

# Commercial Thinking

A topical selection of UK commercial law developments – 3<sup>rd</sup> edition.

## **\*Featured article**

### **1. Company Sales: Dealing with auction bidders**

Despite the higher costs associated with their operation, auction processes have been increasingly utilised by sellers of companies in the current depressed market. By attracting a number of potential bidders, a seller may hope to achieve better sales terms, including a higher price, than would otherwise be the case. However, a seller and its advisers must keep tight control of the auction, and ensure that their dealings with bidders are fair, if they are to avoid future disputes arising from the process.

Terra Firma accused Citigroup, the financial advisers running the sale of EMI by auction process, of providing it with misleading information with the intention of encouraging Terra Firma to offer a higher price for EMI than it would otherwise have offered (*Terra Firma v. Citigroup*, 09-cv-10459, U.S. District Court, Southern District of New York (Manhattan)). Specifically, Citigroup was accused of indicating that there was another bidder involved in the latter stages of the auction process when in fact there was not. Although Terra Firma's claim was unsuccessful, this was due to a lack of evidence and the issues raised by the case still remain key.

#### ***Position under English Law***

A seller will usually, and would be expected to, indicate in its bid instructions that all bidders will be treated equally throughout the process. The scenarios in which a seller may be tempted to deal with bidders in a potentially unfair manner during an auction process include:

- Scenario one – the seller or its advisers provide misleading information to a bidder relating to the number of other bidders involved in the

This update includes the following topics:

- 1. *\*Featured Article - Company Sales: Dealing with auction bidders*
- 2. *ECJ guidance of on of the use of trade marks as advertising keywords for the resale of genuine goods*
- 3. *Damages for consequential loss of business recoverable for trade mark infringement and passing off*
- 4. *A vision of unfair advantage*
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- 6. *Equitable set-off*
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process or the value of their bids;

- Scenario two – the seller favours one bidder over the others and throughout the process provides additional information and assistance to that bidder (either by the use of distinct data rooms for the bidders or on an informal basis).

Although English law will not penalise a seller for making an incorrect, although reasonably held, opinion and will allow some leeway for marketing ‘puff’, it will not permit a seller to benefit from making false statements of fact. The case of *Smith New Court Securities Limited v Scrimgeour Vickers (Asset Management) Limited* [1996] 3 WLR 1051 held that a broker who had deliberately misled a bidder into believing that other bidders were involved in an auction process, and who had provided false information as to the offer price contained in other bids, was guilty of fraudulent misrepresentation.

The remedies available for fraudulent misrepresentation are rescission and damages. Although not always available, if rescission is awarded this will result in the seller being required to take back the target company from the buyer and return the sale price. Damages would be calculated as the amount required to put the buyer into the position it would have been in if the misrepresentation had not been made. A claim for breach of warranty may also be possible. To avoid these penalties a seller must avoid the course of action outlined in scenario one above.

A seller will usually be free to deal with the provision of due diligence information to bidders in an auction process as it sees fit. However, as noted above, the bid instructions often state that the bidders will be dealt with in an equal manner. Such an assertion may form a representation, or even a contractual term, between the bidders and the party issuing the instructions (ie the seller or its advisers). A breach of such a representation or contractual provision may entitle a bidder to damages or indeed rescission, if the breach is sufficiently material. A seller should therefore avoid the course of action outlined in scenario two above, unless the instructions have made it clear that such action may be undertaken.

As regards either scenario, sellers should bear in mind that, in the event that a civil claim is issued against them in an English court, they will be obliged to disclose all documentation retrieved pursuant to a reasonable

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- 8. Mistakes in commercial contracts: *How hard must you try?*
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search which is relevant to the case which is or has been within their control. This includes not just documentation which supports the seller's case, but also documentation which is adverse to the seller's case or which supports another party's case. The term 'document' covers not just paper documents but electronic documents wherever they may be stored (including on laptops, blackberries and mobile phones), up to and including the metadata attached to the document. A failure to comply properly with disclosure obligations can result in committal for contempt of court. Sellers should therefore not assume that a bidder has no ability to discover what has gone on behind the scenes in an auction process.

The Terra Firma case also demonstrates the importance of creating an evidentiary trail. Terra Firma's claim failed because it was unable to produce clear written records of the conversations in which, it was alleged, the seller had been told about the other bidder. Sellers and bidders should ensure that any conversations and issues they regard as important are properly documented, in case they find themselves in dispute at a later date.

### ***Other Considerations***

Other important considerations for a seller include:

- A seller will want to avoid making an offer to bidders that is capable of acceptance by them, until such time as the seller is ready to do so. The bid instructions and all other bid correspondence must be carefully drafted to avoid this.
- A seller must consider the extent of the due diligence information that it is happy to release to bidders at the start of the process. The seller may wish to withhold certain key business information for disclosure to a smaller number of preferred bidders at a later stage of the process, but it must ensure that this is permissible under the terms applicable to the conduct of the bid.
- Approaches to bidders located in the United Kingdom in connection with a sale of shares will constitute a financial promotion (ie an offer to engage in investment activity during the course of business) under section 21 of the Financial Services and Markets Act 2000. Approaches, and the bid instructions, should be approved by the seller's financial advisers, unless an exemption is available.
- Most common law jurisdictions, including the United Kingdom, do not incorporate a duty to negotiate in good faith in their law. Parties to an

auction process subject to English law can therefore terminate at any time prior to signing legally binding documents. This may not be the case in certain other jurisdictions, notably many civil law jurisdictions (for example, France), where damages may be payable by a party that does not make a reasonable attempt to agree the transaction.

- Where the auction process involves bidders from different jurisdictions, care should be taken that the laws of those other jurisdictions do not apply to the process. In addition, dealings with such bidders must not breach local laws relating to the promotion of investment opportunities. Local law advice should be taken in each instance.

### **Public Companies**

The City Code on Takeovers and Mergers (the 'Code') will generally apply to sales of public companies incorporated and managed and controlled in the UK, the Channel Islands or the Isle of Man. The Code sets out a formal procedure for making an offer as well as the circumstances in which a person is required to make an offer for all of a company's shares. An auction process relating to a public company should be designed so as not to conflict with the requirements of the Code.

The provision of due diligence information relating to companies whose shares are listed on a market in the United Kingdom must be considered especially carefully. It is a criminal offence for an individual who holds 'inside information' to deal, or encourage others to deal, in securities when in possession of inside information relating to those securities. 'Inside information' is specific information relating to a company's securities that is not public and that would be likely to have an effect on the price of those securities if made public. The penalties for committing insider trading include fines and imprisonment. However, insider trading may also constitute the civil offence of market abuse and the Financial Services Authority often has the option to pursue either claim.

If a bidder receives material due diligence information then it will not be able to acquire further shares in the target without breaching the insider trading regime unless: (i) the information is disclosed to the market by the target; or (ii) the bidder announces an offer for all of the target's shares. This may significantly disrupt an auction process and a seller should therefore carefully consider the information being disclosed.

*'The provision of due diligence information relating to companies whose shares are listed on a market in the United Kingdom must be considered especially carefully.'*

## **Practical Steps**

A seller and its advisers should consider the following key points in advance of opening an auction process to potential bidders:

- The process, and the requirements at each of its stages, must be clearly defined and understood by all members of the sale team and clearly set out in the bid instructions;
- The bid instructions must be carefully drafted to permit the process to be varied at any time by the seller – the seller must consider whether it will state that all bidders will be treated equally as regards the provision of information;
- The information to be provided to bidders, and the process for dealing with bidders' requests for further information, must be organised – certain information may be withheld until the later stages;
- Consideration must be given to the drafting of any share purchase agreement that is to be provided to bidders for comments – the aim is often to provide a fair draft that can justify a demand for minimal comments only from bidders;
- Consideration should also be given to the dispute resolution provisions governing the auction process; this is particularly the case if overseas or international parties are involved, as this might give rise to issues concerning jurisdiction and enforcement of any resulting order or award; and
- As highlighted by the *Terra Firma* case, the seller must avoid misleading statements as to bidders' intentions or offers – ideally the seller should avoid making comments about other potential bidders or their bids at all.

## **2. ECJ guidance of on of the use of trade marks as advertising keywords for the resale of genuine goods**

Commercial Thinking previously reported on the finding of the European Court of Justice that, in the circumstances of *Google France and Google Inc. v Louis Vuitton Malletier*, *Google France v Luteciel*, and *Google France v CNRRH*, Joined Cases C-236/08, C- 237/08 and C-238/08, 22 September 2009, Google had not infringed the defendants' marks by providing its AdWords service. The ECJ has now issued a preliminary ruling on the use by a trader of another trader's marks as keywords, in *TPortakabin Ltd and another v Primakabin BV*, Case C-558/08, 8 July 2010. This case was

referred by the Dutch court, but will be applicable in the UK.

The defendant had used PORTAKABIN and variants, as keywords for the Google Adwords service, to generate Internet advertising links to its website, for the purpose of offering for sale genuine, but second-hand, products manufactured by the claimants. The defendant also sold its own products from the website, but had changed its advertisement accompanying the URL listing to refer to sales of used portakabins.

It is an infringement of a registered trade mark to, in the course of trade and without the owner's consent, (i) use an identical mark in relation to identical goods or services to those for which the registered mark is registered; (ii) use an identical or similar mark in relation to similar or identical goods or services where, because of the similarity or identity of that mark and the registered mark and of the goods or services, there is a likelihood that the public will be confused, including by associating the two marks; and (iii) (where the local member state so provides, as it does in the UK and Holland) use an identical or similar mark in relation to goods or services, where the trade mark owner has a reputation in that country and use of the sign without due cause takes unfair advantage of, or is detrimental to, the distinctive character or repute of the registered mark. Only use which adversely affects the functions of a mark is infringement; descriptive use, for example, is not.

The trade mark owner's rights are subject to certain limits. For example, it is permissible to use another's trade mark to indicate characteristics of goods or services, or where this is necessary to indicate their intended purpose, provided that the use accords with honest practices in industrial or commercial matters. It is also permissible to use a trade mark where its owners' rights are "exhausted", because the goods bearing the mark have been put on the market by it or with its consent, unless the trade mark owner has legitimate reasons to oppose re-sale of the goods.

The ECJ's preliminary ruling was that:

- The defendant's use of the mark did not adversely affect its function of advertising (as with the Google cases).
- The defendant's use of the mark would adversely affect its function of denoting origin only if the advertisement were presented in such a way that it did not enable normally informed and reasonably attentive

*'The defendant's use of the mark would adversely affect its function of denoting origin only if the advertisement were presented in such a way that it did not enable normally informed and reasonably attentive Internet users (or enabled them only with difficulty) to ascertain if the goods and services originated from the trade mark owner.'*

Internet users (or enabled them only with difficulty) to ascertain if the goods and services originated from the trade mark owner. This is turn is affected by whether or not an economic link is indicated. These are factual issues for the national court to address.

- As regards the use of variants, the national court must assess if the variations are so trivial as to go unnoticed by the relevant public, in which case no confusion is required for an infringement to arise. If, however, the marks are similar rather than identical, the risk that the public will make an economic link will constitute a likelihood of confusion. The assessment is the same as that for establishing an adverse effect on the origin of the mark.
- Use of a mark as a keyword is not likely to provide an indication of the characteristics of goods or services but, in special circumstances, a national court may find to the contrary.
- Use of a mark as a keyword is also unlikely to be necessary to indicate the intended purpose of goods or services, but this depends on the factual matrix. The purpose of the intended purpose exception to infringement is to enable providers of goods and services which are supplementary to those of the trade mark owner, to inform the public of the practical link.
- The assessment of whether the use of the mark is such as to adversely affect its function as indicating origin, described above, is relevant to the issue of honest use.
- It will be for the national court to assess whether, in fact, the trade mark owner has legitimate reasons to oppose use of the mark for further resale of the goods, a question affected by whether the user implied that it was economically linked to the owner, or its advertising was seriously detrimental to the reputation of the mark. Use of the mark in relation to second-hand goods will of itself be insufficient to establish such legitimate reasons. It is also not sufficient to show that the user also sold other goods, unless the volume, presentation or poor quality of those other goods risks seriously damaging the image of the owner's mark.

The conclusion? As a basic proposition, Internet traders are unlikely to infringe trade marks by using them as keywords provided their advertisements make clear that they have no link with the registered marks or their owner. As will be seen from the ECG guidance, however, there is a range of exceptions and qualifications for the protection of the

owner.

### **3. Damages for consequential loss of business recoverable for trade mark infringement and passing off**

The claimant was awarded such damages in the case of Gary Fearn (T/A Autopaint International) v (1) Anglo-Dutch Paint & Chemical Co Ltd & 5 Ors [2010] EWHC 1708 (Ch). Mr Fearn built up a business of selling paint for spray-painting cars under the name AUTOPAINT INTERNATIONAL, which he registered as a trade mark. He sold his paint from his own shops and through franchisees. His main paint supplier was the first defendant, Anglo-Dutch, which was the UK distributor of the second defendant, De Beer, which manufactured paint. After Mr Fearn fell behind in his payments to Anglo-Dutch, the latter started selling significant quantities of Autopaint branded products direct to Mr Fearn's franchisees and Mr Fearn lost them. Following his letter before action to the franchisees, informing them that Anglo-Dutch was not authorised to use the Autopaint mark, Anglo-Dutch introduced a new mark. In the meantime, Mr Fearn struggled to carry on business without the franchisees, and eventually entered into an Individual Voluntary Arrangement with his creditors. The court found the defendants liable in trade mark infringement and passing off, and also for other torts and for breach of contract.

The interesting part of this case is the assessment of damages. As would be expected, Mr Fearn was awarded damages for loss of profits as a result of Anglo-Dutch's unauthorised sales to the franchisees. But Mr Fearn also claimed for the collapse of his business. In considering whether the defendants caused the loss of Mr Fearn's business, the court noted the effect of Anglo-Dutch's unauthorised use of the trade mark in persuading the franchisees away from Mr Fearn. The court concluded, however, that Mr Fearn's business would have collapsed even had he not lost his franchisees. Nevertheless, the court concluded that Mr Fearn would be entitled to damages for the consequential losses caused by the loss of the franchisees, being the loss of profits on further sales.

While the facts of this case are rather specific, there is a general cautionary lesson as to the consequential losses that can, in circumstances, be recovered for trade mark infringement and passing off.

## 4. A vision of unfair advantage

As explained in article 4 above, a registered trade mark is infringed by, in the course of trade, using an identical or similar mark in relation to goods or services, where the trade mark owner has a reputation in that country and use of the second mark without due cause takes unfair advantage of, or is detrimental to, the distinctive character or repute of the registered mark.

The ECJ decided in *L'Oréal v Bellure* C 487/04 what amounts to unfair advantage. This decision has now been applied in *TSpecsavers International Healthcare Ltd & Ors v Asda Stores Ltd* [2010] EWHC 2035 (Ch), which concerned two well established players, and not just a start-up taking advantage of a “celebrity”.

The claimant registered SPECSAVERS as a Community Trade Mark as words and in logo forms. Asda then relaunched its optical business under the strapline “Be a real spec saver at Asda”.

The court summarised what was required to show unfair advantage: “a link between the offending sign, in the sense of calling the registered mark to mind; that an advantage is gained thereby; and that the advantage is unfair”. The link need not be economic. The unfair advantage would be the consequence of similarity between the sign and the mark, by virtue of which the public makes the connection. The court found that the whole point of the play on words in Asda’s slogan was to call to mind the Specsaver mark.

The court then applied the guidance in the *L'Oréal v Bellure* case. It said that unfair advantage must be assessed globally, taking into account all relevant circumstances; the advantage will be unfair if the use amounts to riding on the coat-tails of the mark (use of the mark and its inbuilt reputation to create or enhance the reputation of the infringing product); and it is relevant that the offending mark was created deliberately to create the link with the registered mark. Asda’s slogan was not merely referencing Specsavers’ reputation for value, but also that reputation as established by the brand. *“The unfair use was in commandeering part of the reputation of the Specsavers brand with a view to affixing the qualities of one’s own and then being better still.”* The court found that there could be unfair advantage, even though there was comparison – this was not a case of mere, straight comparative advertising (which is permitted).

*‘Be cautious and fair, before using someone else’s mark and reputation.’*

So, be cautious and fair, before using someone else's mark and reputation.

## 5. Time not of the essence in a payment provision (unless)

In the recent case of *Dominion Corporate Trustees Limited and others v Debenhams Properties Limited* [2010] EWHC 1193, the High Court considered whether time was of the essence in relation to a payment obligation where the agreement provided that interest would be payable on late payments.

Dominion entered into an agreement to lease units to Debenhams and Dominion was required to pay capital contributions to Debenhams in three specified instalments. Dominion failed to meet the second payment deadline and Debenhams served notice to terminate the agreement on the grounds of default. Dominion attempted to make payment two days after the due date but Debenhams refused to accept it. Dominion claimed that Debenhams was not entitled to terminate the agreement and by doing so, had itself committed a repudiatory breach. Debenhams counter-claimed that it was entitled to terminate, as late payment amounted to a repudiatory breach. Debenhams' case was that time was of the essence as there was a close link between payment by Dominion and Debenhams' obligations under the agreement to fit-out the leased units.

The court decided that time was not of the essence. Late payment by Dominion did not deprive Debenhams of substantially the whole benefit of the agreement or render it incapable of performing its own obligations. Also, the agreement expressly provided for interest on late payment and, therefore, it was inappropriate to imply a term in the contract that time of payment was of the essence.

The court has highlighted the importance of clearly drafted clauses. It would be sensible to identify the terms in the agreement which will entitle a party to terminate. Also, where time is of the essence and is essential to the performance, the agreement should expressly state this, as it will not always be implied. Care should also be taken to ensure that the consequences of including a time of the essence provision work together with other provisions of the contract, in particular, those relating to

termination and remedies.

## 6. Equitable set-off

In the case of *Geldof Metaalconstructie NV v Simon Carves Ltd* [2010] EWCA Civ 667 the court has clarified the test for equitable set-off (that is, when a defendant may raise cross-claims as a defence in equity (as opposed to at law or contractually)).

Geldof entered into two separate contracts with Simon; the first related to the supply of items to Simon (the supply contract) and the second, to the installation of other items (the installation contract).

Relations deteriorated and Geldof refused to continue work under the installation contract unless Simon paid invoices relating to both contracts. In response, Simon issued a notice of termination under the installation contract blaming Geldof's repudiatory breach. When Geldof commenced proceedings for payment under the supply contract, Simon counter-claimed for damages for repudiation of the installation contract.

By insisting on payment of invoices under the supply contract as a precondition of continuing performance under the installation contract, the court found that Geldof had brought the two contracts into intimate relationship with one another. Furthermore, the relationship became inseparable and irrevocable when Simon brought the installation contract to an end.

The court decided that although the two contracts were separate from one another, there were practical links between the two; both related to work at the same site and the goods provided under the supply contract were of no use to Simon unless Geldof carried out performance under the installation contract.

Simon was, therefore, entitled to set-off its counter-claim as it would have been manifestly unjust to enforce payment under the supply contract without taking into account the cross claim for repudiation of the installation contract.

Rix LJ (who gave the leading judgment), having run through a significant

number of recent cases on the subject, clarified the test for equitable set-off as having two elements (rather than being a two-stage test) – (i) a formal requirement of close connection between claim and cross-claim, and (ii) that it would be unjust to enforce the claim without taking into account the cross-claim. The best restatement of the test was whether the cross-claim was so closely connected with a claimant's demands that it would be manifestly unjust to allow him to enforce the claim without taking into account the cross-claim.

Be aware - a party may open itself up to a set-off defence if it links two separate contracts in the manner described above. Consider contractually excluding equitable set-off where separate but closely connected contracts are entered into with the same supplier.

## 7. Putting things right – rectification of mistakes in commercial contracts

Generally, the courts are willing to rectify agreements where parties have made a genuine mistake in expressing their true intentions. As the case of *Surgicraft Limited v Paradigm Biodevices Inc* [2010] EWHC 1291 illustrates, the courts may take this approach despite the presence of an 'entire agreement' clause.

Here, when Surgicraft validly terminated its agreement with Paradigm following a change of control in Surgicraft, Paradigm claimed that it was the intention of the parties that it would be entitled to compensation in the event of such a termination. Surgicraft denied there was a mistake and argued that even if there was a mistake it could rely on the entire agreement clause which prevented rectification.

The court decided that both parties had made a common mistake and that it was a common intention that Paradigm would receive compensation. Surgicraft's reliance on the entire agreement clause was rejected by the court, which held that the purpose of such a clause is to limit possible contractual claims arising from dealings outside the agreement and not, to prevent rectification.

The case of *Traditional Structures Ltd v HW Construction Ltd* [2010] EWHC

1530, however, was concerned with rectification of a mistake by one party, a unilateral mistake.

On submitting its final tender for steel work and roof cladding, Traditional omitted the price for cladding in error. The error only became apparent when Traditional requested payment for both steel work and roof cladding. HW refused to pay more than the original quote and Traditional issued a claim against HW, claiming rectification of the contract, by reason of unilateral mistake.

The court ordered rectification of the contract and held that HW had “wilfully and recklessly” failed to enquire about the pricing having had actual knowledge that Traditional had made a mistake and that HW’s behaviour was “unconscionable”.

Both cases serve as a useful reminder of the need for clear and concise drafting and making sure the agreement reflects what the parties have agreed.

## 8. Mistakes in commercial contracts: How hard must you try?

A common point of contract negotiation is the level of endeavour to apply to various obligations, from lowest to highest: “reasonable”, “all reasonable” or “best”. (“Commercially reasonable” has been imported from the US but not been considered in any English case.) Although these terms are common currency, their meaning was discussed in *CPC Group Limited v Qatari Diar Real Estate Investment Company* [2010 EWHC 1535 (Ch)].

The case concerned a real estate development, but its findings on endeavours are relevant to contracts generally. The defendant, owned by the Qatari Investment Authority, entered into a joint venture with the claimant, relating to the upscale development of the Chelsea Barracks site. The defendant then bought out the claimant, some of the purchase price (£81 million or 64%) being deferred until the development had received planning permission. The contract obliged the defendant to “...use all reasonable but commercially prudent endeavours to enable the achievement of the various threshold events and Payment Dates...” In the

*‘A useful reminder of the need for clear and concise drafting and making sure the agreement reflects what the parties have agreed.’*

event, the Prince of Wales disliked the proposal (too modern) and so told the defendant, and the Prime Minister and the Emir of Qatar. The Mayor of London (whose office had powers over the approval) also disliked it publicly (too repetitive). Not a little press comment ensued. The defendant withdrew its planning application.

CPC sued Qatari Diar for (among other things) breaching the above obligation. CPC claimed that a party obliged to use “all reasonable endeavours” must, if necessary, subordinate its own financial interests to obtaining the desired result. This argument was based on Lewison’s *the Interpretation of Contracts* (2007) and *Rhodia International Holdings Ltd v Huntsman International LLC* [2007] 1 CLC 59. In that case, it was held that “reasonable endeavours” probably required the obligor to take only one of a number of reasonable courses of action whereas “best” probably required all courses to be taken, and that “all reasonable” could well equate to “best”. The judge, however, cited the Court of Appeal’s decision in *Yewbelle Limited v London Green Developments* [2007] EWCA Civ. 475, that “all reasonable endeavours” does not always imply an obligation to sacrifice one’s commercial interests. In the present case, the words “but commercially prudent” (although not critical to the decision) supported the interpretation that the sacrifice was not required, thus allowing the defendant to take into account its own commercial interests.

## 9. Interpretation of defined term – Tense argument

We have commented in an earlier edition of *Commercial Thinking* on certain of the points arising from the High Court decision in *GB Gas Holdings Limited v Accenture (UK) Limited and Ors* [2010] EWCA Civ 912. Since then, the case has gone to the Court of Appeal which has, with one exception, upheld the High Court decision on all issues.

The issue on which the High Court judgment has been overturned related to the specifics of the contract and the detail of the wording actually used. It is worth noting this as an example of how important it can be to use precise wording when drafting a contract and also how important it is to look carefully at that wording when reviewing a draft prepared by another party.

The contract was for the supply by Accenture of customer billing system

 **SALANS** *...an example of how important it can be to use precise wording when drafting a contract and also how important it is to look carefully at that wording'*  
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software to GB Gas (referred to as “Centrica”). It is clear from the case report that the provisions of this agreement were comprehensive and sophisticated. As regards defects in the software, the agreement distinguished between what were defined as “Material Defects” and “Fundamental Defects”. Accenture’s obligations to correct defects varied according to the category of the defect and arose if Centrica notified the defect before the end of a stipulated warranty period. The agreement also provided that Centrica could claim damages for breach only if Accenture failed to take corrective action in respect of defects which had been notified.

“Material Defect” was defined as a breach “which has or is likely to have an adverse effect”. “Fundamental Defect” was defined as a breach “which causes a severe adverse effect”. The Court of Appeal held that Centrica could not notify Accenture of a Fundamental Defect unless, at the time of notification, the defect had by then caused a severe adverse effect on Centrica’s business. The Court of Appeal rejected the argument that the word “causes” should be interpreted to include also “could cause” or “will cause”. It followed, therefore, that if the defect in question had not caused an actual severe adverse effect by the time of the notification then the defect could only be included in the “Material Defects” category and with a different level of obligation upon Accenture in consequence.

This decision, therefore, did not allow for the possibility of a severe adverse effect crystallising only after the end of the stipulated warranty period no matter how certain that may be but the court commented that it was not surprising that the parties should have wanted to draw a line as to what Fundamental Defects had arisen at the end of that period. It is not possible to speculate as to what might have been the intentions of the parties when they entered into the agreement but the Court of Appeal decided that it did not need to look beyond the language actually used.

It is worth noting that a contrast can be made between this case, where the Court of Appeal had no difficulty in construing a defined term by reference to the actual wording used, and a recent High Court case, *State Street Bank & Trust Co v Sompo Japan Insurance Inc* [2010] EWHC 1461 (Ch). In the *State Street Bank* case the Court held that there had been a mistake in the wording of a defined term. This related to the amount which a party to a financial transaction should reimburse to a guarantor. The Court held that the defined term omitted an important component in the calculation of

the amount to be reimbursed and that this was obviously a mistake in the document. The Court went on to construe the defined term and the operative provisions of the agreement on the basis that the missing component was included in the definition.

## 10. Interest on commercial debts – is it enough?

The Late Payments of Commercial Debt (Interest) Act 1998 has not attracted much attention in the courts it seems. The High Court has now, however, provided some guidance as to how the provisions of the Act are to be applied.

The Act applies statutory interest to an unpaid debt for the price payable under a contract for the sale of goods or the supply of services (including, for example, the hiring of goods but not a consumer credit agreement). Simple interest runs at the statutory rate from the day after the agreed date for payment or, if no date has been agreed, 30 days after the supply has been made or, if later, the amount is notified to the purchaser. Special rules apply to advance payments and to hiring agreements. In addition to statutory interest, the Act provides for the payment of a one-off sum of between £40 and £100, depending on the amount of the debt.

The rate of statutory interest is set by HM Treasury and at the time the court heard the case mentioned below in early 2010, it was 8% over base rate.

In the case of *Yuanda (UK) v WW Gear Construction Limited* [2010] EWHC 720 (TCC) the contract, which was for the supply and installation of glazed curtain walling, stipulated a contractual rate of interest of 0.5% over base rate for late payment. The Act does allow the parties to agree a contractual rate in substitution for statutory interest provided that the contract does include “a substantial contractual remedy for late payment of the debt”. The Act goes on to set out the meaning of “substantial remedy” although, it must be said, this is more in the nature of guidelines rather than a definition. There are a number of criteria to be considered but perhaps a key item is that the remedy must be sufficient to compensate the supplier for late payment or for deterring late payment.

The court considered that a rate of interest materially below the statutory

rate could fulfil the requirements of a substantial remedy and that statutory interest was, in effect, a penalty that the supplier should pay if it failed to provide in the contract a fair remedy for late payment by it to its supplier. The court concluded, however, that 0.5% over base rate could not be regarded as a substantial remedy in the absence of special circumstances. There were no special circumstances applying in this case and the judge concluded that the contractual provision for interest was void under the Act. The statutory interest should, therefore, be applied.

## 11. Liquidated damages

It is well established that contractual liquidated damages are enforceable but penalties or deterrents are not. In the leading case of *Dunlop Pneumatic Tyre Co Limited v New Garage and Motor Co* [1915] AC 79, the judge said that the essence of a penalty was to be a deterrent to the offending party, while the essence of liquidated damages is a genuine pre-estimate of the injured party's loss from the offending party's breach of contract; the sum would be penal if it was extravagant and unconscionable in comparison with the greatest loss that could conceivably be proved to have followed from the breach.

In *Azimut-Benetti Spa (Benetti Division) v Healey* [2010] EWHC 2234 (Comm), the claimant entered into a contract with the defendant's subsidiary to build a luxury yacht, with payments guaranteed by the defendant. The contract provided that if the subsidiary did not pay on time, the claimant could terminate the contract and retain and/or recover from the subsidiary 20% of the contract price as liquidated damages for estimated losses. The subsidiary failed to pay, the claimant sought to enforce the guarantee, the defendant responded that the 20% was penal, and the claimant sued for summary judgment.

The claimant brought evidence that, in addition to the negotiations for this yacht, the claimants were also involved in negotiations to sell another yacht to an unrelated party, that the same lawyers and yacht brokers advised the buyer on that negotiation as on the defendants' negotiations for a yacht and that this second negotiation included lengthy debate as to whether the liquidated damages for the same breach should be 10% or 20%, including as to whether the buyer would agree to unliquidated damages rather than the liquidated sum. The claimant argued that this indicated that the clause in its own contract with the defaulting subsidiary had a commercial and

compensatory justification. The court agreed.

The court rejected the defendant's argument that the matter should proceed to full trial. The court did not consider that it must decide the maximum possible loss that the parties would have expected to flow from the determination of the contract, which would require extensive disclosure.

In finding for the claimant, the court also noted that both parties had the benefit of expert advice in negotiating the contract and that the terms of the contract, including the liquidated damages, were freely entered into. It said that, in a commercial contract of this kind, what the parties have agreed should normally be upheld.

Bearing in mind those points and the evidence, when negotiating liquidated damages provisions, it can be useful to keep a record of the process of the negotiations and the commercial rationale.

## **12. Extension of in-house legal privilege rejected by EU's highest court**

On 14 September 2010, the European Court of Justice (the "ECJ") held that communications passing between in-house lawyers and their internal clients, in the context of European Commission (the "Commission") investigations, do not attract privilege.

The ECJ's decision arises from a dawn raid, carried out by the Commission and the UK Office of Fair Trading (the "OFT"), on the UK premises of Akzo Nobel Chemicals Limited ("Akzo Nobel") in 2003. Among the documents seized were emails involving Akzo Nobel's in-house lawyers. Akzo Nobel argued that these emails were protected by legal professional privilege; the Commission disagreed.

At first instance, the General Court held that the emails in question were not protected by privilege, primarily on the basis that the advice given by in-house lawyers lacks the necessary independence to attract privilege.

Akzo Nobel's appeal has now been dismissed by the ECJ, which upheld the General Court's decision. The logic was essentially the same, namely, that an in-house lawyer does not enjoy the same degree of independence

as an external lawyer, and so (the argument goes) an in-house lawyer is less able to deal effectively with any conflicts between his professional obligations and the aims of his client.

The ECJ's ruling is based on a previous ruling of the same court (*AM&S Europe v Commission* [1982] ECR 1575), and so the Akzo Nobel ruling does not change the law in this area, but rather reaffirms its earlier position. However, an opportunity to extend the scope of legal professional privilege in the context of Commission investigations has been missed. The ECJ did not accept that the role of in-house lawyers has changed since 1982, which, some might say, is unfortunate.

As a matter of English law, communications passing between in-house lawyers and their internal clients are protected by privilege, and the ECJ's decision does not change that. At the same time, the ECJ's decision exposes a potential conflict between English and European law; communications passing between in-house lawyers and their internal clients may be protected from disclosure to the OFT, but not to the Commission. Any inconsistency between investigations carried out by the OFT and the Commission is surely in no-one's best interests.

In the context of EU competition law issues, companies should consider, for example:

- Asking in-house lawyers to give their advice orally
- Taking care about the creation of preparatory documents which are not in fact sent to external lawyers
- Restricting the circulation of legal advice, because wide dissemination of advice may lead to the loss of privilege
- Ensuring that any external legal advice that is given is circulated in the same form as it was received from the external lawyers
- Avoiding any detail of the in-house advice in board minutes, notes of meetings, etc.

In addition, the rules governing legal professional privilege vary significantly between jurisdictions, and so local advice should always be taken in the context of investigations by national competition authorities.

*'An in-house lawyer does not enjoy the same degree of independence as an external lawyer, and so (the argument goes) an in-house lawyer is less able to deal effectively with any conflicts between his professional obligations and the aims of his client.'*

### 13. OFT publishes for consultation practical Guidance for company directors on competition law compliance

On 19 October 2010, the OFT published for consultation Guidance for company directors in the UK on their duties under competition law. This follows previous Guidance on Director Disqualification Orders and aims to assist directors in knowing what they ought to know about competition law and their role in ensuring a compliance culture.

In the draft Guidance, the OFT distinguishes the role of executive and non-executive directors. In all cases, however, the OFT states that company directors are expected to demonstrate a commitment to competition law compliance, to assess the company's exposure to competition law infringements and to take appropriate steps to mitigate those risks. The OFT states that it considers that "it is reasonable to expect **all directors** [sic.] to understand that compliance with competition law is important and that infringing competition law could lead to serious legal consequences for the company and for them as individuals".

The OFT provides examples of anticompetitive behaviour and the circumstances in which directors may be found to be responsible for, and personally liable for, such behaviour. The examples include price fixing, bid rigging and the exchange of confidential price information with competitors. The examples do not include some of the more difficult issues which directors might face, but this does not mean that the OFT will not look to put responsibility for competition law breaches onto directors in less straightforward cases.

Directors should consider putting a competition law compliance policy in place, backed by a senior compliance officer and suitable training. This could be achieved at the same time as implementing procedures to prevent bribery, which are advisable in the light of the coming into force of the Bribery Act 2010, in April 2011.

## 14. Other Hot Topics

**New codes on data protection** - Since our last edition, the Information Commissioner has published two detailed codes of practice. The first is the **Assessment Notices code of practice** in relation to its new assessment notices powers. Under these powers the ICO will be able to undertake compulsory audits of certain data controllers. The code sets out a framework as to how such audits should be conducted. Currently they only apply to government departments but the ICO has indicated that he is likely to seek an extension of his powers to undertake compulsory audits in both the public and private sectors. The **Personal information online code of practice** is an essential read for any business operating in an online environment. This provides practical guidance on issues such as how the Data Protection Act applies to information processed online, marketing goods and services online, privacy choices, operating internationally and individuals' rights. There is also a helpful list of practices to be avoided which could result in enforcement action being taken. A more detailed analysis will be included in the next Commercial Thinking.

**Copyright in computer programs** – Unauthorised literal copying of the whole or a substantial party of the source code of a computer program can be copyright infringement. Writing a program which merely replicates the functions of a program, having observed and tested it, is not infringement. But is there a grey area where non-literal copying can be an infringement? The court, in the case of *SAS Institute Inc v World Programming Ltd* [2010] EWHC 1829 (Ch), has referred to the European Court of Justice the questions related to the possibility of infringement by non-literal copying. We'll report when the ECJ issues its decision.

**Company names** – The Company Names Tribunal has, for the first time in a full hearing, rejected an application for a change of name. Zurich Investments Limited had been registered under that name since 1999. It had not offered investment services. In 2009, Zurich Insurance Company applied for that company named to be changed on the basis that (a) it had the same name as that associated with the applicant in which it had goodwill, or (b) the names were sufficiently similar that use of the name would be likely to mislead by suggesting a business connection between the companies, and that the name ZURICH was associated with it. The tribunal refused the application. Basis (a) failed because the names were

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not the same. Basis (b) failed because the respondent was able to show it adopted the name in good faith, being one of the statutory defences.

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