

Singapore Court of Appeal Clarifies Employers' Duties in Exercising Contractually Agreed Decision-making Powers *vis-à-vis* Employees and Extent of Review by Courts

The Singapore Court of Appeal comprising a five-member *coram* has, in a landmark decision, clarified the law on the duties owed by employers when exercising contractually agreed decision-making powers *vis-à-vis* employees, and the extent to which a court may review the exercise of those powers, as well as the law on penalties: *Leiman, Ricardo and anor v Noble Resources Ltd and anor* [2020] SGCA 52.

Our Comments

This is the first reported decision which deals with the principles surrounding the construction of contracts in the context of terms that vest decision-making powers in a contractually designated entity (as opposed to a court or tribunal) and the extent to which a court may review the exercise of those powers when a decision made by that entity is challenged.

It is commonplace for organisations which run share / share option benefit schemes for its employees to provide for how such benefits would be affected by employee conduct, and in particular, when employment ceases. In certain instances, settlement agreements are entered into which stipulate the conditions upon which such benefits can be retained by the employee. When the benefits under these schemes are purported to be forfeited by the employer, it is not unusual for disputes to arise as to whether this is legally permissible. Both employers and employees alike would do well to understand the circumstances under which forfeiture of benefits are allowed, whether any ensuing disputes should be determined by the court or any contractually designated entity, and the duties that would be owed by the contractually designated entity to the parties.

The Court of Appeal's decision is welcome as it clarifies the general principles which apply to such arrangements.

Andre Maniam SC (prior to his appointment to the High Court bench on 4 May 2020), Joel Quek and Jeremy Tan acted for the successful appellants.

This update takes a look at the Court of Appeal's decision.

Background

The key facts relevant to the issues discussed in this update are summarised below.

The first appellant ("**Mr Leiman**") is a former employee of the first respondent, Noble Resources Ltd ("**NRL**"), where he first held the position of Chief Operating Officer and later as Chief Executive Officer of the second appellant, Noble Group Ltd ("**NGL**"). NRL and NGL are part of the Noble group of companies ("**Noble**").

During his employment, Mr Leiman was granted NGL shares and share options, some of which were assigned to a trust that was administered by the second appellant, Rothschild Trust Guernsey Limited (“RT”). It was contractually agreed that the award of these benefits was under the purview of NGL’s Remuneration and Options Committee (“**R&O Committee**”).

In late 2011, following negotiations between Mr Leiman and Noble, Mr Leiman and NRL entered into a Settlement Agreement dated 9 November 2011 (“**SA**”) that regulated the terms of his resignation as Chief Executive Officer of NGL.

Clause 3 of the SA set out the terms of Mr Leiman’s post-resignation entitlements, the relevant terms of which had the following effect:

- (a) Mr Leiman would be entitled to receive severance payments and benefits under clause 3 of the SA, if he complied with his non-competition and confidentiality obligations pursuant to his employment agreement and the SA (clause 3(a)).
- (b) Mr Leiman would be entitled to exercise vested but unexercised share options he held in NGL for a certain period of time post-resignation (clause 3(c)).
- (c) Restricted shares and accrued dividends would vest in Mr Leiman on specific dates (clause 3(d)).

Mr Leiman’s entitlements under clauses 3(c) and (d) of the SA were subject to the condition that he did not “*act in any way to the detriment of*” his former employer. On this issue, the R&O Committee would make a “*final determination in the event of any dispute*”.

In November 2011, Noble hired a private investigator to monitor Mr Leiman’s activities and an external consultant to investigate the affairs of certain former employees of Noble whom Mr Leiman had been involved in hiring in 2006. The R&O Committee later relied on the information from these investigations to refuse Mr Leiman’s and RT’s requests to exercise share options and to release restricted shares. Noble alleged, among other things, that Mr Leiman had breached his non-competition and confidentiality obligations, and had acted to the detriment of Noble.

Mr Leiman brought an action against NGL and NRL seeking, among other things, a declaration that the R&O Committee’s decisions relating to his benefits were invalid. It was argued that the R&O Committee failed to accord Mr Leiman due process, and that Mr Leiman did not breach his non-competition and confidentiality obligations, and had not acted to the detriment of Noble.

The High Court’s Decision

The High Court dismissed the appellants’ claims.

It held that the R&O Committee’s decisions had not failed to accord Mr Leiman due process, and found that the R&O Committee did not need to inform Mr Leiman of the allegations made against him, or give him an opportunity to be heard. The High Court also found that Mr Leiman had breached his non-competition and confidentiality obligations, and that the R&O Committee had therefore properly exercised its contractual discretion and not prejudged the matter or acted arbitrarily, capriciously or in bad faith. It further ruled the

requirement of detriment was satisfied so long as Mr Leiman had acted against Noble's business interests, and that Noble did not need to prove that it suffered actual detriment or harm.

The High Court also held that the forfeiture of Mr Leiman's vested but unexercised share options under clause 3(c) of the SA was a primary obligation and did not attract the penalty doctrine. It found that, even if the doctrine was applicable, Mr Leiman did not satisfy the requirement that clause 3(c) was a penalty clause -- whether under the traditional test in *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd* [1915] AC 79 ("**Dunlop**") (i.e., whether the clause was a genuine pre-estimate of loss or was meant to hold the contract-breaker *in terrorem*) or the more recent test as espoused by the UK Supreme Court in *Cavendish Square Holding BV v Makdessi* [2016] AC 1172 ("**Cavendish**") (i.e., whether the secondary obligation 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).

Mr Leiman appealed against the High Court's decision.

The Court of Appeal's Decision

The Court of Appeal allowed the appeal in large part, and ordered that damages be assessed for the appellants' loss as a result of Noble's conduct.

Interpretation of the contractual provisions relating to Mr Leiman's benefits

The Court of Appeal began its analysis by examining the obligations contained in clause 3 of the SA, and in particular the interaction between clause 3(a) on the one hand and clauses 3(c) and (d) on the other.

The Court of Appeal held that, because clause 3(a) encompassed all the benefits and payments contemplated under the whole of clause 3 (including clauses 3(c) and (d)), and conditioned them upon Mr Leiman's compliance with his contractual non-competition and confidentiality obligations, any dispute as to Mr Leiman's compliance as such was a quintessential *legal* question which was solely within the court's purview.

In contrast, it found that clauses 3(c) and (d) were meant to deal with the question whether Mr Leiman had acted to Noble's detriment, and this was to be determined by the R&O Committee as an entirely separate *commercial* question.

As a matter of general principle, the Court of Appeal held that, absent very clear language suggesting otherwise, where parties subject rights to the fulfilment of a legal requirement (such as in clause 3(a)), the question of whether that requirement has or has not been met is a legal question and, hence, is typically to be resolved by a body tasked with making legal determinations (i.e., a court or tribunal) as opposed to a contractually designated entity, such as the R&O Committee in this case.

The Court of Appeal also disagreed with the High Court that detriment in the context of clauses 3(c) and (d) did not require proof of actual detriment or harm. This was consistent with the fact that the determination by the R&O Committee on the issue of detriment was a commercial question, and was more in line with the objective intentions of the parties since the consequences of finding detriment meant that Mr Leiman would lose his right to valuable benefits.

Whether the penalty doctrine applied

In considering whether clauses 3(a), (c) and (d) were unenforceable penalty clauses, the Court of Appeal confirmed that:

- The rule against penalty clauses applies only to clauses that impose secondary obligations to pay compensatory damages to remedy breaches of contract, and not to primary obligations that parties undertake to perform in their contracts.
- Additionally, whether a clause imposes a primary or a secondary obligation is a matter of substance rather than form, and requires consideration of: (a) the overall context in which the bargain in the clause was struck; (b) the reasons that 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 in order to secure some independent commercial purpose or end, or whether it was included as a deterrent to secure compliance of primary obligations.

While the Court of Appeal found that clause 3(a) was phrased as a primary obligation, it imposed an additional obligation by subjecting Mr Leiman's entitlement to share options and shares to the additional condition that he not breach his contractual obligations. It was therefore neither a genuine pre-estimate of loss as it would disentitle Mr Leiman from receiving benefits under the SA regardless of the nature and extent of his breach, nor did it uphold any legitimate interest beyond punishing Mr Leiman since Noble separately retained the right to sue for compensatory damages. The Court of Appeal was therefore satisfied that clause 3(a) was an unenforceable penalty clause, regardless of whether the *Dunlop* test or the *Cavendish* test applied.

On the other hand, it found that clauses 3(c) and (d) imposed primary obligations on Mr Leiman not to act to Noble's detriment in exchange for certain rights in respect of his share options and shares. They were therefore not clauses which imposed secondary obligations to compensate Noble for any breach of his contractual obligations, and the penalty doctrine did not apply.

In light of the findings summarised above, the Court of Appeal held that the issue of whether the principles in *Dunlop* continue to apply in the light of *Cavendish* did not have to be decided in this case.

The duties owed by the R&O Committee under the SA and the validity of its decisions

Given that clause 3(a) was an unenforceable penalty clause, the Court of Appeal next considered the validity of the R&O Committee's determinations under clauses 3(c) and (d) of the SA that Mr Leiman had acted to the detriment of Noble.

The Court of Appeal held that, in determining whether it is open to the court to consider the correctness of a decision or to substitute its own views for those reached by a contractually designated entity, as well as the duties owed by the contractually designated entity, one must consider the specific terms of the contract.

In the present case, the Court of Appeal held that clauses 3(c) and (d) of the SA made clear that Mr Leiman's benefits were liable to be forfeited if the R&O Committee made a final determination that he had acted to Noble's detriment, and it would not be permissible for the court to step into the Committee's shoes and usurp its decision-making powers under the SA.

However, the court could review the process by which the R&O Committee made its decisions to ensure that the process was fair. In this connection, the Court of Appeal highlighted that:

- What constitutes a fair process in the context of a contractually designated entity making determinations would depend on the terms agreed to by the parties. In contracts of employment, absent a term in the contract to the contrary, an employer is not obliged to accord an employee the right to any particular process before undertaking any action, including contractually wrongful action. The remedy for the employee would lie in damages, as opposed to any process-related obligations or rights beyond what was specifically provided for in the contract.
- This general position may be displaced by any express or implied terms in the contract, and entails an examination of the context of the particular contractual right in question, the language of the provision, the consequences of any decision made under that provision, and what if anything, was contemplated by way of any procedural requirements.

After examining clauses 3(c) and (d) of the SA, the Court of Appeal concluded that the R&O Committee's discretion was to be exercised in three ways:

- (a) The R&O Committee's jurisdiction would be triggered only if Mr Leiman had allegedly done something that amounted to acting to the detriment of Noble.
- (b) The R&O Committee was specifically designated to make a final determination on the issue of whether he had acted to the detriment of Noble only in this very specific circumstance: "*in the event of any dispute*". This meant that Noble had to allege that Mr Leiman acted to the detriment of Noble, and Mr Leiman must have disputed this allegation. It followed therefore that any such allegation by Noble had to be put to Mr Leiman so that he could decide whether he was going to dispute it.
- (c) In the event of a dispute, the R&O Committee's determination as to whether Mr Leiman had acted to the detriment of Noble would be final, and a determination made against Mr Leiman would mean that he lost his benefits.

The Court of Appeal therefore concluded it was implicit that Mr Leiman had to be given notice of Noble's allegations that he had acted to its detriment, as well as the basis for such allegations. Only then would Mr Leiman be able to decide if he wished to dispute the allegations. In such an event, the R&O Committee had to a duty to act fairly in making its determination. This was because the SA was meant to be an amicable settlement in relation to Mr Leiman's departure from Noble, the SA was entered into for mutual benefit of the parties, and Mr Leiman, in entering into the SA, was subjecting valuable benefits to a condition — that he not act to Noble's detriment, which final determination was left to Noble's R&O Committee.

The Court of Appeal found that Noble neither informed Mr Leiman of the allegations nor provided him information on the case against him before the R&O Committee made its decisions to deprive him of his benefits under clauses 3(c) and (d) of the SA. There was therefore no dispute under clauses 3(c) and (d) of the SA which engaged the R&O Committee's jurisdiction to make a final determination on the issue of detriment. Further, the R&O Committee's determinations were also invalid because they were not made fairly as Mr Leiman was not given an opportunity to make representations to the R&O Committee before its determinations were made.

In addition, the Court of Appeal held that Mr Leiman did not breach his non-competition and confidentiality obligations, reversing the High Court's findings in that regard. In any event, the Court of Appeal found that there was no evidence that any such breaches caused actual commercial detriment to Noble, as required under clauses 3(c) and (d) of the SA.

If you would like information or assistance on the above or any other area of law, you may wish to contact the Partner at WongPartnership whom you normally work with or any of the following Partners:

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