ALLEN & OVERY

January 2018

Litigation and Dispute Resolution

Review

Contents

Editor: Amy Edwards
Litigation – Senior Professional Support Lawyer – London

Contact
Tel +44 20 3088 2243
amy.edwards@allenovery.com

Top finance litigation and contractual developments in 2017

This is a round-up of the most interesting banking litigation and contractual developments in 2017. The selection is necessarily subjective and draws from a wide range of cases and developments that are of direct relevance to finance parties. Full coverage can be found in our monthly Litigation and Dispute Resolution Review.

Not out of the woods yet on jurisdictional/governing law challenges although some promising developments

Tactics around jurisdiction and governing law have been a common feature of cross-border litigation for many years for parties attempting to avoid, or at least delay, meeting their obligations under financial contracts. 'Italian torpedoes' (starting pre-emptive proceedings in a jurisdiction perceived to be slow), alleging lack of capacity to enter into the contract in the first place, and reliance on mandatory provisions of local law, are some of the weapons in the recalcitrant borrower's armoury. While recent European legal developments, such as the Brussels Regulation (Recast), have sought to limit the opportunity for such jurisdictional chicanery, the cases in 2017 demonstrate that they are likely be with us for some time to come, even before one factors in the possible impact of Brexit on this area.

The dangers of agreeing contracts with the same party that have differing jurisdiction and governing law clauses: *Deutsche Bank AG v Comune di Savona* [2017] EWHC 1013 (Comm). In light of threatened legal action in Italy, Deutsche sought 12 declarations from the English High Court concerning the entry into, validity, enforceability, interpretation and performance of certain swaps it had with Savona. The swaps were under the ISDA Master Agreement, governed by English law and had exclusive jurisdiction clauses in favour of the English courts. Nevertheless, Savona was successfully able to argue that half of the declarations should instead be heard in Italy, owing to the existence of an exclusive jurisdiction clause in favour of the Milan Courts in a contract governed by Italian law, under which Deutsche had agreed to give Savona some unpaid advice in connection with managing its debts. This was despite the fact that, with one exception, the declarations being sought tracked closely contractual representations in the ISDA Master Agreement. It will be interesting to see if it is upheld when it comes before the Court Appeal in July 2018.

'International element' prevents mandatory local laws derailing swap: In *Dexia Crediop S.p.A. v Comune di Prato* [2017] EWCA Civ 428, one of the main questions facing the Court of Appeal was whether a swap under a 1992 ISDA Master Agreement governed by English law was invalid or unenforceable under mandatory provisions of Italian financial services law. Prato argued that the mandatory rules applied, by virtue of Article 3(3) of the Rome Convention on the basis that, apart from the choice of English governing law, "all other elements relevant to the situation at the time of the choice" of law were connected to Italy. The Court of Appeal disagreed, finding that Art 3(3) did not apply as there was an "international and relevant element in the situation", which made it impossible to say that "all elements" were located in a country other than England. These elements included: (i) the choice of an international standard form agreement; (ii) the fact the contract envisaged the use of more than one currency and the involvement of more than one country; and (iii) Dexia's "back to back" swaps with banks outside of Italy. This decision, and the Court's willingness to recognise international elements in interest rate swap transactions, will provide greater certainty to financial institutions looking to enforce their agreements.

The Supreme Court has refused Prato's application to appeal.

Promising ruling on asymmetric (or hybrid) jurisdiction clause although some risk remains: In *Commerzbank Aktiengesellschaft v Liquimar Tankers Management Inc* [2017] EWHC 161 (Comm), an asymmetric (or hybrid) jurisdiction clause in favour of the English Courts was found to be exclusive for the purposes of the Brussels Recast's "anti-torpedo" provisions. This meant that the English Court was able to determine the dispute without having to defer to the Greek Courts which had been first seised of the case. A note of caution here however, as it is far from clear (despite certain obiter comments from the judge in this case) that such clauses would be exclusive for the purpose of the equivalent provisions in the Hague Convention – which is likely to be the applicable regime following Brexit. There have also been certain French cases that have questioned the validity of such clauses at all. As such, parties to financial contracts should be aware that a degree of risk remains in the use of such clauses. This case will not be heard on appeal as the parties reached a settlement agreement in December 2017.

Contract law

More guidance on contractual interpretation: The Supreme Court revisited contractual interpretation in 2017. Since its decision in *Arnold v Britton* [2015] UKSC 36, 10 June 2015, there had been considerable debate as to whether textualism (the natural meaning of the words used) should be given greater weight than the wider context of the contract, such as business common sense (so-called "contextualism"). In *Wood v Capita Insurance Services Ltd* [2017] UKSC 24, the Supreme Court emphasised that textualism and contextualism were not "*conflicting paradigms*"; rather they are complementary tools for ascertaining the objective meaning of the language chosen by the parties to express their agreement. Where there is dispute as to the meaning of a provision the court will adopt an iterative process weighing up the indications given by the language against the implications of the rival meanings. The court also indicated that for certain contracts – for instance where parties are more sophisticated and professionally advised – greater emphasis on a textual approach may be appropriate, albeit this would not be a hard and fast rule. On balance, this is a welcome development as it lessens the likelihood that a drafting ambiguity will be able to threaten the wider commercial structure of a deal. The overall message however remains the same: when drafting, say what you mean and mean what you say, because if you end up in court there is always going to be a degree of uncertainty as to the outcome.

Capacity of state to contract: *The Law Debenture Trust Corporation v Ukraine* [2017] EWHC 655, 29 March 2017, was not only a case in which recent struggles between Russia and Ukraine moved to the English Courts, it was also the first time the English courts had considered the question of a state's capacity to contract. Ukraine argued that it did not have the capacity to enter into the USD3 billion English law governed Eurobond for which Russia had been the only subscriber. The judge found that the question of a state's capacity to contract, which was a question of English law and not the law of the state in question, derived from the state's sovereignty. Once the state was recognised as sovereign in international law, it would have the ability to contract under English law, regardless of any local law restrictions. Having established that Ukraine had the capacity to contract (and hence to borrow), the judge also held that the Ukrainian finance minister had "usual" authority to sign the various transaction documents (on the basis that he had previously signed 31 similar transactions), and also "ostensible" authority having been held out by the Ukrainian Cabinet as someone with the authority to contract. Legal battle lines are currently being contested in the case's appeal before the Court of Appeal.

No principle of futility: In *Astor Management AG & anr v Atalaya Mining PLC & ors* [2017] EWHC 425 (Comm), the Court denied that there was a "principle of futility" which could be relied on to require payment of some deferred consideration when one of the conditions to payment – the raising of money via a Senior Debt Facility – was never going to be formally met. The court held that even though, in economic substance, Atalaya had obtained the funding required to trigger the payment obligation, because this had not strictly been achieved

through a Senior Debt Facility, the condition had not been met and no payment was due.

Subsequent communications relevant to question of whether a contract has been made: *Global Asset Capital & anr v Aabar Block S.A.R.L & ors* [2017] EWCA Civ 37 serves as a reminder that when it comes to assessing the existence of a contract (as opposed to its meaning) subsequent events could be taken into account. Here, subsequent communications such as a reference to the "*proposed transaction*", and the phrase "*upon your agreement that you are willing to proceed*" were persuasive in a finding that a contract had not been formed. This case also reiterated the power and importance of the phrase "subject to contract" to refute contractual intentions.

Increasing corporate criminal liability/ reducing privilege

The Criminal Finances Act 2017 contains two new strict liability corporate offences of failing to prevent the facilitation of UK or non-UK tax evasion: The new tax offences put corporates, particularly financial and professional services firms, under increased pressure in relation to the behaviour of their employees, agents or anyone providing a service for or on behalf of the company. The new offences catch both UK and foreign companies (who do business in the UK) and apply to UK and non-UK tax evasion. The new offences came into force on 30 September 2017. The Act also introduced Unexplained Wealth Orders and made changes to the Suspicious Activity Reporting Regime. Specific guidance on the implications of the new Act for financial services firms can be found here.

The changes made by the Criminal Finances Act 2017, together with the Supreme Court's change to the test for criminal dishonesty (*Ivey v Genting Casinos* [2017] UKSC 67) increases the risk of financial services firms, and their staff, falling foul of the criminal law.

Whilst corporate criminal liability expands, the scope for parties claiming privilege in investigations gets ever narrower: In 2016, the High Court in the *RBS Rights Issue Litigation* [2016] EWHC 3161 (Ch), confirmed that legal advice privilege could not be claimed over a lawyer's notes of interviews with a party's employees (save to the limited extent it betrayed the trend of the lawyer's advice). Only communications with the 'client' (ie those individuals in an organisation authorised to receive legal advice such as the Board or in-house counsel) would be protected. In *Serious Fraud Office (**SFO**) v Eurasian Natural Resources Corporation Ltd* [2017] EWHC 1017 (QB), this approach to legal advice privilege was confirmed in the context of a criminal investigation. Further, the court also ruled that **litigation privilege** did not apply in the context of a criminal investigation by the SFO, as this is not considered to be adversarial litigation for privilege purposes. *SFO v ENRC* goes before the Court of Appeal in July, but before then parties looking into potential criminal wrongdoing or regulatory breaches in their organisations, should work on the assumption that it will be difficult to resist requests from the authorities for material created during the course of those investigations, save for communications made within the narrow confines of the lawyer-client relationship.

Enforcement – increased availability of third party debt orders against letters of credit

Supreme Court has increased the availability of third party debt orders: English Court third party debt orders are a useful arrow in the quiver of successful claimants seeking to enforce court judgments or arbitral awards made in their favour. Armed with one of these orders a party can recover the money owed to it by intercepting payments – for instance to a bank account – or, in this case, under a letter of credit. In *Taurus Petroleum Ltd v State Oil Marketing Company of the Ministry of Oil, Republic of Iraq* [2017] UKSC 64, the issue was whether the legal 'location' (situs) of a debt due under a letter of credit is: (i) the place of the residence of the debtor, or (ii) where the debt is due to be paid. By deciding that it was the former, the Supreme Court increased the availability of third party debt orders, since they can now be sought against payments made under letters of credit issued by a London-based bank even if the debt is to be paid outside the jurisdiction.

Oliver Rule
Counsel
Litigation – Banking Finance & Regulatory – London

Contact
Tel +44 20 3088 2072
oliver.rule@allenovery.com

WHAT TO LOOK OUT FOR IN 2018

A round-up of some of the most interesting developments to look out for in 2018 for disputes lawyers

Brexit

It is impossible not to mention Brexit which will be defined by the politics. 2018 is also likely to bring a significant increase in UK policymaking and related legislative change. We expect to see the publication of significant amounts of draft legislation to supplement/sit alongside the European Union (Withdrawal) Bill (which is making its way through the Parliamentary process). We continue to see questions being raised about whether it is appropriate to include English governing law and jurisdiction clauses in international deals. Our views remain unchanged – in the vast majority of cases there is no need to alter your approach, even in a hard Brexit scenario.

Data protection

The EU General Data Protection Regulation comes into force in May 2018. The recent case involving Morrisons [2017] EWHC 3113 (under the current law) is perhaps an indication of what is to come. A rogue employee with IT access deliberately committed a serious data breach for which he was found to be criminally liable. Despite being found not to be primarily liable for any breach under the Data Protection Act 1998 which caused the disclosure, Morrisons was found to be vicariously liable for the employee's rogue conduct.

Dispute lawyers are most likely to come up against data protection issues in the context of disclosure. This could be to regulators/enforcement agencies or in disputes before courts/tribunals. The requests, demands or court orders for documents/information by overseas authorities or courts on the one hand, have to be weighed against competing data protection requirements on the other. The highly publicised increase in potential fines under the GDPR is likely to have an impact on this balancing exercise.

Fintech

Distributed ledger technology such as blockchain and, in particular, crypto-currencies like Bitcoin as well as so-called initial coin offers have dominated the financial press. Regulators and enforcement agencies are keeping a close eye on developments with some being more forthright than others. In the not-too-distant future this would seem to be an area ripe for regulatory investigation and/or civil disputes. We also expect to see the use of artificial intelligence in regulatory compliance become a hot topic, particularly in the financial services sector. Indeed, it is already being considered by some banks and regulators. The use of AI gives rise to many issues from ethics and data protection through to contractual and regulatory liability.

Privilege

For lawyers, this was one of the most contentious topics of 2017 and one that is likely to continue to be an area of focus in 2018, particularly in the context of internal company investigations and criminal investigations. The outcome of the *SFO v ENRC* [2017] EWHC 1017 appeal in July is keenly awaited.

Parent liability for subsidiaries

There have been a few recent cases which may have an impact on the extent to which a parent may be held liable for the acts of its subsidiary. The facts in these cases tend to involve mining or drilling for oil which it is claimed has led to either environmental damage or personal injury. To date, the decisions have been on jurisdiction challenges and not on substantive issues (the most recent being the appeal of the jurisdiction decision in *Okpabi v Shell* [2017] EWHC 89, which was heard on 21 November 2017 and in respect of which we are awaiting judgment). If these cases proceed to trial they will be of interest to businesses in the energy and mining sector in particular.

State capacity and authority

As this article went to press, the appeal of *Law Debenture v Ukraine* [2017] EWHC 655 was being heard in the Court of Appeal. This concerns a State's capacity to enter into contracts as well as related questions of the authority of Ministers that act on a State's behalf. At first instance: (i) the capacity of a State was held to be unlimited once a State is recognised as such; and (ii) while the Minister of Finance had no actual authority to sign the Eurobonds in question, he did have usual authority based on a history of previous debt issuances, and also ostensible authority. This is an important decision for any business involved in contracting with States.

Consideration

We are awaiting the Supreme Court's decision in *MWB v Rock*. This concerns the licence of some premises (where the written agreement had an anti-oral variation clause). Rock got into financial difficulties and negotiated an oral agreement with MWB, the landlord, to give it extra time to pay. Two days later MWB insisted on the terms of the original licence. The Court of Appeal held the oral agreement to be a binding variation supported by consideration, despite the "anti-oral variation" clause. The practical benefit giving rise to the consideration for the oral variation was that MWB would recover some of the arrears and would have some hope of recovering the rest in due course; it was also better to have premises occupied since an empty property would be worth less.
The decision is important since it demonstrates how carefully negotiated written agreements can be varied orally or by conduct.

Asset striping to avoid judgment

The *Marex v Garcia* [2017] EWHC 918 case will be heard on appeal in June 2018. The issue in this case is whether a director of a judgment debtor company can be liable in tort for moving assets of the company out of the reach of a judgment creditor after the judgment had been handed down in draft and prior to the judgment creditor obtaining a post-judgment freezing order.
At first instance this was held, on an arguable case basis, to be a tort.

Disclosure

We are expecting significant changes to be introduced to the disclosure regime in the English Business and Property Courts on a pilot basis. Standard disclosure will disappear in its current form and will be replaced by five different disclosure "models", ranging from no disclosure at all through to "train of enquiry" style disclosure. A number of Allen & Overy lawyers are helping with the analysis of the current draft proposals and are providing feedback to the Disclosure Working Group.

FCA enforcement

Many enforcement trends from 2017 will continue into 2018. For example, we expect the FCA to continue to dedicate a significant amount of time and resources to investigating individuals, and as outlined in the FCA's 2017/18 Business Plan, financial crime will remain one of its top priorities. New legislation in 2018 will, of course, bring new enforcement risks.

Jason Rix
Senior Professional Support Lawyer
Litigation – London

Contact
Tel +44 20 3088 4957
jason.rix@allenovery.com

Conflicts of law

SUPREME COURT TAKES EXPANSIVE VIEW OF ENGLISH COURT JURISDICTION FOR TORT CLAIMS

Four Seasons Holdings Incorporated v Brownlie [2017] UKSC 80, 19 December 2018

The Supreme Court has considered the meaning of the word "damage" in the tort jurisdiction gateway contained in the Civil Procedure Rules, which permits service of English proceedings in tort on a defendant abroad where "damage was, or will be sustained, within the jurisdiction". Overturning the Court of Appeal, a majority (3:2) of the Supreme Court took the view obiter that "damage" should be given its ordinary and natural meaning and therefore indirect loss suffered in England as a result of a tort committed abroad may be sufficient to establish the English court's jurisdiction to hear the claim. The decision has potentially broadened the English courts' jurisdiction in tort cases.

The case arose from a car accident on a sightseeing trip in Egypt in which the claimant was injured and her husband was killed. The claimant and her late husband were UK citizens. The claimant got permission to serve English proceedings in Canada for breach of contract and tort on the Canadian holding company of an international hotel group on the basis that the contract was made in England and, for the tort claims, damage (in the form of indirect loss) was suffered in England. The defendant challenged the jurisdiction of the English court.

Court of Appeal – narrow interpretation of "damage"

The Court of Appeal held that: (i) the claimant was entitled to bring proceedings in England for damages for breach of contract; and (ii) the English court had no jurisdiction to hear tort claims for personal injury to the claimant and on behalf of her late husband's estate. "Damage" meant direct damage and did not include consequential damage. Claims for indirect loss suffered in England caused by foreign torts would not therefore fall within the English court's jurisdiction. Both parties appealed.

Conditions for permission to serve proceedings outside the jurisdiction – a reminder

Before the English courts can allow service of a claim abroad (in circumstances where the English common law rules apply) the claimant must show that: (i) the case falls within at least one of the jurisdictional gateways in the Civil Procedure Rules (CPR PD 6B para 3.1); (ii) the claim has a reasonable prospect of success; and (iii) England and Wales is the proper place in which to bring the claim.

The evidential standard for establishing that a claim falls within a jurisdictional gateway is that of "a good arguable case" (*Canada Trust Co v Stolzenberg* (No 2) [1997] EWCA Civ 2592). Lord Sumption said that there would be a good arguable case for the application of the gateway if there is a plausible (albeit contested) evidential basis for it.

Jurisdiction for tort claims – what does "damage" mean?

The Supreme Court did not need to consider the tort claims jurisdictional gateway as it found that the Canadian holding company was not the correct defendant to the claimant's claims. The Supreme Court made important *obiter* observations, however, on the meaning of "damage" for the purposes of the tort jurisdictional gateway, which enables the English court

to permit service of an English tort claim abroad where "damage was sustained, or will be sustained, within the jurisdiction".

Damage given a wide meaning – the view of the majority

Lady Hale considered that the claimant's tort claims fell within the tort gateway to the extent that the claimant sought damages for personal injury to herself and, as executrix, to her late husband. There was a consistent line of first instance decisions allowing tort claims to be brought in England if damage is suffered here as a result of injuries inflicted abroad, which Lady Hale considered were correct. Lady Hale was reluctant to disagree with the first instance judges who had found that "damage" referred to the actionable harm caused by the alleged wrongful act and included all the detriment – physical, financial and social – which the claimant had suffered as a result of the defendant's tortious conduct.

Despite giving "damage" a wide meaning, Lady Hale considered that the court's discretion to refuse to give permission to serve proceedings outside of the jurisdiction should be robust enough to prevent claimants from choosing where to bring a claim.

Lord Wilson and Lord Clarke agreed with Lady Hale. In particular, they considered that because the tort gateway refers to "damage" rather than "the damage," "damage" can be wider than the damage which violates the claimant's interests and which completes the cause of action.

Damage given a narrower meaning by the minority

In the minority, Lord Sumption (with whom Lord Hughes agreed) thought that "damage" meant the damage which completed the cause of action.

Lord Sumption considered that "damage" meant direct damage, relating to the nature of the duty broken in a personal injury action and the character of the damage recoverable. There was a fundamental difference between the damage done to an interest protected by law and facts that only go to evidence the financial value of the damage. The first and most important interest protected by the law of tort was bodily integrity. A tort against bodily integrity is complete at the time of the injury, even though damage "is an essential element of it".

Lord Sumption said that there are two important policy considerations supporting a narrow interpretation of "damage":

- The jurisdictional gateways seek to identify a substantial link between the cause of action and England. This purpose is better served by locating jurisdiction where the interest of the claimant was damaged rather than by asking where the claimant experienced the effects of the damage.
- Despite differences between the English and the European jurisdictional regimes, the approach adopted by the European Court of Justice (see eg *Marinari v Lloyds Bank Plc* (Case C-364/93) [1996] QB 217) should be followed. It embodied an unanswerable analysis of what constituted damage and the English tort gateway had been drafted to assimilate the tests for asserting jurisdiction over persons domiciled in a European Union member state and persons domiciled elsewhere.

COMMENT

Although the case related to a personal injury action the Supreme Court's observations are relevant for all types of tort claims in which the English court's permission is required to serve outside England. Lady Hale stressed that the Supreme Court's *obiter* views on jurisdiction "should be treated with appropriate caution", but, they have created new uncertainty by challenging the Court of Appeal's more restrictive interpretation of the meaning of "damage."

The case also suggests at least some judicial appetite for reform of the contract gateway in the Civil Procedure Rules which permits service abroad of claims arising from contracts made in England. When finding that there had not been any contract between the claimant and the defendant, Lord Sumption noted *obiter* that the legal test for where or when a contract is made is somewhat artificial in nature. The test is particularly arbitrary when the mode of communication used is instantaneous as it depends on assumptions about the point at which an

offer is accepted or deemed to be accepted and gives rise to serious practical difficulties. Lord Sumption considered that the issue could "profitably be re-examined" by the Civil Procedure Rules Committee.

The case is also a useful reminder of ensuring proceedings are brought against the correct defendant, which can be easier said than done in the context of claims against companies within complex multinational group structures.

Samantha Holland
Associate
Litigation – Corporate – London

Contact
Tel +44 20 3088 3479
samantha.holland@allenovery.com

Contract

CONTRACTUAL INTERPRETATION AND IMPLIED TERMS: RELATED CONTRACTS AND LIMITATIONS ON CONFIDENTIALITY

Kason Kek-Gardner Ltd v Process Components Ltd [2017] EWCA Civ 2132, 14 December 2017

The Court of Appeal considered the correct interpretation of related contracts and the business efficacy test for implying a term in the context of an alleged breach of confidentiality provisions in an intellectual property licence. The decision is a good reminder that the language of contractual provisions is not to be devalued by over-reliance on commercial common sense and background; only background knowledge known to all parties will be admissible. One contracting party's wider business purpose is not relevant to whether a term should be implied to give business efficacy to a contract.

Kemutec Powder Technologies Ltd (**KPTL**) owned certain intellectual property rights (**IP**) relating to its businesses, including rights relating to the assembly and sale of certain industrial machines and the use of trade names associated with those machines.

KPTL went into administration and its administrators entered into an asset sale agreement with Process Components Ltd (**PCL**) (the **claimant**) for certain parts of KPTL's business. Ten days later, the administrators entered into a second asset sale agreement with Kason Kek-Gardner Ltd (**KGL**) (the **defendant**) for the remaining parts of the business (including the parts of the business relating to the machines). Each asset sale agreement included the sale of IP used in the "Business", but the agreements were unclear as to exactly what was meant by this.

PCL and KGL entered into a licence agreement whereby PCL licenced the use of IP relating to the machines to KGL. KGL was subsequently acquired by a competitor of PCL and, as part of the due diligence exercise, KGL disclosed a copy of the licence agreement to the competitor. PCL then terminated the licence agreement for breach of its confidentiality provisions. PCL argued that KGL no longer had the right to make use of the IP to which the licence related. KGL argued that it had never needed the licence to use the IP in question because it had acquired it under the terms of its agreement with KPTL's administrators and, alternatively, the licence agreement had not been validly terminated by PCL.

The appeal turned on the following two key issues:

- whether, under the terms of its asset sale agreement, KGL had acquired any (and, if so, what) IP formerly

belonging to KPTL (this question, in part, depended on what IP PCL had acquired under its asset sale agreement); and

- whether PCL had validly terminated the licence agreement.

Extrinsic evidence not relevant to interpretation: related contracts

KGL argued that the two asset sale agreements should be read together so that PCL acquired the IP needed to operate the parts of the business it had bought and KGL acquired the IP needed to operate the parts of the business it had bought. KGL reasoned that, as the administrators had an obligation to realise all KPTL's assets for the best possible price, it must have been obvious that to sell parts of the businesses without the necessary IP to carry on those businesses would seriously depreciate their value. In such circumstances, the reasonable reader of the PCL agreement would not have understood it to transfer to PCL the IP that went beyond that necessary for the parts of the business PCL had bought. PCL's primary position was that the natural reading of its asset sale agreement was that it covered all IP owned by KPTL as existed at the date of that agreement and, alternatively, the PCL agreement should be interpreted as including the IP relating to the machines.

Lewison LJ gave the leading judgment, explaining that the general rule is that the subsequent conduct of the parties to an agreement cannot affect the true interpretation of the agreement, much less the subsequent conduct of those not party to the agreement. As such, the second asset sale agreement (to which PCL was not a party) had no bearing on the interpretation of the first asset sale agreement. Lewison LJ also made reference to the Supreme Court decision of *Arnold v Britton*, stating that admissible background is limited to the facts that were known or reasonably available to both (or all) parties; it is not right to take into account facts known only by one of them.[1]

KGL accepted that there was nothing in the language of the PCL agreement that would lead a reasonable reader to conclude that the IP to which it referred was to be divided by purpose. Instead, KGL's interpretation relied on commercial common sense and background. Lewison LJ emphasised that these factors "should not be used to devalue the importance of the language of the provisions to be interpreted". This led the Court to conclude that PCL had acquired all of the relevant IP under its asset sale agreement.

No implied term in the confidentiality agreement

KGL argued that the confidentiality clause in the licence agreement was subject to an implied term that KGL was permitted to disclose the licence agreement "for reasonable business purposes", which would include disclosure to a prospective purchaser. Lewison LJ outlined the test for implying terms in commercial contracts: the term must be necessary to give the contract business efficacy or it must be so obvious that it goes without saying.[2] He went on to say that "[t]he necessity required by the test is necessity for the business efficacy of *the contract*; not some wider business purpose of a contracting party".

The business purpose of the licence agreement was to enable KGL to operate its parts of the business. A sale of KGL's shares by its shareholders was not a necessary business purpose of the licence. Lewison LJ concluded that the implied term was not necessary to give business efficacy to the licence nor was it so obvious that it went without saying.

The breach was 'material', justifying termination

KGL also argued that the termination provisions in the licence agreement provided that only a *material* breach of the confidentiality clause gave rise to PCL's right to terminate immediately, not any breach.

The Court found that KGL's interpretation required the position of the word "material" in the termination provisions to be shifted so that only a material breach of the confidentiality obligations was a non-remediable breach, whereas the clause actually read that a breach of the confidentiality clause was a non-remediable, material breach. The Court also stated that a material breach of a confidentiality clause was likely to be incapable of remedy; and that, where a contract expressly provides for rights of termination, it is irrelevant whether the events on which those rights are exercisable amount to repudiatory breaches or not. Accordingly, KGL's

breach of the confidentiality clause constituted a non-remediable, material breach and PCL had validly terminated the licence agreement.

COMMENT

This decision serves as an illustration (and perhaps a helpful reminder) of how the courts are applying recent case law on contractual interpretation and the approach being taken to implying terms in detailed commercial contracts. In summary, the language of the contractual provisions is not to be devalued by over-reliance on commercial common sense and background.
Only background knowledge known to all parties will be admissible; and a contracting party's wider business purpose is not relevant to a consideration of whether a term should be implied to give business efficacy to a contract.

Alexandra Pedder
Associate
Litigation – Corporate – London

Contact
Tel +44 20 3088 3380
alexandra.pedder@allenovery.com

[1] *Arnold v Britton* [2015] UKSC 26, [2015] AC 1619.

[2] *Marks and Spencer plc v BNP Paribas Securities Services Trust Co (Jersey) Ltd* [2015] UKSC 72, [2016] AC 742.

MAKING A CLEAN BREAK – ARE YOUR TERMINATION CLAUSES SUFFICIENTLY SLICK?

Monde Petroleum v Westernzagros [2018] EWCA Civ 25, 18 January 2018

It is worth giving careful thought when drafting termination provisions in commercial contracts to help avoid tricky disputes about when, and in what circumstances, agreements can be brought to an end early. The Court of Appeal considered when an exploration and production agreement (**EPSA**) became "fully operational and enforceable" for the purposes of a termination clause in a consultancy agreement and when a termination notice could be served.

Westernzagros engaged Monde under a consultancy agreement to help Westernzagros negotiate an ESPA for oil with Kurdistan. The ESPA was executed and ratified by Kurdistan. The consultancy agreement said that Westernzagros could terminate "on thirty days' notice to [Monde] should the EPSA not become fully operational and enforceable within six months from the date [the EPSA]". Westernzagros served a termination notice. Monde brought proceedings to set aside the termination notice and/or to claim damages for repudiatory breach.

The Court of Appeal ruled as follows:

- **Meaning of "fully operational and enforceable"**: The issue was whether the phrase meant (as Monde contended) that it was sufficient that the ESPA was executed and ratified by Kurdistan; or (as Westernzagros contended) that all the various milestones had to be passed including Iraq signing a letter confirming the EPSA. The phrase had to be interpreted consistently throughout the agreement. The use of the phrase elsewhere implied that the aim of the consultancy agreement was for Monde to help Westernzagros secure a fully enforceable and fully operational ESPA and that anything less than that would not be enough. The judge was right to choose the milestone that made more commercial sense in the context of the situation existing at the time the consultancy agreement was made, namely that the EPSA was not "fully operational and enforceable" until Iraq signed a letter confirming the EPSA.
- **When could the termination notice be served?:** No requirement for immediacy was expressed in the termination provision and there was no reason for it to be implied. Westernzagros had an additional right to terminate the consultancy agreement where it was "manifestly apparent that an operational enforceable [EPSA]…cannot be concluded". To lock

Westernzagros into the consultancy agreement until that time would be highly uncommercial. As the only options before the court were to interpret the relevant clause as requiring Westernzagros to terminate immediately on the six-month anniversary of the consulting agreement and otherwise forfeiting that right, or as giving Westernzagros the right to terminate at a time of its own choosing at any time while there was no "fully operational and enforceable" EPSA, the court "unhesitatingly" chose the latter.

My overview of the first instance decision, which focuses on good faith arguments not considered on appeal, is available here.

This article first appeared on Compact Contract, a blog where experts from Allen & Overy analyse the latest contract law themes and developments, and what they mean for your business.

Samantha Holland
Associate
Litigation – Corporate – London

Contact
Tel +44 20 3088 3479
samantha.holland@allenovery.com

Data protection

MORRISONS VICARIOUSLY LIABLE FOR ROGUE EMPLOYEE'S MISUSE OF PERSONAL DATA

Various Claimants v Wm Morrisons Supermarket PLC [2017] EWHC 3113 (QB), 1 December 2017

A landmark ruling in a group action by employees has found Morrisons Supermarket vicariously liable for a deliberate data breach carried out by a rogue employee, out of working hours and at home on a personal computer. The judgment has significant implications for all data controllers (and in the future, data processors) as Morrisons was vicariously liable even though, overall, it had discharged its own obligations as required under the Data Protection Act 1998 (**DPA**) and common law. This is the first group litigation data breach case to come before the courts, and with the General Data Protection Regulation (**GDPR**) coming into force in May 2018, employers will be concerned that the finding is an indication of what is to come under the new regime.

The case involved a data breach of the nearly 100,000 employees of Morrisons whereby personal information from a payroll database (including names, addresses, bank account details and salaries) appeared on a file sharing website in early 2014. Related criminal proceedings found that Mr Andrew Skelton, then a senior internal IT auditor employed by Morrisons, had misused the payroll data that had come into his possession. His motivations were found to be malicious as he bore a grudge against Morrisons in relation to a previous disciplinary incident not related to this case. Skelton published the data on a file sharing website before posting links elsewhere on the internet. He also sent a CD containing a copy of the data to three newspapers. Skelton was convicted and imprisoned for eight years at a subsequent criminal trial.

5,518 employees brought group litigation against Morrisons claiming that Morrisons had both primary and vicarious liability for the actions of Skelton.

Morrisons had no primary liability

It was the claimants' position that Morrisons had primary liability (for breach of statutory duty, breach of confidence and misuse of private information) to compensate its employees for the unlawful actions of Skelton. However this argument failed, with Langstaff J

finding that Skelton's actions were not conducted on behalf of his employer and that Morrisons was not the true data controller at the time of Skelton's criminal actions (Skelton was).

Had Morrisons taken "appropriate technical and organisational measures" to protect against unauthorised or unlawful processing of personal data (as required under Data Protection Principle 7)? Langstaff J concluded that "Morrisons did not directly misuse any information personal to the data subjects. Nor did they authorise its misuse, nor permit it by any carelessness on their part. If Morrisons are liable it must be vicariously or not at all." Accordingly, Langstaff J rejected all claims of primary liability against Morrisons under the DPA. He also held that there was no primary liability in relation to the tort of misuse of private information, or breach of confidence.

As such the only possible basis of liability was that of vicarious liability.

But Morrisons is vicariously liable

Vicarious liability depended on whether a sufficient connection existed between the actions of Skelton and the "course of [his] employment."[1]

There was a sufficient connection because:

- an unbroken thread linked Skelton's employment to the disclosure as a "seamless and continuous sequence of events";
- Morrisons deliberately entrusted Skelton with the data during the course of his employment; and
- Morrisons tasked Skelton with receiving, storing and disclosing the data therefore, his actions (albeit unlawful) were closely related to the task he was given.

The fact that Skelton unlawfully disclosed the data from a personal computer, at home and outside of working hours was not sufficient to break the chain of events.

Skelton's wrongful acts were found to be sufficiently connected to his employment resulting in Morrisons being vicariously liable for those acts. Skelton's motives were irrelevant.

It is clear that Langstaff J was not entirely comfortable with his conclusion in relation to vicarious liability.

In particular, he was mindful that the court was in effect rendered an accessory to Skelton's criminal aim of damaging the company. The judge gave Morrisons permission to appeal the vicarious liability finding but said that without further persuasion he would not agree a cross appeal on his conclusions as to primary liability.

COMMENT

The result of this case will have caused great concern for employers. The judgment acknowledges that there will always be rogue employees who misuse data entrusted to them to handle in the course of their employment, and whilst Morrisons in this scenario had deployed proportionate control mechanisms to prevent misuse, they were still held to be vicariously liable. Any appeal will be eagerly anticipated.

It should be remembered that this case considered only liability and not quantum so the level of compensation owed to each of the claimants is yet to be determined.

The coming into force of the GDPR in May 2018 should also be borne in mind, as this regime will extend the remit of liability from not only data controllers (as catered for under the DPA) but also to data processors. Employers must be proactive in ensuring they have appropriate data security measures, policies and procedures in place to help combat any claims for primary liability. Clients should also consider implementing stricter employee controls for those dealing with personal data.

With the GDPR increasing the potential for group litigation, coupled with the result in this case, we expect to see more group action claims in the sphere of data breaches. For more information on how to prepare for the GDPR and Allen & Overy's data protection experts please see: allenovery.com/publications/en-gb/data-protection/Pages/default.aspx

Mehreen Siddiqui
Associate
Litigation – IP – London

Contact
Tel +44 20 3088 3617
mehreen.siddiqui@allenovery.com

[1] *Mohamud v Wm Morrisons* [2016] UKSC11.

Employment

RESTRICTIVE COVENANTS, BREXIT, AND THE WAR FOR TALENT – WHY PROTECTING YOUR CONFIDENTIAL INFORMATION HAS NEVER BEEN MORE IMPORTANT

Dyson Technology Ltd v Pellerey [2015] EWHC 3000 (Ch), 23 October 2015

In an age of artificial intelligence and robotics and where electric cars are now a reality, restrictive covenants in employment contracts are essential armour for any employer. Certainly for Dyson Technology Limited (**DTL**), where the engineer involved in developing an electric car resigned to join a competitor, Tesla, these contractual provisions were essential for its protection. A successful application for an injunction by DTL enabled it to safeguard business critical information. This case serves as a reminder that fit for purpose drafting of restrictions is key to protecting the legitimate commercial interests of a business.

Factors affecting enforceability

Of course, not all restrictive covenants will be easily enforced. It is well established in case law, as set out in *TFS Derivatives Ltd v Morgan* [2004] EWHC 3181 (QB) and applied in this case, that when deciding the issue of enforceability, it is important to look at four key elements. These are:

- Interpretation of the contract itself. Is the meaning of the clauses apparent and the scope easily understood?
- The breadth of the restraint. Is it wider than reasonably necessary for the protection of the company's legitimate business interests? It is worth noting here that the fact the contract might contain a separate clause restricting the disclosure of confidential information did not prevent a non-compete clause from being regarded as reasonable.
- Will the proposed actions of the employee infringe the covenants?
- Should the court exercise its discretion to grant an injunction? This required consideration of all the facts. Unfortunately for Mr Pellerey, the court considered that he had "acted unwisely" and breached his contractual duties to DTL when failing to inform them at the time he was asked to work on their electric car project that he had already accepted a conditional job offer from Tesla.

The court was therefore satisfied in this case that the grant of an injunction was appropriate.

Immediate steps prior to enforcement action

Before an employer need get to the stage of enforcement action via the courts, there are practical steps which can assist in protecting its confidential information.
For example, if an employer has suspicions that one of its employees is about to resign to join a competitor, it should consider how reasonably to restrict their internal access to confidential information. This might be done by simply removing the employee from internal email distribution lists or meeting invitations. In doing so, care

should be taken not to alert the employee to the fact they are suspected of wrongdoing.

In such circumstances, an employee's recourse could be a constructive dismissal claim against the employer if the employer materially restricts their ability to perform their role or inadvertently reduces their responsibility. This is a tactic often deployed by employees who are planning to leave and wish to deflect attention from their own actions or misconduct onto allegations against their employers. It is important to avoid arguments that there has been a fundamental breach of the employee's contract because this could render void any restrictive covenants the employer should subsequently wish to rely on.

A more subtle approach might be to review the employer's policies on the right to monitor the employee's activity such as email usage (including sent items to Gmail, Yahoo or iCloud accounts), security passes, downloads, printing, CCTV or photocopying patterns. This more covert action will enable the employer to balance the probative value of the evidence it might uncover against any likely prejudice to the employee.

It is also permissible to seek written assurances from the employee and potentially their new employer about information or company property they may have in their possession. Given most employers are taking a flexible approach to remote and home working, it is legitimate to ask for confirmation from an employee that any information belonging to the employer has been returned and not copied. It may also be appropriate to check the employee's electronic devices to review the data held on them.

Potential consequences for employees

Besides the risk of enforcement action and being kept out of the job market for a period of time, concerns about an employee might also be referred to the Data Protection Information Commissioner (**ICO**). This might occur where, for instance, the employer believes that the employee is misusing or planning to misuse confidential data. The ICO can take action to change the behaviour of both organisations and individuals that collect, use and keep personal information. Such action includes criminal prosecution under s55 of the Data Protection Act 1998 which can attract an unlimited fine. This power to impose a fine on those who misuse personal data, together with the prospect of a criminal record, constitutes a real threat to employees.

In addition, where the employer is a bank, accountancy firm, law firm or other organisation which is regulated by a professional body, the employer may be able to raise the issue of misuse of confidential information with those professional bodies such as the FCA, PRA or SRA. In banking, misuse of confidential information gives rise to concerns about a regulatory employee's fitness and propriety as well as their integrity. This will not only impact their ability to perform their current role but also their regulatory reference to prospective employers.

There are therefore considerable personal and professional risks to some employees if they misuse their employer's information. It is worth drawing out these risks in any exit interviews before the employee leaves.

How employers can manage the risks

With the imminence of Brexit in the next 12 months, the competition amongst employers to attract and retain the most talented of employees will continue to gain momentum. The savviest employers should therefore be auditing their contracts and reviewing their restrictive covenants as well as their systems and controls to ensure they afford the right protection to those in business critical and revenue generating roles. This will be an issue particularly in sectors such as financial services, pharmaceuticals, start-ups, the motoring industry (as highlighted here) and digital specialists.

Rachel Reeves
Counsel
Litigation – Employment – London

Contact
Tel +44 20 3088 2970
rachel.reeves@allenovery.com

Key contacts

If you require advice on any of the matters raised in this document, please call any of our Litigation and Dispute Resolution partners, your usual contact at Allen & Overy, or Karen Birch.

Allen & Overy LLP

One Bishops Square, London E1 6AD, United Kingdom

Tel +44 20 3088 0000

Fax +44 20 3088 0088

allenovery.com