Hammonds

COMMERCIAL AND INTELLECTUAL PROPERTY LAW

BULLETIN

March 2010

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Commercial Intellectual Property Data Protection Media

This month's bulletin includes a review of the European Court's important decision in the 'Google Adwords' case, a look at the Supreme Court's ruling that an unsigned contract was binding even though the parties had agreed not to be bound until execution of the contract and a summary of the current status of the Bribery and Digital Economy Bills.

COMMERCIAL

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Liability cap includes contractual but excludes statutory interest

In *Markerstudy Insurance Company Limited & Others v Endsleigh Insurance Services Limited* the High Court has held that a contractual cap on liability includes contractual interest but excludes statutory interest.

Facts

The Claimants (C) were insurance companies writing motor business. The Defendant (D) provided claims handling services to C pursuant to five contracts. C issued proceedings against D alleging breaches of these contracts resulting in losses to C of £14m.

Article 13.2 of the fifth contract provided:

> "*Endsleigh's total liability in contract, tort (including negligence or breach of statutory duty), misrepresentation, restitution of otherwise, arising in connection with the performance or contemplated performance of the Agreement shall be limited to the aggregate amount of fees received pursuant to clause 6.1 above*".

The total fees payable pursuant to clause 6.1 were £3,863,911.

C and D accepted that the effect of Articles 13.2 and clause 6.1 was that D's total liability to C was £3,863,911. The question for the court was whether this sum included or excluded interest. In other words, was C entitled to recover interest on the damages insofar as interest increased the amount payable above £3,863,911?

C argued that if the interest D was to pay was included in the cap then it would effectively be penalised for any delay in the damages being paid. D argued that the contract provided for its "total liability in contract" which would include liability for interest as well as the figure for damages.

Held

Mr Justice David Steel in the High Court held that the contractual cap included contractual interest but excluded statutory interest. Construing Article 13.2, statutory interest was not a "liability in contract" but a discrete statutory liability arising from the exercise of the court's discretion. Accordingly, it was excluded from the cap.

Comment

This ruling means that statutory interest can push payments above a contractual cap. It also means that contractual interest on late payments can take up part of a liability cap which would reduce the total non-interest sum payable and reduce the damages available to a claimant for any future breaches of the contract.

Further reading

Click here for a copy of the judgment.

'Subject to contract' waived where parties performed before agreement signed

In *RTS Flexible Systems v Molkerei Alois Müller GmbH*, the Supreme Court has held that where a clause in a draft contract provided that the contract would not become effective until signed by the parties, the parties had waived that requirement by beginning work on the project. They had entered into a contract on the terms of the draft, even though it had never been signed.

Facts

Müller wanted RTS to supply machinery for the packaging and handling of multi-pack yoghurts. On 21 February 2005 the parties signed a letter of intent which provided for a period of negotiation of the final contract. This period ended on 27 May 2005 but by that date the final contract had still not been executed.

During the negotiation period RTS had begun work on the project and it continued with this work after 27 May. Müller partly paid for the work. A dispute subsequently arose between the parties. The High Court and subsequently the Court of Appeal were called on to decide whether a contract between the parties had ever come into existence.

During the negotiations a draft contract had been circulated between the parties and almost all of the terms were agreed. The draft contract incorporated amended industry standard MF1 conditions. These conditions included limitations on liability (insisted upon by RTS) and liquidated damages provisions. The MF1 conditions also contained the following counterparts clause:

> "*The contract may be executed in any number of counterparts provided that it shall not become effective until each party has executed a counterpart and exchanged it with the other.*"

Previous decisions

The High Court had previously held that a contract had been concluded between the parties after the letter of intent had expired because the parties had reached agreement on all of the essential terms and because they had mutually performed obligations under it. The High Court said that a contract could be created by mutual performance rather than in the normal manner of offer and acceptance. The court found, however, that the MF1 conditions did not form part of this contract because, amongst other things, the counterparts clause had not been complied with.

On appeal, the Court of Appeal held the counterparts clause prevented any contract coming into existence between the parties until a written agreement was executed, not just incorporation of the MF1 conditions into the contract. It said the result of the High Court's decision was that RTS was being asked to assume unlimited liability for its performance under the version of the contract that the High Court found existed. This was a greater responsibility than RTS would have assumed under the final written contract had it been executed. The counterparts clause must apply to the entire contract to prevent any contract whatsoever from being formed before execution. This left RTS to seek payment on a quantum meruit basis and to argue that any liability to Müller was limited to the return of monies paid (rather than for full breach of contract).

Decision

The case went to the Supreme Court which said that it was required to rule on two issues; (1) whether the parties had entered into a contract after the letter of intent had expired and if so (2) what the terms of the contract were. The court said that it must look at all the circumstances of the case and make an objective assessment of the position, considering what the reasonable business-person would make of the situation between the parties. Lord Clarke said:

> "*Whether there is a binding contract between the parties and, if so, upon what terms depends upon what they have agreed. It depends not upon their subjective state of mind, but upon a consideration of what was communicated between them by words or conduct, and whether that leads objectively to a conclusion that they intended to create legal relations and had agreed upon all the terms which they regarded or the law requires as essential for the formation of legally binding relations. Even if certain terms of economic or other significance to the parties have not been finalised, an objective appraisal of their words and conduct may lead to the conclusion that they did not intend agreement of such terms to be a pre-condition to a concluded and legally binding agreement.*"

The court held that the parties had entered into a contract after the letter of intent had expired which governed their relationship from that time. Because the parties had begun performing the contract, they had waived the counterparts clause by conduct meaning that a contract could come into existence between them even though no contract was ever signed. The terms of the contract were those which the parties had agreed and which were contained in the draft contract. This included the MF1 terms. The court was satisfied that the parties had agreed all of the terms which they regarded as essential and that those issues yet to be agreed were minor in nature and not regarded by the parties as pre-conditions to a binding contract. The court commented that its decision made more commercial sense than that reached by the High Court (which found that there was a contract but on only some of the terms agreed between the parties with some of the most fundamental missing) and the Court of Appeal (which found that the parties were performing pursuant to no agreement between them at all).

Comment

Although the decision in this case is fact specific, it is an interesting decision as illustrating the undesirability of beginning work before a contract is concluded. There is no problem while the commercial relationship is working well. But if a dispute arises considerable cost could be involved in establishing what the contractual position is and what the parties' obligations, rights and remedies are. In this case, the parties had to litigate through the entire court system to establish this. This will have involved significant cost. Lord Clarke in the Supreme Court said the following:

> "*The different decisions in the courts below and the arguments in this court demonstrate the perils of beginning work without agreeing the precise basis upon which it is to be done. The moral of the story is to agree first and to start work later.*"

Further reading

Click here for a copy of the Supreme Court's judgment

Court of Appeal reaffirms rule that without prejudice material may not be used as an aid to interpretation

In the case of *Oceanbulk Shipping & Trading SA v TMT Asia Limited*, the Court of Appeal has overturned the High Court's ruling and reaffirmed the rule that without prejudice material may not be put before a court to assist in the interpretation of a settlement agreement.

Background

The without prejudice rule will generally prevent statements made in a genuine attempt to settle a dispute from being put before the court as evidence of admissions against the interest of the party which made them. The public policy reason behind the rule is to encourage parties to settle disputes, in that settlement will be facilitated if they are able to speak freely. In particular any admissions they made have made in an attempt to settle the dispute may not later be used against them.

There are a number of exceptions to the without prejudice rule. Without prejudice communications will be admissible:

- When the issue is whether the without prejudice communications have resulted in a concluded settlement agreement;

- To show that a settlement agreement apparently concluded between the parties during without prejudice communications should be set aside on the ground of misrepresentation, fraud or undue influence;

- As giving rise to an estoppel where a statement made in without prejudice communications is intended to induce the recipient to act in reliance on it and the recipient does in fact act in reliance on it.

In *Chartbrook v Persimmon*, the House of Lords confirmed that when interpreting a clause of an agreement the court should take into account the background knowledge that would have been available to the parties at the time of the contract but that evidence of the pre-contractual negotiations is not admissible. This is known as the exclusionary rule.

Facts

The High Court's ruling was reported in the July/August edition of this Bulletin. The facts of the case were that a dispute arose between the parties over the interpretation of a settlement agreement which, if interpreted one way, would result in a payment of US$47 million to Oceanbulk or, if interpreted the other, would result in a payment of US$86 million to TMT. In support of its interpretation, TMT sought to adduce without prejudice communications between the parties before the settlement agreement was concluded. It argued that these communications would establish a fact which was part of the background material which the court should have available to it when interpreting the settlement agreement, in line with the *Chartbrook v Persimmon* approach to interpretation. Oceanbulk argued that the without prejudice communications were inadmissible as they did not fall within any of the recognised exceptions to the without prejudice rule.

Andrew Smith J in the High Court held that the without prejudice communications were admissible. The judge considered the existing exception to the without prejudice rule which allows without prejudice communications to be looked at to determine whether they have resulted in a concluded settlement agreement. He held that it would be illogical to admit without prejudice communications for this purpose but not for the purpose of determining what the terms of that agreement were. Andrew Smith J held:

- The distinction between identifying whether a concluded settlement agreement had been reached and its terms and interpreting them was a fine one which would often be difficult to apply;

- There was authority for allowing evidence of the without prejudice communications for the purpose of interpretation in *Admiral Management Services Limited v Para-Protect Europe Limited [2002]* (a decision of Stanley Burnton J, now LJ and hearing this appeal);

- Evidence of without prejudice exchanges is admissible if there is a plea of rectification and it would be illogical not to admit it for the purpose of interpretation;

- A court which is deprived of evidence of the background against which an agreement was made will be less well equipped to discern the parties' intentions and less likely to construe the contract in accordance with them.

Decision

Giving the leading judgment (with which Stanley Burnton LJ agreed), Longmore LJ overturned the High Court's ruling and reaffirmed the rule that without prejudice communications were not admissible for the purpose of construing the resulting settlement agreement. He dealt with each of Andrew Smith J's four reasons as follows:

- The distinction between identifying whether a concluded settlement agreement has been reached and its terms and interpreting them is not a fine one, especially if the settlement agreement is written (as in this case). There is then no difficulty in identifying the contract and its terms. Interpretation of those terms would be a different matter altogether.

- The *Admiral Management* case – this case was not the authority that Andrew Smith J had taken it to be. This case was in fact authority for the principle that a without prejudice document referred to in a written settlement agreement could be looked at by the court when interpreting the agreement. This decision only concerned a situation where a without prejudice document was referred to in, and so formed part of, the settlement agreement. It could not be extended to make admissible some background fact which was not part of the terms of the agreement.

- There was no inconsistency between allowing without prejudice communications to be reviewed where the claim was for rectification but not where the issue was interpretation. In the case of rectification the court is ascertaining the true terms of the contract. It is not considering the background facts in order to ascertain the contract's meaning.

- The policy of protecting without prejudice communications and facilitating dispute settlement was stronger than the policy of providing a judge with every conceivable help to arrive at a just interpretation of an agreement.

Ward LJ gave a robust dissenting judgment. He was in favour of lifting the without prejudice veil as between the parties to the negotiations for the purpose of interpreting the resulting settlement agreement. He said:

> "*So, if you can use the antecedent negotiations to prove the agreement, to rescind it, or to rectify it, why on earth can you not use the negotiations to establish the truth of what the concluded contract means? Not to do so would strike my mother as "barmy". Perhaps I should simply say it strikes me as illogical.*
>
> *There is little point in expanding upon [my] reasons for I am outnumbered, nay outgunned, by the commercial colossi seated either side of me. I prefer the instincts of the youthful Stanley Burnton J. before he became corrupted by the arid atmosphere of this Court. It goes to prove what every good old-fashioned county court judge knows: the higher you go, the less the essential oxygen of common sense is available to you. So I am unrepentant. With, of course, great respect to my Lords, I dissent. In my judgment Andrew Smith J. was absolutely correct for the reasons he gave. I would dismiss the appeal*".

Comment

This decision unequivocally confirms that the need to promote dispute resolution ranks above the desirability of having all material relevant to interpretation before the court.

Further reading

Click here for a copy of the judgment

Bribery Bill in final Parliamentary stages

On 3 March 2010, the Bribery Bill received its second reading in the House of Commons. It will now pass to the Committee stage where it will be reviewed on a clause by clause basis.

The Bribery Bill will replace the common law offence of bribery and the Prevention of Corruption Acts 1889 to 1916. The government hopes that the Bill will modernise and simplify anti-corruption law in the UK, paving the way for more successful prosecutions.

The Bill has been significantly amended since first being published almost a year ago. It creates two general offences of giving and receiving a bribe. It also includes other discrete offences, the most controversial of which imposes criminal liability on a corporate body for failing to prevent an employee or other person performing services on its behalf from giving bribes. A business will have a defence if it can show that it has good systems in place to prevent bribery. Under the Bill as amended, the government is obliged to issue guidance on what businesses will actually need to do to be able to rely on this defence.

Businesses need to be aware of the Bill and take steps to ensure they are fully compliant with it when it becomes law, which is expected to be before the general election.

Click here for a copy of the current version of the Bill (the Bill is being amended regularly and www.parliament.uk should always be referred to for the most recent version).

Franchisor will give good consideration even where the goodwill and trade marks are owned by another group company

In the case of *Stream Healthcare (London) Limited v Pitman Education and Training Limited*, the High Court has ruled that a franchisor did not have to own the rights it granted under a franchise agreement to provide good consideration.

Facts

The defendant (PETL) was a member of the Pitman Group of Companies. Pitman Training Group (PTG) was the principal holding company of the Pitman Group.

The Pitman Group granted franchises to operate the business of secretarial and associated training. PETL granted franchises for overseas territories. PETL was dormant despite the fact that it granted the franchises and was entitled to the franchise payments. The relevant goodwill and the relevant trade marks were all held by PTG. Because PETL did not have any assets or relevant employees, in practice PTG complied with the supply obligations under the franchises (whether for physical goods or advice) and all monies paid by franchisees were channelled up to PTG. There were no formal agency or authorisation arrangements in place as between PTG and PETL.

In 2005, PETL granted a franchise to the claimant (Stream) to set up franchises in West Africa. Stream never opened any training centres or granted any sub-franchises. Because of this PETL was not obliged to do very much by way of supplying goods or advice to Stream pursuant to its obligations in the franchise agreement. However, it did (via PTG) supply Stream with a 'décor pack' (a pack of large posters with Pitman publicity material on them) worth £500.

Stream failed to pay the fees when they fell due under the agreement. PETL brought a claim for the monies. Stream's defence was that PETL had not provided consideration for the franchise agreement. It argued that PETL did not have any rights to the goodwill or trade marks and so was not in a position to grant a right to use these. Therefore, Stream argued, it did not get any of the rights under the agreement that it sought to acquire. This amounted to a total failure of consideration by PETL meaning that there was never a binding contract between it and Stream. Stream was never obliged to pay any franchise fees.

Decision

Mann J in the High Court rejected Stream's argument and found that PETL had provided consideration for the franchise agreement. He held that Stream did get something under the agreement, namely the décor pack worth £500. This was more than de minimis consideration.

> "*If one is looking for some sort of consideration, even if nothing else was provided, then at least that was. That seems to me to be a complete and short answer to the total failure of consideration point*."

Mann J went on to say that there were "*other answers as well*". He held that PETL was impliedly authorised by PTG to enter into franchise agreements otherwise the whole set up of the Pitman Group's business would not have worked. In those circumstances he could not see how Stream could assert that it did not have the rights provided in the franchise agreement.

> "*The nature of the agreement does not have to be gone into here. It is enough that there must have been some such rights. In those circumstances, if cannot be said that the absence of the relevant goodwill, trade names or trade marks in PETL somehow means that the franchisees had no rights and can therefore complain about a failure of consideration. They got the rights to enable them to do what the agreement allowed them to do*."

Mann J also found that the other promises of PETL in the franchise agreement (such as to provide assistance and materials) amounted to good consideration as they were "*perfectly valid promises*".

Accordingly, the judge held that there was good consideration by PETL and a binding contract between it and Stream. Stream was obliged to pay the overdue franchise fees.

Comment

This case was decided on its facts; it is implicit in the judgment that the judge thought that Stream was simply constructing an argument to avoid paying the franchise fees. However, it is a useful decision for franchisors that do not own the rights relevant to the franchise agreement (such as goodwill or trade marks).

In this case there was no formal agreement between PETL and the rights holder PTG allowing PETL to grant franchises. The court was willing to imply such an agreement. Because the judgment in this case was fact driven, franchisors should not view it as authority for the proposition that such an agreement will be implied in every case. Where another company in the franchisor's group owns the rights relevant to the franchise agreement it is preferable for the parties to document the rights holder's consent to the franchisor granting franchises. This will defeat any argument by a franchisee that they have not in fact been given the rights under the agreement that they contracted for.

Further reading

Click here for a copy of the judgment

Court of Appeal confirms low threshold for duty to mitigate loss

In *Lombard North Central PLC v Automobile World (UK) Ltd*, the Court of Appeal has reiterated that the duty to mitigate losses caused by a breach of contract is not a demanding one.

Facts

Automobile World (AW) took a rare and expensive car on hire purchase from Lombard (L). The car was a Mercedes Benz S600 Pullman and was the kind of car that a country's head of state might order to an almost bespoke specification. These cars were manufactured by Mercedes Benz for a total of only three years.

The basic cash price of the car under the contract between AW and L was £194,000. AW paid a deposit of £24,000 and agreed to pay 60 instalments of £3,061.23 and a final instalment of £60,000. In fact, AW managed to pay only a few of the initial instalments and then defaulted. Lombard issued a notice of termination and repossessed the car with a view to selling it. It was the sort of car that arguably should have been sold through specialist dealers, allowing sufficient time for the right buyer to come along. As it was, the car was offered for sale in the standard way and sold in a private sale for £59,900 in only 11 days. £50,900 of this was credited to AW's account and Lombard brought proceedings for their outstanding losses amounting to £204, 731.31.

In fact, the car should have been sold for nearer £150,000. AW argued that Lombard's representative responsible for selling the car (Mr Treadwell) had failed to recognise its rare nature and so had failed to properly market the car and mitigate Lombard's losses.

Held

The Court of Appeal held that Lombard had properly mitigated its losses. It said:

> "*It is well recognised that the duty to mitigate is not a demanding one…it is the party in breach which has placed the other party in a difficult situation. The burden of proof is therefore on the party in breach to demonstrate a failure to mitigate. The other party only has to do what is reasonable in the circumstances*."

Mr Treadwell had been careful to obtain the best price for the car in circumstances in which Lombard was attempting to recoup its losses by what was, in effect, a forced sale. In light of this, the court was satisfied that Lombard had acted reasonably in the circumstances.

Further reading

Click here for a copy of the judgment

High Court finds that 'perpetual' does not mean 'never ending'

In *BMS Computer Solutions Limited v AB Agri Limited*, the High Court has considered the meaning of the word 'perpetual' in a software licence agreement.

Facts

BMS developed and supplied computer software. These proceedings related to a BMS software package called 'MillMaster'. MillMaster was used by animal feed companies for managing the production and supply of animal feed using feed mills.

AB Agri carried on the business of animal feed production at feed mills. On 4 November 1994, BMS licensed AB Agri to use MillMaster at its feed mills (the Licence Agreement). The key terms of the Licence Agreement were as follows:

5.2 The Licensee hereby undertakes to enter into a software technical support agreement in the form of the agreement annexed hereto on or before the Actual Delivery Date and to maintain such agreement as amended from time to time in effect throughout the duration of this agreement. In the event that the software technical support agreement is terminated for any reason whatsoever this agreement shall terminate forthwith and the provisions of Clause 16.3 shall apply …

16. Termination

16.1 This agreement shall.…expire on the tenth anniversary of the date hereof unless terminated prior to such date in accordance with the provisions set out below:

16.1.1 by the Licensee upon giving not less than twelve months' written notice to the Company;

… [termination for material breach or insolvency].

16.3 Within seven days of the termination of this agreement (howsoever and by whomsoever occasioned) the Licensee shall return all copies of the Licensed Programs Program Specifications and New Releases in its possession to the registered office of the Company.

On the same day, AB Agri entered into a software technical support agreement as required by clause 5.2 of the Licence Agreement (the Support Agreement). The key terms of the Support Agreement were as follows:

9. Duration of agreement

This agreement shall continue until terminated in accordance with the provisions of Clause 11 below…

11. Termination

11.1 This agreement may be terminated:

11.1.1 by the Licensee upon giving not less than twelve months' written notice to the Company;

… [termination for material breach or insolvency]

11.3 Within seven days of the termination of this agreement (howsoever and by whomsoever occasioned) the Licensee shall return all copies of the Licensed Programs Program Specifications and New Releases or fixes in respect of the same in its possession and supplied under the terms of this agreement to the registered office of the Company…"

By a variation agreement dated 20 December 2000 (the Variation Agreement) the parties made significant modifications to the Licence Agreement, including the following:

4. Software Licence

(a) The Program Licence will be extended to be a UK-wide perpetual licence usable on any processor or PC at all ABN UK operations including the compound animal feed operations of Cereal Industries as per the existing Agreement of 21 March 2000 up to a maximum aggregate annual tonnage of 2.45 million compound feed tonnes as defined in the Agreements.

11. *Agreements*

The parties agree that the current Agreements continue in full force and effect subject to these variations until such time as they are amended by any further variation Agreements.

On 19 December 2008, AB Agri gave notice to terminate the Support Agreement under clause 11.1.1 of the agreement. In its notice of termination, AB Agri claimed that although the Support Agreement had been terminated the Licence Agreement continued in full force and effect. BMS argued that the continuation of the licence was conditional upon AB Agri continuing with the Support Agreement as set out in clause 5.2 of the Licence Agreement. The High Court was asked to determine whether or not the Licence Agreement had been terminated.

AB Agri argued that the grant to it of "a UK-wide perpetual licence" under clause 4(a) of the Variation Agreement was incompatible with clause 5.2 of the Licence Agreement. Therefore, it argued, according to clause 11 of the Variation Agreement, Clause 4(a) of the Variation Agreement superseded and removed clause 5.2 of the Licence Agreement. It was open to AB Agri to 'decouple' the operation of the Licence Agreement and the Support Agreement. BMS' response was that clause 4(a) of the Variation Agreement was not incompatible with the continuation in effect of Clause 5.2 of the Licence Agreement. It argued that, by virtue of Clause 11 of the Variation Agreement, Clause 5.2 of the Licence Agreement continued to have effect and that the Licence and the Support Agreements could not be decoupled. When AB Agri terminated the Support Agreement it also, by operation of Clause 5.2 of the Licence Agreement, automatically terminated the Licence Agreement.

The question for the court was did use of the word 'perpetual' override the termination provisions in the Licence Agreement, including clause 5.2?

Decision

Mr Justice Sales in the High Court found for BMS. He held that the word "perpetual" could carry different shades of meaning. It could mean "never ending" (in the sense of incapable of being brought to an end) or it could mean "operating without limit of time" (so as, in the context of Clause 4(a) of the Variation Agreement, to grant a licence of indefinite duration, but subject to any contractual provisions governing termination of the licence).

Mr Justice Sales preferred the latter interpretation of the word "perpetual" in the context of clause 4(a) of the Variation Agreement. Use of the word 'perpetual' did not override the termination provisions but operated subject to them.

Adopting this interpretation, there was no incompatibility between clause 4(a) and clause 5.2. The Licence Agreement was perpetual but subject to the termination provisions in the agreement. This meant that clause 5.2

continued to have effect. Therefore, when AB Agri terminated the Support Agreement it also terminated the licence.

Mr Justice Sales reasons for reaching this conclusion included:

- Clause 11, and the words "will be extended" in clause 4(a), of the Variation Agreement made it clear that that the parties intended the same Licence Agreement to have effect after the variation, albeit modified in some respects. In particular, they indicated that the parties intended the modified licence to be subject to the same termination provisions. The reasonable inference from this was the parties also intended clause 5.2 (which was a termination provision) to continue to have effect.

- If the parties had intended to delete the termination provisions in the Licence Agreement it was natural to suppose that the parties would have made that intention clear in the Variation Agreement rather than leaving it to be inferred from the use of the vague term 'perpetual'. The parties would have needed to use 'clear and explicit' language to indicate this. There was no such language in the Variation Agreement.

- There was a "clear continued commercial need" for the termination provisions in the Licence Agreement to operate since, otherwise, there would be no mechanism to bring ongoing, potentially onerous obligations under that agreement to an end.

- Clause 11.3 of the Support Agreement created a link between the continuation of the Support Agreement and the Licence Agreement. An obligation to return all copies of the software on termination of the Support Agreement was not consistent with the argument that the Licence Agreement would continue in effect. Practically, the licence could not continue.

Comment

This case illustrates that the courts are prepared to find that 'perpetual' has a meaning other than 'never ending' (cannot be terminated) in the context of a particular contract. Parties using this word in contracts are advised to take note and to make their intentions clear about what the term of the contract is. In light of this judgment, this may require wording in additional to 'perpetual' to explain what perpetual is meant to mean in the context of that particular contract.

Further reading

Click <u>here</u> for a copy of the judgment

INTELLECTUAL PROPERTY

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Reference to ECJ in seizure of counterfeit goods case

In the November/December 2009 edition of this Bulletin, we reported on the Court of Appeal's reference to the ECJ in the case of *Nokia v Her Majesty's Commissioners of Revenue & Customs*. This case concerned fake Nokia telephone handsets, bearing the NOKIA trade mark, arriving at Heathrow Airport in transit between Hong Kong and Columbia. Nokia applied for judicial review of HMRC's decision not to seize the handsets. HMRC had argued that the handsets were not 'counterfeits' within the definition given in the Counterfeit Goods Regulation because they had never been put on the market in the UK. The High Court upheld HMRC's actions. Nokia appealed.

The Court of Appeal made a reference to the ECJ for a preliminary ruling on the issues in this case. In December, we did not know exactly what the ECJ was being asked to rule on. We only knew that it would address the issue of whether goods in transit from one non-EU Member State to another are capable of constituting counterfeit goods within the Counterfeit Goods Regulation if there is no evidence that they will be released into free circulation in the EU or be illicitly diverted into the EU market.

Since then, the specific question that has been referred to the Court of Justice of the European Union (as it is now known) has been published. The question is:

> "*Are non-Community goods bearing a Community trade mark which are subject to customs supervision in a Member State and in transit from a non-Member State to another non–Member State capable of constituting "counterfeit goods" within the meaning of Article 2(1)(a) of Regulation 1383/2003/EC if there is no evidence to suggest that those goods will be put on the market in the EC, either in conformity with a customs procedure or by means of an illicit diversion.*"

This will be an important ruling for brand owners as an interpretation of the Counterfeit Goods Regulation in line with that of the High Court in this case would effectively limit their trade mark rights. They would not be able to use their trade marks to intercept the goods at an EU customs point preventing their subsequent sale in the non-EU destination territory. Instead, they would have to take action in the destination territory itself which could be costly and difficult.

We will report further when we have the Advocate General's opinion.

More changes to customs procedures concerning seizure of counterfeit goods

HM Revenue & Customs (HMRC) have again changed their procedures for seizing and detaining suspected counterfeit goods at UK borders. The latest changes are beneficial to intellectual property rights holders.

Under the old HMRC regime, suspected counterfeit goods would not be detained beyond ten working days unless the owner of the goods agreed to their detention or destruction, or such action was ordered by the Court. As a result, if an agreement could not be reached with the owner of the goods, rights holders had to act quickly and incur the costs of initiating court proceedings or risk the goods being released. This placed a significant burden on rights holders.

Under the new regime, this burden has been significantly eased. The Goods Infringing Intellectual Property Rights (Customs) (Amendment) Regulations 2010, which came into force on 10 March 2010, have introduced a "simplified procedure". Under the simplified procedure, seized goods may be destroyed by HMRC if the owner of the goods agrees to the destruction or fails to oppose the destruction within ten working days of notification of the seizure. Rights owners must, however, bear the cost of destruction.

The real benefit of the new regime, therefore, concerns what happens if the owner of the counterfeit goods fails to respond to communications from either HMRC or the IP rights holder once their goods have been seized. Previously, HMRC would release the goods after 10 days unless the IP rights holder obtained a court order requiring them to detain the goods for longer. Now, where the counterfeit goods owner does not respond, HMRC will simply destroy the goods removing the need for the rights holder to obtain a court order at all.

The old regime also previously drew a distinction between different types of intellectual property right, meaning that HMRC's actions would differ according to whether the IP right allegedly being infringed was, for example, a trade mark or copyright. This distinction has been removed, so HMRC's actions will be the same regardless of the IP right in issue.

Click here for a copy of the Regulations

European ruling on registrability of shapes as trade marks

In *Lego Juris A/S v Office for Harmonisation in the Internal Market (OHIM) and Mega Brands Inc*, the Advocate General of the Court of Justice of the European Union has given guidance to businesses on when the shape of goods will be registrable as a trade mark. The opinion gives an interpretation of Community Trade Mark law but can be applied by analogy to applications for national trade marks where the law is substantially the same.

Background

Community Trade Marks were governed by Regulation 40/94 but this Regulation was replaced by Regulation 207/2009. The Advocate General's interpretation concerns the old Regulation 40/94 but his opinion is current in that the content of the new Regulation is largely the same.

Article 4 of Regulation 40/94 (the Regulation) provides:

> "*A Community trade mark may consist of any signs capable of being represented graphically, particularly words, including personal names, designs, letters, numerals, the shape of goods or their packaging, provided that such signs are capable of distinguishing the goods or services of one undertaking from those of other undertakings*".

Article 7(1) of the Regulation provides:

1. The following shall not be registered:

(a) signs which do not conform to the requirements of Article 4;

(b) trade marks which are devoid of any distinctive character;

(c) ..;

(d) …;

(e) *Signs which consist exclusively of*

(i) ..

(ii) *The shape of goods which is necessary to obtain a technical result; or*

(iii) *The shape which gives substantial value to the goods.*

Article 7(3) provides:

> "*Paragraph 1(b), (c) or (d) shall not apply if the trade mark has become distinctive in relation to the goods or services for which registration is requested in consequence of the use which has been made of it*".

In the case of *Philips v Remington* the Court of Justice was called on to interpretation Article 7(1)(e)(ii) of the Regulation (that the "*shape of goods which is necessary to obtain a technical result*" cannot be registered as a CTM) and this is the only judicial interpretation of this section to date. The dispute in *Philips* concerned the registration of the shape of the head of a type of electric razor. The court held that Article 7(1)(e)(ii) prevented a sign whose essential characteristics performed a technical function from being registered as a trade mark. It stated that one purpose of this provision was to prevent a trade mark proprietor having a monopoly over a technical function which would prevent competitors supplying a product incorporating such a function. Technical functions were more appropriately protected by other IP rights (such as patents or design rights). Another purpose of Article 7(1)(e)(ii) therefore was to prevent businesses from trying to monopolise the technical function using trade mark rights once their other IP rights had expired. This would effectively give them a perpetual monopoly over this function. Competitors would never be able to offer competing products incorporating this technical function. It was irrelevant to the question of whether a shape performing a technical function was registrable as a trade mark that other shapes could be used to achieve the same technical result.

Facts

Lego applied for a CTM for the shape of its toy bricks. It succeeded but the Cancellation Division of OHIM subsequently invalidated the registration relying on Article 7(1)(e)(ii) on the basis that the mark consisted exclusively of the shape of goods which was necessary to obtain a technical result. Its decision was upheld by the Boards of Appeal of OHIM, OHIM's Grand Board of Appeal and Court of First Instance. Lego appealed to the Court of Justice (Europe's Highest Court) for a ruling on the interpretation of Article 7(1)(e)(ii). The Court of Justice's ruling is awaited but in the meantime the Advocate General has given his opinion of the proper interpretation of this provision. His opinion merely guides the Court about what decision it should reach.

Decision

The Advocate General's opinion was as follows:

- The decision in *Philips* is good law. A sign whose essential characteristics perform a technical function cannot be registered as a trade mark.

- To assess whether the essential characteristics of a sign perform a technical function the following stages must gone through:

  (1) take the shape which is to be registered as a trade mark

(2) identify its most important elements (its essential characteristics). To do this each of the individual features of the get up must be analysed in turn;

(3) compare the essential characteristics with the technical result to assess whether there is an connection between them;

(4) if all of the essential characteristics perform a technical function the shape itself is functional and cannot be registered as a trade mark. If some but not all of the characteristics are functional then proceed to stage 5;

(5) In the case of a shape with some functional and some non-functional characteristics there were two possible alternatives (the Advocate General did not elaborate on which was preferable):

   (a) To allow only the non functional characteristics to be registered as a trade mark and require the trade mark proprietor to disclaim any trade marks rights in the functional characteristics; or

   (b) To allow both the functional and non-functional characteristics to the registered as a trade mark but only if there were other shapes which could also perform the technical function. This would mean that registration of the entire shape would not prevent competitors selling competing products.

   In either case, proceed to stage 6.

(6) Assess whether the sign has the necessary distinctive character required of all trade marks taking into account the overall impression conveyed by the sign from the consumer's point of view. Article 7(3) does not apply in the case of a functional shape so it is irrelevant whether the sign has become distinctive through use.

In this case, if stages 1, 2 and 3 were applied, it was clear that not only the essential characteristics of the Lego brick but the brick taken as a whole performed a technical function. This meant that the Lego brick was not registrable as a trade mark. The Advocate General was of the opinion that Lego's appeal should be dismissed.

Comment

The Advocate General has set out his own test for assessing whether any particular shape mark is registrable. However, it is complex and would require both expert and consumer evidence. Whether it will be adopted by the Court of Justice when it delivers its ruling remains to be seen.

Further reading

Click here for a copy of the opinion.

DATA PROTECTION

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Model clauses for transfer of personal data overseas updated

The eighth data protection principle in the Data Protection Act 1998 provides:

> "*Personal data shall not be transferred to a territory outside the EEA unless that territory ensures an adequate level of protection for the rights and freedoms of data subjects in relation to the processing of personal data*"

This implements Article 25(1) of the EU Data Protection Directive (95/46/EC) into UK law.

The effect of Article 25 is that a European business which is a data controller may not transfer personal data to a data processor based in a non-EEA territory (known as a 'third country') unless that territory ensures an adequate level of protection.

One way to ensure compliance with Article 25 is to require the data processor to sign up to the EU 'Model Clauses'. These put in place arrangements to ensure that the rights of the data subjects are protected after the data is transferred. The Model Clauses were contained in a European Commission Decision of 2002 (2002/16/EC). However, the Commission has just issued a new Decision (2010/87/EU) which updates the Model Clauses. The clauses have been updated to reflect the fact that data processors are increasingly outsourcing the processing activities to sub-processors and aim to ensure that the rights of data subjects are protected where this happens. Otherwise, the Model Clauses are unchanged. The updated clauses apply as from 15 May 2010. The old clauses can be used until that date but the new clauses must be used after that date for new contracts or for amended existing contracts.

Click here to navigate to the Commission Decision 2010/87/EU (the new Model Clauses)

MEDIA

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Significant amendment to the Digital Economy Bill

There has been a significant amendment made to the Digital Economy Bill which is currently at the report stage in the House of Lords.

The most controversial aspect of the Bill was clause 17 which gave government ministers the power to change copyright law "*for the purpose of preventing or reducing the infringement of copyright by means of the Internet if it appears to the Secretary of State appropriate to do so having regard to the technological developments that have occurred or are likely to occur*". The minister would have been able to change the law using secondary legislation, involving limited Parliamentary scrutiny.

Clause 17 has now been removed and replaced with Amendment 120A (proposed by Liberal Democrat peer Lord Clement Jones). Amendment 120A provides:

> "*The High Court (in Scotland, the Court of Session) shall have power to grant an injunction against a service provider, requiring it to prevent access to online locations specified in the order of the Court for the prevention of online copyright infringement .. [if] a substantial proportion of the content accessible at or via each specified online location infringes copyright*".

Amendment 120A gives copyright owners a way of forcing ISPs to block access to entire websites if a substantial proportion of the content of that site infringes copyright. Clearly this is a particular issue for sites hosting user generated content, such as YouTube. At the moment, they can host copyright infringing material lawfully provided they block access to or remove the material on request by the copyright owner.

There is concern that sites that host user generated content will be routinely blocked by ISPs who (faced with the prospect of costly legal action) have limited incentive to resist when asked by a copyright owner to block a site. Some organisations have suggested that this could amount to a form of censorship.

The Bill had its third reading in the House of Lords on 15 March and was then passed to the House of Commons. The government hopes that it will become law before the general election.

Illegal content on US server is within UK jurisdiction

In the case of *R v Simon Guy Sheppard and Stephen Whittle*, the Court of Appeal has confirmed that English law applies to material published online even if it is hosted on a server in another country.

Background

Section 19 of the Public Order Act 1986 provides:

> *"(1) A person who publishes or distributes written material which is threatening abusive or insulting is guilty of an offence if –*
>
> *a) He intends thereby to stir up racial hatred, or*
>
> *b) Having regard to all the circumstances, racial hatred is likely to be stirred up thereby.*
>
> *(2) In proceedings for an offence under this section it is a defence for an accused who is not shown to have intended to stir up racial hatred to prove that he was not aware of the content of the material and did not suspect, and had no reason to suspect, that it was threatening, abusive or insulting.*
>
> *(3) References in this part to the publication or distribution of written material are to its publication or distribution to the public or to a section of the public*."

Section 29 of the Act provides that "*written material*" includes "*any sign or other visible representation*".

Facts

Sheppard and Whittle were convicted of offences under section 19 of the Public Order Act 1986 for publishing racially inflammatory material. Whittle composed material which he submitted by e-mail to Sheppard. Sheppard edited it on his computer and then uploaded it to a website called heretical.com which was set up by him and was hosted by a remote server located in Torrance, California. In order to do this he used a format known as File Transfer Protocol. Once the material reached the server, the server converted the format of the material to HTML which made it available to be accessed on the Internet by those visiting the website, including people within the jurisdiction of England and Wales. Sheppard had control of the website as far as its contents were concerned. He could upload and edit material.

The material was not illegal in the US.

On conviction, Sheppard was sentenced to 4 years 10 months imprisonment and Whittle to 2 years 4 months.

Sheppard and Whittle appealed against their sentences on three grounds:

(1) There was no publication of the material in the UK. The act of publishing took place in California when the format of the material supplied by Sheppard was converted to allow it to become accessible on the Internet and when it was accessed by other people clicking on the website. Therefore, the court had no jurisdiction over the matter.

(2) There was no publication of the material. Uploading material to a website was not publication. Proof was needed that someone had read it.

(3) Website content was not "written material".

Decision

The Court of Appeal held:

The court did have jurisdiction over the matter. The test to be applied was that set out in *R v Smith (Wallace Duncan)* (No 4) [2004] which was 'did a substantial measure of the activities constituting the crime take place in the UK?' There was, in the court's view, abundant material to satisfy the substantial measure test. Almost everything in this case related to this country. That was where Sheppard and Whittle operated, one in Preston, the other in Hull; that was where the material was generated, edited, uploaded and controlled. The material was aimed primarily at the British public. The only non-UK element was that the website was hosted by a server in California but the use of the server was merely a stage in the transmission of the material.

The Crown simply needed to show that the material was generally accessible to all or available to or placed before or offered to the public. This accorded with the definition of publication in the Oxford English dictionary. In this case, the material was available to the public generally as it was on the website.

"Written material" did include articles in electronic form. Just because the material was on the Internet did not mean that it did not count as written material.

> "*Whilst in 1986 the world-wide web was a thing of the future and computers were in their infancy it seems to us clear that "written material" is plainly wide enough to cover the material disseminated by the website in the present case. The judge took the same view. He said that what was on the computer screen was first of all in writing or written and secondly that the electronically stored data which is transmitted also comes within the definition of written material because it is written material stored in another form. He drew a comparison with opening and closing a book; when the book is open you can see the writing; when it is closed you cannot*."

Accordingly, Sheppard and Whittle's sentences were not wrong in principle but, taking into account the totality of their criminal conduct, were reduced to 3 years 10 months and 1 year 10 months imprisonment respectively.

Further reading

Click here for a copy of the judgment

Online retailers should not advertise prices in printed brochure if prices will change

Online electronics retailer Dabs.com issued a printed brochure which advertised a particular laptop for sale at £789. Text on the page opposite to the advert said "Check www.dabs.com for latest prices". A complaint was made that the advert was misleading because it was apparent from dabs.com that the laptop was not available at this price.

The price had been included in the brochure in error but Dabs.com said that, in any event, it had to keep changing its prices because of the nature of the online electronics retail market. The point of including "Check www.dabs.com for latest prices" was to take account of this and ensure that customers always had access to up-to-date prices even when the brochure prices had been superseded.

The Advertising Standards Authority (ASA) ruled that the advert in the brochure was misleading because the laptop was not available at the advertised price at the time the advert was in circulation. Consumers would expect an advertised price to be correct at the time they saw the advert. The text "Check www.dabs.com for latest prices" did not make it sufficiently clear that the prices in the advert were subject to regular change. A brochure was an unsuitable medium for dabs.com to advertise its products as it was likely to remain in circulation after prices had changed.

Dabs.com was told to make sure that prices stayed stable while a price specific advert was in circulation and told not to use the advert again.

The adjudication is important for online retailers who produce printed brochures. They should ensure that the prices will remain valid for the lifetime of the brochure, and stipulate what that is.

Click here for a copy of the ASA's adjudication

For further information on any of the items covered in this bulletin please speak to your usual Hammonds contact or Gillian Dennis, Professional Support Lawyer on +44 (0) 161 830 5391 or gillian.dennis@hammonds.com