LEGISLATIVE
TESTIMONY

Offer of Judgment Rule

Proposing Section 35C in the Code of Civil Procedure, 1908

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Centre for CIVIL SOCIETY
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I. Introduction

India is one of the fastest growing economies in the world. Yet, in 2015, India ranked 142— a rank later adjusted to 134—out of 189 countries in the overall ease of doing business, as per the World Bank's Doing Business report. The central government has, since, aggressively focused on this with a view to revitalise the economic engine. As a result, in 2016, the index ranked India 130—up by four places—in the annual report of the same. This is by no means a small achievement for an economy like India and was made possible by electricity and other business reforms. Buoyed by these improvements, the government is now aspiring to join the ranks of the first 50 countries in the next few years

However, there remains room for improvement insofar as other parameters affecting ease of doing business are concerned, especially contract enforcement. Getting to the upper end of the league tables is not very difficult if the institutional machinery is empowered and effective. The 'quality of judicial processes index' measures whether each economy has adopted a series of good practices in its court system in four areas: court structure and proceedings, case management, court automation, and alternative dispute resolution. India's current figure in the World Bank's Doing Business index is 7.5 (out of 18) for India. According to the World Justice Project (WJP), India holds a rank of 59 (out of 102 countries) in the Rule of Law Index 2015. The WJP's Rule of Law Index provides original and impartial data on how the rule of law is experienced by the general public in 102 countries around the globe. A recent Law Commission report also notes (Law Commission of India 2014):

"…the judicial system is unable to deliver timely justice because of the huge backlog of cases for which the current judge strength is completely inadequate. Further, in addition to the already backlogged cases, the system is not being able to keep pace with the new cases being instituted, and is not being able to dispose of a comparable number of cases. The already severe problem of backlogs is, therefore, getting exacerbated by the day, leading to a dilution of the Constitutional guarantee of access to timely justice and erosion of the rule of law."

There are several other alarming figures which sum up the need for judicial reforms when it comes to contract enforcement; these lists can be referenced ad nauseam. The solidarity, however, lies in their implication—one which spells the imminent need for reform in various facets of the judicial regime to deliver speedy and cost effective case management. A responsive and strong judicial system, especially with respect to contract enforcement, is vital for any economy that aims to foster a healthy business environment conducive to investment, foreign or domestic. This paper undertakes a comprehensive analysis of the solution to improve contract enforcement in India, lobbying for a demand-side approach with special focus on the offer of judgment rule, that is, Rule 68 of the Federal Rules of Civil Procedure as suggested by Shubho Roy. The methodology used comprises a literature review of the current debate over the efficacy of Rule 68 of the Federal Rules of Civil Procedure. Section II talks about the greater relevance of demand-side solutions as compared to supply-side solutions, given the current frame of reference. Section III analyses the basic structure and efficacy of Rule 68 and Section IV gives policy recommendations to improve the overall efficiency of Rule 68. Finally, Section V offers concluding remarks.

II. Supply-side solutions versus demand-side solutions

The dispute-resolution system of contract farming in India suffers from excessive delays (Shubho Roy, 2015) and spiralling costs. Most solutions are supply-side solutions aimed at increasing judicial expenditure to achieve judicial efficiency, such as putting ad-hoc numerical limits on the number of proceedings or adjournments, setting up commercial divisions in existing courts, appointment of more judges, and the likes. The correlation between judicial expenditure and judicial efficiency, however, is not vouched for by data. Although additional resources (by virtue of increased judicial expenditure) increase court productivity initially and reduce pendency, the additional supply inevitably increases the workload of courts because of the creation of additional demand. The benefits taper off after a while; and the increase in court productivity is only temporary (Buscaglia, Edgardo and Thomas Ulen, 1997, p. 275-291). Therefore, the need is to shift the focus to long term solutions, given the limited funds at the central government's disposal and the temporary reprieve offered by supply-side solutions. Demand management is a demand-side solution that has long term scope for tackling the problem at hand. Coupled with an incentive-based approach, the idea is to create incentives for parties to not delay legal proceedings. Assuming agents in the legal system to be rational and utility maximising individuals, such an approach to solve the problem yields palpable results. An example of this is Rule 68 or the "Winner beware" rule of the Federal Rules of Civil Procedure in the United States. The Rule was intended to provide an incentive for parties to settle, and was adopted in 1938 to foster settlements and expedite the litigation process by taxing a plaintiff with the defendant's post-offer costs should the plaintiff refuse an offer and not improve on it at trial.

III. Rule 68—A Panacea?

It is universally accepted that Rule 68 was meant to encourage settlements by forcing plaintiffs to think hard before rejecting an offer. Although Rule 68 is not a core Federal Rule and is not used as much as other rules, its importance has increased greatly since its inception. According to Bone (2008), if the conventional view is correct, Rule 68 is probably the only Federal Rule which is devoted exclusively to encouraging settlement. It has been the subject of close attention since the late 1970s, when enthusiasm for settling cases rose abruptly in the US, and interest in improving the Rule as a settlement device remains strong today (Bone, R.G., 2008, p. 102, 1561).

Rule 68 imposes a penalty on a plaintiff who refuses a reasonable settlement offer. Before the trial starts, the defendant can make an offer to the plaintiff to settle the case. If the plaintiff accepts the offer, the dispute does not go to the court saving both time and cost. If the plaintiff rejects the offer, the judge is informed about the rejection, but not the terms of the offer that was rejected (this is kept in a sealed copy with the court and is used only to decide upon the penalty). If the plaintiff wins and the sum awarded in the judgment is

less favourable than the pre-trial offer made by the defendant, the plaintiff has to bear the costs incurred by the defendant from the date the offer was made by him/her. Both parties therefore make their own assessment in terms of cost and time before taking the dispute to litigation. This Rule, thus, creates incentives for reducing litigation in the system.

The Rule is, however, a one-way street— that is, only defendants can invoke it. Even the timings and terms of the rule are influenced by the defendants. The plaintiff only gets a period of 10 days in which to evaluate the substance and worth of the offer. Moreover, post-offer costs are often argued to be too small a disincentive to litigate in the US.

One could be skeptical and ask why a rule encouraging settlement is explicitly needed if settlement is indeed an economically better alternative to litigation, especially when such a settlement might be mutually rewarding to both parties. However, hard bargaining, irrational optimism, strategic behaviour and asymmetric information may not necessarily lead to settlement even when such a mutually beneficial alternative might exist. Rule 68 was simply meant to overcome these glitches and give settlement the gentle nudge needed in the right direction.

Even though Rule 68 may be well intentioned, opinion is divided about its practical efficacy among the upper echelons of the law academia composed of scholars who have meticulously studied this "enigmatic" Rule. The Advisory Committee on the Federal Rules of Civil Procedure notes that Rule 68 "rarely has been invoked and has been considered largely ineffective as a means of achieving its goals." The existing theoretical literature suggests that offer-of-judgment rules may increase the likelihood of trial or have an ambiguous effect (Priest, G.L, 1982). This research advances the theoretical and anecdotal evidence based on abstract theory that Rule 68 is successful in encouraging settlements only marginally. Acknowledgement of the aforesaid does not, however, undermine the objective of the Rule, or the Rule itself for that matter. Outside theory, a host of not-readily quantifiable factors can influence the incentive structure in any particular case. Conclusions inferred in theoretical or economic analyses are, therefore, generic in nature, context-specific, and lack the coherence required for a clear understanding of the definitive effects of Rule 68 in particular. The principal takeaway from the prevailing discourse on the impediments in the execution of Rule 68 is simple: the pro-defendant bias of a one-sided Rule 68 (allowing only the defendant to make a Rule 68 offer) as identified by Priest (1982) and Miller (1986).

Moreover, post-offer costs are way too small a penalty to discourage excessive litigation. Current economic analyses show the Rule works to encourage settlements marginally and to redistribute wealth from plaintiffs to defendants, driving down the amounts at which plaintiffs settle their cases. (Miller, 1986; Chung, 1996; Priest, 1982).

Since plaintiffs are likely to settle for less under Rule 68, defendants are likely to offer less. This doesn't necessarily increase the settlement rate. It simply gives defendants an advantage over the plaintiffs by driving down the settlement range. Rule 68 affects the settlement range of offers and, hence, will have an ambiguous effect on the incentives to litigate. It affects the incentives to settle in two ways. First, it shifts the settlement range in favour of the defendants. That is, it reduces the offer the defendant is willing to make

because his expected loss from trial is lesser. Similarly, the plaintiff is willing to accept less in settlement because his expected gain from trial is lower. Second, some authors even argue that this settlement range is compressed because the maximum offer is reduced more than the minimum offer (Miller, G., 1986, p. 93-125).

To be fair, Rule 68 has clauses that are counterproductive to its purpose, to the central idea of taxing a plaintiff who refuses a reasonable settlement offer, even if arguments for these hinge on abstract theory, anecdotal evidence and empirical literature in some cases. Having established that, the immediate response of any law maker or policy drafter should be to fine tune these counterproductive clauses in harmonious alignment with the Rule's central purpose by distributing the cost of excessive litigation symmetrically with respect to the stakeholders involved, while simultaneously doing away with the pro-defendant bias. It is here that this paper seeks to propose a customised set of reforms for Rule 68 that bid fair to reduce judicial pendency in commercial civil cases in the Indian legal landscape.

IV. Proposed Recommendations

The recommendations proposed in this paper have been compiled from various law journals published at different databases. The following offer a workable blueprint of Rule 68 as envisaged for handling civil commercial cases in India, catering specifically to breach of contract cases involving monetary damages.

1. In order to deal with the pro-defendant bias, allow both parties to make a Rule 68 offer, including counter offers. Counter offers increase the scope for bargaining by adding weight to the incentive for settlement, tipping the scales in favour of settlement and away from litigation. This helps parties analyse their settlement possibilities better and theoretically increases the settlement chances, giving both parties an unequivocal say in determining the terms of settlement and negotiations. Additionally, the system of levying the penalty can be adjusted to suit this change of frame. There are two ways to decide how to levy the penalty:

    a. The highest offers by the plaintiff and the defendant are selected. Assuming plaintiff's highest offer to be greater than that of the defendant, if plaintiff prevails for defendant's highest offer or less, then plaintiff will pay the post offer costs of the defendant. If the plaintiff prevails with their highest offer or an amount greater than that, the defendant will pay the post-offer costs of the plaintiff. If the final judgment is between the highest offers of the plaintiff and the defendant, no cost shifting ensues (Miller, G., 1986, p. 93-125).

    b. Florida Statutes, Section 768.79: The 25% rule under this, the last offer for settlement is selected. This is a two-way rule providing for recovery of post-offer costs, in cases in which the verdict is at least 25% below the offer when the offer is made by the defendant, or 25% above when the

offer is made by the plaintiff. The 25% margin embodied in this rule has appeal in that it may be thought to protect an offeree from severe consequences for "missing by a small margin" (Shapard, J., 1995).

2. Time for the offeree to evaluate an offer should be a minimum of 20 days and not 10 days like in the US. Too short a period is not advisable because when weighing the merits of an offer, a party needs time to evaluate. Similarly, too long a period might lead to unforeseen circumstances, like passing of a law that may alter the nature of dispute, death of a key witness, etc. This period should be inclusive of all negotiations between parties. Therefore, this time period should be strictly non-expandable so as to not delay legal proceedings due to hard bargaining.

3. The nature of the penalty is also a concern. The Rule currently allows for recovery of post-offer costs without the inclusion of attorney fees. This penalty may be small and needs to be reappraised. The legal literature offers much economic analysis of fee-shifting mechanisms. Given the complexity of the subject, opinions diverge on whether such mechanisms encourage early settlement. One writer concludes that "until a better empirical foundation has been established, the existing theoretical arsenal is still too weak to resolve many of the ultimate questions of interest." (Donohue, 1991). "Institutional details" motivating and constraining the behaviour of parties and lawyers, the writer noted, are not necessarily accounted for by the current economic analysis of fee shifting (Schwarzer, 1992). A better practice would be to increase the damage awards as compared to cost-shifting (Kaplow, L 1993). A normative sanction can be agreed upon to decide this. Imposing an ad-valorem sanction indexed to the damage awards such as 1-2% of the awards can be one way to implement this.

4. Several research papers argue that courts should have the discretion to reduce the severity of cost-shifting so as not to cause undue hardship to a party, based on the merit of the case. An argument for this lies in taking cognition of the hindsight bias. One can be tempted to think that a plaintiff's rejection is always unreasonable whenever— and simply because— the plaintiff does not recover more than the offer at trial. This is a classic example of hindsight bias. Litigation, among other things, is a gamble, and hence has an element of uncertainty by virtue of which perfectly reasonable gambling choices may not always have consequences that one bargains for. When a party does their best to predict the outcome and the outcome turns out differently from their prediction, the resulting litigation costs may seem unnecessary ex post. However, neither does this make them unnecessary ex ante (implying the risk taken was superfluous), nor does it insinuate in the slightest way that the party's rejection of the offer is unreasonable in any meaningful sense (Bone, R.G., 2008, p.102, 1561). Giving discretion to the courts will tend to soften the impact as well as deterrence, for which a harsh penalty was initially created. Knowing that

there could be a chance to get one's penalty reduced is tantamount to parties discounting the actual severity of the penalty when deciding their minimum settlement offers. This, in turn, affects the pay-offs from litigation vis-à-vis settlement and defeats the purpose of setting up a harsh penalty— discouraging excessive litigation. In light of the above, removing any element of discretion whatsoever from Rule 68 is the best measure to adopt. No discretion must be given to the courts when deciding whether to impose a penalty or to lessen the severity of the same.

5. A supporting framework analogous to the provision for discovery (Federal Rules Of Civil Procedure, Rule 26(b)(1)) existing in the States is needed in order to have fruitful negotiations for settlement, such that parties can evaluate offers and arrive at realistic estimates of the settlement offer. This is needed to simply equip the parties with greater transparency in assessing the damages faced by the other party. This, through a domino effect, affects settlement offers, which, by the same token affects settlement range, ultimately culminating in greater probability of settlement.

6. If a breach of contract involves two or more issues, then parties should have the leeway to resolve either issue under this Rule. Settlement should therefore be 'severable'. This would allow issues that do not require judicial intervention to be sorted out of court freely, thereby reducing the number of issues to be addressed by the court.

V. Proposed Section 35C

It is proposed that a new section—section 35C be included in the Code of Civil Procedure, 1908 to encourage settlement. It should be worded as follows:

a. Offer: After the notice is issued and service of summons, but not less than twenty days before the evidence begins, any party may serve upon the adverse party an offer to settle the claim for the money specified, and to enter into an agreement dismissing the claim or to allow judgment to be entered accordingly.

b. Acceptance: If within 20 days after the service of the offer the adverse party serves written notice that the offer is accepted, either party may then file the offer and notice of acceptance together with proof of service and the clerk shall enter judgment. Additionally, both parties must sign an agreement to keep the judgment entered confidential.

c. Non-acceptance: An offer not accepted shall be deemed withdrawn and evidence thereof is not admissible except to determine sanctions under this Rule.

d. Subsequent offers: The fact that an offer is made but not accepted does not preclude subsequent counter-offers. If a counteroffer is made, the court will take

the sum of an offer and a counter-offer to determine an average offer for the purposes of this Rule.

e. Sanctions: If the judgment finally obtained is within ±25% of the latest offer or an average offer as the case may be, then the offeree shall be liable to pay two per cent of the award as costs to the offeror.

f. Offer-after-Judgment: When the liability of one party to another has been determined by verdict, order, or judgment, but the amount or extent of the liability remains to be determined by further proceedings, either party may make an offer of settlement, which shall have the same effect as an offer made before trial or arbitration if it is served within a reasonable time prior to the commencement of hearings to determine the amount or extent of liability.

g. Exceptions: This rule does not apply in family law and divorce actions, or claims involving only injunctive relief.

VI. Conclusion

An efficiently functioning and empowered legal milieu, which assures and safeguards the property rights of people, is crucial for any economy that seeks to plant itself amongst the front ranks of the world's fastest growing economies. The role of the state for the economy is mainly protective and supportive. Robert Heilbroner (1985, p. 105) has explained the importance of the state for a capitalist regime—"Remove the regime of capital and the state would remain, although it might change dramatically; remove the state and the regime of capital would not last a day." This is rendered through its legal services which can be thought of as a public good in today's scenario. The Indian state's provision of these services leaves a lot to be desired. The possible solutions to improving the provision of these essential services can be either supply-side or demand-side. Supply-side solutions, as discussed in Section II, are myopic in their nature with benefits that last only until additional supply creates its own additional demand. Moreover, they require additional funding from the centre, which is not always feasible because of limited resources. To find a long-term answer, one then needs to turn to the demand-side's arsenal of solutions. Demand-management, being incentive driven, can be more efficient is one way in which the provision of legal services can be done. Given the need to utilise resources available at the centre's disposal judiciously, creating incentives that encourage people to use these judiciously themselves is a cost-effective demand-management strategy that this paper advocates. Taking lead from Shubho Roy's recommendation for Rule 68, the solution is half-discovered. Rule 68, as discussed and analysed in legal literature, has the right intent and is consistent with the rationale we derived in Section II. It fits the bill we developed in Section II. However, Rule 68 in its sacrosanct form, is not fit to be adopted primarily because of certain self-defeating clauses that seek to tie up the Rule's hands, stymieing the Rule itself.

Therefore, the main objective of this paper has been to tweak Rule 68 so as to add teeth to its functioning, and make it navigable over the Indian legal landscape. The paper proposes a compilation of policy recommendations suggested by distinguished scholars of the law academia. The aim here is to improve the quality of settlements that our legislation should encourage, and not just hypothetically count the coerced settlements that could be brought about at the cost of a risk-averse plaintiff, should a Rule 68 of the original version ever be adopted. By further limiting the cases this Rule should be made applicable for, we have sufficiently insulated it from criticisms that usually come with cases concerning civil rights and the like. Therefore, given how India fares at international rankings which rate contract enforcement and quality of the judicial system, Rule 68 stands a good chance of turning out to be the panacea that could reform our legal system and boost rankings. Rule 68 makes a fair case and should be considered for adoption, albeit with caution.

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Prashant Narang has been in the sphere of policy ideas for nearly 15 years. A regulatory researcher in the area of education and livelihood, he speaks often on the Rule of Law, K-12 education, street vending, and public policy issues at top law schools and Centre for Civil Society (CCS). He currently serves as a Senior Fellow, Research and Policy Training Programs at CCS.

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He co-authored "NEP 2020: One Time Comprehensive Evaluation" and contributed to quality assessment of all state-level Education Laws. He co-drafted the Model State School Code - a Model Law to implement the NEP 2020 and an amendment to the Right to Education Act 2009.

Prashant has a Doctorate degree from Center for the Study of Law and Governance at Jawaharlal Nehru University, where he submitted his thesis on the Constitutional Right to Trade and Business. He led a team of 15 people to conduct a process audit of 24 public services across five departments in Punjab. This work has been instrumental in reforming the public services in the state.

Prashant has taught Constitutional Law at the Faculty of Law, University of Delhi. While he enjoys legislative drafting, he finds law and economics, and empirical legal research fascinating.

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