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Employment update

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Penalty clauses: what is the test where a clause is claimed to be unenforceable?

Cavendish Square Holding BV v El Makdessi and ParkingEye Ltd v Beavis

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Redundancy: does a resignation following unilateral substantial change in working conditions count as "redundancy" under the Collective Redundancies Directive?

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Property Alliance Group Limited v The Royal Bank of Scotland Plc
(5 November 2015)

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Any comments or queries?

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Litigation privilege: is the "dominant purpose" requirement satisfied where recordings are secretly made?

***Property Alliance Group Ltd v Royal Bank of Scotland Plc* (20 November 2015)**

The court held that where a litigant had secretly recorded meetings he had made with two of the defendant's former employees, the recorded conversations and their transcripts were not privileged information. more›

Privilege: Quick refresher and practical tips

What is privilege?

If you are able to hold privilege over a document, you may withhold it from being shown to another party, including the courts and tribunals. The communication must remain confidential, or privilege is lost. "Document" has a very wide meaning and includes hard copy (notes, correspondence, memos, agreements, forms, calendars, financial statements etc) and electronic documents (computer files, e-mails, CD-ROMS, tape recordings, texts, voicemails etc).

more›

Penalty clauses: what is the test where a clause is claimed to be unenforceable?

Cavendish Square Holding BV v El Makdessi and ParkingEye Ltd v Beavis

The Supreme Court has recently considered two appeals relating to whether certain contractual clauses were penalty clauses (and therefore unenforceable) and restated the principles underlying the penalty rule.

This area of law had not been reviewed in the Supreme Court for over a century, with *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd* the leading case.

Facts

Though heard jointly, the two cases differ substantially in fact. In Cavendish, the Defendant sold a controlling stake in a company to Cavendish, agreeing the purchase price was payable in instalments. The agreement also included an anti-competition covenant. Should the defendant compete, the agreement contained two clauses – one stating he forfeited his right to the final two purchase price payments, and the other stating he could be forced to sell his remaining shares at a price based on asset value, ie at a price which excluded goodwill. Mr Makdessi breached the covenant and Cavendish brought proceedings. Mr Makdessi argued the clauses were penalties and therefore unenforceable.

ParkingEye revolved around an £85 parking charge Mr Beavis was given for overstaying a two hour parking limit at a shopping centre. Mr Beavis contested his liability on the basis it was either a penalty or contrary to the Unfair Terms in Consumer Contract Regulations 1999.

The old test

The decision in *Dunlop* contained a set of principles to assist in determining if a clause could be considered a penalty. The over reliance and quasi statutory status of these principles was heavily criticised in the Supreme Court's judgment.

The original test in *Dunlop* considered whether a clause was a genuine pre-estimate of a party's loss or had a deterrent effect. If it was a genuine pre-estimate it was enforceable, but if it bore no relation to the maximum loss a party could have realistically suffered, and its purpose was to act was a deterrent, it was a penalty.

It is important to note the Supreme Court has not abolished Dunlop, it is still applicable when deciding if a clause is a penalty, but it has also created a new test.

The new test

Whether a clause is a genuine pre-estimate of loss or acts as a deterrent is not a deciding factor in the new test. Instead, it contains two steps:

- Is a legitimate business interest being served and protected by the clause?
- Is the provision made for that interest extravagant, exorbitant or unconscionable?

The Supreme Court also confirmed that the interest does not necessarily have to be financial, it can also apply to obligations to transfer assets (as was the case in the second clause of *Cavendish*). In addition, a clause does not have to purely cover compensation for breach, it can take into account wider interests.

Outcome

The Court held that in both *Cavendish* and *ParkingEye* the clauses were not penalties and were enforceable.

On the facts of *Cavendish*, both clauses had a legitimate interest to protect the goodwill of the Cavendish group, and the clauses were not extravagant in the context of a carefully negotiated agreement between two legally advised parties.

In *ParkingEye*, the Court recognised that under the *Dunlop* principles the charge would not have been considered a genuine pre-estimate of loss, and could be considered to have a deterrent effect. However, the Court determined that *ParkingEye* had a wider legitimate interest – namely the interests of its employers/landowners. It also did not consider the scheme excessive or unconscionable simply because some customers underestimated the time required for shopping. Both limbs of the new test were satisfied.

Points to note

It is important to note that the relevant provisions in *Cavendish* were contained as terms of the sale of a business, in an extensively negotiated document between parties of equal bargaining power. In employment contracts there is assumed to be an inequality of bargaining power. The clauses found within employment contracts are, therefore, more likely to be assessed with far greater scrutiny.

The new test provides far greater flexibility than principles in Dunlop, but this also results in more uncertainty as to what is or is not a penalty clause. There is particular concern over how certain terms in the new test will be interpreted and defined, namely "a legitimate interest" and "extravagant, exorbitant or unconscionable".

It is important to remember that *Dunlop* has not been abolished. The principles do still apply, and in straightforward damages cases it is possible the *Dunlop* principles alone will be adequate in determining the validity of the clause.

For employers, when seeking to avoid falling foul of the penalty doctrine, when for example drafting a restrictive covenant in an employment contract, the following should be borne in mind: ensure that the drafting provides for a series of primary and/or conditional primary obligations which fall outside the scope of the penalty doctrine all together. It may also be wise to specifically address the commercial rationale and legitimate business interests being protected and the proportionality between the detriment in question and potential consequences of breach.

The new rule applies to all future cases, so will have a retrospective effect, as the new rules will apply to disputes relating to contracts already in existence.

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Redundancy: does a resignation following unilateral substantial change in working conditions count as "redundancy" under the Collective Redundancies Directive?

Pujante Rivera v Gestora Clubs Dir SL and another

The ECJ has held that the definition of "redundancy" in the European Collective Redundancies Directive (the Directive) is wide enough to include resignations where the employer has unilaterally made a significant change to essential elements of an employee's employment contract, for reasons unrelated to the individual, which cause them substantial detriment.

Facts

The Spanish company Gestora Clubs Dir SL (Gestora) dismissed 10 employees between 16 and 26 September 2013 on objective grounds. Mr Pujante Rivera was one of these employees. During the 90 day period preceding the last of these dismissals, an additional 22 contracts were terminated for various reasons. These terminations included a resignation by an employee which was in response to Gestora's reduction of her salary by 25%.

Mr Pujante Rivera brought proceedings against Gestora challenging the validity of his dismissal. He alleged that his redundancy was invalid as Gestora had failed to carry out a collective redundancy process. He put forward that, if account had been taken of the terminations which occurred in the 90 day period before and after his own redundancy, the necessary threshold for collective consultation was satisfied.

The Spanish national court stayed the proceedings and referred a number of questions to the ECJ regarding the interpretation of the Directive. One of these questions asked whether an employee's resignation in response to an employer's significant unilateral variation of a contract to their detriment amounted to a redundancy for these purposes.

Outcome

The ECJ held that the Directive does cover a situation where an employee resigns as a result of unilateral and significant changes by their employer to essential elements of their contract for reasons not related to them as an individual and which are to their detriment.

The ECJ noted that the Directive does not expressly define the concept of "redundancy". However, as the purpose of the Directive is to afford workers greater protection in the event of collective redundancies, it can be said to include any termination of an employment contract not sought by the worker and, therefore, without his consent.

The ECJ also noted that in the present case, the worker resigned and so could be said to have sought her own termination. However, termination of the employment relationship arose from the unilateral change made by her employer to an essential element of her employment contract for reasons unrelated to her personally.

The court stated that "redundancy" should not be given a narrow definition for these purposes. Excluding employees from the protection of the Directive whose contracts are terminated in circumstances such as those in the proceedings would alter the scope of the Directive and deprive it of its full effect.

Points to note

It has long been established that the definition of "redundancy" under the Directive has a much wider meaning than redundancy for the purposes of statutory redundancy. This decision has now confirmed that the wide definition of "redundancy" also includes resignations where an employer has unilaterally made significant and detrimental changes to essential elements of an employee's employment contract for reasons not related to them as an individual.

The decision shows that even when an employer considers that they have reached an agreement with an employee, the Courts are prepared to look beyond this to see why such an agreement was needed in the first place. Employers should therefore ensure that they are careful when commencing any redundancy exercise and or variation of terms and conditions to ensure they do not fall foul of the collective consultation obligations.

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Legal advice privilege: does it extend to factual information?

Property Alliance Group Limited v The Royal Bank of Scotland Plc (5 November 2015)

The High Court has ruled that legal advice privilege is not restricted to actual legal advice but can extend to factual information exchanged between lawyer and client in the course of giving advice.

Facts

In this ongoing case Property Alliance Group Limited (PAG) contends that the Royal Bank of Scotland Plc (RBS) mis-sold swap contracts to PAG in the period 2004 to 2008. RBS asserted privilege in various categories of documents prepared by its external lawyers relating to meetings of the bank's Executive Steering Group (ESG), which was a special committee formed by the bank to oversee the regulatory investigations in relation to LIBOR misconduct and related litigation and to liaise with the bank's lawyers.

The court was required to determine whether RBS had properly claimed legal advice privilege over documents otherwise subject to disclosure in ongoing litigation. Snowden J was appointed as the inspecting judge. The documents fell into either of two categories.

- Confidential memoranda in the form of tables, which informed and updated the ESG on the progress, status and issues arising in the regulatory investigations. Many of the relevant entries in the body of documents were no more than a brief factual recital of a recent event that had occurred or which was scheduled that would not, by their nature, have attracted privilege.
- Confidential notes/summaries concerning the discussions between the ESG and its legal advisors at the ESG meetings. These notes reflected the external lawyers' views on the regulatory investigations, as the firm ultimately determined the information to be included in the notes.

Outcome

Snowden J upheld RBS's claim to legal advice privilege in respect of both categories of documents. He noted that the areas of debate as to the proper extent of legal advice privilege have arisen from two sources: firstly, over the years, solicitors have tended to offer their clients a range of what might loosely be described as "business" services; and secondly, that not all communications between a solicitor and his client will necessarily be for the purposes of giving or obtaining legal advice.

The court was entirely satisfied that the external lawyers were engaged by RBS in a "relevant legal context" and that both categories of document formed part of "a continuum of communication and meetings" between lawyer and client, the object of which was the giving of legal advice as and when appropriate.

The judge considered that the first category of documents constituted "information ... passed by the solicitor or client to the other as part of the continuum aimed at keeping both informed so that advice may be sought and given as required" as they were entirely focused on providing the information concerning the regulatory investigations which the ESG needed to know.

As for the second type of document, the summary minutes showed that the lawyers from different jurisdictions supplemented the contents of the tables with reports and references to meetings and communications that they had with regulators on behalf of RBS. Importantly, the lawyers gave their impressions of those matters, responded to questions as to RBS' position and gave their suggestions as to what the bank should do next in the context of the investigations.

Snowden J did also comment, however, that he could well see that, depending on the facts, a court might not uphold a claim to privilege in respect of the minutes of a business meeting simply because the minutes were taken by a lawyer, or to press cuttings provided from its own library to a client for a board meeting where the client's own public relations department could not find them. This would be because the lawyer was not "being asked qua lawyer to provide legal advice".

For completeness, Snowden J considered whether the communications within the ESG documents fell within the policy underlying the justification for legal advice privilege. He concluded that they did; there is a clear public interest in regulatory investigations being conducted efficiently and in accordance with the law. That public interest will be advanced if the regulators can deal with experienced lawyers who can accurately advise their clients how to respond and co-operate. Such lawyers must be able to give their client candid factual briefings as well as legal advice, secure in the knowledge that any such communications and any record of their discussions and the decisions taken will not subsequently be disclosed without the client's consent.

Points to note

This decision confirms that legal advice is not restricted to actual legal advice, but also includes factual information communicated between lawyer and client in the course of giving legal advice.

The decision is helpful for businesses faced with regulatory investigations, where legal advice and decision making may be based on the information provided by investigations and other third parties. Ultimately, however, the question of privilege will always be fact-dependant. The case therefore serves as a reminder that businesses will need to be alive to the issue of privilege in setting up their lines of communication from the start.

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Litigation privilege: is the "dominant purpose" requirement satisfied where recordings are secretly made?

Property Alliance Group Ltd v Royal Bank of Scotland Plc (20 November 2015)

The court held that where a litigant had secretly recorded meetings he had made with two of the defendant's former employees, the recorded conversations and their transcripts were not privileged information.

Facts

The Royal Bank of Scotland Plc (RBS) applied for Property Alliance Group Limited (PAG) to allow inspection of certain audio recordings and transcripts of those recordings over which PAG has asserted privilege.

In the months preceding and subsequent to filing its claim form, PAG's managing director had arranged meetings with two men who had worked for RBS.

The managing director led them to believe that he was interested in setting up business relations between PAG and the men's new companies. However his real motive for arranging these meetings was to seek assistance in PAG's claim against RBS.

He secretly recorded the meetings in the hope that they would yield evidence to support PAG's claim.

In the course of disclosure during the claim's proceedings, PAG accidently included an email to its solicitors that mentioned the recordings and the meetings, inadvertently bringing their existence to RBS's attention.

The issues the court had to consider were whether RBS should be permitted to inspect the audio recordings and their transcripts and the email referring to the recordings. PAG contended that both the recordings and transcripts were subject to litigation privilege as they were created for the purpose of gathering evidence for use in its claim, and that the situation was indistinguishable from one where a solicitor arranged a meeting with a potential witness to take a proof of evidence.

Outcome

The court granted the application. It held that the test for establishing litigation privilege was whether the recordings and transcripts had been produced for the "dominant purpose" of conducting litigation. However, litigation privilege could not apply to a verbatim recording of a conversation for use in litigation, or the transcript of such a recording, unless the conversation itself was privileged.

The question of whether the conversations between PAG and RBS's former employees turned on the dominant purpose of the meetings. The court held that this is an objective question, which should take into account all the evidence, including what the parties involved said their intentions were.

The court decided that it was clear that the managing director arranged the meetings to gather evidence for litigation. Equally clear was the fact that the former employees attended these meetings with the purpose of discussing future business. From just these facts, it was not possible to distil a dominant purpose as they are two clear entirely divergent purposes.

The critical point was that the managing director had actively deceived RBS's former employees. This deception distinguished the situation from the example of a solicitor taking a proof of evidence from a potential witness.

Therefore, it was held that the dominant purpose of the meetings had not been litigation, thus the meetings were not privileged and neither were the recordings, transcripts or email. Consequently RBS was entitled to inspect them.

Points to note

This case highlights the importance of the "dominant purpose" requirement in litigation privilege. Where there is not one clear dominant purpose, privilege cannot be asserted. The test is an objective one.

Where you are seeking to assert litigation privilege over a document, ensure that all parties are aware that the dominant purpose is the prospect of litigation.

Also see this blog, written by our Commercial Disputes' Partner Davina Given, which comments on an earlier instalment in the LIBOR swaps proceedings where the High Court considered "without prejudice" communications with a regulator.

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Privilege: Quick refresher and practical tips

What is privilege?

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Quick overview of the main types of privilege

- Legal advice privilege covers confidential communications passing between a client and his lawyer for the purpose of giving or receiving legal advice.
- Litigation privilege covers confidential communications with a lawyer or third party for the dominant purpose of litigation.
- Without prejudice privilege covers communications which are made in a genuine attempt to settle a dispute.

Practical steps

Do

- Instruct colleagues or employees to mark all communications in relation to obtaining legal advice as "privileged and confidential".
- Circulate privileged documents only on a need to know and confidential basis.
- Review emails before forwarding them on.
- Keep business and practical advice/communications (which are not privileged) separate from legal advice.
- Avoid the temptation to respond to a crisis by telling lots of people about it in unnecessary and unhelpful detail.
- With contentious matters, consider organising a specific team to communicate with the lawyers.
- Assume that any document created may be seen by a judge so think about your language as how you put things may be read out of context.
- Remember that there is no "private", "personal", "confidential", "secret" or "off the record" communication. For disclosure in litigation, all communications which are relevant and not privileged must be disclosed.
- Adhere to all document retention policies.
- Contact RPC if in doubt.

Do not

- Assume that marking a document "privileged" makes it so.
- Assume that just copying in a lawyer to communications means that privilege arises.
- Make any suggestions that privilege has been waived whether expressly or impliedly.
- Refer to without prejudice communications in unprivileged documents.
- Create unnecessary documents (eg emails, briefings, handwritten notes, presentations) in a hasty reaction to contentious or sensitive issues without legal supervision.
- Mark documents with any inappropriate comments. Remember that the obligation to disclose extends to copies of originals with comments or annotations on them.
- Destroy relevant documents if there is a prospect of legal proceedings.

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About RPC

RPC is a modern, progressive and commercially focused City law firm. We have 78 partners and over 600 employees based in London, Hong Kong, Singapore and Bristol.

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- **Winner – Competition Team of the Year – Legal Business Awards 2014**
- **Winner – Best Corporate Social Responsibility Initiative – British Insurance Awards 2014**
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