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Dispute Resolution
Tokyo

Client Alert
2 November 2017

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International Arbitration Update No. 9

The Use of Sealed Offers in International Arbitration

In the present economic climate, aggrieved parties considering whether to pursue a claim through international arbitration are acutely aware of the associated costs. This concern is particularly pertinent when taking into account the proportionality of the costs of an arbitration in comparison to the claim amount, and the fact that tribunals increasingly allow for "costs to follow the event", i.e. a losing party in an arbitration will often be required to pay the winning party's legal fees and costs of the arbitration.

Coupled with parties' concerns pertaining to cost is the increasing tendency for arbitral institutions and tribunals to acknowledge their roles in ensuring that proceedings are conducted efficiently.

In this client alert, we explore the concept of sealed offers, a commonly-used mechanism in England & Wales and numerous other common law jurisdictions, and consider how this tool may be used in an international arbitration to reach an effective and economical conclusion to a dispute.

1. What is a Sealed Offer?

A sealed offer is an offer to settle a dispute made by one party to a counterparty, historically used in litigation in certain common law jurisdictions. Distinct from an ordinary offer to settle, a sealed offer is not disclosed to the judge or arbitrator until immediately prior to when the question of legal fees and costs is to be addressed (after a decision has been made on the merits and sums to be awarded in a case). This mechanism, by which an offer cannot be divulged until the issue of legal fees and costs is decided, is also referred to as an offer made "without prejudice save as to costs".

Should a winning party reject a sealed offer and then fail to achieve more than that offer at a final hearing, the judge or tribunal may require that this winning party pay a substantial portion of the losing party's legal fees and costs as a result of its "unreasonable" rejection.

The concept of sealed offers, together with the aforementioned legal fees and costs penalty, was established in the courts of England & Wales over forty years ago in the case *Calderbank v. Calderbank [1975]* and formalized later through Part 36 of the Civil Procedure Rules 1998. In addition to potential liability for an element of the losing party's legal fees and costs, Part 36 of the Civil Procedure Rules was amended in April 2015 to include a further potential penalty equal to up to 10% of the sum awarded to the claimant, or 10% of legal fees where the claimant's claim does not include a monetary element. This additional percentage represents a further consequence for a party that rejects a reasonable offer to settle.

The rationale behind sealed offers is to encourage parties to attempt to resolve a dispute early through incentivized settlement so as to ensure that conflicts are dealt with as proportionately, efficiently and cost-effectively as possible. Further, as the concept was established in the English courts, numerous other common law jurisdictions including Hong Kong, Australia and Canada, use a similar system.

While a defendant or respondent would commonly be the party making a sealed offer in a dispute, it is also open to a claimant to make an offer, as a claimant will still be afforded the same legal fees and costs protection (where it achieves more than its offer at a final hearing). This approach reflects that a sealed offer should not be considered a sign of weakness; rather, it is a consistently used device by which to apply pressure on an opponent to settle.

By way of an illustrative worked example under Part 36 of the Civil Procedure Rules:

- Party A brings a claim for GBP 1,000,000 against Party B on 1 August 2016;
- Party B makes a sealed offer to settle of GBP 600,000, which is open for acceptance until 6 January 2017; and
- Party A rejects Party B's offer. At the conclusion of the dispute on 1 December 2017, Party A is awarded only GBP 500,000.

In the above case, providing that the offer was made in accordance with the relevant requirements, the judge may order Party A to pay Party B's legal fees and costs from the last date on which Party B's offer could have been accepted (6 January 2017) until the conclusion of the case (1 December 2017).

As the above illustrates, while ordered to pay GBP 500,000 in damages, Party B would make a significant saving on legal fees and costs in such circumstances. Conversely, Party A has achieved less than half of the sum it claimed, and is liable to pay a sizeable portion of Party B's legal fees and costs.

2. The Benefits of Sealed Offers in International Arbitration

(1) Protection Regarding Legal Fees and Costs

The vast majority of arbitral institutions require the tribunal to make an award relating to costs at the conclusion of an arbitration. Further, most arbitration rules empower the tribunal to apportion costs as they deem fit, while a limited number of arbitral bodies expressly provide that the successful party's legal fees and costs of arbitration shall be borne by the unsuccessful party.

With this in mind, a sealed offer may provide a significant level of protection relating to legal fees and costs to the party making the offer, given that there may be a departure from the general position that an award as to legal fees and costs should be relative to a party's success where that party unreasonably rejects an offer.

(2) A Party's Position Is Not Prejudiced By Making an Offer

Parties to a dispute often fear that an offer to settle may unfairly prejudice the court's or tribunal's view, considering an offer an admission as to a perceived weakness in its case. However, the fact that a sealed offer cannot prejudice a party's position due to non-disclosure, until and unless it becomes pertinent on the issue of legal fees and costs, should serve to alleviate the reluctance of a party to make an offer.

(3) Proper Case Analysis

Far from merely providing a party with an opportunity to cap its potential liability regarding legal fees and costs, one key function of sealed offers is to force the parties to carefully consider the scope, and any weaknesses, in their cases (the offering and receiving parties). Further, an appropriately pitched

offer will necessitate a proper analysis by both parties as to what the receiving party's case may realistically be worth, especially bearing in mind the potential for extensive liability as to legal fees and costs.

(4) Narrowing the Issues in Dispute

Regardless of the intentions of the parties, the issues in an arbitration may expand progressively during its course. With this in mind, where a sealed offer is made as to a distinct issue, or set of issues, the offer can help to focus the minds of the parties as to what is really in dispute, thereby limiting the scope of the arbitration.

(5) Savings in Legal Fees and Costs

Through the aforementioned, an effective sealed offer is likely to result in reducing the time, legal fees and costs, and dedication of labor time pertaining to a dispute between the parties.

3. How Sealed Offers May Be Used in Arbitration

Distinct from the system in England & Wales and other common law jurisdictions, there is no formal established procedure for making sealed offers in arbitration. However, it remains possible to incorporate the use of sealed offers into an arbitration.

Use of the sealed offer mechanism would be incorporated ideally into the Terms of Reference (in the case of ICC arbitration) or other such institutional procedural protocols as the tribunal and parties may agree. Should it not be possible to do so, it may still be feasible to incorporate the use of sealed offers during the course of the arbitration, or for the parties merely to make sealed offers unilaterally. However, whether or not the tribunal will accept the use of a sealed offer in a given arbitration will depend on the views of the tribunal itself. In such regard, the background of the tribunal will be of importance, given that tribunals in which one or more of the arbitrators are from jurisdictions in which sealed offers are commonly adopted are more likely to be open to using sealed offers.

Further, in countries in which the concept of "without prejudice" communications does not exist, it will be necessary to enter into an additional agreement by which the parties explicitly agree not to disclose "without prejudice" communications, or the offering party risks its offer being revealed to the tribunal prior to the conclusion of the arbitration.

The timing at which an offer should be unveiled to the tribunal will also be of the utmost importance as the tribunal will consider the merits, sums to be awarded in a case, and the allocation of legal fees simultaneously after the final hearing. This is distinct from the situation in litigation, where offers are usually revealed after the decision on the merits and sums to be awarded is made, but before the issue of legal fees and costs is addressed. Given this, it would be advisable for the offer should be enclosed in a sealed envelope and handed to the tribunal at the end of the final hearing, stating prominently "*without prejudice save as to costs - only to be opened by the tribunal after its determination of the substantive award and immediately prior to its determination of costs.*"

The specific contents of a sealed offer and the terms to be included therein are nuanced, and will require consultation with a lawyer.

4. Conclusion

In the current dispute resolution landscape, it can often be the case that legal fees and other costs associated with arbitration are almost as substantial as the sums in dispute between the parties. However, there are a number of commercial and legal tactics available to the progressive dispute lawyer to assist to bring a conflict to an effective and economical conclusion.

While not currently readily adopted in international arbitration, sealed offers represent an efficient tool in the context of an arbitration to achieve a satisfactory conclusion, together with a significant consequent saving in legal fees and costs.

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