



Hong Kong – Parties agreed settlement terms without formal settlement agreement

20 January 2023

Introduction

In *MSB International Ltd v Lok & Anor*¹, the Court of First Instance of the High Court found that the parties had agreed a full and final settlement of all their claims in two related proceedings, by way of an exchange of without prejudice written communications between their legal representatives, although no formal draft settlement agreement referring to more comprehensive release terms and stated to be “subject to contract” had been agreed. In the circumstances, the court granted the applicants’ application to stay the proceedings, save for the purpose of enforcing the settlement terms that had been agreed. While the case turns on its facts, it illustrates the important mechanics of settlement in complex commercial litigation and the need for parties to make it expressly clear from the outset when they desire settlement terms to be subject to a formal settlement agreement.

Background

The parties became embroiled in two main proceedings. In March 2021, the plaintiff company (the plaintiff) commenced proceedings against two defendants for (among other things) alleged breach of fiduciary duties (the main action). In October 2021, the first defendant (the first defendant) commenced proceedings seeking (among other things) payment of outstanding dividends allegedly owed to him as a former shareholder of the plaintiff (the shareholder action).

There followed a series of without prejudice settlement negotiations between the parties’ legal representatives in February and March 2022. One of the main issues in the

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negotiations was the amount of any dividend to be paid to the first defendant. After a series of written offers and counter-offers between the parties’ legal representatives, on 18 March 2022 the defendants’ legal representatives in the main action wrote to the plaintiff’s legal representatives stating:

“..... In short, the only item outstanding between our respective clients is the figure to be paid.”

There followed a further written offer as to the amount of the dividend to be paid by the plaintiff to the first defendant, culminating in the plaintiff’s written acceptance of the first defendant’s final offer on 22 March 2022 (the March settlement agreement). Until that point, none of the without prejudice offers and counter-offers appear to have been made “subject to contract” – namely, subject to agreement of a formal settlement document.

1. [2022] HKCFI 3751, HCA 400/2021 and HCCW 386/2021, 15 December 2022.

After 22 March 2022 there followed a further series of communications between the parties' legal representatives concerning the mechanics of settlement and how best to document the settlement terms. For example, the parties communicated about a draft settlement deed (the draft settlement deed) with supporting documents concerning the first defendant's former shareholding. These further communications appear to have been conducted on a without prejudice and "subject to contract" basis.

Things appear to have taken a significant turn in April 2022 when the defendants' legal representatives in the main action proposed to add a fuller release of claims to the March settlement agreement (apparently, for the benefit of related parties). The plaintiff did not agree to the fuller release provision.

In May 2022, the plaintiff and two individuals (the applicants) – a former shareholder and a director – commenced a further court action against the defendants in the main action (the respondents) seeking specific performance to enforce the March settlement agreement (the specific performance action)². The applicants also applied to stay the main action and the shareholder action until final determination of the specific performance action.

On the applicants' stay application the main issue for the court's determination was whether the March settlement agreement was a binding agreement to settle the parties' claims in the main action and the shareholder action. The determination of that issue would make the applicants' claim for specific performance unnecessary. The court considered that the main issue in dispute involved two specific questions for determination.

- Whether the March settlement agreement was a binding settlement or subject to conditions (such as the fuller release and execution of a formal settlement agreement)? If the March settlement agreement was not binding, then no settlement had been agreed because the parties had failed to reach agreement on the draft settlement deed.
- In the event that the March settlement agreement was not subject to conditions, whether its terms were sufficiently certain and complete to constitute a binding settlement agreement?³

On the applicants' case, the March settlement agreement was binding and its terms were sufficiently certain. In particular, on 22 March 2022 the applicants' legal representatives had accepted the respondents' offer with respect to the only outstanding issue between the parties. At that point (so the applicants' argument went) there was a binding settlement that was not "subject to contract" or any other terms (such as the fuller release) and the further discussions regarding the draft settlement deed did not change the fact that a settlement had been agreed.

On the respondents' case, the March settlement agreement was not binding because any settlement was subject to a formal settlement deed with fuller releases and, in any event, the March settlement agreement was not sufficiently certain to constitute a binding agreement. The respondents characterised the events leading to the March settlement agreement as a "framework" for further negotiations.

Judgment

Having reviewed the parties' without prejudice communications and heard evidence from their legal representatives, the court held that the parties had settled all their claims in the main action and in the shareholder action on the basis of the terms of the March settlement agreement. Therefore, the court ordered a stay of those proceedings, save for the purpose of carrying the terms into effect.

Legal principles

The court noted that it had an inherent and statutory jurisdiction to regulate its proceedings, including granting a stay in appropriate circumstances.⁴

The court also summarised the legal principles governing the formation of a settlement agreement⁵. A useful passage, particularly pertinent to the case, reads as follows:

"If the documents relied on as constituting a contract contemplate the execution of a further contract between the parties, it is a question of construction whether that is a condition of the bargain or whether it is merely an expression of the desire of the parties as to the manner in which the transaction already agreed to will in fact go through."

"It is possible for the parties to intend to be bound forthwith even though there are further terms to be agreed or some further formality to be fulfilled, provided that the unagreed terms do not render the contract void for uncertainty."⁶

2. HCA 547/2022.

3. *Supra* note 1, at para 48.

4. *Supra* note 1, at para 39. Section 16(3) of the High Court Ordinance (Cap. 4).

5. *Supra* note 1, at para 41.

6. *Supra* note 1, at paras 41(3) and (4).

Status of March settlement agreement

Having reviewed the evidence in detail, the court concluded that the March settlement agreement was binding on the parties and not subject to any further conditions⁷. The court referred to the following.

- There was no documentation to support the respondents' argument that the negotiations in the run up to the March settlement agreement were conditional on a fuller release being agreed and "subject to contract".
- Even immediately after the March settlement agreement there was no reference in the draft settlement deed to either the provision for a fuller release or it being "subject to contract".
- By a letter dated 5 May 2022 to the applicants' legal representatives, the respondent's legal representatives appeared to have asserted in writing for the first time that any settlement was conditional on a fuller release of all claims against related parties and the execution of a settlement deed.

Consistent with the legal principles summarised above, the court observed that:

"It was plainly open to the parties to negotiate on other terms set forth in the draft [Settlement Agreement] to see if they would be able to agree on such terms. If no agreement was reached, the parties would still have to abide by the terms of the Settlement Agreement."⁸

Contractual certainty

The court made a number of interesting observations and findings in this regard.

- The fact that the parties had not reached agreement on the terms that the respondents wanted to include in the draft settlement deed did not (on the facts) mean that the March settlement agreement was uncertain or incomplete. The terms of the March settlement agreement were apparent from the written communications between the parties' legal representatives up to 22 March 2022.⁹
- While the legal representatives may have negotiated a more "all-encompassing settlement" to ensure a clean break between the parties this did not mean that the March settlement agreement was insufficiently certain to be enforceable – particularly, given that the parties had negotiated with the benefit of legal advice.¹⁰

- As a matter of law, there was nothing conceptually wrong about a settlement agreement that only covered ongoing proceedings between the parties but not other "potential claims".¹¹

Comment

The judgment and the parties' legal submissions are a useful summary of the legal principles governing – (i) the courts' power to grant a stay in such circumstances and (ii) the formation of a settlement agreement.

Settlement negotiations in complex commercial litigation involving multiple parties are a matter that require careful handling and clear instructions. If a party's intention is that the terms offered on a without prejudice basis are subject to documentation in a formal settlement deed this should be made clear at the outset of the negotiations and expressly stated in the written without prejudice communications and documents.

In this case, the respondents' insistence on a fuller release (which, of itself, is not unusual in commercial litigation involving multiple parties) appears to have come after the applicants' acceptance of the outstanding issue between the parties. Moreover, the parties' written without prejudice offers do not appear to have made it consistently clear that a binding settlement was "subject to contract", including execution of a formal settlement deed – on the contrary, the court found that there was a binding settlement agreement based on the language of the parties' previous written offers and counter-offers. The case helps to illustrate the difference between settlement communications that are "without prejudice" (and capable of being accepted without more) and settlement communications that are also clearly "subject to contract" (and dependent on the execution of a formal settlement agreement).

Contact us

Please contact [Rebecca, James](#) or [Antony](#), if you have any queries regarding the issues raised in this article.

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7. *Supra* note 1, at paras 44 and 60.

8. *Supra* note 1, at para 59(2).

9. *Supra* note 1, at para 66.

10. *Supra* note 1, at para 67(2).

11. *Supra* note 1, at para 67.