

*Order 26 of the Rules of the Supreme Court is concerned with offers of compromise. Discuss the discretion given under rules 26.08(2) and 26.08(3) in light of the decided cases.*

## **I. Introduction**

The engagement in litigation is synonymous with risk and the inherent probability that the case brought forth against the defendant may fail. The burden of costs imposed on a party who has unreasonably rejected an otherwise reasonable offer of compromise has been a long established rule of judicial engagement. The increasing cost of litigation coupled with the sheer number of claims that are presented to the Courts each year compels the need for adverse sanctions to be enforced against those who do not attempt to reasonably settle a dispute prior to trial. It has been argued that the settlement of such disputes can often lead parties to a cynical view of the judicial system<sup>1</sup> and the inherent belief that justice was not adequately achieved. Such contentions are principally unfounded given that all settlements are at the free will of each litigant and are decided with the guidance of their legal counsel in respect to an assessment of costs if the matters were to proceed to trial.<sup>2</sup> The importance of a pragmatic costs judgment, in addition to a realistic assessment of the strength of each party's arguments, forms the critical determination of whether an offer of compromise is accepted or rejected. The reliance on legal practitioners in this regard is paramount in balancing the outcome the litigant desires against the probability of success or failure in the trial itself.

Accordingly, it is axiomatic in civil proceedings that costs typically always follow the event and are awarded to the successful litigant in light of their subsequent claims.<sup>3</sup> While this is the generally accepted methodology in most civil proceedings, s24(1) of the *Supreme Court Act 1986 (Vic)* is explicit in its direction that an order for costs '[i]s in the discretion of the Court and the Court has full power to conclude by whom and to what extent the costs are to be paid'.<sup>4</sup> Correspondingly, it is apparent that even a successful litigant can have costs awarded against them if the Court exercises its judicial power in determining such costs.<sup>5</sup> Such a determination by the Court cannot be based on any 'material that is illegitimate or is non-existent, or in violation of some principle of substantive right'<sup>6</sup> thereby restricting the judicial discretion to those matters which are inherent to the trial proceedings. An unsuccessful party will usually be ordered to cover the costs of the successful party in the proceeding because

*'costs are compensatory in that they are awarded to indemnify the successful party against the expense to which he or she has been put by reason of the legal proceedings. The order is not made to punish the unsuccessful party.'*<sup>7</sup>

Thus, this paper will examine offers of compromise within the ambit of O 26 Pt 2 *Supreme Court (General Civil Proceedings) Rules 2005 (Vic)*<sup>8</sup> which deal with offers of compromises and the economic consequences of a failure to accept such an offer. It will focus on the

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<sup>1</sup> Colbran, Reinhardt, Spender, Jackson and Douglas, *Civil Procedure – Commentary and Materials 3<sup>rd</sup> Edition*, LexisNexis Butterworths, 2006 at pg. 776.

<sup>2</sup> *Ibid* at pg. 777.

<sup>3</sup> *Ritter v Godfrey* (1920) 2 KB 47.

<sup>4</sup> *Supreme Court Act 1986 (Vic)*, s24(1).

<sup>5</sup> *Donald Campbell & Co v Pollak* [1927] AC 732.

<sup>6</sup> *Ibid* at 752.

<sup>7</sup> *Latoudis v Casey* (1990) 170 CLR 534 per Mason CJ at 543, per Toohey J at 562–563, per McHugh J at 566–567.

<sup>8</sup> Herein referred to as 'the Supreme Court Rules'.

leading judgments from the Supreme Court of Victoria and the Court of Appeal in respect to this order, and examine the rationale of exercising discretion and departing from the general rule. It will focus on offers of compromise contained within the scope of Order 26 Pt 2 Rule 26.08 of the Supreme Court Rules and consider the rationale that parties, and those advising them, must contemplate before proceeding to trial. A conclusion will then be drawn encompassing the modern application of offers of compromise and the relevant statutory discretion which is afforded to the Courts when an offer of compromise has been rejected.

## II. Offers of Compromise and Costs

O 26 of the Supreme Court Rules endorses the use of offers of compromise to expedite the settlement of proceedings by imposing adverse costs on parties who reject a reasonable offer from the other litigant. Most relevantly is Rule 26.08 of the Supreme Court Rules which details the method in which the Court can exercise its costs discretion in proceedings where an offer of compromise has been made - but is subsequently rejected - and the offer made was retrospectively more favourable than that provided in judgment.<sup>9</sup> The Rule is an important articulation of policy which is intended to encourage the resolution of disputes, and to restrain the continuation of expenditure on litigation which cannot achieve a more adequate outcome than that which is offered.<sup>10</sup> It forces each of the parties to carefully measure and evaluate the probable outcome of the dispute in respect to any offer of compromise which is served by the other party. As stated by Pagone J in *Griffiths & Beerens Pty Ltd v Duggan*<sup>11</sup>

*'The Rule encourages the defendant to make an offer that will be attractive to a plaintiff seeking to secure compensation on the claim. The Rule also requires the plaintiff to make a careful evaluation of the outcome which continued litigation may achieve and to compare that with the offer.'*<sup>12</sup>

Rule 26.08(2) and 26.08(3) apply to both plaintiffs and defendants respectively, and the application of the rule is dependent on which party in the proceedings makes an offer of compromise. It seems that the rules are less favorable to defendants than they are to plaintiffs when an offer of compromise is rejected by a plaintiff. In respect to both rules 26.08(2) and 26.08(3), where the plaintiff does not obtain a judgment more favorable than the offer of compromise offered by the defendant, then the plaintiff is entitled to costs on a party and party basis to the date of the offer, and the defendant is entitled to costs on a party and party basis thereafter. Evidently, the reason for such differences between each of the Rules is that defendants have an expectation that they must pay the costs of the plaintiff in any proceedings which are not frivolous.

It follows that without such differences there would be a clear lack of incentive to drive a defendant into accepting an offer of compromise from a plaintiff if the offer of compromise was not greater than the costs associated with going to trial. A defendant must weigh the economic benefit of going to trial and the potential for failing in its defense, against any associated offer of compromise to a plaintiff which could substantially reduce their civil proceeding costs. Equivalently, the reverse is also true, such that a plaintiff must provide

<sup>9</sup> Dempsey, Mark, *Offers of compromise under the Supreme Court Rules* (1995) 33 (7) LSJ 29 at 29.

<sup>10</sup> Ellis, Matthew, *The cost of compromising: Offers of compromise and Calderbank offers* (2008) 17 JJA 253 at 259.

<sup>11</sup> *Griffiths & Beerens Pty Ltd & Ors v Duggan & Ors (No 3)* [2008] VSC 462.

<sup>12</sup> *Ibid* at 5.

adequate consideration to an offer of compromise as any rejection of an offer without careful consideration could result in the Court awarding costs against the plaintiff from the date of the offer.

The order of costs is at the discretion of the Court as per s24(1) of the *Supreme Court Act (Vic) 1986* and this discretion must be exercised judicially.<sup>13</sup> It cannot be exercised in a manner that is arbitrary or capricious and it cannot be exercised on grounds which have no real connection to the litigation<sup>14</sup> or in circumstances leading up to the litigation.<sup>15</sup> Normally, costs are awarded on a party and party basis and in certain circumstances the Court can also order indemnity costs.<sup>16</sup> The specific circumstances in which an order of indemnity costs will be made were outlined and summarized by Harper J in *Ugly Tribe Co Pty Ltd v Sikola*.<sup>17</sup> His Honour stated that such orders typically stem from one parties acts of fraud or false assertions, acts which result in a loss of time or acts which constitute procedural misconduct such as a failure to adequately discover documentation which would have shortened, or avoided, the trial.<sup>18</sup> Typically, the Court will refrain from departing from the general rule and awarding indemnity costs unless the circumstances fall into one of these aforementioned instances.

Rule 26.08(2) and 26.08(3) of the Supreme Court Rules both provide that a cost order be imposed unless ‘the Court otherwise orders’. In *Maitland Hospital v Fisher (No 2)*<sup>19</sup> the Court suggested that the ‘ordinary provision is expected to apply in the ordinary case’,<sup>20</sup> and in *Larkin McDonald & Associates v Mahoney*<sup>21</sup> the Court stated that ‘it is the duty of the courts, allowing for exceptions in particular cases, to give effect to the purpose of the rule’.<sup>22</sup> This infers that Courts will hesitate in departing from the Rule unless some special circumstances provide for it such as those detailed by Harper J in *Ugly Tribe Co Pty Ltd v Sikola*.<sup>23</sup> In this regard, it is critical that parties are afforded a reasonable basis on which to consider the fairness an offer of compromise in respect to the cost-benefit ratio and the offeror’s desire to settle. The strictness of the Courts adherence to the rule is clearly identified in *Griffiths & Beerens Pty Ltd v Duggan*<sup>24</sup> where, despite evidence tendered by the plaintiffs to suggest that procedural misconduct occurred on the defendant’s behalf which adversely affected the plaintiffs judgment in respect to the offer of compromise – the Court did not depart from the normal operation of the Rule 26.08. Most notably in this regard, Pagone J commented that

*‘The plaintiffs cannot avoid the risk transferred to them by an offer under r 26.08(3) by pointing to their success on liability: an offer under r 26.08(3) presupposes a finding of liability and seeks to encourage an end to litigation by focusing the parties’ attention on the outcomes.’*<sup>25</sup>

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<sup>13</sup> *Donald Campbell & Co v Pollak* [1927] AC 732.

<sup>14</sup> *Cretazzo v Lombardi* (1975) 13 SASR 4.

<sup>15</sup> *Oshlack v Richmond City Council* (1998) 193 CLR 72 at 97 per McHugh J.

<sup>16</sup> *GT Corporation Pty Ltd v Amare Safety Pty Ltd (no 3)* [2008] VSC 296.

<sup>17</sup> *Ugly Tribe Co Pty Ltd v Sikola* [2001] VSC 189.

<sup>18</sup> *Ibid* at 7.

<sup>19</sup> *Maitland Hospital v Fisher (No 2)* (1992) 28 NSWLR 721.

<sup>20</sup> *Ibid* at 4.

<sup>21</sup> *Larkin McDonald & Associates v Mahoney* (Queensland Court of Appeal, 24 June 1992, unreported).

<sup>22</sup> *Ibid*.

<sup>23</sup> *Ibid* 17.

<sup>24</sup> *Griffiths & Beerens Pty Ltd & Ors v Duggan & Ors (No 3)* [2008] VSC 462.

<sup>25</sup> *Ibid* at 9.

Additionally, it seems Court will have significant regard to an offer of compromise even during the very late stages of a trial. In *Broomhall v National Roads and Motoring Association Insurance Ltd (No 2)*,<sup>26</sup> Smith J stated that

*'it must not be forgotten that there is still a considerable benefit in resolution of an injuries claim even at the late stage of this proceeding. It avoids the possibility of further costs and expenses being incurred in appeals and the taking up of court time in such appeals.'*

In contrast, in *Simonovski v Bendigo Bank (No 2)*<sup>27</sup> the Court ruled that the defendants conduct was sufficient to vary from Order 26 despite the fact the defendants offer of compromise was significantly more favorable than the judgment. The plaintiffs established that a combination of the defendant's procedural misconduct in respect to discovery, and the doubtful veracity of their expert witness statements led to a miscarriage in the consideration of the sufficiency of the offer of compromise. Most importantly, Ashley J established that when an offer is made, and for the period which it is being considered, the offeree must have in its possession all material from the opposing party as necessary to adequately determine the reasonableness of the offer. His Honour stated that *'[a]n offeree should not be obliged to consider an offer whilst ignorant of required detail of the offeror's case'*<sup>28</sup> and if such a case is established against the offeror, then departing from the Supreme Court Rules is appropriate.

### **III. A proper consideration**

It seems fundamental to Order 26 of the Supreme Courts Rules that parties, and those that are advising them, take a realistic view upon the probability of success and the achievable outcome of the case. It is apparent that Courts will very rarely depart from the Rule 26.08 - even in circumstances where *prima facie* evidence is alleged against one party.<sup>29</sup> The evidence presented to the Court must prove that a party has engaged in misconduct, and this misconduct has been sufficiently serious enough to justify a departure.<sup>30</sup> In *MT Associates Pty Ltd v Aqua-Max Pty Ltd*,<sup>31</sup> Gillard J commented that Courts should encourage the use of offers of compromise from both parties in order to settle litigation faster.

His Honour commented that

*'It is in the interests of the administration of justice that litigation should be compromised as soon as is reasonably possible. It is in the public interest to do so ... Lawyers have an interest in the length of litigation and as professional people they should guard against the temptation of lengthy and expensive litigation. They should be encouraged to reduce costs.'*<sup>32</sup>

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<sup>26</sup> *Broomhall v National Roads and Motoring Association Insurance Ltd (No 2)* [2004] VSC 366.

<sup>27</sup> *Simonovski v Bendigo Bank (No 2)* [2003] VSCA 139 (it is noted that this the decision was subsequently upheld by the Victorian Court of Appeal in *Simonovski v Bendigo Bank* [2005] VSCA 125).

<sup>28</sup> *Ibid* 27 at 18.

<sup>29</sup> Refer to *Griffiths & Beerens Pty Ltd & Ors v Duggan & Ors (No 3)* [2008] VSC 462.

<sup>30</sup> Compare the decision of *Griffiths & Beerens Pty Ltd & Ors v Duggan & Ors (No 3)* [2008] VSC 462 and *Simonovski v Bendigo Bank (No 2)* [2003] VSCA 139.

<sup>31</sup> *MT Associates Pty Ltd v Aqua-Max Pty Ltd* [2000] VSC 163.

<sup>32</sup> *Ibid* at 72.

Evidently, the object of making any offer of compromise is to bring litigation to an end and to place the other party on notice that if its offer is refused and the offeror recovers more in the proceeding, then the Court will impose a special order for costs to be made. In *Maitland Hospital v Fisher (No 2)*<sup>33</sup>

*‘The rule does no more than to oblige litigants, and those advising them, to consider realistically, upon the best information available to them, the prospects of success and the likely outcome of the litigation.’*

Evidently, the reliance on each of the respective parties’ legal representation is critical to ascertaining the appropriateness of an offer of compromise in comparison to the probability of success at trial. The purpose of Rule 26.08 is to effectively put ‘[a] premium on the realistic assessment of cases’<sup>34</sup> and ensure that the legal representation of each party affords due consideration to any offer made. This requires a reasonable assessment, on the basis of the information available to the offeree, of the risk involved in proceeding to trial and the extent to which an offeree is willing to compromise with respect to the matters in dispute. As Gillard J commented in *MT Associates Pty Ltd v Aqua-Max Pty Ltd*<sup>35</sup>

*‘If a proposal is put forward the litigant and his adviser receiving the proposal ignores that proposal at his peril. Some proposals will involve discussions and negotiations between the parties. But any litigant and his adviser who takes the view that the proposal or offer can be ignored on some technical ground does so at their own risk.’*<sup>36</sup>

In light of this, it is axiomatic that offers of compromise must be afforded significant attention so as to avoid adverse costs. Costs orders seek to assist parties in their consideration of whether to proceed to trial, or whether to accept an offer of compromise which has been made on just and reasonable terms, and which will expedite the outcome of the dispute without significant legal costs. The reliance on each parties legal representation in this regard cannot be underestimated and nor is it disregarded by the Courts or in policy. Rule 63.23 of the Supreme Court Rules provides a plausible remedy to individual parties in circumstances where their legal representation has caused costs to be incurred improperly, or without reasonable cause, or in circumstances which have resulted in a failure to act with reasonable competence and expedition. The existence of such a rule enforces assiduous consideration and diligence on the behalf of legal practitioners in respect to any offers of compromise made. The adverse effect of Rule 26.08 is that parties can seek costs order from their legal representation under Rule 63.23 if they deem the advice to reject an offer of compromise unreasonable and without competence after the fact. The presence of Rule 63.23 should be afforded more attention by the Courts in the context of Rule 26.08(2) and 26.08(3), such that legal practitioners should be held more accountable in respect to the advice they to provide their clients in rejecting an otherwise reasonable offer of compromise. The balance between legal profitability and the attainment of a reasonable outcome for the client should be at the forefront of all legal practitioners’ advice in light of this Rule.

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<sup>33</sup> *Maitland Hospital v Fisher (No 2)* (1992) 28 NSWLR 721 at 725.

<sup>34</sup> *Ibid.*

<sup>35</sup> *MT Associates Pty Ltd v Aqua-Max Pty Ltd* [2000] VSC 163.

<sup>36</sup> *Ibid* at 75.

#### **IV. Conclusion**

It is definitively apparent that Rule 26.08 of the Supreme Court Rules enforces each party to carefully consider the matters in dispute once an offer of compromise has been made. The increasing cost of litigation and the substantial rise in legal costs has made the use of offers of compromise ever more prevalent.<sup>37</sup> Rule 26.08 of the Supreme Court Rules enforces each party to carefully reflect on the offer of compromise and the consequential action of rejecting it. The purpose of the rule is clearly to save costs, and to avoid the inherent risks associated with proceeding to trial where the claim may fail entirely, or the economic outcome achieved is less favorable than the offer made. A defendant must realistically assess a plaintiff's claim, and determine an appropriate offer of compromise which is attractive enough to avoid litigation, and which substantially reduces the probability that a higher award - and the associated legal costs of such an award - will be bestowed to the plaintiff through the judicial process. In contrast, a plaintiff would be improvident to disregard an offer of compromise without first establishing the probability of success at trial, the expense associated with their legal representation, a realistic assessment of the 'best case' economic award scenario, the probable length of proceedings and the approximate costs associated with the defendants legal counsel from the time the offer is made.

Rule 26.08 requires both parties to consider the implications of rejecting an offer of compromise as the Rule is absolute in its cost assignment after an offer is made. It is entirely rational to expect the party rejecting the offer to bear the opposing parties legal costs as this party is primarily responsible for the litigation proceeding to trial. The reason that discretion is afforded to the Courts under the Rule is to provide for exceptions where a party has erred in its rejection of an offer of compromise due to special circumstances which it bears the burden of proving. The Courts have consistently upheld that such circumstances must be of a manifestly high standard to 'otherwise order' a valid departure from the Rule.<sup>38</sup> It is in this regard, that it seems the primary function of the Rule is to add a new level of consideration to the utility of legal practitioners in advising their clients to accept or reject an offer of compromise. This increased level of attention to offers of compromise will both 'protect the interests of litigants and of the public interest in the prompt and economical disposal of litigation',<sup>39</sup> and ensure that justice and fairness are maintained in the judicial system.

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<sup>37</sup> Duffy, Michael, *A classy offer* (2008) 82(3) LIJ, p. 52.

<sup>38</sup> Refer to the decision of *Griffiths & Beerens Pty Ltd & Ors v Duggan & Ors (No 3)* [2008] VSC 462 and *McConnell Dowell Middle East LLC v Royal & Sun Alliance Insurance Plc (No 2)* [2009] VSC 49 as two prominent and recent examples.

<sup>39</sup> *Maitland Hospital v Fischer (No 2)* (1992) 27 NSWLR 721 at 725.

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