
Without prejudice privilege

A modern approach to contractual interpretation

The Supreme Court's decision in *Oceanbulk Shipping & Trading SA v TMT Asia Ltd & Ors*, handed down on 27 October 2010, considered the issue of whether what was written or said during the course of without prejudice negotiations was admissible in evidence as an aid to construction of a concluded settlement agreement resulting from those negotiations ([2010] UKSC 44).

Representations

The parties entered into a written settlement agreement to resolve a dispute relating to a series of forward freight agreements. There was no issue between the parties as to the existence or terms of the settlement agreement; there was, however, a dispute between them as to the interpretation of one of the terms of the agreement. The issue in the appeal to the Supreme Court was whether it was permissible for TMT to rely upon certain representations made on behalf of Oceanbulk as an aid to the interpretation of the settlement agreement.

Oceanbulk sought to exclude the representations on the ground that they were made during the course of without prejudice discussions. The trial judge had held that the evidence was admissible notwithstanding the without prejudice rule. The majority of the Court of Appeal had disagreed.

The Supreme Court was not asked to decide whether, quite apart from the without prejudice rule, the representations would be part of the factual matrix and therefore admissible. It was assumed for the purpose of the appeal that, subject to the issue of whether it was excluded by the without prejudice rule, the evidence would be admissible at trial.

Admissibility

The Supreme Court held that representations made in without prejudice

negotiations were, in principle, admissible in a dispute as to the correct interpretation of a settlement agreement. The leading judgment was given by Lord Clarke, with whom the other six Justices agreed. Lord Clarke's reasoning followed two main threads.

The matrix. The modern approach to contractual interpretation, which emerged from *Investors Compensation Scheme Ltd v West Bromwich Building Society* ([1998] 1 WLR 896), as further discussed in *Chartbrook Ltd v Persimmon Homes Ltd* ([2009] UKHL 38), emphasised the importance of the factual background or "matrix" when construing a contract (see *News brief "The exclusionary rule: Hoffmann's last word"*, www.practical-law.com/0-386-6895).

In every case in which interpretation is an issue, the courts must consider what a reasonable person having all the background knowledge would have understood the relevant terms to mean. Objective facts which emerge during negotiations are admissible as part of the factual matrix.

There was no reason why the principles applied to the interpretation of a settlement agreement should be any different to those applied to an agreement which was not reached following a without prejudice negotiation. To admit evidence of without prejudice negotiations was the only way in which the modern principles of construction could properly be respected.

No distinction. Any other conclusion from that above would introduce an "unprincipled" distinction between this type of case and the existing exceptions to the without prejudice rule. One established exception to the rule was that without prejudice communications should not be admissible where there

was a dispute as to whether the parties to without prejudice negotiations had reached a concluded agreement.

Although not part of the established exceptions, Lord Clarke concluded that another of the exceptions to the without prejudice rule was where the issue was rectification of a concluded settlement agreement. Lord Clarke could see no sensible distinction between admitting without prejudice communications in order to resolve a dispute about whether an agreement was concluded, and admitting them to resolve the issue of what that agreement was.

Having added rectification to the list of exceptions to the without prejudice rule, Lord Clarke identified a close relationship between the modern approach to contractual interpretation and to rectification of contracts. He found the problems with which they grapple to be so closely related that there was no sensible basis on which a line could be drawn between admitting without prejudice communications for one purpose but not the other.

Lord Clarke made a point of emphasising that his judgment was not intended to diminish the importance of the without prejudice rule or to change the circumstances in which evidence of pre-contractual negotiations was admissible.

Impact of the decision

The principle that an agreement negotiated without prejudice should be construed applying the same principles as one which is not is difficult to argue with as a matter of fairness or logic.

Similarly, the conclusion that any distinction between rectification and interpretation would be unprincipled, given the modern approach to interpreta-

tion, is consistent with the blurring of the distinction which has occurred in recent decisions between the approach to be adopted in each case.

In *Chartbrook*, for example, Lord Hoffmann referred with approval to a description of the process of interpretation of contracts as “the rectification of mistakes by construction”.

However, Lord Clarke’s view that this decision will not discourage parties from speaking freely when negotiating a settlement is more questionable. The without prejudice rule is not limited to admissions but extends to the content of the wide-ranging and unscripted discussions which often occur in settlement negotiations.

Settlement agreements must now suffer the same fate as those not negotiated without prejudice: of being liable to be “corrected” through judicial scrutiny of the admissible factual background (the scope of which is, itself, opaque to say the least).

Knowing that the other side may resort to a detailed analysis of what was said and written during without prejudice

negotiations in the event that they take a point on interpretation might result in greater caution and less candour in settlement discussions than has previously been the case.

Oceanbulk is another example of collateral damage to established principles caused by the “modern approach to construction”. Supporters of that approach are likely to regard the decision as a further step in the right direction. Others, who consider the perceived benefits of such an approach to be outweighed by the additional uncertainty and cost of resolving contractual disputes, will take a different view.

It has been suggested by some commentators that the answer is for the in-house or external lawyer to ensure that the concluded agreement is as clear and unambiguous as possible, so that the risk of without prejudice negotiations being admitted in a subsequent dispute is reduced. However, it seems unlikely that lawyers are currently aiming for anything less than maximum clarity and lack of ambiguity in drafting their settlements. Further, applying the “modern approach” to contractual

interpretation (as explained by Lord Hoffmann in *Chartbrook*), the fact that a word or phrase has a clear and unambiguous meaning on its face is not the end of the matter.

As Lord Hoffmann put it, if consideration of the matrix drives one to the conclusion that something has gone wrong with the language: “it is no answer that the [preferred] interpretation does not reflect what the words would conventionally have been understood to mean.” Even where the words used have a clear meaning, it is open to a judge to interpret the contract as meaning something else if, in his or her judgment, taking into account the surrounding circumstances, the clear meaning cannot have been what the parties intended.

The case will now go back to the trial judge to decide the meaning of the settlement agreement in the light of the new evidence.

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