The Limits to Freedom of Contract:
***Leiman, Ricardo and another v Noble Resources Ltd and another* [2020] SGCA 52**

I. Executive Summary

In line with the principle of freedom to contract, the courts will give effect to the intention of the parties in creating their contract, and also hold them to their duty to perform their primary obligations under such contract. However, where the contracting parties agree to vest certain decision-making powers to a specific (non-judicial) entity, to what extent may a court review the exercise of powers by such entity?

In addition, the corollary to recognising the parties' freedom of contract is that the law also allows them the freedom to change their mind and break their contractual agreements if they so wish, albeit at a price. However, at what point can such price be considered a penalty imposed by the non-breaching party, and hence not enforceable under the law?

These questions were dealt with by the Court of Appeal ("**CA**") in *Leiman, Ricardo and another v Noble Resources Ltd and another* [2020] SGCA 52. Ricardo Leiman ("**Leiman**"), former chief executive officer of Noble Group Ltd ("**NGL**"), filed suit against Noble Resources Ltd ("**NRL**") and its parent company NGL, for denying him certain post-resignation entitlements under an agreement that he entered into with NRL to deal with the terms of his departure from the Noble group of companies ("**Noble**"). These entitlements concerned certain share options that had vested or were due to vest in him; shares which had been assigned to him or whose allotment was pending shareholder approval; and a bonus for 2011.

II. Material facts

Leiman began his employment with Noble in 2006. The terms of his employment were set out in an employment agreement ("**Employment Agreement**"). As part of his compensation, he was awarded NGL share options pursuant to the Noble Group Share Option Scheme 2004, NGL shares pursuant to Noble's Annual Incentive Plan ("**AIP**"), as well as discretionary annual bonuses. He assigned his shares and share options to the Adelaide Trust, a trust that he established. This trust is administered by Rothschild Trust, the second appellant, as trustee.

In 2011, Leiman and the Chairman of NGL, Mr Richard Samuel Elman ("**Elman**"), got into some disagreements, leading the parties to start planning for Leiman's exit from Noble in late 2011. The parties signed a separation agreement ("**Settlement Agreement**") in November 2011, which set out the terms on which Leiman was to resign from NRL. This included ensuring that Leiman would preserve his entitlements to certain shares and share options that had been awarded to Leiman over the past few years. Specifically,

- Clause 3(a) stated that Leiman was entitled to receive the payments and benefits as stipulated in the Settlement Agreement, but only if he complied with his non-competition and confidentiality obligations under the Employment Agreement and the Settlement Agreement;
- Clause 3(b) required Leiman to enter into an advisory agreement with Noble;
- Clause 3(c) stated that Leiman was entitled to exercise his outstanding 7,727,272 NGL share options as well as 44,818,182 vested but unexercised options (collectively, the "**Share Options**"), provided in part that "prior to exercise he has not acted … to the detriment of Noble," and the Renumeration and Options Committee ("**R&O Committee**") of Noble "shall make a final determination in the event of any dispute";[1]
- Clause 3(d) provided that 17,276,013 NGL shares (the "**Shares**") previously awarded to

[1] This clause preserved Leiman's entitlement to exercise certain share options that would otherwise have automatically lapsed upon his termination.

Leiman under the AIP would vest in him and be free of trading restrictions,[2] also provided that "prior to exercise he has not acted … to the detriment of Noble and the [R&O Committee] …shall make a final determination in the event of any dispute"; and

- Clause 3(e) stated that Leiman was entitled to be considered for a discretionary bonus for 2011.

Not covered under the Settlement Agreement were an additional 5,652,421 shares ("**Additional Shares**") under the AIP, which were separately awarded to Leiman through a letter in May 2011, and whose allotment was pending shareholder approval.

Unbeknownst to Leiman, Noble had hired a private investigator in November 2011 to monitor his activities. The investigator's reports revealed that Leiman had met with current and former Noble employees between late 2011 and early 2012. He was also corresponding with the President and CEO of Summa Capital, one of Noble's business and strategic partners, regarding entering the global commodities trading market.

In February 2012, Noble engaged Wolfe Associates to conduct an investigation into Leiman's dealing with two individuals (collectively "**Carlier and Ozeias**"). Leiman had been involved in hiring them in 2006 to run one of Noble's sugar mills in Brazil. That same month, Rothschild Trust asked to exercise certain of Leiman's NGL share options. The R&O Committee, made up of Elman and two independent directors, was informed of the request. It also received copies of Leiman's e-mails to Summa Capital, as well as a report from Wolfe Associates which set out preliminary findings on allegations against Carlier and Ozeias of fraudulent mismanagement of a Brazilian company, and Leiman's involvement in their hiring despite his knowledge of these allegations. The R&O Committee, which convened on 1 March 2012, unanimously resolved to refuse approval of the exercise of Leiman's share options. Rothschild Trust protested the decision and asked for details of the information upon which the decision had been based, but NGL did not provide these details.

The R&O reconvened on 27 March 2012 and reaffirmed its 1 March 2012 decision. NGL's Group General Counsel and a NRL director, who assisted the R&O Committee, informed Rothschild Trust that Leiman's right to exercise the share options was "conditional on [his] not acting in any way to the detriment of Noble prior to exercise". The R&O Committee considered that this condition had not been fulfilled as Leiman had breached his non-competition and confidentiality obligations, and had hired certain persons who were not qualified and might have participated in "fraudulent conduct at a previous employer". Noble also subsequently informed Rothschild Trust that: (a) Leiman was not entitled to the Shares referred to in clause 3(d) of the Settlement Agreement; (b) the R&O Committee did not approve the vesting of the Additional Shares; and (c) Leiman was not awarded a bonus for 2011 (the "**2011 Bonus**").

Leiman and Rothschild ("**appellants**") subsequently commenced suit against NRL and NGL in the High Court ("**HC**"). They sought, amongst other things, declarations that the R&O Committee's decisions pertaining to Leiman's benefits were invalid, and that NRL was in breach of the Settlement Agreement. They also brought claims against NRL and NGL in conspiracy, inducement of breach of contract and unlawful interference. The HC dismissed the claims.

III. Issues

On appeal, the CA considered the following issues:

- the interpretation of clause 3 of the Settlement Agreement;
- whether certain clauses under clause 3 were void for being penalty clauses;

[2] Under the AIP, common stock issued to Noble employees were held by a discretionary trust established by NGL for a stipulated period, during which time it could not be transferred or assigned except in the event of the employee's death.

- the validity of the R&O Committee's decisions under clauses 3(c) and 3(d) of the Settlement Agreement; and
- whether Leiman was entitled to the 2011 Bonus, and the Additional Shares.

The CA also considered whether the HC erred in dismissing the appellants' economic tort claims, and the remedies that they are entitled to (if any).

A. The interpretation of clause 3

The CA first noted that the Settlement Agreement was a mutually beneficial arrangement between Leiman and NRL that regulated Leiman's post-resignation conduct and relationship with Noble. With that context in mind, the CA noted that clause 3 established a "two-track" regime. Clause 3(a) encompassed all of Leiman's severance entitlements as contemplated under clauses 3(a) to 3(e), and conditioned them upon his compliance with his contractual non-competition and confidentiality obligations. The CA held that the question of whether or not he was in compliance with these obligations was a *legal* question to be determined by the courts. On the other hand, clauses 3(c) and 3(d) dealt with the entirely separate *commercial* question of whether Leiman had acted to Noble's commercial detriment, and as such was to be determined by the R&O Committee. His rights to the Share Options and the Shares, under clauses 3(c) and 3(d) respectively, were subject to the condition in clause 3(a) that he comply with his contractual non-competition and confidentiality obligations, as well as the *additional* condition in clauses 3(c) and 3(d) that he not act to Noble's detriment.

The next question was therefore the interpretation of the word "detriment". The CA disagreed with the HC's finding that this did not need proof of actual detriment to Noble. Instead, the CA held that the word must refer to some negative *consequence* to Noble arising from Leiman's conduct. The CA noted that absent any actual detriment to Noble, it was difficult to see how it could be said that Leiman had acted to Noble's detriment. It also noted that this interpretation cohered better with the context of the Settlement Agreement, which rested on a mutually beneficial arrangement to bring about a smooth and amicable parting of ways. This objective called for commercially sensible arrangements that duly protected both sides.

The CA further noted that such "detriment" related only to conduct taking place *after* the parties' entry into the Settlement Agreement; this was in line with their purpose in entering the agreement, which was to regulate Leiman's post-resignation conduct and relationship with Noble in a mutually beneficial way. The CA also rejected the appellants' argument that Leiman would only be found to have acted to Noble's "detriment" if he was in breach of the obligations under clause 3(a). It would be counterintuitive for the parties to have left the identical issue of his compliance with his contractual obligations to be dealt with by two separate bodies, i.e. the courts and the R&O Committee. The parties would also have repeated the qualification in clause 3(a) in clauses 3(c) and 3(d) if they had intended the "detriment" considered by the R&O Committee to be co-extensive with breaches of the same contractual obligations.

Finally, the CA stated that in assessing whether Leiman had acted to Noble's detriment, the R&O Committee was not entitled to consider whether he had complied with his contractual obligations. The R&O Committee, being a body of commercial people, was not suited to make determinations of a legal nature. Commercial detriment can follow upon conduct that does not involve a breach of contract, and not every breach of a contractual obligation will give rise to commercial detriment. Moreover, it was not objectively plausible that a legal determination by the court should be interpreted as being open to annulment by the determination of a body of commercial people. Finally, the R&O Committee's task was never to determine the appropriate legal remedies for any breach of contract by Leiman. If the court found that he had breached his contractual obligations, it would be the court's task to ensure that NRL was adequately compensated for the loss of its bargain with Leiman, through the grant of appropriate remedies. In contrast, the R&O Committee was concerned only with

Leiman's Noble-related severance entitlements; the deprivation of these entitlements would not be a recognised remedy for a purported breach of contract.

B. Whether certain clauses under clause 3 were void for being penalty clauses

The CA then considered whether clause 3 fell afoul of the rule against penalties. The corollary of recognising the parties' freedom of contract is that the law allows them the freedom to change their mind and break their contractual undertakings, albeit at a price. To address this, the law imports into contracts a secondary obligation to pay compensatory damages to remedy breaches of contract. Where the parties stipulate the way in which a secondary obligation is to be discharged, this will be scrutinised by the court before it is upheld.

In this respect, the rule against penalties makes a clause unenforceable if that clause imposes consequences on a party who breaches a contract which are not reflective of the innocent party's interest in being compensated, but are in fact meant to hold the breaching party *in terrorem*, or "in terror", with a view to compelling the breaching party to act in a certain way.[3] Such penalty clauses would not be given effect by the courts.

The traditional test for whether a clause is a penalty is whether the penalty constitutes a genuine pre-estimate of damages ("***Dunlop* test**").[4] A later test, however, has reformulated the rule and stated that a clause is a penalty clause if it imposes a secondary obligation (rather than a primary obligation) which imposes a detriment on the breaching party which is out of all proportion to the legitimate interest of the innocent party that is sought to be protected by the clause ("***Cavendish* test**").[5] Singapore had, up to now, adopted the *Dunlop* test, and had yet to decide on the *Cavendish* test. However, the HC adopted the *Cavendish* test and found that clause 3(c) was not an unenforceable penalty clause.

The CA did not either affirm or overrule the HC on the applicability of the *Cavendish* test. The CA found that clause 3(a) was a penalty clause regardless of whether the *Cavendish* or *Dunlop* test was applied. As to clauses 3(c) and 3(d), the question did not even arise as they were not secondary obligations that were triggered by Leiman's breach of contract.

Primary versus secondary obligations. The CA reiterated that the rule against penalties applied only to clauses that impose secondary obligations.[6] In considering whether a clause imposes a primary or secondary obligation, the court should approach the issue as a matter of *substance* rather than *form*, with the inquiry being directed towards and guided by: (a) the overall context in which the bargain in the clause was struck; (b) any reasons why the parties agreed to include the clause in the contract; and (c) whether the clause was entered into and contemplated as part of the parties' primary obligations under the contract in order to secure some independent commercial purpose or end, or whether it was to hold the affected party *in terrorem* in order to secure his compliance with his primary obligations.

The CA then applied this framework to the present case. Looking to the overall context of the Settlement Agreement, the CA first noted that the impetus for this agreement was the parties' desire

[3] A classic example of an unenforceable penalty clause would be if X agreed to build a house for Y in a year for $50, and that if X failed to do so he would pay Y $1,000,000 as a penalty.

[4] This test comes from *Dunlop Pneumatic Tyre Company, Limited v New Garage and Motor Company, Limited* [1915] AC 79.

[5] This test comes from C*avendish Square Holdings BV v Makdessi* [2016] AC 1172 ("*Cavendish*").

[6] Breaches of primary obligations give rise to secondary (substituted) obligations on the part of the breaching party, and may even relieve the innocent party from further performance of his own primary obligations. For example, a loan contract may provide for A to repay B the loan amount by a specified date; further, if A fails to do so by that date, A would have to pay an additional amount to B. Here, the obligation to repay by the specified date is the *primary* obligation, while the obligation to pay the additional amount is a *secondary* obligation (arising only upon a breach of the primary obligation).

to create a mutually beneficial compromise to effect a "clean break" in their employment relationship, with the intention of leaving no outstanding legal issues between them.

Clause 3(a). The CA considered that as a matter of *form*, clause 3(a) was phrased as a *primary* obligation upon Noble to provide Leiman with payments and benefits upon a contingency being fulfilled, i.e. Leiman's continued compliance with his contractual obligations of non-competition and confidentiality. However, *in substance*, clause 3(a) imposed a *secondary* obligation on Leiman, which engaged the rule against penalty clauses.

First, the rights provided under clauses 3(b) (regarding the advisory agreement) and 3(e) (regarding his entitlement to the 2011 Bonus) were based on considerations independent of Leiman's continued compliance with his non-competition and confidentiality obligations under the Employment Agreement and the Settlement Agreement. It is not clear what independent commercial purpose would be served by requiring Leiman to continue to comply with his contractual non-competition and confidentiality obligations in order to be entitled to these rights. *Second*, while it was possible to discern that Noble had an independent commercial purpose in extracting from Leiman an agreement to subject his rights under clauses 3(c) (with regard to the Share Options) and 3(d) (with regard to the Shares) to his being a "good leaver" after his resignation, the parties had already specifically provided for a "good leaver" condition under clauses 3(c) and 3(d). As such, clause 3(a) imposed an *additional* hurdle on Leiman, by subjecting his rights to these Share Options and Shares to the additional condition that he not breach his contractual obligations of non-competition and confidentiality. The CA concluded that in substance, clause 3(a) was included in the Settlement Agreement *in terrorem* with regard to Leiman, and any thought he might have had of breaching his contractual non-competition and confidentiality obligations.

As a secondary obligation, clause 3(a) was an unenforceable penalty clause, regardless of whether the *Dunlop* test or the *Cavendish* test was applied. It was not a genuine pre-estimate of damages under the former test, since it disentitled Leiman from receiving fixed benefits under clause 3, regardless of the nature and extent of his breach of his contractual non-competition and confidentiality obligations. Clause 3(a) would also fail the *Cavendish* test, as it was unclear what legitimate interest Noble could have had in upholding this clause, beyond punishing Leiman if he breached his obligations of non-competition and confidentiality.

Clauses 3(c) and 3(d). However, the CA held that clauses 3(c) and 3(d) were not penalty clauses. As a result of clause 3(c), Leiman gave up his unqualified ability to exercise some vested rights, in return for an extension of time to exercise those rights and the grant of more rights that he would not otherwise have been entitled to. The consummation of those enhanced rights was subject to the condition that he not act to Noble's detriment. This was a condition mutually arrived at by the parties. In short, the parties agreed to clause 3(c) as part of their primary obligations, so that Leiman could exchange one set of entitlements for another in return for being a "good leaver". Moreover, this did not impose on Leiman any secondary obligation to pay damages to or compensate Noble for any breach of his contractual obligations. Clause 3(d) similarly set out a fresh primary obligation on Noble to vest the Shares in Leiman on the condition that he not act to Noble's detriment, as determined by the R&O Committee in the event of a dispute. As such, clauses 3(c) and 3(d) superseded the original terms of the grant of the Share Options and the Shares, as part of a fresh bargain that Leiman struck with Noble, and imposed fresh primary obligations on Noble to honour Leiman's enhanced rights in respect of the Share Options and the Shares.

C. The validity of the R&O Committee's decisions under clauses 3(c) and 3(d)

As the CA found that clause 3(a) was an unenforceable penalty clause, Noble could not deny Leiman his rights under clause 3 of the Settlement Agreement, even if he had breached those obligations.

However, the respondents *could still deny* him those rights if the R&O Committee validly determined under clauses 3(c) and 3(d) that he had acted to Noble's detriment.

In considering the validity of the R&O Committee's decisions, the CA first established that there is no general requirement that a party purporting to exercise a particular contractual right, or to act in a particular way that might be prejudicial to the other party, has a general duty to act fairly. There is also no specific duty to observe any particular requirements of natural justice. Contracting parties are generally entitled to act in their own interests. If, in doing so, it should turn out that a party has breached its contractual obligations, then it may be liable in damages.

However, this general position may be displaced by the terms that the parties have agreed on, whether expressly or impliedly. As such, a court's assessment of whether the exercise of a particular contractual right has been made subject to any duty of fairness or observance of any particular procedure is a contextual one that considers: the particular contractual right in question, the language of the relevant provision, the consequences of any decision made under that provision, and what was contemplated procedurally. In other words, a claim that any requirement of fairness has been breached is in actuality a claim in breach of contract, and the first port of call must always be the terms of the contract.

With regard to clauses 3(c) and 3(d), the CA *first* found the R&O Committee's jurisdiction would only be triggered if Leiman had allegedly done something that amounted to acting "to the detriment of Noble". *Second*, the R&O Committee was specifically designated to make a final determination on whether Leiman had acted to the detriment of Noble "in the event of any dispute", which was a very specific circumstance. That phrase meant that there had to be a contention that Leiman had acted to the detriment of Noble, and such allegation had to be put to Leiman, so that he could decide whether he was going to dispute it. *Third*, in the event of a dispute, the R&O Committee's determination as to whether Leiman had acted "to the detriment of Noble" would be final.

The CA thus found it implicit that Leiman had to be given notice of Noble's allegations that he had acted to its detriment, and the basis for such allegations if necessary, before the R&O Committee could even be activated to make its determination. This was because the R&O Committee's jurisdiction was engaged only when there was a *dispute*. For there to be a dispute, Leiman would have to be informed of the basis of allegations to decide whether he wanted to dispute the allegations. If so, the R&O Committee would then have to give Leiman an opportunity to put forward his reasons for disputing the allegations before it could exercise its power to make a final determination as to whether Leiman had acted "to the detriment of Noble". Beyond this, once Leiman was apprised of the allegations against him and if he chose to dispute them, the R&O Committee had to act fairly in making its final determination on whether he had acted to Noble's detriment.

These requirements were not complied with. The R&O Committee did not make Leiman aware of the allegations against him or give him the opportunity to decide whether he disputed them, and if so to respond to them. Thus, he was never in a position even to decide whether to dispute the allegations. Further, he was not given any opportunity to make representations to the Committee before it made its determination against him. There was therefore no valid "final" determination under clauses 3(c) and 3(d) of the Settlement Agreement. As such, the R&O Committee's determinations that Leiman had acted to Noble's detriment were invalid, as were its subsequent refusal to allow him to exercise his Share Options and receive the Shares on the basis of those determinations.

D. Leiman's other entitlements (2011 Bonus and the Additional Shares)

The CA agreed with the HC that Leiman was not entitled to the 2011 Bonus. The evidence showed that a general decision was taken that no bonus would be awarded to Noble's top management for

2011, and also that other members of Noble's top management indeed did not receive bonuses for 2011.

However, the CA held that the forfeiture of Leiman's right to the Additional Shares was invalid. These were excluded under clause 3(d) of the Settlement Agreement, and were governed by the AIP instead. Clause 5 of the AIP stated that the shares awarded to Leiman under the AIP would be forfeited if Leiman "act[ed] or engag[ed] in inimical or contrary to or against the interests of the Noble Group". Such conduct included "any other conduct or act reasonably determined by the [R&O] Committee to be injurious, detrimental or prejudicial to the interests of the Noble Group".

Therefore, the question was whether there was a "reasonabl[e] determin[ation]" made by the R&O Committee to deny Leiman the Additional Shares. The CA reiterated that "detriment" assessed by the R&O Committee under the AIP must refer to actual loss, damage and harm; the same approach applied for the terms "injurious" and "prejudicial". There was no basis for the Committee's determination under clause 5 of the AIP to be sustained as a "reasonabl[e] determin[ation]" of injury, prejudice, or detriment, given that Leiman's conduct did not amount to actual detriment or damage to Noble's business interests.

E. Economic torts and remedies

With regard to the economic tort claims, the CA upheld the HC's dismissal of these claims, as it was satisfied that the elements of the pleaded economic torts had not been proved adequately. As for remedies, while the CA found that the R&O Committee's decision relating to the Shares and Share Options was invalid, it did not direct the R&O Committee to reconsider the entitlements, as the time for such action had long passed and the Committee as it was constituted at the material time no longer existed. The CA instead ordered that damages were to be assessed for the losses sustained a result of the wrongful decisions.

IV. Key Takeaways

Regarding the penalty doctrine: it remains to be seen whether the *Cavendish* test will become part of Singapore law, and how it will interact with the *Dunlop* test. However, the CA's decision that the relevant clauses would have been caught as a penalty clause under both tests indicates that it would be prudent to consider implications under both tests when drafting. The CA also laid down various considerations that are relevant in determining whether a clause stipulates a primary or secondary obligation. In particular, the consideration of whether the clause was intended to secure some commercial purpose, as opposed to simply to holding the relevant party *in terrorem* to secure compliance, reveals the CA's inclination to consider the background and purpose of the commercial transaction in its entirety. This makes it clear that while clear drafting of the clause is still highly important, at the end of the day, the court would still consider substance over form.

Regarding the issue of contracts which vest decision-making powers in a contractually designated entity: it is now clear that there is no general duty to abide by the principles of natural justice when such powers are exercised. However, where non-judicial decision-making bodies are concerned, the courts have the jurisdiction to review how these bodies may validly exercise their powers, as part of a contractual analysis undertaken through a detailed construction and examination of the specific contractual language and the parties' intentions. The first port of call is the contract, and hence, should parties contemplate and agree on certain procedural requirements on decision-making bodies, these intentions should be accurately reflected and captured by the language of the contractual provision.

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