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Arbitration Jujitsu: 'Sealed Settlement Offers' Add Leverage

By **Gilbert A. Samberg** (May 22, 2018, 1:48 PM EDT)


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The cost of arbitration, including attorneys' fees, can be substantial, commensurate with the matters in dispute. Your desire to settle a dispute that is going to arbitration is often as or more substantial. But sometimes your adversary is not willing to settle at your very rational number. What next — increase your settlement offer or reduce your demand? How about using the anticipated arbitration costs to your advantage? Consider incentivizing your adversary with a "sealed settlement offer," which could eventually make a settlement offeree pay a heavy price in such costs for miscalculation or intransigence.

The principal models for this mechanism are (1) an offer of judgment under Rule 68 of the Federal Rules of Civil Procedure, and (2) a "Calderbank offer" under English law and practice, Civil Procedure Rules, Part 36. In U.S. federal court practice, if an offer of judgment is accepted by an offeree, then there is in effect a settlement. If the offer of judgment is not accepted, then:

> [i]f the judgment that the offeree finally obtains is not more favorable then the unaccepted offer, the offeree must pay the costs incurred after the offer was made.[1]

Of course, the "costs" that are thus affected in federal litigation are relatively minor. (Under the even less punishing New York state law analog, a plaintiff-offeree that rejects such an offer merely loses the right to recover certain costs that it incurs from the date of the rejected offer to compromise.[2]

The "costs" that are affected in English law and practice, on the other hand, are far broader and more substantial. A Calderbank offer of settlement is "made without prejudice save as to costs." In practice, the details of a rejected settlement offer are described in a sealed document that is deposited with the court until the conclusion of proceedings other than the court's determination of the costs for which the respective parties will be responsible. Hence, the term "sealed settlement offer." In essence, however, it is the confidentiality of the rejected settlement offer vis-à-vis the adjudicator until the costs allocation stage of proceedings that is important. Then, if a rejected Calderbank offer was as or more favorable to the offeree than the court's eventual judgment, the court would order the offeree to pay all costs of both parties incurred after the date of the offer. (The English rule typically is loser pays, and so this is a potentially robust cost-shifting tool.)

In connection with an arbitration, by analogy, rejection of a settlement offer could be made to affect the arbitral tribunal's allocation of the costs of arbitration, including administrative fees, arbitrators' fees and attorneys' fees. Such an offer too should be made expressly "without prejudice save as to costs," and should be clear and detailed enough to be accepted or rejected without the need for further clarification. The offeror should describe its intended use of the offer, if it should be rejected, in connection with seeking an award of costs from the arbitral tribunal. Other suggested offer details are: (1) whether it is in full and final settlement of all claims and counterclaims, or some claims or counterclaims; (2) whether it is in full settlement also of all costs responsibilities to the date of the offer; (3) whether interest of any kind was included in the offer; (4) the duration of the offer (which should be a reasonable period); and (5) that the offer is unconditional.

If the offeree fares less well in the tribunal's award on the merits than it would have if it had accepted the offer, then the offeror could argue that its post-offer costs could have been avoided if the offeree had accepted an inferredly reasonable offer, and that the offeree should be liable for all of the offeror's arbitration costs after the offer date. Thus, the potential cost consequence — often substantial — creates

pressure on a settlement offeree.

There remains the question of when and how to deliver a sealed settlement offer to the arbitrators. An arbitral tribunal most often issues an award that includes an allocation of costs. It may be necessary, therefore, (a) to bring the sealed settlement offer to the attention of the tribunal during its deliberations, while proposing to deliver the offer itself to the tribunal when it indicates it has made its decisions on the merits and regarding a money damages award, but before its deliberations regarding an allocation of costs; or (b) to deliver a sealed copy of the rejected settlement offer to the administering organization (or to the tribunal itself) at the commencement of deliberations with an instruction on the sealed envelope regarding its contents and when the envelope is to be opened — i.e., after the tribunal's determination of an award on the merits, including money damages, and before deliberations on the allocation of costs.

It is noteworthy that there are virtually no institutional rules regarding the use of a sealed settlement offer in arbitration. The International Chamber of Commerce has acknowledge a sealed settlement offer procedure for this purpose.[3] The ICC secretariat would take custody of a sealed offer, and would only disclose it to the arbitral tribunal after the tribunal had determined the merits of the case, including the damages to be awarded in that regard, but before it had made a determination regarding an allocation of the costs of arbitration. However, the ICC appears to be alone among the principal administering organizations in acknowledging or formalizing this mechanism.

In circumstances where the controlling arbitration rules do not include a "sealed settlement offer" procedure, or even if they do, the parties can nonetheless themselves agree to a procedure regarding such a settlement offer, including requiring the tribunal to consider a rejected offer in its allocation of arbitration costs.

It would also be reasonable to deter gamesmanship concerning such a mechanism — e.g., it could be agreed that if an offer were rejected, but the offeror had failed at the time of the offer to produce requested evidence (a) that was unavailable to the offeree at the time the offer was open, and (b) that the arbitral tribunal determines was dispositive or substantially important in its determination on the merits, then the offeree should not be penalized by this mechanism.

In any case, an arbitral tribunal arguably may take a rejected sealed settlement offer into account even if it is not compelled to do so by the parties' agreement or by the rules or other guidance of an administering organization. Institutional rules generally give the arbitrators discretion to allocate the burden of the costs of arbitration, including attorneys' fees, among the parties in the absence of a different scheme of cost allocation agreed on by the parties. In the exercise of their discretion, the arbitrators are not limited in the factors that they may consider. For example, the London Court of International Arbitration rules enable an arbitral tribunal to "take into account the parties' conduct in the arbitration, including ... any non-cooperation [in facilitating the proceedings as to time and cost] resulting in ... unnecessary expense."[4]

Conclusion

While the costs of arbitration generally end up being less than the costs of litigation of the same claims, those costs may be substantial nonetheless. When aiming for a settlement before having to incur such costs, if counsel has made a realistic calculation of the settlement value of the matter, then he/she may leverage the weight of such arbitration costs in the settlement negotiation by means of a sealed settlement offer to put additional pressure on a counterparty to be realistic as well. Ideally, the parties will have agreed on the terms of a sealed settlement offer procedure in the arbitration, even if ad hoc after the commencement of arbitration, but such a mechanism can in any case be utilized in any arbitral proceeding, likely with significant effect.

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[1] Fed. R. Civ. P. 68(d).

[2] N.Y. CPLR 3221.)

[3] ICC Note to Parties and Arbitral Tribunals on the Conduct of the Arbitration under the ICC Rules of

Arbitration (March 1, 2017), at ¶¶ 193-196.

[4] LCIA Arbitration Rules 28.4.