

LEGAL UPDATE

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CASE UPDATE

Settlements And The Reasonable Businessman

Bristone Pte Ltd v Smith & Associates Far East, Ltd [2007] SGCA 47

Executive summary

In its recent decision in *Bristone Pte Ltd v Smith & Associates Far East, Ltd* [2007] SGCA 47, the Singapore Court of Appeal affirmed that a settlement may be relied on to prove a claim for loss as against a third party if the settlement amount reasonably reflects the quantum of loss suffered by the claimant. The court also provided guidance as to the considerations to be taken into account in determining the reasonableness of a settlement.

Background

The appellant, Bristone Pte Ltd ("**Bristone**"), is a Singapore company engaged in the sourcing of electronic components for its clients. Smith & Associates Far East, Ltd ("**Smith**") is a Hong Kong company that distributes electronic components, semiconductors and computer products.

In August 2003, Smith bought 52,000 "AVX" capacitors from Bristone. Smith re-sold the capacitors to Celestica Thailand Ltd ("**CTL**"), which then installed the capacitors onto printed circuit boards for its customer, EMC Corporation ("**EMC**").

A month later, CTL discovered that the capacitors were counterfeit, after two capacitors caught fire at EMC's premises. A purging exercise was initiated and the counterfeit capacitors were removed from the printed circuit boards and substituted with genuine capacitors. EMC claimed US\$444,680 from CTL as expenses associated with the purging exercise.

CTL in turn claimed the same amount of US\$444,680 from Smith. A damages assessment exercise was carried out between representatives of CTL and Smith. CTL was represented by its commodity manager and Smith was represented by its general counsel. After nine months of negotiations, a settlement was reached in July 2004, with Smith agreeing to pay CTL a sum of US\$300,000 in full and final settlement of CTL's claims against Smith. Smith paid CTL the settlement sum in September 2004.

Throughout the negotiations between Smith and CTL, Smith repeatedly attempted to engage Bristone in the talks, with a view towards seeking Bristone's contribution to the settlement amount. Smith's requests, however, fell on deaf ears.

When Smith's solicitors eventually issued a letter demanding payment of US\$309,776, Bristone's solicitors responded denying the allegations that the capacitors supplied by it had been counterfeit and requesting for more documents in support of Smith's claim.

MAIN OFFICE

20 Raffles Place
#17-00 Ocean Towers
Singapore 048620

t +65 6535 0733

f +65 6535 4906

mail@drewnapier.com
www.drewnapier.com

Co. Reg. No. 200102509E

Smith commenced proceedings against Britestone in February 2005 alleging breach of an implied condition of the contract of sale under Section 13 of the Sale of Goods Act and claiming the settlement sum of US\$300,000 paid to CTL as well as US\$2,184 as loss of profits.

On 20 March 2006, both parties agreed to a consent judgment by which Britestone admitted liability for damage caused, leaving the issue of quantum to be assessed by the court. At the hearing for assessment of damages, the assistant registrar considered the evidence and concluded that the settlement sum was reasonable. She awarded Smith the amount of US\$302,184 claimed. The assistant registrar's decision was upheld by a High Court judge on appeal.

Dissatisfied with the judge's decision, Britestone appealed to the Court of Appeal.

Decision of the Court of Appeal

The Court of Appeal had to determine whether the settlement reached between Smith and CTL was reasonable and could be relied on as reflecting the actual loss suffered by Smith.

Reliance on a settlement to prove a claim for loss is permitted

The Court of Appeal endorsed the position that a prior settlement reached between two "downstream" parties can be relied on to prove a claim for loss as against an "upstream" third party, provided that liability is not an issue between the parties before the court and the court is satisfied that the settlement has been reasonably reached and is reasonable in nature.

Considerations to be taken into account in assessing the reasonableness of the settlement

As a preliminary point, the party seeking to rely on the prior settlement must plead sufficient details and particulars regarding the methodology and process of arriving at the settlement. Such details may include, for example, an explanation as to how the settlement sum was derived and evidence as to how or why or on what advice the settlement was entered into. If sparse particulars are proffered, the court may find that there is insufficient evidence to prove the reasonableness of the settlement.

Next, the settlement must pass what the court described as the "reasonable businessman" test. As explained by VK Rajah JA:

"There must be some logical basis for arriving at the settlement sum, which cannot be simply plucked out of thin air. In the final analysis, as stated above, all the sub-factors showing such logical basis ... can be encapsulated in an overriding test which is based on the viewpoint of the "reasonable businessman". In other words, the pertinent question which the courts must answer is this: What would a reasonable businessman have done in the circumstances of the case?"

In this connection, the court took pains to emphasise that a businessman is *not* automatically presumed to have acted reasonably in settling business claims made against him:

"We do, however, have some reservations in relation to this court's earlier unqualified adoption of the suggestion ... that there is an evidential presumption that business

settlements are made reasonably ... Settlements can be made for a number of reasons, not all of which are objectively reasonable. Settlements are sometimes made to preserve business relationships regardless of the legal merits and/or reasonableness of a claim ... There is a real need to be wary of excessive settlement amounts that may sometimes be hastily reached to preserve business relationships. Such settlements should not be imposed on third parties as they will not pass muster as being objectively reasonable."

The reasonableness of a business decision to enter into a settlement is to be assessed by *objective* factors. First, it must have been reasonable, in the context of the case, for the party to settle the claim. Secondly, the party must have acted reasonably in obtaining advice from an expert (which can include legal counsel or an industry expert). A businessman who is equipped with competent advice would be less likely to settle a claim at a figure higher than the true value of the damage. Thirdly, the methodology underpinning the assessment of damages must itself be objectively ascertainable and reasonable.

The Court of Appeal also noted that the following factors could be a useful practical guide in assessing whether a claimant has acted as a "reasonable businessman" in reaching a settlement:

- the duration or period of negotiations as well as their general content;
- the trade customs or previous business dealings between the parties and/or other legitimate business considerations or contractual requirements (eg. dispute resolution clauses, etc.) enjoining a settlement;
- the availability of and/or reliance on legal advice, expert advice or independent survey reports (taking into account considerations of cost and time);
- the arm's length nature of the settlement;
- the opportunity accorded to the third party/ultimate payee to be involved in the negotiations (if notice is not given, the court may be more likely to investigate the settlement terms and process and may be slower to acknowledge the reasonableness of the settlement);
- the positive reception of complaints by the third party/ultimate payee;
- the payment of the settlement amount, and if so, how and when it was paid;
- the relative bargaining strengths of the parties involved in the settlement, taking into account (among other things) alternative means by which the dispute could have been concluded;
- the objective assessment and proper calibration of the settlement figure against the factual matrix; and
- the practical consequences of the decision on reasonableness.

Decision

The Court of Appeal took the view that Smith had conducted itself in a commercially reasonable manner throughout the settlement process. The negotiations between the parties had been long and protracted, with deep discounts given by CTL before the eventual settlement sum of US\$300,000 was agreed upon. The figures used in support of CTL's claim had been rigorously dissected and the negotiations had been conducted with legal advice from Smith's in-house counsel. Smith had tried repeatedly to engage Britestone throughout the entire settlement process. The settlement talks had been conducted at arm's length and Smith had made full payment of the settlement sum to CTL.

Accordingly, the court dismissed Britestone's appeal and upheld the decision to award Smith the settlement sum of US\$302,184.

Comment

The Court of Appeal has again adopted a common-sense and business-friendly approach in analysing relationships and contracts. It has shown great reluctance to undermine an agreement reached by parties negotiating at arm's length.

Importantly, the Court of Appeal also commented on the role played by in-house counsel. The court gave weight to the fact that, during negotiations, the advice of in-house legal counsel was obtained. That fact was used to support the court's finding that negotiations were carried out at arm's length. The court noted that it is not essential for legal advice to be invariably sought from external counsel. As long as the advice given is, when objectively viewed, independent, sound, prudent and consistent with established legal principles, it will be accorded some weight, regardless of the identity of the legal adviser. A party that relies on advice to arrive at a settlement must be prepared to have the reasonableness of that advice examined and tested if it seeks to invoke that settlement against a third party. A settlement that is capable of withstanding objective judicial scrutiny is one that has been concluded on reasonable terms.

The decision also starkly demonstrates that if parties, in particular, middlemen and part procurers, fail to include in their contracts clauses that legitimately limit their potential liability, they may find themselves confronted with responsibility for significant consequential losses.

If you would like more information about this case or wish to discuss how it may potentially affect you or your business, please feel free to contact the dispute resolution lawyers in Drew & Napier LLC (please refer to the Directors' Profiles on our website), or:

Adrian Tan
Director (Litigation & Dispute Resolution)
T: +65 65312424
E: adrian.tan@drewnapier.com

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OUR BUSINESS GROUPS AND PRACTICE AREAS

BANKING/GENERAL FINANCE

David Ang
T +65 6531 2236
F +65 6535 4864
E david.ang@drewnapier.com

Valerie Kwok

T +65 6531 2222
F +65 6535 4864
E valerie.kwok@drewnapier.com

BIOMEDICAL SCIENCES

Tony Yeo
T +65 6531 2512
F +65 6220 0324
E tony.yeo@drewnapier.com

BUILDING & CONSTRUCTION

Tan Liam Beng
T +65 6531 4139
F +65 6533 3591
E liambeng.tan@drewnapier.com

CAPITAL MARKETS

Sin Boon Ann
T +65 6531 2206
F +65 6535 4864
E boonann.sin@drewnapier.com

CHINA BUSINESS GROUP

David Chin
T +86 21 6335 1628
F +86 21 6335 0638
E david.chin@drewnapier.com

COMPETITION LAW

Lim Chong Kin (non-contentious)
T +65 6531 4110
F +65 6535 4864
E chongkin.lim@drewnapier.com

Cavinder Bull (contentious)

T +65 6531 2416
F +65 6533 3591
E cavinder.bull@drewnapier.com

CORPORATE

David Ang
T +65 6531 2236
F +65 6535 4864
E david.ang@drewnapier.com

Gary Pryke

T +65 6531 4104
F +65 6535 4864
E gary.pryke@drewnapier.com

Yeo Wee Kiong

T +65 6531 2500
F +65 6535 4864
E weekiong.yeo@drewnapier.com

CORPORATE INSOLVENCY & RESTRUCTURING

Sushil Nair
T +65 6531 2410
F +65 6532 7149
E sushil.nair@drewnapier.com

Manoj Sandrasegara

T +65 65314156
F +65 65327149
E manoj.sandra@drewnapier.com

**EMPLOYMENT & IMMIGRATION
Indranees Rajah, SC (contentious)**

T +65 6531 4100
F +65 6532 7149
E indranees.rajah@drewnapier.com

FAMILY & MATRIMONIAL

Randolph Khoo
T +65 6531 2418
F +65 6532 7149
E randolph.khoo@drewnapier.com

FUND MANAGEMENT, REIT & PRIVATE EQUITY

Petrus Huang
T +65 6531 2208
F +65 6533 0694
E petrus.huang@drewnapier.com

INFO-COMMUNICATIONS, MEDIA & TECHNOLOGY

Lim Chong Kin
T +65 6531 4110
F +65 6535 4864
E chongkin.lim@drewnapier.com

INSURANCE & REINSURANCE

Gary Pryke
T +65 6531 4104
F +65 6535 4864
E gary.pryke@drewnapier.com

INTELLECTUAL PROPERTY

Morris John (Patents)
T +65 6531 2503
F +65 6533 0694
E mj@drewnapier.com

Redar Singh Gill (Trade Marks)

T +65 6531 2507
F +65 6533 0694
E redar.singh@drewnapier.com

LITIGATION & DISPUTE RESOLUTION

Jimmy Yim, SC
T +65 6531 2504/2505
F +65 6533 3591
E jimmy.yim@drewnapier.com

PROJECT FINANCE

Gary Pryke
T +65 6531 4104
F +65 6535 4864
E gary.pryke@drewnapier.com

PROPERTY

Chua Bee Lan
T +65 6531 2302
F +65 6535 1952
E beelan.chua@drewnapier.com

SHIPPING & INTERNATIONAL TRADE

Ian Koh
T +65 6531 2436
F +65 6533 3591
E ian.koh@drewnapier.com

TAX, TRUSTS, ESTATE PLANNING & PROBATE

Teoh Lian Ee
T +65 6531 2248
F +65 6535 4864
E lianee.teoh@drewnapier.com

TRANSNATIONAL & CROSS-BORDER WORK

Julian Kwek
T +65 6531 2485
F +65 6532 7149
E julian.kwek@drewnapier.com

OTHER OFFICES

Shanghai Office
#2501 Office Tower
Bund Center
222 Yan An Road East
Shanghai 200002
China
T +86 21 6335 1628
F +86 21 6335 0638
E china@drewnapier.com

Drewmarks Patents & Designs (Malaysia) Sdn Bhd
9th floor
Bangunan Getah Asli (Menara)
148 Jalan Ampang
50450 Kuala Lumpur, Malaysia
T +603 2162 2522/2162 2529
F +603 2162 2804
E drewmark@tm.net.my

PT Drewmarks Konsultama
Correspondence address:
20 Raffles Place
#17-00 Ocean Towers
Singapore 048620
T +65 6531 2503/6531 2504
F +65 6533 0694
E ip@drewnapier.com

DrewCorp Services Pte Ltd
20 Raffles Place
#09-01 Ocean Towers
Singapore 048620
ROC No. 200102492H
T +65 6531 2266
F +65 6533 1542/6533 7649
E services@drewcorpservices.com