LOS ANGELES & SAN FRANCISCO

Daily Journal

www.dailyjournal.com

FRIDAY, MAY 19, 2023

PERSPECTIVE

Settlements must now address Section 998 costs and fees

By Scott Carr

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Parties aiming to settle their disputes outside the court room are always advised to tie up all loose ends. If they fail to do so, they could find themselves paying unexpected expert fees and costs. This basic rule of thumb was highlighted in a recent case regarding the effect of 998 offers to compromise on settlement agreements.

It happened in a lemon law dispute. A divided three-judge panel of the California Court of Appeals for the Third Appellate District, in the case of *Madrigal v. Hyundai Motors America* (Super. Ct. No. S-CV-0038395), handed the plaintiffs one more lemon.

In a case of first impression, the court ruled that when Oscar and Audrey Madrigal agreed before trial to settle their claim against Hyundai Motors America for less than what they would have received under the auto manufacturer's Section 998 offer to compromise, they became liable for Section 998 costs and fees.

Code of Civil Procedure Section 998 was established to facilitate settlement of claims outside the courtroom. At any time not less than ten days prior to the commencement of trial, any party can make a written offer to the other side to resolve the dispute. Compromise offers must include all terms and conditions of the proposed judgment. They can only be accepted in writing by the other party. If that happens, judgment in the agreed upon amount can then be entered by the court. For matters scheduled for arbitration, the agreed upon award will be made by the arbitrator.

But what if an offer to compromise is not accepted? The matter might proceed to trial, with judgment issued at the conclusion of the trial, or the parties may end up negotiating a settlement outside of court. This is what happened in the Madrigal case. Hyundai had tendered two compromise offers under Section 998, neither of which was accepted by the Madrigals. At trial, the parties decided that settling the case would be in their best interests.

They agreed on the settlement amount — significantly less than either of Hyundai's earlier 998 offers — but they left open the issue of costs and attorney fees for the trial court to decide upon motion. Without further clarification in the settlement agreement, this ended up being a big mistake.

To encourage parties to seriously consider early settlement of their claims, Section 998(c)(1) provides all parties with a cost-shifting mechanism. As applied here, if a compromise offer "is not accepted and the plaintiff fails to obtain a more favorable judgment or award, the plaintiff shall not recover his or her post-offer costs and shall pay the defendant's costs from the time of the offer." It gets even more burdensome: "the court or arbitrator, in its discretion, may require the plaintiff to pay a reasonable sum to cover post-offer costs of the services of expert witnesses" incurred in preparation for trial.

Hyundai argued that under the foregoing provision, the plaintiffs should be required to pay costs and expert fees incurred by Hyundai following its second 998 compromise offer. The trial court saw things differently. In an order filed on July 18, 2019, the court ruled that the whole point of Section 998 was to encourage settlement before trial and that the parties' settlement did not constitute a judgment subject to Section 998; therefore, Section 998 did not apply to settlements.

On appeal, the appellate panel disagreed. The case, it observed, "presents the novel question of whether section 998's cost-shifting penalty provisions apply when an offer to compromise is rejected and the case ends in settlement." In a lengthy dissent, Acting Presiding Justice Robie underscored the historic nature of the court's

review: "It is worth noting that section 998(c)(1)'s cost-shifting provision has been a part of California law, in one form or another, since California adopted the initial version of the statute in 1851, over 170 years ago."

The first issue to be resolved was whether the matter was subject to appellate review. The court ruled that the lower court's order on attorney fees and costs met the requirements of the collateral order doctrine and qualified as a "final determination" because "'further judicial action is not required on the matters dealt with by the order.'" (citing *Apex LLC v. Korus-food.com* (2013) 222 Cal.App.4th 1010.)

The justices then considered whether the parties' settlement constituted a "judgment" within the meaning of Section 998. The majority held that a broad interpretation of "judgment" would best effectuate the legislative purpose "to encourage parties to make and accept reasonable offers to compromise." Citing *On-Line Power, Inc. v. Mazur* ((2007) 149 Cal. App.4th 1079), the court ruled that "a dismissal with prejudice is tantamount to a judgment and a final disposition of the case, and ... therefore in accord with section 998."

"We agree with Hyundai that the terms of the stipulated settlement under section 664.6 constituted a "judgment" within the meaning of section 998, subdivision (c) and that the trial court should have examined the parties' entitlement to costs and attorney fees through the lens of that statute."

Ultimately, the decision came down to a single issue: Would application of the cost-shifting penalty under Section 998(c)(1) to an out-of-court settlement serve to further or frustrate the legislative intent of encouraging such settlements?

In the majority's view, shifting post-offer costs and expert fees to the plaintiff would further the law's purpose because "the statute is designed not to encourage pretrial settlements generally, but specifically to encourage the acceptance of offers to compromise within the parameters of the statute by using the stick of post-offer costs and fees against reluctant offerees."

Dissenting Justice Robie vociferously disagreed. Under his reading of the statute, cost-shifting only applied "when a plaintiff through unilateral action obtains a less favorable judgment than a previously rejected section 998 offer." A negotiated settlement, he wrote, was not the result of the plaintiff's unilateral action but the joint efforts of both parties.

Applying Section 998(c)(1) to settlements, wrote Robie, "would discourage a plaintiff who previously rejected a section 998 offer from later making a non-section 998 settlement offer for less than the previously rejected section 998 offer in response to newly discovered evidence or any subsequent change in the law bearing on the plaintiff's injuries or the defendant's culpability."

Most cases settle, Robie noted, but until the instant case "no case has addressed the question whether section 998(c)(1)'s cost-shifting provision applies to a negotiated settlement." "Does that not seem odd? I believe it is indicative of the overall historical understanding that section 998(c)(1) applies when a less favorable result is obtained while the parties act in their respective litigant roles, e.g., as adversaries at trial or arbitration."

This is likely not the final word on cost-shifting of 998 costs and expert fees. Given the clear divide among the appellate justices, there is a reasonable chance the matter will be appealed to the state Supreme Court or that the legislature will take the opportunity to redraft the law to clarify the meaning of "judgment."

Until this happens, Madrigal is the current state of the law. Parties involved in settlement negotiations must take notice and draft agreements to address any potential 998 issues. As a neutral, I will be advising parties and their counsel to be proactive as they draft settlement agreements. Such agreements should now detail all attorneys fees and costs that are part of the negotiated settlement or, in the alternative, include an express waiver of Section 998 offers to compromise in cases where such an offer was made and the final settlement amount would otherwise trigger the cost and expert fee-shifting provisions.

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