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Building A Bridge

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The Victorian Civil Procedure Act promotes the timely resolution of litigation. Offers of compromise and Calderbank offers provide flexible options to parties, and may have differing implications for costs.

By Matthew Hicks

Lawyers who practise in the area of commercial litigation are acutely aware of the need to consider, and advise their clients on, the possibility of compromise. The legislature encourages it, the courts require it, the public expects it and their clients demand it. The *Civil Procedure Act* 2010 (the Act) requires Victorian courts to give effect to an overarching purpose in civil proceedings ("to facilitate the just, efficient, timely and cost-effective resolution of the real issues in dispute" (s7(1)) and imposes overarching obligations.[1] These obligations have reinforced the requirement for lawyers to advise their clients on the appropriate use of settlement options throughout the litigation process.

In particular, s22 provides:

"A person to whom the overarching obligations apply must use reasonable endeavours to resolve a dispute by agreement between the persons in dispute, including, if appropriate, by appropriate dispute resolution, unless –

(a) it is not in the interests of justice to do so; or

(b) the dispute is of such a nature that only judicial determination is appropriate.

Example A proceeding where a civil penalty is sought may be of such a nature that only judicial determination is appropriate".

"Appropriate dispute resolution" (ADR) is defined in s3 to mean:

" . . . a process attended, or participated in, by a party for the purposes of negotiating a settlement of the civil proceeding or resolving or narrowing the issues in dispute, including, but not limited to –

(a) mediation . . . ;

(b) early neutral evaluation;

. . .

(d) settlement conference . . . ".

This is an inclusive definition. Taking into account the ability of the courts to refer a proceeding to ADR (s66), it is suggested that the meaning of ADR would not extend to without-prejudice negotiations between the parties and their lawyers outside a formal structure such as a mediation. Even so, it is submitted that the obligation imposed by s22 would extend (in cases where it could be seen to be reasonably required) to making and, in appropriate cases, even responding to offers of compromise and Calderbank offers because the obligation is to use reasonable endeavours to resolve a dispute by agreement *including*, if appropriate, by ADR.

Other related overarching obligations under the Act in this context include the obligation to only take steps to resolve or determine disputes (s19); to cooperate in the conduct of civil proceedings (s20); to narrow the issues in dispute (s23); and to ensure costs are reasonable and proportionate (s24). It has been held that in applying the overarching purpose and the overarching obligations, the Act requires the courts to be proactive and innovative in their approach to achieve the Act's objectives.[2]

The consequences of any failure to comply with the overarching obligations could include cost penalties or orders requiring payment of compensation for financial loss against parties (or potentially their lawyers) who are in default: ss28-31.

OFFERS OF COMPROMISE

All Victorian courts[3] and VCAT[4] have provisions for parties to serve offers of compromise. An offer of compromise in the courts has some formal requirements and characteristics, for example:

(a) it must be in writing;

(b) it must contain a statement to the effect that it is served in accordance with O.26;

(c) it must be open for a period not less than 14 days after service;

(d) it must not be withdrawn during the time it is open to be accepted, unless the court otherwise orders;

(e) it may take into account other claims between the parties made in the proceeding.

The usual costs consequences of an offer of compromise made by a plaintiff apply if the plaintiff obtains a judgment not less favourable to it than the terms of the offer. In that event the plaintiff is entitled to party-party costs up to the date of the offer and thereafter on an indemnity basis: r26.08(2)(b). In the case of a defendant's offer of compromise, where the plaintiff obtains judgment not more favourable to it than the terms of the offer, the plaintiff is entitled to party-party costs up to the date of the offer and the defendant is entitled to its costs thereafter on a party-party basis: r26.08(3). The rules are silent on circumstances where the defendant serves an offer of compromise on a plaintiff and the plaintiff's claim fails entirely.

In the recent case of *Pepe v Platypus Asset Management Pty Ltd (No 2)*[5] Almond J considered whether a plaintiff's rejection of an offer of compromise entitled the defendant to benefit from an indemnity costs order in circumstances where the plaintiff was wholly unsuccessful.

The defendant had made two offers of compromise to pay amounts to the plaintiff. Both offers were rejected. The defendant argued that the terms of the offers of compromise should be considered in the exercise of the court's general discretion as to costs on the basis that the plaintiff's rejection of each offer of compromise was unreasonable. The defendant drew on *Foster v Galea (No 2)*[6], where Byrne J considered that an unsuccessful plaintiff's failure to accept a "very handsome" offer was a significant factor warranting an order for costs more severe than a party-party basis. In circumstances where it is unreasonable for a plaintiff to reject an offer of compromise, the defendant argued, the court should exercise its general discretion to make a special costs order.

Almond J balanced the court's general discretion as to costs with the policy rationale of not

discouraging potential litigants from bringing their dispute to the courts. Having weighed up the arguments, Almond J was not of the view that the plaintiff was necessarily in a position to properly assess his prospects of success as at the date of the offers and held that a "fair and just outcome" did not require the court's departure from its usual course of awarding costs on a party-party basis.

CALDERBANK OFFERS

Calderbank offers[7] are well-known settlement mechanisms made outside the formal offer-of-compromise procedures and are designed to reserve the right to the offeror to produce the terms of the offer to the court at an appropriate time in support of a special costs order. The usual restriction associated with "without prejudice" communications (that the offeror cannot refer the court to the contents of the offer) does not apply, because the offeror specifically reserves the right to refer to the offer when the court determines questions of costs. Heading the letter "without prejudice save as to costs" and referring to Calderbank should be sufficient to draw the inference that it is intended to be such an offer.[8]

In the case of an offer made by a plaintiff, costs consequences may apply when the court's decision is at least as favourable to the offeror as the terms of the offer. In the case of an offer made by a defendant, costs consequences may apply when the decision is less favourable to the plaintiff than the terms of the offer.

In the case of an offer made by a plaintiff, the usual submission in favour of a special costs order would be that the defendant pay the plaintiff's costs on an indemnity basis, usually from the date of the offer. In the case of an offer made by a defendant, there is a wider scope for particular cost orders. Examples include an order that the defendant pay the plaintiff's costs up to the date of the offer and thereafter the plaintiff pay the defendant's costs on a party-party basis or on an indemnity basis.

The fundamental principle that is considered in determining whether or not a Calderbank offer should have costs consequences is whether it was unreasonable for the offeree not to have accepted the offer.

The well-known formula for determining whether the rejection of a Calderbank offer was unreasonable so that costs penalties might apply was set out by the Court of Appeal in *Hazeldene's Chicken Farm Pty Ltd v Victorian WorkCover Authority (No 2)*[9] to require a consideration of at least the following factors:

(a) the stage of the proceeding at which the offer was received;[10]

(b) the time allowed to the offeree to consider the offer;

(c) the extent of the compromise offer;

(d) the offeree's prospects of success, assessed as at the date of the offer;

(e) the clarity with which the terms of the offer were expressed; and

(f) whether the offer foreshadowed an application for indemnity costs in the event of the offeree's rejecting it.

In *Eshuys v St Barbara Limited (No 2)*[11] the plaintiff had been the defendant's managing director and chief executive officer. After the plaintiff's employment with the defendant ceased, the plaintiff claimed that the defendant failed to properly assess the amount payable to him, and that as a result he suffered loss and damage. The plaintiff was wholly unsuccessful at trial.

The defendant applied to the court for an order that the plaintiff pay the defendant's costs on an indemnity basis. The application was in part based on a Calderbank offer, in which the defendant offered to settle on the basis that the plaintiff discontinue the proceeding with each party bearing their own costs. The plaintiff did not accept that offer or two subsequent offers made under O.26.02.

Kaye J identified the critical issue as being whether it was unreasonable for the plaintiff to have rejected the offer, having regard to his prospects of success at the date at which the offer was made. In the circumstances his Honour found that the plaintiff's rejection of the Calderbank offer was not unreasonable. One significant factor was that the offer had been

made early in the proceedings, before all relevant information had emerged.

On the information then in the plaintiff's possession, and in the absence of hindsight, the plaintiff was entitled to understand that he had good prospects of success and it was not unreasonable for him to reject the Calderbank offer. Having lost the case, there was no dispute that the plaintiff would pay the defendant's costs of the proceeding on at least the usual party-party basis. The decision to refuse the defendant's application for an indemnity or solicitor-client costs order highlights the court's discretion in awarding costs.

WHY SERVE A CALDERBANK OFFER AND NOT AN OFFER OF COMPROMISE?

An offer of compromise under the rules limits the discretion of the courts as to costs (*Blackman & Ors v Gant & Anor (No 2)*).[12] Provided the threshold elements are made out, an offer made under the rules gives rise to a presumption that the party making the offer is entitled to a special order for costs.

This can be compared to a Calderbank offer, which "enlivens the court's power to make an order for indemnity costs, but does not create a prima facie right to such an order" (*Chief Commissioner of State Revenue v Platinum Investments Management Ltd (No 2)*).[13]

There are some occasions when a Calderbank offer, as distinct from an offer of compromise, would be appropriate, including, for example:

(a) when no proceeding has yet been commenced;

(b) the offeror wishes to vary the usual requirement of an offer of compromise that the offeror pay the offeree's costs on acceptance;

(c) the offeror apprehends that circumstances may change within the period for acceptance of the offer, making it desirable to retain the ability to withdraw the offer, an option which is not available (without leave) under the offer-of-compromise procedures;

(d) when a Calderbank offer has previously been served and the offeror wishes to refer to or draw on the previous offer's contents in the subsequent offer.

Some jurists have suggested that, in view of the increased flexibility of the formal offer-of-compromise rules (unlike their more restrictive form when they were introduced), there are few cases where a formal offer of compromise cannot be made. Further, there is an advantage in making an offer of compromise rather than a Calderbank offer in that in order to rely on it there is no need to prove that the recipient acted unreasonably in not accepting it.[14]

REQUIREMENT OF A GENUINE COMPROMISE

It is well established that a Calderbank offer should amount to a genuine effort to compromise a claim; the offer should not merely be an invitation for the offeree to capitulate.[15]

Simply stating that the other side's case is "fundamentally flawed" or has "poor prospects of success" is unlikely to assist the recipient to consider or evaluate whether to compromise the proceeding.[16] It is desirable (though not always essential) that the offeror include in the letter sufficient reasons as to why the offeror's position should ultimately prevail and that, accordingly, it would be unreasonable for the offeree to refuse to accept the offer.

There will of course be cases where it is not possible to provide a statement of reasons as to why an offer should be accepted, for example where at a very early stage the basis for the offeree's position has not been fully elaborated. In such circumstances, an offer of compromise may be more appropriate.

MULTIPLE OFFERS

The rules allow for a party to serve more than one offer during the course of a proceeding: r26.03(2). Similarly, multiple Calderbank offers can clearly be made. The possibility of serving second and subsequent offers should be seriously considered as the litigation progresses and the apparent prospects of success on key points wax and wane. In the case of a Calderbank offer, it may be reasonable for a party to refuse to accept an offer at a particular point in time but unreasonable to do so at a subsequent point.[17]

CONDITIONAL CALDERBANK OFFERS

The courts will not have regard to a conditional Calderbank offer where it is apparent that the condition would have had the effect that the offer could not have been effective. Thus in *Apostolidis & Ors v Kalenik & Ors (No 2)*[18] the Court of Appeal considered a Calderbank offer made by the appellant during the appeal. The offer was conditional on approval by the Australian Taxation Office (ATO) as to the terms of the offer (which included varying an adjustment order) and as to payment, given that the ATO had in place freezing orders over the appellant's property. The court decided that the qualification set out in the offer deprived it of the status of a Calderbank offer, given the attitude of the Deputy Commissioner of Taxation which had become apparent by the time of the appeal. The ATO's position (that there should be no adjustment order in favour of the respondent) would have rendered the offer worthless.

A DUTY TO NEGOTIATE

There is considerable English authority to the effect that a party which fails to negotiate constructively in response to a Calderbank offer may be penalised on the question of costs.[19]

The extent of the statutory duty to "use reasonable endeavours to resolve a dispute by agreement" (s22), in particular whether that overarching obligation could be used against a party (or their lawyer) who fails to use reasonable endeavours by failing to respond to a Calderbank offer or indeed an offer of compromise, has not yet been decided.

It is submitted that the obligation could extend to require parties to engage in the available and widely known settlement mechanisms (offers of compromise and Calderbank offers) when it is reasonably possible to do so. A failure to do so might ultimately see the recalcitrant party penalised by the court with a costs order, whether or not the Calderbank offer could otherwise be relied on for a special costs order by the offeror.[20]

LAWYER'S DUTY TO CLIENTS

It is often said that litigation is conducted on two levels: first, considering and documenting the facts and law relating to the claims made in the proceeding itself and, second, considering and formulating the possibility of compromise. The overarching purpose and the overarching obligations, as the names suggest, have an influence on both levels.

Lawyers practising in the area of commercial litigation need to carefully consider their obligations in this area, including the requirement to advise clients promptly and fully on the desirability of attempting to resolve disputes and the potential consequences of not doing so.

MATTHEW HICKS is a partner with Hicks Oakley Chessell Williams, an LIV accredited commercial litigation specialist and a member of the LIV Commercial Litigation Advisory Committee. He is also a member of the LIV Litigation Lawyers Section Courts Practice Committee. The writer acknowledges the assistance of Shayne Barnett in researching this article.

1. The Act came into operation on 1 January 2011. Section numbers in the body of this article refer to the *Civil Procedure Act* 2010 unless otherwise specified. An obligation to take genuine steps to resolve a dispute before proceedings are instituted in federal courts was introduced by the *Civil Dispute Resolution Act* 2011 (Cth).

2. See for example *Hodgson v Amcor Ltd* [2011] VSC 63, per Vickery J at [26].

3. Order 26 *Supreme Court (General Civil Procedure) Rules* 2005; *County Court Civil Procedure Rules* 2008; *Magistrates' Court General Civil Procedure Rules* 2010. Rules set out in this article refer to these rules.

4. *Victorian Civil and Administrative Tribunal Act* 1998 ss112–114.

5. [2011] VSC 21.

6. [2008] VSC 331.

7. *Calderbank v Calderbank* [1976] Fam 93; [1975] 3 All ER 333.

8. *Jones v Bradley (No 2)* [2003] NSWCA 258, [14]–[15].

9. (2005) 13 VR 435.

10. The failure to accept a Calderbank offer made very early in a proceeding might well not be unreasonable. See for

example *Horesh v The Sephardi Association of Victoria & Ors (No 2)* [2011] VSC 117, in which the first defendant sought to rely on a Calderbank offer made three days before the plaintiff commenced a proceeding. Almond J did not accede to the request, although he found that the plaintiff's continuation of the proceeding beyond a later Calderbank offer made by the second and third defendants was unreasonable: "In addition to the policy considerations which favour the promotion of early offers to compromise litigation, there is the countervailing policy consideration that potential litigants should not be discouraged from bringing disputes to the courts" [20].

11. [2011] VSC 150.

12. [2010] VSC 246.

13. [2011] NSWCA 197, [9].

14. Justice Margaret Beazley, "Calderbank offers", *Australian Construction Law Newsletter* #121, July/August 2008, p6.

15. See for example *Ryde City Council v Tourtouras (No 2)* [2007] NSW CA 262 [4]; *Mediterranean Olives Financial Pty Ltd & Ors v Lederberger & Ors (No 2)* [2011] VSC 333, at [9]; *IPEX ITG Pty Ltd (in liq) v State of Victoria (No 2)* [2011] VSC 39, [28]–[30].

16. In *Mediterranean Olives Financial Pty Ltd & Ors v Lederberger & Ors* a "bald assertion" ([10]) in an offer that the plaintiffs' case had no foundation was insufficient to persuade the court to adopt a finding that the plaintiffs' refusal to accept the offer was unreasonable. Compare the discussion on this point by Redlich J in *Aljade and MKIC v OCBC* [2004] VSC 351, [82]–[87].

17. *Horesh v The Sephardi Association of Victoria & Ors (No 2),* note 10 above.

18. [2011] VSCA 329 (28 October 2011).

19. *GW v RW* [2003] 2 FLR 108, [97]; *A v A (Costs Appeal)* [1996] 1 FLR 14, [25].

20. As to the admissibility of negotiations, see Richard Vinciullo, "A question of admissibility", September 2011 *LIJ*, p36.