

Financial institutions  
Energy  
Infrastructure, mining and commodities  
Transport  
Technology and innovation  
Life sciences and healthcare

 **NORTON ROSE FULBRIGHT**

# Corporate and commercial disputes review

Issue 03 / April 2016

**In this issue:**

**Penalty clauses**

**Contractual interpretation and  
implied terms – a return to  
orthodoxy?**

**Navigating privilege in global  
investigations – English and US  
law perspectives**

**The continuing importance of the  
'proper purpose rule' in English  
company law**

**Is what's mine really yours?  
Responding to requests for personal  
data under the Data Protection Act 1998**

**Restoring companies to the register:  
guidance on the 'limitation direction'**  
18

**Partnership and LLP disputes**

**Surreptitious dealing**

**Corporate criminal liability  
in Germany**

**Predictive coding in the disclosure  
process**

## Contents

Penalty clauses	03
Contractual interpretation and implied terms – a return to orthodoxy?	06
Navigating privilege in global investigations – English and US law perspectives	08
The continuing importance of the ‘proper purpose rule’ in English company law	13
Is what’s mine really yours? Responding to requests for personal data under the Data Protection Act 1998	15
Restoring companies to the register: guidance on the ‘limitation direction’	18
Partnership and LLP disputes	21
Surreptitious dealing	24
Corporate criminal liability in Germany	26
Predictive coding in the disclosure process	28

## From the editor

Welcome to the latest edition of *Corporate and commercial disputes review* in which we examine key developments that are likely to affect our corporate clients.

Contractual disputes and important decisions of the Supreme Court feature heavily in this edition. We examine the Supreme Court’s landmark decision on penalties as well as two other Supreme Court decisions dealing with contractual interpretation. We also analyse the Supreme Court’s decision on the rule that directors must only exercise powers for the purposes for which they were conferred.

Moving away from the Supreme Court, we look at a decision of the High Court as to whether the doctrine of repudiatory breach applies to LLP agreements, and review the Court of Appeal decision in a case addressing the effect of surreptitious dealing by a contractual counterparty.

In other areas affecting companies, we look at the arguments surrounding the possibility of a corporate criminal code in Germany; consider the limitation issues surrounding the restoration of a company to the register; analyse issues concerning data subject access requests and their use as a litigation weapon; and note an important decision on the use of predictive coding in the context of electronic disclosure.

Finally, we navigate questions of privilege in global investigations.

Please feel free to contact me with any questions or comments.



**Antony Corsi**  
**Partner, London**  
Tel +44 20 7444 5863  
[antony.corsi@nortonrosefulbright.com](mailto:antony.corsi@nortonrosefulbright.com)

# Genuine pre-estimate and legitimate interests

## The Supreme Court's judgment on penalty clauses and what it means for you

On a foggy London morning in November, the UK Supreme Court handed down its highly anticipated judgment on a no less foggy area of the law: penalty clauses. Heard in tandem, the appeals of *Cavendish Square Holdings B.V. v El Makdessi and ParkingEye Ltd v Beavis* [2015] UKSC 67, gave the UK's highest court its first opportunity to consider the penalty doctrine in over a century.

Despite concluding that 'the penalty rule in England is an ancient, haphazardly constructed edifice which has not weathered well', the Court unanimously refused invitations to abolish or extend the doctrine, instead choosing to recast the test for whether a contractual provision would be considered penal.

This article analyses the key changes to the penalty doctrine flowing from the Supreme Court's judgment, and assesses the potential implications for commercial parties.

### Summary

The Supreme Court has abolished the dichotomy between a genuine pre-estimate of loss and a penalty or deterrent, and re-cast the test:

'The true test is whether the impugned provision is a secondary obligation which imposes a detriment on the contract-breaker out of all proportion to

any legitimate interest of the innocent party in the enforcement of the primary obligation.'

There are two important outcomes for commercial parties. First, it will now be more difficult to argue successfully that a clause is a penalty. Second, the commercial interests of the parties, rather than merely the financial implications of a breach, will become a focus of any enquiry as to whether a clause is a penalty.

### Facts

From a share purchase agreement to a parking fine, the facts of the two appeals before the Supreme Court could not have been more different.

#### *Cavendish Square Holdings B.V. v El Makdessi*

Mr Makdessi sold part of his shareholding in a company to Cavendish. The terms of the share purchase agreement provided that

further consideration would be paid to Mr Makdessi at various stages after completion, provided that he did not breach certain restrictive covenants. Mr Makdessi breached the restrictive covenants and, when Cavendish withheld the further consideration, Mr Makdessi argued that the relevant terms were unenforceable penalties.

#### *ParkingEye Ltd v Beavis*

In *ParkingEye*, Mr Beavis parked in a private car park which allowed two hours of free parking but charged a £85 fine if motorists overstayed this period. Mr Beavis overstayed by almost an hour and the managers of the car park, ParkingEye, issued the £85 fine. Mr Beavis did not pay and, when sued by ParkingEye, argued that the £85 fine was an unenforceable penalty or, in the alternative, not binding by virtue of the Unfair Terms in Consumer Contracts Regulations 1999.

### What is the change?

Prior to the Supreme Court's judgment, the case law had generally led to the position that if a clause was not a genuine pre-estimate of loss, it must be a penalty.

This dichotomy arose, in the opinion of the Court, as a result of an 'over-literal reading of Lord Dunedin's four tests'<sup>1</sup> in the (previously) leading case

<sup>1</sup> At paragraph 31.

of *Dunlop Pneumatic*<sup>2</sup>. In an attempt to reformulate the case law before him, Lord Dunedin had suggested the following often quoted factors:

- A provision is penal if the sum stipulated for is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach.
- A provision is penal if the breach consisted only in the non-payment of money and the provision provided for the payment of a larger sum.
- There is a presumption (but no more) that a provision is penal if the same sum is payable in a number of events of varying gravity.
- A provision is not penal by reason only of the impossibility of precisely pre-estimating the true loss.

English courts (including the Court of Appeal in both *El Makdessi* and *ParkingEye*) had more recently taken steps to mitigate the harshness of the dichotomy by taking into account other considerations such as whether a clause, if not a genuine pre-estimate of loss, is nevertheless ‘commercially justified’. The Supreme Court, however, decided to completely abolish the dichotomy, emphasising that a damages clause may be neither a genuine pre-estimate nor a penalty, or it could be both.

The Supreme Court also commented on the related concept that a clause which has some deterrent effect is inherently penal, deciding that there is, in effect, no difference between clauses which deter and clauses which induce. Both are designed to influence the conduct of the counterparty.

The Supreme Court’s re-cast test is: ‘The true test is whether the impugned provision is a *secondary obligation* which imposes a *detriment* on the contract-breaker *out of all proportion to any legitimate interest of the innocent party* in the enforcement of the primary obligation. The innocent party can have no proper interest in simply punishing the defaulter. His interest is in performance or in some appropriate alternative to performance. [Emphasis added].’<sup>3</sup>

Applying the new test to the cases before them, the Supreme Court held (Lord Toulson dissenting in respect of *ParkingEye*) that the provisions in question in both *El Makdessi* and *ParkingEye* were not penal (thereby overturning the Court of Appeal’s judgment in *El Makdessi*). This was because *Cavendish* and *ParkingEye* both had ‘legitimate interests’ in enforcing the primary obligations, with which the detriment imposed by the clauses was proportionate. In *ParkingEye* the Court accepted that there was a legitimate interest in keeping the car park available for shoppers and, separately, in *ParkingEye*’s ability to make a profit from the fines. In *El Makdessi*, the legitimate interest was the party’s commercial interests, which in this case were difficult to value.

### What is still unclear?

Two issues come out of this decision which may impact the way commercial parties approach drafting contracts.

First, a determination of what constitutes a ‘legitimate commercial interest’, and whether a contractual provision is proportionate to that interest, can only be determined on a case by case basis. This concept of proportionality tied to the innocent

party’s legitimate interest is the real paradigm shift in the law. Courts must now consider what, if any, legitimate business interest is served and protected by a given clause, and then consider whether the clause is proportionate to such interest.

Second, the Supreme Court confirmed the principle that only secondary obligations (i.e. obligations that are triggered on breach of primary obligations) are capable of being penalties. However, the Supreme Court did not deal in detail with the categorisation of certain clauses as primary or secondary obligations and was split on whether the obligation to sell shares was a primary or secondary obligation (clearly demonstrating the possibility of uncertainty). Whilst careful drafting could be used to transform a secondary into a primary obligation, there will always be a risk that a Court will construe such a clause as a secondary obligation, and therefore a potential penalty.

### What does this mean for commercial parties?

The new test sets a higher threshold, which will make it harder for commercial parties to raise penalty arguments successfully, particularly in circumstances where the terms of a contract were negotiated between sophisticated commercial parties of roughly equal bargaining power, who have been legally advised.

There is a wide spectrum of types of clauses that potentially fall within the penalty rule which need to be considered. On the simpler end of the spectrum are straightforward liquidated damages clauses requiring payment of a sum, and on the more complex end sit, for example, restrictive covenants in sale agreements, take

---

<sup>2</sup> *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd* [1914] A.C. 79.

<sup>3</sup> Per Lord Neuberger and Lord Sumption at paragraph 32.

or pay provisions in long-term supply agreements and deposit and pre-payment forfeiture clauses.

When dealing with simple liquidated damages clauses, the innocent party's legitimate interest will rarely extend beyond compensation for the breach, and therefore (as recognised by the Supreme Court) the Dunlop principles (as outlined above) are still 'good law' as to whether a clause is penal.

However, for the more complex provisions and non-straightforward liquidated damages clauses, Courts (and therefore parties) may now take into account ancillary commercial factors (such as reputational damage and loss of goodwill, back-to-back contractual obligations, and possibly even incentive payments) in determining the scope of the innocent party's legitimate interest in performance of the primary obligation.

Interestingly, the Supreme Court specifically considered the application of the penalty rule to forfeiture clauses, and determined that in some circumstances a forfeiture clause could also be a penalty. However, it did not provide a conclusive or detailed reasoning for this, and instead stated that the application of the penalty rule to deposits and clauses forfeiting pre-payments will have to await future decisions.<sup>4</sup>

Whilst this judgment is significant (and many articles have and will be written discussing it), in practical terms it is likely to have a limited impact on how secondary obligation clauses in contracts governed by English law will be drafted.

However, parties negotiating contracts will still want to consider whether

a particular clause is potentially a penalty, and in some instances may even consider stepping away from using a liquidated damages clause altogether, and instead rely on a right to claim damages at large (subject to that party's bargaining power).

### What to think about?

Whether a party has a legitimate commercial interest (which the clause in question protects) will be measured at the time the contract is entered into (or subsequently amended). It is therefore necessary to consider that point in time if you are reviewing the provisions of any agreements already in place.

However, it is open to commercial parties negotiating contracts to take a number of steps in light of this decision. If relevant, it may be important to ensure that:

- If a clause is to be effective as a primary obligation, that this is drafted carefully. However, it is worth bearing in mind that drafting alone will not prevent a Court from determining that a clause is a penalty – such a clause must be a primary obligation as a matter of substance, and whether the clause is proportionate to an actual legitimate interest will be a question of fact.
- The negotiation of clauses which potentially engage the penalty rule (being those that impose a secondary obligation on a defaulting party upon breach of a primary obligation) are recorded.
- The commercial justification for the inclusion of such secondary obligations should be recorded and communicated to contractual counterparties.

- Again, whilst not determinative, it may be useful to record the parties' agreement as to the innocent party's legitimate interests and that a given clause is proportionate to such interests. This could be achieved in the contract itself as part of the preamble or recital, or in a side letter confirming the other party's acceptance of the legitimate and proportionate nature of the interest.

### For more information contact:



**Katie McDougall**  
Senior associate, London  
Tel +44 20 7444 3344  
kate.mcdougall@nortonrosefulbright.com



**Philip Schock**  
Associate, London  
Tel +44 20 7444 5443  
philip.schock@nortonrosefulbright.com



**Sam Cash**  
Associate, London  
Tel +44 20 7444 2760  
sam.cash@nortonrosefulbright.com

<sup>4</sup> Per Lord Mance at paras 160 and 170.

# Contractual interpretation and implied terms – a return to orthodoxy?

In two decisions delivered during the past year, the Supreme Court has adopted a more literal approach to contractual interpretation and implied terms, moving away from a more interventionist approach.

The general principles for contractual interpretation are relatively well established as a matter of English law. As Lord Hoffman set out in *Chartbrook Ltd v Persimmon Homes* [2009] AC 1101, ‘... the question is what a reasonable person having all the background knowledge which would have been available to the parties would have understood them to be using the language in the contract to mean’.

However, the application of such principles can, in practice, be more difficult. Problems can often arise in cases of perceived ambiguity, where a contract fails to deal with a particular matter or where the result appears uncommercial or unfair.

In such circumstances, to what extent can parties appeal to notions of fairness or commercial common sense and how great must the error or ambiguity be before the court will step in? Insofar as there has been any suggestion of a creeping increase in the importance being placed on commercial common sense and the surrounding circumstances, any such trend, whether perceived or real, appears to have been halted by two Supreme Court decisions delivered over the past year.

The more ‘commercial’ approach to contractual interpretation reached its high water mark in the case of *Re Sigma Finance* [2009] UKSC 2, in which the Supreme Court was concerned with construction of a clause determining the distribution of assets in a security trust deed. The majority considered that the Court of Appeal had attached too much weight to what was perceived to be the natural meaning of the words and too little weight to the context in which that sentence appeared and the scheme of the deed as a whole.

## *Arnold v Britton*

*Arnold v Britton* [2015] UKSC 36 concerned service charge provisions in residential leases. The lessees typically covenanted to pay ‘a proportionate part’ of the cost of providing the services, expressed to be £90 in the first year, rising by 10 per cent per year thereafter.

The issue for the court was essentially whether this meant: (i) a fixed service charge of £90 with a yearly increase of 10 per cent; or (ii) a fair proportion of the cost of providing the services, up to a maximum of £90 in the first year,

that maximum figure rising by 10 per cent each year thereafter. If the former, it would mean that by 2072, the lessees would be paying over £550,000 per year in service charge.

The majority of the Supreme Court preferred the former, more literal construction. According to Lord Neuberger, ‘The reliance placed in some cases on commercial common sense and surrounding circumstances ... should not be invoked to undervalue the importance of the language of the provision which is to be construed.’

The Court accepted that the less clear the words, the more ready the court will be to depart from their natural meaning. However, that did not mean that the court should look for drafting errors to facilitate a departure from the natural meaning.

Further, it was stressed that commercial common sense should not be invoked retrospectively, just because, for example, the contractual arrangement had worked out badly for one of the parties. In this regard it should be noted that at the time the leases were drafted, an inflation rate of 10 per cent was not out of the ordinary and therefore the leases could not be said to have lacked commercial purpose at the time they were entered into. In any event, as Lord Neuberger noted, the purpose of contractual interpretation is to ascertain what the parties agreed and not what the court thought they should

have agreed. It was not the court's role when interpreting an agreement to relieve a party from the consequences of his imprudence or poor advice.

This does not of course change the position where there is actual ambiguity and in this regard, decisions such as *Rainy Sky v Kookmin Bank* [2011] UKSC 50 remain good law. Accordingly, where there are two possible constructions, the court was entitled to prefer the construction which was consistent with business common sense and to reject the other. The qualification that *Arnold v Britton* provides is that the court should not go looking for ambiguity.

### **Marks & Spencer v BNP Paribas**

A similar approach was adopted by the Supreme Court in the more recent case of *Marks & Spencer v BNP Paribas* [2015] UKSC 72, a case which concerned the issue of implied terms.

The Supreme Court acknowledged that construing words the parties have used and implying terms into a contract are different processes and are governed by different rules. However, the two are closely connected in the sense that it is only after the express terms of a contract have been construed that the question of whether additional terms should be implied can be considered.

On the facts of the case, M&S, the tenant of commercial premises under four commercial leases, exercised a break clause. The leases provided for the payment of advance rent and M&S's most recent payment comprised periods both before and after the break date. M&S sought to recover the proportion of advance rent for the period after the break date. There was no express term of the lease that allowed for an apportionment of

advance rent in such circumstances. Instead, M&S argued that a term should be implied whereby the proportion of rent paid in advance of the break date that related to the period after the break date should be refunded. The Supreme Court confirmed that rent payable in advance is not apportioned unless the lease provides so expressly and that it was not 'necessary' to imply a term for repayment to make the leases work.

Of wider importance, the court clarified the principles that apply to implied terms. The following principles were reiterated:

- A term should not be implied into a detailed commercial contract merely because it appears fair.
- It must be necessary either to give business efficacy to the contract or because otherwise the contract would lack commercial or practical coherence.
- It must be so obvious that it 'goes without saying'. Lord Neuberger noted that while obviousness and necessity are alternatives, it will be a very rare case where only one of the two requirements are satisfied.
- It must be capable of clear expression.
- It must not be contradicted by any express term of the contract.

In *Belize Telecom*, an earlier decision of the Privy Council, Lord Hoffman had stated that '[t]here is only one question: is that what the instrument, read as a whole against the relevant background, would reasonably be understood to mean.' Insofar as it had been suggested that this gave courts greater scope for implying terms or in any way watered down the necessity requirement, such suggestion was rejected by the Supreme Court.

This decision, when taken together *Arnold v Britton*, suggests a stricter and more literal approach to construing the scope of contracts.

### **Comment**

A more literal approach to contractual interpretation should in principle be well received by corporates, as it should lead to greater certainty in how contracts will be construed. However, the corollary is that the courts are less likely to come to a party's rescue where things have gone wrong and a party is appealing for what it considers to be common sense to prevail.

Nevertheless, the extent of a change in approach following these two decisions should not be overstated and there is no reason why there cannot continue to be a balance between achieving commercial certainty and the ability of the court to intervene where something has clearly and obviously gone wrong.

### **For more information contact:**



**Andrew Sheftel**  
Senior knowledge lawyer, London  
Tel +44 20 7444 5682  
andrew.sheftel@nortonrosefulbright.com

# Navigating privilege in global investigations – English and US law perspectives

Privilege is a fundamental right and powerful tool under both English and US law, granting individuals and corporate entities the right to resist disclosure of confidential and potentially sensitive material to third parties, including regulators and prosecutors. Privilege protection is not, however, available for every communication, even when the communications involve lawyers, and inappropriate claims of privilege are viewed unfavourably in both England and Wales and the US. For example, in recent months there have been a number of pronouncements from both the Serious Fraud Office and the Financial Conduct Authority denouncing improper claims to privilege and making clear that individuals and entities making erroneous claims may not receive cooperation credit.

That being the case, it is important that individuals and entities understand the scope of privilege, especially in the context of investigations. There is no such thing as ‘investigation privilege’ in either England or the United States, and it cannot be assumed that all communications and documents prepared during the course of an investigation will benefit from privilege protection. In global investigations, there is the added complexity that material that is granted privilege protection in one jurisdiction may not be granted privilege protection in another.

This article will consider, from both an English and US law perspective: (i) when investigation material may be privileged and when it may not be; (ii) whether privileged material can be circulated and, if so, how; (iii) whether or not directors (or other employees) can object to a company’s privileged material being disclosed to regulators and/or prosecutors; and (iv) the extent to which privilege recognised in one jurisdiction will be respected in another.

## When is investigation material privileged?

When an issue or investigation first arises, companies respond in a number of ways. Some will choose to address the matter internally, usually through the in-house legal and/or compliance teams or through a dedicated investigations function. Others will appoint external advisers to assist, for example by instructing accountants or lawyers to carry out forensic reviews or to conduct the investigation or discrete aspects of the investigation such as interviews. The extent to which materials prepared during the course of an investigation will be privileged will depend on the privilege rules that apply, as well as the conflict of law rules on privilege of the jurisdiction examining the question.

There are two main types of privilege under English and US law that serve to protect communications arising in the context of investigations. Broadly, these privileges protect communications between lawyer and client (legal advice privilege/attorney-client privilege) and documents prepared for litigation (litigation privilege/work product protection). There are strict rules for when each of these types of privilege apply. There are also some important differences between the English and US approaches that corporates should take into account when conducting an investigation involving both jurisdictions.



‘... a man must be able to consult his lawyer in confidence, since otherwise he might hold back half the truth. The client must be sure that what he tells his lawyer in confidence will never be revealed without his consent. Legal professional privilege is thus much more than an ordinary rule of evidence ... It is a fundamental condition on which the administration of justice as a whole rests ...’ (*R v Derby Magistrates, ex p B* [1996] 1 AC 487).

### Legal advice privilege/ attorney-client privilege

Legal advice privilege under English law protects written or oral confidential communications between a lawyer and a client for the purpose of giving or receiving legal advice, as well as documents which reflect such a communication.

Similarly, the attorney-client privilege under US law generally protects communications between in-house or external counsel and their clients that are intended to be confidential and made for the purpose of seeking or obtaining legal assistance or advice.

#### Requirement for a lawyer?

Under English law, there must be a ‘lawyer’ on the communication for legal advice privilege to apply. While this is defined widely to include solicitors, barristers, and foreign lawyers admitted to practice in their home jurisdiction, ‘lawyer’ does not extend to other professionals, such as accountants, even where they are purporting to provide legal advice, or to a non-legally-qualified compliance officer or investigations function – whether internal or external. Although English law does not draw any

distinction between in-house lawyers and lawyers in private practice, the European Court of Justice has held that communications between a company and its in-house lawyers in the context of EU competition investigations are not protected by legal advice privilege on the basis that, unlike external lawyers, in-house lawyers are not deemed sufficiently independent.

The definition of lawyer for the purposes of attorney-client privilege under US law is also defined widely. In contrast to the English law position, attorney-client privilege can also protect communications with non-legal advisers if the purpose of the communication is to facilitate the rendering of legal service by the attorney. For example, communications and materials created during an investigation have been found to be privileged even if they are the result of interviews by non-attorneys so long as the non-attorneys are serving as ‘agents’ of the attorneys in the investigation.

#### Who is the client?

Under English law, only communications between a lawyer and a ‘client’ will be protected by legal advice privilege, and the frequently-posed question of ‘who is the client?’ for these purposes continues to cause unease. Not all communications that the lawyer has with employees at the corporate client will be privileged. Instead, ‘client’ is narrowly construed under English law to refer only to those individuals who, as a matter of fact, are authorised to give instructions to and receive advice from the lawyer in relation to the issue at hand. Who is the ‘client’ should be kept under review given that the individuals at the corporate client dealing with the lawyers will change over time.

In the United States, an employee is usually considered part of the corporate client group as long as four conditions are met: (1) the communication is authorised by company superiors; (2) the employee was aware that the communication related to legal advice; (3) the communication concerns information that cannot be obtained from more senior employees; and (4) the communication relates to the employee’s duties.

Communications between lawyers and employees who are not part of the corporate client group may be privileged under English and US law where litigation privilege or the work product doctrine applies – i.e. where the communication or document was prepared in anticipation of actual or contemplated litigation (see below).

#### What is a communication?

For legal advice privilege to apply under English law, there must be a communication between a lawyer and a client, or a document that reflects such a communication. This means that any preparatory material of the client that is not communicated to the lawyer may not be privileged under legal advice privilege principles.

By contrast, a lawyer’s preparatory material is privileged; the general rule is that if a lawyer commits to paper, during the course of his retainer, matters that he knows only as a consequence of the professional relationship with his client, those papers will be privileged even if they are not sent to the client.

Similar to English law, US law requires a communication to trigger the attorney-client privilege. The communication can be written or oral and can be to or from a lawyer. While US law protects the communication as long as it is for the purpose of

seeking or obtaining legal advice, underlying facts that form part of the communication are generally not protected by the privilege unless they are themselves privileged. Likewise, documents transmitted to a lawyer are not shielded by privilege solely because they were communicated to a lawyer.

### What is legal advice?

Legal advice privilege under English law arises in the context of giving or receiving legal advice. This is construed widely to cover advice given in a 'relevant legal context', including presentational advice on how to present a case to an inquiry, but may not cover situations where the lawyer is acting as general business adviser and advising on, for example, investment or finance policy or other business matters.

In the recent English case of *Property Alliance Group Limited and The Royal Bank of Scotland plc* [2015] EWHC 3187 (Ch), the High Court upheld a claim to privilege by RBS in respect of certain factual updates and minutes prepared by Clifford Chance in the context of LIBOR investigations by regulators in various jurisdictions, given that they were part of the 'continuum' of communications between lawyer and client in a 'relevant legal context' – which in this case was to provide 'advice and assistance' in relation to the serious and complex matter of how to deal with and coordinate communications and responses to various regulators whose investigations had potentially serious consequences in terms of penalties and private action.

In the US case *In re Kellogg Brown & Root*, 756 F.3d 754 (D.C. Cir. 2014), the D.C. Circuit Court held that communications and materials created during a company's confidential internal investigation are protected

by the attorney-client privilege when 'one of the significant purposes' of the investigation is to obtain legal advice.

---

**The purpose of the attorney-client privilege is 'to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice.'** (*Upjohn Co. v United States*, 449 US 383, 389 (1981)).

### Litigation privilege/work product doctrine

#### The English law position

Where a lawyer is not involved, legal advice privilege will not apply. Communications with or material produced by external or internal non-legal functions in the course of an investigation will only be privileged as a matter of English law where litigation privilege applies.

Under English law, litigation privilege protects confidential written or oral communications between client or lawyer (on the one hand) and third parties (on the other), or other documents created by or on behalf of the client or his lawyer, which come into existence once litigation is in contemplation or has commenced and the dominant purpose of the communication or document is for use in the litigation.

Litigation privilege is therefore wider than legal advice privilege and can protect communications with and documents prepared by accountants and non-legal investigations functions during the course of an investigation. While investigations can constitute 'litigation' for litigation privilege

purposes, exactly when litigation can be treated to be in contemplation in the context of an investigation is always a matter of judgment.

The starting position is that the situation must be adversarial. Whether or not investigations and inquiries are sufficiently adversarial to constitute 'litigation' for litigation privilege purposes will depend on the nature of the investigation or inquiry and how it is carried out. Litigation will not include processes which are purely administrative or fact-finding. Litigation privilege may, however, be available where the purpose of the internal investigation is to defend claims which are genuinely anticipated.

In practice, the nature of some inquiries and investigations may change over time from being fact-finding to adversarial, allowing litigation privilege to apply to the later stages, if not the earlier stages. The initial or informal stages of a regulatory investigation, where the relevant agency is using its evidence-gathering powers as part of an investigation of the facts giving rise to the concern, may well not be sufficiently adversarial even where regulators have set out suspected breaches and/or offences.

Exactly when an investigation becomes adversarial enough to constitute litigation will vary from case to case. In the course of regulatory proceedings, the point at which the regulator formally states its case against the company in question is likely to signal that litigation is in contemplation.

Even once litigation can be said to be in contemplation, or litigation has commenced, to qualify for protection as privileged material the dominant purpose of the communications must be for use in the actual or contemplated litigation.

### The US law position

Where communications with non-lawyers are not protected by attorney-client privilege, they may be protected by the work product doctrine. In many US jurisdictions the work product doctrine functions in a similar manner as litigation privilege under English law—typically protecting documents prepared by the attorney, client or any third party so long as they were prepared in anticipation of litigation or for trial.

Actual litigation is not necessary but there needs to be a threat of litigation. In some jurisdictions, a threat of litigation is present when litigation is imminent. In others, there need only be a credible probability that litigation will ensue. In the context of government investigations, courts generally find that litigation is imminent or that there is a credible probability that litigation will ensue once the investigation has begun.

Even when there is a threat of litigation, the document must generally have been prepared because of the anticipated litigation to warrant protection.

### Can privileged material be circulated and, if so, how?

#### The English law position

There are circumstances where it may be necessary for legal advice to be circulated outside of the ‘client’ group, whether to the board of directors who may not constitute the ‘client’ for legal advice privilege purposes, or externally – perhaps to other professional advisers such as accountants. This is possible under English law, but must be done carefully.

A fundamental component of privilege is confidentiality, and therefore the key is to maintain confidentiality in the

privileged material: if the privileged material is circulated too widely, there is a risk that confidentiality – which is a pre-requisite to privilege – will be lost.

It is not just a matter of not communicating privileged advice in a public area, or of not posting privileged material online. Confidentiality, and therefore privilege, may be lost by circulating legal advice to a wide group of people beyond the ‘client’ group. Care must therefore be taken to ensure that the privileged document is not circulated to more people than necessary.

It is also important to make clear when circulating privileged material that the document is marked as confidential and privileged, and that it should be treated as confidential and not be circulated any further. Unless the sender is an in-house lawyer giving legal advice, so far as possible the sender should refrain from providing any written commentary on the advice, as that commentary may not itself be privileged.

The same risks arise when circulating legal advice to third parties outside the corporate client, including to regulators and prosecutors. In addition to the above safeguards, it will be prudent to specify the limited purpose for which the advice is being disclosed and to make clear that no waiver of privilege is intended as against the wider world. Confidentiality agreements may also be appropriate.

As a general matter, it is prudent to avoid, as far as possible, the transmission of particularly sensitive information by email as it is more difficult to control the limits of distribution. IT safeguards should be put in place to ensure that risks are minimised.

### The US law position

As a general rule, circulation or disclosure of privileged material under US law – especially documents covered by attorney-client privilege – is more likely to lead to a waiver of privilege than under English law. The waiver can occur through disclosure to government regulators, parties to legal proceedings, or a company’s outside auditors. Privilege can also be waived by broad dissemination within a company. The law varies among US jurisdictions in relation to circulation of privileged material and should be reviewed carefully prior to disclosure. The sharing of information with experts, including accountants, retained for the specific purpose of assisting in-house or external counsel in an investigation may be protected by the attorney-client and work product privileges.

### Cross-border considerations

The privilege rules that apply to communications within global businesses will depend on the country in which proceedings are brought. Even where the existence and control of privilege has been established, difficult questions can arise about the extent to which privilege recognised in one jurisdiction will be respected in another.

#### The English law position

Where proceedings are brought in England, the English courts will apply the English law on privilege to determine the extent to which documents can be withheld. So long as a document satisfies the test for legal advice privilege or litigation privilege under English law, the document will be treated as privileged, and it does not matter that the document would not have been privileged under any other law. This is the case even where foreign lawyers advise foreign clients on

foreign law, regardless of the location of client and lawyer.

By the same token, the English courts will not treat a document as privileged simply because it is privileged under another law: it must be privileged under English law.

### The US law position

In the United States, courts will often apply the privilege laws of the country in which the privileged communication took place. It is therefore important to understand the context of communications when conducting an internal investigation and the substance of the potentially applicable privilege laws.

Courts are divided about whether US privilege law also applies to foreign communications. Some courts hold that if a document is protected under either the foreign privilege law or US privilege law, then it can be protected from disclosure. Other courts are strict in their adherence to foreign law and hold that if a communication occurs in

a foreign country and is not protected by that country's privilege law, then the communication is not protected from disclosure in the United States even if the communication would be protected by US privilege law.

### Conclusion

Privilege is a complex area. There is no 'cure' for non-privileged documents or a waiver or loss of privilege, and specific fact patterns may require local law advice. While there are a number of issues to consider with respect to privilege, maintaining the confidentiality of privileged or potentially privileged communications is a key factor in any privilege determination. Increasingly, corporate clients use portals and/or read only documents and restrict access to specified individuals to assist in maintaining privilege, especially when liaising with parties in jurisdictions which may have a wholly different understanding of privilege (or may not recognise the concept of privilege at all).



---

For more information contact:



**Ruth Cowley**  
Partner, London  
Tel +44 20 7444 3396  
ruth.cowley@nortonrosefulbright.com



**Yasmin Lilley**  
Senior associate  
Tel +44 20 7444 5520  
yasmin.lilley@nortonrosefulbright.com



**Mark Oakes**  
Partner, Austin  
Tel +1 512 536 5221  
mark.oakes@nortonrosefulbright.com



**John Byron**  
Associate, Houston  
Tel +1 713 651 5261  
john.byron@nortonrosefulbright.com

# *Eclairs Group Ltd and Glengary Overseas Ltd v JKK Oil & Gas plc – the continuing importance of the ‘proper purpose rule’ in English company law*

A recent decision of the Supreme Court has brought into focus the continuing importance of the ‘proper purpose rule’, which applies to directors of English companies under s171(b) of the Companies Act 2006. This long-standing equitable rule, codified by the 2006 Act, requires that a director must ‘only exercise powers for the purposes for which they were conferred’.

The decision also serves as authority on the appropriate use of the procedure set out in ss793–797 of the 2006 Act, which allows companies to issue a notice to their shareholders requesting information about the beneficial ownership of those shareholders.

## **The facts**

JKK is an English company listed on the London Stock Exchange whose business involves the development of oil and gas reserves in Russia and the Ukraine. The Appellants in this case – Eclairs and Glengary – were shareholders in JKK.

Eclairs and Glengary had taken a number of steps in the period up to early 2013 which JKK perceived to be a ‘corporate raid’ on the company – in other words, an attempt to destabilise the company in order ultimately to obtain control of it without paying what other shareholders would regard as a fair price. As part of this alleged tactic, Eclairs and Glengary had sought the removal of a number of JKK’s directors and had opposed a number of steps which JKK had taken to raise funds.

In the period prior to JKK’s 2013 AGM, JKK served notices on Eclairs and Glengary pursuant to s793 of the Companies Act 2006, seeking information about their beneficial ownership and enquiring whether any agreements or arrangements were in place between the persons who had an interest in each company. JKK, like many companies, had a provision in its articles of association specifically permitting the company to impose restrictions on the voting rights attached to shares where there was reasonable cause to believe that the information provided in response to a s793 notice was false or materially incorrect.

Eclairs and Glengary responded to the disclosure notices but the directors of JKK took the view that the information provided was such that a restriction on voting rights was permitted under the company’s articles. The directors sought to impose such restrictions, with the effect of barring Eclairs and Glengary from voting at JKK’s 2013 AGM. The directors of JKK were also aware at that time that Eclairs and Glengary were likely to vote against a number of proposed resolutions at the

AGM and that the two shareholders could, given their combined 39 per cent shareholding in JKK, have blocked any special resolution that was to be voted on at the AGM.

## **The proceedings**

In response, Eclairs and Glengary commenced proceedings in the High Court seeking a declaration that the notices restricting voting rights had been unlawful under s171(b) of the Companies Act 2006, on the basis that the directors had breached their obligation to ‘only exercise powers for the purposes for which they were conferred’.

Eclairs’ and Glengary’s contention was that:

- the notices had been served with the improper purpose of preventing the shareholders from voting at the AGM and thereby maximising the possibility that the proposed resolutions would be passed at the AGM
- the proper purpose of restricting voting rights would have been limited to obtaining the information sought from shareholders in a disclosure notice.

At first instance, Mann J agreed with Eclairs and Glengary and the restrictions on their voting rights were therefore set aside. This affirmed the importance of the proper purpose rule and suggested that the rule must be borne in mind when directors are exercising powers

that are expressly conferred upon them, including in circumstances where the directors are acting in a way which they genuinely believe is in the best interests of the company.

## The Court of Appeal

However, a majority in the Court of Appeal overturned Mann J's judgment and determined that the proper purpose rule did not apply in the context of a struggle for control of a company.

The majority in the Court of Appeal gave primacy to the express provision set out in JKX's articles of association, allowing a restriction on voting rights where there is reasonable cause to believe that information provided by a shareholder in response to a disclosure notice was false or materially incorrect. The majority also placed weight on the fact that the shareholders could have avoided the imposition of restrictions on their voting rights by voluntarily providing further information.

The Court of Appeal, therefore, took a much more restrictive view of the role of the proper purpose rule.

## The Supreme Court

The Supreme Court reverted to the High Court's position in determining that the proper purpose rule did apply to the imposition of restrictions on the voting rights of Eclairs and Glengary. The Supreme Court also found that those restrictions were imposed for an improper purpose.

In particular, the Supreme Court found that the relevant article of JKX's articles of association had three related purposes:

- to induce a shareholder to comply with a disclosure notice
- to protect the company and its shareholders against having to make

decisions about their respective interests in ignorance of relevant information

- as a punitive sanction for a failure to comply with a disclosure notice.

These purposes do not extend to directors seeking to influence the outcome of the AGM, which it was accepted was a purpose underlying the board's decision to impose restrictions on the shares of Eclairs and Glengary. The restrictions had therefore been imposed for an improper purpose and were invalid.

In reaching this conclusion, Lord Sumption highlighted the fundamental importance of the proper purpose rule in stating:

'The rule that the fiduciary powers of directors may be exercised only for the purposes for which they were conferred is one of the main means by which equity enforces the proper conduct of directors. It is also fundamental to the constitutional distinction between the respective domains of the board and the shareholders.'

Lords Sumption and Hodge applied a 'but-for' causative test in determining whether the actions of a board will be invalid due to a breach of the proper purpose rule. That is to say, where there are a mixture of proper and improper purposes underlying the board's decision, the decision will breach the rule if it would not have been taken but for the existence of the improper purpose(s). Lords Mance, Clarke and Neuberger reserved their position on what the proper causative test should be, given the absence of detailed submissions on this point during the hearings.

## What does this mean for directors?

The Supreme Court's decision makes clear that the proper purpose rule is pervasive and should be considered

whenever a board is exercising the powers conferred upon it. The rule is not about directors acting in excess of their powers. Rather, it is an obligation imposed on directors to act for a proper purpose when exercising the powers which they have. It is not sufficient for the directors to act in a way which they genuinely consider to be in the interests of the company – the proper purpose rule is an additional consideration which must at all times be borne in mind.

Directors should therefore consider in detail what the purpose is behind any decision that they take and whether that purpose would be considered proper, given the intended nature of the relevant power conferred upon them. This will, in each case, be a subjective judgment which will be open to challenge.

In making these considerations, directors should therefore ensure that their compliance with the proper purpose rule is considered in detail, properly documented and supported by legal advice, where necessary.

---

For more information contact:



**Ffion Flockhart**  
Partner, London  
Tel +44 20 7444 2545  
ffion.flockhart@nortonrosefulbright.com



**Steven Hadwin**  
Associate, London  
Tel +44 20 7444 2290  
steven.hadwin@nortonrosefulbright.com

# Is what's mine really yours? The requirements and limitations of responding to requests for personal data under the Data Protection Act 1998

Section 7 of the Data Protection Act 1998 (DPA) provides individuals (or 'data subjects') with a right of access to their personal data by making data subject access requests (DSAR) of 'data controllers' – namely persons (including organisations) who either alone or with others determine how and for what purpose the personal data of others is processed.

We consider the scope of DSAR obligations on data controllers and the exemptions which may be applied. We also consider the impact of the decision in *Ashley Judith Dawson-Damer and others v Taylor Wessing LLP and others* [2015] which provides some insight into the treatment of DSARs in the context of ongoing litigation and consider responses to DSARs during settlement negotiations. We also provide some practical tips when preparing a DSAR response.

Personal data is defined under the DPA as data which relate to a living individual who can be identified –

(a) from the data, or

(b) from those data and other information which is in the possession of, or likely to come into the possession of, the data controller,

and includes any expression of opinion about the individual and any indication of the intentions

of the data controller or any other person in respect of the individual.

## Identifying personal data

In the leading authority of *Durant v Financial Services Authority* [2003] EWCA Civ 1746 the Court of Appeal noted that section 7 of the DPA did not automatically cover all information or matters in which the data subject may be named or involved. To be deemed 'personal data' the information must either be 'biographical in a significant sense' (going beyond the data subject's involvement in a matter or an event which has no personal connotations), or the information should have the data subject as its 'focus', rather than some other person with whom the data subject may have been involved or some transaction or event in which he may have figured or have had an interest. Above all, personal data is information which affects that individual's privacy, 'whether in his personal or family life, business or professional capacity'.

In practice, it is not always straightforward to identify which information will constitute personal data.

## Responding to a DSAR

In exchange for the data subject paying a £10 fee, the data controller must undertake a proportionate search for the data subject's personal data, responding to the DSAR within 40 calendar days. Receipt of a DSAR should be acknowledged promptly, and the scope of the DSAR should be examined and additional information sought from the data subject if necessary (the 40 day response period commences once the data controller has received any additional information needed to produce its response).

The data subject should be contacted in anticipation of any delays in dealing with the request. A delay in responding to a DSAR may result in the data subject bringing the matter to the attention of the Information Commissioner (ICO) who may then require the data controller to 'comply or explain.' To date, the ICO has investigated and fined data controllers for breaches of data protection (for example in disclosing the personal data of third parties within DSAR responses). However, although the ICO has brought enforcement actions, it is yet to fine a data controller for failure to fully comply with a DSAR request.

Data controllers should also consider whether the data subject's personal data is being held by any data processors engaged to act on the data controllers' behalf, including external entities to which a business function has been outsourced, such as a payroll or HR. Data controllers will also have an obligation to provide personal data held by such data processors.

## Exemptions to disclosure

There are a number of exemptions to disclosure under the DPA. Some of the most common include:

- material covered by legal privilege, such as legal advice or material prepared for the dominant purpose of actual or contemplated litigation
- material which evidences the intentions of the data controller in relation to negotiations to the extent that disclosing the information would be likely to prejudice the negotiations, such as records of internal strategy discussions
- material which is processed for management forecasting or planning if disclosure would be likely to prejudice such activity
- material constituting third-party personal data, unless consent is obtained from the third party or it is reasonable in all the circumstances to comply with the request without that individual's consent. Even if third parties are not specifically named, they may be identifiable to the data subject by reference to their job title or in relation to a certain event or location.

Personal data in hard-copy documents will not be disclosable where these are not part of a 'relevant filing system' – i.e. a manual filing system which must:

1) relate to individuals; 2) be a 'set' or part of a 'set' of information; 3) be structured by reference to individuals or criteria relating to individuals; and 4) be structured in such a way that specific information relating to a particular individual is readily accessible. The obligation on the data controller is to provide to the data subject the information constituting their personal data, as opposed to a complete copy of every document that includes their personal data. In practice, provided that it is carefully set out in an intelligible form, personal data can be extracted and placed into a table noting the corresponding document source and date.

## A litigation tool?

While the original purpose of a DSAR is for data subjects to check the accuracy of their personal data held by a data controller, in practice DSARs are increasingly being used by litigants as a quick, inexpensive means of seeking interparty or third-party disclosure alongside or in advance of contentious proceedings.

The recent judgment in *Ashley Judith Dawson-Damer and others v Taylor Wessing LLP and others* provides some insight into the judicial treatment of DSARs in the context of ongoing litigation.

In that case the beneficiary of a trust sought to challenge the appointment of settlement funds and submitted DSAR requests to Taylor Wessing for copies of all her personal data held by the firm, including any personal data of her children. Taylor Wessing, the lawyers of the trust company, asserted legal professional privilege, declining to respond on the basis that it was not reasonable nor proportionate for them to carry out a search of their client's files (dating back over 30 years), to

determine whether or not particular documents were privileged.

In agreeing that *Taylor Wessing* could rely on the privilege exemption, the High Court judge referred to the purpose of the DPA which, pursuant to the EU Directive 25/46/EC, is to enable data subjects to obtain copies of their personal data so as to check whether the data controller's processing unlawfully infringes their privacy and, if so, to protect their data by correcting any inaccuracies. The judge also noted that under the DPA the data controller is not required to provide copies of data which 'would involve disproportionate effort;' noting that the claimants had only paid £10 each to request the information.

The *Taylor Wessing* decision evidences the reluctance of English courts to enforce DSARs made for the purpose of obtaining information or documents to assist in litigation or complaints against third parties, especially where this will involve disproportionate and unreasonable effort and cost. This is in contrast to the ICO's Code of Practice which states that 'the purpose for which the SAR is made does not affect its validity, or your duty to respond to it...there is nothing in the Act that limits the purposes for which a SAR may be made, or which requires the requester to tell you what they want the information for.'

In practice, this case may be confined to its facts. As a law firm, Taylor Wessing sought to protect its clients' privilege by undertaking a blanket application of the privilege exemption over all of its clients' files, but it will be difficult – if not impossible – for a corporate entity to take the same approach. It is also worth remembering that, depending on the issues in dispute, much of the material provided in a DSAR response may be disclosable in any event as part of the litigation process.



It remains to be seen whether the scope to use DSARs as a litigation tool will be limited to the facts of this first instance judgment or widened by the Court of Appeal in a hearing scheduled for July 2016.

## Settlement

Settlement of, or attempts to settle, ongoing litigation does not terminate the data controller's regulatory obligation to produce a DSAR response. Even when a dispute appears to be resolved a DSAR could be used to obtain information in an attempt to reopen old wounds. Areas of particular sensitivity to a data controller are likely to include any information that could potentially be detrimental to the litigation process, along with negative comments of a personal nature. Robust internal communication protocols are therefore essential to ensure that, where applicable, material is subject to privilege and to prevent the creation of unnecessary prejudicial material.

## Practical tips

### Advance preparation:

- Ensure that you have a firm understanding of your organisation's IT structures, including the location of exchanges, particularly if overseas, as such data may be exempt from disclosure.
- Investigate whether your company has software to search audio (e.g. recorded telephone calls) and video (e.g. video conferences) as such formats are covered by the DPA's obligations on data controllers.
- Investigate what personal data is held by data processors, and the ability and capacity of data processors to retrieve material

relating to an individual at short notice.

- Train employees on how to manage their communications, and warn them that throw-away personal remarks and comments concerning individuals may become accessible to future litigants via the DSAR process.

### Following receipt of a DSAR:

- Consider carefully the scope of the data subject's request and, where agreeable to the data subject, seek to narrow unclear or unjustifiably broad requests directly with the data subject in writing.
- Consider the sources of electronic material (whose email accounts, which servers?) and assess whether hard-copy material falls within a relevant filing system.
- Consider using a reputable electronic document review platform which provides an efficient, cost effective means of conducting a DSAR review, allowing for the material to be de-duplicated (where the same emails have been recovered from multiple accounts), searched by way of key-word search, coded as non-disclosable where exemptions apply and redacted electronically, as appropriate. This can also generate a DSAR review report instantaneously, producing a comprehensive record by way of audit trail.
- Ensure that any commercially sensitive information is identified. To the extent that this does not constitute personal data of the data subject, it can be redacted.
- Monitor the timeframe and keep the data subject informed of any delays.

## For more information contact:



**Marcus Evans**  
**Partner, London**  
 Tel +44 20 7444 3959  
[marcus.evans@nortonrosefulbright.com](mailto:marcus.evans@nortonrosefulbright.com)



**Yasmin Lilley**  
**Senior associate**  
 Tel +44 20 7444 5520  
[yasmin.lilley@nortonrosefulbright.com](mailto:yasmin.lilley@nortonrosefulbright.com)



**Kate Langley**  
**Associate, London**  
 Tel +44 20 7444 2819  
[kate.langley@nortonrosefulbright.com](mailto:kate.langley@nortonrosefulbright.com)

# Restoring companies to the register: guidance on the ‘limitation direction’

The ability to restore a dissolved company to the register can be a useful tool for a party seeking relief after wrongful conduct comes to light. In *County Leasing Asset Management Limited and Others v Mark Glenn Hawkes* [2015] EWCA Civ 1251 the Court of Appeal has provided guidance on the principles applicable to the Court’s discretion when ordering that the period of a company’s dissolution should not count for limitation purposes. Such an order is often referred to as a ‘limitation direction’.

## Background facts

In December 2004, Telerate Limited (the Company) entered into a sale and leaseback arrangement (the Arrangement) arranged by the respondent (Mr Hawkes), the Company’s sole director and shareholder, with a view to salvaging the Company’s business before an impending winding up petition initiated by HMRC.

Mr Hawkes was assisted in structuring the transaction by Mr Cook and Mr Kirkpatrick, the third and fifth appellants, and arranged to sell the Company’s assets (including a large plot of land) for £225,000 to the second appellant, County Leasing Limited (CLL) of which Mr Kirkpatrick was a director. The intention was that CLL would lease the assets back to two new

companies formed by Mr Hawkes, MGP 2 Limited and Quotepool Limited, with their liabilities under the leaseback agreements being guaranteed by Mr Hawkes. County Leasing Asset Management Limited (CLAM) also provided some funding towards the Arrangement. The Arrangement proceeded before the Company was placed into administration in late January 2005.

Of the £225,000 due under the Arrangement, the administrator, Mr Valentine, received only £40,000 and substantial sums appeared to have been paid to, or for the benefit of, Mr Kirkpatrick and Mr Cook. Mr Valentine began investigating the transaction in April 2005, but he was unable to achieve any tangible result for the Company before it was dissolved in April 2009. By that time, Mr Hawkes’

attempt to continue the former business of the Company had failed, and he was made subject to proceedings in the County Court by CLL and CLAM to enforce his guarantees and to claim rental arrears from MGP 2 Limited and Quotepool Limited.

In September 2010, Mr Hawkes applied for the restoration of the Company to the register and in December 2010, just before the expiry of the period in which a claim could be brought, Mr Hawkes applied for a direction that the period for which the Company had been dissolved should not count for limitation purposes. At this point Mr Hawkes had received judgment in the County Court proceedings upholding his defence and counterclaim on the ground that both he and his new companies had entered into the Arrangement in reliance upon misrepresentations for which CLL and CLAM were responsible.

The restoration order was made in October 2011 and the Company was restored for the purpose of continuing its liquidation under a new liquidator, who assigned any cause of action the Company might have against CLL, CLAM, Mr Kirkpatrick and Mr Cook to Mr Hawkes in September 2012.

## First Instance Judgment of Andrews J

At first instance, Andrews J considered that the discretion to direct that the period of dissolution should not count for limitation purposes was ‘an exceptional jurisdiction’ and was one that would always cause prejudice to defendants who were thereby deprived of a defence. Andrews J regarded the merits of the claim as relevant only to the extent that a limitation direction would not be given to allow the pursuit of an obviously unmeritorious claim. Andrews J considered that the dicta of Jonathan Parker LJ in *Regent Leisuretime Ltd v Natwest Finance Ltd* [2003] EWCA Civ 391 (discussed further below), in which he stated that different considerations would apply to the granting of a limitation direction in favour of the company being restored to the register as compared against a third party creditor, was obiter. Andrews J effectively held that the principles applicable to granting a limitation direction in favour of a restored company were comparable to those applicable to granting a direction in favour of third party creditors and that she was, therefore, able to grant a limitation direction in favour of the Company if appropriate.

Andrews J considered that there was sufficient evidence to raise concern over the independence of Mr Valentine in not pursuing claims against the appellants. The evidence at first instance, for example, suggested that Mr Valentine had either received threats from Mr Cook or that there had been ‘an over-cosy relationship between them’. As such, Andrews J held that based on the evidence in the case, there was a danger that Mr Valentine had taken decisions for improper motives and that to deny a direction in the terms sought would

be to allow an injustice to be done to the Company. On this basis, Andrews J granted Mr Hawkes’ application for an order that the period of dissolution should not count for limitation purposes.

## Judgment of the Court of Appeal

The Court of Appeal reversed the first instance decision of Andrews J. Briggs LJ considered that there were a number of ‘serious difficulties with the Judge’s approach’ at first instance. Primary among these he considered was Andrews J’s focus on an analysis of the reasons why the Company had not pursued the claims by the time of its dissolution.

Having reviewed the relevant case law, Briggs LJ stated that Jonathan Parker LJ’s decision in the *Regent Leisuretime* case, on whether discretion could be exercised in the company’s favour, formed part of the ratio of the judgment and was not obiter as held by Andrews J. The result of this is that the Court was bound by Jonathan Parker LJ’s dicta on the exercise of the discretion to make a limitation direction in favour of a company, to the effect that:

- it may only be exercised in exceptional circumstances
- its effect is to override the statutory limitation regime
- fairness will generally require that a company, like any other claimant faced with a limitation defence, should be left to attempt to meet that defence by recourse to the statutory regime in the Limitation Act 1980.

Briggs LJ considered that the starting point for the achievement of the

statutory purpose contained in section 1032(3) Companies Act 2006 is to recognise that time would have run in the same way as if the Company had not been dissolved. The Court must ask whether, had it not been dissolved, the Company would have commenced the relevant proceedings in time. It was, therefore, held that there must be a causative link between the Company’s dissolution and the applicant’s failure to bring proceedings in time.

Briggs LJ commented that the limitation regime exists mainly to serve the public interest in the prohibition of stale claims. He noted that the Company’s dissolution is ‘not some accident which has befallen it...but the consequence of a deliberate decision by the company’s responsible officer’.

Briggs LJ, with whom King and Jackson LJ agreed, allowed the appeal and set aside the limitation direction made by Andrews J on the grounds that there was nothing to suggest that Mr Hawkes would have brought proceedings whether on behalf of the Company or by himself before they became statute-barred.

## Commentary

The Court’s discretion, when restoring a company to the register under section 1032(3) Companies Act 2006, to ‘give such directions and make such provision as seems just for placing the company and all other persons in the same position (as nearly as may be) as if the company had not been dissolved’ is not new. Equally, it has long been established that such orders can include a limitation direction. This case, however, brings welcome practical guidance from the Court of Appeal in an area that has lacked judicial clarification since the *Regent Leisuretime* case.



As Briggs LJ himself stated in the present case: ‘For my part, a rule requiring the presence of exceptional circumstances does not on its own provide much assistance, beyond making it clear that the burden of demonstrating the existence of such circumstance must lie squarely on the company seeking the limitation direction’. Briggs LJ’s judgment certainly goes some way to laying down concrete principles for parties to apply in such situations.

The approach set out by the Court in light of this reasoning is as follows:

- The Court must first ask whether the company (or assignee) would have commenced proceedings in time had it not been dissolved.
- If so, the Court should then consider whether it would be just to provide that opportunity, after the event, by way of a limitation direction.

The Court also makes clear that as the limitation regime does not offer relief in the absence of misconduct, even where the claimant has had difficulties in obtaining funding or in finding a willing assignee to take on the litigation, the discretion available under section 1032(3) Companies Act 2006 should not be used as a substitute to provide this relief.

It is interesting that the Court of Appeal placed some emphasis on the need for a causative link between the Company’s dissolution and the applicant’s failure to bring proceedings in time. From the judgment of Briggs LJ it would appear that the broader principles that have historically been applied by the Court will be replaced by a more rigorous and formalised approach. Those seeking the benefit of a limitation direction should pay heed to the guidance in this case and prepare for their application to be subjected to heightened scrutiny.

---

For more information contact:



**Radford Goodman**  
**Partner, London**  
Tel +44 20 7444 2081  
radford.goodman@nortonrosefulbright.com



**Robin Spedding**  
**Associate, London**  
Tel +44 20 7444 2055  
robin.spedding@nortonrosefulbright.com

# Partnership and LLP disputes: High Court decides that the doctrine of repudiatory breach does not apply to multi-party LLP agreements

In recent times, an important focus of the cases concerning Limited Liability Partnerships (LLPs) has been the status of LLP members and, specifically, whether an individual can have the dual status of member and employee (or worker) under certain circumstances. Many of these cases have also involved the more commonplace LLP agreement construction and breach of contract issues to which the expulsion of a member can give rise.

In *Flanagan v Liontrust Investment Partners LLP & Ors* [2015] EWHC 2171 (Ch), however, the High Court was required to consider an altogether different question: whether the common law doctrine of repudiatory breach can apply to multi-party LLP agreements implemented under section 5 of the Limited Liability Partnership Act 2000 (the 'LLPA 2000'). Framed in such terms, this might appear to be a rather esoteric point. However, the implications of the Court's decision for LLPs are significant.

In the Flanagan case, the claimant's argument was that the service of an invalid retirement notice, determined without following the proper procedure, was a repudiatory breach of contract which terminated the LLP agreement. As a consequence, it was said that the default provisions of the Limited Liability Partnership Regulations 2001 (the 'LLPR 2001') applied, entitling the claimant to a pro rata share in the LLP's capital and profits. As the claimant had only been

entitled to a fixed income allocation and a performance-linked allocation under the LLP agreement, the practical result of a finding that the default provisions applied would, in all probability, have been a windfall for the claimant in the order of many millions of pounds.

Ultimately, the Court decided against the claimant on this issue. However, the judgment creates new law, runs contrary to the views expressed previously by most commentators in this area and therefore warrants close attention.

## The law of LLPs

LLPs were established as a new form of legal entity under the LLPA 2000, with members as opposed to partners. Under section 1(5), the general position is that the law relating to partnerships does not apply to LLPs, with the result that the legal basis for LLPs is to be found in the LLPA 2000 and the regulations

made pursuant to that legislation (which include the LLPR 2001).

As for the relationship between the members of an LLP, the relevant principles are located in section 5 of the LLPA 2000 and Regulations 7 and 8 of the LLPR 2001, and are as follows:

### *Section 5 (1) LLPA 2000*

*Except as far as otherwise provided by this Act or any other enactment, the mutual rights and duties of the members of a limited liability partnership, and the mutual rights and duties of a limited liability partnership and its members, shall be governed –*

- (a) by agreement between the members, or between the limited liability partnership and its members, or*
- (b) in the absence of agreement as to any matter, by any provision made in relation to that matter by regulations under section 15(c).*

### *Regulations 7 and 8 LLPR 2001* **Default provision for limited liability partnerships**

*7 The mutual rights and duties of the members and the mutual rights and duties of the limited liability partnerships and the members shall be determined, subject to the provisions of the general law and to the terms of any limited liability partnership agreement, by the following rules:*

*(1) All the members of a limited liability partnership are entitled to share equally in the capital and profits of the limited liability partnership.*

### **Expulsion**

8 *No majority of the members can expel any member unless a power to do so has been conferred by express agreement between the members.*

By section 994 of the Companies Act 2006 (as applied to LLPs), an LLP member may apply to court if his interests are being unfairly prejudiced by the LLP or the other members. While many LLP agreements exclude this right, that was not the case in Flanagan.

### **The facts**

In 2011, the claimant, Mr Flanagan, joined the defendant LLP where he managed a hedge fund with an emphasis on emerging markets equities (the 'Fund'). His relationships with the LLP and its other members were governed by an LLP Agreement and a Side Letter. Amongst other matters, the LLP Agreement:

- provided for the LLP to be managed by a Management Committee (of which Mr Flanagan was a member)
- prescribed a procedure whereby members could be compelled to retire from the LLP pursuant to a decision by the Management Committee at a meeting
- expressly excluded the default provisions under Regulations 7 and 8 of the LLPR 2001.

The Side Letter:

- dealt with Mr Flanagan's remuneration, which was to be a fixed allocation of £125,000 in each financial year and a variable allocation linked to performance

- specified a compulsory membership period of two years, coupled with a notice period of six months (with such notice to expire 'no earlier than the 24 month anniversary').

In 2012, the LLP's senior management decided to close the Fund and part company with Mr Flanagan. To that end, a notice to retire was served which purported to place Mr Flanagan on garden leave and terminate his membership of the Management Committee with immediate effect. However, the notice was served more than six months prior to the 24 month anniversary date and the decision to expel Mr Flanagan had not been taken at a meeting of the Management Committee. The LLP subsequently attempted to reinforce its position by serving two further retirement notices, in case the preceding notices were non-compliant.

### **The issues**

Mr Flanagan brought proceedings against the Fund in the Chancery Division, claiming declarations as to the status of the LLP Agreement and side letter, and as to the application of the default rules under the LLPR 2001. He also concurrently petitioned for unfair prejudice under section 994 of the Companies Act 2006.

Mr Flanagan's claim turned on two key issues:

- whether the first retirement notice and decision to place him on garden leave were invalid, amounting to a renunciation (i.e. a repudiatory breach) of the LLP Agreement and Side Letter
- if the LLP Agreement and Side Letter had been renounced, whether the default rules under the LLPR 2001 applied so that Mr Flanagan was entitled to an equal share of the LLP's capital and profits and could

not be expelled by a majority of the LLP's members.

On this basis, Mr Flanagan maintained that he was still a member of the LLP and that the appropriate remedy should be an order that the LLP buy out his 'share'. Conversely, the LLP's position was that the doctrine of repudiatory breach does not apply to multi-party LLP agreements under section 5 of the LLPA 2000 and, accordingly, that Mr Flanagan did not remain a member and his only remedy was damages, calculated by reference to the non-payment of his annual fixed allocation of £125,000 since the date of the first retirement notice.

### **Judgment**

The Court rejected Mr Flanagan's claim, holding as follows.

- The first retirement notice and decision to place Mr Flanagan on garden leave were invalid. This was because, for a notice of retirement to be valid, the language of the Side Letter required that it be given for a period of precisely 6 months expiring on or after the 24 month anniversary date. However, the notice had been served early and the Side Letter (and LLP Agreement) did not permit a longer notice period. The LLP Agreement also required a resolution of the Management Committee, which there had not been. As to the effect of this breach, the LLP had evinced a clear intention not to be bound by the LLP Agreement, going to the root of the contract between Mr Flanagan and the LLP. The breach was therefore repudiatory and Mr Flanagan had accepted it.
- However, Parliament cannot have intended the doctrine of repudiatory breach to apply to LLP agreements under section 5 of the LLPA 2000, except perhaps if the LLP has only 2 members. If it did, the default rules

under the LLPR 2001 would apply to the wronged member and his relationship with the LLP, whereas the other members of the LLP and their relationship would continue to be governed by the LLP Agreement. Amongst other matters, this outcome would lead to legally incoherent results, ran contrary to commercial common sense and contradicted the express exclusion of the default rules under the LLP Agreement. This decision was reached in the absence of any preceding authority on the operation of the doctrine in relation to multi-party LLP Agreements.

The general effect of the Court's decision was, therefore, that once an LLP agreement under section 5 of the LLPA 2000 had been made, it will continue to bind the LLP and its members until the agreement is terminated by common agreement or is varied in accordance with an agreed procedure.

## Comment

Mr Flanagan's was not the only attempt by an expelled LLP member to obtain an enhanced interest in 2015. That was also the claimant's aim in *Reinhard v Ondra LLP and others*, although in that case the arguments centred on the construction of the LLP agreement and what had been agreed when the

member joined the LLP. By contrast, the Flanagan case decides, for the first time, a question of more general application, concerning the operation of LLP agreements and their interaction with the default rules. It is submitted that the Court's decision is a reasonable answer to this question, avoiding the confusion which would have followed from the application of mutually inconsistent rules.

For multi-party LLPs with carefully drafted LLP agreements, the decision delivers comfort that retired members may not circumvent their contract with the LLP in order to take advantage of more generous provisions under the default rules. In addition, it brings home the importance of LLP agreements being comprehensive and where appropriate including standard clauses, such as express exclusions of the default rules and the right to claim unfair prejudice. A similar message follows from the *Reinhard* case, where the dispute arose (in part) due to a dispute as to which version of the LLP agreement applied at the relevant time.

Finally, it is worth noting that the application of the doctrine to two-member LLPs is still to be decided. For those LLPs, it would seem that there is more of a case for arguing that the doctrine should apply, as there would be no risk of two sets of rules applying (unlike the multi-party situation).

## For more information contact:



**Ffion Flockhart**  
Partner, London  
Tel +44 20 7444 2545  
ffion.flockhart@nortonrosefulbright.com



**Charles Weston-Simons**  
Senior associate, London  
Tel +44 20 7444 2261  
charlie.weston-simons@nortonrosefulbright.com



**Steven Hadwin**  
Associate, London  
Tel +44 20 7444 2290  
steven.hadwin@nortonrosefulbright.com

# Surreptitious dealing – *Tigris International N.V. v China Southern Airlines Company Limited*

The Court of Appeal has confirmed that where there has been surreptitious dealing by an agent with the other party in a contractual arrangement during the contract period, the innocent principal should be entitled to terminate the contract from the point of discovering the fact of the bribe. However, the contract will be avoided for the future only and not from the outset.

## Facts

Tigris was a joint venture company formed by two individuals, Mr Koolhaas (K) and Mr Pakdaman (P), who essentially ‘fell out’ during the course of their business venture. Tigris’ plan was to buy aircraft from China Southern Airlines Company Limited (CSN) and sell them in Iran, a delicate commercial transaction given the UN sanctions at the time and the company’s lack of experience – Tigris had no market history, assets or published accounts.

Tigris’ agent, Mr Ventner, was appointed to represent the company in all technical matters relating to the sale and purchase of the aircraft in return for 20 per cent of the net profits.

In July 2009, Tigris and CSN entered into a sale and purchase agreement for the purchase of six aircraft, with the first three to be delivered by July 31, 2009 and the remaining three to be

delivered by August 27, 2009. Payment was to be made in three stages: a deposit of approximately US\$10.8 million (paid prior to entering into the purchase agreement), the first instalment of approximately US\$57.2 million before July 31, 2009 and the second instalment of approximately US\$55.8 million before August 27, 2009.

Tigris had difficulty obtaining financing and was unable to pay the full amount of the first instalment by 31 July 2009. The relationship between P and K began to deteriorate. Given that P had the business contacts to secure the back-to-back contracts to sell the aircraft in Iran, which is how Tigris would fund the purchases from CSN, the venture was dependent on P’s ongoing involvement.

In August 2009, P began making arrangements to take over Tigris’ responsibility to purchase the aircraft. Several emails were exchanged between P and K in which K stated that

P was not authorised to act on behalf of the company as P was a shareholder and not a director (whereas K was a director of the company).

Eventually, the first aircraft was delivered on September 1, 2009. However, the relationship between P and K finally broke down and, in late September 2009, P and Mr Ventner took steps to incorporate another company, Thesa, to replace Tigris.

K alleged that P had entered into a secret agreement with CSN to divert the sale contract.

In October 2009 CSN gave notice to Tigris that it would terminate the purchase contract unless payment was made for delivery of the remaining five aircraft and Tigris took delivery at the rate of one aircraft per week.

In November 2009, Tigris asserted that CSN was in repudiatory breach on the basis that CSN’s conduct demonstrated that it did not intend to be bound to perform the terms of the purchase agreement. On December 4, 2009 Tigris sent a letter confirming that it accepted CSN’s repudiatory conduct as having brought the contract to an end. CSN purported to terminate the purchase agreement on December 19, 2009.

In 2010 CSN entered into aircraft sale agreements with another company, GALink, to sell two of the aircraft that



had been the subject of the arrangement with Tigris. Ultimately, only one was sold to GALink and the remaining aircraft were eventually sold back to the manufacturer, Airbus SAS.

Tigris started proceedings claiming the return of its deposit (as well as other costs such as parking charges for the aircraft) amounting to approximately US\$10.5 million. CSN's counterclaim was for the amounts due but not paid to it by Tigris pursuant to the purchase contract less the amounts it had received following the sales to GALink and Airbus.

## Decision

At first instance, the judge held that Tigris was in breach of the purchase agreement as it had only paid part of the first instalment due on July 31, 2009 and therefore CSN was entitled to terminate the purchase agreement from as early as August 2009 (but had delayed in exercising this right).

The judge did not consider there to be any evidence that a secret agreement had been reached by CSN, P and Mr Ventner, and recognised that CSN had not been acting in bad faith during the prolonged period in which it had been caught between wanting to sell the aircraft whilst knowing that Tigris could not fund the purchase without P.

The judge decided that Tigris would not have been entitled to treat CSN's dealings with P as a repudiation of the purchase agreement. Therefore, Tigris was not entitled to bring the purchase agreement to an end and it had itself committed a repudiatory breach on December 4, 2009 when asserting that CSN had repudiated the contract by virtue of its surreptitious dealing. The judge decided that the purchase agreement was ultimately brought to

an end by CSN on December 19, 2009. Tigris appealed.

The Court of Appeal recognised that the fundamental basis of Tigris' claim was an allegation of 'surreptitious dealing' which derives from *Panama and South Pacific Telegraph Co v India Gutta Percha Telephone Works Co [1875] 10 Ch App 515*.

The court did not define what exactly is meant by the phrase 'surreptitious dealing'. In the *Panama* case, the surreptitious dealing took the form of a bribe and the court held that the innocent principal could rescind the contract, thereby avoiding it from the beginning. Surreptitious dealing was therefore identified in light of the fraudulent and dishonest conduct amounting to a bribe.

In the appeal brought by Tigris, the Court of Appeal agreed with the trial judge. It did not consider there to have been any conduct amounting to surreptitious dealing nor a secret agreement between CSN and P. CSN had not acted in bad faith and had instead dealt with P on the basis that K would be involved if the agreement was to be transferred from Tigris.

The Court of Appeal went on to consider whether CSN would have been entitled to damages for Tigris' breaches (i.e. its failure to pay and perform the terms of the purchase contract) even if CSN had repudiated the purchase agreement in November 2009 and been guilty of surreptitious conduct.

In those circumstances the Court considered that Tigris would only have been entitled to accept a repudiation or rescission from that moment; it would not have been able to treat the contract as void from the beginning. Tigris would have had to give credit to CSN for damages that had accrued before the contract was terminated.

## Comment

This decision confirms that the *Panama* case remains authority for the proposition that a principal whose agent has been bribed to enter in a contract may rescind the contract when the principal party discovers the fact of the bribe. In this regard, rescission is an equitable remedy which is available provided that counter restitution may be made. The case is also authority for the proposition that if a contract is terminated by a party due to surreptitious dealing between its agent and a counterparty during the course of performing the contract, the contract may only be rescinded for the future and the terminating party will remain liable to the counterparty for any obligations, including damages, which have already accrued.

---

### For more information contact:



**Patrick Farrell**  
Partner, London

Tel +44 20 7444 2723  
patrick.farrell@nortonrosefulbright.com



**Elizabeth McArthur**  
Associate, London

Tel +44 20 7444 5239  
elizabeth.mcarthur@nortonrosefulbright.com

# Corporate criminal liability in Germany

In 2013 the Minister of Justice of North Rhine Westphalia, Thomas Kutschat, presented a first draft of a corporate criminal code (*Verbandsstrafgesetzbuch*) for Germany. Since then, although the need for a German corporate criminal code has been discussed extensively, no corporate criminal law has been enacted.

In contrast, almost all other member states of the European Union as well as Switzerland and Norway have corporate criminal laws. However, following various incidents during recent years, including the recent Volkswagen emission scandal and Porsche's failed attempt to take over Volkswagen in 2008, where in both cases it is unclear if and to what extent criminal liability of individuals can be found, the discussion is now in full swing again.

As a result, the issue is as relevant as ever: would the introduction of a corporate criminal code in Germany support the fight against corporate and white-collar crime, both from a preventive perspective and as a deterrent?

## Current legal situation

German authorities already have certain powers to sanction companies, although no explicit law on corporate criminality exists. Most of the existing provisions are found in the German Act on Regulatory Offences (*Ordnungswidrigkeitengesetz*, OWiG). In

the case of certain violations fines can be imposed on companies and profits gained from offences confiscated.

Pursuant to Section 30 para. 1 OWiG, regulatory fines may be imposed on a corporate entity where someone representing the entity has committed a criminal or regulatory offence in violation of duties imposed on the company by law, or where the company has been enriched or was intended to be enriched. The fines imposed can be up to €10 million for intentional criminal offences and up to €5 million for negligent criminal offences. In the case of regulatory offences the possible fines depend on the offence in question.

Pursuant to Section 130 para. 1 OWiG, further fines might be imposed on an owner of a company as a result of breaches (including by omission) of supervisory measures required to prevent contravention of duties incumbent on the owner. Such measures include the appointment, careful selection and surveillance of supervisory personnel. Regulatory

offences may carry fines as high as €1 million, where the breach of duty carries a criminal penalty. Where the breach of duty carries a regulatory fine, the fine depends on the maximum regulatory fine imposable for the breach of duty.

Where the economic advantage gained through the offence is higher than €10 million, the ostensible 'fine limit' may even be exceeded and any profits exceeding the regulatory fine may be confiscated.

While it is clear that the authorities already have the powers to impose considerable fines, under the Act on Regulatory Offences, fines are subject to the authorities' discretion (known as *Opportunitätsprinzip*). In contrast, if corporate offences were to be qualified as crimes, prosecution would be mandatory (known as *Legalitätsprinzip*). Statistics indicate that the present system of penalties apparently lacks efficiency: although a high number of corporate crimes come to the attention of the authorities every year (e.g. 71,000 cases in 2013 and 63,000 cases in 2014), public prosecutors very rarely make use of the powers to impose regulatory fines on corporations. One reason for this situation is that according to the provisions of the Act on Regulatory Offences it is necessary to prove the individual guilt of a member or the owner of the affected corporation.

To overcome this problem, the provisions of the proposed draft corporate criminal code do not require individual guilt to be proved. The draft code addresses the corporate itself and the imposition of a fine does not depend on an individual being accused. For example, the corporate would be liable in cases of corporate-related offences committed by personnel engaged in positions with substantial responsibility, or in cases where responsibilities within the corporate are unevenly distributed. Further sanctions can follow from the violation of supervisory duties by decision-makers of the corporation.

### Arguments for and against the introduction of a corporate criminal law in Germany

In 2000 a reform commission engaged to evaluate the necessity of a corporate criminal law in Germany stated that no supranational regulations exist according to which it would be mandatory to introduce such laws; and to implement such laws could give rise to various constitutional and criminal procedural problems. Opponents of the introduction of a German corporate criminal code generally doubt the necessity of it. According to many it would not be possible to prevent corporate criminality in any event. Options to sanction violations committed by companies or their members already exist in German law, essentially codified in the Act on Regulatory Offences as described above. Any deficits could be overcome by amending or changing the Act on Regulatory Offences. Further, the prevention of corporate offences could be strengthened by the confiscation of not only the net profit, but also the entire gross income in case of a violation (known as '*Bruttoprinzip*').

Opponents further argue that a constitutional and dogmatic problem exists, because according to German law criminal liability always requires fault on the part of the offender (known as '*Schuldprinzip*') whereby fault cannot exist on the part of the corporate itself (*societas delinquere non potest*). Also, it is questioned whether German law enforcement authorities would be sufficiently equipped and qualified to comprehend operational procedures of corporates and to monitor them adequately.

Proponents of the introduction of a corporate criminal code in Germany argue that the imposition of criminal sanctions against corporates (instead of mere regulatory fines) could have positive preventive effects. A compliance culture would become more prevalent and a different perception as to white collar crimes would be promoted. It is also suggested that options for reducing threatening sentences could be installed in the event that the corporate implemented appropriate compliance measures.

A further argument frequently raised in favour of a corporate criminal code is that liability of an individual under German law is dependent on that individual's economic situation. Proponents argue that in most cases the punishment bears no relation to the economic advantage gained by the corporate benefiting from the respective offence or action. This is even more true if individuals face a prison sentence, which cannot be compared to a fine imposed on a corporate.

According to others it would be important to introduce a corporate criminal code in Germany for unification reasons, since most other EU states already have implemented laws against corporate criminality.

### Conclusion

The introduction of a corporate criminal code in Germany would certainly send a positive signal to the public. It would also help Germany regain trust as a country with a sound and reliable investment environment and promote more responsible conduct on the part of corporates. However, its introduction would require a fundamental rethink in German criminal law, since corporates cannot currently face criminal liability. Accordingly, the argument is that any corporate criminal code should include the mandatory prosecution of relevant corporate crimes. In order to avoid constitutional and/or procedural problems such a code would have to consider the principle of *Schuldprinzip* (the requirement of fault on the part of the offender as described above) or present an alternative solution.

It will be interesting to see how Germany responds to recent corporate scandals involving German corporates. From a legal policy perspective the introduction of certain changes to the system of corporate liability in Germany seem likely to happen and should be welcomed.

#### For more information contact:



**Jamie Nowak**

**Partner, Munich**

Tel + 49 89 212148 304

[jamie.nowak@nortonrosefulbright.com](mailto:jamie.nowak@nortonrosefulbright.com)

# Predictive coding in the disclosure process

In a landmark ruling, an English court has approved expressly the use of predictive coding technology in the electronic disclosure process.

In the modern disputes world, document disclosure is often dominated by the enormous exercise of sifting vast quantities of electronic documents produced in the ordinary course, looking for those documents relevant to the issue in the case. That process and the associated costs of providing such disclosure are frequently critical and sensitive issues in commercial litigation both for the courts and the parties to the litigation.

The English Civil Procedure Rules provide that in giving disclosure: 'a party is required to make a reasonable search for documents'. However, neither the relevant rule or the practice direction deal with how the search for electronic documents should be conducted. Practice Direction 31B states: 'it may be reasonable to search for Electronic Documents by means of Keyword Searches or other automated methods of searching if a full review of each and every document would be unreasonable', yet it does not address the extent to which it is permissible to conduct electronic disclosure through the medium of a computer program.

Simply put, predictive coding, sometimes described as technology assisted review, is the review of documents undertaken by proprietary

computer software after a human reviewed seed set is used to 'train' the software. The software analyses the documents and then 'scores' them for relevance to the issues in the case. The purpose of the process is to identify the documents relevant to the case while reducing the time and cost of the review by reducing the number of irrelevant documents.

## *Pyrrho Investments Limited & Anr v MWB Property Limited and Others*

The case concerns claims by companies against directors in respect of payments allegedly made as a result of breach of fiduciary duty.

The parties agreed case management directions subject to the approval of the court, including as to the use of keywords and predictive coding to be employed in the electronic disclosure exercise. The scale of the exercise concerned more than 17.6 million documents which was reduced to 3.1 million by a process of electronic de-duplication. The parties sought the Court's approval to use predictive coding.

## The judgment

Master Matthews approved the use of predictive coding technology. The court identified ten factors in favour of the use of predictive coding in the electronic disclosure process, whilst noting that there were no factors of any weight pointing in the opposite direction. The factors identified by the court were as follows.

- Experience in other jurisdictions shows that predictive coding software can be useful in appropriate cases. In the absence of English case law on the application of predictive coding, Master Matthews turned to decisions in other jurisdictions notably, the US Federal Court case of *Moore v Publicis Groupe*, 11 Civ 1279 (ALC)(AJP) and the Irish High Court case of *Irish Bank Resolution Corporation Ltd v Quinn* [2015] IEHC 175, both of which had endorsed the use of predictive coding.
- There was no evidence to show that the use of predictive coding software leads to less accurate disclosure than manual review alone or keyword searches and manual review combined, and indeed there is some evidence to the contrary.
- There will be greater consistency in using the computer to apply the approach of a senior lawyer towards the initial sample to the whole document set, than in using dozens of lower-grade fee-earners, each



independently applying the relevant criteria in relation to individual documents.

- There is nothing in the CPR or Practice Directions to prohibit the use of such software.
- The number of electronic documents which must be considered for relevance and possible disclosure in the present case was huge.
- The cost of manually searching these documents would have been enormous, amounting to several million pounds. Therefore a full manual review would be ‘unreasonable’ under Practice Direction 31B where a suitable automated alternative exists.
- The cost of using predictive coding software would depend on various factors, including whether the number of documents was reduced by keyword searches. The estimates given in this case varied between £181,988 (plus monthly hosting costs of £15,717), to £469,049 (plus monthly hosting costs of £20,820). In either case, it was considerably less expensive than the alternative of a full manual review.
- The ‘value’ of the claims made in this litigation is in the tens of millions of pounds. Therefore the estimated cost of using the software was proportionate.
- The trial in the present case is not due to take place until June 2017, so there

would be plenty of time to consider other disclosure methods if for any reason the predictive coding software route turned out to be unsatisfactory.

- The parties had agreed on the use of the software, and also how to use it, subject only to the approval of the Court.

### Comment

In keeping with the Jackson reforms, which focussed on costs management, a theme of this judgment is cost control and the comparison between the cost of a manual review against the cost of predictive coding. Master Matthews noted that, ‘provided that the exercise is large enough to absorb the up-front costs of engaging a suitable technology partner, the costs overall of a predictive coding review should be considerably lower’. Moreover, the Master expressly recorded that the decision is in accordance with the overriding objective in CPR1.1(1) of, ‘enabling the court to deal with cases justly and at proportionate cost’.

The decision is important as being the first time an English court has provided a detailed judgment closely examining and approving the use of predictive coding. Also of assistance is the court’s confirmation that predictive coding can satisfy disclosure obligations, which will provide litigants with encouragement to explore the method in future cases (although industry consensus is that predictive coding has been used for some time by parties to

litigation). It is now almost inevitable that parties to litigation will use developments in technology to reduce the costs of litigation as a whole and disclosure exercises in particular. In many cases, predictive coding will help to achieve this.

However, it should be stressed that this decision does not open the way for predictive coding to be used in every case. Several of the factors identified by Master Matthews were specific to the particular case. The judgment notes that whether predictive coding would be right for other cases will depend upon the particular circumstances in each case. Predictive coding is but one option.

The case therefore provides an important incremental step in the development of the law and practice around predictive coding, but parties will have to continue to consider carefully what methods of disclosure are appropriate in any given case.

*This article was co-written by Sarah Bramley.*

For more information contact:



**Antony Corsi**  
**Partner, London**  
 Tel +44 20 7444 5863  
[antony.corsi@nortonrosefulbright.com](mailto:antony.corsi@nortonrosefulbright.com)

## Dispute resolution and litigation

We have one of the largest dispute resolution and litigation practices in the world, with experience of handling and resolving multi-jurisdictional mandates and international arbitration across all industry sectors. We advise many of the world's largest companies on complex, high-value disputes. Our lawyers both prevent and resolve disputes by giving practical, creative advice that focuses on our clients' strategic and commercial objectives.

---

### Lawyers

1200

---

### Contact

**Gerry Pecht**  
Tel +1 713 651 5243  
gerard.pecht@nortonrosefulbright.com

---

**'The lawyers co-ordinate well across the Norton Rose [Fulbright] network, and the different offices work as a single team.'**

*Chambers Global – Global-wide  
2015*

---

### Our practice covers

---

Antitrust and competition

Appellate

Catastrophic and mass disaster  
disputes

Class actions

Commercial disputes

Construction and engineering

Data protection, privacy and access to  
information

eDiscovery and information governance

Employment and labor

Energy

---

Environmental

Financial institutions

Insurance

International arbitration

Life sciences and healthcare

Marine casualty, admiralty and  
shipping

Mass tort and toxic tort disputes

Patent litigation

Pharmaceutical medical device  
disputes

Product liability

---

Professional liability

Qui Tam/False Claims Act

Real estate

Regulatory and governmental  
investigations

Securities litigation, investigations and  
SEC enforcement

Transnational litigation

White collar crime

---

## Global resources



### Europe

Amsterdam	Milan
Athens	Moscow
Brussels	Munich
Frankfurt	Paris
Hamburg	Piraeus
London	Warsaw

### United States

Austin	New York
Dallas	Pittsburgh-
Denver	Southpointe
Houston	St Louis
Los Angeles	San Antonio
Minneapolis	Washington DC

### Canada

Calgary	Québec
Montréal	Toronto
Ottawa	

### Latin America

Bogotá
Caracas
Rio de Janeiro

### Asia

Bangkok
Beijing
Hong Kong
Jakarta <sup>1</sup>
Shanghai
Singapore
Tokyo

### Australia

Brisbane
Melbourne
Perth
Sydney

### Africa

Bujumbura <sup>3</sup>
Cape Town
Casablanca
Dar es Salaam
Durban
Harare <sup>3</sup>
Johannesburg
Kampala <sup>3</sup>

### Middle East

Abu Dhabi
Bahrain
Dubai
Riyadh <sup>2</sup>

### Central Asia

Almaty
--------

<sup>1</sup> TNB & Partners in association with Norton Rose Fulbright Australia

<sup>2</sup> Mohammed Al-Ghamdi Law Firm in association with Norton Rose Fulbright US LLP

<sup>3</sup> Alliances

## Norton Rose Fulbright

Norton Rose Fulbright is a global law firm. We provide the world's preeminent corporations and financial institutions with a full business law service. We have 3800 lawyers and other legal staff based in more than 50 cities across Europe, the United States, Canada, Latin America, Asia, Australia, Africa, the Middle East and Central Asia.

Recognized for our industry focus, we are strong across all the key industry sectors: financial institutions; energy; infrastructure, mining and commodities; transport; technology and innovation; and life sciences and healthcare.

Wherever we are, we operate in accordance with our global business principles of quality, unity and integrity. We aim to provide the highest possible standard of legal service in each of our offices and to maintain that level of quality at every point of contact.

Norton Rose Fulbright US LLP, Norton Rose Fulbright LLP, Norton Rose Fulbright Australia, Norton Rose Fulbright Canada LLP and Norton Rose Fulbright South Africa Inc are separate legal entities and all of them are members of Norton Rose Fulbright Verein, a Swiss verein. Norton Rose Fulbright Verein helps coordinate the activities of the members but does not itself provide legal services to clients.

---

References to 'Norton Rose Fulbright', 'the law firm', and 'legal practice' are to one or more of the Norton Rose Fulbright members or to one of their respective affiliates (together 'Norton Rose Fulbright entity/entities'). No individual who is a member, partner, shareholder, director, employee or consultant of, in or to any Norton Rose Fulbright entity (whether or not such individual is described as a 'partner') accepts or assumes responsibility, or has any liability, to any person in respect of this communication. Any reference to a partner or director is to a member, employee or consultant with equivalent standing and qualifications of the relevant Norton Rose Fulbright entity. The purpose of this communication is to provide information as to developments in the law. It does not contain a full analysis of the law nor does it constitute an opinion of any Norton Rose Fulbright entity on the points of law discussed. You must take specific legal advice on any particular matter which concerns you. If you require any advice or further information, please speak to your usual contact at Norton Rose Fulbright.