"A general judicial discretion would do not more harm than good. It would introduce an unacceptable element of uncertainty into the law . . . "

I rest my case.

THE SEALED OFFER IN ARBITRATION
by Julian Critchlow, Winward Fearon & Co.

Not so long ago two ladies who were wrongfully prosecuted by Tesco for alleged shoplifting themselves subsequently brought proceedings against Tesco for defamation. At trial both ladies established liability and were awarded modest compensation. However, a substantial proportion of the costs of the action, which were considerable, was ordered to be paid by the ladies to Tesco. As a consequence, both ladies were severely out of pocket and expressions of outrage at this presumed injustice appeared in the national press.

This upsurge of righteous indignation stemmed from a failure to appreciate the significance of the High Court process of the payment into court (which was operated by Tesco in this case) and which has a sister process, the sealed offer, which is applicable to arbitrations.

Purpose

The payment into court and sealed offer perform identical functions namely:

(i) the promotion of settlement;

(ii) provision of an opportunity to defendants in litigation, and to respondents in arbitration, to guard against costs liability in circumstances where the plaintiff's claim (in litigation) or claimant's claim (in arbitration) is excessive.

Costs

In order to appreciate the operation of sealed offers it is necessary to understand a little of the basis upon which costs are awarded. The award of costs is at the discretion of the judge in litigation and of the arbitrator in arbitration. However, that discretion must be exercised judicially and certain principles have evolved which must be adhered to in the absence of special circumstances. The most important of those principles is that costs "follow the event". That is, the losing

party pays the taxed costs of the winning party (taxation being the Court process for determination of the *level* of costs to which the receiving party is entitled).

In deciding which party has "won" the judge or arbitrator will look at the extent to which a plaintiff or claimant has succeeded on the claim. Generally, if a claim succeeds even in part (e.g. £10,000 of a £50,000 claim) the plaintiff/claimant is deemed to have "won" and will recover all his taxed costs – not merely a fifth of them. The position is more complicated where a claim and counterclaim both succeed and much may turn in such circumstances on whether the counterclaim also operates as a set-off. However, the technicalities of that need not be gone into for present purposes.

It follows from the above that a defendant/respondent who believes that he owes the plaintiff/claimant *something* but not as much as is claimed (e.g. he accepts that £10,000 of a £50,000 claim is due) potentially faces serious difficulties. If he defends to trial, even though he may succeed in reducing the claim by 20%, he will still have to pay 100% of the plaintiff's/claimant's taxed costs. In recognition that such a situation would proliferate litigation by reducing the incentive of plaintiffs/claimants to accept realistic offers (because they could proceed to trial for the whole amount sought with limited costs risk) the procedures of payment into court (in litigation) and sealed offer (in arbitration) have been instituted. Whilst the rationale for each process is the same, the mechanisms differ.

Principal Features of Sealed Offers

Taking the above example, if a claimant claims £50,000 in an arbitration and the respondent believes that only £10,000 is due, the respondent can make a sealed offer to the claimant of £10,000. If, within twenty-one days, the claimant accepts the offer, he is entitled to be paid that £10,000 plus his taxed costs up to the date he accepts the sealed offer. The arbitrator's fees are borne by the respondent. On acceptance the claimant cannot, however, proceed for the £40,000 balance. The arbitration stops at that stage.

If the claimant declines the sealed offer and the case proceeds to a hearing and an award, treatment of costs depends upon the outcome. If, in respect of this substantive issue, the arbitrator awards more than the amount of the sealed offer (i.e. more than £10,000 in the above example) the claimant will recover the amount awarded by the arbitrator plus all his taxed costs incurred in the proceedings and the offer will have no effect. However, if the claimant is awarded

by the arbitrator only the amount of the sealed offer (i.e. £10,000) or less he will only recover the amount awarded plus his taxed costs incurred up to the date the sealed offer was made. Further, he will have to pay all the *respondent's* taxed costs from the date the sealed offer was made until the end of the proceedings. If the sealed offer is made at an early stage this can be a substantial proportion of the entire costs of the action.

Accordingly, it can be seen that the sealed offer goes some way towards transferring the costs risk from the respondent to the claimant.

Technical Points

It may be that after having made a sealed offer (of say, £10,000) the respondent subsequently decides that that sum is too low. In such circumstances he is entitled, certainly until within a short time of the arbitration hearing, to make an increased offer superseding the previous offer: perhaps £15,000 in the above example. The same principles apply in respect of the later offer as in respect of the first offer. The later offer is effective from the date it is made.

This gives rise to one particular area of uncertainty. Suppose that an initial sealed offer is made of £10,000 and then, some months later, a further offer is made this time of £15,000. Further, suppose that the claimant is ultimately awarded £9,000, i.e. less than the amount of the *first* offer. Has the second offer superseded the first offer so that the claimant recovers his costs up to the date of the second offer? Alternatively, is the first offer still effective so that the claimant only obtains his costs up to the date the first offer was made, thereby leaving the claimant liable to pay all the respondent's costs incurred subsequent to the first offer?

There appears to be no decisive authority on this point, but considering the matter from first principles, the better view is probably that the first offer indeed remains effective. The basis for that view is that the rationale behind sealed offers is to promote settlement and ensure that cases do not unnecessarily go to a full hearing. The arbitrator should, therefore, consider the question of whose "fault" it is that the case has gone to a full hearing. £10,000 was initially offered and that £10,000 turned out to be more than adequate to cover the claim. Consequently, the continuation of the proceedings subsequent to that first offer of £10,000 was a direct result of the claimant's failure to accept it. The fact that the respondent subsequently made an even higher offer is, it is suggested, irrelevant. This view is consistent with the approach adopted by Donaldson J (as he then was) in *Tramountana* -v- *Atlantic Shipping* [1978] 2 A11 ER 810 who stated that, in

respect of sealed offers, the arbitrator should ask himself: "Has the claimant achieved more by rejecting the offer and going on with the arbitration than he would have achieved if he had accepted the offer?"

A further possible area of uncertainty concerns the date at which sealed offers become effective. It is clearly established in respect of payments into court that the defendant must allow twenty-one days to the plaintiff to decide whether to accept the payment in. If the plaintiff accepts it on the twenty-first day, it also seems clear that he obtains all his costs up to the date of *acceptance* and not merely up to the date the offer was made. It is suggested that the same principle properly applies to sealed offers in arbitrations. Support for this view is to be found in *Everglade Maritime Inc* -v- *Schiffahrtsgesellschaft Detlef von Appen mbH, "The Maria"* [1992] 2 Lloyds Rep 167 in which it was expressly held that the sealed offer is the arbitral equivalent of the payment into court and, as a general rule, an arbitrator must exercise his discretion in the same manner as a judge in the litigation equivalent. If the claimant elects not to accept the sealed offer and a full twenty-one days elapse after the sealed offer is made, it seems that the respondent is protected as to costs from the date the sealed offer is made and not merely from the expiry of the twenty-first day.

Finally, it should be noted that the procedure is equally available to a claimant defending a counterclaim. The procedure is operated in precisely the same manner as by a respondent defending a claim. The claimant's sealed offer should make it clear, however, whether that offer is intended to be in full and final settlement of both the claim and the counterclaim, or merely in respect of the counterclaim.

Mechanism of Sealed Offers

An offer is made to the claimant (or its representatives) by letter. Although there is no prescribed form, good practice dictates that the letter should set out the sum offered and the claims to which the offer relates. It should normally be expressed to be open for twenty-one days (two days if the Hearing has commenced) and confirm that, if accepted, the claimant's taxed costs will be met up to the date of acceptance. It should also declare itself in terms to be a sealed offer and state that it is not to be shown to the arbitrator until all questions of liability and quantum have been finally decided. Thus, the arbitrator is not informed that the offer has been made: specifically, the claimant is not at liberty to divulge the existence of the offer to the arbitrator. Clearly, informing the arbitrator could seriously prejudice his view as to the merits of the action as an offer by the respondent

might well be regarded (perhaps wrongly) as tantamount to an admission that *something* is due to the claimant. The moment to notify the arbitrator of the offer is subsequent to his making his substantive award on the merits of the case but prior to his making an award as to costs.
One method of notification suggested in *Tramountana,* is to give the arbitrator a sealed envelope prior to his publishing his substantive award. That envelope might or might not contain an offer. He opens the envelope after publishing his substantive award but prior to giving his costs award. His costs award depends on whether the envelope contains an offer from the respondent as high or higher than the substantive sum (if any) that he has awarded to the claimant. However, this procedure appears seldom to be adopted. More usual is simply to ask the arbitrator at the commencement of the hearing not to make an award as to costs until he has been specifically addressed on this issued by the parties. The respondent will then, after the substantive award is published, bring the offer to the arbitrator's attention. On the basis of a comparatively recent case - *King* -v- *Thomas McKenna* 1991 2QB 480, it appears that if the respondent fails as a result of a "procedural mishap" to bring the sealed offer to the attention of the arbitrator prior to the arbitrator's publishing his award as to costs, it may be possible to apply successfully to the court pursuant to Section 22 of the Arbitration Act 1950 for the award to be remitted to the arbitrator to allow him to revise his order as to costs in the light of that sealed offer. This is not, however, procedure that it is wise to rely upon as remission by the court is discretionary.

Conclusion

What the press failed to understand in respect of the Tesco case was that the two ladies in question had not in fact "won" even though judgment was entered in their favour on the substantive issue. From the date of the payment into court the main issue was whether they were entitled to greater compensation than the amount Tesco offered: the judge determined that they were not and they were penalised in costs accordingly.

Similarly, in arbitrations, the sealed offer is a potent weapon in the respondent's armoury to turn the costs risk back on to the claimant. Used skilfully, the mechanism can be used effectively to stop arbitration in its tracks in the face of over-ambitious claims.