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Insights

SANCTIONED OFFER MADE AT AN EARLY STAGE OF THE PROCEEDINGS – UNJUST TO IMPOSE COSTS CONSEQUENCES?

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It is well known to dispute resolution practitioners that an important matter is to turn your mind to putting in place costs protection, and to do so as at early stage of the dispute.

In Hong Kong litigation, a plaintiff may make a "sanctioned offer" at any time after the commencement and before the conclusion of a legal action. If the plaintiff obtains a judgment better than the sanctioned offer, and assuming that the offer was not accepted by the defendant, the defendant may have to face consequences on costs, namely costs on the indemnity basis, and also may face having to pay enhanced interest on the judgment sum and/or costs.

However, when a sanctioned offer is made by the plaintiff at an early stage of the legal proceedings, at which time the defendant might not have sufficient information to assess the merits of the case, under what circumstances might the Court consider it unjust to impose costs consequences on the defendant?

A recent Hong Kong District Court case *Leung Tak Kwan trading as Wallpaper Warehouse (HK) Co. v Gao Meng Fa Ltd* ([2022] HKDC 260, DCCJ 2532/2019, 23 March 2022) dealt with the costs consequences where the sanctioned offer was made shortly after the close of pleadings.

BACKGROUND

On 13 September 2016, shortly after the close of pleadings, the Plaintiff made a sanctioned offer (the "**Sanctioned Offer**") under O.22, r.24 of the Rules of District Court (Cap. 336H) ("**RDC**"), to the effect that the action be fully and finally settled upon the Defendant paying to the Plaintiff the sum of HK$1,000,000. The Sanctioned Offer was not accepted by the Defendant and the case proceeded to trial.

On 9 December 2021, the Court handed down its judgment in favour of the Plaintiff in the sum of HK$1,715,820 plus interest. Regarding the costs of the action, the Defendant was ordered on a nisi basis to pay, among other things, the costs of this action including all costs reserved, to be taxed if not agreed.

On 22 December 2021, based on the Defendant's non-acceptance of the Sanctioned Offer, the Plaintiff sought to vary the costs order by virtue of RDC O.22, rr.24(2)-(3), which reads:-

"*(2) The Court may order interest on the whole or part of any sum of money (excluding interest) awarded to the plaintiff at a rate not exceeding 10% above judgment rate for some or all of the period after the latest date on which the defendant could have accepted the offer without requiring the leave of the Court.*

(3) The Court may also order that the plaintiff is entitled to—

a. *his costs on the indemnity basis after the latest date on which the defendant could have accepted the offer without requiring the leave of the Court; and*

b. *interest on those costs at a rate not exceeding 10% above judgment rate.*"

THE DEFENDANT'S CONTENTION

The Defendant did not dispute:-

- the Sanctioned Offer was validly made by the Plaintiff;
- the Defendant did not accept the Sanctioned Offer;
- the judgment against the Defendant was more advantageous to the Plaintiff than the proposals contained in the Sanctioned Offer; and
- therefore, RDC O.22, r.24 was triggered.

However, the Defendant relied on RDC O.22, r.24(4), which reads:-

"*(4) Where this rule applies, the Court shall make the orders referred to in paragraphs (2) and (3) [RDC O.22, rr.24(2)-(3)] unless it considers it unjust to do so.*"

The Defendant relied upon the fact that the Sanctioned Offer had been made shortly after the close of pleadings, a very early stage of the entire proceedings. At that time, the Defendant contended, it was unable to make any informed decision as to whether to accept the Sanctioned Offer.

Therefore, the Defendant submitted that it would be "unjust" for the Court to make orders referred to in RDC O.22, r.24(2)-(3), and even if they were to be ordered, they should not be ordered in terms as stringent as sought by the Plaintiff.

LEGAL PRINCIPLES ON SANCTIONED OFFER MADE AT AN EARLY STAGE

In *Qvist Henrik v Clatronic Far East Limited and Another* (HCA 1144/2015, 13 January 2020), Recorder Stewart Wong SC dealt with a similar contention regarding a sanctioned offer made

before the filing of the statement of claim.

The Court in the present case found the following observations made by Recorder Steward Wong SC "*very pertinent*":-

- The defendant should not be required to make a decision whether to accept or reject a sanctioned offer without a careful review of the case with proper information. However, it is a question of fact in each case as to whether a defendant is able to do so when the sanctioned offer is made, depending on the nature and complexity of the case and the issues involved.
- If a defendant considers it does not have sufficient information or evidence to properly evaluate a sanctioned offer, it should seek further information if possible.
- A balance must be struck between (a) fairness to the defendant in that it should not be required to make a decision whether to accept a sanctioned offer without proper information to assess the merits of the case, and (b) the spirit behind the sanctioned offer regime of encouraging settlement of actions as early as possible.
- The principle that a defendant ought to be allowed to make a decision with proper information must be applied with circumspection because it always is open to a defendant to say that proper assessment cannot be made with only the pleadings, without full discovery and the exchange of witness statements. On this argument, however, it could be said that no sanctioned offer ought to be made or accepted until quite an advanced stage of the proceedings is reached, which would be contrary to the whole intent behind the sanctioned offer regime.
- A defendant ought to make reasonable efforts to settle the matter as early as possible. A defendant who does not react to an early sanctioned offer at all but simply sits on its hands without attempting to seek any further information required will need to convince the Court that it has not been acting unreasonably.

UNJUST TO IMPOSE COSTS CONSEQUENCES ON THE DEFENDANT?

The Court said the present case could not be regarded as a straightforward one so far as the issue of liability was concerned.

In the circumstances of the present case, the Court considered proper sufficient information to assess the Sanctioned Offer should consist of the witness statements (exchanged on 27 April 2017), the liability expert report (available in October 2017) and quantum expert report (available on 12 March 2018).

The court was of the view, therefore, that as at the latest time the Defendant could have accepted the Sanctioned Offer without leave (i.e. 11 October 2016), there was insufficient proper information

available to the Defendant such as to reasonably expect the Defendant to evaluate the Sanctioned Offer.

However, once the witness statements and the liability and quantum expert reports were available, it behoved the Defendant to consider the Sanctioned Offer, and the Defendant ought to have taken steps to accept the Sanctioned Offer by either (a) trying to agree with the Plaintiff on the liability for costs so that the Defendant could accept the Sanctioned Offer without leave under RDC O.22, r.16(2)(b)(i) or (b) failing agreement between parties, apply to the Court for leave to accept the Sanctioned Offer under RDC O.22, r.16(2)(b)(ii).

Therefore, the Court:-

- found that it would be unjust to impose the costs consequences starting from the last date when the Defendant could have accepted the Sanctioned Offer without leave; but
- did not find it unjust to impost the consequences from 9 April 2018, being 28 days after the quantum expert report was available on 12 March 2018.

THE DEFENDANT'S SUBJECTIVE BELIEF

The Defendant also contended that it did not accept the Sanctioned Offer because of its view that the Plaintiff might have failed to prove her case.

The Court said it is trite that a Defendant's own subjective (which turned out to be erroneous) belief that its defence has good merits would not amount to a good reason making the imposition of the costs consequences "unjust".

Therefore, the Court rejected this contention by the Defendant.

COSTS TAXED ON AN INDEMNITY BASIS (RDC O.22 R.24(3)(A))

The Plaintiff sought an order that the costs of this action be assessed on an indemnity basis as from 11 October 2016, being 28 days after the Sanctioned Offer was made.

Based on the reasons discussed above, the Court varied the costs order nisi to the extent that the costs of this action be assessed on an indemnity basis as from 9 April 2018.

ENHANCED INTEREST ON JUDGMENT SUM (RDC O.22 R.24(2))

The Plaintiff sought (a) pre-judgment interest at 10% above Prime Lending Rate from the date of the writ to the date of the judgment and (b) post-judgment interest at 10% above the judgment rate after the date of the judgment until payment.

The Defendant contended that either no enhanced interest should be awarded, or that enhanced interest only at judgment rate should be awarded, and that such enhanced interest should not be

awarded regarding certain periods.

The Court's power to award enhanced interest on the judgment sum is compensatory and not penal in nature. Pursuant to *McPhilemy v Times Newspapers Ltd (No 2)* [2002] 1 WLR 934, such power "*is conferred to enable the court … to redress the element of perceived unfairness, otherwise inherent in the legal process, which arises from the fact that damages, costs (even costs on an indemnity basis) and statutory interest will not compensate the successful claimant for the inconvenience, anxiety and distress of having to resort to and pursue proceedings which he had sought to avoid by an offer to settle on terms which (as events turned out) were less advantageous to him than the judgment which he achieved*".

In the present case, the Court took the view that the judgment rate, being an uplift of 3% over the Prime Lending Rate, would be the appropriate rate of enhanced interest on the judgment sum, for the following reasons:-

- In the present case, the issue of liability hinged very much on the evidence of the liability experts. The Defendant decided not to accept the Sanctioned Offer based on its heavy reliance on its liability expert. In this circumstances, the Court would not fault the Defendant's reliance on its liability expert as being unreasonable.
- The low interest regime over the relevant period formed the background to and context of the Court's consideration of the appropriate rate of enhanced interest.
- The amount of the judgment sum of HK$1,715,820 was substantial. Any uplift in the interest rate would have a relatively significant impact.
- The enhanced interest rates sought by the Plaintiff, in light of the low interest regime, would create a huge windfall to the Plaintiff. This would be a disproportionate benefit to the Plaintiff and a disproportionate burden on the Defendant.
- It had been held in *Golden Eagle International (Group) Limited v GR Investment Holdings Limited* [2010] 3 HKLRD 273, that (a) a 3% uplift form Prime Lending Rate to the judgment rate already carried an enhanced element for pre-judgment interest and (b) the parties' agreement to adopt the judgment rate as an appropriate rate for the enhanced interest was approved.

The Defendant submitted that it would be unjust for it to pay enhanced interest for the several delays in the proceedings which were out of the Defendant's control, including the change of the Plaintiff's liability and quantum experts and the adjournment of trial due to the pandemic. The Plaintiff did not dispute that these changes were out of the Defendant's control. Therefore, the Court accepted the Defendant's submission.

INTEREST ON COSTS (RDC O.22 R.24(3)(B))

The Plaintiff sought interest on the taxed costs at judgment rate plus 10% per annum until full payment.

Pursuant to *McPhilemy v Times Newspapers Ltd (No 2)* [2002] 1 WLR 934, the Court's power to order interest on costs under RDC O.22 is conferred to redress the element of perceived unfairness which arises from the general rule that interest is not allowed on costs paid before judgment, and therefore the successful party who has made payments to its own solicitors on account of costs in advance of the trial will be out of pocket even if it obtains, at the trial, an order for costs on an indemnity basis. An order for payment of interest on costs under RDC O.22 enables the court to achieve a fairer result.

Therefore, it follows that a party seeking interest on costs under RDC O.22 will need to show that it has made payments to its solicitors by way of costs on account (whether for profit costs or disbursements). Pursuant to *Shih Pik Nog v G2000 (Apparel) Ltd* [2011] 4 HKLRD 121, it is incumbent on that party to state in its supporting affidavit the amount of disbursements, costs, and costs on account paid to its solicitors during the period commencing from the last date of acceptance up to the date of the supporting affidavit, and the date(s) of payment. Without such evidence, there may be no basis for any order for pre-judgment interest on costs.

In the present case, the Plaintiff did not put forward any information on the payment of disbursements, costs or costs on account, and the date of such payments. In the absence of evidence that the Plaintiff actually had made payments and therefore was out of pocket, the Court considered the award of interest on costs would be a total windfall and that it would be unjust to so award.

BCLP COMMENTS

The sanctioned offer regime encourages parties to give serious consideration to settlement of proceedings by imposing adverse costs consequences on a defendant which fails to do better than the rejected sanctioned offer, as well as offering a high level of costs protection to the plaintiff.

The present case sheds light on the possibility that the Defendant's failure to do better than the rejected sanctioned offer may not necessarily be followed with the imposition of severe costs consequences, at least for the full period between the date of the sanctioned offer and the ultimate judgment. Overall, the Court will endeavour to strike the right balance between (a) justice to the defendant that it be allowed to evaluate a sanctioned offer with proper and sufficient information and (b) the spirit and purpose of the sanctioned offer regime of encouraging early settlement of action. All of that said, a defendant in receipt of a sanctioned offer of course should give proper and timely consideration of the offer according to its merits and respond to it accordingly.

RELATED PRACTICE AREAS

- Litigation & Dispute Resolution

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