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INVALID OFFERS OF COMPROMISE – IMPLICATIONS FOR INSURERS

Background

While early settlement discussions are, more often than not, initiated by way of *Calderbank* letter, unsuccessful negotiations typically conclude with service of an Offer of Compromise.

Such offers operate not only as effective settlement tools, but a means by which future costs protection may be obtained.

The *Uniform Civil Procedure Rules* (**UCPR**) provide a mechanism by which formal Offers of Compromise can be made, and a regime for, *inter alia*, the costs consequences that flow from a party's rejection of such an offer, where a less favourable result is achieved at trial.

Before the recent amendments to the UCPR in June 2013 (**2013 Amendment**), the position was unequivocal; an Offer of Compromise was to be expressed as exclusive of costs.[1] Notwithstanding the unambiguous drafting, uncertainty in relation to the way in which a valid Offer of Compromise could be expressed has troubled the legal profession.

Resolution of this tension has now been achieved by way of both the 2013 Amendment and the New South Wales Court of Appeal's decision in *Whitney v Dream Developments Pty Ltd.*[2]

While clarity seemingly has been restored, the implications arising from invalid Offers of Compromise served previously may not yet have run their course.

The key cases

Old v McInnes[3] and *Vieira v O'Shea*[4]

Prior to the 2013 Amendment, and the Court's most recent commentary concerning the way in which Offers of Compromise were to be validly expressed, it was customary for solicitors to craft Offers of Compromise to contain the words 'plus costs as agreed or assessed' after detailing the substantive monetary component of the settlement. No harm was seen in doing so. It added clarity to the terms of an offer, which otherwise might have been construed as costs inclusive.

The validity of such Offers of Compromise was examined by the Court of Appeal in *Old v McInnes (**Old**)*, delivered on 22 December 2011.

In *Old*, the Court of Appeal rejected an application for indemnity costs, said to flow from the plaintiff's failure to accept an Offer of Compromise framed in such terms. The Court concluded that the inclusion of the phrase 'plus costs as agreed or assessed' rendered the offer invalid and specifically offended the requirement that an offer be 'exclusive of costs'.

The Court of Appeal went on to consider whether the Offer of Compromise otherwise operated as a *Calderbank* offer. In rejecting that submission, the Court considered significant the omission of any statement or other indication that the offer was to operate in that fashion.

Approximately four months later, on 4 May 2012, the Court of Appeal revisited the validity question in *Vieira v O'Shea (**Vieira**)*.

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[1] Except in certain specific prescribed circumstances, for example an offer that provides for a verdict for the defendant with the parties to bear their own costs

[2] [2013] NSWCA 188

[3] *Old McInnes and Hodgkinson* [2011] NSWCA 410

[4] *Vieira v O'Shea (No.2)* [2012] NSWCA 121

The Court of Appeal determined that a mere reference to costs in an otherwise compliant Offer of Compromise (in that case the inclusion of the words 'with the defendants to pay his [the plaintiff's] costs') would not exclude that offer from the ambit of Part 20 of the UCPR, unless the reference to costs operated inconsistently with the UCPR.

The Court of Appeal noted that:

- while the offer was not stated specifically to be exclusive of costs, it could have been understood by its terms to indicate that it was not inclusive of costs;
- it was unnecessary for an offer to state specifically that the sum to be paid was 'exclusive of costs', in circumstances where it did not purport to be inclusive of costs and was asserted to be an offer made pursuant to rule 20.26 of the UCPR; and
- the commentary in relation to costs within the offer (ie. 'with the defendants to pay his costs') was otiose, as that was the costs consequence that followed from the application of rule 42.13A(2) of the UCPR if the offer was accepted in any event.

Rule 42.13A(2) (as it then was) relevantly provided that:

> 42.13A(2) 'The plaintiff is entitled to an order against the defendant for the plaintiff's costs in respect of the claim, assessed on the ordinary basis up to the time when the offer was made, unless:
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> (a) the offer states that it is a verdict for the defendant and the parties are to bear their own costs, or
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> (b) the court orders otherwise.'

The decision in *Vieira* did not sit comfortably with *Old*. Nor did it clarify, with any certainty, the validity of Offers of Compromise specifically expressed to be 'plus costs as agreed or assessed'.

Whitney v Dream Developments Pty Ltd[5]

Just over a year later, on 25 June 2013, a five Justice bench of the Court of Appeal delivered judgment in *Whitney v Dream Developments Pty Ltd (**Whitney**)*, confirming once and for all that an Offer of Compromise which included the words 'plus costs as agreed or assessed' was invalid.

Significantly, the Court of Appeal determined that:

- the language of the UCPR required that a compliant Offer of Compromise 'would not deal with costs at all'; and
- any reference to costs (including 'payment of costs as agreed or assessed') would remove the Court's residual discretion to make its own award as to costs (see rule 42.13A(2)(b), extracted above).

While it is uncontroversial that the Court would rarely order, in the exercise of its discretion, costs contrary to the usual order contemplated by rule 42.13A(2), an Offer of Compromise which prescribes the payment of costs in some form (whether agreed, assessed or otherwise) usurps the Court's residual discretion and is thus 'inconsistent with the scheme for the making of offers of compromise' and invalid.

The Court of Appeal again considered whether the Offer of Compromise constituted a *Calderbank* offer. In rejecting the submission, the Court of Appeal determined that the 'essence' of a *Calderbank* offer was that the recipient had notice that the offer would be relied upon in relation to costs. While the conduct of parties during litigation is relevant to the appropriate manner of the Court's discretion 'an offer made expressly pursuant to rule 20.26 will not of itself take effect as a *Calderbank* offer unless there is something in it or in the surrounding circumstances to indicate that it is proposed to be relied upon on the question of costs...'.

Change to the UCPR: 2013 Amendment

On 7 June 2013 Part 20.26 of the UCPR was amended, clarifying the way in which Offers of Compromise can be validly expressed. Among other things, those amendments provide that

[5] [2013] NSWCA 188

an Offer of Compromise can be formulated to include a proposal that costs as agreed or assessed, up to the time the offer was made, be paid by the offeror.

The residual discretion in rule 42.13A of the UCPR, set out above, also has been removed.

The consequences

An Offer of Compromise made prior to 7 June 2013 is subject to the rules in force before that date (UCPR Sch 12 Pt 1). It will thus be invalid if it is expressed to be 'plus costs as agreed or assessed'.

Absent an accompanying statement to the effect that the Offer of Compromise was to operate as a *Calderbank* offer (or some other conduct that clearly establishes that intention), the Court's strict approach to the issue provides little comfort that a non conforming Offer of Compromise will be capable of transformation so as to provide costs protection.[6]

Costs protection

Civil litigation is expensive, often disproportionately so relative to the amounts at issue. A party's inability to rely on an invalid Offer of Compromise, to support an application for costs (indemnity or otherwise), may well have a significant effect on the commercial outcome for that party, irrespective of the litigant in whose favour judgment substantively was given.

Costs capping provisions

Offers of Compromise have a particular importance in smaller personal injury claims. In personal injury litigation a party's ability to exempt themselves from the cost capping provisions contained in Division 9 of the *Legal Profession Act 2004* (**LPA**) will be circumvented by a determination that an Offer of Compromise served in the proceedings is invalid.

Pursuant to s.338 of the LPA if the amount recovered on a claim for personal injury damages does not exceed $100,000, the maximum costs for legal services provided to a party in connection with the claim are, (relevantly) in the case of legal services provided to a defendant, fixed at:

- 20% of the amount sought to be recovered by the plaintiff; or
- $10,000

whichever is greater.

The effect of s.340 of the LPA is that, if a party to a claim for personal injury damages makes a reasonable Offer of Compromise, which is not accepted, the costs capping provisions contained in Division 9 do not prevent the awarding of costs on an indemnity basis in respect of legal services provided after the Offer of Compromise is made.

Risks for practitioners: professional negligence claims

Solicitors who fail to serve valid Offers of Compromise expose their clients to adverse costs consequences.

In the case of an invalid offer made on behalf of a plaintiff, the loss is an inability to recover indemnity costs from the date of the offer.

In the case of an invalid offer made on behalf of a defendant, the consequences are potentially far more significant. If the plaintiff is successful at hearing, and there is no valid Offer of Compromise which can be deployed, not only will the defendant be unable to recover its costs from the plaintiff from the date of the Offer of Compromise, but it is exposed to the plaintiff's costs of the entire proceedings on the principle that costs follow the event.

A solicitor who prepared an Offer of Compromise expressed to be 'plus costs as agreed or assessed' prior to *Old* may be able to defeat an allegation of breach of duty arising from such drafting by virtue of s.5O of the *Civil Liability Act* 2002 (NSW).

Section 5O provides that a professional does not incur a liability in negligence arising from the provision of a professional service if it is established that the professional acted in a manner

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[6] Pursuant to rule 42.1 of the UCPR, the Court has a discretion to refuse to follow the general rule that costs follow the event, and service of an Offer of Compromise, even if ultimately determined to be invalid for the purposes of Part 20.26, is a matter that may be relevant to the exercise of that discretion: see for example *Ziliotto v Hakim* [2013] NSWCA 359

that (at the time the service was provided) was widely accepted in Australia by peer professional opinion as competent professional practice.

However, it is arguable that a solicitor's failure to advise their client of the effect of the decision in *Old*[7], and the utility of service of a further Offer of Compromise, may leave it exposed to a professional negligence claim if:

- the solicitor's client has been denied the costs protection to which it would (or may) otherwise have been entitled, because an Offer of Compromise was determined to be invalid; and
- it can be established that, but for the solicitor's failure to inform the client of the impact of *Old*, a further Offer of Compromise would have been served and delivered costs protection.

Complexities inevitably will surround the causation issues in such cases and the appropriate way in which the alleged loss should be quantified. However, the net loss that may flow to a party as a result of its inability to rely on an Offer of Compromise could be significant.

Conclusion

Solicitors and their clients should be aware of the need to review all matters in which pre 7 June 2013 Offers of Compromise, providing for 'costs to be paid as agreed or assessed', were served.

That review is not only important for the appropriate management of the litigation on foot, but with a view to avoiding satellite proceedings that may arise between solicitors and their clients.

A word of warning in conclusion. While the 2013 Amendment provides a new regime by which Offers of Compromise are to be validly extended, and seeks to remedy the uncertainties that have plagued the area, for abundant caution, all Offers of Compromise should be served under cover of a letter confirming that, absent compliance with the UCPR, the offer is extended in accordance with the principles of *Calderbank v Calderbank*.

March 2014

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[7] Or at the very least *Whitney*, accepting the interim confusion and uncertainty arising from *Vieira*