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NEWS

Exception that proves the Rule – Supreme Court extends Exception to Without Prejudice privilege

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Michael Axe reports on the Supreme Court's controversial decision to allow the admission of Without Prejudice communications as evidence in relation to the Interpretation of a settlement agreement.

Without Prejudice (WP) privilege covers communications between parties (whether written or verbal) which represent a genuine attempt to settle a dispute. The general rule is that WP communications are not admissible in Court as evidence. This rule has developed as a matter of public policy to ensure that parties can negotiate freely during settlement discussions, without fear that anything they say can later be used against them in Court by the other side.

As with any general rule, there are exceptions, and one of the key exceptions to Without Prejudice privilege is that WP communications can be used as evidence to show that a binding settlement agreement had been concluded. This exception was historically applied very narrowly, and the Courts would only allow WP communications as evidence when a dispute related to the *existence* of a settlement agreement, not to the *interpretation* of a settlement agreement.

Oceanbulk Shipping & Trading SA v TMT Asia Limited

This all changed in 2009, however, when the High Court ruled in the case of *Oceanbulk Shipping & Trading SA v TMT Asia Limited* that WP communications were also admissible as evidence in relation to a dispute regarding the interpretation of an existing settlement agreement. The Judge ruled that he could see *"no cogent reason, either of public policy or of any other kind, that evidence of without prejudice exchanges should be admissible to identify terms but inadmissible as to the meaning of the terms"*.

This High Court decision was a controversial one, as it marked the first time that the existing exception to the WP rule had been extended in this way. Perhaps unsurprisingly, the decision was then appealed to the Court of Appeal.

Division in the Court of Appeal

In February 2010, the Court of Appeal voted by 2-to-1 to reverse the High Court's earlier decision. The Court of Appeal ruled that the fact that WP communications could potentially assist with the interpretation of a settlement agreement was insufficient reason to override the protection of WP privilege. Lord Justice Longmore went on to state that *"the policy of protecting without prejudice communications seems to me to be stronger than the policy of providing the judge with every conceivable help to arrive at a just solution"*.

This logic was no less controversial than the High Court's original decision, as the Court of Appeal had effectively decided not to admit evidence which would clearly assist the Court in deciding the issues in dispute between the parties. Lord Justice Ward, who was outvoted in the Court of Appeal 2-to-1, confirmed that in his view, where a settlement agreement had already been concluded, the purpose of the WP privilege had been served and the restrictions between the parties should fall away. He criticised the logic applied by the other Court of Appeal judges, commenting *"it goes to prove what every good old-fashioned county court judge knows: the higher you go, the less the essential oxygen of common sense is available to you"*.

Perhaps unsurprisingly, the Court of Appeal's decision was then itself appealed to the Supreme Court.

The Supreme Court's new exception

In October 2010, the Supreme Court unanimously overturned the Court of Appeal's decision, and confirmed that a new "interpretation exception" to the Without Prejudice rule should be recognised because *"justice clearly demands it"*.

The reasoning behind the judgment was that it was already established legal principle that where there is a dispute regarding the correct interpretation of an agreement, the Court should consider what a reasonable person, with full knowledge of the same background facts as the parties had, would have understood the terms of the contract to mean. The Supreme Court said that sometimes the relevant background facts which were known to the parties will have been communicated between the parties in WP communications, but that this should not prevent the Court from adopting the same approach to the interpretation of the contract as it would have if the relevant facts had been conveyed in open correspondence.

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On this basis, the Supreme Court ruled that objective facts which were passed between the parties via WP communications during settlement negotiations could be admissible as evidence of the *"factual matrix or surrounding circumstances"* relating to the correct interpretation of a settlement agreement.

The Supreme Court did stress, however, that it was not seeking to *"underplay the importance of the without prejudice rule"* or to extend the exception beyond the terms set out in this decision. The Supreme Court concluded by clearly stating that *"nothing in this judgment is intended otherwise to encourage the admission of evidence of pre-contractual negotiations"*.

The Future

Although the Supreme Court has recognised the existence of a new exception to the Without Prejudice rule, in reality, it is still a very narrow exception which is unlikely to undermine the protection afforded to settlement discussions by Without Prejudice privilege. In particular, it is worth remembering that the "interpretation exception" will only apply where a settlement agreement has already been concluded, and therefore the exception will not allow one party to use another party's WP communications against them in Court proceedings relating to the original dispute.

That said, parties engaged in settlement negotiations should bear in mind that the other parties can now potentially refer to facts raised during the course of settlement discussions, if a dispute subsequently arises regarding the interpretation of the concluded settlement agreement. This issue, of course, reinforces the need to ensure that any settlement agreement concluded is drafted as clearly as possible in the first place, so that disputes regarding its interpretation do not arise further down the road.

For further information on this or any other contractual issues, please contact [Michael Axe](#) by emailing [Michael](#) or by calling him on 08450 990045, or speak to your usual contact in the [Commercial Disputes Team](#).

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