

## Arbitration & ADR - United Kingdom

### Refusal to pay share of costs deposit does not entitle other party to litigate

Contributed by **Clifford Chance LLP**

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#### Introduction

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#### Introduction

Towards the beginning of arbitration proceedings, parties are often ordered to pay a deposit on account of the expected costs of the arbitration. The requirement to pay this deposit or 'advance on costs' to the institution administering the arbitration is found in most institutional rules, including those of the International Chamber of Commerce (ICC).

The amount of the advance on costs is based on an estimate of the arbitrators' fees and the costs charged by the arbitral institution for administering the arbitration. Depending on how such costs are calculated, the advance can be substantial. The ICC calculates the advance on costs based on the monetary value of the claims and refunds any amounts not disbursed at the end of the proceedings.

The arbitration will generally proceed only if the parties pay the advance on costs. The ICC Rules provide that if one party (usually the respondent) fails to pay its share, the other party may do so on its behalf. Claimants frequently agree to substitute for a respondent in paying its share in the hope that the arbitral tribunal will ultimately make an award in their favour and order the respondent to reimburse their payment of the advance on costs in full.

The recent decision in *BDMS Limited v Rafael Advanced Defence Systems*<sup>(1)</sup> illustrates what can happen if a respondent fails to pay its share of the advance on costs and the claimant refuses to pay the balance of the advance on the respondent's behalf.

#### Facts

BDMS Limited filed arbitration proceedings against Rafael Advanced Defence Systems in respect of alleged non-payment of a success fee under a consultancy agreement which provided for London-seated ICC arbitration. A sole arbitrator was appointed. The ICC wrote to the parties fixing the advance on costs and ordering the parties to pay it in equal shares.

Rafael's solicitors expressed concern about BDMS's ability to meet any adverse costs order and stated its intention to apply for an order that BDMS provide security for Rafael's costs. Rafael made clear that until adequate security had been put in place, Rafael would not pay its share of the advance on costs. This remained Rafael's position throughout.

BDMS paid its share of the advance on costs, but Rafael refused to pay its share and made a formal application for security for costs against BDMS. On several occasions, the ICC Court renewed its invitation to Rafael to pay the outstanding share of the advance on costs and invited BDMS to substitute for Rafael in paying its share. The ICC Court gave notice that if payment was not received, the proceedings would be withdrawn.

BDMS chose not to substitute for Rafael in paying the outstanding portion. It took the position that Rafael's failure to pay amounted to a fundamental or "repudiatory" breach of the parties' agreement to arbitrate, entitling BDMS to pursue its claim in the High Court instead.

Rafael rejected BDMS's position. It stated that it would continue to comply with the timetable and file submissions in the arbitration. It also reconfirmed that it would pay its share of the advance on costs as soon as BDMS had posted security.

Despite this, BDMS commenced proceedings in the High Court and withdrew the arbitration claim. Rafael applied for a stay of the court proceedings under Section 9 of the Arbitration Act 1996, pursuant to which a court must stay proceedings commenced against a party to an arbitration agreement unless the agreement is null and void, inoperative or incapable of being performed.

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The judge found in favour of Rafael. Holding that Rafael had not committed a repudiatory breach of the arbitration agreement and that the agreement therefore had not become inoperative, he granted a permanent stay of the court proceedings.

## Issues

### ***Did Rafael's failure to pay amount to a breach of the arbitration agreement?***

The judge first considered whether Rafael's non-payment of the advance on costs was an issue of procedure or of substance. He dismissed the contention that an order for payment of an advance of costs was a procedural decision of administrative nature, which was within the exclusive responsibility of the ICC Court and therefore not subject to review by state courts.

The judge found that it was consistent with English law that non-payment of an advance on costs was a breach of a contractual obligation giving rise to a substantive claim. The parties had expressly agreed in the consultancy agreement that the arbitration should take place under the ICC Rules and thereby that they would comply with express provisions of the rules to pay the advance on costs. Rafael's failure to pay therefore amounted to a breach of the arbitration agreement.

### ***Was Rafael's breach repudiatory?***

For Rafael's breach to be repudiatory, BDMS had to show that Rafael had clearly and unequivocally evinced an intention not to perform its obligations under the arbitration agreement in some essential respect or had committed a breach of the arbitration agreement which went to the root of the contract.

The judge considered Canadian and French decisions in support of the conclusion that a refusal or failure to pay an advance on costs might in appropriate cases be repudiatory and observed that the issue of repudiation was necessarily fact dependent.

He concluded that Rafael's breach was not repudiatory and cited the following reasons in support of his conclusion:

- Rafael was not refusing to participate, but in fact actively participated in the arbitration. Its refusal to 'play by the rules' was limited to the issue of payment of the advance on costs. That refusal was not absolute, but a refusal to pay unless security for costs was granted. It did not form part of a wider pattern of repudiatory conduct.
- The breach did not deprive BDMS of its right to arbitrate. It was open to BDMS to proceed with the arbitration by posting a bank guarantee for Rafael's share and then seeking an order or award from the arbitrator ordering the advance to be paid by Rafael. Under the ICC Rules, BDMS could also have objected to the ICC Court against withdrawal of the claim.
- BDMS had not been substantially deprived of the whole benefit of the contract. While BDMS was under no obligation to pay Rafael's share, the ICC Rules provide machinery for dealing with the situation and avoiding a withdrawal of the claim.
- Even if a claim was withdrawn as a result of a default in payment of the advance on costs, the arbitration agreement was not repudiated. There was no restriction on the same claim being brought to arbitration again. Future arbitrations of the same claim were expressly contemplated by the ICC Rules.

The judge held that for the same reasons, the arbitration agreement was not rendered inoperative. Accordingly, Rafael was entitled to a stay of the proceedings.

## Comment

The decision confirms that a respondent's failure to pay an advance on costs amounts to a breach of the arbitration agreement. However, in Rafael's case, the breach was not repudiatory and did not entitle BDMS to treat the arbitration agreement as at an end and to initiate court proceedings instead.

If parties refuse to pay their share of the advance on costs, institutional arbitration rules provide little by way of penalties. The judge in this case gave clear instructions as to what claimants could do in the circumstances: pay the respondent's share and seek an order or award from the tribunal ordering the respondent to reimburse them.

The tactical option to refuse payment of their share of the advance on costs remains open to respondents. However, they run the risk of the arbitral tribunal making an order or award for payment of the advance on costs against them or, at the very least, of the tribunal's looking less favourably on them.

Moreover, respondents that do not pay their advance on costs remain subject to the risk of court proceedings being pursued against them. While Rafael succeeded in obtaining a stay of those proceedings in this case, the judge made clear that the issue was fact dependent. Considerable importance was placed on the fact that Rafael had actively participated in the arbitration and its refusal to pay did not form part of a wider pattern of repudiatory conduct. Whether the result would have been the same had the respondent refused to take part outright remains unclear.

*For further information on this topic please contact [Marie Berard](mailto:marie.berard@cliffordchance.com) or [Katharina Lewis](mailto:katharina.lewis@cliffordchance.com) at Clifford Chance LLP by telephone (+44 20 7006 1000), fax (+44 20 7006 5555) or email ([marie.berard@cliffordchance.com](mailto:marie.berard@cliffordchance.com) or [katharina.lewis@cliffordchance.com](mailto:katharina.lewis@cliffordchance.com)). The Clifford Chance website can be accessed at [www.cliffordchance.com](http://www.cliffordchance.com).*

## Endnotes

(1) [2014] EWHC 451 (Comm).

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