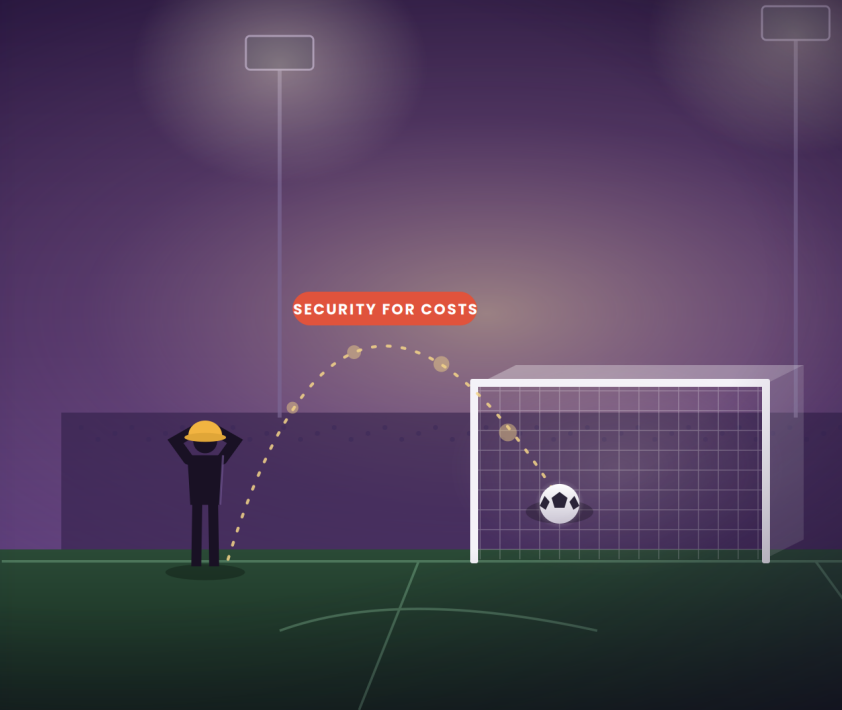


SECURITY FOR COSTS

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# An Own Goal for Main Contractors

Stephen Rayment · Founder &amp; CEO, Systech MDP



*Why an application for security for costs can stifle a legitimate subcontractor claim, and why, in arbitration, it can rebound on the main contractor that makes it.*

Specialist subcontractors live and die by cash flow. Mechanical, electrical and plumbing trades carry heavy upfront exposure in labour, plant, prefabrication and long-lead equipment, and they carry it on margins that leave very little room for a main contractor who decides to sit on payment. So when a legitimate claim finally reaches arbitration, the subcontractor is often already financially stretched by the very non-payment it is trying to recover.

That is precisely the moment a main contractor reaches for an application for security for costs. On paper it looks like sensible risk management. In practice, against a specialist subcontractor, it is frequently **the most effective pressure tactic in the box**, and, used cynically, it can rebound on the contractor who deploys it.

## What security for costs actually is

In an arbitration seated in England and Wales, the tribunal's power comes from **section 38(3) of the Arbitration Act 1996**, which lets it order a claimant to provide security for the costs of the arbitration. Most institutional rules (the LCIA and ICC among them) contain an equivalent power. Two features matter here.

First, the order can only be made against **the party bringing the claim or counterclaim**. A respondent defending a claim is effectively immune, because it did not choose to start the fight. In construction, the claimant is almost always the unpaid subcontractor, so the weapon points one way.

Second, the security is **real money tied up for the duration**. The subcontractor must either deposit a substantial sum into an account for what may be years, or pay for a bank guarantee, a bond, or

after-the-event (ATE) insurance to stand behind any future adverse costs order. None of that is free, and for a business already short of working capital, it can be the difference between pursuing a claim and walking away from it.

## Why it is a genuine problem for specialist subcontractors

The honest reason security-for-costs applications work so well against subcontractors is not that the claims are weak. It is that the applications exploit a financial position the contractor often helped to create.

A subcontractor that has not been paid for completed works is, by definition, more likely to look impecunious on paper. The main contractor then points to that same balance sheet as evidence that an adverse costs award might go unsatisfied, and asks the tribunal to make the subcontractor fund the contractor's defence costs in advance. The effect, intended or not, is to make it more expensive and more risky for the subcontractor to chase money it is genuinely owed. At its worst this is **a denial of justice in slow motion**: a meritorious claim stifled not on its merits but on the claimant's cash position.

Tribunals are alert to this, which is the first reason the tactic is riskier than it looks.

### THE REAL EFFECT

**A denial of justice in slow motion: a meritorious claim stifled not on its merits but on the claimant's cash position.**

## The own goal, part one: the application often fails, at the contractor's expense

There is a well-worn and powerful line of resistance to these applications: a tribunal will be reluctant to order security where **the claimant's financial weakness was caused by the respondent's own breach**. If the subcontractor can show that it is only short of funds because the contractor failed to pay what was due, the equity of the application collapses. Why should a contractor be allowed to benefit from the consequences of its own default?

The Chartered Institute of Arbitrators' guidance and a consistent body of case law push tribunals to weigh the unfairness of stifling a genuine claim against the unfairness of leaving a successful respondent unable to recover its costs. Where the respondent manufactured the very impecuniosity it now relies on, that balance tips against the order. The contractor has then spent legal fees and management time on a failed interim application, and has handed the subcontractor a compelling narrative of bad-faith conduct to carry into the main hearing.

## The own goal, part two: the cost of providing security can become recoverable

This is the point most main contractors miss, and it is where the tactic can genuinely backfire.

Costs in arbitration are not the same as costs in court litigation. **Section 59(1)(c) of the Arbitration Act 1996** defines the recoverable "costs of the arbitration" to include the "legal or other costs of the parties," and section 63(3) gives the tribunal a wide discretion over what to award. That phrase, "other costs," is materially broader than what the Civil Procedure Rules allow a court to award.

In *Essar Oilfield Services Ltd v Norscot Rig Management Pvt Ltd* [2016] EWHC 2361 (Comm), the Commercial Court upheld an arbitrator's award that allowed the successful claimant to recover the cost of the third-party funding it had been forced to obtain, a sum of around £1.94 million, as "other costs" under s.59(1)(c). The decisive findings were about the losing party's conduct: the tribunal found that the respondent had set out to cripple the claimant financially, leaving it no realistic alternative but to fund the claim externally. The court confirmed that **the arbitration costs regime stands on its own feet** and is not subservient to the litigation rules, so costs that would never be recoverable in court can be recoverable in arbitration.

The logic translates directly to security for costs. If a main contractor's non-payment forces a subcontractor to take out a bond, buy ATE cover, or arrange funding to provide the security the contractor itself has demanded, the financing costs of doing so are exactly the kind of "other costs" that *Essar* opened the door to recovering. Put bluntly: the contractor may end up paying not only the subcontractor's claim and legal costs, but also **the cost the subcontractor incurred to satisfy the contractor's own tactical application**.

Two cautions, because this is not a magic wand. *Essar* turned on egregious conduct, and recovery of funding or security costs as "other costs" remains discretionary and fact-sensitive rather than automatic. But a later challenge (in 2021) confirmed that *Essar* cannot simply be dismissed as confined to its facts, and the conduct that makes such an award likely, squeezing a subcontractor financially and then leaning on its weakened position, is depressingly common in payment disputes. Aggressive tactics also invite costs to be assessed on the indemnity basis, which widens recovery further.

### **The ATE twist: nil cost to the subcontractor, a real bill for the contractor**

This is where the economics get genuinely uncomfortable for the contractor.

After-the-event (ATE) insurance can be arranged so that the premium is deferred and contingent, payable only out of the proceeds if the subcontractor wins, and waived entirely if it loses. The cover is non-recourse: if the claim fails, no premium is owed and the insurer pays out under the policy. In practical terms, the subcontractor can insure against an adverse costs order, or post ATE cover as the very security the contractor has demanded, with **nil up-front cost** and no drain on its working capital. The risk sits with the insurer, not the sub.

The trade-off is that a deferred, success-based premium is materially more expensive than one paid up front, precisely because the insurer is only paid if the case succeeds and prices that risk accordingly. And in an arbitration seated in England and Wales, the *Essar* reasoning means that premium is potentially recoverable from the losing contractor as part of the "other costs" of the arbitration.

Put the two together and the contractor's position is stark. By pressing for security, the contractor may push the subcontractor straight into an ATE policy that costs the sub nothing now, costs the sub nothing if the claim fails, and, if the claim succeeds, lands a substantial success-based premium on the contractor, on top of the damages and legal costs it already owes. **The pressure tactic has, in effect, written the contractor a cheque payable only in the event that it loses.**

#### **THE OWN GOAL**

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## What about the United States?

The analysis above is built on the Arbitration Act 1996 and is strongest for arbitration seated in England and Wales. The United States starts from the opposite default: under the “**American Rule,**” each party bears its own attorneys’ fees and costs unless an exception applies. So the costs-recoverability argument does not run automatically, but it is far from closed, and whether it bites depends on several factors.

The main routes by which a US subcontractor’s costs, and potentially its financing and insurance costs, can become recoverable include:

- **A contractual fee-shifting clause.** Prevailing-party attorneys’ fee provisions are increasingly common in US construction subcontracts, and commentators have described a steady erosion of the American Rule in the sector. Where the subcontract contains one, the door to recovery is already open.
- **A fee-shifting statute.** Many states allow attorneys’ fees to a prevailing claimant under prompt-payment acts, mechanics’ lien statutes, or payment-bond statutes, precisely the kinds of claims specialist subcontractors bring.
- **The arbitration rules and what the parties ask for.** Under the AAA Construction Industry Arbitration Rules (and comparable JAMS provisions), an arbitrator may award attorneys’ fees where all parties have requested them, or where it is authorised by law or the arbitration agreement. A contractor that itself requests fees can inadvertently open the same gateway for the subcontractor.

On top of these, tribunals in arbitrations seated in or governed by US law have in some cases awarded contingent fees, and even the costs of a litigation funder, again depending on the facts. The lesson is the same on both sides of the Atlantic: the more aggressively a contractor litigates costs, the more avenues it may be creating for those costs to travel back the other way.

## The practical takeaways

### For specialist subcontractors

- Treat a security-for-costs application as an argument to be won, not a bill to be paid. Build the evidential record early that links your cash position to the contractor’s non-payment.
- Keep clean records of every cost of providing security or funding the claim: bond fees, ATE premiums, the financing cost of tying up capital. These are potentially recoverable, and you cannot recover what you have not documented.
- Get specialist arbitration advice before conceding security or abandoning a claim under pressure. The application may be weaker than it feels.

### For main contractors and GCs

- Ask whether the application is genuine risk management or a tactic, because a tribunal will ask the same question.
- Recognise that if your own payment behaviour created the subcontractor’s weakness, the application is likely to fail and to expose you to the subcontractor’s funding and security costs on the back end.
- Factor in the conduct point. The same behaviour that makes a security application attractive in the short term is the behaviour that attracts indemnity costs and “other costs” recovery in the final award.

## The bottom line

Security for costs is a legitimate tool, and there are cases where it properly protects a respondent. But used as a lever to choke off a specialist subcontractor's genuine claim, it carries a sting in the tail. In a costs regime as broad as the Arbitration Act 1996's, **the contractor who tries to make the subcontractor pay to play may find it has simply added another recoverable line to the award against it.**

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*If you build, sub-contract or arbitrate in this space, it is worth asking on which side of that line your next security-for-costs decision falls.*

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*This article addresses arbitration seated in England and Wales under the Arbitration Act 1996, where the costs-recoverability argument is strongest, and separately outlines the narrower, factor-dependent position in the United States under the American Rule. It is general commentary, not legal advice; outcomes turn on the facts, the seat of the arbitration, the governing contract and the applicable rules.*