The Devil's in the Detail: Interpreting Compromise Agreements after Oceanbulk

by

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Admissibility; Contractual negotiations; Interpretation; Shipping contracts; Without prejudice communications

1. The Case

In *Oceanbulk Shipping & Trading SA v TMT Asia Ltd*[1] the parties had reached an agreement negotiated in a mixture of open and without prejudice correspondence and meetings. There was no dispute between the parties as to the validity or as to the terms of the agreement reached. Both accepted that the agreement was an accurate reflection of what had been agreed. The difficulty concerned the interpretation of the wording of the agreement. What the Supreme Court was being asked in this case was whether or not evidence of what had been said in without prejudice correspondence and at without prejudice meetings could be used as an aid to interpreting the agreement which had been reached between the parties.

The dispute between the parties related to a series of forward freight agreements (FFAs) in 2008. During the period from May 2008 to December 2008 the Baltic Exchange index of daily rates of time charter hire for Capesize Bulk Carriers (the vessels with which these FFAs were concerned) fell from about US$200,000 per day to $3,000 per day. Each FFA is a swap agreement under which the buyer "bets" that the average settlement rate for the relevant month will be higher than the price paid for the FFA, and the seller "bets" that the price will be lower than the price for which it sold the FFA. The sums due from one party to the other are payable at the end of each month. At the end of May 2008 TMT owed Oceanbulk $40 million and were likely to owe a further $30 million for shortfalls in the following month. They failed to pay. If Oceanbulk had terminated the agreements on the basis of their default TMT would have been liable for $300-$400 million by way of liquidated damages. TMT and Oceanbulk entered into negotiations to try to resolve the matter. As a result an agreement was reached on June 20, 2008: (a) to crystallise 50 per cent of each of the FFAs for 2008 based on the difference between the contract rate and the average of the ten-day closing prices for the relevant Baltic indices from June 26, 2008; and (b) to co-operate to close out the 50 per cent balance of the open 2008 FFAs against the market on the best terms achievable by August 15, 2008. Both parties agreed that this was the agreement and that it was accurately recorded; however, there was a dispute as to the meaning of the "co-operation" requirement—item (b). Oceanbulk said that TMT had not co-operated to close the balance of 50 per cent of the open FFAs for 2008 against the market on the best terms achievable by August 15. Oceanbulk sought damages which reflected the difference between the profit it would have made from TMT if the positions had been closed out by August 15, 2008—some $47 million—and the $86 million it ended up owing TMT when the market turned drastically in TMT's favour later in the year.[2] A net turnaround of $133 million!

[1] [2010] UKSC 44; [2010] 3 W.L.R. 1424.
[2] J. Mulrenan, "Tradewinds Shipping Index", October 22, 2010, available at: *http://www.tradewinds.no/drycargo/article569294.ece* [accessed March 2, 2011].

What was in dispute in this case was the admissibility of information provided by Mr Petros Pappas on behalf of Oceanbulk (Oceanbulk was described by Tradewinds Shipping Index as "Petros Pappas' Group"[3]), in the form of a without prejudice email, which TMT claimed showed that he understood that the FFAs were to be "sleeved":[4] and in assertions made by Mr Pappas, or the fact that he allowed the without prejudice negotiations to proceed on the assumption, that the FFAs were "sleeved". Whilst the definition of "sleeving" is somewhat complex,[5] the question before the Supreme Court was, in essence, whether the email and the meetings, which both parties agreed had been "without prejudice", could be looked at by the court as an aid to interpretation of the agreement between the parties to establish whether the "co-operation requirement" reflected an agreement between the parties that the FFAs were to be "sleeved". It is noteworthy that the judge at first instance thought that the evidence from these without prejudice sources was "potentially of significant probative value and might possibly be crucial upon an issue of construction that is central to these proceedings".[6]

2. Exceptions to the Without Prejudice Rule

There are a number of situations where, although communications have been "without prejudice", the court can still go behind those communications and negotiations. Robert Walker L.J. in *Unilever Plc v Procter & Gamble Co*[7] held that "among the most important instances"[8] of exceptions to the without prejudice rule there were seven types of case:[9] (i) where it is necessary to establish whether the without prejudice communications have resulted in a concluded compromise agreement; (ii) where it is alleged that an agreement concluded during the negotiations should be set aside on the ground of misrepresentation, fraud or undue influence; (iii) where in the absence of a concluded settlement something said by one party and acted on by the other is alleged to give rise to an estoppel; (iv) where the exclusion of the evidence would act as a cloak for perjury, blackmail or other "unambiguous impropriety"; (v) where evidence of negotiations is needed to explain apparent delay or acquiescence; (vi) where a third party claims that the negotiating party failed to mitigate its loss; and (vii) where the negotiations were expressed to be "without prejudice save as to costs" and the material is being looked at in relation to costs. In *Oceanbulk*,[10] the Supreme Court was again considering the exceptions to the without prejudice rule.[11]

[3] Mulrenan, "Tradewinds Shipping Index", October 22, 2010, available at: *http://www.tradewinds.no/drycargo/article569294.ece* [accessed March 2, 2011].

[4] The agreed description, which appears in para.9 of the decision, is that: "'Sleeving' is an arrangement by which one party (party B) will, at the request of another party (party A), enter into a specific FFA trade with a third party (party C) and party B will then replicate that position back-to-back with party A. The usual reasons for such an arrangement are that (i) party C would not be willing to trade with party A (eg because of perceived counterparty risk) and/or (ii) party A does not wish to reveal to the market that he is seeking that position, eg because he is concerned that he will move the market. However, once the contracts have been concluded then (absent eg an agency arrangement), the two contracts are independent and each party acts as a principal: the contracts do not necessarily remain 'coupled'."

[5] See fn.4 above.

[6] *Oceanbulk Shipping & Trading SA v TMT Asia Ltd* [2010] UKSC 44 at para.13. Although it should also be noted that Longmore L.J., in the minority in the Court of Appeal, finding that the evidence of the email and of the meetings was admissible, considered it "not entirely easy" to see how the facts relied on by TMT assisted them with the construction of the relevant part of the agreement.

[7] [2000] 1 W.L.R. 2436 CA (Civ Div).

[8] [2000] 1 W.L.R. 2436 at 2444D. Interestingly, in Lord Clarke's speech in *Oceanbulk*, he refers to the exceptions set out by Robert Walker L.J. in *Unilever* as having been "what he called the most important instances"—see [2010] UKSC 44 at para.32—rather than being "among the most important instances".

[9] In fact Robert Walker L.J. propounded eight types of case—the eighth was in family matters where without prejudice communications are dealt with on the basis that they are virtually sacrosanct—subject only to issues of safety, particularly of children.

[10] [2010] UKSC 44.

[11] Various aspects of the "without prejudice" rule and exceptions to it have already been looked at in some recent editions of *Arbitration*. See D. Altaras, "The Without-Prejudice Rule in England" (2010) 76 *Arbitration* 474, and E. Suter, "Discrimination without prejudice—Woodward v Santander UK Plc" (2011) 77 *Arbitration* 147. This article therefore does not look at the overall area in any detail.

3. Should the Exceptions to the Without Prejudice Rule be Extended?

Robert Walker L.J.'s first category of exception to the without prejudice rule is where the court needs to look behind without prejudice negotiations to see if an agreement has been reached between the parties. In *Oceanbulk* there was no dispute but that an agreement had indeed been reached. The question in this case was whether the court could look at the without prejudice negotiations as an aid to interpreting the agreement which the parties had reached. This, in turn, involved three potential difficulties. First: using without prejudice negotiations as an aid to interpretation of a compromise agreement was not one of the previously accepted exceptions to the without prejudice rule, and this had to be considered in light of the second issue: the House of Lords decision in *Ofulue v Bossert*,[12] where their Lordships had declined to extend the exceptions to the without prejudice rule beyond the current ones. Finally, there was the question of whether the court was entitled to look at what was said in the course of negotiations as an aid to contractual interpretation in any event.

In some ways the answer to the first question was the most readily dealt with. Robert Walker L.J.'s first exception to the without prejudice rule was where it was necessary to go behind negotiations to establish whether or not there had been a concluded agreement. The Supreme Court also noted that:

> "Although it is not included in that list, it is not in dispute between the parties that another of the exceptions to the rule is rectification. A party to without prejudice negotiations can rely upon anything said in the course of them in order to show that a settlement agreement should be rectified. It was so held at first instance in Canada in *Pearlman v National Life Assurance Co of Canada*[13] and in New Zealand in *Butler v Countrywide Finance Ltd*[14] … both courts treated the point as self-evident. In my opinion the parties correctly recognised such an exception because it is scarcely distinguishable from the first exception.[15]
>
> …
>
> In light of the fact that both the question of whether or not an agreement had been reached and rectification of any such agreement were already within the accepted exceptions to the without prejudice rule; not allowing for interpretation of the terms of the agreement as an exception to the rule 'would be to introduce an unprincipled distinction between this class of case and two others [rectification and the question of whether or not an agreement has been reached] which have already been accepted as exceptions to the without prejudice rule'."[16]

On the second issue in *Oceanbulk*, the question of whether or not the exceptions to the without prejudice rule could be extended, Lord Clarke noted that the majority members of the House of Lords in *Ofulue v Bossert*[17] had all been concerned that the without prejudice rule should not be eroded, and he rejected the proposed exception in that case which would limit the protection to identifiable admissions.[18] However, whilst it was clear that, in *Ofulue*, their Lordships were concerned to protect the without prejudice rule, they nonetheless accepted that they were not restricted, in principle, from extending the exceptions to the rule in appropriate circumstances. Lord Hope, in *Ofulue*, said that:

[12] [2009] UKHL 16; [2009] 1 A.C. 990.
[13] (1917) 39 OLR 141.
[14] (1992) 5 PRNZ 447.
[15] [2010] UKSC 44 at para.33. See also at para.42, where Lord Clarke again makes it clear that rectification has correctly been accepted as an exception to the without prejudice rule. See also the Court of Appeal decision, which had also accepted that rectification of the agreement was an allowable ground for going behind without prejudice negotiations in an appropriate case—see *Oceanbulk Shipping & Trading SA v TMT Asia Ltd* [2010] EWCA Civ 79; [2010] 1 W.L.R. 1803.
[16] [2010] UKSC 44 at para.42.
[17] [2009] UKHL 16.
[18] [2010] UKSC 44 at para.27.

> "where a letter is written 'without prejudice' during negotiations with a view to a compromise, the protection that these words claim will be given to it unless the other party can show that there is a good reason for not doing so."[19]

Lord Walker in *Ofulue* said that he "would not restrict the without prejudice rule unless justice clearly demands it".[20] These opinions, Lord Clarke thought, accorded with the approach of Lord Griffiths in *Rush & Tompkins Ltd v Greater London Council*,[21] who considered that:

> "the [without prejudice] rule is not absolute and resort may be had to the without prejudice material for a variety of reasons when the justice of the case requires it."[22]

In *Oceanbulk* itself Lord Clarke was of the view that, since the two other exceptions existed (i.e. in respect of ascertaining whether or not a compromise agreement had been agreed; and in relation to rectification of an agreement):

> "I would hold that the interpretation exception[23] should be recognised as an exception to the without prejudice rule. I would do so because I am persuaded that, in the words of Lord Walker in *Ofulue*[24] justice clearly demands it."[25]

4. Can Negotiations be Used as an Aid to Interpretation?

Whilst, in principle, it was held that without prejudice material could be used as an aid to interpretation of a compromise agreement, this still left open the question of whether material arising from *negotiations* can be looked at as an aid to interpreting an agreement. This was, of course, fundamental. Only if negotiations can, in principle, be considered as an aid to the interpretation of an agreement, could the question arise of whether material which came from without prejudice negotiations could be considered.

The House of Lords considered the "exclusionary rule", which generally prevents negotiations from being considered as an aid to interpretation, in *Prenn v Simmonds*,[26] where Lord Wilberforce, giving the only judgment of the House, said:

> "In my opinion, then, evidence of negotiations, or of the parties' intentions, and *a fortiori* of Dr Simmonds' [the offeree's] intentions, ought not to be received, and evidence should be restricted to evidence of the factual background known to the parties at or before the date of the contract, including evidence of the 'genesis' and objectively the 'aim' of the transaction."[27]

In *Chartbrook Ltd v Persimmon Homes Ltd*[28] Lord Hoffmann, having reviewed the cases, said that "the conclusion I would reach is that there is no clearly established case for departing from the exclusionary rule".[29]

The limits of the exclusionary rule are such, however, that:

[19] [2009] UKHL 16 at para.2, noted in *Oceanbulk* [2010] UKSC 44 at para.28.
[20] [2009] UKHL 16 at para.57, noted in *Oceanbulk* [2010] UKSC 44 at para.29.
[21] [1988] 3 All E.R. 737; [1989] A.C. 1280.
[22] [1988] 3 All E.R. 737 at 740; [1989] A.C. 1280 at 1300C.
[23] i.e. allowing the use of "without prejudice" material as an aid to interpretation of a compromise agreement.
[24] [2009] UKHL 16 at para.57.
[25] [2010] UKSC 44 at para.46.
[26] [1971] 3 All E.R. 237 HL.
[27] [1971] 3 All E.R. 237 at 240. In *Utica City National Bank v Gunn* (1918) 222 N.Y. 204 at 208 Cardozo J. suggested that surrounding circumstances may "stamp upon a contract a popular or looser meaning" than the strict legal meaning, certainly when to follow the latter would make the transaction futile. "It is easier to give a new shade of meaning to a word than to give no meaning to a whole transaction." See also *Prenn v Simmonds* [1971] 3 All E.R. 237 at 239.
[28] [2009] UKHL 38; [2009] 1 A.C. 1101.
[29] [2009] UKHL 38 at para.41.

> "It does not exclude the use of … evidence [from negotiations] for other purposes: for example, to establish that a fact which may be relevant was known to the parties, or to support a claim for rectification or estoppel. These are not exceptions to the rule. They operate outside it."[30]

The difference between what can and what cannot be looked at, as part of the background without offending against the exclusionary rule, depends on:

> "the distinction between objective facts and other statements made in the course of negotiations [as] was clearly stated by Lord Hoffmann in para 38 of Chartbrook: [31]
>
> > 'Whereas the surrounding circumstances are, by definition, objective facts, which will usually be uncontroversial, statements in the course of pre-contractual negotiations will be drenched in subjectivity and may, if oral, be very much in dispute.'"[32]

In other words, whilst the subjective elements of any negotiation cannot be looked at as an aid to interpretation of an agreement—because each party would have its own subjective view of what it was bargaining for—the objective facts forming the background to the negotiation could be taken into account in interpreting the final agreement. And this was so even if those objective facts were part of the background to a negotiation which had been "without prejudice".

In this case, in the view of the Supreme Court, the question of "sleeving" was one of the background facts which could be looked at in interpreting the agreement.

5. Conclusion

On the public policy issue of going behind without prejudice negotiations Lord Clarke said in *Oceanbulk*:

> "As I see it … to admit evidence of objective facts, albeit based on what was said in the course of negotiations, is likely to engender settlement and not the reverse. I would accept the submission made on behalf of TMT that, if a party to negotiations knows that, in the event of a dispute about what a settlement contract means, objective facts which emerge during negotiations will be admitted in order to assist the court to interpret the agreement in accordance with the parties' true intentions, settlement is likely to be encouraged not discouraged."[33]

In many cases, one of the main reasons for going into without prejudice negotiations or mediation is to keep confidential the issues which are subject to the negotiations and the agreement which is reached. The idea of what has been said during the course of negotiations and/or mediation being available for use in a court case as an aid to the interpretation of the final agreement might lead to grave concerns on the part of one or more of the parties. There is a huge difference between purely objective background facts, such as the meaning of "sleeving"; its usage in the sphere of FFAs; and its potential application to the final agreement reached in a case such as this on the one hand; and going behind the negotiations themselves to try to establish the basis on which the negotiations were being conducted on the other. The latter seems to me to stray dangerously close to the realms of taking into account the subjective negotiating stances taken by each of the parties rather than merely the objective background. Lord Clarke's observation on the likely positive impact on parties' being more inclined to settle is, however, perhaps, borne out by the fact that TMT and

[30] [2009] UKHL 38 at para.42.
[31] *Oceanbulk* [2010] UKSC 44 at para.38.
[32] *Chartbrook* [2009] UKHL 38 at para.38.
[33] [2010] UKSC 44 at para.41.

Oceanbulk settled their differences, on October 22, 2010, reaching a "full and final resolution of all disputes"[34] even before the Supreme Court's judgment was published on October 27, 2010.

[34] Mulrenan, "Tradewinds Shipping Index", October 22, 2010, available at: *http://www.tradewinds.no/drycargo /article569294.ece* [accessed March 2, 2011].