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# business matters!

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# Welcome to business matters!...

by Matthew Atkins  
Partner

There have been some changes since our last edition of Business Matters was published in 2009; we have a new government in the UK and Robert Peston has not been quite so prominent in BBC news broadcasts recently. However these remain uncertain times for the economy and both the (new) Chancellor and the (same) Governor of the Bank of England continue to tell us that the going will be sticky for some time to come.



For the moment, there continue to be some long faces about. To continue on the horse racing theme, there is a line in a novel by Anthony Powell that is apposite here:

**“His face bore that look of sadness with which you associate people accustomed throughout their lives to the boundless unreliability of horses.”**

For ‘horses’ read ‘the economy’. Short of joining together in a stirring sing-song (‘Jerusalem’? ‘Always Look on the Bright Side of Life’? ‘Come up and See Me (Make me Smile)’?) I suspect that there is little that we can do (individually or collectively) to cheer ourselves up. When the going improves so will our collective mood. Until then it really is a question of doing the best we can in difficult circumstances.

I recognise, however, that tough times give rise to both challenges and exciting opportunities. The businesses that do best in the current economic climate will be those who prepare themselves to deal with both, whenever and however they arise. The theme of meeting challenges and exploiting opportunities is one that we continue in this edition of Business Matters. Some of the articles address the challenges that are being faced; some the opportunities that will unquestionably arise. Others simply recognise that life goes on. Whether you are facing challenges or seizing opportunities we have the resources to help you.

For any queries please contact Matthew Atkins on 01473 406211 or [matthew-atkins@birketts.co.uk](mailto:matthew-atkins@birketts.co.uk)

[www.birketts.co.uk](http://www.birketts.co.uk)

# Pre-Packs: an update

by  
Mark Henry  
Partner



## What is a pre-pack?

A pre-pack is a deal for the sale of an insolvent company's business or assets which is put in place before a company goes into a formal insolvency procedure, usually administration. The sale is then executed immediately following the appointment of the administrator or liquidator etc.

## What is the focus of the criticism?

The main focus of the criticism is that pre-packs unfairly prejudice unsecured creditors (i.e. the trade creditors and other creditors who do not hold security) and enable unfair competition.

## What are the justifications for them?

That they save businesses and jobs.

## Are they legal?

The courts have endorsed the pre-pack as legitimate but:

(1) The courts have placed great reliance on the expertise and experience of **impartial** Insolvency Practitioners and in a case where evidence had been produced to support the allegation by a creditor that the administrator had failed to conduct himself independently, the court held that the evidence raised a serious issue for investigation;

(2) There are proposals for the law in this area possibly to be changed - see below.

## Is there any regulation of pre-packs?

The concern about the use and abuse of pre-packs led to the issue of Statement of Insolvency Practice 16 (SIP 16) with effect from January 2009. SIP 16 sets out basic principles and procedures which Insolvency Practitioners are required to comply with to avoid disciplinary or regulatory action, but it does not have force of law. Among other things, it requires administrators on a pre-pack to keep a detailed record as to why a pre-pack has been chosen as the best course of action for creditors. This demonstrates they have performed their functions in the interests of creditors as a whole and discloses certain information to creditors - including the identity of the buyer, any connection it has with the directors etc. of the insolvent company, valuations and alternative courses of actions considered.

The Insolvency Service published its first annual report on SIP 16 in March which concluded that the requirements of SIP 16 were not being adequately complied with in 38% of cases. Insolvency Practitioners would point out that material non-compliance (justifying a formal complaint to the regulatory body) only accounted for 7% of these cases, whilst conversely pre-pack critics would argue that there are likely to be many more Insolvency Practitioners who simply do not report their pre-packs to the Insolvency Service!

The last government announced consultation on new measures to boost confidence in pre-packs, including possible changes to the law, and this is likely to remain near the top of the political agenda with the new government. Some of the options that will be considered may include:

- putting SIP 16 on a statutory footing with penalties for non-compliance;
- provision for automatic scrutiny of directors' and administrators' actions by the Official Receiver (who is regarded as an independent public official) following a pre-pack;
- making it impossible for the Insolvency Practitioner advising on the pre-pack to become the administrator;
- requiring court or creditor sanction for pre-pack deals involving connected parties.

As always, there are pros and cons in respect of the effectiveness/practicality of each of the above options.

It is self-evident that pre-packs to connected parties - i.e. to directors and/or shareholders of the insolvent company - are those which creditors find most objectionable and it would make sense for any additional regulation that is introduced to focus specifically on this area. The argument against introducing court or creditor sanction for such pre-packs is that the fees and expenses in the administration will necessarily increase - as would lawyer involvement - which may in fact then reduce the return to creditors rather than maximise their recovery. That, however, is a price that most unsecured creditors may be prepared to pay for the sake of putting in place this additional safeguard against abuse.

## What is the average return to creditors on a pre-pack and how does that compare to returns on other business sales from an insolvency process?

The average return from pre-packs to unsecured creditors is 5% - miserably low - but the average return to unsecured creditors from other business sales from administration and other insolvency processes is even lower (4%). (Source: Dr Sandra Frisbee, Associate Professor at the University of Nottingham - 'Recovery' Newsletter Spring 2010).

## Overhaul of the Corporate Insolvency regulatory regime generally

To further put this into context, in late June the Office of Fair Trading (OFT) concluded its 'Market Study into the Corporate Insolvency Industry'. The OFT found that it 'is currently unable to effectively protect the interests of small creditors' and mentions the 'weak position of unsecured creditors and the failure of the regulatory regime to correct for this.' The recommendations by the OFT to the government included a new independent complaints handling body with wide ranging powers.

The insolvency trade body R3 welcomed the opportunity to help shape regulatory reform to build further trust among unsecured creditors in Insolvency Practitioners and the process of insolvency.

Accordingly, it also looks likely that there will be a complete overhaul of the entire corporate insolvency regulatory regime sooner rather than later.

## Conclusion

Whilst pre-packs currently have their place as a restructuring/insolvency tool, if SIP 16 is not seen as successfully reducing the number of 'bad'/inappropriate pre-packs then it seems almost certain that there will be legal and/or regulatory intervention sooner rather than later. Matters will be unfolding over the next few months and we will look to update you on the latest developments in future editions of 'Business Matters'.

For further details on this article please contact **Mark Henry** on **01473 406306** or **mark-henry@birketts.co.uk**



Attack is  
the best form  
of defence

(sometimes)

## The increase in contentious work carried out by employment lawyers has included an increase in work involving the prevention of and/or restriction of unlawful competition from former employees.

by  
Jolyon Berry  
Partner



### The level playing field

Fair competition is welcomed by consumers and is a fact of life for the rest of us. Unfair competition, however, can significantly disadvantage businesses who have spent time and money creating goodwill and establishing a brand within a market. Unfair competition can take many forms, but can include a concerted attempt by a former employee or group of former employees to begin a venture by utilising elements from their previous employment as a short cut to bigger profits at an earlier stage than would otherwise be the case.

### Contract is king

This scenario is becoming an increasingly familiar one, usually communicated with a great deal of emotion and with the words “bring a claim” often included in the conclusion. The starting point is always the same, however, namely the contract of employment that will contain express and implied terms.

Express terms might include a restrictive covenant preventing the employee from doing certain things post-employment. Such restrictions will usually relate to the poaching of clients, suppliers and staff, and will often restrict the former employee from competing against the former employer for a period of time (sometimes by reference to a specific geographical area). They may also include a prohibition on accepting work or orders from customers or clients of the former employer. These terms are often referred to as ‘non-soliciting’, ‘non-compete’ and ‘non-dealing’ clauses. To be enforceable, they must be as narrow as possible so as to protect the legitimate business interests of the former employer.

A discussion of what is or is not a legitimate business interest, or of the enforceability of restrictive covenants, is outside the scope of this article. However, it should be understood that not all express terms will be enforceable in all circumstances.

Terms which are implied into employment contracts include a duty of good faith and the obligation not to compete against one’s employer (during employment). Statutory directors and some other senior members of staff owe a fiduciary duty to act at all times in the best interests of the company and to report their own breaches.

If an employer is able to establish a breach of a fiduciary duty it will be entitled to an account of the profits, as opposed to contractual damages which will be limited to the loss suffered.

When considering unwelcome competition from a former employee, one must first ask if there has been a breach of an express or implied term of contract. If there has been a breach, there may be a remedy.

### Injunctions and damages

There is a difference between seeking a remedy for a breach of contract that has already happened and obtaining protection from an employee or former employee who threatens to breach their contract in the future.

In most cases when the breach is historic the most appropriate course of action is to seek damages or an account of profits, but sometimes damages are not an appropriate and/or adequate remedy. So, for example, it is not uncommon for an employee to commit a breach of contract by downloading and copying the employer’s client database before leaving, or to threaten to breach the express terms of the contract by setting up in competition with the employer.

In such circumstances, interim relief may be available in the form of an injunction or a ‘springboard’ injunction. An injunction is an order of the Court preventing a party from acting in a particular way which **would** be in breach of contract. A springboard injunction recognises that a breach has already occurred, but the Court makes such an order as is necessary to prevent a party from adverting any benefit from a past breach.

### Preparing to compete and preparing to litigate

It is unfortunately true that in order to be confident that an application for interim relief will be successful a lot of work will need to be done by lawyers who will check the enforceability of the contracts, consider the evidence, seek pre-action resolution, prepare witness statements in support of the necessary application and issue the application at court. All this has to be done quickly; any delay is fatal to an application for interim relief. Emphasis has to be put on the word **interim** as well. Obtaining an injunction is, actually, only the start of a claim for a breach of contract. Once an interim injunction has been obtained, then the claim itself (for a final injunction and/or damages and/or an account of profits) will then need to be pursued.

In short, litigation in this area is not something one should enter into lightly. Such litigation needs to be carefully and fully prepared and considered.

### Top tips

- Always have written contracts of employment;
- Ensure restrictive covenants have been expertly drafted;
- Review employment contracts regularly to keep covenants fresh and relevant;
- Conduct routine monitoring of the use of databases and have a policy which describes appropriate use of the company’s intellectual property;
- Set up IT alerts in the event that large files are downloaded or copied - make sure that there is a good reason for it;
- If you suspect a breach of contract and/or actual or intended competition, act immediately and collect evidence;
- The best evidence is written; computers contain a vast amount of historical data which can be retrieved by specialist IT consultants. Search your systems and the employee’s IT equipment for evidence but, again, make sure that there is good reason for such a search.

For further details on this article please contact Jolyon Berry on 01473 406356 or [jolyon-berry@birketts.co.uk](mailto:jolyon-berry@birketts.co.uk)



# Preserving guarantees on assignment in the wake of Good Harvest

**A difficult development for landlords and tenants has appeared in the case of *Good Harvest Partnership LLP v Centaur Services Ltd* [2010] EWHC 330 (Ch).**

by  
**Kath Herbert**  
Partner



The case focussed on whether a landlord could require his tenant's current guarantor to further guarantee either the outgoing tenant's Authorised Guarantee Agreement (AGA) or the incoming assignee's obligations under the lease.

The court held that allowing this would mean the guarantor could remain liable however many times the lease was assigned - while a tenant could not remain liable beyond a second assignment. They decided that for their own protection the guarantor should not be allowed to give such guarantees. Even if the current guarantor is the willing and obvious choice to guarantee either the tenant's AGA or the assignee, the *Good Harvest* decision now forbids it.

Following this, tenants may now find it difficult to satisfy their landlord's assignment tests if they cannot provide another guarantor, while landlords will be unhappy at the guarantees they will be losing. How then can landlords hope to restore business efficacy to lease assignments?

1. The case involved a landlord **forcing** a guarantor to give further guarantees. However if the guarantor **chooses** to guarantee the assignee's obligations, this may not in practice be rendered ineffective by *Good Harvest* as it is considered a new guarantee. This is untested however, and may not be effective.

2. On assignment, the tenant will usually assign before entering into an AGA. It is suggested that on a technicality their covenants in the AGA would not fall under the Act and so could be guaranteed by their existing guarantor.

3. Often modern leases will contain clauses extending guarantors' liability, allowing them to remain liable beyond assignment. These could provide a solution. However they are thought very unlikely to stand up to scrutiny by a court, so reliance on them is a very risky approach.

4. Leases could be granted to the tenant and their proposed guarantor jointly. The proposed guarantor would instead become another tenant. Unlike guarantors, these tenants can be required to enter into AGAs and so an AGA could then be taken from each of the joint tenants on assignment. The landlord would have the benefit of two AGAs rather than one which is guaranteed.

5. Many leases currently include clauses restricting assignments to a group company. These are intended to prevent the loss of the original tenant's covenants on second assignment (group companies might easily assign multiple times). Under *Good Harvest*,

however, the guarantor's covenants would already have been lost on the first assignment, meaning that these group assignment restrictions no longer provide sufficient protection by themselves.

6. Landlords may decide to exert greater control over lease assignment if assignment will cause them to lose the covenants given by the guarantor. The downside is that on rent review the lease will appear unfavourable if it is very difficult to assign and the landlord may have to accept a lower rent. A balance must be struck between keeping the guarantor's covenants and the amount of rent the landlord is willing to settle for.

7. Instead of assigning, the landlord could take back the lease and re-grant it to the party who would otherwise be the assignee. The original guarantor can then guarantee the new tenant's obligations. Nothing in *Good Harvest* or the legislation prevents this. The major downside, however, is that there may be a liability to Stamp Duty Land Tax (SDLT) which assignment would not have triggered. Again the landlord will need to balance the value of the guarantees against the cost of the SDLT.

8. The landlord could suggest to the tenant that a subletting may be permitted where an assignment is not. In contrast to assignments, *Good Harvest* does not prevent a tenant's guarantor from guaranteeing a sub-tenant's obligations.

There has been a good deal of upset over the impractical conclusion reached by *Good Harvest*, highlighting a deficiency in the legislation. It may be that in due course this will be amended to correct the situation, but until then landlords will have to work around the decision in *Good Harvest* and decide just how important their tenants' guarantees are to them.

**For further details on this article please contact Kath Herbert on 01223 326624 or [katherine-herbert@birketts.co.uk](mailto:katherine-herbert@birketts.co.uk)**



# Endeavour clauses

**These days, rarely is a contract concluded which does not include at least one provision imposing an obligation upon one of the contracting parties to use either its 'best', 'all reasonable' or 'reasonable' endeavours (or certain variations) to meet a specified contractual aim.**

Perhaps, unsurprisingly, there has been a great deal of uncertainty as to what these phrases actually mean. Over the years judicial opinion has frequently been divided. The uncertainty in this area has left parties at risk of being held subject to a claim for breach of contract because of their failure to meet the required level of endeavour. However, in June 2010, the High Court, in the case of *CPC Group Limited v Qatari Diar Real Estate Investment Company* [2010] EWHC 1535 (ch) ('*Qatari*') revisited the meanings to be ascribed to these endeavour obligations and provided some clarification to this somewhat grey area.

As a result of the decision in *Qatari* and other recent case law, the standards to be applied to the three main 'endeavour' provisions can be summarised as follows, although in any given situation the facts, intention and context of the provisions within the contract will also be relevant:-

- 'Best Endeavours' - still viewed as the most onerous of the 'endeavour' obligations and should not be entered into lightly. It requires the obligated party to pursue and exhaust **all** (and not just one) of a number of reasonable courses which could be taken in order to achieve the required result. This may involve substantial financial expenditure in pursuing a number of options available.
- 'All Reasonable Endeavours' - the High Court in *Qatari* has confirmed the approach taken in other recent case law, including the cases of *Rhodia International Holdings Limited v Huntsman International LLC* [2007] EWHC 292 (Comm) ('*Rhodia*') and *Yewbelle Limited v London Green Developments Ltd & Anor* [2007] EWCA Civ 475. An obligation to use "all reasonable endeavours" would appear to be

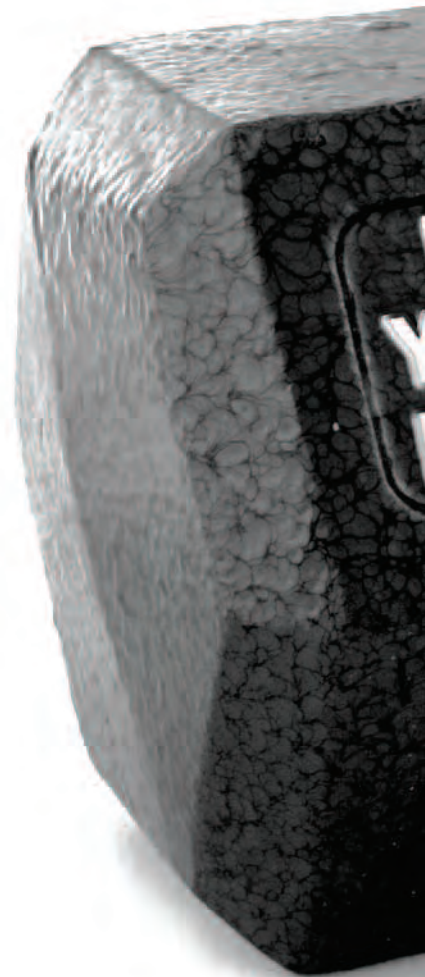
just as onerous as an obligation to use best endeavours i.e. the obliged party is to take **all** reasonable courses available to it in the circumstances. However, *Qatari* confirmed that an obligation to use 'all reasonable endeavours' will not require the obligor to sacrifice its commercial interests, which should also be taken into consideration. In this respect, the obligation is less onerous than the 'best endeavours' obligation. Notwithstanding this, where a contract expressly specifies certain steps to be taken by a party when fulfilling its obligation to use 'all reasonable endeavours', the judiciary in *Rhodia* commented that as part of its exercise in fulfilling its obligations, those specified steps **will** have to be taken, even if doing so could be said to involve that party sacrificing its commercial interest.

- 'Reasonable Endeavours' - the least onerous of the three and which the courts have interpreted as 'probably' requiring the obligated party to take and pursue just **one** reasonable course of action in order to achieve the particular aim.

Any party entering into a contract which contains provisions incorporating one or more of the more onerous 'endeavour obligations' should be mindful of the potential implications and costs that doing so might entail.

**For further details on this article please contact Sarah Lewis on 01473 406287 or [sarah-lewis@birketts.co.uk](mailto:sarah-lewis@birketts.co.uk)**

by  
**Sarah Lewis**  
Solicitor





# E-Disclosure



**Electronic communication now lies at the heart of every business; even paper documents will commonly have begun life electronically. So it is no surprise that when it comes to the disclosure of documents in legal proceedings, the duty extends to a search of documents held electronically.**

by  
**Susannah Hall**  
Solicitor



Under rule 31 of the Civil Procedure Rules (CPR), parties to litigation must disclose to each other the existence, or past existence, of a 'document' or a 'copy' of a document. Each party then has a right, subject to some exceptions (such as legal advice privilege), to inspect such documents which still exist. A 'document' is defined as meaning anything in which information of any description is recorded and 'copy' means anything onto which information recorded in the document has been copied, by whatever means and whether directly or indirectly. The practical application of these definitions means that any information created in Word, Excel, PowerPoint, emails, text messages, tweets, blogs, messages on social networking sites, voice mails, sound recordings, visual recordings and photographs is deemed to constitute a document within the meaning of the CPR. As technology advances and the means of communication increase, so will the list of potentially disclosable documents.

Fortunately, the duty to search for electronic data is not unlimited. Rather the parties are required to carry out a 'reasonable' search for documents. What constitutes 'reasonable' is case specific and parties are actively encouraged to cooperate and agree how to approach electronic disclosure at an early stage and to assist the court to make appropriate directions. Factors the parties and the court will consider include; the size of the case, the number of parties, the value, the potential number of documents, the costs of carrying out a search, the issues and the likely relevance of the documents which might be revealed. Proportionality is the key. For example, in a contract dispute if the first contact between the parties was in 2008, it is not necessary or reasonable to search for documents created or viewed before that date. Despite the requirement for reasonableness and proportionality, the process of electronic disclosure can be time consuming and costly and on some occasions uncover some documents or emails that do very little to assist the case.

In terms of the practical impact for businesses, there is not yet a requirement to preserve electronic data prior to litigation, but following the recent case of *Earles v Barclays Bank PLC [2009] EWHC 2500*, there are suggestions that the courts may move towards an American style 'litigation hold' where organisations will need to

ensure that they have systems in place so that electronic data can be easily preserved and made available for review. The judge in *Earles* acknowledged that in some circumstances it might be right to withdraw inferences on a party's conduct prior to the commencement of proceedings. Therefore, it is prudent once it becomes apparent that litigation may be on the horizon, to take steps to preserve data or risk facing criticism from the court in the form of adverse inferences or adverse cost awards.

The interesting feature of electronic documents is that they often record data, observations, emotions and other information that historically people have never bothered to document. This is particularly the case with emails, electronic notes and texts. As a result e-disclosure can be very revealing. It can win and lose cases. So make sure that everyone in your business is aware that their commercial lives are lived on the record and the record will be retrieved and scrutinised if a dispute ever reaches the courts.

**For further details on this article please contact Susannah Hall on 01603 756455 or [susannah-hall@birketts.co.uk](mailto:susannah-hall@birketts.co.uk)**





[www.birketts.co.uk](http://www.birketts.co.uk)

# Spotlight on the Cambridge Property Team



In 2008, Birketts opened its Cambridge office. The commercial property team entered the Cambridge market with Jonathan Greenhalgh at the helm. Despite its entry into Cambridge during a tough financial climate, the team nevertheless gained a steady foothold in the market. This was strengthened by the arrival of Kath Herbert in January 2010, who has over 20 years' experience in the Cambridge market and is skilled in high profile strategic land projects. The team includes lawyers William Stokes and Luke Callaghan and is now busily making a name for itself as a quality provider of real estate legal services.

A range of property work both in and outside of Cambridge is covered, benefiting from the extensive experience of its members in various fields. Jonathan and Kath specialise in development work, acting on large projects including joint ventures for strategic land promotion, option agreements and acquisitions for development. William specialises in landlord and tenant and often assists the corporate team on the due diligence and property aspects of corporate transactions. Luke is an agricultural lawyer and supports Kath and Jonathan with their work for landowners and works closely with the private client team.

Business development is of course a priority and the team divides its time carefully between keeping an active profile in the market, establishing and maintaining good relationships with clients, developers and agents and of course getting the work done promptly!

To highlight the expertise on offer both in the team and across the firm, Kath and Jonathan have recently set up the Strategic Land Group, a pooling of the combined wisdom and legal know-how of some of our most skilled real estate lawyers. The Group looks to promote Birketts' talent and set the firm apart as providing a first class service dedicated to landowners and developers involved in strategic development, coupled with reasonable fees and a client-friendly approach to business.

Jonathan  
Greenhalgh  
Partner



Kath  
Herbert  
Partner



To discuss how the Cambridge property team can help you or to receive further details of the property team's services, please contact Jonathan on 01223 326615 or Kath on 01223 326624



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**Ipswich:**

24 - 26 Museum Street  
Ipswich Suffolk  
IP1 1HZ

T: +44 (0)1473 23 23 00  
F: +44 (0)1473 23 05 24  
E: [mail@birketts.co.uk](mailto:mail@birketts.co.uk)

**Norwich:**

Kingfisher House  
1 Gilders Way  
Norwich Norfolk  
NR3 1UB

T: +44 (0)1603 23 23 00  
F: +44 (0)1603 23 05 33  
E: [mail@birketts.co.uk](mailto:mail@birketts.co.uk)

**Chelmsford:**

Brierly Place  
New London Road  
Chelmsford Essex  
CM2 0AP

T: +44 (0)1245 21 12 11  
F: +44 (0)1245 35 47 64  
E: [mail@birketts.co.uk](mailto:mail@birketts.co.uk)

**Cambridge:**

Daedalus House  
Station Road  
Cambridge Cambridgeshire  
CB1 2RE

T: +44 (0)1223 32 66 00  
F: +44 (0)1223 32 66 29  
E: [mail@birketts.co.uk](mailto:mail@birketts.co.uk)

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