JONES DAY

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WHEN "WITHOUT PREJUDICE" COMMUNICATIONS ARE NO LONGER WITHOUT PREJUDICE

"I prefer the instincts of the youthful Stanley Burnton J. before he became corrupted by the arid atmosphere of this court…," per Ward LJ.

These were some of the last words of Ward LJ in his dissenting judgment from the Court of Appeal in England and Wales. The cause of his frustration was due to his fellow lordships' unwillingness to extend the exceptions to the rule that allows without prejudice communications to be raised in evidence to interpret the meaning of a settlement agreement.

The words "without prejudice" commonly appear in various communications during settlement negotiations between parties. These two words have given parties peace of mind knowing that without prejudice communications will not be used against them in future court proceedings. There are, however, exceptions to this rule since courts will admit without prejudice exchanges if such information would assist the court in determining whether there was a concluded agreement, or if the agreement was induced by fraud.

In July 2009, the High Court of England and Wales extended the exceptions to the rule when it held in the case of *Oceanbulk Shipping & Trading SA v TMT Asia Limited* that without prejudice exchanges during negotiations could be admissible if it would assist the court in properly construing the meaning of a settlement agreement.

However, the recent appeal in this case to the Court of Appeal overturned the decision at first instance by a 2–1 majority and held that it is more important to protect the public policy of encouraging parties to settle without resorting to litigation.

BACKGROUND

Oceanbulk and TMT had entered into a chain of freight forward agreements ("FFA"). The FFAs provided for monthly cash settlements of the net amounts due

between the parties depending on the contract rates and the market rates. Oceanbulk presented TMT with an invoice for approximately US$40.5 million, the amount due in respect of the monthly settlement for May 2008.

When TMT failed to pay, the parties entered into without prejudice negotiations that resulted in them entering into a written settlement agreement.

Oceanbulk subsequently claimed against TMT for non-compliance with the settlement agreement because TMT defaulted on the monthly payments and delayed in transferring the shares.

TMT, in its defense, sought to rely on the without prejudice exchanges leading up to the settlement agreement with Oceanbulk, claiming that such exchanges contained relevant background information that would help the court to properly interpret the settlement agreement as well as to support its argument for an estoppel and issues related to remoteness of damage.

Oceanbulk argued that since the exchanges were without prejudice, they could not be considered by the court.

JUDGMENT AT FIRST INSTANCE

Andrew Smith J acknowledged the importance of the without prejudice rule. However, he held that TMT was entitled to plead and prove without prejudice exchanges to help the court understand the meaning of the terms within the concluded settlement agreement.

In coming to this decision, the judge first identified three exceptions to the without prejudice rule:

- Communications that indicate whether or not there was a concluded agreement are admissible;
- Communications that evidence grounds to set aside a concluded agreement on the basis of misrepresentation, fraud, or undue influence would be admissible; and
- Communications that, independent from any agreement, would give rise to an action in estoppel would be admissible.

Andrew Smith J pointed out that under the first exception, it would not make sense for the law to admit evidence about whether there was a concluded agreement but not admit evidence as to what the terms meant within the agreement. In light of this, the judge found it hard to distinguish between without prejudice exchanges that identify the terms and without prejudice exchanges that give meaning to the terms.

Accordingly the judge held that evidence of exchanges, although privileged when they were made, is admissible in the event of a dispute as to the meaning of the term in the settlement agreement.

Specifically, the judge stated that the interest of justice requires the meaning of a settlement agreement to be ascertained by reference to the without prejudice exchanges. He pointed out that the law generally admits evidence of the contractual context, by way of background facts known to both parties, because it is recognized that such information helps to ascertain the parties' true intentions.

For these reasons, Andrew Smith J held that the court should be able to consider evidence that is without prejudice in nature if such evidence would help the court to properly construe the meaning of a settlement agreement. As a result, the fine distinction between admitting without prejudice exchanges for determining the terms of a settlement agreement and using that evidence to interpret the meaning of those terms was rejected by the court.

COURT OF APPEAL

In a 2–1 majority, the Court of Appeal overturned Andrew Smith J's judgment and held that although certain exceptions to the without prejudice rule were recognized, a further exception is not needed.

Longmore LJ agreed that, in the interest of justice, courts would want to maximize every possible assistance they can get to arrive at the correct answer. However, this point alone was not enough to persuade Longmore LJ to "lift the without prejudice umbrella" because his lordship held that the policy of protecting without prejudice communications, thus encouraging and facilitating parties to come to

an agreement, was stronger than the policy of providing the judge with all conceivable help to arrive at a just solution.

Stanley Burnton LJ agreed with this rationale and added that privilege should apply even when the correspondence is relevant because if relevance alone can displace privilege, then "privilege would have no content."

Ward LJ disagreed and gave a strong dissenting judgment, stating, among other things, that if one can use antecedent negotiations to prove the agreement or to rectify it, why "on earth" can the negotiations not be used to establish the truth of what the contract means? Ward LJ further said, with apparent exasperation, that "not to do so would strike my mother as 'barmy.'"

Ward LJ supported that negotiations should be privileged to facilitate public interest. However, his lordship held that once the purpose is served, there could be "no justification for continuing to wrap the negotiations in this cloak of secrecy."

Logic and justice were good enough reasons for Ward LJ to remove the protection. However, little could be done now since, as his lordship put it, he was "outnumbered and outgunned" by his fellow judges.

COMMENTARY

Admitting without prejudice evidence is a sensitive topic for the courts. On the one hand, there is the interest of justice argument and on the other, there is protecting public interest.

Seeing how this issue has evolved in the two courts in the current case, nothing is set in stone yet. Although the Court of Appeal did overturn Andrew Smith J's judgment, Ward LJ gave quite a strong dissenting judgment. It would not be surprising if this issue is taken to the House of Lords in this case or in a future case.

In Hong Kong, the courts stand behind the efforts to protect public policy. This was evident in the case of *RE Dartina Development Ltd* [2007] 4 HKLRD 188, where it was held that affidavits containing without prejudice communications during negotiations could be struck out due to reasons of public policy.

Nonetheless, given the recent judgments in *Oceanbulk Shipping,* it would be interesting to see how Hong Kong courts deal with similar arguments.

With the Civil Justice Reforms settling in, there is an increased use of alternative dispute resolution methods in Hong Kong. Thus, the importance of privilege becomes increasingly significant. The new Practice Direction 31 provides some assurance as it specifically states that the court cannot call for the disclosure of or admit without prejudice communications in mediation meetings. However, this applies only to mediation in a court action. For mediations outside of a court action, such as disputes subject to arbitration, without prejudice communications may still be allowed as evidence by the courts.

This possibility is supported by the judgments of Andrew Smith J and Ward LJ. It is also supported by a recent decision in the case of *Farm Assist Limited (In Liquidation) v The Secretary of State for the Environment, Food and Rural Affairs (No. 2)* [2009] EWHC 1102, where the courts compelled a mediator to give evidence on what was said during the mediation meetings despite the mediator's claim for privilege and a confidentiality clause in the mediation agreement between the parties. Hence the question still remains: When are without prejudice communications no longer without prejudice?

LAWYER CONTACT

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