Costs: personal liability of legal practitioners

By Arthur Moses

Of all the changes wrought by the *Civil Liability Act 2002* (NSW), perhaps that which caused the greatest consternation in the legal profession was the insertion of Division 5C into the *Legal Profession Act 1987* (NSW). Division 5C created a statutory power by which legal practitioners could be made personally liable for costs orders in failed litigation in circumstances where the legal practitioner acted without holding the belief that there were reasonable prospects of success in the proceedings.

On one view, the consternation was surprising, given that statutory powers to make such orders already existed in New South Wales (see s76C of the *Supreme Court Act 1970* (NSW) and Part 52A Rule 43 of the *Supreme Court Rules*), and that a non-statutory power to make such orders is of longer standing again (see, for example, the cases discussed by Goldberg J in *White Industries (Qld) Pty Ltd v Flower & Hart* (1998) 156 ALR 169). On another view, the consternation was entirely understandable given the potential for the new statutory power to eviscerate the cab rank rule by requiring counsel to act as a pre-trial screen between the courts and parties with genuine but problematic cases. The position was not assisted by the fact that the new division was one of a raft of reforms for which very little cogent policy justification was advanced (and some would say, for which there was very little cogent policy justification capable of advancement).

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Readers seeking to allay this consternation now have a number of resources to assist them in this regard. The first is the very useful article on the subject by Beaumont ('What are reasonable prospects of success?' (2004) 78 ALJ 812). The second is the decision of Barrett J in *Degiorgio v Dunn (No. 2)* [2005] NSWSC 3 (unreported, NSWSC, 1 February 2005). And the third is the recent decision of the NSW Court of Appeal in *Lemoto v Able Technical Pty Limited* [2005] NSWCA 153 (unreported, Hodgson, Ipp and McColl JJA, 9 May 2005.) The judgment of McColl JA, with whom Hodgson and Ipp JJA join, is deserving of that most happy triumvirate of adjectives which can be applied to judicial decisions: clear, comprehensive and closely reasoned.

Degiorgio holds (at [44]) that the test to be applied in respect of Division 5C 'is more stringent, from the lawyer's perspective' than the pre-existing statutory and non-statutory powers referred to above. *Lemoto* describes the test as representing 'a substantial departure from the ambit of the power hitherto available to courts' [at 83].

However, it is also plain that the conduct of a legal practitioner in advancing a weak case (and even, a manifestly weak case) will not usually be sufficient of itself to expose that legal practitioner to personal liability for costs. It is worth noting that of the three cases discussed in this article (albeit, allowing for the effects of appellate correction) a set of circumstances in which it was appropriate to make an order under s198M has yet to arise.

The legislation

Division 5C contains five sections, ss198J – 198N. (It should be noted that these sections are replicated in ss344 – 349 of the yet to commence *Legal Profession Act 2004* (NSW)). The power to make costs orders is found in s198M, which is as follows:

> 198M Costs order against solicitor or barrister who acts without reasonable prospects of success
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> (1) If it appears to a court in which proceedings are taken on a claim for damages that a solicitor or barrister has provided legal services to a party without reasonable prospects of success, the court may of its own motion or on the application of any party to the proceedings make either or both of the following orders in respect of the solicitor or barrister who provided the services:
>
> (a) an order directing the solicitor or barrister to repay to the party to whom the services were provided the whole or any part of the costs that the party has been ordered to pay to any other party,
>
> (b) an order directing the solicitor or barrister to indemnify any party other than the party to whom the services were provided against the whole or any part of the costs payable by the party indemnified.
>
> (2) The Supreme Court may on the application of any party to proceedings on a claim for damages make any order that the court in which proceedings on the claim are taken could make under this section.
>
> (3) An application for an order under this section cannot be made after a final determination has been made under this Part by a costs assessor of the costs payable as a result of an order made by the court in which the proceedings on the claim concerned were taken.

(4) A solicitor or barrister is not entitled to demand, recover or accept from his or her client any part of the amount for which the solicitor or barrister is directed to indemnify a party pursuant to an order under this section.

To understand s198M, it is necessary to have regard to s198J, which is as follows:

198J Solicitor or barrister not to act unless there are reasonable prospects of success

(1) A solicitor or barrister must not provide legal services on a claim or defence of a claim for damages unless the solicitor or barrister reasonably believes on the basis of provable facts and a reasonably arguable view of the law that the claim or the defence (as appropriate) has reasonable prospects of success.

(2) A fact is provable only if the solicitor or barrister reasonably believes that the material then available to him or her provides a proper basis for alleging that fact.

(3) This division applies despite any obligation that a solicitor or barrister may have to act in accordance with the instructions or wishes of his or her client.

(4) A claim has reasonable prospects of success if there are reasonable prospects of damages being recovered on the claim. A defence has reasonable prospects of success if there are reasonable prospects of the defence defeating the claim or leading to a reduction in the damages recovered on the claim.

(5) Provision of legal services in contravention of this section constitutes for the purposes of this division the provision of legal services without reasonable prospects of success."

It can be seen that if s198J(1) is contravened, then s198J(5) makes operative s198M. For completeness, it should be noted that a contravention of s198J is capable of amounting to unsatisfactory professional conduct or professional misconduct (s198L(1)).

It will be noted that s198J(1) refers to 'a claim or defence of a claim for damages'. It is unnecessary here to enter into a discussion of the width of the expression 'a claim for damages'. It is sufficient to note that in *Degiorgio*, although the claims advanced in the statement of claim primarily sought relief of an equitable kind (see [30]), Barrett J held that the inclusion amongst those claims of a claim for damages meant that s198M was operative in that case (see [34]).

'Without reasonable prospects of success' – the *Momibo factors*

The question then becomes how to identify whether a practitioner has acted 'without reasonable prospects of success'. In *Degiorgio*, Barrett J adopted the five element test propounded by Neilson DCJ in *Momibo Pty Ltd v Adam* (2004) 1 DCLR (NSW) 316 (*'Momibo'*) as to what 'reasonable prospects of success' should entail. The relevant elements are as follows (see [17]):

a) The first is an overarching element that the practitioner subjectively held a reasonable belief about prospects which is based on propositions which can be regarded as logically arguable in an objective sense;

b) The second is that the reasonable belief must have its objective foundation in material available to the practitioner at the relevant time (which material need not be admissible evidence as such and can extend to material which is credible albeit not strictly admissible);

c) The third is that the material thus identified constitutes a proper basis for alleging each relevant fact;

d) The fourth is that the claim must proceed according to a reasonably arguable view of the law. This element is not to be approached narrowly and encompasses arguably available extensions and innovation; and

e) The fifth is that there must be reasonable prospects of damages being recovered in the action, even if those damages are modest or merely nominal or token.

Momibo concerned a claim for a breach of lease (and associated matters). The vast bulk of the damages claimed related to a claim for loss of profits based on the exercise of an option to renew. However, it was unarguable that the option had been validly exercised, and Neilson DCJ described this aspect of the claim as being 'totally unfounded'. However, there were other aspects of the claim which Neilson DCJ regarded as rasing triable issues. In this context, it was submitted to Neilson DCJ that the legislation was intended to capture cases where the damages claimed were exaggerated or 'ramped up.' However, Neilson DCJ rejected this submission and held that reasonable prospects of recovering damages meant reasonable prospects of recovering *some* damages, or *any* damages, rather than all damages.

What has happened in this case is a salutary warning to courts to ensure that Division 5C applications do not assume a costly life of their own McColl, JA in *Lemoto.*

Before turning to consider the way that this case was applied in *Degiorgio*, it is worth repeating a delightful passage from the reasons of Neilson DCJ which is deserving of a wider audience. After reciting his second reading speech on 28 May 2002, the premier had said, 'The government has changed the standard for assessing unmeritorious claims in the Bill', Neilson DCJ continued: 'I do not need to consider whether the use of the perfect tense in [the above sentence] reflects ignorance of the legislative process, arrogance, or merely poor speech writing.'

Further consideration of the *Momibo* factors in *Degiorgio*

In *Degiorgio*, after noting that the relevant provisions impose upon lawyers a standard that is more demanding than that imposed by the general law (see [19] and [26]), and considering material including the Beaumont article referred to above, Barrett J concluded by finding that, 'without reasonable prospects of success', equated in meaning to 'so lacking in merit or substance as to not be fairly arguable' (see [28]).

The finding that the standard imposed by the relevant legislation is more demanding than the general law is not, however, to be understood as requiring legal practitioners to eschew weak cases. That point is forcefully made by Barrett J at [27]. Of particular importance are the concluding words of that paragraph: 'The legislation is not meant to be an instrument of intimidation, as far as lawyers are concerned.'

After a consideration of all of the relevant facts, Barrett J held that the solicitor had discharged the responsibility to satisfy the five elements referred to above, and dismissed the application for a costs order.

The decision of the Court of Appeal in *Lemoto*

Lemoto was an appeal from a decision of Phegan DCJ to award costs against a solicitor acting for a plaintiff in a personal injury matter. The manner in which Phegan DCJ came to that decision was the subject of criticism by reason of the failure of Phegan DCJ to afford to the solicitor a proper hearing. It is unnecessary to deal with that aspect of the case at length, save to say that Phegan DCJ appears to have proceeded upon the misapprehension that an order under s198M was mandatory if a prima facie case, once raised, was not displaced by the solicitor. As Hodgson JA noted at [10], this cannot, with respect, be a correct construction of a provision which includes the word 'may.'

McColl JA, having noted at [83] that the enactment of Division 5C represented a substantial departure from the ambit of the inherent power to order costs, held that the making of a costs order under Division 5C involves 'either an exercise of disciplinary power or the exercise of a power ancillary to a disciplinary power, rather than merely the exercise of the court's costs jurisdiction.' This is supported by the fact that the provision is to be found in legislation dealing with the regulation of the professional conduct of legal practitioners and that a breach of s198J is, as has been noted above, capable of amounting to unsatisfactory professional conduct or professional misconduct. Before turning to consider the ambit of the new power, McColl JA considered the ambit of the inherent power, and derived from the authorities a series of principles which are set out at [92].

In construing the provisions of Division 5C, McColl JA (albeit without directly referring to the *Momibo* principles) endorsed the approach of Barrett J in *Degiorgio*. Indeed, a lengthy passage from *Degiorgio* is extracted at [131]. McColl JA also notes at [123] that the 'grave consequences' of making an order under s198M indicate that the application of the provision need be 'no wider than is clearly required by the statute', and this is consistent with the view expressed at a number of places throughout the judgment, that the jurisdiction ought be exercised sparingly and cautiously.

It would be a sad consequence of Division 5C if it influenced legal practitioners to become 'timorous souls' as opposed to 'bold spirits'. McColl, JA in *Lemoto*.

Procedure in respect of orders under section 198M

Having noted that there is no express procedure to be followed by a party who seeks an order under s198M, McColl JA then sets out at [149] a suggested procedure to be followed. The desirability of regulations being made to the Legal Profession Act is then noted. It is suggested that the drafter of the regulations would not have a particularly difficult task in so doing, in that the drafter need only express in legislative language what appears in paragraph [149]. However, any legislative response might also need to consider how to deal with the prospect of such applications being used a tool of oppression, which question has arisen as a subject of potential concern consistently through the cases.

Is it intimidatory to threaten to seek personal costs orders against one's opponents?

The concluding words of McColl, JA at [194] also shed light upon the question of whether it is inappropriate for a party to threaten (or, to use a more neutral expression, to give notice of or to intimate) an intention to seek personal costs orders against opposing legal practitioners. Such a practice has been deprecated under the general law in Australia (see *Re Benedeich (No. 2)* (1994) 53 FCR 422 at 426-7 and *Patrick v Capital Finance Corporation (Australasia) Pty Ltd* [2004] FCA 1249 (unreported, Tamberlin J, FCA, 24 September 2004) and in the United Kingdom (see *Orchard v South Eastern Electricity Board* [1987] QB 565). Indeed, those cases use the decidedly non-neutral term 'browbeat' to describe such conduct, and suggest (as does Beaumont's article) that such conduct may, in serious cases, be capable of amounting to contempt of court.

In response to reports of threats being made by practitioners and against practitioners to engage s198M, the Council of the Law Society of New South Wales issued a president's message to its members on 7 August 2004 prescribing the limited basis on which such intimations can properly be made. That president's message, in summary:

a) Reminds practitioners of their duty to ensure that their

communications are courteous and that provocative or offensive conduct is avoided, and refers specifically to Rules 25 and 34 of the *Revised Professional Conduct and Practice Rules 1995;*

b) States that a threat to seek a personal costs order against a practitioner should not be made unless:

   a. There is material available which clearly suggests that the proceedings have little merit and are likely to fail; and

   b. The practitioner has specific instructions from the client to make the threat after the client has been made aware of its seriousness and the possible consequences for the client if the allegation is not made out; and

   c. The practitioner makes known to the opposing practitioner the evidentiary basis for the view referred to in (a.) above and that the warning is being given as a matter of professional courtesy;

c) Notes that interlocutory proceedings for dismissal or strike-out should be a more appropriate course; and

d) Reminds practitioners that they have an obligation to maintain professional independence and should not make an application for an order merely because a client has instructed them to do so.

Do *Degiorgio* and *Lemoto* alter this position?

However, the view that such intimations (or threats) are inappropriate in the context of the legislation is difficult to reconcile with the finding of Barrett J in *Degiorgio* that the standard imposed by the legislation is more demanding than that imposed by the general law. It should be noted that an order cannot be made under s198M without the precondition of a breach of s198J(1). To put it another way, a legal practitioner is under no danger of incurring personal liability if that legal practitioner has complied with the obligations which arise elsewhere in the Division.

In a circumstance where parliament has expressly armed litigants with a right of recourse against a legal practitioner who has breached s198J(1), it seems odd indeed that a party should be prevented from intimating an intention to rely upon the very right which parliament has made available. It would be a very curious result if applications for personal costs orders under s198M could be made only where no notice that such an application was to be made had been given to the legal practitioner against whom the order was sought.

It may be possible to resolve the general law approach with the entitlement to resort to the new right of recourse by ensuring that intimations are not made until judgment has been delivered, on the basis that argument as to costs is reserved to allow the court to consider the potential applicability of s198M.

The difficulty with this approach is that, as McColl JA in *Lemoto* notes at [193], it is the making of an application for an order under s198M after the delivery of judgment that does create a more serious risk of denying a party its right to approach the court (albeit, an appellate court) than does the intimation of such an approach prior to judgment. This is because of the fact that an application for such an order might permit the party seeking the order to drive the wedge of conflict of interest between the other party and its legal representatives. It is difficult to envisage a situation in which a practitioner would be able to act for a client when there is a contested application as to whether that client, or the legal practitioner, should bear the burden of the costs which are payable to the successful party. Thus, the legal practitioner would not be in a position to advise the client as to any prospects of success on appeal.

Of course, there will be many circumstances in which making an application for an order under s198M will not amount to a contempt, but if the application were made for the collateral or ulterior purpose of dividing a party and its legal representatives, the risk that it might amount to contempt is real.

Summary

Degiorgio and *Lemoto* provide very helpful guidance on a subject which has considerable implications for the professional conduct of solicitors and counsel alike. These decisions have identified the scope of the legislative provisions in a manner which, although confirming that the provisions impose a more demanding duty upon legal practitioners than that existing at general law, also provide considerable guidance as to what is necessary to meet that duty. Practitioners will have to turn to other aspects of the civil liability reforms if they are to maintain their recommended daily intake of consternation.