration practice have much to learn from each other. We dedicate this contribution to *Karl-Heinz Böckstiegel*, who has done so much to bring them together with hard and precise strokes.

30 *Jan Paulsson*, The Unwelcome Atavism *of Ken-Ren*: The House of Lords shows its Meddle, ASA Bull. 1994, p. 439 et seq.