Settling Proceedings: Tips and Traps

a paper presented by

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for Newcastle Law Society

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About the Author

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Settling Proceedings: Tips and Traps

Nicholas Smith

Litigation has always involved the possibility of compromise. Now more than ever, parties are encouraged to compromise their differences, rather than pursue their legal rights and remedies in court. Regardless of what area of law we practice in, disputes are a fact of our practising lives. Resolution of those disputes is, therefore, an important part of our work.

This paper covers four key topics that are relevant to the settlement of a proceeding, and looks at particular issues that arise in respect of them. They are:

1) Making offers under the Rules of the Court and under the principles of *Calderbank v Calderbank*
2) The admissibility of statements and offers made in the course of settlement negotiations.
3) Tips on drafting settlement agreements
4) Issues relating to the enforcement and setting aside of settlement agreements.

The principles discussed in this paper are directed primarily to the resolution of disputes that have evolved into litigation. However, many of these principles also apply to resolution of disputes at earlier stages, such as where a commercial agreement has broken down and the parties need to discuss and resolve areas of dispute before the dispute descends into litigation.

**Making offers under the Rules of the Court and under the principles of *Calderbank v Calderbank***

The first step in settling a dispute is the making (or receiving) of a settlement offer. There are three ways in which such an offer can be made. The offer can be an ordinary offer, an offer of compromise under the rules of the court where the matter is heard, or a *Calderbank* offer (an offer exercising the principles of *Calderbank v Calderbank* [1975] 3 All ER 333)
Rules of the Court

Rule 20.26 of the UCPR sets out a number of formal requirements that must be followed when making an offer of compromise in NSW. It is important to comply with the Rules of the Court when making an offer of compromise under the rules, as failure to comply with the requirements can invalidate the offer for the purposes of costs. An offer under the UCPR:

- must be in writing;
- must be exclusive of costs;
- must bear a statement to the effect that the offer is made in accordance with these rules;
- must be open for a minimum of 28 days if made more than 2 months before the trial and a period that is “reasonable in the circumstances” if made less than 2 months before the trial; and
- cannot be withdrawn without leave of court (even if offer open for more than 28 days).

The Federal Court Rules (Rule 25) are similar, except that:

- an offer may be made inclusive of costs (this must be clearly specified);
- an offer must be open for a minimum of 14 days; and
- an offer can be withdrawn after 14 days without leave of court;

The UCPR (Rules 42.14-16) provide that unless the court otherwise orders, the party making the offer under the rules is entitled to costs on an indemnity basis from the day after the offer, if offeree does not accept the offer and subsequently does not receive a better outcome then the offer they chose not to accept. A different order will be made only in “sufficient circumstances” – Hiller v Sheather (1995) 36 NSWLR 414.

The Federal Court Rules (Rule 25) provide for a similar outcome, but federal case law has found that a different order will be made only in “exceptional circumstances” – Futuretronics.com.au Pty Ltd v Graphix Labels Pty Ltd [2009] FCAFC 40.

The circumstances in which an order for indemnity costs will not be made vary depending on the facts of the case, but include, in both NSW and Federal courts, circumstances in which an offer of compromise does not involve a real element of compromise. Individual
courts consider different factors and take different approaches in determining if an offer does not contain a real element of compromise. Presumably, an offer consisting of a full consent judgment on all issues, and served with the statement of claim, would not contain a real element of compromise. However, offers of compromise have been found in to have involved a real element of compromise in the following situations:

- A discount of less than 5% on the verdict sought - *Amaca Pty Ltd v Hicks (No 2)* [2011] NSWCA 360; and
- A ‘walk away’ offer (parties seek to forgo costs) by the defendant - *Sagacious Legal Pty Ltd v Wesfarmers General Insurance Ltd* [2011] FCAFC 53

Whether the court will find that an offer does not involve a real element of compromise depends on the particular circumstances of the case. For example a ‘walk away’ offer will generally only involve a real element of compromise if a significant potential costs entitlement has been built up.

An order for indemnity costs will not be made if the offer was made when the parameters of the dispute were uncertain – UCPR r20.26(4). A court will not penalise the recipient of an offer for failing to accept it if the recipient does not have any idea of the case it is expected to meet.

A further consideration to bear in mind when making an offer is to ensure that the offer is within the range of possible outcomes of the proceeding. If an offer is not within the range of outcomes available from the court (such as agreeing to extend a business relationship in substitution for a damages claim, or making an undertaking that a court would not order) a court cannot determine if the outcome as a result of the offer is better or worse than an outcome achieved by the court, and will not make an order for indemnity costs.

An example of this is the case of *Austin, Nichols & Co Inc v Lodestar Anstalt* (No 2) [2011] FCA 450. This was an application to remove a trade mark for non-use. The Respondent made a settlement offer which included the following provisions:

- The applicant to withdraw its application for removal of the respondent’s WILD GEESE mark;
- The respondent not to sell bourbon whiskey (the applicant’s product) in Australia and the rest of the world (the respondent’s product was Irish whiskey);
• The applicant to withdraw its oppositions to the respondent’s mark globally; and
• Each party to pay its own costs.

The respondent succeeded in opposing the applicant’s application for the removal of the mark (the judgment was later overturned on appeal), but it failed in its application for indemnity costs. Justice Cowdroy of the Federal Court refused to make an order for indemnity costs, as he could not determine if the outcome that resulted from the court proceeding (the applicant’s application for removal being rejected with costs) was better or worse than the outcome proposed in the settlement agreement (the applicant withdrawing its oppositions in other jurisdictions but no order for costs).

**Calderbank Offers**

Calderbank offers take their name from an English family law case, *Calderbank v Calderbank* [1976] Fam 93. The concept of a ‘Calderbank’ offer is simply that if a reasonable offer of settlement is made in the course of litigation, and is rejected, and the party rejecting the offer receives a less favourable judgment, there should be an adverse cost consequence to the party rejecting the offer.

The application may be made by a successful party seeking an order for costs on an indemnity basis after the date of the offer (contrary to the general rule that costs are awarded on the ordinary basis), or by a losing party seeking an order for costs, possibly on an indemnity basis, after the date of the offer (contrary to the general rule that costs follow the event). There is no presumption that costs will also be ordered on an indemnity basis in favour of a defendant who has made an offer better than the result obtained by the plaintiff, but the court has power to make such an order *Jones v Bradley (No 2)* [2003] NSWCA 258.

The approach generally taken by the courts is to ask two questions: (a) whether there was a genuine offer of compromise, and (b) whether it was unreasonable for the offeree not to accept it:

Relevant factors that are often considered as to whether the offer was a genuine compromise, and whether it was unreasonable for the offeree not to accept, it include:

• The stage of proceeding
• The time provided for acceptance
- The extent of the compromise
- The offeree’s prospects of success
- The clarity of offer
- Whether or not the offer conveyed an intention to rely on the offer for the purpose of indemnity costs
- Other case-specific issues (did the case change after the offer made, did the other party need for 3rd party approval to accept the offer)

A Calderbank offer must clearly state that it is a Calderbank offer but is otherwise much more flexible than an offer under the Rules of the Court.

The advantages of using a Calderbank offer as opposed to an offer under the rule of the court include:
- It can be inclusive of costs.
- It is more flexible in timing (can be open for a shorter period).
- It can be withdrawn at any time without leave of the court.
- It may be oral (such as an offer in a mediation).
- It can be limited to specific interlocutory provisions of the proceeding.
- It is possible to make an offer that covers outcomes outside the proceedings although it may be more difficult to show whether it was unreasonable for the offeree not to accept it.
- It can be used if a party is not sure if its settlement offer is strictly in compliance with the rules of the court.

The key disadvantage of a Calderbank offer is that the cost consequences for the recipient in rejecting the offer are much less certain than an offer under the Rules, which creates a strong presumption that indemnity costs will be awarded. It is accordingly less powerful.

**Admissibility of ‘without prejudice’ correspondence in settlement negotiations**

There are three legitimate circumstances in which ‘without prejudice’ correspondence is generally adduced in a proceeding. They are:

1) A claim for costs following a Calderbank Offer or Offer of Compromise;
2) A question about the interpretation of a settlement agreement; and
3) An application to set aside a settlement agreement (for example due to the unconscionable conduct of the other party).

The Evidence Act is fairly clear on the admissibility of ‘without prejudice’ correspondence in the circumstances above. It includes the following provisions:

_S131(1) Evidence is not to be adduced of:_

(a) a communication that is made between persons in dispute, or between one or more persons in dispute and a third party, in connection with an attempt to negotiate a settlement of the dispute; or

(b) a document (whether delivered or not) that has been prepared in connection with an attempt to negotiate a settlement of a dispute.

_S131(2) provides a series of exceptions to s131(1) including the following (emphasis added):_

_S131(2) (f) the proceeding in which it is sought to adduce the evidence is a proceeding to enforce an agreement between the persons in dispute to settle the dispute, or a proceeding in which the making of such an agreement is in issue; or_

_S131(2) (g) evidence that has been adduced in the proceeding, or an inference from evidence that has been adduced in the proceeding, is likely to mislead the court unless evidence of the communication or document is adduced to contradict or to qualify that evidence; or_

_S131(2) (h) the communication or document is relevant to determining liability for costs_

_S131(2)(i) making the communication, or preparing the document, affects a right of a person:_.

Section 131 of the Evidence Act applies to evidence of settlement communications, or casual settlement conferences, that is sought to be adduced. However, when it comes to mediations, the position is more complex. In mediations governed by an ordinary confidentiality agreement, evidence of what had occurred can be admissible pursuant to the Evidence Act – _Silver Fox Co v Lenard’s (No 3) [2004] FCA 1570_.

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However, s53B of the Federal Court Act and s30(4) of the Civil Procedure Act (NSW) contain provisions that deem information transmitted in court-ordered mediation to be inadmissible in subsequent proceedings. In particular s53B states:

Evidence of anything said, or of any admission made, at a conference conducted by a mediator in the course of mediating anything referred under s 53A is not admissible:

(a) in any court (whether exercising federal jurisdiction or not); or
(b) in any proceedings before a person authorised by a law of the Commonwealth or of a State or Territory, or by the consent of the parties, to hear evidence.

There are two cases that have reviewed the question of whether evidence of conduct or statements in court-ordered mediation is admissible, and both of them have found that, despite s131(2) of the Evidence Act, such evidence is inadmissible – Pinot Nominees Pty Ltd v Commissioner of Taxation [2009] FCA 1508 and Tony Azzi (Automobiles) Pty Ltd v Volvo Car Australia (2007) 71 NSWLR 140. In Pinot, the Applicant (the respondent in the primary proceedings) made a settlement offer in a court-ordered mediation which it sought to rely on for the purpose of costs, following the resolution of the proceedings.

Despite such evidence being prima facie admissible pursuant to s131(2)(h) of the Evidence Act, the court applied s53B of the Federal Court Act, and found that the evidence of that offer was inadmissible.

There are two key points you must keep in mind when attending negotiations for settlement:

1) If you are in a non-court ordered mediation or settlement conference, taking good file notes is vital as it will assist if there is any dispute about the form and content of any offers made, the circumstances of the offer, and the state of mind of the other party.

2) If you are in a court-ordered mediation, be aware that nothing in the mediation is admissible in that or subsequent proceedings. If you wish to rely on a settlement offer made during a mediation for the purpose of costs, even if it is rejected, you should re-send the offer in a ‘without prejudice’ letter in the days following the mediation.
Tips on drafting settlement agreements

Once you have reached a settlement, the next stage is drafting a settlement agreement. A settlement agreement is like a contract so the key to drafting an agreement is to think like a contract lawyer.

One basic issue is determining what type of settlement agreement has been entered into; in particular whether the terms are an accord executory or an accord and satisfaction or an accord and conditional satisfaction. There are important consequences of the distinction. A good reference on the distinctions is to be found in Osborn v Mc Dermott [1998] 3 VR 1 at pages 10-11.

The different types of settlement agreement are as follows:

**Accord executory:**
This is where no new rights are created until some act of performance takes place. When performance occurs the original cause of action is discharged. The agreement is not enforceable *per se*.

**Accord and Satisfaction:**
This is where there is an immediate and enforceable agreement in replacement of the original cause of action. In this case a plaintiff accepts from a defendant a new promise in substitution for an existing obligation. No proceeding can be brought on the original cause of action but only on the substituted obligation.

**Accord and Conditional Satisfaction:**
This sits between the above two categories. It is where the compromise amounts to an enforceable agreement. However, the existing cause of action is not replaced until an act of performance takes place, *e.g.* the release is conditional upon and not given effect until payment.

The best way to think about this is in the context of a settlement agreement (release in exchange for payment of a sum) which is not complied with by the payor. If the agreement is an accord executory, the payee can sue under the original cause of action, but not for the payment owed under the settlement agreement. If the agreement is an accord and satisfaction, the payee can only sue on the agreement, not the original cause of action. If the agreement is an accord and satisfaction, the payee can elect to determine whether to sue on the agreement or on the original cause of action.
When drafting an agreement, if the release is to be conditional upon performance, such should be clearly provided, and the consequences of non-performance specified. In Osborn v McDermott, Justice Phillips also noted that “it would surely be in the best interests of the parties if their legal advisers saw to it, when settling litigation, that the intended consequence on default was clearly expressed and not left to implication”.

**Judgment vs. Discontinuance**

Another issue in finalising settlement is whether to seek a consent judgment (i.e. a judgment making certain findings, including orders for the payment) or file for a discontinuance and rely on the agreement signed between the parties.

The first question to consider is whether the court has the power to issue the consent judgment. If it does not then the question is moot. Section 73 of the Civil Procedure Act provides Courts with powers to make orders to give effect to an agreement between the parties. However, courts will not make such an order when the orders don’t accord with legal principle, don’t come within the jurisdiction of the court, or are not in the public interest. A court will not make an order, as part of a settlement of a dispute, that certain conduct must or must not take place, if the court could not order such conduct in the case itself (for example, a court cannot order that the parties resolve other disputes between the parties that are not currently before the court).

If a court issues a judgment which includes orders and payment of funds, then that judgment operates as a defence to any subsequent claim a plaintiff may make (even if new evidence arises) – a res judicata exists. Equally important, if the plaintiff wishes to sue on a similar or related cause of action, then a consent judgment can operate as an Anshun estoppel, i.e. if the future proceedings could and should have been issued in the proceedings that were settled, the plaintiff is estopped from bringing those proceedings. No res judicata or Anshun estoppel exists if the proceedings have been discontinued.

There are, however, several advantages to resolving a dispute with a consent judgment. First, the enforcement of a judgment is simpler then the enforcement of a contract, as the enforcement of a contract involves the extra step of suing on the contract prior to enforcing the contract judgment. Second, an advantage of a consent judgment is that it can be publicised. This is especially the case where the plaintiff is suing an infringer, and wishes to use the judgment for publicity. A solicitor acting for a defendant in these circumstances
may well be able to “trade-off” the plaintiff’s desire for publicity in the form of a consent judgment in exchange for a lower settlement figure. In some circumstances it is possible to agree to a consent judgment for a large amount, and then reach a side agreement not to enforce that judgment in exchange for payment of a smaller amount and compliance with the other terms of the settlement agreement.

**Release vs. Covenant not to sue**

A further issue arises when co-debtors are involved in a case, in particular a case where one but not all of the co-debtors wishes to settle with the plaintiff. In those cases it is important to ensure that the cause of action is not discharged by the terms of settlement in order to enable a proceeding to be continued against the other co-debtors. It is important to ensure that the release of one of the co-debtors does not release the others who are not party to the settlement (see *Walker v Bowry* [1924] HCA 28; 35 CLR 48, 58).

The law, as set out in *James and Ors v Surf Road Nominees* [2004] NSWCA 475, *Associated Retailers Limited v Toys Unlimited Pty Ltd* [2011] VSC 297, and *Carr and Purves v Thomas* [2009] NSWCA 208, is reasonably clear. At common law, a release of a co-debtor who is jointly or jointly and severally liable for the same debt releases all the co-debtors to the same debt. However this rule does not apply where the creditor enters into a covenant not to sue a debtor, as it does not affect the underlying liability of the co-debtor or guarantors. A court must determine whether the settlement agreement amounts to a release in law or a covenant not to sue.

When considering this situation, a court will look at the agreement itself to see if it contains a release or a covenant not to sue. Obviously, if the agreement contains a clear release or a covenant not to sue, this will assist interpretation. One further indication that a document is a covenant not to sue is if it specifically reserves rights against co-debtors.

The consequence is that, whenever a settlement is contemplated with one of several co-debtors, the drafter of the settlement agreement must consider carefully whether the other debtors are to be released or not. If rights against the remaining debtors are to be maintained then the release of the first debtor has to be in the form of a covenant not to sue, reserving rights against co-debtors. A failure to draft a settlement agreement to reserve rights required to protect the client’s interest may amount to negligence, see *Associated Retailers Limited v Toys Unlimited & Ors* [2011] VSC 297 at [211] to [213].
One concern that arises if a solicitor is negotiating a settlement agreement for a co-debtor is that, if the co-debtor settles with the creditor on the basis of a covenant not to sue, and the creditor obtains judgment for the full amount against another co-debtor, the judgment co-debtor can make a claim against the settled co-debtor for contribution. A covenant not to sue only protects a party *vis-à-vis* the creditor. It doesn’t release that party from the debt, including the possibility of a claim for contribution. One way of dealing with this is to request an indemnity against any cross-claims from the creditor as part of any settlement agreement.

**Enforcement of settlement agreements**

A settlement between the parties does not necessarily resolve a dispute. There is always a risk that a party does not comply with a settlement agreement. In many cases, where the settlement has involved a consent judgment, the remedy is simply to enforce the judgment through a writ for possession or similar remedy. However, there are other circumstances that are more complex.

**Summary enforcement**

In circumstances where a settlement agreement is not being complied with, the court does have the power to make orders giving effect to that settlement, and enforcing it on a summary basis.

In *Zippo Manufacturing co v Jaxlawn Pty Ltd* [2011] FCA 1125, the parties agreed to settle a dispute about the importation of counterfeit Zippo lighters. The respondent agreed to a settlement agreement, consisting of undertakings to the court and the forfeit of goods, and in exchange the applicant agreed to orders dismissing the proceedings with a right of reinstatement. In particular, in the settlement Jaxlawn had agreed to consent to an order for summary judgment and indemnity costs if the undertakings were broken. The respondent breached undertakings, and Court reinstated proceedings, issued summary judgment and injunctions against the Respondent’s conduct, and made several related orders for the calculation of damages.

In *Seachange Management Pty Ltd & Anor v Pital Business Pty Ltd* [2009] VSCA 139, Pital was suing to enforce a settlement agreement for Seachange to pay Pital $4.3 million. At trial, it received summary judgment in its favour. Seachange appealed, with the basis of
its defence being that the payment of $4.3 million was in exchange for certain partnership assets, which since the settlement agreement had been rendered valueless. As the case raised questions about the ownership of the assets to be transferred pursuant to the settlement agreement, the court chose not to enforce summarily. It summarised the authorities on its power to enforce summarily below.

In summary, therefore, the net effect of the authorities to this point seems to be that, although the power summarily to enforce a compromise is discretionary and is wider now than once was the case, it is not to be invoked unless the court is ‘clearly satisfied that justice can be done’; and whether justice can be done is a question of degree. Consistently with the equitable origins of the power, one must weigh among other competing considerations the extent to which enforcement would involve extraneous matters, how substantial the questions to be determined as a precursor to enforcement may be, and procedural considerations like the desirability of pleadings and discovery and substantial cross-examination.

**Contempt of court**

If the settlement includes consent orders to refrain from conduct, or other similar orders, the failure to comply with these orders may amount to contempt of court. In *Vaysman v Deckers Outdoor Corporation Inc* [2011] FCAFC 17, the defendant was sued for manufacturing counterfeit ‘Ugg’ Boots. The Defendant agreed to orders preventing them from manufacturing such Boots. However, over a period of years, it consistently did not comply with these orders. The Defendant’s directors were eventually fined significant sums, and then imprisoned for several months each. The court found that such deliberate and contumacious defiance amounted to criminal contempt of court, punishable by imprisonment.

**Enforcement of heads of agreement.**

In circumstances where the parties have agreed to settle the dispute, but have not signed consent orders (or even a final settlement agreement), a court may order the enforcement of the terms agreed to by the parties. In the case of *AW Ellis Engineering Pty Ltd v Malago* [2012] NSWSC 55, the parties reached an agreement to settle their dispute in a mediation, and drafted some heads of agreement that were signed by the principals of each company. After the mediation, Malago attempted to withdraw, and refused to sign any further
agreement. The NSW Supreme Court found that the heads of agreement signed at mediation was binding (not an agreement to agree). The court noted that such cases depend on the court making a finding as to whether the parties had intended the agreement to be immediately binding, and that such a finding is to be determined objectively. In this case the court found that the parties expected to be bound by the contract negotiated at the mediation (and then replace it with a further written contract). The fact that the agreement contained the heading “Heads of Agreement” went towards the interpretation that the parties intended to be bound by it.

**Setting aside settlement agreements**

When seeking to set aside a settlement agreement, or a judgment based upon the settlement agreement, there are two questions that need to be asked:

1) Does the court have power to set aside this settlement agreement/judgment; and
2) On what basis will the court set aside the settlement agreement/judgment.

Regulation 36.15 of the UCPR provides that a court may set aside a judgment, if that judgment was given or entered illegally, irregularly, or against good faith. A court also has an inherent jurisdiction to set aside a judgment. The principles of the inherent jurisdiction are set out in *Harvey v Phillips* [1956] HCA 27; (1956) 95 CLR 235, summarized in *Singh v Secretary, Dept of Family & Community Services* [2001] FCA 1281 at [9]-[10], as below

*The first situation is the situation which exists before the formal entry of judgment. Here, the Court possesses a judicial discretion to set aside a compromise and to intercept that entry, for instance, in the event of an injustice arising by reasons of misapprehension or mistake made by counsel in consenting to an order. This discretion may be exercised notwithstanding that there were not grounds sufficient to invalidate a contract under the general law. But in the case of a compromise made within the actual, as well as the apparent, authority of counsel, a court does not appear to possess an authority to rescind it or set it aside.*

*The second situation is after the entry of formal judgment. Here (as in the case of a compromise entered into within counsel's actual and apparent authority), the question whether the compromise is to be set aside depends upon the existence of a ground sufficient to render a simple contract void or voidable, or to entitle the
party to equitable relief for illegality, fraud non-disclosure, duress, mistake, undue influence, abuse of process and the like.

In situations where judgment has been formally entered, the only grounds to set aside the judgment are the grounds to set aside the settlement agreement underlying the judgment.

A recent case that looked at the grounds to set aside a settlement agreement is *National Australia Bank Limited v Koller* [2011] VSC 228. This was a loan default case, where the defendant Ms Koller had mortgaged her land to the NAB to fund construction on the land. NAB issued a notice of demand and commenced proceedings for possession. The proceedings were mediated, and a settlement agreement was reached, on the basis that Ms Koller would pay NAB a sum of money on a specified date. If she failed to make the payment NAB would be able to seek a consent judgment for the full sum.

No payment was made by Ms Koller, and NAB entered a consent judgment in accordance with the settlement agreement. Ms Koller then engaged new lawyers and sought to set aside the judgment. Ms Koller sought to impeach the settlement agreement underlying the judgment on the basis that NAB reached the settlement agreement by “taking surreptitious or unconscientious advantage” of her when she was “unable to judge or properly judge for herself by reason of weakness, inexperience, necessity, ignorance, or impaired facilities”; and, also that NAB engaged in oppressive and unconscionable conduct during the settlement negotiations.

The Court did not set aside the consent judgment, preferring the evidence put forward by NAB. The Court found that Ms Koller had failed to establish that NAB been aware of or had taken advantage of any incapacity that she might have had, so that the unconscionable conduct case failed. Ms Koller’s claim that she was mentally impaired also failed, because there was no evidence that NAB had knowledge of any mental impairment, and in any event the judge did not consider that Ms Koller did not understand the terms of settlement when she signed the settlement agreement. The case set out the grounds on which a settlement agreement is usually challenged and listed them below.

- Duress and incapacity/unconscionability;
- Mistake;
• Fraud and bad faith/misleading and deceptive conduct;
• Failure of consideration;
• Impossibility of performance;
• Illegality;
• Non est factum.

If the parties have reached agreement, and issued a consent judgment, it is very difficult to challenge that judgment, absent evidence that can impeach the settlement agreement on the grounds listed above.

As legal practitioners, we are required to assist our clients in their disputes from beginning to their conclusion. Even though many cases are resolved by the parties reaching agreement, our obligations do not end there. It is vital to be aware of the tricks and traps of settling disputes so we can assist our clients to resolve their disputes with finality.

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