Business Law Briefing

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Information Law

11 King's Bench Walk
Temple London EC4Y 7EQ

t. 020 7632 8500
f. 020 7583 9123

e. clerksroom@11kbw.com
w. www.11kbw.com

DX: 368 LDE
tw: @11KBW

Editors: Julian Wilson
Richard Leiper

Shareholder disputes

Cavendish Square Holdings BV & others v El Makdessi

[2012] EWHC 3582 (Comm)

Application of the restraint of trade doctrine to covenants in a share sale agreement, where the vendor remained a shareholder, and of the penalty doctrine to provisions requiring a defaulting shareholder to forfeit part of the price and to sell back his remaining shares.

Findings

The consideration for the sale of shares included an initial payment on completion, and an interim and final payment, based largely on future profitability. In addition, the vendors had a put option on their remaining shares, which allowed them to sell those shares in the future. However, if the vendor became a defaulting shareholder (including by breaching restrictive covenants), he would lose his right to receive any outstanding consideration and could be required to sell his shares to the purchaser at a price based on net asset value (thereby also losing his put option).

The Defendant admitted that his conduct fell within the definition of defaulting shareholder, but contended that (a) the covenants were in unlawful restraint of trade and (b) the requirements that he sell his shares at the net asset value and/or that he lose his right to outstanding consideration were unenforceable penalties. Burton J rejected these contentions; permission to appeal is being sought.

Commentary

- The case provides a helpful summary of the propositions of law which apply to restraint of trade in business sale cases (¶ 15), reiterating that the Court should be slow to strike down clauses freely negotiated between parties of equal bargaining power.
- The Judge also reviewed the authorities on the scope and application of the penalty doctrine, accepting that the doctrine is not limited to clauses requiring the party in default to pay a sum of money which is not a reasonable pre-estimate of the innocent party's loss. It extends to clauses which, in the event of breach, entitle a party not to make payments which, apart from the breach, would have been payable; ie where the party in breach forfeits that to which he was otherwise entitled.
- In considering whether a clause is penal, there is an increasing concentration on the question whether the clause is commercially justifiable, rather than on the traditional dichotomy of a liquidated damages clause and a penalty.
- However, to say that a clause is a penalty clause –because it requires the payment of money or absolves the innocent party from making payment or requires the party in breach to transfer property – is not an end to the matter. Where a clause requiring payment is a penalty, the innocent party can still sue for the loss he has suffered. All he cannot do is rely on the penalty clause to quantify that loss. He will have to prove his loss and will be able to recover the loss in fact suffered and for which the law provides a remedy. Where the clause provides for money not to be paid, equity allows the court to enforce the clause only to the extent that it is equitable to do so.
- The case demonstrates that a carefully crafted agreement may allow a purchaser of a business to decouple the business from a vendor in the event that the vendor starts acting against the interests of the business.

Richard Leiper acted for the claimants.

Restricted awards

Imam-Sadeque v Bluebay Asset Managements (Services) Ltd

[2012] EWHC 3511 (QB)

Application of the penalty doctrine to restricted awards granted as unvested fund units.

Findings

The Claimant was a senior employee of the Defendant. In July 2011 he formed an intention to leave as a result of which the parties reached a compromise agreement which provided that he should be on garden leave until the end of 2011 and that he would be treated as a "good leaver" if he complied with the terms of the compromise agreement and his employment contract until his employment terminated; if he were a good leaver, he would receive fund units which were due to vest in 2012.

The Court (Popplewell J) found that the Claimant had acted in breach of his employment contract (including the implied duty of fidelity) in the period prior to 2011 (in the steps he had taken to set up and prepare to launch a competitive business).

The Claimant argued that the contractual consequences of his breach, depriving him of the substantial value of the 2012 fund units, was penal.

Commentary

- The judge offered a thorough review of the authorities on the penalty doctrine (at ¶ 187-202).
- He found, however, that the doctrine could be of no application in the present case, since the contractual provisions in issue did not deprive the Claimant of his interest in the 2012 fund units: throughout 2011 the fund units were unvested; by reason of his conduct, the Claimant never acquired any rights to them. The penalty doctrine does not apply to contingent future interests.
- In addition, it was not the terms of the compromise agreement which caused the loss of the unvested fund units: this happened because of the original terms on which the units were granted which provided that he could not be a good leaver if he resigned. His breach of the compromise agreement meant that he was left only with those original terms and lost the enhanced opportunity to be a good leaver which had been offered under the compromise agreement.
- In any event, even had the doctrine applied, the provisions were not penal. It was material that the compromise agreement had been freely negotiated by sophisticated parties of comparable bargaining power (¶ 225). It contained a bundle of benefits and burdens, the value of which for each party could not easily be expressed in monetary terms. It could not be said that the value of the rights forfeited exceeded the greatest loss which could conceivably be suffered from the breach. The losses suffered as a result of the Claimant's conduct might be impossible to establish and in any event, such a damages claim would likely be difficult and expensive to seek to prove and involve further uncompensatable loss by having to have management time and resources devoted to it.
- Furthermore, the bonus plans were themselves in accordance with industry practice and regulatory requirements, involving commercial objectives it was relevant to take into account.

Daniel Oudkerk QC and Amy Rogers acted for the Claimant.

Freezing injunctions

AH Baldwin & Sons Ltd v Al Thani

[2012] EWHC 3156 (QB)

General guidance given on the matters relevant to the grant of an interim freezing injunction in support of proceedings in another jurisdiction

Findings

The High Court (Haddon-Cave J) granted a worldwide asset-freezing injunction in the sum of US$15 million against the Defendant, a member of the Qatari royal family, who had unsatisfied debts to the Claimant auctioneers of around US$25 million. The injunction was granted pursuant to section 25 of the Civil Jurisdiction and Judgments Act 1982 in support of breach of contract proceedings issued in the courts of Washington DC.

The basis of the Claimant's application for a freezing injunction was principally that the Defendant appeared to be engaged in the compulsive purchase of extremely valuable ancient coins in circumstances where he knew that he did not intend to, or was not in a position to be able to, pay for them. He had not denied liability in the Washington DC proceedings, and indeed appeared to have no defence to them. There was evidence before the Court that (amongst other debts) he also owed in excess of US$40 million to Sotheby's and £4.3 million to Bonhams.

Haddon Cave J was satisfied that all of the elements required for the grant of a freezing injunction (or 'Mareva injunction' as the judge continued to call it) were present. The Claimants had a good arguable case in the debt claim and had presented more than sufficient material to conclude that there was a real risk of dissipation of assets. Moreover, the Defendant had strong ties with and substantial assets in England meaning that it was plainly expedient to grant the relief sought under section 25 CJJA 1982.

Commentary

- Haddon-Cave J's summary of matters relevant to the Court's exercise of its discretion to grant freezing injunctions, which is gleaned from eight other authorities and the leading textbook on commercial injunctions, is clear, helpful and concise (see ¶ 30-31).
- The same is true of the summary of matters relevant to the question of expediency under section 25(2) CJJA 1982 (see ¶ 53-57).
- The injunction was granted in the context of a simple (albeit valuable) debt claim in which there were no direct allegations of dishonesty. The judge considered some of the Defendant's recent conduct to have been "*discreditable, dishonourable and disturbing*" but not dishonest. He also noted that his behaviour was "*redolent of someone with a complete disregard for his contractual obligations*". These dicta are clearly capable of application in many factual situations in which this type of relief might be sought.
- The judgment is an example of the Court being willing to look through prima facie evidence of considerable assets based in the jurisdiction to what, after investigation, could be a void on the other side.

11KBW Business Law members regularly act in support of – and resisting – applications for interim relief for business protection.

Shareholder disputes

Royal Westminster Investments SA v Varma

[2012] EWHC 3439 (Ch)

Consideration of the grant of interim relief in support of proceedings in another jurisdiction; and of the circumstances in which a shareholder may bring proceedings against a director.

Findings

The underlying proceedings had been issued in the BVI. The Defendant was the sole shareholder and director of Nilon Ltd. The Claimants alleged that Nilon had been formed for the purposes of a joint venture between it and the Defendant but that in breach of agreement the Claimants had not been issued with any shares. They therefore claimed in the BVI specific performance of the alleged agreement to issue shares.

The Claimants sought interim relief in this jurisdiction (where the Defendant lived) alleging that the Defendant had been wrongfully causing Nilon to incur substantial expenditure on the BVI proceedings. They sought an injunction under s 25 of the Civil Jurisdiction and Judgments Act 1982 (which empowers the Court to grant interim relief where proceedings have been brought in another jurisdiction) to restrain any further, substantial expenditure, and further ancillary relief.

The application for these injunctions was refused by Newey J. In order to consider the application, it was necessary to consider whether relief would have been granted had the underlying proceedings been brought in this jurisdiction.

There is a general principle that a company's money should not be expended on disputes between shareholders. However, a shareholder suing exclusively on his own behalf does not have standing to apply for interim relief against a director. If it is alleged that the director has not complied with his duties to the company, then such a claim must be brought by or on behalf of the company, not by an individual shareholder. Thus, the relief sought was not made in aid of any claim for substantive relief and would not be granted.

In any event, there were other grounds for refusing relief, including that damages would be an adequate remedy given the evidence that the Defendant was a man of substantial means.

Commentary

- The power to grant interim relief conferred by s 25 is exercisable in relation to proceedings anywhere in the world (¶ 18).
- In exercising the s 25 jurisdiction a two-stage test is applied, the first of which is to consider whether the relief sought would be granted in this jurisdiction if the underlying proceedings had been brought here; secondly, whether the fact that the proceedings have not been brought here makes it inexpedient to grant the relief sought (in particular because it will interfere in the management of the case in the primary court).
- The Judge considered the authorities where interim relief has been granted in order to prevent a company's money being expended on disputes between shareholders. The general principle is not confined to unfair prejudice petitions.
- The Claimants' lack of standing to bring proceedings against the Defendant was determinative.

11KBW Business Law members act in unfair prejudice petitions and other shareholder disputes; they are experienced in a wide variety of cross-jurisdictional claims.