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# THREE LESSONS FOR THE DRAFTING OF EMPLOYMENT AGREEMENTS IN THE WAKE OF *RICARDO LEIMAN v NOBLE RESOURCES LTD* (PART I)

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## I. Introduction

1 This article is the first in a two-part series where the authors discuss three lessons in the drafting of employment agreements which can be extracted from the Court of Appeal's decision in *Leiman, Ricardo v Noble Resources Ltd*[1] ("*Leiman*").

2 Although *Leiman* was primarily concerned with a suite of agreements which regulated the terms of Ricardo Leiman's ("RL") *resignation* from the company, the lessons gleaned from the Court of Appeal's judgment can also be applied to the drafting of employment contracts, especially for the structuring of bespoke employee incentive and remuneration packages in a nuanced and sophisticated manner.

3 The first lesson pertains to how remuneration or incentive packages, be it in post-employment agreements or employment contracts generally, should be structured in order to minimise

1 [2020] 2 SLR 386.

the risk of the clauses therein being invalidated for being penalty clauses. Parties to a contract would generally have two intertwined goals – (a) to ensure its counterparty upholds its obligations and (b) to protect its own interests. One way of ensuring this is to include provisions in the contract which would have the effect of *discouraging* the counterparty from breaching any of its obligations. This is no different in the context of employment. Unfortunately, some clauses intended to have such an effect may be regarded by the court as being a penalty clause and therefore struck down, as was the case in *Leiman*.

4 The second and third lessons, which will be covered in the next part of this article, pertain to how the terms of an employment contract can be drafted to limit (or ensure, as the case may be) the court's (a) involvement in the determination of whether pre-requisites to a benefit under the contract have been fulfilled, and (b) powers of review over determinations made by a contractually stipulated body.

## II. Summary of facts in *Leiman, Ricardo v Noble Resources Ltd*

5 The first appellant, RL, was employed by the first respondent, Noble Resources Ltd ("NRL"), as the chief operating officer of the second respondent, Noble Group Limited ("NGL") from 2006 to 2010, and then subsequently as NGL's chief executive officer from 2010 to 2011. RL's employment with NRL was governed by an employment agreement (the "Employment Agreement"). NGL and NRL are part of the Noble group of companies (the "Noble Group"). During the course of his employment with the Noble Group, RL was awarded NGL share options pursuant to the Noble Group Share Option Scheme 2004 and NGL shares pursuant to the Noble Group's annual incentive plan ("AIP"). RL assigned some of his NGL shares and NGL share options to a trust administered by the second appellant, Rothschild Trust Guernsey Limited[2] ("Rothschild Trust").

2 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [5]–[12].

6 The underlying suit was commenced by RL against the respondents, for allegedly denying him certain post-resignation benefits which he claimed to be entitled to under a settlement agreement dated 9 November 2011[3] (the "Settlement Agreement"). RL had entered into the Settlement Agreement with NRL to govern the terms of his resignation from NGL and his departure from the Noble Group. RL and NRL had also entered into another agreement where RL would continue providing advisory services to NRL for a minimum term of nine months after the termination of his employment[4] (the "Advisory Agreement").

7 RL's severance payments and benefits, which were the subject of the dispute, were set out in cl 3 of the Settlement Agreement. Given that the appeal essentially hinged on the Court of Appeal's interpretation of cl 3, it bears setting out in full:[5]

> 3. Severance Payments and Benefits
>
> (a) Noble [meaning NRL] and [RL] shall, on the Effective Date, execute a payment schedule attached hereto as Exhibit A. [RL] shall be entitled to receive the payments and benefits provided for in this Section 3 and the schedule *but only if he complies with his ongoing non-competition and confidentiality obligations* under the provisions of the Employment Agreement and this Settlement Agreement and which shall continue in full force and effect regardless of this termination.
>
> (b) On or before 1st December 2011, [RL] shall enter into [the Advisory Agreement] with the Company under which he will provide such advisory services as the company shall reasonably request in consideration of remuneration calculated on the basis of US$350,000 per calendar year. …
>
> (c) [RL] shall be entitled to exercise the outstanding 7,727,272 options he holds in the Noble Group Limited Share Option Schedule 2004 vesting on 2nd April 2012 as well as all options vested to date but unexercised, in each case provided he does so exercise on or prior to 2nd April 2013 and *provided that prior to exercise he has not acted in any way to the detriment of Noble and the [R&O Committee] of Noble shall make a final determination in the event of any dispute*.

3 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [38]–[42].
4 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [13]–[18].
5 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [21].

> (d) [RL] holds 17,276,013 restricted shares of Noble Group (the 'Restricted Stock'). The Restricted Stock and all accrued dividends shall vest and become free of transfer restrictions in accordance with its term of grant *provided [RL] does not act in any way to the detriment of Noble and the [R&O Committee] of Noble shall make a final determination in the event of any dispute*.
>
> (e) [RL] shall be entitled to be considered for a 2011 discretionary bonus by the Company which (if any) will be payable in April 2012.
>
> [emphasis added]

8 The authors refer to:

> (a) the 7,727,272 NGL share options in cl 3(c) that were to vest on 2 April 2012, as well as all vested but unexercised share options, collectively as the "Share Options"; and
>
> (b) the 17,276,013 NGL "Restricted Stock" in NGL in cl 3(d) as the "Shares".

9 It should be noted that RL's entitlements under cll 3(c) and 3(d) were subject to two conditions. First, the condition that he "not act … to the detriment of Noble", with NGL's Remuneration and Options Committee ("R&O Committee") to make a "final determination in the event of any dispute". Second, RL's compliance with his "ongoing non-competition and confidentiality obligations". This second condition was applicable to entitlements under cl 3 in general.

10 Apart from the Shares referred to in cl 3(d) of the Settlement Agreement, RL was also awarded 5,652,421 NGL shares under the Noble Group's AIP by way of a letter dated 4 May 2011.[6]

11 In November 2011, the Noble Group hired a private investigator ("PI") to monitor RL's activities. The PI uncovered e-mails between RL and Summa Capital, one of Noble Group's business partners, which showed them discussing a plan to start a new commodities business. Noble also engaged a consulting firm, Wolfe Associates, in February 2012 to investigate RL's

6 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [11].

dealings with two individuals whom he had been involved in hiring in 2006 to run one of the Noble Group's sugar mills in Brazil.[7]

12 In late February 2012, Rothschild Trust sought to exercise 5,000,000 of RL's Share Options as referred to in cl 3(c) of the Settlement Agreement. However, based on (a) the R&O Committee's review of the e-mails between RL and Summa Capital, and (b) Wolfe Associates' preliminary findings on RL's involvement in the hiring of the two individuals to run one of Noble Group's sugar mills in Brazil despite his knowledge of various allegations against them, the R&O Committee decided to refuse Rothschild Trust's request.[8]

13 Rothschild Trust protested against the R&O Committee's decision and made multiple requests for the information upon which the decision had been based, to no avail. The R&O Committee subsequently reconvened to consider the issue again, but it merely reaffirmed its earlier decision. Noble Group informed Rothschild Trust of this, explaining that RL's right to exercise the Share Options was "conditional on [his] not 'acting in any way to the detriment of Noble prior to exercise'". The R&O Committee considered that this condition had not been satisfied as RL had breached his non-competition and confidentiality obligations, and had appointed certain persons to run Noble Group's operations in Brazil from 2006 even though they were unqualified and might have participated in "fraudulent conduct at a previous employer".[9]

14 Noble Group subsequently informed the appellants that:[10]

(a) RL was not entitled to the Shares referred to in cl 3(d) of the Settlement Agreement;

(b) the R&O Committee did not approve the vesting of the 5,652,421 NGL shares under the AIP which had

7 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [29], [31] and [32].
8 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [32]–[35].
9 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [35].
10 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [36] and [37].

previously been awarded to RL by way of the 4 May 2011 letter; and

(c) RL was not entitled to the 2011 bonus.

15 The appellants brought an action in the Singapore High Court, seeking a declaration that the R&O Committee's decisions pertaining to RL's entitlement to the benefits under the Settlement Agreement were invalid. The appellants also sought damages for conspiracy by unlawful means, wrongful inducement of breach of contract and unlawful interference or causing loss by unlawful means.[11]

## III. Summary of relevant issues and holdings

16 Clause 3(c) of the Settlement Agreement provided:

> [RL] shall be entitled to exercise the outstanding **7,727,272 options he holds in the Noble Group Limited Share Option Schedule 2004 vesting on 2nd April 2012** as well **as all options vested to date but unexercised**, *in each case provided he does so exercise on or prior to **2nd April 2013** and provided that prior to exercise he has not acted in any way to the detriment of Noble and the [R&O Committee] of Noble shall make a final determination in the event of any dispute*. [emphasis added]

17 Clause 3(c) of the Settlement Agreement (which was executed on 9 November 2011) thus applied to:

(a) 7,727,272 Share Options *vesting subsequently* on 2 April 2012; and

(b) 37,090,910 Share Options that had previously *already vested* (in December 2010).

18 In both the High Court and the Court of Appeal, the appellants submitted that cl 3(c) was an unenforceable penalty clause in so far as it purported to forfeit the 37,090,910 unexercised Share Options that had previously already vested in RL in December 2010. These 37,090,910 Share Options fell into the limb of cl 3(c) of the Settlement Agreement which applied

11 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [38]–[41].

to "all options vested to date but unexercised". The appellants argued that cl 3(c) was a penalty because it purported to impose penal sanctions by divesting a party of its entitlement to claim *already vested* rights and benefits.[12]

19 The appellants did not make the same submission in respect of the Share Options mentioned in cl 3(c) that were to vest only on 2 April 2012 or the Shares mentioned in cl 3(d) which had not yet vested. This difference in position arose because the appellants appeared to proceed on the premise that the rule against penalty clauses applies only to provisions that purport to divest a party of its entitlement to *already vested* rights and benefits, and not to provisions that impose *conditions* for the *future* vesting of its rights and benefits. Similarly, the appellants did not submit that cl 3(a) was unenforceable for being a penalty clause.[13]

### *A. Decision of the High Court*

20 The High Court judge dismissed the claim brought by the appellants, on the basis that the R&O Committee was justified in its finding that RL had acted to Noble Group's detriment by breaching his non-competition and confidentiality obligations.

21 Specifically, on the issue of whether cl 3(c) of the Settlement Agreement was an unenforceable penalty clause, the High Court dismissed that argument. The High Court noted that cl 8.3(a) of the Share Option Rules provided that any share option which RL had left unexercised (and he did leave some vested Share Options unexercised at the time of resignation or end of full-time employment)[14] will "immediately lapse" once the participant "ceas[es] to be in the full-time employment" with Noble, "unless the [R&O] Committee, in its sole discretion, determines otherwise". After his resignation in October 2011, RL

12 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [80].
13 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [80].
14 *Leiman, Ricardo v Noble Resources Ltd* [2018] SGHC 166 at [209].

was already not entitled to the already-vested Share Options in the absence of the Settlement Agreement.[15]

22 The High Court then found that cl 3(c) of the Settlement Agreement had the effect of conferring upon RL *additional* benefits which he otherwise would not have had (*ie*, by allowing RL an extension of time, until 2 April 2013, to exercise his already-vested but unexercised Share Options even after RL's cessation of full employment), subject to the condition that he did not act in any way detrimental to Noble. The High Court judge went on to find that cl 3(c) did in fact stipulate a *secondary obligation* for breach of cl 3(c) (*ie*, the forfeiture of the Share Options). However, applying the test laid down in the UK Supreme Court decision of *Cavendish Square Holding BV v Makdessi*[16] ("*Cavendish*"), the High Court judge ultimately did not consider cl 3(c) to be a penalty clause as it did not impose a detriment on RL that was "out of proportion to Noble's legitimate interest in ensuring that [RL] did not compete against it or otherwise act to its detriment".[17] The High Court judge also found that the 5,652,421 NGL shares under the AIP were not covered by cl 3(d) of the Settlement Agreement, and that given RL's improper acts of competition against Noble Group, those shares had been properly forfeited.

23 RL was also denied his 2011 bonus. Clause 3(e) of the Settlement Agreement provided that:

> [RL] shall be entitled to be considered for a 2011 discretionary bonus by the Company which (if any) will be payable in April 2012.

24 The High Court found there was no breach of cl 3(e) of the Settlement Agreement, as Noble Group had considered RL's entitlement to the 2011 bonus in a rational and *bona fide* manner. Finally, given that the R&O Committee's decisions were valid, the appellants' economic tort claims could not be sustained.[18]

15 *Leiman, Ricardo v Noble Resources Ltd* [2018] SGHC 166 at [23] and [202].
16 [2016] AC 1172.
17 *Leiman, Ricardo v Noble Resources Ltd* [2018] SGHC 166 at [211] and [213].
18 *Leiman, Ricardo v Noble Resources Ltd* [2018] SGHC 166 at [230], [231] and [254]–[257].

### *B. Decision of the Court of Appeal*

25 The Court of Appeal allowed RL's appeal in part. The court found, *inter alia*, that the R&O Committee's decision to disentitle RL from the Share Options under cl 3(c) of the Settlement Agreement, as well as the forfeiture of the 5,652,421 shares awarded pursuant to the 4 May 2011 letter, was invalid. The Court of Appeal, however, upheld the High Court's finding in relation to the 2011 bonus under cl 3(e), as well as the dismissal of the economic tort claims.

26 A few salient points of the Court of Appeal judgment, some of which are relevant to the discussion below on the drafting and structuring of employee severance and incentive packages, are highlighted. The Court of Appeal's holding in relation to the *scope* of the R&O Committee's duties, as well as the court's observations on the *process* by which the R&O Committee should have carried out its inquiry, will be further elaborated upon in the subsequent instalment of this article.

27 First, the Court of Appeal held as a preliminary point that any dispute as to whether RL had complied with his *contractual* non-competition and confidentiality obligations was a *legal* matter solely for the *court* to determine.[19] The proper remit of the R&O Committee was to determine the *commercial* matter as to whether RL had acted to Noble Group's commercial detriment, as provided for in cl 3(c).[20] In addition, any determination by the R&O Committee that RL had acted to the detriment of Noble would necessarily require some particularisation of actual loss, harm or damage to the Noble Group that could be attributed to RL's allegedly wrongful acts that had taken place subsequent to the signing of the Settlement Agreement. In this regard, the Court of Appeal found that there was no actual commercial detriment suffered by Noble as a result of RL's acts, nor had he breached his non-competition and confidentiality obligations under the relevant contracts.[21]

19 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [64].
20 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [64].
21 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [161]–[164].

28 Second, on the issue of penalty clauses, the Court of Appeal stated that the rule against penalty clauses would only apply to *secondary obligations*. The court held that "[w]here a clause imposes a stipulated consequence following a breach of contract by one party, and that consequence, in the opinion of the court, is not reflective of the innocent party's interest in being compensated but is in fact stipulated *in terrorem* of [*ie*, to threaten] the contract-breaker, that clause will be regarded as an unenforceable penalty clause".[22] The court further laid down some factors that would be considered in determining whether a clause should be regarded as a primary or secondary obligation, which will be further elaborated on below.[23]

29 Applying this to the facts of the case, the Court of Appeal held that even though cl 3(a) was *phrased* as a primary obligation, there was no "independent commercial purpose" to be served in requiring RL to comply with his contractual non-compete and confidentiality obligations in order to be entitled to the various benefits under cl 3(a) of the Settlement Agreement. The benefits under cl 3(a) included, *inter alia*, a Schedule of Payments from NRL that were due to RL upon his resignation, including his 2011 salary and reimbursements for RL's expenses that he incurred during his employment.[24]

30 The Court of Appeal found it was not clear what independent commercial purpose would be served by NRL requiring RL to continue to comply with his contractual non-competition and confidentiality obligations in order to be entitled to his cl 3(a) payments (which included his prior salary and reimbursement of prior expenses). The court considered cl 3(a) to be *in terrorem* of any intention that RL may have had of breaching his contractual non-compete and confidentiality obligations, and therefore a secondary obligation which engaged the rule against penalty clauses.[25] Crucially, the court stated that regardless of whether the traditional test in the House of Lords decision of *Dunlop*

22 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [100].
23 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [101].
24 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [65] and [104].
25 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [104].

*Pneumatic Tyre Company, Limited v New Garage and Motor Company, Limited*[26] ("*Dunlop Pneumatic*") or the test in *Cavendish* was applied, cl 3(a) would be regarded as an unenforceable penalty clause.[27]

31 Since the decision in *Leiman*, the Court of Appeal has confirmed in *Denka Advantech Pte Ltd v Seraya Energy Pte Ltd*[28] ("*Denka v Seraya*") that the *Dunlop Pneumatic* test rather than the approach in *Cavendish* will be used to determine whether a clause is unenforceable for being a penalty.

32 The Court of Appeal in *Leiman* held that cl 3(a) was not a genuine pre-estimate of damages under the *Dunlop Pneumatic* test, given that it operated to disentitle RL from receiving fixed benefits regardless of the nature and extent of his breach of his contractual non-competition and confidentiality obligations. There was simply no correlation between the damages that might be awarded to NRL for any breach of contract on RL's part and the sanction for such breach.[29] Clause 3(a) would also fail the *Cavendish* test, given that it was unclear what legitimate interest NRL could possibly have had in upholding that clause, beyond punishing RL if he were to breach his contractual obligations of non-competition and confidentiality in any way. If there was a breach of the non-competition and/or confidentiality clauses, NRL's interest in seeking compensation against RL for any such breach remained wholly preserved.[30]

33 In contrast, the Court of Appeal held that, *inter alia*, cl 3(c) imposed a *primary obligation* on NRL to honour RL's *enhanced* rights in relation to the exercise of the Share Options (*ie*, rights that he would otherwise not have been entitled to absent the Settlement Agreement – such as an extension of time to exercise the Share Options), in exchange for RL's promise to not act to the detriment of Noble. Clause 3(c) therefore did not engage the rule

26 [1915] AC 79.
27 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [98].
28 [2021] 1 SLR 631.
29 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [107].
30 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [108].

against penalty clauses, and the finding of the High Court was overturned in this regard.[31]

34 Third, as regards the *procedural* propriety of the R&O Committee's inquiry and determination under cll 3(c) and 3(d), the Court of Appeal stated that a party purporting to exercise a particular contractual right did not have a general duty to act fairly, nor a duty to observe any requirements of natural justice unless there were contractual terms to that effect, but that may be displaced by terms which parties have agreed upon explicitly or implicitly.[32]

35 As alluded to above, the authors will subsequently elaborate more on the court's observations in this regard in relation to contractually formed bodies such as the R&O Committee, and the associated drafting issues that parties should be mindful of in part 2 of this article. It suffices to note for now that because the R&O Committee had not informed RL of the allegations against him nor did they afford him the opportunity to dispute these allegations, this suggested that the R&O Committee was not properly convened under the Settlement Agreement, and its determinations were therefore null and void as the requirements for fairness under, *inter alia*, cl 3(c) were not met.[33]

36 Finally, with regard to the 5,652,421 shares awarded to RL by way of the 4 May 2011 letter, this was to be governed by the terms of the AIP. To this end, the R&O Committee's decision to forfeit the said shares (under cl 5 of the AIP) due to RL's conduct that was "injurious, detrimental or prejudicial" to Noble's interest was erroneous as there was actually no detriment suffered by Noble.[34]

31 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [105].
32 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [133] and [134].
33 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [157] and [160].
34 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [176]–[178].

## IV. Lesson No 1 – Structuring an incentive package such that it is not invalidated for being a penalty clause

37 Flowing from the decision of the Court of Appeal as summarised above, there are two conjunctive requirements that must be satisfied in order for a clause to be struck out for being an unenforceable penalty:

(a) the clause imposes a secondary, as opposed to a primary, obligation; and

(b) the clause falls afoul of the tests in *either*:

(i) *Dunlop Pneumatic*: where the clause stipulates a payment of money *in terrorem* of the contract-breaker which is not a *genuine pre-estimate* of the loss suffered by the innocent party;[35] or

(ii) *Cavendish*: whether the impugned provision is a secondary obligation which imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation.[36]

38 As alluded to at para 31 above, although the Court of Appeal had not considered it necessary to determine the issue of the applicable test pertaining to penalty clauses on the facts of *Leiman*, it has since clarified and confirmed that the applicable test in Singapore remains the traditional test in *Dunlop Pneumatic*.[37] Drafters of employment contracts and employee remuneration and incentive packages therefore need only focus on the *Dunlop Pneumatic* test when considering whether certain clauses fall afoul of the rule against penalties, *ie*, whether the stipulated payment is a *genuine pre-estimate* of the loss that would be suffered by the innocent party.

35 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [97].
36 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [98].
37 *Denka Advantech Pte Ltd v Seraya Energy Pte Ltd* [2021] 1 SLR 631 at [151].

### *A. Drafting tip No 1: avoid framing the clause as a secondary obligation*

39 The first clear way by which drafters can ensure that a clause will not be invalidated for being an unenforceable penalty is by ensuring that the clause is framed as a *primary*, as opposed to a secondary, obligation. As noted by the Court of Appeal, the rule against penalty clauses is *not* engaged where the clause in question concerns a primary obligation.[38]

40 Citing Lord Diplock's formulation of the conceptual distinction between primary and secondary obligations in *Photo Production Ltd v Securicor Transport Ltd*,[39] the Court of Appeal in *Leiman* noted that "*[t]he corollary of recognising the parties' freedom of contract is that the law also allows them the freedom to change their mind and break their contractual undertakings if they so wish, albeit at a price*" [emphasis added]. This "price" is the secondary obligation on the part of the contract-breaker to compensate the innocent party, which only arises upon a breach of the contract.[40]

41 The Court of Appeal further held that in considering whether a given clause imposes a primary or secondary obligation, the court should approach the issue as a matter of *substance* rather than form. Indeed, the Court of Appeal had previously noted that although a contract may use words and labels such as "liquidated damages" and "penalties", such labels are inconclusive.[41] The court then laid down three guiding considerations, as follows:[42]

> (a) the overall context in which the bargain in the clause was struck;
>
> (b) any reasons why the parties agreed to include the clause in the contract; and
>
> (c) whether the clause was entered into and contemplated as part of the parties' primary obligations under the contract to secure some independent commercial

38 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [96] and [100].
39 [1980] AC 827.
40 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [99] and [100].
41 *Xia Zhengyan v Geng Changqing* [2015] 3 SLR 732 at [78].
42 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [101].

> purpose, or whether it was to hold the affected party *in terrorem* in order to secure his compliance with his primary obligations.

42 In the authors' view, the crux of the inquiry appears to lie in factor (c), *ie*, whether the clause was entered into to secure some "independent commercial purpose", or whether it was to "hold the affected party *in terrorem* in order to secure his compliance with the primary obligation". The determination of the inquiry in factor (c) requires the consideration of the context in which the bargain in the clause was struck and the reasons that the parties may have had for including the clause.

43 The question that follows is – what exactly is an independent commercial purpose? The answer to this can be found in the Court of Appeal's analysis of cll 3(a), 3(b) and 3(c) of the Settlement Agreement. Starting first with cl 3(a), the Court of Appeal stated that as a matter of *form*, it was *phrased* as a primary obligation upon NRL to provide RL with payments and benefits upon a contingency being fulfilled, namely RL's continued compliance with his non-competition and confidentiality obligations.[43]

44 However, the court noted that each of these "benefits" that NRL was obligated to provide RL under cl 3(a), *ie*, the severance payments under cll 3(b) to 3(e), as well as the "Final Due Payments" according to the payment schedule set out in Exhibit A, were in fact premised on corresponding conditions which were independent of RL's continued compliance with his non-competition and confidentiality obligations:[44]

> (a) the remuneration promised to RL under cl 3(b) was in exchange for RL's advisory services under the Advisory Agreement;
>
> (b) the 2011 bonus under cl 3(e) was based on RL's performance in 2011; and

43 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [104].
44 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [65] and [104].

> (c) the "Final Due Payments" under Exhibit A were payments incidental to RL's resignation, and included his 2011 salary and reimbursements for expenses that he made during his employment;

45 Further, the rights under cl 3(c) were also different from the rights under cl 3(a), cll 3(b) and 3(e). Clause 3(c) provided for certain *enhanced* rights to be provided to RL (in relation to the extension of time to exercise the unexercised Share Options), with such rights of RL being enhanced only by virtue of his entry into the Settlement Agreement.[45] The court concluded that NRL had an independent commercial purpose in extracting from RL an agreement to subject his enhanced rights under, *inter alia*, cl 3(c) to his being a "good leaver" after resignation.[46]

46 Based on the foregoing, it appears to the authors that there is an "independent commercial purpose" when one contracting party offers *enhanced* rights, in order to incentivise the other contracting party to undertake a *corresponding obligation in order to enjoy these enhanced rights*. For example, NRL's agreement to grant RL an extension of time to exercise his unexercised Share Options gave RL *enhanced rights* in relation to his Share Options. In exchange for these enhanced rights as an incentive, RL undertook to comply with the non-competition and confidentiality obligations. On the other hand, if a clause was phrased in such a way as to incentivise (or disincentivise) the other contracting party to comply with (or from breaching) its *existing obligations* but did *not* offer *enhanced rights* in exchange, that could be seen as a penalty clause. For example, under cl 3(a), NRL was offering to pay various existing payments under cl 3(a) (such as salary during RL's 2011 employment and reimbursement of expenses incurred during RL's employment), but RL would lose the benefit of these payments if he failed to comply with his "ongoing non-competition and confidentiality obligations". In those circumstances, cl 3(a) was held to be a penalty clause.

45 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [105].
46 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [105].

47 By way of illustration, assume that Parties X and Y have no pre-existing contractual relationship. Party X then enters into an agreement with Party Y, for Party Y to provide services to Party X in exchange for remuneration (the "Primary Clause"). This would be to secure an independent commercial purpose, *ie*, Party Y's provision of the services to Party X, and therefore be regarded as a primary obligation. If, however, Party X inserts a clause into the agreement providing that in the event Party Y fails to provide the services according to the terms of the agreement, Party Y has to either (a) pay Party X a certain sum or (b) lose its right to remuneration for any work done (the "Secondary Clause"), this would be regarded as a secondary obligation. Indeed, given that the Primary Clause has already secured the independent commercial purpose (*ie*, the provision of the services), all the Secondary Clause does is to secure compliance with the Primary Clause. In fact, if Party Y failed to provide the services, Party X could sue Party Y in damages. Hence, the payment limb of the Secondary Clause could be seen as a "surcharge" on top of damages, as argued by RL and accepted by the Court of Appeal.[47]

48 In the authors' respectful view, and by way of illustration, it could perhaps have been possible to couch cl 3(a) of the Settlement Agreement as a primary obligation, not just in *form* but also in *substance*. NRL's objective was essentially to ensure, *inter alia*, that RL complied with his non-competition and confidentiality obligations.

49 In order to secure RL's compliance with these requirements without having cl 3(a) of the Settlement Agreement struck down, the authors suggest that NRL could have done the following.

50 It may have been possible to structure cl 3(a) such that it included "enhanced" payments to RL (and not just his existing benefits such as salary and reimbursements for expenses incurred). If there are enhanced benefits in favour of NRL, it may be possible for NRL to justify RL's requirement to comply with his non-competition and confidentiality obligations in order to enjoy his "enhanced" benefits.

47 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [107].

### *B. Drafting tip No 2: ensure that the secondary obligation does not fall afoul of the test in* Dunlop Pneumatic

51 Notwithstanding the above, the authors acknowledge that there may be instances where a party to a contract may want to provide for a secondary obligation arising from the breach of a primary obligation. Indeed, contracting parties often include a liquidated damages clause in their agreements, which serves as a contractually stipulated secondary obligation (as opposed to one that is imposed by implication of law – *ie*, the right to sue for damages). One of the vital functions of a liquidated damages clause is to give parties certainty as to their risk exposure. Moreover, the injured party is spared the time and expense of having to prove its loss in a common law action for damages.

52 Specifically in the employment context, the difficulties with proving loss arising from breaches of non-competition and confidentiality obligations are well founded. These were the facts in the UK Supreme Court decision of *Morris-Garner v One Step (Support) Ltd*,[48] in which a company sued its former director and employee for, among other things, breaches of their non-competition and non-solicitation obligations. However, it was difficult for the plaintiff to identify its actual financial loss arising from these breaches. The court at first instance awarded the plaintiff *Wrotham Park*[49] damages based on the hypothetical "release fee" which the plaintiff would have demanded from the defendants to discharge them of their obligations under the restrictive covenants. On appeal, the majority of the UK Supreme Court held that *Wrotham Park* damages would *not* be awarded for breaches of non-competition obligations. This was on the basis that the breach of a non-compete obligation may cause the claimant to suffer pecuniary loss resulting from wrongful competition, such as loss of profits and goodwill, which can be measured by conventional means. While such loss may be difficult to quantify, and some elements of it may be incapable of precise measurement, this was nevertheless a "familiar type of loss" for

48 [2019] AC 649.
49 *Wrotham Park Estate Co Ltd v Parkside Homes Ltd* [1974] 1 WLR 798.

which damages were frequently awarded.[50] There was therefore no necessity for the court to award *Wrotham Park* damages.

53 Closer to home, the Singapore High Court decision of *Tan Kok Yong Steve v Itochu Singapore Pte Ltd*[51] also demonstrates the practical difficulties of proving loss arising from a breach of non-competition and non-solicitation obligations. Upon finding the former employee liable for breaching his non-competition obligation, the court imposed an injunction to restrain the latter from dealing in certain products in certain geographical regions, thereby enforcing the restrictive covenant for the remainder of its duration.[52] The High Court also considered whether damages should have been awarded in the interim period between the date that the former employee had first breached the non-competition obligation and the date of the injunction order. Notably, the court ultimately awarded nominal damages, given that the company was unable to show that the financial losses suffered by the company were *attributable* to the former employee's breaches. Indeed, the court noted that a drop in business could be caused by a range of factors, including an economic downturn and changing business cycles.[53]

54 The cases above therefore illustrate the practical necessity of providing for a contractually stipulated secondary obligation in the event that restrictive covenants such as non-competition and confidentiality obligations are breached. In such instances, the contract drafter should ensure that the secondary obligation in question does not fall afoul of the *Dunlop Pneumatic* test, to which the authors now turn.

55 To recapitulate, the *Dunlop Pneumatic* test for determining whether a secondary obligation is an unenforceable penalty clause is as follows. The foremost inquiry is whether the clause in question is a genuine covenanted *pre-estimate of damage*. Additionally, a clause will be presumed to be a penalty if:[54]

50 *Morris-Garner v One Step (Support) Ltd* [2018] UKSC 20 at [98].
51 [2018] SGHC 85.
52 *Tan Kok Yong Steve v Itochu Singapore Pte Ltd* [2018] SGHC 85 at [110].
53 *Tan Kok Yong Steve v Itochu Singapore Pte Ltd* [2018] SGHC 85 at [116].
54 *Xia Zhengyan v Geng Changqing* [2015] 3 SLR 732 at [78].

(a) the sum stipulated for is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach;

(b) if the breach consists only in not paying a sum of money, and the sum stipulated is a sum greater than the sum which ought to have been paid; and

(c) when a single lump sum is made payable by way of compensation, on the occurrence of one or more or all of several events, some of which may occasion serious and others but trifling damage.

56 In essence, the secondary obligation stipulated must be *commensurate* to the loss and damage suffered by the innocent party. Practically, this would mean that the compensation payable under a secondary obligation should be *reflective* of the loss that the innocent party will suffer. That said, the nature of some obligations and the breaches thereof are such as to make precise estimation of the losses to be suffered almost impossible. However, this is in any event "no obstacle to the sum stipulated being a genuine pre-estimate of damage".[55] It would be prudent for parties to maintain a documentary trail of their negotiations on the liquidated damages provision, in the event that there is a subsequent attempt to strike the clause out for being an unenforceable penalty.

57 One way to ensure that the secondary obligation is commensurate to the loss suffered is to structure the clause in a *dynamic* manner – such that the amount of compensation payable changes according to the amount of losses suffered. To this end, the Court of Appeal considered that cl 3(a) was not a genuine pre-estimate of damage because it provided for the disentitlement of a *fixed* amount benefits regardless of the nature and extent of the breach of RL's non-competition and confidentiality obligations.[56]

55 *Xia Zhengyan v Geng Changqing* [2015] 3 SLR 732 at [78(d)].
56 *Leiman, Ricardo v Noble Resources Ltd* [2020] 2 SLR 386 at [107].

58 Additionally, the secondary obligation should not operate as a *surcharge* on the contract-breaker, *ie*, an additional penalty on top of the damages which would be payable, as the Court of Appeal considered was the effect of cl 3(a) of the Settlement Agreement. This was on the basis that NRL had at all times retained its right to sue RL for compensatory damages in respect of any alleged breach of his primary obligations of non-competition and confidentiality under the Employment Agreement. Indeed, liquidated damages clauses are often a *substitute* for the common law right to sue for damages arising from a particular breach. Therefore, the clause in question should contain language to the effect that it provides the *sole* remedy in the event of a breach of the corresponding primary obligation.

## V. Concluding thoughts

59 In industries where former employees may be in possession of highly specialised information, as well as goodwill and relationships built up with customers, it is important to regulate post-employment conduct. Based on the discussion above, it can be seen that while the law does make provision for the proverbial carrot, it does not look as favourably upon the proverbial stick. Therefore, employers may have to make do with the proverbial carrot over the proverbial stick in order to secure the former employee's compliance with his post-employment obligations.

60 Ultimately, it boils down to a cost benefit analysis to be undertaken by the former employee. It may in some cases be more beneficial to him to breach the non-competition obligations in order to exploit a new opportunity. Therefore, apart from a consideration of the *legal* aspects of drafting such post-employment agreements, employers must be sure to carefully calibrate the size of this proverbial carrot, such that the loss of it will act as a sufficient disincentive to the former employee.