

# TANFIELD

## Employee Competition Update

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# EMPLOYEE COMPETITION UPDATE

## ***Latest developments in employee competition law and the practicalities of going to court.***

1. When preparing to compete is unlawful?
  - 1.1. *Re-Use Collections v Sendall* [2015] IRLR 226. D was a senior employee of C glass recycling business. 6 months prior to his departure he set up a company in which he intended to compete with Re-Use, together with his sons. By 2 months prior, he was actively contacting C's suppliers and at least one of their customers with a view to winning their business for his new company. He was spending by then a significant amount of his time whilst at work on matters relating to the new company. He gave three months notice of termination and shortly afterwards C discovered what he was doing and suspended him pending a disciplinary hearing relating to this conduct. He did not participate and they deemed that he had either resigned or been dismissed.
  - 1.2. The court found he did not owe a fiduciary duty – one could not be inferred from the terms of his contract, nor from wider factors relied on by C. He was a highly trusted, well remunerated and long standing senior employee and was in charge of their entire operation at Dagenham. But not a director and did not attend or even report to board meetings. There was no evidence he had any high level responsibility, strategic, financial or otherwise. (applying *Ranson v Customer Systems* [2012] EWCA Civ 841)
  - 1.3. His actions did amount to a breach of the duty of fidelity. The Judge said this would be the case even if his conduct had been limited to providing finance for his two sons to set up the business (given that NewCo was intended to be directly competitive, operating in the same area of the country and competing for the same pool of suppliers and

customers – he could not have had that financial interest and carried out his duties fully.

- 1.4. Shortly before his departure, D had given him a new contract of employment including restrictive covenants, which he signed. The Judge found there was no consideration for these new covenants. C had pointed to his increase in salary and continued employment. Judge found there was no evidence that either was directly referable to his entry into the covenants, in the absence of evidence that had he not entered the covenants, his employment would have come to an end<sup>1</sup>.
- 1.5. D, his son and the company he had set up were liable for the tort of conspiracy to cause economic loss. However, the company he had set up could not be liable for inducing breach of contract.
2. This case makes an interesting comparison with *Ranson v Customer Systems* [2012] EWCA Civ 841 and its guidance from the Court of Appeal on the scope of both fiduciary duties and fidelity. D worked in a sales function for the Respondent employer, which provided specialist information technology consultancy. He was not a director but had direct or indirect responsibility for a significant part of their revenue. He resigned, and before and during his notice period he made preparations to establish a business in competition. 2 days before his employment terminated an order was placed, due to him discussing potential work with clients.
3. The Court of Appeal's reasoning was as follows:
  - (i) Unlike directorships, not every employment contract gives rise to fiduciary relationships.
  - (ii) As the nature of fiduciary obligations will vary depending on the relationship, it is dangerous to reason by analogy from cases

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<sup>1</sup> cf *Pickwell v Pro Cam CP Ltd* [2016] EWHC 1304 and *Decorus v Penfold* [2016] EWHC 1421

about directors to cases about employees. The first question is always whether fiduciary obligations arise at all and that is entirely dependent on the contract.

- (iii) The duty of loyalty or fidelity, as set out in *University of Nottingham v Fishel* [2000] IRLR 471, requires each party to have regard to the interests of the other, but not that either must subjugate his or her own interests to those of the other.
- (iv) Further, *Fishel* confirmed there was no general principle that an employee must inform his employer if and when he is doing outside work in breach of his contract.
- (v) Whilst it was possible that such a disclosure obligation could arise out of an employment contract, it did not in this case. *Helmet Integrated Systems Ltd v Tunnard* [2007] IRLR 126 suggested that where an employee learned information about the activities of a competitor, the fact or misuse of which rendered the employer vulnerable, fiduciary obligations might arise. That did not arise here as the Appellant did not divert or interfere with any business opportunity being pursued by his employer and the Respondent continued to deal with the client who had placed an order.
- (vi) The argument that *Item Software v Fassihi* [2004] EWCA Civ 1244 had altered the position such that a disclosure obligation existed for all employees was rejected.
- (vii) The implied term of trust and confidence could not be used to create fiduciary obligations, as it does not impose a positive duty and is conceptually different, being a matter of contract law, not of the law of fiduciary obligations.

#### 4. Interplay with garden leave: Elsevier and Finn

- 4.1. *Finn v Thomas Brook Holliday* [2014] IRLR 102 (Simler J): D indicated an intention to resign but C exercised its express contractual right to place on garden leave on a 12 months notice period. C resigned summarily, alleging there had been a repudiatory breach of contract

by C and stating he intended to take up the employment. C sought and obtained an interim injunction restraining D from taking up the employment, pending a speedy trial.

- 4.2. At trial having found there was no repudiatory breach, the decision focussed on whether it was appropriate to grant an injunction to enforce or aid the period of garden leave. That had to be considered in light of the restraint of trade doctrine – C still had to show there was a legitimate interest to protect and that the injunction extended no further than was necessary to protect it. Here the interest was customer connection and D had built up strong connections during his 14 years working for C. C needed a reasonable time to build up its own relationships and on the evidence, 12 months was a minimum period.
  - 4.3. The decision in *Elsevier v Munro* [2014] IRLR 766 was to the same effect, but at the stage of an interlocutory injunction. D had waived any breach of contract he relied on, so the contract remained in being and contained a provision that he should not be engaged in any business in competition during his employment. Importantly, Warby J held that an injunction would be granted without proof that the employee would misuse his confidential information. Here C retained confidential information in his memory. Whilst he would not deliberately misuse it, there was a real risk he would do so unconsciously and he would foster the competitor's business in areas where it was in competition with C.
5. Conclusions:
- (i) In some such cases, express restraints in the contract<sup>2</sup> are being enforced by the garden leave injunction, in other cases the implied duty of fidelity.

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<sup>2</sup> eg a clause precluding employee from being engaged in any other employment during the term of his contract, as in *Symbian v Christensen* [2001] IRLR 77

- (ii) There are some decisions to the effect that a restriction on working for a competitor during employment is not subject to the restraint of trade doctrine. Underhill LJ in *Sunrise Brokers* said that the courts would be “very ready to enforce” the duty of fidelity.
  - (iii) However, in *Finn*, Simler J said that restraint of trade did not normally apply to restrictions during the contract and garden leave, but the principles would be engaged “where an employer has put an employee on garden leave and then seeks an injunction to restrain an unwilling employee from joining a competitor”. This was because of the scope for abuse by employers of a garden leave provision, which she said was “well recognised” (para 56-57)
  - (iv) The fact the employee agreed to the provisions was only “a factor in the court’s consideration”, not the primary factor.
6. Finally, it is important to emphasise the scope for an employee who considers he or she is subject to the unreasonable imposition of garden leave by the employer to seek a declaration as to the enforceability of the term which the employer seeks to impose.

## **The practicalities of going to court**

### **7. (i) The decision to go for an injunction or not**

- 7.1. Employers often know of or suspect competitive activity. The perennial question is at what point is there is enough to convince a court that an injunction is needed?
- 7.2. The legal test at interim injunction stage is to show “serious question to be tried”. Unless the material fails to disclose that C has any real prospect of succeeding, the court should go on to consider the balance of convenience (*American Cyanamid* [1975] AC 396, pp407B and 408G). The serious question to be tried is a “minimalist” threshold “which sets [it] at a level which does little more than exclude claims

which might be characterised as frivolous or vexatious” (*Bartholomews v Thornton* [2016] IRLR 432 para 10).

7.3. But where grant or refusal of injunction will effectively end the action it is appropriate for the court in assessing the balance of convenience to investigate “degree of likelihood” of C succeeding at trial (*WNL v Woods* [1979] 1 WLR 1294 p1306).

7.4. Delay will be a factor against awarding an injunction; see *Legends Live* [2016] EWHC 1938.

- The case concerned rival tribute shows in Blackpool. The Defendant left the Claimant to perform for a rival show. The Claimant’s solicitors set a deadline for him to agree to comply with his express restrictive covenant and not perform, which was two days before the first performance. No proceedings were instituted until 2 months later.
- The Judge found the injunction was being sought not just for protection but to cause avoidable loss and destruction to a rival. He inferred this in the absence of any explanation for the delay.
- It was not the length of the delay which mattered but the reason and the circumstances.

**(ii) Is it necessary to establish that there are damages at the end?**

7.5. An injunction should not be granted if “damages would be an adequate remedy”. Whilst it may appear that damages are always adequate in practice the courts regard unlawful competition as a situation where the true extent of loss will be difficult to establish.

7.6. In *D v P* [2016] IRLR 355 the Claimant had not claimed damages but only an injunction to restrain the Defendant from taking up a position with a rival. The CA said:

- damages “will usually be unquantifiable and will rarely, if ever, provide the covenantee with an adequate substitute for an injunction”.

- Absence of damage to the Claimant is not in general a bar to relief save where there is exceptional prejudice or hardship to a Defendant.
- The starting point in the consideration of a claim by an employer to enforce an employee's negative covenant is that the ordinary remedy is an injunction.

**(iii) Evidence of approaching customers**

- 7.7. If breach of a non-solicitation clause or competitive activity before leaving is being relied on, some actual evidence of contact with customers is generally necessary. The wording of the covenant ("solicitation"/"supply services to" etc.) affects the evidence required. However, a small number of examples might suffice, if (for example) they evidence a clear breach of a clear restrictive covenant which the employee must have (or ought to have) known about.
- 7.8. It can assist to put the allegations as precisely as possible to the (ex) employee in correspondence. Failure to contest allegations (or an admission) is often relied on in support of an injunction.
- 7.9. One example is worthy of note. In *Croesus Financial Services v Bradshaw* [2013] EWHC 3685 it was found that it was not necessarily true there was no solicitation where the former employee was contacted by the customer. The communications could have involved him persuading them to transfer their business.

**(iv) Evidence of preparing to compete**

- 7.10. Because the line between legitimate and illegitimate competition is so unclear, at the interim injunction stage it can be relatively easy to show that steps which are known to have been taken by an employee prior to leaving the business create a "serious question to be tried" about their activities.
8. How do undertakings work in practice?

**(i) voluntary undertakings between the parties**

- 8.1. Pre-action, the employer can seek undertakings and threaten proceedings against the (ex)employee if they will not give those undertakings.
- 8.2. The form of undertaking may follow the wording of a restrictive covenant and restrain specified activity for the duration of covenant (or different period if springboard argument is relied on).

**(ii) status of a voluntary undertaking**

- 8.3. The employer's solicitor often demands written undertakings as a condition of not proceeding to court. Such undertakings will have the status of a contract – consideration is provided by the forbearance to sue.
- 8.4. The employer could rely on a subsequent breach as a basis for injunction proceedings.
- 8.5. Breach could be relied on as evidence of untrustworthiness/ bad faith and may also help the employer in relation to costs arguments/indemnity costs.
- 8.6. Arguably, an employee's acceptance of undertakings demonstrates a degree of acceptance that restrictive covenants are reasonable and/or enforceable.
- 8.7. If it is not intended they should have that effect, it is best to include a carve-out to the effect that they are entered without admission as to the reasonableness or enforceability of covenants.
- 8.8. If undertakings are not given before the Court, any cross undertaking in damages which they include is unlikely to be enforceable.

**(iii) Undertakings given to court**

- 8.9. Often once an injunction application has been made, a holding position is reached pending a return date, or pending trial. Things to note:

- For an (ex)employee Defendant, this is often preferable to the court ordering an injunction as gives control over wording of order and (possibly) costs paid to Claimant
- The whole matter could be settled on basis of court undertakings, particularly where they have a time limit, matching the length of a restrictive covenant; a consent order would then stay proceedings, save for the purpose of enforcing the undertakings.
- In practice the undertakings can be included in the body of a consent order.
- Given to court not to other side; breach is a contempt of court, which could result in prison, fine or seizure of assets
- Cross undertaking in damages will be implied (Chancery Guide 1A-39) but better if express.

## 9. The absence of covenants and springboard injunctions

- 9.1. Often there are no restrictive covenants (or, indeed no written contract of employment). If an employee competes whilst still employed or removes confidential information (eg customer lists and pricing) or works for the employer's customers after they have left, the employer may still have various remedies.
- 9.2. Competing with the employer or other action prejudicial to the employer's business whilst still employed will be a breach of the duty of fidelity and (if the employee is a fiduciary) a breach of fiduciary duty.
- 9.3. There is also an implied term of confidentiality in every contract of employment so any removal of confidential information by an existing employee is also a breach of contract.
- 9.4. Often the employer only becomes aware of the situation after (or just before) the employee has left to set up in competition. By the time s/he has left, in the absence of restrictive covenants, on the face of it there is no existing restriction on the employee's activities. The

springboard injunction fills this gap by restricting the employee's activities after leaving in order to prevent them taking advantage of breaches of contract committed (generally mis-using confidential information) before the employment relationship ended and thereby obtaining a "springboard" advantage.

9.5. The basic principles are summarised in *QBE v Dymoke & Ors* [2012] EWHC 116 (QB) paragraph 8.

- 1) First, the form of the Order and 'springboard' relief should fit the facts.
- 2) Second, the 'springboard' relief should reflect and restrain the spectrum of the unlawful activities which made up the 'springboard'.
- 3) Third, in granting 'springboard' relief, the Court may restrain otherwise lawful activities taking place on unlawful foundations.
- 4) Fourth, the form and content of the 'springboard' relief should match the tensile strength of the 'springboard' unlawfully used by a defendant.
- 5) Fifth, in granting 'springboard' relief, the Court should take account of all the circumstances and grant relief which it thinks is fair, just and equitable.

9.6. The court must consider how long the advantage lasted and limit the duration to that<sup>3</sup>. It is not intended to punish a Defendant for wrongdoing.

9.7. The advantage must still exist at the time the injunction is sought and it must be shown that it would continue unless restrained. It is to protect against future loss and must not be used to punish breaches of contract<sup>4</sup>. A good example of the length of the springboard restraint is in *Dorma v Bateman & Ors* [2016] IRLR 616 involving a team move where only one of the four Ds had restrictive covenants.

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<sup>3</sup> *Roger Bullivant v Ellis* [1987] ICR 464.

<sup>4</sup> *Clear Edge v Elliot* [2011] EWHC 3376 QB 54 paragraph 54

The injunction restrained them all from working in the same business in the UK market and from soliciting specified customers. However, the length of the 'spingboard' injunction for the other three Ds matched the 6 month non-compete PTR in the First Defendant's contract.

## **Disclosure and examining of computers**

### **(i) Pre-action disclosure**

10. An application for pre—action disclosure may only be made:
  - (i) Where the applicant and respondent are likely to be parties to the proceedings;
  - (ii) If proceedings had been started, where the respondent's duty by way of standard disclosure would extend to the document or class of document of which pre-action disclosure is sought (see CPR r. 31.16(3)(a), (b), and (c)); and
  - (iii) So long as disclosure before proceedings have started is "desirable in order to dispose fairly of the anticipated proceedings, assist the dispute to be resolved without proceedings or save costs.' See CPR r. 31.16(3)(d).

### **(ii) Getting disclosure on the interim application**

11. The limits of what might be obtained are illustrated in *Intelsec Systems & Ors v. Grech-Cini & Ors* [2000] 1 W.L.R. 1190 per Nicholas Warren QC (sitting as a deputy High Court Judge (allegations made that a former employee had used names and addresses of business contacts). Plaintiffs applied for interim relief including an order that the defendants disclose the names and addresses of all persons with whom they had been in contact both whilst employed by C <sup>5</sup> and since the commencement of their new employment with a view to supplying or

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<sup>5</sup> "If the employee has approached the contact on his own account...the employer must be entitled to claim the contact as his own...there is a strong case for disclosure to the employer of names and addresses..."

soliciting orders. This was subject to the condition that post employment it was disclosed only to C's solicitors and not to C without an order from the court. Note: this is a mandatory injunction granted on an interim application. This will not be ordered readily.

12. The Court may grant interim relief on a springboard basis to return control of corporate LinkedIn 'groups' to her former employer: *Whitmar Publications v Gamage* [2013] EWHC 1881. She had managed these groups as part of her employment and the groups had been used as a source of email addresses for marketing for the employee's new business. It is long established that it is unlawful to appropriate a compilation of customer contacts for the purposes of future competition through LinkedIn: see *Hays Specialist Recruitment (Holdings) v Ions* [2008] IRLR 904, involving transferring contacts to LinkedIn with a view to the subsequent use of that information in a competing business.
13. It is not uncommon for a claimant to seek an affidavit from the defendant(s) setting out the use they have made of the confidential information. Note *Dorma v Bateman & Ors* [2016] IRLR 616 in which C applied for such an affidavit. The Judge said that it had been appropriate to ask but said it was not necessary because the information requested had already been provided in the Ds witness statements and if that proved to be false, the remedy of contempt would be available.

**(iii) Examination of computers**

14. It is increasingly common for claimants to obtain orders allowing experts to examine computers to find confidential information which has been improperly retained or to see whether it has been transferred.
15. *Warm Zones v Thurley* [2014] EWHC 988: C brought proceedings against R, the next employer of two employees who had worked for C, which led them to discover emails with R suggesting they had misused confidential information whilst still in C's employment. C successfully sought interim relief against the employees consisting of an order for

imaging and inspection of their computers by a specialist<sup>6</sup>. Simler J accepted a mandatory injunction should only be granted if it carried the least risk of injustice if it turned out to be wrong. The court would have to feel a high degree of assurance that C would establish its right at trial. There was strong prima facie evidence of misuse by them of C's database during the course of their employment.

16. *AJG v Skripchenkov* [2016] EWHC 603: C brought proceedings against 2 Ds who had left to join a competitor and obtained delivery up of their electronic devices and computer systems for inspection by C's experts. This revealed that further employees should be defendants. C sought a mandatory injunction for the search of devices and deletion of any confidential material which was found. Copies of all materials would be retained. Any dispute as to whether material was confidential was referred to the judge. Inspection and deletion was to be carried out by experts appointed by the Ds, using agreed search terms. It was agreed that the material need not be shown to C if D contended that it contained confidential information. However, disputed information was not to be available to Ds until trial.
17. The court gave the mandatory injunction. The Ds had admitted taking and misusing the confidential information. The court was not satisfied the Ds could be trusted to search out and delete the materials themselves.

## **Damage Options**

### **(i) Wrotham Park Damages**

18. "Wrotham Park" damages are a tool which permits the court to assess damages by reference to what the parties might have agreed for the release of a particular obligation. So in the case of restrictive covenants, they can calculate loss by reference to the price which would have been negotiated between the parties for the release of the covenant (see

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<sup>6</sup> the precise terms of that order are not clear from the report but C was to provide assurances to Ds within the terms such that the search would not reveal their confidential information.

*Wrotham Park Estate Co Ltd v Parkside Homes Ltd* [1974] 1 WLR 798). Prior to *One Step*, it has been regarded as a remedy which might be available where the claimant has suffered no loss<sup>7</sup> or there would be “difficulty” in establishing loss<sup>8</sup>, and has also been referred to as “exceptional”<sup>9</sup>.

19. In *One Step (Support) Ltd v Morris Garner* [2016] EWCA Civ 180, D breached confidentiality whilst still employed by C by sending herself a large volume of documents. On leaving, she entered 36 month restrictive covenants and set up her own competing company. It was difficult to prove the extent of damage. The Court of Appeal held:

- (i) The purpose of these damages is to give damages at the price which would have been agreed in a hypothetical bargain with a claimant for the right to use property that had been appropriated without permission;
- (ii) Such damages were flexible. They could apply when a party could not demonstrate identifiable financial loss, but not only in those circumstances. The threshold was difficulty showing the damages.
- (iii) They were not restricted to exceptional cases or “manifest injustice” but are available where justice requires it.

20. The factors in this case that made an award of *Wrotham Park* damages “just” included that the non-compete clauses were the crucial part of the settlement agreement that had led to the Ds being paid a large sum of money to sell their shares, and the fact that their breaches of those covenants were deliberate, intended from the very start, and conducted with subterfuge and furtiveness. This last factor meant that *One Step* had been unable to seek an injunction to resolve the dispute at an early stage.

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<sup>7</sup> As happened on the facts of *Wrotham Park*

<sup>8</sup> per *Experience Hendrix v PPX Enterprises* [2003] EWCA Civ 323

<sup>9</sup> per *Attorney General v Blake* [2001] 1 AC 268, Lord Nicholls (the “Spy Catcher” case)

21. Remaining questions:
- does this represent a broadening of the category of cases in which these damages can be used?<sup>10</sup>
  - Does this have an application in a case which does not involve a breach of restrictive covenants?
  - How are *Wrotham Park* damages assessed<sup>11</sup>?

**(ii) Other creative damages options**

22. Another damages option which employers are frequently unaware of is a claim for wasted management time. Where a departing employee has caused difficulty (for example trying to poach clients who have to be won back and damage to business property and systems) it is important to consider all the losses which flow from that breach.

23. There is clear authority that such damages are recoverable in principle and can possibly be recovered on an hourly rate basis in respect of work done by the staff, even in the absence of contemporaneous records:

- *Tate & Lyle v. GLC* [1982] 1 WLR 149
- *Horace Holman v. Sherwood International* [2001] (QB), LTL 14/11/2001

**(iii) Practicalities in starting proceedings**

24. Consider the correct Defendants. If the employees have gone to a competitor, that competitor might well be liable for inducing breach of contract. (However, note that in *Re-Use Collections* it was found that the company C set up could not be liable for inducing breach of his contract, not least because C had formed an intention to breach his contract long before the company was set up. The company was, however properly made a Defendant to unlawful means conspiracy.)

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<sup>10</sup> the case has been appealed to the Supreme Court

<sup>11</sup> some guidance is given in *CF Partners v Barclays Bank* [2014] EWHC 3049 (Ch) (a breach of confidence case)

25. Consider the correct court. Interim relief in an employment context can be sought in the Queen's Bench Division or the Chancery Division of the High Court or the County Court (depending on what relief is sought).
26. There is no monetary limit on the jurisdiction of the County Court to award damages in actions in contract and tort but Circuit judges have limited power to grant search order.
27. The following proceedings would have to be brought in the Chancery Division, as opposed to QB or County Court.
  - (i) Claims based on Copyright and Rights in Databases Regulations 1997
  - (ii) Claims otherwise involving Copyright
28. Practical considerations will include the urgency, as in the QBD a special appointment is needed for any hearing which is listed for longer than one hour.
29. Consider an application for a speedy trial. The Court has the power to fix the date under its general powers: see CPR r. 29.2(2) and to expedite any hearing date: CPR r. 3.1(2(b)).
30. Judicial commentary has been supportive of speedy trials in restrictive covenant cases but see *Ifone Ltd v. Davies* [2005] EWHC 1504. Laddie J commented that the Court should not order an expedited trial unless it was convinced that there were pressing reasons to justify the course.

**(iv) Practicalities in defending proceedings**

31. Timing Get the matter to counsel at the earliest opportunity.
32. Consider giving undertakings to hold the matter until trial.
33. Consider the conduct of the Claimant.
  - (i) The award of indemnity costs is usually reserved to cases where the court wishes to indicate disapproval of the conduct in the litigation of the party against whom costs are ordered. Unreasonable conduct to high degree will be sufficient.

- (ii) Can apply where a party issues without consideration of undertakings: *QBE Management Services (UK) v. Dymoke* [2012] EWHC 116 (QB)
- (iii) Another good example is *Caterpillar Logistics v Huesca de Crean* [2012] EWCA Civ 156

I regard the conduct of CLS in deciding to bring proceedings against the respondent, without any prior complaint or attempt to see whether there was the basis of an amicable solution to its concerns, as wholly inappropriate. It is particularly appropriate for the possibilities of such a solution to be explored where there is on one side a large corporation and on the other a former employee whose annual salary would be a small fraction of the costs of litigation. Many defendants, faced with such a claim, would simply concede rather than risk bankruptcy. When CLS made its decision to bring proceedings, there could have been no assurance that QH would stand behind the respondent. The very short time given to her to respond to CLS's solicitors' letter of 30 August 2011, which must have taken much longer to prepare, and the manner of its service on her, were similarly inappropriate. Furthermore, CLS had not properly verified the only serious allegation of impropriety made by it against the respondent, namely that she had surreptitiously invited managers from Klarius/QH to a rugby match at Twickenham sponsored by CLS, thus demonstrating the closeness of her relationship with Klarius/QH even while she was an employee of CLS. Before the judge, it was common ground that the evidence of CLS was false, having been demonstrated to be so by the respondent.

- (iv) In the same case the Court of Appeal strongly criticised the fact that the C had not served particulars of claim until after the return date for the interim injunction and (in fact) outside the time limit under the CPR. Having refused the application for an injunction, the court awarded indemnity costs against D.

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