

ICCA-QMUL TASK FORCE ON TPF IN INTERNATIONAL ARBITRATION  
SUBCOMMITTEE ON SECURITY FOR COSTS AND COSTS

DRAFT REPORT

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## **INTRODUCTION**

The *Costs Subcommittee* of the ICCA-Queen Mary Task Force on Third-Party Funding was established to address a range of policy and practical issues concerning costs that arise with the participation of third-party funders, including the effect of third-party funders on the decisions of arbitrators on cost allocation and security for costs applications. The purpose of this draft Report on Costs is to provide guidelines in respect of the impact of TPF on allocation of costs and security for costs applications.

Member of the Costs Subcommittee are: Professor Stavros Brekoulakis (Chair), Mr Audley Sheppard, QC, Ms Susan Dunn, Mr Mick Smith and Mr Jonas von Göler.

## **EXECUTIVE SUMMARY**

The draft Report first examines issues on awarding of costs, and then issues on security for costs applications. Unless a tribunal establishes the likelihood that costs will be awarded, it cannot make a decision on a security for costs application.

As regards **allocation of costs**, the report has reviewed a number of arbitration laws, arbitration rules and arbitral awards on allocation of costs to conclude to the following observations and recommendations:

1. When a party is funded by a third party funder it typically assumes an obligation to reimburse the funder for the costs advanced, in case of successful recovery. This should be sufficient for tribunals to accept that a funded party has incurred costs.
2. The fact that a party's costs have been funded should generally not be regarded as a relevant factor in determining whether or not costs are to be allocated based on the outcome of the case.
3. It is not appropriate for tribunals to award funding costs (such as a conditional fee, ATE-premium, or litigation funder's return), as they are not procedural costs incurred for the purpose of an arbitration.
4. In principle, a tribunal will lack jurisdiction to issue a costs order against a third-party funder.

As regards **security for costs**, the report has reviewed a number of arbitration laws, arbitration rules and arbitral awards on security for costs to conclude to the following observations and recommendations:

1. Arbitral tribunals should ascertain the financial situation of the claimant starting from general financial records, such as annual accounts and statutory returns. A third-party funding agreement may be considered as an indication of the funded party's financial situation along with other financial records, however on its own it is no necessary indication that a claimant is impecunious.
2. *It is not for this committee to lay down a test for awarding security for costs. However, if the test in commercial arbitration is that the applicant must show material change of circumstances that were commercially unforeseeable (consent perspective), then*

*procuring external funding of legal costs should not usually be proof that circumstances have materially changed in a way that is commercially unforeseeable.*

3. *It is not for this committee to lay down a test for awarding security for costs. However, if the test in investment arbitration is that the applicant must show that there are extreme circumstances that warrant a security for costs order, then mere recourse to third-party funding by a claimant that has become impecunious cannot readily be characterized as carrying an element of abuse, and cannot of itself be taken as a reason for tribunals to award security for costs.*
4. When reviewing third-party funding agreements for the purpose of assessing security for costs applications, tribunals should pay particular attention to clauses on termination rights and clauses on funders' liability for adverse costs.
5. Arbitral tribunals should consider indicating to the requesting party that, should the defence fail, it will be held liable for the costs reasonably incurred by the funded party in posting security.

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## AWARDING OF COSTS

When awarding costs at the end of the proceedings, an arbitral tribunal has to address a number of issues. First, it must determine whether costs will be awarded. Second, if costs will be awarded, how they should be allocated. Third, where costs are allocated based on the outcome of the case, the tribunal must determine which of the prevailing party's costs are recoverable (type and amount of recoverable costs). An arbitral tribunal's decisions on these issues will be framed by the applicable arbitral laws and rules [A]. A number of arbitral tribunals (and state courts) have already dealt with the awarding of costs in the presence of a third-party funder. These decisions shall be looked at [B] before presenting the recommendations of the sub-committee on how Tribunals should award costs in claims funded by third-party funders [C].

The Report addresses the following issues:

1. *Should a funded party that has prevailed in the arbitration be able to recover party costs at all where these costs have been funded by a third party?*
2. *Where costs are allocated based on the outcome of the case and the funded party prevails, what type of costs can it recover from the opponent?*
3. *Where costs are allocated based on the outcome of the case and the non-funded party prevails, could an arbitral tribunal render a costs order directly against a third-party funder?*

### **[A] Arbitral Laws and Rules**

#### **[1] Arbitral Laws**

English arbitration law contains comparatively detailed provisions on costs allocation. Section 61 English Arbitration Act 1996 provides that:

- (1) The tribunal may make an award allocating the costs of the arbitration as between the parties, subject to any agreement of the parties.
- (2) Unless the parties otherwise agree, the tribunal shall award costs on the general principle that costs should follow the event except where it appears to the tribunal that in the circumstances this is not appropriate in relation to the whole or part of the costs.

As regards the amount of recoverable costs, Section 63 English Arbitration Act 1996 states:

- (3) The tribunal may determine by award the recoverable costs of the arbitration on such basis as it thinks fit.

If it does so, it shall specify—

- (a) the basis on which it has acted, and
- (b) the items of recoverable costs and the amount referable to each.

(4) If the tribunal does not determine the recoverable costs of the arbitration, any party to the arbitral proceedings may apply to the court (upon notice to the other parties) which may—

(a) determine the recoverable costs of the arbitration on such basis as it thinks fit, or

(b) order that they shall be determined by such means and upon such terms as it may specify.

(5) Unless the tribunal or the court determines otherwise—

(a) the recoverable costs of the arbitration shall be determined on the basis that there shall be allowed a reasonable amount in respect of all costs reasonably incurred, and

(b) any doubt as to whether costs were reasonably incurred or were reasonable in amount shall be resolved in favour of the paying party.

Default rules on costs shifting can also be found in the arbitration laws of Hong Kong, Germany, Spain, Brazil and Portugal.<sup>1</sup> While the arbitration laws of UNCITRAL Model Law, France, Switzerland, and the United States are silent on the issue of costs allocation, it is clear that tribunals sitting in these jurisdictions have the power to render awards on costs.

## **[2] Arbitral Rules**

Many widely used arbitral rules contain a presumption that costs should follow the event, or should be allocated based on the degree of success, unless particular circumstances call for a different approach.<sup>2</sup> Other rules simply provide for wide arbitrator discretion.<sup>3</sup>

As regards the type and amount of recoverable party costs, Article 40(2)(e) UNCITRAL Rules is representative, limiting recoverable costs to ‘[t]he legal and other costs incurred by the parties in relation to the arbitration to the extent that the arbitral tribunal determines that the amount of such costs is reasonable’. Similar formulations can be found, for instance, in the ICC Rules,<sup>4</sup> the LCIA Rules,<sup>5</sup> and the CIETAC Rules<sup>6</sup>

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<sup>1</sup> Hong Kong Arbitration Ordinance 2011, s. 72(4) (written offer to settle as a particularly relevant factor), German Code of Civil Procedure, s. 1057(1) (outcome of the case as a particularly relevant factor), Spain, Art. 37 of Law 60/2003, Portugal Art.42 of Law 63/2011 and Brazil Art.27 of Law 13.129 of 26 May 2015.

<sup>2</sup> UNCITRAL Rules, Art. 42 (‘costs of the arbitration shall in principle be borne by the unsuccessful party’); LCIA Rules, Art. 28(4) (‘costs should reflect the parties’ relative success and failure in the award or arbitration or under different issues, except where it appears to the Arbitral Tribunal that in the circumstances the application of such a general principle would be inappropriate under the Arbitration Agreement or otherwise’); DIS Rules, s. 35(2) (‘[i]n principle, the unsuccessful party shall bear the costs of the arbitral proceedings’, but the tribunal may order each party to bear its own costs or apportion the costs between the parties, in particular, where each party is partly successful and partly unsuccessful); WIPO Rules, Art. 74.

<sup>3</sup> ICSID Convention, Art. 61(2) (‘the Tribunal shall, except as the parties otherwise agree, assess the expenses incurred by the parties in connection with the proceedings, and shall decide how and by whom those expenses, the fees and expenses of the members of the Tribunal and the charges for the use of the facilities of the Centre shall be paid’); SIAC Rules, Art. 31(1) (‘[u]nless the parties have agreed otherwise, the Tribunal shall determine in the award the apportionment of the costs of the arbitration among the parties’); ICC Rules, Art. 37(5) (‘[i]n making decisions as to costs, the arbitral tribunal may take into account such circumstances as it considers relevant, including the extent to which each party has conducted the arbitration in an expeditious and cost-effective manner’).

<sup>4</sup> ICC Rules, Art. 37(1) (‘reasonable legal and other costs incurred by the parties for the arbitration’).

### [3] *Arbitral Practice*

Since the procedural matrix established by the arbitration law and rules typically allow tribunals wide discretion as regards costs allocation, it is not always easy to predict how an arbitral tribunal will ultimately approach the issue in a given case. The award of substantial costs based on the case's outcome – notably of legal costs based on counsel's hourly fees – constitutes an approach that is especially prevalent in the United Kingdom and affiliate jurisdictions. Nevertheless, it is one that appears to be increasingly applied in international arbitration as well, not least since, as discussed above, many widely used arbitral rules provide that the prevailing party is presumptively entitled to its costs, while authorizing the tribunal to adopt a different standard if appropriate in the particular case.

### [B] *Costs Decisions in Third-Party Funding Scenarios*

This section looks at the nascent body of (arbitral) case law dealing with the awarding of costs in the context of third-party funding.

#### [1] *Kardassopoulos v. Georgia*

In *Ioannis Kardassopoulos & Ron Fuchs v. Georgia*<sup>7</sup> (Fortier (P), Orego Vicuna, Lowe) the investors were successful in an arbitration funded by German company Allianz Litigation Funding for a claim against Georgia for compensation for the unlawful termination of a concession to build and maintain a pipeline. Claimants requested that they be awarded costs of proceedings including legal costs, arguing that there is a trend of outcome-based recovery in investment-treaty arbitration. Respondent argued, *inter alia*, that claimants' legal costs were excessive and they could have been borne in part by a third-party investor and therefore not properly recoverable. The Tribunal held that:

The Tribunal knows of no principle why any such third party financing arrangement should be taken into consideration in determining the amount of recovery by the Claimants of their costs.<sup>8</sup>

This passage has been adopted by the ICSID annulment committees in *RSM v. Grenada*<sup>9</sup> and *ATA v. Jordan*<sup>10</sup>.

#### [2] *Siag and Vecchi v. Egypt*

In *Siag and Vecchi v. Egypt*<sup>11</sup> the claimants' law firm (King & Spalding) had acted on a contingency fee basis. Despite this, the claimants requested recovery of a specified amount of

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<sup>5</sup> LCIA Rules, s. 28(3) ('legal or other expenses incurred by a party ... The Arbitral Tribunal shall decide the amount of such Legal Costs on such reasonable basis as it thinks appropriate').

<sup>6</sup> CIETAC Rules, Art. 50(2) (winner entitled to 'the expenses reasonably incurred by it in pursuing the case').

<sup>7</sup> *Kardassopoulos and Fuchs v. The Republic of Georgia*, ICSID Case Nos. ARB/05/18 and ARB/07/15, Award of 3 March 2010.

<sup>8</sup> *Ibid.*, para. 691.

<sup>9</sup> *RSM Production Corporation v. Grenada*, ICSID Case No. ARB/05/14 (Annulment Proceeding), Order of the Committee Discontinuing the Proceeding and Decision on Costs of 28 April 2011, para. 68.

<sup>10</sup> *ATA Construction, Industrial and Trading Company v. The Hashemite Kingdom of Jordan*, ICSID Case No. ARB/08/2 (Annulment Proceeding), Order Taking Note of the Discontinuance of the Proceeding of 11 July 2011, para. 34.

<sup>11</sup> *Siag and Vecchi v. The Arab Republic of Egypt*, ICSID Case No. ARB/05/15, Award of 1 June 2009.

normal (hourly) fees, without the corresponding invoices or other details. The tribunal accepted this. Orrego Vicuna dissented, albeit not on the issue of substantiation of costs, but more generally on the allocation of costs:

In respect of the costs of this arbitration I believe that a more adequate approach would be to require each party to pay one half of such costs, particularly taking into account the fact that the Claimant agreed to pay attorney's fees only on a successful recovery. While there is nothing unusual in such arrangement, it entails the acceptance of the Claimant of a degree of risk that should not entirely be shifted to the Respondent, particularly in view of the amounts involved.<sup>12</sup>

### **[3] *Quasar de Valores v. Russia***

In *Quasar de Valores v. Russia* the tribunal denied the prevailing Spanish portfolio investors in Yukos recovery of their costs because the funder (Menatep, ex-majority shareholder in Yukos) had funded the entirely costs of the proceedings and had no contractual right vis-à-vis the claimants for reimbursement of these costs. The tribunal explained that:

The usual arguments about the recoverability of costs where a party's representation in a case has been financed by a third party are inapposite here, because such third-party financing is typically part of a legally enforceable bargain under which the prevailing party in the arbitration has given up something in return for that support. Here, it is conceded that there is no legal duty on the part of the Claimants to hand over any recovery on account of costs to Menatep.<sup>13</sup>

### **[4] *ICC Case No. 7006***

By contrast to *Quasar de Valores v. Russia*, an ICC tribunal noted (obiter) that the legal costs of a respondent that had been paid by a third party (insurer) would have been recoverable had the respondent succeeded:

I believe that they are [recoverable], at least from the point that Defendants rather than the [indemnifier], mandated counsel to represent them in the arbitration. By so doing, they incurred the primary obligation to pay such counsel's fees and expenses-one not negated by the fact that someone else, through prior arrangement, paid them on their behalf. The counterpart to this determination is that Defendants would be obliged to reimburse their indemnifier any costs they recovered from the arbitration.<sup>14</sup>

### **[5] *Case Law From the UK and the US holding Funders Liable for Costs***

As regards the question whether a third-party funder may be ordered to pay adverse costs should the funded claim fail, there is case law from the UK<sup>15</sup> and the US<sup>16</sup> to the effect that

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<sup>12</sup> *Siag and Vecchi v. The Arab Republic of Egypt*, ICSID Case No. ARB/05/15, Dissenting Opinion of Francisco Orrego Vicuña of 11 May 2009, 6.

<sup>13</sup> *Quasar de Valores SICAV S.A. et al. v. The Russian Federation*, SCC Arbitration No. 24/2007, Award of 20 July 2012, para. 223.

<sup>14</sup> *Supplier v First distributor, Second distributor*, ICC Case No. 7006, Final Award of 1992, 4 *ICC Bull.* (May 1993) 49, 49.

<sup>15</sup> *Excalibur Ventures LLC v. Texas Keystone Inc. & Ors v. Psari Holdings Limited & Ors*, English High Court (Queen's Bench, Commercial Court), Order of 23 October 2014, Case No. 2010 Folio 1517, [2014] EWHC



costs can be awarded against third-party funders if they have obtained a sufficient degree of economic interest and control in relation to the claim. It is doubtful whether these cases, stemming from litigation proceedings, can readily be transferred to consensual arbitration proceedings; this will be addressed further below.

***[6] Recoverability of Funding Costs in the UK and the US***

In the United Kingdom, conditional fees and the premium for additional after-the-event insurance were declared recoverable under the British Courts and Legal Services Act as amended by the Access to Justice Act 1999. This has changed with the Legal Aid, Sentencing and Punishment of Offenders Act 2012, which abolished the recoverability of after-the-event insurance premiums and conditional fees for agreements entered into after 1 April 2013. In the United States, the Supreme Court has clarified that in case of contingency fees, only reasonable hourly fees (lodestar-method) are recoverable.<sup>17</sup>

***[C] Key Observations and Suggestions of the Sub-Committee***

This section proceeds from the assumption that the tribunal is generally willing to allocate costs based on the outcome of the case. It also assumes that the amount of legal fees claimed by the prevailing party is reasonable.

***[1] Should a funded party that has prevailed in the arbitration be able to recover party costs at all where these costs have been funded by a third party?***

***[a] Amount of costs: did a funded party ‘incur’ costs?***

Although the answer to this question will depend on the billing structures adopted by third party funders for each case, when a party is funded by a third party funder it typically assumes an obligation to reimburse the funder for the costs advanced. *This should be sufficient for tribunals to accept that a funded party has incurred costs.*

More specifically, the usual practice where a funder is involved, is that the invoices by lawyers are issued in the funded party’s name and become payable by the funder as a result of the funding agreement. The funded party’s lawyers would usually send the invoice to the funder (along with a monthly report). If the funded party and funder are satisfied that the invoice is consistent with the pre-agreed budget then the funder will pay the invoice directly to the lawyer. The fact that there is a funder involved does not change the funded party’s primary liability to discharge the bill. The funded party incurs the obligation to reimburse the funder for the costs so advanced in case of successful recovery (plus a return to the funder as per the funding agreement). For these reasons, the fact that the funder pays the bills can

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3436, paras 4, 161; *Arkin v. Borchard Lines Ltd. & Ors*, English Court of Appeal, Judgement of 16 May 2005, [2005] EWCA Civ. 655 ([w]here ... the non-party not merely funds the proceedings but substantially also controls or at any rate is to benefit from them, justice will ordinarily require that, if the proceedings fail, he will pay the successful party’s costs’).

<sup>16</sup> *Abu-Ghazaleh v. Chaul*, Florida Third District Court of Appeal, Decision of 2 December 2009, Nos. 3D07–3128, 3D07–3130, 36 So. 3d 691.

<sup>17</sup> *City of Burlington v. Dague*, Supreme Court of the United States, Judgement of 24 April 1992, 505 U.S. 557 (addressing costs recovery under federal fee shifting statutes).

hardly give the opposing party a ‘free pass’ on not having to repay any costs if it ultimately fails to defend the claim against it.

***[b] Allocation of costs: should a tribunal deviate from otherwise applicable outcome-based methods of costs allocation in case the prevailing party’s costs have been funded?***

*The fact that a party’s costs have been funded should generally not be regarded as a relevant factor in determining whether or not costs are to be allocated based on the outcome of the case. These costs are still costs that the funded party will have to repay to the funder if it is successful in the claim. The result of not doing this is that the funded party would be left uncompensated for the costs it has incurred which it would have recovered had it not been funded.*

***[2] Where costs are allocated based on the outcome of the case and the funded party prevails, which costs can it recover from the opponent? Only its normal legal costs? Normal legal costs plus additional funding costs contingent on success?***

*It is not appropriate for tribunals to award funding costs (such as a conditional fee, ATE-premium, or litigation funder’s return), as they are not procedural costs incurred for the purpose of an arbitration. The success portion payable to a third-party funder results from a trade-off between the funded party and the funder, where the funder assumes the cost and risk of financing the proceedings and receives a reward if the case is won. This agreement is not linked to the arbitration proceedings as such. The reasonable legal fees incurred by a funded party should remain recoverable.*

Funding costs may be claimed as damages where permitted by the applicable substantive law. It is unclear whether such funding costs would meet the relevant tests for causation and foreseeability.

***[3] Where costs are allocated based on the outcome of the case and the non-funded party prevails, could an arbitral tribunal render a costs order directly against a third-party funder?***

In principle, a tribunal will lack jurisdiction to issue a costs order against a third-party funder. The third-party funder is not typically party to the arbitration agreement, and has no involvement in the underlying dispute between the two parties in an arbitration. While funders may be involved in the proceedings, this cannot readily be interpreted as consent to arbitrate. The sub-committee is not aware of any arbitral award ordering a third-party funder to pay adverse costs.

However, in the English *Excalibur* case, the third-party funders of the unsuccessful claimant were joined to the proceedings and ordered to pay the defendants’ costs.<sup>18</sup> In the United Kingdom, the court’s power to make costs orders flows from section 51(1) and (3) of the Supreme Court Act 1981 (now known as Senior Courts Act), which provides that ‘[s]ubject to the provisions of this or any other enactment and to rules of court, the costs of and incidental

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<sup>18</sup> *Excalibur Ventures LLC v. Texas Keystone Inc. & Ors v. Psari Holdings Limited & Ors*, English High Court (Queen’s Bench, Commercial Court), Order of 23 October 2014, Case No. 2010 Folio 1517, [2014] EWHC 3436, paras 4, 161.

to all proceedings ... shall be in the discretion of the court ... The court shall have full power to determine by whom and to what extent the costs are to be paid'. Such type of discretionary powers for ordering costs is very different from the consensual basis of arbitration. It therefore appears difficult to draw an analogy to the situation in international arbitration.

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## SECURITY FOR COSTS

An arbitral tribunal seized with a security for costs request must balance the claimant's interest in having access to justice and the respondent's interest in being able to recover its costs in case of success. Should an arbitral tribunal take into account the fact that a claimant has obtained third-party funding in deciding whether to grant security for costs? If so, how?

An important threshold issue is whether an arbitral tribunal will allocate costs to the losing party (or whether each party will bear its own costs). The more likely it is that the tribunal will allocate costs to the losing party, the more likely it will consider granting the respondent security for its – potentially recoverable – costs. Awarding of costs and third-party funding has been addressed in the preceding section. Assuming that an arbitral tribunal will shift costs to the losing party, the question arises how third-party funding affects whether or not security for costs may be granted. A tribunal's power to order security for costs is shaped by the applicable arbitral laws and rules [A]. Since these laws and rules do not provide specific guidance on when to grant security, it is helpful to review the practice of arbitral tribunals in investment arbitration and commercial arbitration [B]. Finally, this section identifies the key issues and criteria regarding security for costs, and presents the views of the sub-committee on the significance of third-party funding for evaluating security for costs requests [C].

*As regards security for costs, the report distinguishes between commercial and investment arbitration and addresses the following issues:*

- 1. What is the relevance of a third-party funding agreement in ascertaining whether the claimant is impecunious?*
- 2. Should tribunals take into account third-party funding arrangements when assessing applications for security for costs?*
- 3. Should the party seeking security for costs be held liable for the claimant's cost of posting security if the defence fails?*

### **[A] Arbitral Laws and Rules**

As regards an arbitral tribunal's power to order security for costs, three situations can broadly be identified. No problems should arise where the parties have expressly conferred to the tribunal the power to order security for costs, or have agreed to arbitrate under an arbitration law that expressly allows arbitrators to order security for costs,<sup>19</sup> or have chosen arbitral rules containing such provisions<sup>20</sup>. The situation is less clear where the applicable arbitration law or arbitration rules only contain a general clause for interim measures.<sup>21</sup> Recently, an ICSID tribunal noted that one of the reasons why the general clause on interim measures contained in Article 47 ICSID Convention should cover security for costs is that, when the ICSID

<sup>19</sup> See, e.g., English Arbitration Act 1996, s. 38(3); Hong Kong Arbitration Ordinance 2011, s. 56(1)(a).

<sup>20</sup> See, e.g., LCIA Rules, Art. 25(2); HKIAC Rules, Art. 24; CEPANI Rules, Art. 27(1); SIAC Rules, Art. 24(k).

<sup>21</sup> See, e.g., French Code of Civil Procedure (as reformed in 2011), Art. 1468; Swiss Private International Law Act, Art. 183(1); German Code of Civil Procedure, s. 1041(1); ICC Rules, Art. 28(1); ICDR Rules, Art. 21(1).

Convention was drafted in 1965, ‘issues such as third party funding and thus the shifting of the financial risk away from the claiming party were not as frequent, if at all, as they are today’.<sup>22</sup> In the third situation, neither express provisions nor a general clause on interim measures exists that could serve as a basis for the tribunal’s power to order security for costs. In that case, it can still be argued that the tribunal’s power to order security for costs is anchored in its inherent power to preserve the integrity of the proceedings.<sup>23</sup>

### ***[B] The Practice of Arbitral Tribunals – Criteria for Security for Costs***

While the above arbitral laws and rules allow tribunals to order security payment, they do not lay down the circumstances or conditions upon which tribunals may order security for costs. As a result, arbitrators typically enjoy discretion in this regard. While no uniform test has developed, review of the practice of arbitral tribunals allows us to make a number of guidelines which may inform tribunals when deciding to award security for costs. It should be noted though that the purpose of this report is not to recommend a test for a security for costs award, but to examine the relevance of the Third Party Funding in security for costs applications.

In the practice of arbitral tribunals, a key aspect is usually the financial situation of the party against which security payment is requested. There must be sufficient evidence to assume that the current financial circumstances of the claimant are such that it will not be able to pay the respondent’s costs at the end of the proceedings.<sup>24</sup> Generally speaking, the burden of proof lies on the party seeking security.<sup>25</sup>

### ***[1] Commercial Arbitration***

In international commercial arbitration, when assessing the financial situation of the claimant tribunals should take into account that the parties have *agreed* at some point to submit disputes arising between them to arbitration. For this reason, it may not suffice that the funded claimant is likely not to be able to pay a potential adverse costs award. Rather, a tribunal will usually need to consider whether the financial situation of the claimant has materially and unforeseeably changed since the conclusion of the arbitration agreement.<sup>26</sup> A respondent which knew (or ought to have known) that the claimant is impecunious when agreeing to arbitrate disputes with that claimant should not be able to obtain security for its costs. The

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<sup>22</sup> *RSM Production Corporation v. Saint Lucia*, ICSID Case No. ARB/12/10, Decision on Saint Lucia’s Request for Security for Costs of 13 August 2014, para. 55. Whether the explanation offered by the Tribunal in this case is accurate or supported by the history of drafting the ICSID Convention is questionable, and the question of the propriety and jurisdiction to order a State to post security for costs is much more complex.

<sup>23</sup> Craig, Park & Paulsson, *International Chamber of Commerce Arbitration*, 467 (who report that even when the ICC Rules did not yet contain a general clause for granting interim measures, ‘ICC tribunals had found that they had the power to grant security for costs as part of their inherent powers in connection with the conduct of arbitral proceedings’) (with further references); *Commerce Group Corp. & San Sebastian Gold Mines, Inc. v the Republic of El Salvador*, ICSID Case No. ARB/09/17 (Annulment Proceeding), Decision on El Salvador’s Application for Security for Costs of 20 September 2012, para. 45.

<sup>24</sup> See, e.g., Chartered Institute of Arbitrators, Practice Guideline 11: Guideline on Security for Costs, para. 3.2.

<sup>25</sup> Waincymer, *Procedure and Evidence in International Arbitration*, 653-654.

<sup>26</sup> See, e.g., *XXX INC., incorporée dans une île des Caraïbes v. YYY S.A., incorporée dans un pays d’Amérique latine*, ICC Case No. 15951/FM, Procedural Order No. 2 of 29 May 2009, 28 *ASA Bull.* (2010) 71, 75; ICC Case No. 10032, Procedural Order of 9 November 1999, para. 45, cited in Karrer & Desax, in *Liber Amicorum Böckstiegel* 339, 348.

possibility that the credit standing of a business partner changes over time is part of normal commercial risk. Therefore, due to the consensual nature of international commercial arbitration, there is less justification generally for granting security for costs when compared with litigation.

In its order dated 3 August 2012, an ICC tribunal (Charles Poncet, Louis Degos, Stephen Bond) examined in great detail a security for costs requests against a claimant that had entered into a litigation funding agreement.<sup>27</sup> The terms of the funding agreement were on the record because claimant had previously transferred the agreement to the respondent, without indicating any reasons for this. The tribunal undertook a detailed survey of the criteria applicable to security for costs requests in international arbitration. In its view, the decisive question was whether the litigation funding agreement ‘constitutes a fundamental change of circumstances which would justify granting security for costs’.<sup>28</sup> It ultimately affirmed this question, the key reasons being the following:

- The claimant was a holding company based in Cyprus that was unlikely to be able to pay adverse costs;
- The funding agreement did not cover adverse costs;
- The tribunal interpreted the funder’s termination rights under the funding agreement to the effect that the funder was ‘empowered to terminate the Agreement at any time, entirely at its discretion’.<sup>29</sup>

The tribunal put emphasis on the fact that the funder could ‘walk out at any time’, thereby increasing the respondent’s risk of walking away empty handed.

## **[2] Investment Arbitration**

Tribunals in ICSID arbitration have occasionally required evidence of *exceptional circumstances* before security can be ordered, such as abusive conduct or some evidence of bad faith on the claimant side.<sup>30</sup> Unlike the case in commercial arbitration, the respondent State here, at least in treaty-based and legislation-based investment arbitration (albeit not for contract-based investment arbitration), has not signed an arbitration agreement with a particular claimant. However, the respondent is often alleged of having unlawfully expropriated the claimant, thereby causing claimant’s impecuniosity. For this reason, access

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<sup>27</sup> *X v. Y and Z*, ICC Case, Procedural Order of 3 August 2012, published in Pinsolle, *Cah. Arb.* (2013), 399-416.

<sup>28</sup> *Ibid.*, paras 28, 33.

<sup>29</sup> *Ibid.*, para. 43.

<sup>30</sup> See *RSM Production Corporation v. Saint Lucia*, ICSID Case No. ARB/12/10, Decision on Saint Lucia’s Request for Security for Costs of 13 August 2014, para. 75; *Phoenix Action, Ltd. v. Czech Republic*, ICSID Case No. ARB/06/5, Decision on Provisional Measures of 6 April 2007, para. 32; *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Order of the Tribunal on the Claimant’s Request for Urgent Provisional Measures of 6 September 2005, para. 38; *Saipem S.p.A. v. People’s Republic of Bangladesh*, ICSID Case No. ARB/05/7, Decision on Jurisdiction and Recommendation on Provisional Measures of 21 March 2007, para. 175; *Occidental Petroleum Corporation and Occidental Exploration and Production Company v. Republic of Ecuador*, ICSID Case No. ARB/06/11, Decision on Provisional Measures of 17 August 2007, para. 59; *Rachel S. Grynberg, Stephen M. Grynberg, Miriam Z. Grynberg and RSM Production Corporation v. Grenada*, ICSID Case No. ARB/10/6, Decision on Respondent’s Application for Security for Costs of 14 October 2010, para. 5.17; *Commerce Group Corp. & San Sebastian Gold Mines, Inc. v the Republic of El Salvador*, ICSID Case No. ARB/09/17 (Annulment Proceeding), Decision on El Salvador’s Application for Security for Costs of 20 September 2012, para. 45; *Burimi S.R.L. and Eagle Games S.H.A. v. Republic of Albania*, ICSID Case No. ARB/11/18, Procedural Order No. 2 of 3 May 2012, para. 34.

to justice for claimants can be an even more delicate issue in investment arbitration disputes. This may explain why investment tribunals are usually very cautious when it comes to requiring investors to post security in order for the claim to proceed.

In *RSM Production Corporation v. Saint Lucia*,<sup>31</sup> an ICSID tribunal – for the first time ever – ordered a claimant to post security for costs. In line with previous ICSID cases, the tribunal required a showing of exceptional circumstances. The Tribunal held that:

Those circumstances are, in summary, the proven history where Claimant did not comply with cost orders and awards due to its inability or unwillingness, the fact that it admittedly does not have sufficient financial resources itself and the (also admitted) fact that it is funded by an unknown third party which, as the Tribunal sees reasons to believe, might not warrant compliance with a possible costs award rendered in favor of Respondent.<sup>32</sup>

While the tribunal was of the opinion that the “Claimant’s consistent procedural history in other ICSID and non-ICSID proceedings provide compelling grounds for granting Respondent’s request”, there was no evidence in the record as to the identity of the funder, the funding agreement, and whether or not the funder was contractually responsible for adverse costs.

Gavan Griffith, the respondent appointed arbitrator, published an assenting opinion in which he lays down the reasons that in his view justify the security order. In contrast to the chairman (Siegfried Elsing), who based the order mainly on the claimant’s proven history of not honouring costs awards, Griffith stressed the funding aspect. He suggested that:

once it appears that there is third party funding of an investor’s claims, the onus is cast on the claimant to disclose all relevant factors and to make a case why security for costs orders should not be made... An example of contrary circumstances might be to establish that the funded claimant has independent capacity to meet costs orders.<sup>33</sup>

In assessing the implications of this case, it appears important to avoid confusing the security order with the respondent appointed arbitrator’s assenting reasons, which are not part of this order. The objective behind the order was to secure the respondent’s right of recovering its legal costs against a claimant that had admitted it would not be able to pay, and – this is the decisive point – had a proven history of defaulting on costs orders. The tribunal viewed the claimant’s past conduct as sufficient evidence of bad faith. It additionally pointed out that third-party funding could not alleviate the concerns that the claimant will again default on payment, as the funder’s responsibility for adverse costs was uncertain. Unlike what is sometimes alleged, nothing in the decision supports the idea of ordering security payment whenever third party funding is present.

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<sup>31</sup> *RSM Production Corporation v. Saint Lucia*, ICSID Case No. ARB/12/10, Decision on Saint Lucia’s Request for Security for Costs of 13 August 2014.

<sup>32</sup> *Ibid.*, para. 86.

<sup>33</sup> *RSM Production Corporation v. Saint Lucia*, ICSID Case No. ARB/12/10, Assenting Reasons of Gavan Griffith of 12 August 2014, paras 18, 16.

***[C] Key Observations and Recommendations of the Sub-Committee***

***[1] What is the relevance of a third-party funding agreement in ascertaining whether the claimant is impecunious?***

*The Sub-Committee recommends that arbitral tribunals ascertain the financial situation of the claimant starting from general financial records, such as annual accounts and statutory returns. A third-party funding agreement may be considered as an indication of the funded party's financial situation along with other financial records, however on its own it is no necessary indication that a claimant is impecunious. Third-party funding is increasingly used by large, solvent, companies as a way to offset risk. The mere presence of a third-party funder is therefore not, in itself, sufficient reason to grant security for costs. As such, the presence of a funder should not shift the burden of proof as to whether the requirements for security for costs are fulfilled.*

***[2] Should tribunals take into account third-party funding arrangements when assessing applications for security for costs?***

Third-party funding should be one factor for the tribunals to take into account in both Commercial (a) and Investment Arbitration (b). But, following disclosure of the funding agreement (where disclosure is warranted in the first place), tribunals will need to carefully review the terms of the funding agreement (c).

***[a] Security for Costs Applications in International Commercial Arbitration***

*It is not for this committee to lay down a test for awarding security for costs. However, if the test in commercial arbitration is that the applicant must show material change of circumstances that were commercially unforeseeable (consent perspective), then procuring external funding of legal costs should not usually be proof that circumstances have materially changed in a way that is commercially unforeseeable. However, where a third party funder has agreed to be liable for adverse costs, and then opts to discontinue funding, this may be a relevant consideration suggesting material and unforeseeable change of circumstances. It is suggested that third-party funders or funded parties should notify the defendant, if funding is discontinued, particularly in circumstances where the defendant has previously knowingly proceeded on the basis that the funder would meet the adverse costs.*

Even where recourse to funding is not considered unforeseeable, a tribunal might want to take into account broader fairness considerations and ask whether it would be unfair for the requesting party to proceed without security in light of all circumstances, including the funding agreement.

***[b] Security for costs application in Investment Arbitration***

*It is not for this committee to lay down a test for awarding security for costs. However, if the test in investment arbitration is that the applicant must show that there are extreme circumstances that warrant a security for costs order, then such extreme circumstances may involve an element of abuse or bad faith. That might be the case, for example, in situations where the claimant company was deliberately created as a mere procedural shell to collect money if the case is won, and frustrate the respondent's costs claim if the case is lost. By*



*contrast, mere recourse to third-party funding by a claimant that has become impecunious cannot readily be characterized as carrying an element of abuse, and cannot of itself be taken as a reason for tribunals to award security for costs.*

***[c] Which terms of a funding agreement may become relevant?***

***Termination rights***

The circumstances in which the funder is entitled to terminate their funding and their liability for adverse costs in circumstances where they do terminate are relevant and should be taken into account by tribunals when deciding security for costs applications.

Most professional funders have very clear termination provisions which spell out, in circumstances where they have agreed to be liable for adverse costs, when they are liable for such costs, which typically is for the duration of their funding. Where a funder is a member of the Association of Litigation Funders of England and Wales (ALF), its funding agreements must comply with the ALF Code of Conduct for Litigation Funders (ALF Code, January 2014). Article 13.2 ALF Code requires that, in case of a dispute over termination, ‘a binding opinion shall be obtained from a Queen’s Counsel who shall be instructed jointly or nominated by the Chairman of the Bar Council’. Only if the Queen’s Counsel agrees with the funder that it is lawful to terminate, will the Termination Notice be valid. Funders operating in other jurisdictions have internal codes that set out their practice in respect of whether and under which circumstances they can terminate funding.

***Arrangements that the funder is not liable for adverse costs***

Where a funded party steps forward and shows that a solvent funder is contractually liable for a potential adverse costs award, this will usually render unnecessary an order for security for costs. Where a funder has agreed with the funded party to be liable for adverse costs, the capital adequacy of that funder to meet an adverse costs award, whether in its own right or by virtue of an ATE policy, is clearly relevant in assessing whether adequate security has been provided. *It is therefore important for arbitrators to be aware of and take account of arrangements between the funder and the funded party that the former is not liable for adverse costs.*

***Further terms***

Other TPF terms may come into play when Tribunals consider whether to award an order for security for costs, for example terms setting limits for the amount of funding,

*[Other terms to suggest?]*

***[3] Should the party seeking security for costs be held liable for the claimant’s cost of posting security if the defence fails?***

The sub-committee considers *that an arbitral tribunal should consider indicating to the requesting party that, should the defence fail, it will be held liable for the costs reasonably incurred by the funded party in posting security.* It should be for the funded party to substantiate the amount of costs it reasonably incurred in posting security.