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OFFERS OF COMPROMISE: FOLLOWING, BENDING AND BREAKING THE RULES

Introduction

1 I wish to premise my remarks tonight with a lesson learned by nearly every litigant in our courts: costs in litigation are as important a consideration as the claim that is made.

2 Put simply, it is bad financial planning to spend more than you are seeking to get by way of return. As lawyers, effective representation of your clients cannot be achieved without an eye to their commercial interests. The costs of litigation are not just those ordered by the court; they may also extend to the disruption of a client's business and damage to their reputation.

3 Some clients may be content to run an inefficient or high cost matter. But the duty to conduct matters efficiently and with a stern eye to the costs implications of a claim is a duty owed not only to the client. Section 56 of the *Civil Procedure Act 2005* (CPA) places a duty on the parties to civil proceedings to assist the court in furthering the overriding purpose of the "*just, quick and cheap resolution of the real issues in the dispute or proceedings*",[1] and their representatives must not cause a party to breach such duty.[2]

4 If costs, as a general feature of litigation, outstrip the value of claims – a 'costs overrun' – the law itself will be brought into disrepute. A system in which there are persistent costs overruns will be seen as a system for lawyers. Lawyers will be seen as the only winners – and perhaps those clients with deep enough pockets to win a war of attrition. That perception will bring the law into disrepute. Once the legal system is brought into disrepute, there is a rule of law issue.

[1] CPA, ss 56(1) and 56(3).
[2] CPA, s 56(4)(a).

5 Offers of compromise, the topic of this paper, must be seen in this context. As Hunt AJA explained, the purpose of rules of court in respect of offers of compromise is:

> "…to encourage the proper compromise of litigation, in the private interests of the litigants and in the public interest of the prompt and economical disposal of litigation."[3]

The Court's cost discretion

6 The Court's costs powers are found in the CPA, s 98 and the Uniform Civil Procedure Rules (UCPR), pt 42. Subject to statute and the rules of court, costs are in the discretion of the Court which has full power to determine by whom, to whom and to what extent costs are to be paid.[4]

7 The primary rule, contained in UCPR rr 42.1 and 42.2, is that costs follow the event and that they are assessed on the "*ordinary basis*". The "*ordinary basis*" refers to the basis of assessing costs in s 364(1) and (2) of the *Legal Profession Act 2004*.[5]

8 Offers of compromise provide a potential exception to this general rule. There are two species of offer of compromise that may result in the award of indemnity costs:

(1) Offers made under the rules of court;

(2) Calderbank offers.

9 If a valid offer under the rules is made but rejected, and the offeree obtains an order or judgment on the claim that is no less favourable to that offered, the offeror is entitled (unless the court orders otherwise) to their costs assessed

[3] *South Eastern Sydney Area Health Service v King* [2006] NSWCA 2 at [83] (Hunt AJA, Mason P and McColl JA agreeing).
[4] CPA, s 98.
[5] CPA, s 3(1).

on an indemnity basis from the date of offer.[6] Indemnity costs are defined in UCPR, r 42.5 and generally include all costs other than those that appear to have been unreasonably incurred or appear to be of an unreasonable amount.[7]

10 By contrast, *Calderbank* offers do not comply with the rules of court, and so "*the Rules which govern costs in those circumstances do not apply and the matter remains one for the exercise of the Court's discretion.*"[8] This accords with the High Court's statement in *Stewart v Atco Controls Pty Ltd*:[9]

> "This Court has a general discretion as to costs. The non-acceptance of a *Calderbank* offer is a factor, in some cases a strong factor, to be taken into account on an application for indemnity costs."[10]

11 This observation reflects a significant difference between offers made under the rules and *Calderbank* offers. Rule compliant offers have this advantage – if the offer is not accepted, and the order made by the court is as good as or better than the offer made by the offeror, the rules operate so as to provide for an indemnity costs order from the date of the offer. While it is subject to the court's discretion to provide otherwise, the onus of persuading the court to order otherwise has shifted to the party opposing the indemnity costs order. By contrast, the making of a *Calderbank* offer does not displace the ordinary rule that the party seeking a departure from the general rule as to costs bears the persuasive onus of establishing that a favourable costs order ought to be made.[11]

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[6] This is the statement of the rule where the plaintiff makes the offer under UCPR, r 42.14. See UCPR, rr 42.15 and 42.15A for offers made by a defendant.

[7] The exception to this general rule is that where the costs are payable out of property held or controlled by a person who is a party to the proceedings in a fiduciary capacity, indemnity costs are all costs other than those that have been incurred in breach of the person's duty in that capacity: UCPR, r 42.5(a).

[8] *Jones v Bradley (No 2)* [2003] NSWCA 258 at [5].

[9] (2014) 252 CLR 331.

[10] Ibid at [4].

[11] *Evans Shire Council v Richardson (No 2)* [2006] NSWCA 61 at [26]; Walsh v Walsh (No 2) [2013] NSWSC 1281 at [44]. See also para 89 below.

12 If the intention is to make an offer under the rules, it is incumbent upon the practitioner to draft the offer of compromise in terms that comply with the rules. The relevant rule is UCPR, r 20.26.

13 Rule 20.26 is a detailed provision, and is both prescriptive and proscriptive in parts. It underwent significant amendment in 2013,[12] with the provision as it currently stands commencing operation on 7 June 2013.[13] The body of case law as to the proper construction and application of the new rules remains limited.

Whether an offer of compromise under the UCPR may refer to costs

The old rules

14 The cases considering the old rules are not of direct relevance to practitioners seeking to draft offers of compromise today, and so will not be discussed in any detail. Nonetheless, the following brief sketch of the jurisprudence will provide some useful context to the operation of the new rules.

15 Prior to 7 June 2013, r 20.26(2) provided:

> An offer must be exclusive of costs, except where it states that it is a verdict for the defendant and that the parties are to bear their own costs.

16 The costs consequence of an offer being accepted was contained in r 42.13A. Stated in general terms, if the offer was accepted, the plaintiff was entitled to an order for their costs on an ordinary basis up until the offer was made. This rule was subject to the Court's discretion to make some other order.[14]

17 The meaning of the stipulation in r 20.26(2) that the offer of compromise must be "*exclusive of costs*" became the subject of agitation before the Court. The authorities were clear that an offer that set out a sum for costs was not rule

[12] Uniform Civil Procedure Rules (Amendment No 59) 2013.
[13] UCPR, sch 12.
[14] UCPR, r 42.13A(2)(b).

compliant – this might have been thought to be self-evident.[15] Similarly, and as self-evidently, an offer of compromise expressed to be inclusive of the costs of proceedings was not rules compliant.[16]

18 However, it was not uncommon for an offer of compromise purportedly made under the rules to contain the following term:

> "First Defendant to pay the Plaintiff's costs as agreed or assessed."[17]

19 Was an offer of compromise containing such a term "*exclusive of costs*"?

20 A division of opinion emerged. On one view, the phrase "*exclusive of costs*" meant that the offer must not reference costs at all.[18] On the other view, a reference to costs did not take the offer outside the rules unless the cost consequence provided for was inconsistent with the relevant costs rule, namely, r 14.13A.[19] This division was resolved in the five judge bench decision in *Whitney v Dream Developments Pty Ltd* (*Whitney*).[20]

21 The relevant offer in *Whitney* was in the following terms:

> "This offer is made in accordance with Rule 20.26 of the Uniform Civil Procedure Rules 2005.
>
> The [Plaintiff][21] offers to settle the Plaintiff's claim against the Defendant on the following basis:
>
> 1. Judgment for the Plaintiff.
>
> 2. The Defendant to pay the Plaintiff $14,000.00 within 28 days of written acceptance of this offer.
>
> 3. **The Defendant to pay the Plaintiff's costs as agreed or assessed.**

[15] *Penrith Rugby League Club Ltd t/a Cardiff Panthers v Elliot (No 2)* [2009] NSWCA 356; *Tarabay v Fifty Property Investments Pty Ltd* [2009] NSWSC 951.
[16] *Trustee for the Salvation Army (NSW) Property Trust v Becker (No 2)* [2007] NSWCA 194.
[17] This clause is taken from the offer of compromise in consideration in *Old v McInnes and Hodgkinson* [2011] NSWCA 410.
[18] *Old v McInnes and Hodgkinson* [2011] NSWCA 410 (Beazley, Giles and Meagher JJA).
[19] *Viera v O'Shea (No 2)* [2012] NSWCA 121.
[20] [2013] NSWCA 188.
[21] It will be noted that the bracketed word "[Plaintiff]" originally read "Defendant". It was common ground that this was a typographical error.

> This offer is open for acceptance until 5.00pm Tuesday, 14 September 2010, which given this matter is listed for hearing on Friday 17 September 2010 is a reasonable time from the making of this offer of compromise, after which it will lapse." [Emphasis added]

22 The Court unanimously held that such an offer did not comply with r 20.26(2).

23 Bathurst CJ, with whom McColl JA, Emmett JA and I agreed, observed that the use of the phrase "*exclusive of costs*" in r 20.26(2) intended that "*a compliant offer will not deal with costs at all*."[22] The Chief Justice explained that the reason for this is that r 42.13A provided the cost consequence to follow where an offer was accepted, but reserved to the court the power to make a contrary order. An offer of compromise that provides for the payment of costs "*removes that residual discretion*".[23] His Honour held it was "*thus inconsistent with the scheme for the making of offers of compromise laid down by the rules*" to include any term as to costs in an offer.[24]

24 Barrett JA, in additional remarks with which McColl JA and myself additionally agreed, explained the operation of the rules in these terms:

> "In providing that an offer must be 'exclusive of costs', r 20.26 requires that the offer not attempt to deal with the matter of costs at all (that is, it must say nothing about that matter) and, in that way, leave the Division 3 rules to operate untrammelled by any apparent contractual qualification, supplement or contradiction."[25]

25 While there were some judicial murmurings about the correctness of this decision,[26] "*the proper construction of the rule is not in doubt following the decision of this Court in [Whitney]*."[27] Debates about the proper construction of the old rules will become increasingly academic with the passage of time.

The new rules

[22] *Whitney* [2013] NSWCA 188 at [24].
[23] Ibid at [25].
[24] Ibid.
[25] Ibid at [52]
[26] See *Council of the City of Canterbury v Milich* [2013] NSWCA 215 at [11]-[15].
[27] *Council of the City of Botany Bay v Michos* [2013] NSWCA 244 at [32].

26 The provisions governing the question whether provision can be made for the order as to costs underwent significant revision in 2013. The first relevant change is found in r 20.26(2)(c), which provides:

> "An offer under this rule… must not include an amount for costs and must not be expressed to be inclusive of costs"

27 There are a number of things to note about this rule. It applies to an offer made by either a plaintiff or a defendant. It states that an offer must not include an "*amount*" for costs or be expressed as "*inclusive*" of costs. An offer to pay costs "*as agreed or assessed*" would not be prohibited by this sub-rule, nor would an offer that each party pay their own costs.[28]

28 In *Jojeni Investments Pty Ltd v Mosman Municipal Council (No 2),*[29] the Court, comprised of Macfarlan, Gleeson and Leeming JJA, stated in relation to r 20.26(2)(c):

> "[T]he purpose of the rule is clear. It is directed to the mischief of a monetary offer in a lump sum which does not differentiate between a plaintiff's claim (which will regularly have been the subject of pleadings, particulars and evidence) and the plaintiff's costs (as to which the other party will have no basis for making an informed decision to compromise). Further, an offer expressed to be inclusive of costs is not capable of ready comparison with a judgment obtained by the party in the event that the offer is not accepted and the matter proceeds to a final hearing."[30]

29 The next relevant change was to r 20.26(3):

> "(3) An offer under this rule may propose:
>
> (a) a judgment in favour of the defendant:
> (i) with no order as to costs, or
> (ii) despite subrule (2)(c), with a term of the offer that the defendant will pay to the plaintiff a specified sum in respect of the plaintiff's costs, or
>
> (b) that the costs as agreed or assessed up to the time the offer was made will be paid by the offeror, or

[28] See *Jojeni Investments Pty Ltd v Mosman Municipal Council (No 2)* [2015] NSWCA 208
[29] Ibid.
[30] Ibid at [11].

> (c) that the costs as agreed or assessed on the ordinary basis or on the indemnity basis will be met out of a specified estate, notional estate or fund identified in the offer."

30 The introductory language of sub-rule (3) is important. It arguably raises a question as to whether the rule delimits the types of offers that may be made under the rules, or whether the rule is permissive. I will return to this question shortly. It is first necessary to understand the component parts of r 20.26(3).

First scenario: UCPR r 20.26(3)(a)

31 Paragraph (a) of r 20.26(3) only operates when the offeror proposes judgment in favour of the defendant. However, the offer can be made by either the plaintiff or the defendant. The offer may propose there be no order as to costs, or that the defendant will pay to the plaintiff a specified sum for the plaintiff's costs. There is no provision for the plaintiff paying the defendant's costs.

32 An offer of compromise made under this provision was considered in *Salmon v Osmond*.[31] In that case, the defendant made an offer that there be judgment entered for the defendant, with each party paying their own costs – a "walk away offer".[32] That in effect was an offer under r 20.26(3)(a)(i). On appeal, I observed that an offer in those terms may be a genuine offer of compromise, with the element of compromise being in respect of costs.[33] One matter relevant to that assessment is the time at which the offer is made. If the offer is made too early, few costs may have been incurred, and there may not be sufficient material available by way of pleadings, evidence, statements and reports to permit a reasonable assessment of the prospects of success. Conversely, if made at a later point, the element of compromise may be sufficient to constitute as a genuine compromise of the proceedings on the question of costs alone.

[31] [2015] NSWCA 42.
[32] See *Leach v The Nominal Defendant (QBE Insurance (Australia) Ltd) (No 2)* [2014] NSWCA 391 at [50]; *Taheri v Vitek (No 2)* [2014] NSWCA 344 at [8].
[33] Ibid at [167].

Second scenario: UCPR r 20.26(3)(b)

33 Under this provision, there is no restriction on whether the offer is being made by the plaintiff or the defendant. However, the party making the offer must be the party agreeing to pay the costs as agreed or assessed. That is, the *offeror* must pay the costs.

34 The most likely scenario in which this provision would be used is where a defendant makes an offer proposing judgment in favour of the plaintiff, with costs to be paid by the defendant as agreed or assessed.

35 The other permutations of the rule are unlikely:

- A plaintiff could make an offer proposing judgment in favour of the defendant, with costs to be paid by the plaintiff as agreed or assessed. However, this would have the same consequences as the plaintiff discontinuing proceedings: see UCPR, r 42.19.

- A party could propose judgment in their own favour, but offer to pay the other side's costs – an unlikely prospect.

Third scenario: UCPR r 20.26(3)(c)

36 This provision can operate irrespective of who makes the offer or in whose favour the proposed judgment would be. An offer may simply provide that costs, however assessed or agreed, be met out of a specified estate, notional estate or fund. This type of offer would typically arise in a succession matter.

The costs consequences

37 If a valid offer has been made under r 20.26, UCPR pt 42, div 3 applies.[34] The cost consequences dealt with by Div 3 are:

[34] UCPR, r 42.13.

- Rule 42.13A: Where an offer is accepted, but there is no provision for costs, the party in whose favour judgment is proposed will be entitled to costs on an ordinary basis up to the time when the offer was made.

- Rule 42.14: Where a plaintiff's offer is rejected, and the plaintiff obtains a judgment no less favourable than the offer, the plaintiff is entitled to costs on an ordinary basis until the date of offer[35] and on an indemnity basis thereafter (unless the Court orders otherwise);

- Rule 42.15: Where a defendant's offer is rejected, and the plaintiff obtains a judgment no more favourable than the offer, the plaintiff is entitled to their costs on an ordinary basis until the date of offer, and the defendant is entitled to their costs on an indemnity basis thereafter (unless the Court orders otherwise); and

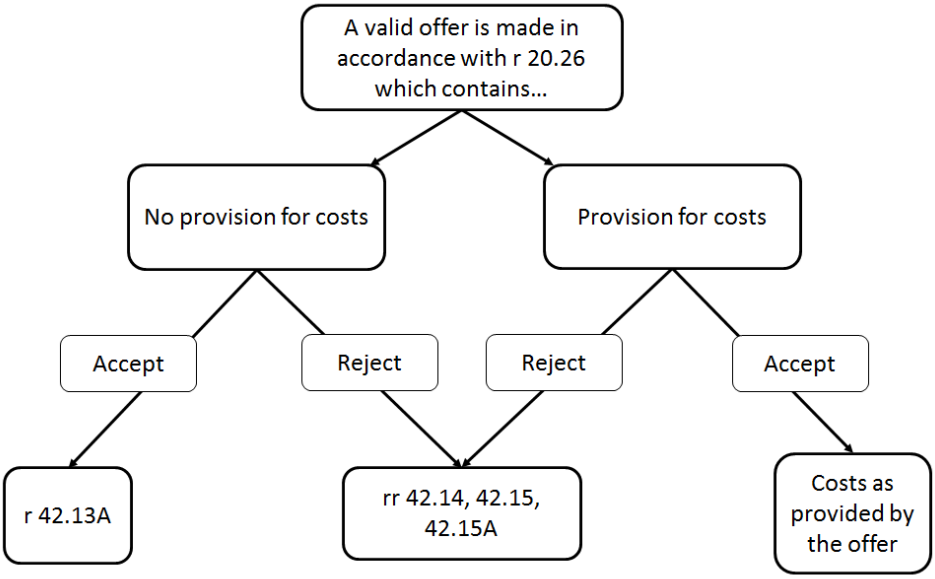
- Rule 42.15A: Where a defendant's offer is rejected, and the defendant obtains a judgment no less favourable than the offer, the defendant is entitled to their costs on an ordinary basis until the date of offer and an indemnity basis thereafter (unless the Court orders otherwise).

38 The rules do not provide for the situation where an offer which makes provision for costs is accepted, leaving the terms of the offer of compromise to operate according to their terms. That is, if an offer is accepted, the contractual result will follow.[36]

39 The various costs consequences that follow where a valid order is made may be represented as follows:

[35] The precise time from which indemnity costs will become available is the beginning of the day after the offer was made (if the offer was made before the beginning of a trial), or 11am of the day after the offer was made (if the offer was made after the beginning of a trial): see r 42.14(2)(b)(i) and (ii). However, 'the date of offer' is adopted as a shorthand in respect of rr 42.14, 42.15 and 42.15A.

[36] *Zilotto v Hakim* [2013] NSWCA 359 at [14].



40 An important observation should be made about r 42.13A. The old r 42.13A provided as follows:

> "(1) This rule applies if the offer concerned:
>
> (a) is made by the plaintiff and accepted by the defendant, or
>
> (b) is made by the defendant and accepted by the plaintiff.
>
> (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:
>
> (a) the offer states that it is a verdict for the defendant and the parties are to bear their own costs, or
>
> (b) the court orders otherwise."

41 As explained above, the existence of old r 42.13A formed part of the Court's rationale for requiring that offers of compromise be entirely exclusive of costs.[37] If an offer of compromise specified a particular costs outcome, it would be inconsistent with r 42.13A at least insofar as it removed the court's discretion.

[37] *Whitney* [2013] NSWCA 188 at [25].

42 The new r 42.13A provides:

> "(1) This rule applies if the offer:
>
> (a) is accepted by the offeree, and
>
> (b) does not make provision for costs in respect of the claim.
>
> (2) If the offer proposed a judgment in favour of the plaintiff in respect of the claim, 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.
>
> (3) If the offer proposed a judgment in favour of the defendant in respect of the claim (including a dismissal of a summons or a statement of claim), the defendant is entitled to an order against the plaintiff for the defendant's costs in respect of the claim, assessed on the ordinary basis up to the time when the offer was made."

43 The new rule applies only where an offer contains no provision for costs. That is, it operates as the default cost consequence when an offer is silent as to costs. There is no longer a discretion for the court to order otherwise. Thus, there is no longer any inconsistency between offers that deal with costs and Pt 42, division 3. If an offer provides for costs and is accepted, r 42.13A simply does not apply.

Rule 20.26(12)

44 Rule 20.26(12) provides:

> "A notice of offer that purports to exclude, modify or restrict the operation of rule 42.14 or 42.15 is of no effect for the purposes of this Division."

45 Rules 42.14 (offer made by a plaintiff) and 42.15 (offer made by a defendant) only operate in circumstances where an offeree *rejects* an offer. Therefore, the purpose of r 20.26(12) can only be to prevent an offer purporting to specify what the costs consequences in the event the offer is *not* accepted.[38]

46 The consequence of purporting to modify rr 42.14 and 42.15 is that the whole offer would automatically be "*of no effect*". However, it should be observed

[38] *Council of the City of Canterbury v Milich* [2013] NSWCA 215 at [11].

that a term of an offer purporting to modify the cost consequences if an offer is *not* accepted would be meaningless in any event. In such a circumstance, there would be no agreement between the parties, and so no basis for the Court to give effect to such a term.

47 Another curiosity in relation to r 20.26(12) is that it does not refer to UCPR, r 42.15A. In *Leach v The Nominal Defendant (QBE Insurance (Australia) Ltd) (No 2)*,[39] McColl JA considered that this may be because r 42.15A was only inserted into the rules in December 2006,[40] when it became apparent that r 42.15 did not deal in express terms with the situation where a plaintiff who rejects a defendant's offer of compromise is wholly unsuccessful in the proceedings.[41] Rule 20.26(12), by contrast, has subsisted in identical form since the commencement of the UCPR. The legislature has perhaps overlooked amendment of r 20.26(12) so as to refer to r 42.15A.

48 What, then, if an offer of compromise included a term purporting to exclude or modify the operation of r 42.15A?

49 For the same reasoning outlined above, such a term in an offer would be meaningless. It would have no effect except when the offer is rejected, in which case there would be no agreement between the parties. The offer of compromise as a whole would not automatically be "*of no effect*" by operation of r 20.26(12), but the Court would simply apply the rules to determine the costs consequences of the rejection of the offer.

Two case studies

50 It is useful to consider the operation of the new rules by reference to two factual scenario's arising under the old rules. In both cases, the offers of compromise were held to be non-compliant with the old rules. The first case

[39] [2014] NSWCA 391 at [35].
[40] Uniform Civil Procedure Rules (Amendment No 11) 2006 (NSW); *New South Wales Government Gazette*, Number 175, 8 December 2006, at 10465-10466.
[41] For the history of that provision, see *Seven Network Ltd v News Ltd* [2007] FCA 1489; 244 ALR 374 at [35].

involves a relatively simply application of the rules. The second case raises more difficult questions.

Case Study 1: *Old v McInnes and Hodgkinson*[42]

51 This case involved an offer of compromise in the following terms:

> "The First Defendant offers to compromise the Plaintiff's claim against him on the following terms:
>
> 1. Judgment for the Plaintiff against the First Defendant in the sum of $8,190.00.
> 2. First Defendant to pay the Plaintiff's costs as agreed or assessed.
>
> This offer is made pursuant to Rule 20.26 of the Uniform Civil Procedure Rules 2005.
>
> This offer is open for acceptance for 28 days."

52 The Court of Appeal (Beazley, Giles and Meagher JJA) was unanimous in holding that the offer was not made under r 20.26 and was of no effect for the purposes of the offer of compromise regime under the UCPR.

53 What would be the position now?

- The offer does not include an amount for costs, and is not expressed to be inclusive of costs, so the offer does not violate r 20.26(2)(c).

- The offer is made by the first defendant, and the first defendant offers to pay the costs. That is, the offeror will pay the costs if the offer is accepted. This falls within the scenario outlined in r 20.26(3)(b).

54 The offer would therefore be valid under r 20.26.

Case Study 2: *Whitney v Dream Developments Pty Ltd*[43]

55 *Whitney* involved an offer of compromise in the following terms:

[42] [2011] NSWCA 410.
[43] [2013] NSWCA 188.

> "This offer is made in accordance with Rule 20.26 of the Uniform Civil Procedure Rules 2005
>
> The [Plaintiff] offers to settle the Plaintiff's claim against the Defendant on the following basis:
>
> 1. Judgment for the Plaintiff.
>
> 2. The Defendant to pay the Plaintiff $14,000.00 within 28 days of written acceptance of this offer.
>
> 3. The Defendant to pay the Plaintiff's costs as agreed or assessed.
>
> This offer is open for acceptance until 5.00pm Tuesday, 14 September 2010, which given this matter is listed for hearing on Friday 17 September 2010 is a reasonable time from the making of this offer of compromise, after which it will lapse."

56 As discussed above, the Court of Appeal determined that this offer was not compliant with the rules because it was not silent on costs.

57 The position now is more complicated. First, the offer does not fall foul of r 20.26(2)(c) – it neither includes an *amount* for costs, nor is expressed to be inclusive of costs.

58 However, the offer does not fall within (a), (b) or (c) of s 20.26(3). It proposes judgment in favour of the plaintiff, not the defendant, so (a) is not engaged. And (b) is not engaged as the offer was made by the plaintiff, but required the defendant to pay the costs – so it was not an offer that the offeror pay costs.

59 This leads to the question that I raised earlier. Does r 20.26(3) delimit the types of offers that may be made under the rules? Or is the rule simply permissive of the offers that *may* be made?

60 The rules are not accompanied by any explanatory note, as would be expected with legislation. There is no explanation as to what was intended by the rules, and indications point in both directions.

61 In support of the position that r 20.26(3) is permissive is the language of "*may propose*". This can be contrasted to the language in r 20.26(2)(c) of "*must not*

include". Rule 20.26(3) could have, but does not, say "*may only propose*". Another indication is that r 42.13A deals with offers that are silent as to costs, but there is no express reference to an order that is silent as to costs in r 20.26(3).

62 However, a strong contrary indication may be that the rules cover the field or are a code. It would be unnecessary to expressly contemplate the scenarios covered by r 20.26(3) if Parliament had intended that an offer as to costs on any terms could be made. Also relevant is the fact that prior to the introduction of r 20.26(3), no offers as to costs (other than "walk-away offers"[44]) could be made at all. The amendments, by listing three specific scenarios where costs 'may' be referred to, do not evince an intention to effect a wholesale reversal of the former position.

63 What position should you take? If you are making the offer, the obvious answer is that you ought to take no risks whatsoever. Do not make a *Whitney*-type offer that does not fall within a limb of r 20.26(3). If you follow that advice, the position will be covered by the rules and your client will obtain the benefits that offers of compromise under the rule are intended to provide.

64 I should note that a *Whitney*-type offer was considered by the Court of Appeal in *Curtis v Harden Shire Council (No 2)*.[45] In September 2013, after the commencement of the new rules, the appellant in the proceedings made the following offer:

> "Verdict for the Appellant, with damages to be assessed but reduced by 10%, plus costs as agreed or assessed."

[44] The old r 20.26 allowed parties to make an offer that there be a verdict for the defendant, with the parties to bear their own costs. Such an offer was referred to a "walk away offer": *Leach v The Nominal Defendant (QBE Insurance (Australia) Ltd) (No 2)* [2014] NSWCA 391 at [50]; *Taheri v Vitek (No 2)* [2014] NSWCA 344 at [8]. Walk away offers would now fall within r 20.26(3)(a): see the offer of compromise discussed in *Salmon v Osmond* [2015] NSWCA 42, discussed at para 32 above.

[45] [2014] NSWCA 45.

65 That is, the appellant (the offeror) made an offer for a verdict in the appellant's favour, but required the respondent to pay the costs. As in *Whitney*, such an offer would not fall within r 20.26(3).

66 The Court of Appeal (Bathurst CJ, Beazley P and Basten JA) held that the rule was compliant with r 20.26(2)(c). However, the question of the consequences of it not falling within an express category of r 20.26(3) was not raised by the parties nor considered by the Court.

The Consequences of Non-Compliance

67 Let us assume that you draft an offer of compromise that you intend to fall within the rules, but which is held to be non-compliant. What are the possible consequences?

Can a non-compliant offer have effect under the rules?

68 The first question is whether all breaches of r 20.26 will disqualify the offer from attracting the cost consequences provided in Pt 42, division 3. Rule 42.13 limits the application of that division to "*proceedings in respect of which an offer of compromise… is made under rule 20.26 with respect to the plaintiff's claim*."

69 This question was recently considered by the Court of Appeal in *Leach v The Nominal Defendant (QBE Insurance (Australia) Ltd) (No 2)* (*'Leach'*).[46]

70 The respondent in *Leach* made an offer of compromise to the appellant in the following terms:

> "Without admission of liability, the Respondent offers to compromise this action on the following terms:
>
> 1. Verdict for the Respondent.
>
> 2. Each party to pay their own costs in respect of proceedings in the District Court (2010/253820) and the Court of Appeal.

[46] [2014] NSWCA 391.

> 3. This offer of compromise is made in accordance with rule 20.26 of the Uniform Civil Procedure Rules 2005."

71 The covering letter advised that the offer was "*open for acceptance for 28 days only*."

72 The appellant never responded to this correspondence, and the respondent sought to obtain indemnity costs in accordance with r 42.15A.

73 McColl JA, with whom Gleeson JA and Sackville AJA agreed, observed that it was apparent that the offer was drafted by reference to the old r 20.26, rather than the amended rule that was in force at the time of the offer.[47] Thus, the offer proposed that each party "*pay their own costs*", reflecting the former r 20.26(2), rather than proposing "*no order as to costs*", as the language of the amended r 20.26(3)(a)(i) provides. Likewise, the ofer used the language of "*verdict*" rather than "*judgment*". However, her Honour found that despite using a different form of words, the effect of those words was the same.[48]

74 Another omission in the offer of compromise was that the time in which the offer could be accepted was included in the covering letter, rather than the offer itself. Rule 20.26(2)(f) provides:

> "An offer under this rule… must specify the period of time within which the offer is open for acceptance."

75 Notwithstanding this omission, McColl JA considered that the offer was not inefficacious and constituted an offer made under the rules. Her Honour approached the issue as a question of statutory construction – whether the statute, properly construed, intended that an act done in breach of the provision should be invalid. Her Honour reasoned:

> "Whether non-compliance with the requirements of UCPR 20.26 as to the form of an offer invalidates the offer turns on whether "it was a purpose of the legislation that an act done in breach of the provision should be invalid ... [i]n

[47] Ibid at [17], [30].
[48] Ibid at [33].

> determining the question of purpose, regard must be had to the language of the relevant provision and the scope and object of the whole statute": *Project Blue Sky Inc v Australian Broadcasting Authority* [1998] HCA 28; (1998) 194 CLR 355 (at [91] - [93]) per McHugh, Gummow, Kirby and Hayne JJ."[49]

76 Her Honour observed that r 20.26 only addresses the consequences of non-compliance in one respect, namely, the provision in r 20.26(12) that an offer is "*of no effect for the purposes of this Division*" if it purports to exclude, modify or restrict the operation of rr 42.14 or 42.15. Her Honour stated:

> "[T]he fact that UCPR 20.26 does not sanction non-compliance with the otherwise apparently obligatory requirements for the form of the offer suggests that the legislature did not intend to render inefficacious an offer which otherwise complied with its requirements."[50]

77 The Court therefore found that a prima facie entitlement to have costs awarded in accordance with r 42.15A arose in favour of the respondent.[51] However, the Court held that it was not unreasonable for the appellant to refuse to accept the offer, and exercised its discretion to "*order otherwise*".

78 This case suggests that non-compliance with r 20.26 does not toll the death knell for that particular offer of compromise. It may still be able to have effect, not only as a Calderbank offer or as a factor relevant to the exercise of the Court's discretion, but as a valid offer under the rules attracting costs consequences under rr 42.14, 42.15 or 42.15A.

79 This element of the reasoning in *Leach* has not yet been applied in any other Court of Appeal decisions, and the recent decision of *Davis v Swift (No 2)*[52] provides an example of a contrasting approach.

80 The offer of compromise in *Davis v Swift (No 2)* was made prior to the amendment of the rules in 2013. As then in force, r 20.26(3)(b) provided:

[49] Ibid at [37].
[50] Ibid at [38].
[51] Ibid at [40].
[52] [2015] NSWCA 137.

> "[I]f the offeror has made or been ordered to make an interim payment to the offeree, [the offer] must state whether or not the offer is in addition to the payment so made or ordered."

81 The appellant had received interim payments, but had not complied with the r 20.26(3) requirement. The covering letter of the offer confirmed the amount of the interim payments, but did not expressly indicate whether the offer was in addition to those payments. Meagher JA, with Leeming JA and Adamson J agreeing, stated that:

> "For that reason and, more fundamentally because it was not part of the 'notice of offer', it could not satisfy the subrule.
>
> It follows that the Offer of Compromise was not in accordance with UCPR, r 20.25 and did not attract the operation of the costs rule in r 42.15."[53] [emphasis added]

82 While the breach of r 20.26 in *Davis v Swift (No 2)* was of a more substantive nature than that in *Leach*, the emphasised portion of the above quotation suggests that the inclusion of a mandatory element of an offer in the covering letter rather than the offer itself would be sufficient to disqualify an offer from the operation of the costs rule in part 42, division 3.

83 Meagher JA also rejected in short shrift a submission that the offer could:

> "nevertheless be taken into account in the exercise of the costs discretion because the non-compliance was technical and there was no request for clarification or evidence that the absence of the statement as to the inclusion of the advance payment affected the appellant's consideration of the offer."[54]

84 His Honour noted that there was nothing in the terms of the offer or the accompanying letter which indicated that it was to be relied on in relation to costs otherwise than under the rules. His Honour did not consider any argument of the type accepted in *Leach* – that non-compliance with r 20.26 would not necessarily render it inoperative under the rules. Presumably, this was because counsel did not put such an argument to the Court.

[53] Ibid at [12].
[54] Ibid at [14].

85 It will be interesting to follow the impact that *Leach* will have in respect of arguments put to or accepted by Courts when there has been non-compliance with r 20.26.

Can a non-compliant offer take effect as a Calderbank offer?

86 If an offer is held to be invalid under the rules, can it nonetheless take effect as a *Calderbank* offer?

87 *Calderbank* offers, as the Court in *Jones v Bradley (No 2)* explained,[55] are a "*means of making offers of settlement in circumstances where the party making the offer ultimately seeks a costs advantage if the offer is not accepted.*"[56] *Calderbank* sit outside offers made under the rules of court.

88 A *Calderbank* offer is a matter to which a court will have regard when deciding whether to make a costs order other than that costs follow the event.[57] However, a favourable costs order will not automatically follow from a rejected *Calderbank* offer.[58] There is no "*prima facie presumption*" that the offeror will be awarded indemnity costs.[59]

89 The purpose of including *Calderbank* offers in the scope of this paper is to address the jurisprudence as to the circumstances in which a non-compliant rules offer may be treated as a *Calderbank* offer.[60]

90 The decision in *Whitney*[61] is the leading authority regarding when a non-compliant offer could be treated as a *Calderbank* offer. In *Whitney*, the offer was expressly made pursuant to r 20.26 but, because it was not exclusive of

[55] [2003] NSWCA 258.
[56] Ibid at [5].
[57] See *Jones v Bradley (No 2)* [2003] NSWCA 258 at [9]; approving *SMEC Testing Services Pty Ltd v Campbelltown City Council* [2000] NSWCA 323 at [37].
[58] Ibid.
[59] *Jones v Bradley (No 2)* [2003] NSWCA 258 at [7] and [9].
[60] I refer you to an earlier paper I have delivered on the question as to what constitutes a valid *Calderbank* offer: M J Beazley, *Calderbank Offers* (speech delivered at the Australian Lawyers Alliance Hunter Valley Conference, 14-15 March 2008), available online at http://www.supremecourt.justice.nsw.gov.au/Documents/beazley140308.pdf.
[61] *Whitney* [2013] NSWCA 188.

costs, was non-compliant. The Court unanimously held that the defective offer could not of itself take effect as a *Calderbank* offer.

91 Bathurst CJ observed that:

> "There was nothing in either of the offers to indicate that they were intended to have effect other than as offers under r 20.26. Further, there was nothing in the correspondence with which the offers were enclosed or in the surrounding circumstance to indicate they would be relied on in relation to the question of costs should a verdict more favourable than the offer be achieved. Such an indication, in my opinion, is the essence of a *Calderbank* offer.
>
> That is not to say that the conduct of the parties during litigation, including the making of open offers, may not in certain circumstances be relevant to the appropriate manner in which a court's discretion as to costs should be exercised. However, **an offer made expressly pursuant to r 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, irrespective of its effectiveness as an offer under r 20.26**."[62]

92 Thus, according to the Chief Justice, where an offer is expressly made pursuant to the rules, there must be an indication "*that it is proposed to be relied upon on the question of costs, irrespective of its effectiveness as an offer under r 20.26*."[63] It is relevant to consider the terms of the offer itself, the correspondence with which the offers were enclosed or the surrounding circumstances in determining if there was such an indication.

93 Barrett JA similarly observed:

> "An offer is of the Calderbank type only if the maker of it is shown to intend that the fact of its non-acceptance may be deployed as a basis for seeking a special costs order in the event of that party's ultimate success in the action. Everything therefore depends on the message conveyed by the offer itself and any covering letter or other attendant circumstance…
> …
> [T]he crucial matter is the manifested intention of the offeror. In the present case, the message conveyed by the making of each offer in the context in which it was made was that the plaintiff intended to have resort to the r 20.26 regime. In the absence of any **intimation** (for, example, in a covering letter) **that the plaintiff intended its offer expressly founded on r 20.26 to have some secondary or alternative significance**, the fact that the plaintiff's

[62] Ibid at [42]-[43]
[63] Ibid at [43].

> attempt to act under r 20.26 miscarried neither required nor justified any assumption of intended secondary or alternative significance."[64]

94 In some respects, the decision in *Whitney* broadened the approach taken by earlier authorities as to when a non-compliant offer could take effect as a *Calderbank* offer. The Court made clear that the terms of the offer, the correspondence enclosing the offer and surrounding circumstances are all relevant to ascertaining the intention of the party making the offer, whereas some older authorities restricted the enquiry to the terms of the offer itself.[65]

95 However, in other respects *Whitney* has narrowed the circumstances in which a non-compliant offer will be treated as a *Calderbank* offer. This was discussed in a judgment handed down shortly after *Whitney*, *Ziliotto v Hakim*.[66]

96 The offer in that case was made by the respondent pursuant to the old r 20.26. However, the offer was not exclusive of costs and so, following *Whitney*, was non-compliant with the rules. The covering letter of the offer contained the words "*without prejudice except as to costs*". The respondent submitted that the surrounding circumstances, and the phrase "*without prejudice except as to costs*", clearly indicated to the appellant that, at an appropriate stage, the letter could be tendered to attract an indemnity costs order.

97 Tobias AJA, with whom Macfarlan JA agreed, rejected that submission. His Honour reasoned:

> "The attached Offer was expressly stated to be made in accordance with r 20.26. There was nothing in the covering letter or the Offer itself to indicate that it had some "secondary or alternative significance": *Whitney* at [59].
> …
> Each of [the statements of Bathurst CJ, Barrett JA and Emmett JA in *Whitney*] makes clear that there must be something in the offer, the covering letter or the surrounding circumstances that manifested an intention on the part of the

[64] Ibid at [57] and [59].
[65] *Old v McInnes and Hodgkinson* [2011] NSWCA 410 at [85].
[66] [2013] NSWCA 359.

> offeror that **it was proposed to be relied upon with respect to costs irrespective of its effectiveness under r 20.26**."[67]

98 Basten JA likewise stated that *Whitney* had the effect of changing the law such that it was no longer sufficient to identify a *general* intent that an offer carry costs consequences if rejected. Rather, in Basten JA's view, the law had been:

> "reformulated so as to require an **express intimation that the offer was intended to have some secondary or alternative operation**."[68]

99 Both Basten JA and Tobias AJA, in separate reasons, therefore held that the offer could not take effect as a *Calderbank* offer. A general intention to rely on an offer for costs purposes was insufficient.

100 The lesson for legal practitioners is that it is necessary to expressly include a statement to the effect that:

> "In the event that the Offer of Compromise is found not to be valid under the Rules, the respondent will on the question of costs rely on the offer in accordance with the principles enunciated in *Calderbank v Calderbank*."[69]

101 This may be indicated by the offer itself, the enclosing correspondence or the attendant circumstances. But there must be an "*express intimation*" of the secondary operation of the offer.

Can a non-compliant offer otherwise be relevant to the Court's discretion as to costs?

102 If an offer does not have effect under the rules and is not a *Calderbank* offer, is there a third option? Can the court nonetheless rely on the existence of the offer to help inform its ordinary costs discretion under the CPA, s 98, and its discretion under r 42.1 to not order that costs follow the event where "*it*

[67] Ibid at [128]-[129].
[68] Ibid at [16].
[69] This example was taken from the offer considered in *Leach v The Nominal Defendant (QBE Insurance (Australia) Ltd) (No 2)* [2014] NSWCA 391 and is by way of example only.

appears to the court that some other order should be made as to the whole or any part of the costs"?

103 *Ziliotto v Hakim* would suggest that it can. Tobias AJA states that:

> "[T]he conclusion that the Offer was not effective as a *Calderbank* offer does not preclude the Court from taking into account the conduct of the parties, including attempts at settlement, in exercising its discretion pursuant to UCPR r 42.1 as to whether to make some order other than that costs should follow the event."[70]

104 Tobias AJA relied on an observation I made, in dissent, in *Old v McInnes and Hodgkinson*:

> "Given the court's discretionary power as to costs and the important public policy considerations and the private interests of parties in settling litigation, the fact that a failed Rules offer of compromise is not strictly conformable with the usual *Calderbank* offer, does not preclude the court from considering whether it should exercise its discretion as to costs so as to make some other order than costs follow the event, in accordance with UCPR, r 42.1. Rather, when the court is asked to exercise its discretion as to costs, it is entitled to look at the conduct of the parties throughout the proceedings, including attempts made at settlement and the terms of the failed UCPR offer."[71]

105 His Honour also considered that remarks made in *Whitney* supported this approach. In particular, Bathurst CJ, after rejecting the submission that the offer could be given effect as a *Calderbank* offer, stated:

> "[t]hat is not to say that the conduct of the parties during litigation, including the making of open offers, may not in certain circumstances be relevant to the appropriate manner in which a court's discretion as to costs should be exercised."[72]

106 Tobias AJA considered that, in all the circumstances, the appellant's rejection of the respondent's offer was unreasonable. However, given that no valid offer was made so there was never an available basis for ordering indemnity costs, his Honour proposed the order that there should be no order as to the costs of

[70] *Ziliotto v Hakim* [2013] NSWCA 359 at [134].
[71] *Old v McInnes and Hodgkinson* [2011] NSWCA 410 at [34].
[72] *Whitney* [2013] NSWCA 188 at [43].

the trial from the date of the offer. Macfarlan JA agreed, and this became the order of the Court.[73]

Summary

107 If an offer is not compliant with r 20.26, three possibilities will arise:

(1) The Court will find that the non-compliance does not prevent the offer from being a valid offer made under the rules attracting the cost consequences provided in Part 42, division 3 – this is the *Leach* scenario;

(2) The Court will treat the offer as a *Calderbank* offer;

(3) The Court will treat the conduct of the parties, including the making of open offers, as a relevant factor in the exercise of their broader costs discretion – the Tobias AJA approach in *Ziliotto*, which derived from my statements in *Old v McInnes and Hodgkinson*.

108 I have ordered these four options in order of how favourable the outcome would be for the offeror is accepted by the court. Of course, in all cases, costs ultimately remain in the discretion of the court.

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[73] Basten JA would have ordered that the plaintiff pay the defendant's costs of the trial on an ordinary basis. His Honour's reasons were based on an interpretation of the "event", in the phrase "*costs follow the event*" in the general rule as to costs in r 42.1. His Honour reasoned, at [20], that once a party makes a bona fine offer to settle a claim by payment of a specific amount, there is in substance no longer a dispute about the claim up to that amount. The 'event', therefore, was to be understood as success or failure in respect of any sum greater than that offered. The majority expressly disagreed with that approach, stating at [142]:

> "[The]problem with this approach is that the issue of whether to make an order other than that costs should follow the event is to be determined as at the time of judgment. The fact that a genuine offer has been made by a defendant and unreasonably refused and judgment for a lesser amount achieved by the plaintiff is the trigger for the making of such an order. But once the offer is refused, unless an admission is made that the plaintiff is entitled to the amount offered so that the only dispute is whether the plaintiff is entitled to more, then the dispute relates to the total amount of damages to which the plaintiff is entitled."

Basten JA's view has not been supported in any later authorities. In *Karabay v Carr* [2014] NSWCA 143, Gleeson JA noted the difference of opinion, but held that it was unnecessary to express a view of the competing approaches as to what is meant by the 'event'.

109 The *Leach* scenario, where the offeror receives the benefit of the application of the rules, is the most favourable, as there would be a presumption in favour of indemnity costs. However, I should note that this line of reasoning is novel, and it is difficult to know how many benches would be persuaded to overlook non-compliance with r 20.26.

110 *Calderbank* offers, as stated above, are no guarantee of the award of indemnity costs. However, having an offer characterised as a *Calderbank* will at least put the option of indemnity costs on the table. In *Ziliotto*, Tobias AJA considered that ordering costs on an indemnity basis was "*never an available option*" in circumstances where the offer could not be characterised as a *Calderbank* and there was no misconduct on the part of the offeree.

111 Seeking to convince the court that, in the whole of the circumstances, the conduct of your client was such that the court should exercise its general discretion to order other than the costs should follow the event, is an available third line of defence.[74] This approach accords with the Court's discretionary power as to costs and the importance, both in terms of public policy and the private interests involved, in encouraging the settlement of litigation.

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[74] *Old v McInnes and Hodgkinson*[2011] NSWCA 410; *Ziliotto v Hakim* [2013] NSWCA 359. Alternatively, if the allegation is misconduct on the part of the opposing party, see *Oshlack v Richmond River Council* (1998) 193 CLR 72.