Neutral Citation Number: [2023] EWHC 322 (Comm)

Case No: CL-2019-000742

IN THE HIGH COURT OF JUSTICE
KING'S BENCH DIVISION
COMMERCIAL COURT

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 16/02/2023

Before :

Christopher Hancock KC
Sitting as a Judge of the High Court

- -

Between :

(1)	**VIRGIN AVIATION TM LIMITED**	
(2)	**VIRGIN ENTERPRISES LIMITED**	**Claimants**
	- and -	
	ALASKA AIRLINES INC	
	(formerly VIRGIN AMERICA INC)	**Defendant**

- -
- -

Daniel Toledano KC and Joshua Crow (instructed by **Slaughter and May**) for the **Claimants**
Tom Weisselberg KC and Edward Ho (instructed by **Jones Day**) for the **Defendant**

Hearing dates: October 10, 11, 12, 17 and 18 2022

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Approved Judgment

I direct that no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

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CHRISTOPHER HANCOCK KC SITTING AS A JUDGE OF THE HIGH COURT

This judgment was handed down by the judge remotely by circulation to the parties' representatives by email and release to The National Archives. The date and time for hand-down is deemed to be Thursday 16 February 2023 at 10:30am.

Christopher Hancock KC :

Introduction and factual background.

1. This is a claim for a declaration in relation to the meaning of a contract dated 19 November 2014 (a contract which, for reasons which will become apparent, is referred to herein as "**the Current TMLA**"). That contract was entered into between the Claimants ("**Virgin**"), who are part of the well known Virgin Group, and a separate entity, "**Virgin America**", which merged with Alaska Airlines Inc ("**Alaska**") on 20 July 2018. By virtue of that contract, Virgin licensed to Virgin America certain rights to use certain trade marks (hereafter for convenience, the "**Virgin Brand**", referred to throughout this judgment also as the "Names and Marks" or the "Names or Marks").

2. The parties produced a very helpful statement of agreed facts prior to the hearing. In the paragraphs that follow, the main relevant facts, taken from that statement, are set out.

The formation of Virgin America

3. Virgin America was formed in 2004 by a consortium of investors including companies in the Virgin Group. The investors intended that Virgin America would operate an airline in the US.

4. Under the original bylaws of Virgin America, the Virgin Group had, in effect, a veto right to prevent any sale or merger of Virgin America or any material portion of Virgin America's assets to a US airline operator.[1] Similarly, under the original stockholders' agreement between the Virgin Group and other Virgin America investors, Virgin had the right in its absolute and sole discretion to prevent any transfer of any equity or debt of Virgin America to a US airline operator or to any person holding 5% or more of the voting power of a US airline operator, and it also had a similar veto to that set out in the original bylaws.[2]

5. In 2005, Virgin granted to Virgin America the right to use certain Virgin trade marks under a trade mark licence agreement (the "**2005 TMLA**").[3] The 2005 TMLA contained the following terms:

    (1) Clause 3.6 provided that: "*The User undertakes that, for as long as it provides the Licensed Activities, it shall continue to do so using the Names and shall use all reasonable efforts to promote its conduct of the Licensed Activities under the Names.*"

    (2) Under Clause 8.1, Virgin America agreed to pay to Virgin an annual royalty calculated as 0.5% of "*Gross Sales*". Gross Sales were defined as "*the total amount received by the User and/or its sublicensees and assignees in connection with the carrying on of the Licensed Activities…*". Thus, Gross Sales referred solely to

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[1] Article III, Section 6(b)(ii), which required the approval of at least one Virgin nominated director in order to approve any proposal to "*merge or consolidate with or into, or sell, lease, transfer, assign, exchange, mortgage, pledge, hypothecate or otherwise dispose of a material portion of the assets of the Corporation to, a U.S. Airline Operator (as defined in the Stockholders Agreement)*".

[2] Sections 4(b) and 20(e)(B).

[3] The First Claimant was not party to the 2005 TMLA or the 2007 TMLA; a predecessor entity (VAL Trademark Three Limited, or "**VALTM3**") in the Virgin Group was. However, this has no relevance to the present dispute, and the predecessor entity is described simply within the epithet 'Virgin' for the purposes of this document.

revenues from the Licensed Activities, and did not distinguish between revenues attributable to use of the Virgin brand and other revenues.

(3) The Licensed Activities were defined in Schedule 1 and, broadly, encompassed the operation of an airline in the US, Canada, Mexico and the Caribbean, and associated activities.

The DOT certification process

6. In order to operate a domestic airline in the US, Virgin America required certification by the US Department of Transportation (the "**DOT**"). Such certification could only be granted to US citizens (as defined in the relevant regulatory provisions).

7. Virgin America applied for DOT certification in December 2005.

8. On 27 December 2006, the DOT issued an 'order to show cause' (Order 2006-12-23), making a tentative finding that Virgin America was not a US citizen and providing a 14 day period in which Virgin America or other interested persons could comment on the tentative decision. The DOT explained that its decision was "*principally because the applicant's affairs are structured so as to give their actual control to a foreign citizen. We also tentatively conclude that less than 75 percent of the total equity of Virgin America is held by U.S. citizens. Therefore, we propose to deny its application for certificate authority.*"

9. In its detailed explanation of its tentative finding on 'actual control', the DOT stated as follows:

(1) By way of summary:

"*In determining actual control, the Department reviews the totality of the circumstances surrounding the relationship between the air carrier and the foreign entity or entities involved. No single factor dictates a finding of foreign or domestic control; rather, all factors are reviewed in combination to determine a foreign entity's ability to influence the actions of an air carrier. We have thoroughly reviewed the record of this case and identified numerous relationships between the applicant and the Virgin Group. Based on our review of the totality of the circumstances and the various indicia of control, we tentatively find that Virgin America is under the actual control of the Virgin Group and Sir Richard Branson.*"

(2) The DOT analysed five specific control factors. The fourth factor was the 2005 TMLA. In this regard, the DOT stated:

"*At the very heart of this matter is the contractual arrangement that will govern Virgin America's commercial operations – its licensing agreement with the Virgin Group. There is no doubt from the undisputed record in this proceeding that Virgin America's business plan rests entirely on its ability to implement this agreement, essentially importing the powerful Virgin trademark into the U.S. market. American, Continental, and Delta state that the License Agreement between Virgin America and the Virgin Group further supports their position that the Virgin Group controls the applicant. Delta further states that use of the*

Virgin brand itself is not a problem, instead pointing to "the fact that the brand and license are inextricably linked with Virgin's principal foreign investor which has other influencing connections to the applicant."

We tentatively agree.

According to the record, Virgin America entered into the License Agreement to conduct its proposed operations using the "Virgin" name and to build on the brand and add to "its well-recognized attributes of quality, service, value, and innovation." However, our review of the License Agreement identified several conditions, detailed in the confidential record, that significantly restrict Virgin America's commercial decision-making authority and essentially prevent Virgin America from acting as an independent air carrier. For example, Virgin America is limited to conducting operations exclusively within the United States, and between the United States and Canada, Mexico, and the Caribbean (collectively referred to as the "Territories"). This restriction takes away from the applicant – that is, absent the consent of a foreign citizen – the basic right to conduct international transportation. In addition, the applicant is only authorized to enter into code-sharing arrangements with Virgin Atlantic and to operate aircraft having more than 20 passenger seats and an operational ceiling of no more than 85,000 feet. Moreover, the License Agreement grants Virgin Atlantic the sole right to operate aircraft within the Territories on any routes that have at least three arrival/departure points, one of which is outside the Territories, and similarly to market and operate any code share routes that have at least three arrival/departure points in conjunction with another airline, provided that such route is marketed primarily as a route between a point between the Territories and a point within the United Kingdom, and the part of the route provided by the other airline links and feeds passengers to and/or from the part of the route operated by Virgin Atlantic or another "Virgin" named airline. Therefore based on the foregoing, we must tentatively find that this agreement, including its terms and conditions, represents another significant avenue of control for the Virgin Group over Virgin America's proposed operations.

Although the terms of this license agreement thus play a major part in our tentative decision in this case, our tentative finding does not mean that U.S. air carriers may not enter into franchise or similar marketing arrangements with foreign carriers. We do not believe that U.S. citizenship law necessarily prevents a U.S. air carrier from licensing the trademark of a foreign carrier, as part of an arms-length franchising agreement or from sharing the revenues of the resulting operations with the licensor; we also recognize that a legitimate commercial agreement of this sort would inevitably involve some degree of influence by the licensor over the U.S. carrier's operations. Any such arrangement, however, must be structured so as to preserve fully the independence of the U.S. carrier's decision-making authority — and of its management — as well as preserve the air carrier's ability to exist outside of the franchise. Such arrangements could pass muster if they avoid the appearance, and reality, of foreign control over the purported U.S. air carrier. Independent franchises are permissible; U.S. outlets of foreign air carriers are not under current law. What Virgin America has proposed in its application in this matter,

> *which we must tentatively reject, appears to involve restrictions that make the applicant almost completely under the influence of a foreign citizen.*"

10. On 17 January 2007, Virgin America submitted a response to the DOT's order. The submission referred to a number of amendments that Virgin had made or proposed to make to relevant agreements and documents, including amendments to the 2005 TMLA. In this regard:

    (1) Virgin America explained that:

    > "*…the parties have now agreed to an amendment to the [2005 TMLA] to make it abundantly clear that the DOT's new requirement – that the airline can exist outside the license or franchise agreement – will demonstrably be present.*"

    (2) Virgin America went on to explain that the amended 2005 TMLA would give Virgin America the right to fly and code-share unfettered outside the designated territories (the US, Canada, Mexico and the Caribbean (the "**Territories**")) without using the Virgin brand, so that Virgin America could fly and codeshare anywhere in the world, including in the Territories under any brand, and in the Territories under the Virgin brand.

    (3) Virgin America further stated as follows:

    > "*In addition, the parties have agreed to amend and clarify the License by removing any restriction on Virgin America's licensed activities if it does not use the "Virgin" trademark. Thus, Virgin America, as a licensor of the mark, will still be allowed to use the mark and fly as Virgin America in the Territories. It will still be allowed to fly internationally or code-share with any foreign or domestic air carrier and now additionally to operate within the Territories unfettered by the License, provided it does not use the Virgin mark, and with the amendment, the U.S. controlled Board may now decide to forgo the mark entirely and not be bound by any of the trademark agreement's customary restrictions on licenses.*"

    (4) In this context, Virgin America relied on evidence given by an economist, Professor Alan Shapiro, that "*when compared to standard franchise agreements … this Licensing Agreement is uncommonly loose. Indeed, far from constituting control, the Licensing Agreement … particularly as amended, is quite liberal and permissive.*"

    (5) The key amendment proposed to be made to the 2005 TMLA was that Virgin America proposed to add the following words as Clause 3.7:

    > "*Notwithstanding any other provision of this License nothing in this License shall prohibit the User at any time during the Term from electing to perform the Licensed Activities without in any way using the Names or Marks so long as the User continues to pay the Royalties in full as and when due and on the basis set out in this License.*"

(6) Virgin America also explained that Virgin had given up a number of veto rights, but had retained the veto right "*over ... the company selling itself to a U.S. airline competitor*".

11. On 20 March 2007, the DOT issued a further 'order to show cause' or "**SCO**" (Order 2007-3-16 or the "**March SCO**").

(1) This order made a tentative finding that, contrary to the previous order to show cause, Virgin America was a US citizen.

(2) The order set out the arguments of Virgin America and of the opponents of Virgin America's application. The DOT's decision in respect of the TMLA proposals was (in full) as follows:

> "*In Order 2006-12-23, the Department tentatively determined that the Virgin Trademark License Agreement ("License Agreement") represented another potential avenue by which the Virgin Group could actually control the applicant. We cited several critical provisions allowing the Virgin Group effectively to dictate the scope and nature of the applicant's operations and that went beyond what was necessary to protect the legitimate interest the former might have in protecting its brand equity, but as we observed in our show cause order, franchises do not inherently confer actual control of the air carrier on the franchisor. To comply with the law, any such arrangement must nevertheless be structured so as to preserve the independence of the U.S. carrier's decision-making authority, as well as preserve the air carrier's ability to exist outside the franchise.*
>
> *In response to the Department's concerns, Virgin America proposes to amend the License Agreement so as to expressly preserve Virgin America's ability to operate "completely free of the Virgin brand and to freely code-share with any carrier domestically or internationally, anywhere and with any carrier," with the exception that "Virgin Atlantic is the only U.K. based carrier it may code-share with under the Virgin brand and in those few markets in which Virgin Atlantic operates, it may only code-share with Virgin Atlantic." In addition, the applicant proposed to revise Section 3.7 of the License Agreement to read as follows: "Notwithstanding any other provision of this License nothing in this License shall prohibit the User at any time during the Term from electing to perform the Licensed Activities without in any way using the Names or Marks, so long as the User continues to pay the Royalties in full as and when due and on the basis set out in this License."*
>
> *The Interested Parties characterize the changes to the License Agreement as inadequate, asserting that, under the agreement, the applicant's code-sharing opportunities remain limited in both geography and choice of airline partners. ALPA notes that the agreement's new provision allowing Virgin America "to perform the Licensed Activities" without using the Virgin brand is disqualified by other provisions that limit the scope of "Licensed Activities." ALPA also argues that the obligation to pay royalties even on unbranded revenues creates a strong disincentive for the applicant to operate without the brand. American makes similar points, also arguing that the Virgin Group would retain significant oversight powers, regardless of whether an operation uses the brand.*

Delta also describes an apparent conflict between sections 3.6 and 3.7 of the agreement, arguing that the former section obliges Virgin America to use the Virgin brand, with the latter purportedly freeing it from this obligation. Delta suggests that the freedom to operate without the brand is of limited value, and argues that Virgin America would effectively have to create a new and separate airline, in contrast to its fundamental proposal to operate under the Virgin brand. Delta also claims that the applicant would face regulatory constraints in mounting such an operation.

We have reviewed the changes proposed by the applicant in light of the arguments posed by the Interested Parties, and it appears that the Interested Parties' arguments do have some merit. The draft agreement defines the Licensed Activities as including airline functions within the Mainland Territory and between that Territory and the Caribbean Territory, but then goes on to include "all activities... which would ordinarily be regarded as part of the business of an airline," without geographic limitation. That provision apparently would permit the applicant to code-share within the Territories, but outside them only with Virgin Atlantic. It does not explicitly include the right to function "as an operating carrier outside the Territories." Therefore, we propose to condition certification of the applicant on modification of the License Agreement so as to permit any operations (including code sharing)—even in direct competition with Virgin Atlantic—so long as the applicant does not use the "Virgin" name in those operations.

The geographic restrictions on Virgin America's operations also appear to be overly broad. While it is reasonable to prevent the applicant from operating under the licensed Virgin name in markets that directly compete with Virgin Atlantic either with its own equipment or through code-share arrangements with competitors of the Virgin Group, the structure of the license and the restrictions on the applicant go further. It appears that the effect of the license is to limit the applicant's operations in general, permitting it to operate independently only as an exception to the broad rule. Thus, we propose to condition certification of the applicant on a modification of the license such that the applicant's operations are presumptively permitted, except in certain limited respects such as operations that use the Virgin mark. (In this regard, we do not find the 85,000- foot ceiling unduly onerous given the Virgin Group's announced plans to mount a suborbital commercial service.)

We disagree with the Interested Parties' that the applicant's offer to include a new provision in the License Agreement that allows it the ability to operate independently of the "Virgin" brand is of illusory value. We believe that this provision does indeed constrain the Virgin Group's ability to control the applicant and accordingly propose to require that the agreement be amended in this way as a condition to certification. <u>However, we see no reason why the applicant's operations outside of the license should still be subject to a royalty obligation to the Virgin Group. Payment of "royalties" on revenues not derived from use of the brand name would undermine the applicant's independence; therefore, we propose to condition the applicant's certificate on an amendment to the license that allows such activities to occur without royalty obligation</u>." (*my emphasis*).

12. On 30 March 2007, Kenneth Quinn, an external lawyer advising Virgin America, wrote to Virgin USA Inc., a Virgin Group company, on behalf of Virgin America. Mr Quinn set out the history of the DOT application, and explained as follows:

> "*The Order favorably highlighted changes that had been offered on the License Agreement, but it also found that they did not go far enough to address all aspects of impermissible License Agreement control. To remedy these remaining concerns, the DOT set out three additional conditions that had to be satisfied before Virgin America could be granted a certificate.*
>
> *First, the Department noted that the License Agreement must be modified to show that "any operations (including code sharing) - even in direct competition with Virgin Atlantic - so long as applicant does not use the 'Virgin' name in those operations" would be permitted.*
>
> *Second, the Department noted that the License Agreement must presumptively permit Virgin America's operations, except "in certain limited respects such as operations that use the Virgin mark." In other words, DOT requires that Virgin America's ability to operate with the Virgin Name or Mark to be stated affirmatively, not as an exception.*
>
> *In its third and final condition to certification, the Department required the deletion of the provision that required Virgin America to pay royalties even when it operated without using the Virgin Name or Mark. In particular, DOT required "an amendment to the [License Agreement] that allows [Virgin America to operate outside of the Name or Mark] without royalty obligation." The Department went on to explain that the "payment of 'royalties' on revenues not derived from use of the brand name would undermine the applicant's independence."*
>
> *The DOT's Order in this respect appears consistent with the text of the new EU-US agreement, specifically in Annex 5 regarding franchising and branding. There, the parties recognized that airlines of each party can enter into franchising or branding arrangements, including conditions relating to brand protection and operational matters provided that: "they comply, in particular, with the applicable laws and regulations concerning control," and provide for the "right of the franchisor or franchisee to terminate the arrangement and withdraw the brand." In short, the new EU-US agreement ensures that "the ability of the airline to exist outside the franchise is not jeopardized."*
>
> *We are not admitted to practice law in the United Kingdom, so we cannot render any official interpretation of the rights and obligations of the parties under the License Agreement according to English law, which the License Agreement states is controlling law. However, we would note, that as was previously discussed and agreed upon with your U.S.-based counsel, it is our view that your January 17, 2007 amendment to section 3.7 (quoted above) already permits Virgin America to operate or code share internationally outside the defined "Territories," including in competition with Virgin Atlantic, provided it does so without using the Virgin Mark or Name. As a result, DOT'S first two "conditions" can be addressed simply by amending section 3.7 of the License*

> *Agreement and restating this provision and our understanding of it in the affirmative, as we have proposed in the attached redline draft agreement.*
>
> *Regarding the condition to remove the requirement of Virgin America to pay royalties in the unlikely event that the airline does not use the Virgin Name or Mark, we have also suggested language in the attached document to conform to the Order.*"

13. Mr Quinn's letter attached a "*redline draft agreement*".

14. On 3 April 2007, Virgin America wrote a letter to VALTM3, which (as noted in footnote 3 above) was the signatory to the 2005 TMLA subsequently replaced by the First Claimant, requesting further amendments to the 2005 TMLA. Virgin America attached Order 2007-3-16, and Mr Quinn's letter of 30 March 2007 as set out in paragraph 12 above. Virgin America stated as follows:

> "*As you will see on page 57 of the Order, three of the conditions require limited amendments to the Trademark License Agreement (the "License"). We are writing to formally request modification of the License by VAL Trademark Three Limited to address DOT's requirements and ensure DOT will issue Virgin America an operating certificate. For your background, I also attach a letter from our regulatory counsel to Ms. Frances Farrow explaining these conditions and the required changes.*
>
> *As you will see from the Order and letter, two of the conditions essentially require the rights already conferred by the License to be re-stated in affirmative terms rather than the "no prohibition" wording presently included. As DOT stated:*
>
> • *"[W]e propose to condition certification of the applicant on modification of the License Agreement so as to permit any operations (including code sharing)—even in direct competition with Virgin Atlantic—so long as the applicant does not use the "Virgin" name in those operations."*
>
> • *"[W]e propose to condition certification of the applicant on a modification of the license such that the applicant's operations are presumptively permitted, except in certain limited respects such as operations that use the Virgin mark."*
>
> *In my view, these conditions should be addressed relatively easily by simply amending the License to affirmatively state such rights, as our counsel has suggested. This would not appear to change the substance of the License, as amended.*
>
> *As you know, Virgin America's business plan does not envision operations outside the Territories, nor does it envision operating outside of the Virgin name. It remains our intent to utilize the brand to the fullest extent possible under the License to grow and enhance Virgin America's network within the Territories. I believe this view is shared by our US investors, who have re-iterated that the ability to utilize the brand was and is fundamental to their decision to invest.*

> *The third condition requires the deletion of the provision requiring Virgin America to pay royalties in the event that the airline elects at some future point to operate without using the Virgin name. As DOT stated: "[W]e see no reason why the applicant's operations outside of the license should still be subject to a royalty obligation to the Virgin Group," which in their view "would undermine the applicant's independence.*"

15. Virgin America's letter attached a draft mark-up of the 2005 TMLA, which I am told the parties infer is the same as that attached to Mr Quinn's letter of 30 March 2007, showing Clause 3.7 as follows:

> "~~*3.7*~~ *3.7 Notwithstanding any other provision of this Licence, nothing in this License shall prohibit the User at any time during the Term from electing to perform the Licensed Activities or any other activities, including, but not limited to, operating flights, code sharing agreements, blocked space arrangements, or any form of marketing agreements with any other airlines or entities, or operating flights between any points regardless of where such flights originate or terminate, without* ~~*in any way using the Names or Marks*~~ *the payment of royalties, so long as the User* ~~*continues to pay the Royalties in full as and when due and on the basis set out in this Licence.*~~ *does not use the Name or Mark while undertaking such activities.*"

16. On 9 April 2007, Virgin and Virgin America executed a further TMLA (the "**2007 TMLA**"). Clause 3.7 of the 2007 TMLA provided as follows:

> "*Notwithstanding any other provision of this Licence, nothing in this Licence shall prohibit the User at any time during the Term from electing to perform the Licensed Activities or any other activities, including, but not limited to, operating flights, code sharing agreements, blocked space arrangements, or any form of marketing agreements with any other airlines or entities, or operating flights between any points regardless of where such flights originate or terminate, without the payment of royalties, so long as the User does not use the Names or Marks while undertaking such activities. Provided, however, that in the event user ceases to use the Names or Marks in a material manner, which shall include but not be limited to where Licensee derives more than twenty percent of its operating revenues within the Territories without using the Names or Marks, then Licensor will have the right to terminate the Licence after 45 days prior written notice and failure to cure by User. Nothing in this provision shall in any way give Licensor the right to terminate the Licence on the basis of the User's non-use of the Names or Marks outside the Territories.*"

17. On 10 April 2007, Virgin America submitted further comments to the DOT, requesting that the DOT finalise its tentative conclusion that Virgin America was a US citizen. Virgin America set out Clause 3.7 as above, and explained:

> "*In an attempt to further address the Department's stringent citizenship requirements, the parties have added further language to make clear the presumption that Virgin America can make unfettered business decisions about whether it chooses to use the Virgin Name or Mark or not; and if it decides not to use the Name or Mark, the Company will not have to pay royalties.*

[…]

The parties have agreed, at the Department's behest, to far-reaching changes in the License that now give Virgin America far more flexible rights than it had previously in both domestic and international operations. Because of these required changes, the parties have also agreed to ensure that normal and customary trademark protections continue to be found in this license. Specifically, to avoid a situation where Virgin America could decide to discontinue use of the brand on all except a few flights in the Territories and operate under another brand name on all remaining flights – fulfilling the Department's desire to be able to exist "outside the brand" – but tying up the trade name with minimal use without any ability of the Virgin Group to terminate and reserve or reassign its License, the parties have now also agreed to a usage requirement, so that the License can be rescinded in the highly unlikely event that Virgin America were to set up another brand within the Territories and reduce in a material manner the operating revenues it generates from use of the License within the Territories. Notably, as the language in the revised Trademark License expressly states "Nothing in this provision shall in any way give Licensor the right to terminate the Licence on the basis of the User's non-use of the Names or Marks outside the Territories," and the Company is not required to pay any royalties on any operations inside or outside of the territories, which do not involve the use of the Virgin Mark or Name.

With these additional changes to the Trademark License Agreement, all concerns surrounding Virgin America's ability to exist and thrive outside of the franchise should be conclusively eliminated."

18. On 18 May 2007, the DOT made a final order setting out its decision that Virgin America was a US citizen (Order 2007-5-11). In response to a further filing in opposition to Virgin America's application (this one from the Association of Flight Attendants), the DOT reiterated its position in respect of the 2007 TMLA, including by stating that: "*Payment of "royalties" on revenues not derived from use of the brand name would undermine the applicant's independence; therefore, we proposed to condition the applicant's certificate on an amendment to the license that allows such activities to occur without royalty obligation.*".

19. The DOT's order attached a certificate of public convenience and necessity for interstate air transportation ("**CPCN**")'. The certificate was issued on 18 May 2007 but, pursuant to paragraph (1) of the Attachment, would not become effective until the DOT had determined that Virgin America "*…has satisfactorily met the conditions specified [t]herein and in Appendix A of [Order 2007-5-11]*". Appendix A stated that Virgin America's certificate authority would be made effective when it had submitted a number of documents, agreements and evidence to the DOT in a form satisfactory to it. These included an executed version of the 2007 TMLA which expressly permitted Virgin America:

"*3ai. … to conduct <u>any</u> operations (including code sharing), even in direct competition with Virgin Atlantic and without any royalty obligations to the Virgin Group, so long as the company does not use the "Virgin" name in those operations; and*

ii. ... to conduct operations that use the Virgin mark, except in certain limited respects."

Paragraph 3ai referred is to in this judgment as "**Condition 3.a.i**" or "**paragraph 3.a.i**".

20. Paragraph 3b of Appendix A required Virgin America to file an executed voting trust agreement which governed the Virgin Group's equity interests in Virgin America. Further, paragraph 7 of Appendix A required submission of evidence that the Virgin Group's stock had been placed in the voting trust.

21. During the period May to July 2007, the Virgin America Bylaws and Stockholders Agreement were amended. However, the provisions set out above concerning mergers or sales to competitor US airlines were retained.

22. On 17 August 2007, the DOT made a further final order "*issuing an effective certificate*" (Order 2007-8-17). The order recorded that on 27 June 2007 Virgin America had submitted copies of all signed and executed documents and/or agreements specified in Order 2007-5-11. Footnote 3 of Order 2007-8-17 refers to Appendix A, which is attached to the Order in the same form as in Order 2007-5-11 (including Condition 3.a.i). The certificate was stated to be effective on 7 August 2007 and included an amended set of conditions which were set out in a new Attachment. The new Attachment removed paragraph (1) of the previous Attachment. Further, the Attachment still contained the following conditions:

> "*(3) The holder shall at all times remain a "Citizen of the United States" as required by 49 U.S.C. 40102(a)(15).*
>
> *[...]*
>
> *(8) Should the holder propose any substantial change in its ownership, management, or operations (as defined in 14 CFR § 204.2(l)), it must first comply with the requirements of 14 CFR § 204.5.*"

23. Order 2007-8-17 included a paragraph stating: "*[w]e direct that, should Virgin America Inc., propose to conduct operations with more than 22 aircraft, it must notify the Department in writing at least 45 days prior to the proposed change in operations and demonstrate its fitness to conduct such operations.*"

Change of ownership in 2010

24. In the second half of 2009, Virgin America notified the DOT of the proposed transfer of the shares in VAI Partners LLC, Virgin America's 75% US shareholder, to new U.S. investors. This was a substantial change in ownership requiring notification to the DOT in accordance with 14 CFR § 204.5. Alongside that change of ownership, Virgin America also notified the DOT of various other changes. All of the changes were described in the DOT's letter dated 8 January 2010. The DOT's letter:

    (1) noted that various of the changes being made would "*strengthen the actual control of U.S. citizens*";

    (2) explained that the Virgin Group was modifying various veto rights in the company's constitutional documents, including in particular as follows:

"*The Virgin Group's consent right related to mergers, consolidations, and sales involving a U.S. airline operator will also be revised so that the consent for an asset sale or similar transaction is required only if the assets comprise all or substantially all of Virgin America's assets. […] The amendment or removal of these consent rights protects against the Virgin Group's potential use of such rights to exert negative control over Virgin America and hinder the air carrier's ability to operate independently;*"

(3) concluded that Virgin America would remain a US citizen after the various changes; and

(4) stated:

"*We also remind the air carrier that it continues to remain subject to the provisions of section 204.5 of the Department's rules, which requires the company to advise us of any substantial changes in operations, ownership, or management. These changes would include, but are not limited to, any alteration to the ownership structure discussed above, any change in key management and technical personnel, or any other circumstances affecting foreign involvement in the structure or capitalization of the air carrier, including new governance provisions (such as supermajority voting rights). In addition, the air carrier must notify the Department of any exercise of warrants that would constitute a change in ownership. Lastly, we remind Virgin America of the requirement that the voting trust established during its initial proceeding must remain in place and can only be dissolved upon the Department's written consent. Such changes may affect the Department's fitness determination with respect to the air carrier's citizenship.*"

The IPO and the Current TMLA

25. In early 2014, Virgin America determined to make an initial public offering of its shares on the NASDAQ (the "**IPO**"). There is no dispute between the parties that (i) the IPO materially increased the likelihood of Virgin America deciding to decrease or cease its use of the Virgin brand (a "**de-brand**"); and (ii) the parties to the Current TMLA could reasonably have been aware of the materially increased likelihood of a de-brand following the IPO at the time they entered the Current TMLA. The following paragraphs set out the circumstances leading to the IPO and the parties' entry into the Current TMLA in further detail.

26. In the period between August 2007 and early 2014, a number of amendments and additions to the 2007 TMLA had been made through side letters and separate documents. In an email dated 11 February 2014, James Cahillane, a Virgin Group lawyer, emailed Allen Huang of Virgin America, suggesting that various TMLA-related agreements and amendments (specifically, the 2007 TMLA itself, an agreement relating to credit cards and a 2013 amendment to the 2007 TMLA by way of side letter) be brought into a single agreement. Mr Huang agreed with that suggestion. Mr Huang also suggested that there should be a discussion regarding the terms of the 2007 TMLA (as amended), because Virgin America was unlikely to meet the revenue threshold which would give it the right to renew the 2007 TMLA (as amended) in 2022 (meaning that Virgin America faced the risk of the 2007 TMLA (as amended) expiring in 2022). Mr Huang's suggestion regarding the term of the 2007 TMLA (as amended) was repeated by Mr Charlie Everitt

of Virgin and Mr John Varley of Virgin America in an exchange of emails dated 10 and 18 March 2014. Mr Everitt produced a resulting draft restated TMLA and sent it to Virgin America by email dated 10 March 2014.

27. Following further negotiations, in an email dated 26 June 2014, Mr Cahillane asked Mr Varley: "*[g]iven that there will be changes to the TMLA post-IPO, are you intending to include something on these in your presentation to the DOT? I think both VEL and VX will want comfort that there will be no DOT issues with the TMLA changes post-IPO.*" Mr Huang responded to the email, stating "*I haven't spoken with John or Peter on this, but I fully anticipate needing to review changes to the TMLA with the DOT, as I understand it was an area of focus during the initial certification process.*"

28. On 4 July 2014, following further discussions between the parties, Charlie Everitt of Virgin emailed Mr Varley concerning the negotiations of the 2007 TMLA (as amended). He stated:

> "*Hi John*
>
> *I'm writing to follow up with Virgin Aviation TM's response on the matters outstanding from our phone call on Wednesday. Sorry for the delay. Taking the various issues on the TMLA:*
>
> *1. Effective Date - you were going to let me have some wording around conditionality of the TMLA on the IPO.*
>
> *2. Board seat - to reconfirm, the ask here is limited to a board appointee right in the event that another Virgin Group entity doesn't have a board appointee. In other words, not an additional director. On that basis we don't see a likely DOT concern. In any case, Evan is meeting with Cush on Monday and will take this up with him direct.*
>
> *3. Royalty reversion date - we will agree to your request that the $4.5bn gross sales test should be looked at on a 4 consecutive calendar quarters basis (not just at financial year end).*
>
> *4. Minimum Royalties - Virgin Aviation's position is that these should be as per the draft - i.e. calculated on the basis of the 0.7% royalty rate, and subject to CPI increase. You said that you were thinking about CPI increase.*
>
> *5. Must use - if we can agree other points (inc. board seat), we would be willing to drop the request for an exclusive must use (ie use only Virgin marks) obligation. We would remain with the existing must use regime under Clauses 3.6/3.7. Something for another day.*
>
> *6. Term - we would like to have an initial term of 25 years, with automatic renewal for successive ten years periods, in the absence of either party electing to terminate at a point of renewal.*"

29. Mr Varley responded:

> "*Hi Charlie,*

Thanks for your comments and suggestions.

In regard to your note ...

1. Allen will send you something on this.

2. David and Evan will discuss the Board seat.

3. Thanks for this.

4. I am checking with the business team here on your CPI adjustment proposal. For the minimum royalty, our revenue fluctuates significantly from one quarter to another so it would be better to structure as an annual rather than quarterly guarantee.

5. Very good.

6. That will work."

30. On 4 July 2014, Mr Varley explained the derivation of the Minimum Royalty amount in an internal email as follows:

> "*Minimum Royalty Fee. As you will recall, we had discussed a minimum royalty based on 80% of 2013 revenues which would work like this:*
>
> *$1,424,678,000 (VX 2013 revenue) x .8 (80% guarantee) x .007 = (royalty rate) = $7,978,197 (guaranteed annual royalty).*"

31. On 8 July 2014, the First Claimant's board approved the changes to the TMLA in principle.

32. Also on 8 July 2014, Virgin America presented its plans for the IPO to the DOT. As regards the TMLA, the presentation stated:

> "*Virgin License Agreement modified:*
>
> ■ *Term of license extended to 25 years*
>
> ■ *Term of license no longer tied to minimum revenue thresholds*
>
> ■ *Commencing Q1 2016, increased license fee from 0.50% of revenue to 0.70% of revenue until VX reaches $4.5 billion in annual revenue, at which point the fee reverts back to 0.50%*
>
> ■ *Right to appoint one person to the Virgin America board of directors, but only to the extent that another Virgin Group representative is not otherwise sitting on the Virgin America board.*"

33. In a later slide, the presentation set out further details as follows:

> "*Amendment to Virgin License Agreement*

■ *Virgin America and Virgin Group will revise the Virgin trademark license agreement as part of the 2014 Recapitalization*

- Trademark license provides for rights to use the Virgin name on operations in the U.S., Canada, Mexico and the Caribbean (and code share rights to most international destinations)

- Key revisions extend the duration of the agreement and modify license fees:

■ *Existing agreement expires in 2022*

- Revised license is for 25 years

- Term of license no longer tied to minimum revenue thresholds

■ *Commencing Q1 2016, license fee will increase from 0.50% of revenue to 0.70% of revenue until VX reaches $4.5 billion in revenue, then reverts back to 0.50%*

- Assuming a revenue CAGR of 9%, expect to reach the $4.5 billion threshold by 2028

- The parties will amend and restate the trademark license agreement

■ *New agreement will (1) consolidate current and prior amendments into a single contract, and (2) combine two current license documents (today there are separate airline and affinity credit card license agreements)*

- During the term of the license, Virgin Group will have the right to appoint one person to the Virgin America board of directors, but only to the extent that a Virgin Group representative is <u>*not*</u> *otherwise sitting on the Virgin America board.*"

34. The written presentation to the DOT dated 8 July 2014 did not refer to minimum royalties.

35. On 9 September 2014, a meeting took place between representatives of Virgin America and representatives of the DOT. In this regard:

(1) Prior to the meeting, Mr Huang emailed Mr Everitt as follows: "*We're preparing for the meeting with DOT today, and we are planning on giving them a redline of the TM license as against the latest full version of the document. Can you send the Word version of the current TM license so that I can prepare a redline against the proposed version you sent yesterday?*" Mr Everitt provided a copy of the 2007 TMLA, and a redline was produced which included the various changes, including the introduction of a minimum royalty.

(2) Mr Huang requested 5 colour copies of the redline of the TMLA be printed for the DOT meeting.

(3) A table was also produced which set out the reduction of the Virgin Group's rights in respect of Virgin America as a result of the IPO. The table set out Virgin's

current rights, and indicated which would be lost through the IPO. In summary, after the IPO:

(a) Virgin Group would only have the right to appoint one director to Virgin America's board of directors, compared to two prior to the IPO, and the board could be quorate without any Virgin nominated director, which was not the case prior to the IPO.

(b) Virgin Group would lose a series of veto rights, including the right to block amendments to the bylaws, the right to block sales or mergers of Virgin America or its assets to a US airline and the right to block sales of Virgin America shares to persons operating or owning a US airline.

(i) Mr Huang requested that 10 copies of this table be printed for the DOT meeting.

(4) A presentation was also prepared for the DOT meeting. That document referred to modifications to the TMLA in summary. It also showed that Virgin's voting stock was predicted to be 16.85% of the total and that its general equity interest was predicted to be 38.8% of the total. Prior to the IPO, the figures were c.24.9% and c.49.8% respectively.

(a) The documents referred to in sub-paragraphs (1) to (4) were presented to and/or discussed with the DOT at the 9 September 2014 meeting.

36. On 12 September 2014, Damon Walker of the DOT requested a further redline of the TMLA, indicating that the redline he had "*does not track the last redline we received in 2013*". Mr Huang responded with "*a fuller redline … [i]t now shows all changes since inception…*". The attached redline shows the minimum royalty provisions (in particular in Clauses 8.1 and 8.6), which I set out below, in mark-up. The emails also indicate that Mr Walker "*had a few questions*", and that Mr Huang and Mr Walker consequently spoke on the phone around this time.

37. On 20 October 2014, the DOT issued a letter concluding that Virgin America would remain a US citizen following the IPO (the "**October 2014 Letter**"). The DOT also agreed to grant Virgin America's request to dissolve the voting trust following its IPO and related restructuring. The letter described the various changes, including the reduced rights of the Virgin Group in respect of Virgin America. As regards the TMLA, the DOT stated as follows:

> "*In addition to the ownership changes noted above, you have also stated that Virgin America intends to amend its Trademark License Agreement ("TMLA") with the Virgin Group. Specifically, you note that the term of TMLA would be extended for 25 years and the TMLA would no longer be subject to minimum revenue thresholds. In addition, commencing in the first quarter of 2016, royalties due under the TMLA ("licensing fees") would increase from 0.50 percent of revenues to 0.70 percent of revenues until Virgin America reaches $4.5 billion in annual revenue, at which point the licensing fee would revert back to 0.50 percent. <u>The amended TMLA would also require Virgin America to pay the Virgin Group a minimum royalty payment if Virgin America's royalty payment from licensing fees would otherwise be less than that minimum</u>*

> *payment. The Virgin Group would also be provided with a right to appoint one representative to Virgin America's board of directors under the amended TMLA. You also note that the amended TMLA will continue to permit Virgin America the ability to operate independent of the "Virgin" names and marks without the obligation to pay royalties.*" *(my emphasis)*

38. The IPO went ahead on 14 November 2014. At the same time, Virgin America's bylaws were amended to remove the Virgin Group's veto rights over mergers with competitor US airlines. The Virgin Group's veto rights under the stockholders agreement were also removed in the course of the IPO.

39. On 19 November 2014, the parties entered into the Current TMLA.

40. On 7 January 2015, following the IPO, Mr Huang sent copies of various documents to Mr Walker of the DOT. The documents included the Current TMLA.

Later events

41. On 2 March 2016, following Virgin America's notification to the DOT and filing, the DOT issued an order removing a condition of Virgin America's certificate: "*[b]y this order, we remove the condition that limits the number of large aircraft that Virgin America, Inc., ("Virgin America") may operate.*" As a result, the paragraph of Order 2007-8-17 which imposed a limit on the number of aircraft Virgin America could operate (paragraph 4 of the ordering paragraphs of that order) was disapplied.

42. In December 2016, Virgin America was acquired by and became a wholly owned subsidiary of Alaska Air Group Inc. ("**Alaska Group**)", a company in the same corporate group as Alaska) with a purchase price of $2.6bn.

43. In March 2017, Alaska Group announced that it intended to wind down its use of the Virgin brand (i.e., to de-brand).

44. In July 2018, Alaska Group merged Virgin America and Alaska. Alaska thereby assumed all of Virgin America's rights and obligations.

45. Alaska asserts that it ceased all use of the Names and Marks by 30 May 2019.

46. On 15 July 2019, Alaska told Virgin that the amount Alaska believed was due for Q2 2019 under the Current TMLA was US$1,420,226.

47. Since 16 July 2019, no royalty payments have been made by Alaska to Virgin.

48. These proceedings were issued on 2 December 2019.

Virgin's investigations into re-using the Virgin brand

49. Since the second half of 2017, the Virgin Group has been considering various possibilities as regards potential termination of the Current TMLA and re-use of the Virgin brand within the US domestic aviation market.

50. The investigations have not led to any successful commercial ventures, and Virgin has never expressly terminated the Current TMLA.

Summary of the issues at trial.

51. The parties prepared a list of issues, which is annexed to this judgment as Appendix 1. However, prior to the trial, certain of those issues fell away. In particular, Alaska's contention that Virgin should have terminated the Current TMLA since they had no legitimate interest in continuing it, and their argument, in the context of Virgin's allegation that by not using the Virgin brand, Alaska had acted in breach of contract, that Virgin had failed to act reasonably to mitigate its loss, were both abandoned.

52. In the light of this, there were only three questions that I was called on to decide, as follows:

    (1) Is Alaska obliged to pay the Minimum Royalty even if it does not use the names or marks?

    (2) If Alaska stops all use of the names or marks part way through the financial year, is the royalty obligation modified pro-rata in respect of that financial year?

    (3) If Alaska stops all use of the names or marks, is that a breach of Clause 3.6 of the Current TMLA?

The oral evidence.

53. I heard from a number of factual and expert witnesses at trial. My findings as to the relevance and credibility of those witnesses' evidence are set out in the following paragraphs.

<u>The factual evidence.</u>

54. I start with the witnesses from whom I did hear. Alaska's contention was that all of the witnesses were credible, while Virgin accepted this, with the exception of Mr Varley.

55. First, I heard from Ms Allison Daniels. She gave evidence as to the steps taken by Virgin after Alaska ceased to use the Virgin brand and ceased to make payment under the Current TMLA. That evidence was, of course, originally principally relevant to the doctrine of legitimate interest as regards termination of the Current TMLA and the issue of mitigation, which was abandoned. It was not suggested that her evidence was unreliable. Instead, Alaska argued that the evidence was irrelevant to the remaining issues, whilst Virgin argued that this evidence was good evidence of the types of difficulty that might have been in the minds of the parties at the time of the conclusion of the Current TMLA, and was thus relevant to the reasonableness or otherwise of a particular construction. As a matter of fact, Virgin contended that:

    (1) Virgin sought over a number of years to re-use the Virgin brand in the context of the US airline industry. It pursued a number of avenues, and a series of obstacles and risks were identified. However, none of the avenues pursued proved successful.

    (2) Amongst the key reasons that the attempts proved unsuccessful was that Virgin was unable to raise US capital investment for the venture.

56. Alaska argued that Ms Daniels' evidence was irrelevant, because she had no direct knowledge of the position at the date of the Current TMLA, and because her evidence related to a later period.

57. I consider that this evidence is of little assistance to me. The general risks which would have been known to both parties as at the date of the Current TMLA are, in my view, relevant. However, opinion evidence, of the sort given by Dr Dempsey is in my judgment likely to be of more utility to the Court. I consider this below.

58. Next, I heard from Mr Kenneth Quinn, who (as I have noted) was an external legal adviser appointed by Virgin America. Virgin accepted that his evidence was reliable, and I so hold. However, in my judgment little of that evidence is in fact admissible. Certainly, Mr Quinn's evidence as to his subjective understanding of the contract is inadmissible; and his evidence as to why clauses were included, unless this was made known to the other contracting party, is equally inadmissible. Overall, in my judgment, the contemporaneous documentation is a surer guide to what happened than the oral evidence, produced many years after the event.

59. Next, I heard from Mr John Varley, who was employed by Delta Airlines at the time of the first DOT application in 2007, and who was involved in discussions with the DOT in 2014. Virgin submitted that Mr Varley was not a satisfactory witness, particularly because, it was contended, he made up evidence in the witness box which he was later forced to retract. The particular statement which Virgin singled out was a statement to the effect that there was discussion in a meeting with the DOT in 2014 as to whether there would be a requirement to pay royalties if there was no use of the brand name, which had not appeared in Mr Varley's witness statement. I am not prepared to accept this particular part of Mr Varley's oral evidence, although I do not think he was actively seeking to mislead me.

60. Turning from the witnesses I did hear from to those who were not called, Alaska contended that it was striking that Virgin chose to call only a single factual witness, namely Ms Daniels. However, it was argued, they did not call James Cahillane, who is still Virgin Management's General Counsel and was intimately involved with Mr Varley in the preparation of the Current TMLA. Nor did they call Evan Lovell or Luigi Brambilla, whom Ms Daniels explained: still worked for Virgin; had provided her with context on the factors which existed in 2014 concerning Virgin's ability to relicense the Names or Marks (in the case of Mr Lovell, having himself worked on Virgin America in 2014); and who therefore might have known what those factors were. They also failed to call Charlie Everitt, who was closely involved in the genesis of the Current TMLA and could have given evidence as to the objective aim of the transaction. Although he no longer works for Virgin no reason has been given as to why he has not given evidence. In contrast, Mr Varley, who no longer works for the Defendant, attended to give evidence of the events and exchanges occurring as the Current TMLA was negotiated.

61. In my judgment, I can take little from the absence of these witnesses. It has not been suggested that I should draw some sort of adverse inference, nor would I have been prepared to do so. It seems to me that I have to do the best that I can, by reference to the positive evidence available to me, to put myself in the position of the parties, to the extent that this is relevant to the issues of contractual construction that I am required to decide.

<u>Expert evidence.</u>

62. Alaska reminded me that it was important to bear in mind the proper limits of admissibility of expert evidence:

(1) In *MCC Proceeds Inc v. Bishopsgate Investment Trust* [1999] C.L.C. 417 (CA) at §23, Evans LJ explained:

> "*the function of the expert witness on foreign law can be summarised as follows:*
> *(1) to inform the court of the relevant contents of the foreign law; identifying statutes or other legislation and explaining where necessary the foreign court's approach to their construction;*
> *(2) to identify judgments or other authorities, explaining what status they have as sources of the foreign law; and*
> *(3) where there is no authority directly in point, to assist the English judge in making a finding as to what the foreign court's ruling would be if the issue was to arise for decision there.*"

(2) How foreign law applies to the facts, including (for example) what on their proper construction particular orders made by a regulatory body mean, is a matter for the Court alone. *MCC Proceeds* implicitly recognises that the application of the law to the facts is not a matter for foreign law experts, and this was confirmed explicitly by the Federal Court of Australia in Noza Holdings Pty Ltd v. Commissioner of Taxation [2010] FCA 990, where at §13, Gordon J. said:

> "*An expert's ability to give an opinion on foreign law is circumscribed. A distinction is drawn between the content of the foreign law and evidence about the application of the foreign law to the facts of the particular case: Neilson at [119] and Allstate Life Insurance Co v Australia and New Zealand Banking Group Ltd (No 6) (1996) 64 FCR 79 at 82. The content of the foreign law is a question of fact about which expert evidence is receivable: Allstate at 82-83. However, once the "content" is ascertained, the application of that foreign law is a matter upon which evidence is not receivable: Neilson at [119]. The reference to "content" is a reference to identifying and expounding, in general terms, the scope, meaning and effect of relevant statutory and non-statutory foreign law: Allstate at 82-83.*"

(3) Alaska accordingly submitted that:

(a) **First**, to the extent Mr Podberesky has done more than answer the two focused questions of "*US aviation law*", upon which HHJ Pelling Q.C. gave permission for expert evidence, there is no permission for that evidence and it is inadmissible; and

(b) **Second**, in any event, to the extent Mr Podberesky has gone beyond the functions of a foreign law expert identified in *MCC Proceeds*, and has for example applied the law to the facts, his evidence is inadmissible.

63. In my judgment the correct approach is that identified in the *MCC* case. In this case, however, for the reasons I come on to consider later, I do not consider that there was any significant disagreement between the experts on regulatory practice (namely Mr Podberesky and Mr Lehman), and thus I do not think it is necessary to dwell on this aspect.

64. Finally, I turn to the evidence of Dr Dempsey, who gave evidence as to the various issues which would occur with the potential re-use of the Virgin brand in the US airline industry,

once Alaska had ceased to use that brand. Alaska chose not to call Ms Hughes, who they had permission to call to give evidence on this issue.

65. Alaska did not challenge the veracity of Dr Dempsey's evidence, but again argued that it was inadmissible and irrelevant, for a number of reasons.

(1) First, it was said, Dr Dempsey agreed that the aviation market was not a static one, but one intimately connected with fluctuations in both the global economy and national economies, as well as other factors which "*create an enormous amount of volatility in* [the aviation] *industry*". Any analysis of the opportunities in the aviation market therefore had to look at the situation at the particular time the analysis is done, because the economic environment within the aviation industry will vacillate.

(2) Dr Dempsey agreed that the analysis he had conducted in his report was to consider what options Virgin had if, after 25 July 2022, it terminated the Current TMLA and looked to re-use the Names or Marks. That was a forward looking analysis, although it drew on historical data.

(3) Dr Dempsey made clear that he had not analysed the power or value of the Names or Marks in 2014 and had not analysed what a reasonable person would have thought in 2014 would be the ability to use the Names or Marks.

66. Virgin, for its part, argued that Dr Dempsey explained at length the regulatory obstacles, and common issues in starting airlines, such as the difficulty obtaining aeroplanes, or the cost of repainting aircraft in a new livery. The reality, they argued, was that the issues to which Dr Dempsey referred, such as repainting aircraft upon rebranding an airline, were general points which did not turn on specific facts only arising after November 2014, and accordingly would have been in the reasonable contemplation of the parties at the time of the Current TMLA. Moreover, Dr Dempsey made it clear that, although he had been answering a forward-looking question as of the date of his report, the position in the past would not – at least at a high level and as regards financial risk – have been any different.

67. Nor did it matter, Virgin contended, that the market might change over time. Even if one assumes that in 2014, it would have been very easy to re-use the Virgin brand given the market circumstances, if one also assumes that things might change as soon as 12 months later, then the relevant risks on which Virgin relies, of being unable to find a replacement revenue stream in respect of the Virgin brand, are present.

68. I have concluded that Dr Dempsey's expert opinion as to the nature of the industry is relevant and admissible. In my judgment, these matters are ones which reasonable people in the position of these parties would have had in mind in 2014.

The relevant principles of contractual construction.

69. The parties were, in the main, in agreement as to the relevant principles of contractual construction. I was referred by both parties to the decisions of the Supreme Court in Arnold v Britton [2015] AC 1619 and Wood v Capita [2017] AC 1173.

70. In Arnold's case, Lord Neuberger said:

15. When interpreting a written contract, the court is concerned to identify the intention of the parties by reference to "what a reasonable person having all the background knowledge which would have been available to the parties would have understood them to be using the language in the contract to mean", to quote Lord Hoffmann in Chartbrook Ltd v Persimmon Homes Ltd [2009] AC 1101 , para 14. And it does so by focussing on the meaning of the relevant words, in this case Clause 3(2) of each of the 25 leases, in their documentary, factual and commercial context. That meaning has to be assessed in the light of (i) the natural and ordinary meaning of the clause, (ii) any other relevant provisions of the lease, (iii) the overall purpose of the clause and the lease, (iv) the facts and circumstances known or assumed by the parties at the time that the document was executed, and (v) commercial common sense, but (vi) disregarding subjective evidence of any party's intentions. In this connection, see Prenn [1971] 1 WLR 1381 *, 1384-1386;* Reardon Smith Line Ltd v Yngvar Hansen-Tangen (trading as HE Hansen-Tangen) [1976] 1 WLR 989 *, 995-997, per Lord Wilberforce;* Bank of Credit and Commerce International SA v Ali [2002] 1 AC 251 *, para 8, per Lord Bingham of Cornhill; and the survey of more recent authorities in* Rainy Sky [2011] 1 WLR 2900 *, paras 21-30, per Lord Clarke of Stone-cum-Ebony JSC.*

16. For present purposes, I think it is important to emphasise seven factors.

17. First, the reliance placed in some cases on commercial common sense and surrounding circumstances (e.g. in Chartbrook [2009] AC 1101 , paras 16-26) should not be invoked to undervalue the importance of the language of the provision which is to be construed. The exercise of interpreting a provision involves identifying what the parties meant through the eyes of a reasonable reader, and, save perhaps in a very unusual case, that meaning is most obviously to be gleaned from the language of the provision. Unlike commercial common sense and the surrounding circumstances, the parties have control over the language they use in a contract. And, again save perhaps in a very unusual case, the parties must have been specifically focussing on the issue covered by the provision when agreeing the wording of that provision.

18. Secondly, when it comes to considering the centrally relevant words to be interpreted, I accept that the less clear they are, or, to put it another way, the worse their drafting, the more ready the court can properly be to depart from their natural meaning. That is simply the obverse of the sensible proposition that the clearer the natural meaning the more difficult it is to justify departing from it. However, that does not justify the court embarking on an exercise of searching for, let alone constructing, drafting infelicities in order to facilitate a departure from the natural meaning. If there is a specific error in the drafting, it may often have no relevance to the issue of interpretation which the court has to resolve.

19. The third point I should mention is that commercial common sense is not to be invoked retrospectively. The mere fact that a contractual arrangement, if interpreted according to its natural language, has worked out badly, or even disastrously, for one of the parties is not a reason for departing from the natural language. Commercial common sense is only relevant to the extent of how

matters would or could have been perceived by the parties, or by reasonable people in the position of the parties, as at the date that the contract was made. Judicial observations such as those of Lord Reid in Wickman Machine Tools Sales Ltd v L Schuler AG [1974] AC 235 *, 251 and Lord Diplock in* Antaios Cia Naviera SA v Salen Rederierna AB (The Antaios) [1985] AC 191 *, 201, quoted by Lord Carnwath JSC at para 110, have to be read and applied bearing that important point in mind.*

20. Fourthly, while commercial common sense is a very important factor to take into account when interpreting a contract, a court should be very slow to reject the natural meaning of a provision as correct simply because it appears to be a very imprudent term for one of the parties to have agreed, even ignoring the benefit of wisdom of hindsight. The purpose of interpretation is to identify what the parties have agreed, not what the court thinks that they should have agreed. Experience shows that it is by no means unknown for people to enter into arrangements which are ill-advised, even ignoring the benefit of wisdom of hindsight, and it is not the function of a court when interpreting an agreement to relieve a party from the consequences of his imprudence or poor advice. Accordingly, when interpreting a contract a judge should avoid re-writing it in an attempt to assist an unwise party or to penalise an astute party.

21. The fifth point concerns the facts known to the parties. When interpreting a contractual provision, one can only take into account facts or circumstances which existed at the time that the contract was made, and which were known or reasonably available to both parties. Given that a contract is a bilateral, or synallagmatic, arrangement involving both parties, it cannot be right, when interpreting a contractual provision, to take into account a fact or circumstance known only to one of the parties.

22. Sixthly, in some cases, an event subsequently occurs which was plainly not intended or contemplated by the parties, judging from the language of their contract. In such a case, if it is clear what the parties would have intended, the court will give effect to that intention. An example of such a case is Aberdeen City Council v Stewart Milne Group Ltd 2012 SC (UKSC) 240 *, where the court concluded that "any ... approach" other than that which was adopted "would defeat the parties' clear objectives", but the conclusion was based on what the parties "had in mind when they entered into" the contract: see paras 21 and 22.*

23. Seventhly, reference was made in argument to service charge clauses being construed "restrictively". I am unconvinced by the notion that service charge clauses are to be subject to any special rule of interpretation. Even if (which it is unnecessary to decide) a landlord may have simpler remedies than a tenant to enforce service charge provisions, that is not relevant to the issue of how one interprets the contractual machinery for assessing the tenant's contribution. The origin of the adverb was in a judgment of Rix LJ in McHale v Earl Cadogan [2010] HLR 412 , para 17. What he was saying, quite correctly, was that the court should not "bring within the general words of a service charge clause anything which does not clearly belong there". However, that does not help resolve the sort of issue of interpretation raised in this case.

71. In Wood v Capita, Lord Neuberger said:

> *9. It is not appropriate in this case to reformulate the guidance given in the Rainy Sky and Arnold cases; the legal profession has sufficient judicial statements of this nature. But it may assist if I explain briefly why I do not accept the proposition that the Arnold case involved a recalibration of the approach summarised in the Rainy Sky case.*
>
> *10. The court's task is to ascertain the objective meaning of the language which the parties have chosen to express their agreement. It has long been accepted that this is not a literalist exercise focused solely on a parsing of the wording of the particular clause but that the court must consider the contract as a whole and, depending on the nature, formality and quality of drafting of the contract, give more or less weight to elements of the wider context in reaching its view as to that objective meaning. In* Prenn v Simmonds [1971] 1 WLR 1381 *, 1383H–1385D and in* Reardon Smith Line Ltd v Yngvar Hansen-Tangen (trading as HE Hansen-Tangen) [1976] 1 WLR 989 *, 997, Lord Wilberforce affirmed the potential relevance to the task of interpreting the parties' contract of the factual background known to the parties at or before the date of the contract, excluding evidence of the prior negotiations. When in his celebrated judgment in* Investors Compensation Scheme Ltd v West Bromwich Building Society [1998] 1 WLR 896 *, 912–913 Lord Hoffmann reformulated the principles of contractual interpretation, some saw his second principle, which allowed consideration of the whole relevant factual background available to the parties at the time of the contract, as signalling a break with the past. But Lord Bingham of Cornhill in an extrajudicial writing, "A New Thing Under the Sun? The Interpretation of Contracts and the ICS decision" (2008) 12 Edin LR 374, persuasively demonstrated that the idea of the court putting itself in the shoes of the contracting parties had a long pedigree.*
>
> *11. Lord Clarke of Stone-cum-Ebony JSC elegantly summarised the approach to construction in the* Rainy Sky case [2011] 1 WLR 2900 *, para 21f. In the* Arnold case [2015] AC 1619 *all of the judgments confirmed the approach in the Rainy Sky case: Lord Neuberger of Abbotsbury PSC, paras 13–14; Lord Hodge JSC, para 76 and Lord Carnwath JSC, para 108. Interpretation is, as Lord Clarke JSC stated in the Rainy Sky case (para 21), a unitary exercise; where there are rival meanings, the court can give weight to the implications of rival constructions by reaching a view as to which construction is more consistent with business common sense. But, in striking a balance between the indications given by the language and the implications of the competing constructions the court must consider the quality of drafting of the clause (the Rainy Sky case, para 26, citing Mance LJ in* Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd (No 2) [2001] 2 All ER (Comm) 299 *, paras 13, 16); and it must also be alive to the possibility that one side may have agreed to something which with hindsight did not serve his interest: the Arnold case, paras 20, 77. Similarly, the court must not lose sight of the possibility that a provision may be a negotiated compromise or that the negotiators were not able to agree more precise terms.*

> *12. This unitary exercise involves an iterative process by which each suggested interpretation is checked against the provisions of the contract and its commercial consequences are investigated: the Arnold case, para 77 citing* In re Sigma Finance Corpn [2010] 1 All ER 571 *, para 12, per Lord Mance JSC. To my mind once one has read the language in dispute and the relevant parts of the contract that provide its context, it does not matter whether the more detailed analysis commences with the factual background and the implications of rival constructions or a close examination of the relevant language in the contract, so long as the court balances the indications given by each.*
>
> *13. Textualism and contextualism are not conflicting paradigms in a battle for exclusive occupation of the field of contractual interpretation. Rather, the lawyer and the judge, when interpreting any contract, can use them as tools to ascertain the objective meaning of the language which the parties have chosen to express their agreement. The extent to which each tool will assist the court in its task will vary according to the circumstances of the particular agreement or agreements. Some agreements may be successfully interpreted principally by textual analysis, for example because of their sophistication and complexity and because they have been negotiated and prepared with the assistance of skilled professionals. The correct interpretation of other contracts may be achieved by a greater emphasis on the factual matrix, for example because of their informality, brevity or the absence of skilled professional assistance. But negotiators of complex formal contracts may often not achieve a logical and coherent text because of, for example, the conflicting aims of the parties, failures of communication, differing drafting practices, or deadlines which require the parties to compromise in order to reach agreement. There may often therefore be provisions in a detailed professionally drawn contract which lack clarity and the lawyer or judge in interpreting such provisions may be particularly helped by considering the factual matrix and the purpose of similar provisions in contracts of the same type. The iterative process, of which Lord Mance JSC spoke in* Sigma Finance Corpn [2010] 1 All ER 571 *, para 12, assists the lawyer or judge to ascertain the objective meaning of disputed provisions.*
>
> *14. On the approach to contractual interpretation, the Rainy Sky and Arnold cases were saying the same thing.*
>
> *15. The recent history of the common law of contractual interpretation is one of continuity rather than change. One of the attractions of English law as a legal system of choice in commercial matters is its stability and continuity, particularly in contractual interpretation.*

72. Next, as to the relevance of negotiations, Alaska reminded me of what was said in ***Prenn v. Simmonds*** [1971] 1 W.L.R. 1381 at p.1385H, where Lord Wilberforce held that while evidence of the parties' intentions or their negotiations was inadmissible, "*…evidence of the factual background known to the parties at or before the date of the contract, including evidence of the 'genesis' and objectively the 'aim' of the transaction*" was admissible.

73. I do not think that there was any disagreement as to this latter proposition.

74. The sole real area of dispute related to the presumption against surplusage. Virgin relied on this presumption, whereas Alaska indicated it had no application on the facts; and that it was in any event a weak presumption in the commercial context. As to the legal position, I was referred to Lewison on the Interpretation of Contracts, at 7.24 to 7.29. There the learned author points out the following:

> "*7.24 The interpretation of a document as a whole necessarily involves giving effect to each part of it in relation to all other parts of it. Accordingly, as a corollary of the principle that a document must be interpreted as a whole, effect must be given to each part of the document. This in turn means that in general each part of the document is taken to have been deliberately inserted, having regard to all the other parts of the document, with the result that there is a presumption against redundant words (usually called "surplusage"). This principle is sometimes labelled the argument from redundancy. Although this principle was often given weight in earlier cases, its value is much reduced in more modern cases. As Patten LJ put it in* Al-Hasawi v Nottingham Forest Football Club Ltd *, "arguments based on surplusage or redundancy are rarely reliable or sure ground on issues of construction*"

75. Virgin, for their part, drew a distinction between two clauses which are repetitious, where surplusage may occur as "*a common consequence of a determination to make sure that one has obliterated the conceptual target*" (*Arbuthnott v Fagan* [1995] CLC 1396 at 1404, Hoffman LJ) and the position in an individually negotiated contract where two provisions appear to <u>conflict</u>, such as Clause 3.6 and 3.7 in this case. In the latter case, Virgin argued that the Court must do its best to harmonise clauses which potentially conflict so as to give effect to every part of the contract. I consider this argument below, when I come to consider Clauses 3.6 and 3.7 below.

The main relevant contractual Clauses.

76. The principally relevant contractual clauses were as follows:

    (1) Clause 3.1 begins with the words: "*In consideration of the payment of Airline Royalties to [Virgin] by [Alaska], [Virgin] grants to [Alaska] the right ... to use the Marks only in connection with and in the ordinary course of carrying on the Licensed Activities*".[4]

    (2) The term "*Licensed Activities*" means, "*…the activities described in Schedule 1…*".

    (3) 3.6 provides:

    > "*Subject to Clause 3.7, [Alaska] undertakes that, for as long as it provides the Licensed Activities it shall continue to do so using the Names and shall use all reasonable efforts to promote its conduct of the Licensed Activities under the Names.*"

    (4) Clause 3.7 provids:

[4] The Airline Royalties is defined as the royalties described in Clause 8.1 (which includes reference to the Minimum Royalty).

"*Notwithstanding any other provision of this Licence nothing in this Licence shall prohibit [Alaska] at any time during the Term from electing to perform the Licensed Activities or any other activities, including, but not limited to, operating flights, code sharing arrangements with any other airlines or entities, or operating flights between any points regardless of where such flights originate or terminate, without the payment of royalties, so long as [Alaska] does not use the Names or Marks while undertaking such activities. […]*"

(5) Clause 8.1 provides as follows:

"*In consideration of the Airline Rights granted pursuant to Clause 3, [Alaska] agrees to pay [Virgin]:*

(a) with effect from the Effective Date and until December 31, 2015, a quarterly royalty which shall be 0.5% of Gross Sales in respect of each Quarter or part of a Quarter;

(b) with effect from January 1, 2016 and until the Trigger Date, a quarterly royalty which shall be 0.7% of Gross Sales in respect of each Quarter or part of a Quarter; and

(c) with effect from the Trigger Date and for the remainder of the Term, a quarterly royalty which shall be 0.5% of Gross Sales in respect of each Quarter or part of a Quarter

In each case, subject to the requirement that [Alaska] will in each financial year during the Term pay at least the annual Minimum Royalty in accordance with Clause 8.6."

(6) Clause 8.6 states

"*For the avoidance of doubt, [Alaska's] obligation in respect of payment of royalties due to [Virgin] in each financial year of [Alaska] is to pay the greater of (a) a royalty based on a percentage of [Alaska's] Gross Sales in the relevant period, at the rates set out in Clauses 8.1 and 8.3 above, and (b) the Minimum Royalty payment applicable for that period.*

[set out full clause]"Where the Reconciliation Statement reveals an underpayment of any amount due to [Virgin], the amount of such underpayment shall be paid in full by [Alaska] within 20 days following receipt of a relevant invoice from [Virgin]. […]'"

(7) Minimum Royalty is a defined term, and is defined as follows:

"***Minimum Royalty:** means in respect of each financial year of the Licensee, the amount of US$7,978,200 (or a pro rata part of such amount in the case of a partial fiscal year); such amount to be adjusted annually on the Year 1 End Date and any anniversary thereof to increase (but not decrease) by the same percentage as the percentage change in USCPI over the relevant period;*"

The parties' respective contentions.

Issue 1: Virgin's case.

77. I start with Virgin's case based on the *express words of the contract*.

78. Virgin submitted that Clause 8 unambiguously provides for the payment of at least the Minimum Royalty in any given financial year, with no exceptions (the "**Minimum Royalty Obligation**").

79. Virgin drew my attention to a number of features of Clause 8 which they said supported their position:

(1) **First**, it states that the payment of royalties is: "*In consideration of the grant of the Airline Rights granted pursuant to Clause 3*", defined as "*the rights granted by [Virgin] to [Alaska] pursuant to Clause 3 of this agreement*". Clause 3 goes on to define the scope and extent of the rights granted to Alaska. Therefore, the payment of royalties is not, it was argued, in consideration of the actual use of the Virgin brand, or in consideration of the generation of revenues: the payment of royalties, including the Minimum Royalty, is in consideration for the grant of the rights to use the Virgin brand as defined in Clause 3.

(2) **Second**, the primary method for calculating and paying the royalty is quarterly, by reference to a percentage of quarterly "*Gross Sales*". Gross Sales are defined, broadly, as revenues received "*in connection with the carrying on of the Licensed Activities*". The Licensed Activities have a lengthy definition in Schedule 1 of the Current TMLA but essentially comprise the operation of an airline in the US and other defined territories. Thus, the primary obligation is the payment of royalties quarterly based on a given percentage of revenues generated from the operation of a US airline.

(3) **Third**, however, the primary obligation is subject to the Minimum Royalty Obligation in the event that the primary method would produce a figure lower than the Minimum Royalty in any given financial year. They argued that there is nothing in this clause which would disapply it if use of the Virgin brand in connection with the Licensed Activities fell to zero.

80. The mechanics of payment of royalties were to be as follows:

(1) Clauses 8.4 and 8.5 set out obligations on Alaska to provide quarterly statements of the Gross Sales within 10 days of the end of each quarter, to pay royalty sums on a quarterly basis alongside the quarterly statements, and to provide an annual statement of Gross Sales within one month of the financial year end (the "**Reconciliation Statement**").

(2) The second half of Clause 8.6 then makes clear that if the quarterly payments, in total, fall below the Minimum Royalty, the amount of such underpayment is to be paid.

(3) Thus:

(i) percentage-based royalties, calculated by reference to a given percentage of revenues on Gross Sales, are to be paid on a quarterly basis; and

(ii) at the end of the year, if the Reconciliation Statement show that the total of the quarterly percentage-based royalties is lower than the Minimum Royalty, Alaska is to be obliged to 'top up' the payment to the Minimum Royalty by making an additional balancing payment (a "**Top Up**" or "**Top Up Obligation**").

81. As regards Clause 3.7, the terms of which I have set out above:

(1) Clause 3.7 means that no royalty is to be payable on non-branded revenues or on non-branded activities. Absent Clause 3.7, the effect of the definition of Gross Sales would be to include revenues from Licensed Activities generated without use of the Virgin brand within the percentage royalty calculations in Clause 8.1. Therefore, on Virgin's case, Clause 3.7 has an important function to perform: it excludes any revenues not derived from use of the Virgin brand from the royalty calculations. Without Clause 3.7, all US airline revenues would be taken into account. With Clause 3.7, non-branded revenues are excluded from all royalty calculations, and the royalty payments would only be made based on Virgin branded revenues.

(2) This leaves the Minimum Royalty Obligation intact, because the Top Up is simply derived from the amount of royalties paid on branded revenue in the given year, without any consideration of non-branded revenue. On Virgin's case, Clause 3.7, which was included in identical terms in the earlier 2007 TMLA, means exactly the same thing and performs exactly the same function in both documents.

(3) The fact that Clause 3.7 begins "*Notwithstanding any other provision…*" is consistent with the above: those words are necessary to ensure that Clause 3.7 is effective both to permit non-branded operations in the first place, and also to exclude non-branded revenues from the quarterly royalty calculations. However, the fact that Clause 3.7 takes precedence over any other clause is only relevant to the extent Clause 3.7 comes into conflict with another clause. It does not come into conflict with the Minimum Royalty provisions, because the latter do not set out a royalty applicable to non-branded activity. Therefore, it was argued, Clause 8.6 stands irrespective of Clause 3.7.

82. Virgin went on to contend that, consistent with the above, Clauses 3.6 and 3.7 read together place an obligation on Alaska to continue to use the Virgin brand in connection with the Licensed Activities to some material degree and stated that it is obliged to use reasonable efforts to promote its conduct of the same. Thus, both Clauses 3.6 and 3.7 have a role to play in defining obligations:

(1) without Clause 3.7, the obligation would be to use only the Virgin brand, which was a matter of significant concern to the DOT in around 2007 ('must use');

(2) without Clause 3.6, there would be no obligation to use the Virgin brand at all ('no use'); and

(3) in combination, the result is a 'some use' obligation.

83. Virgin's construction, it was contended, gives effect to both clauses, and harmonises them. It was contended that Alaska's construction (which I set out below) does not, since the only meaning that Alaska put forward for the causes is clearly wrong; and the argument that the presumption against surplusage is a weak one in the commercial context, so that it did not matter if Clause 3.6 was denuded of content is incorrect.

84. I consider both these points below.

85. Turning to the *factual material*, Virgin argued that since Clause 3.7 was introduced into the 2007 TMLA, and did not change in the Current TMLA, the relevant history of Clause 3.7 was the 2006-2007 DOT application process. It was their case that that material incontrovertibly showed that the DOT's concern in 2007 was to avoid a situation whereby royalties were paid on revenues not derived from use of the Virgin brand. The DOT said so much explicitly in Order 2007-3-16. In that regard they relied on the emphasis passage that I have set out at paragraph 11, above.

86. Virgin America and Virgin amended the 2005 TMLA to accord with this specific objection of the DOT. In Virgin America's comments on Order 2007-3-16, set out at paragraph 17 above, Virgin America drew attention to the provisions stating that there was no obligation to pay royalties if there was no use of the name. This agreement as regards Non Virgin Activity (or "NVA"; this is referred to also as "non-branded activity", with revenues derived from such activity "non-branded revenues"), was then reflected in the form of Clause 3.7.

87. For good measure, the DOT repeated the key extract from its March SCO (Order 2007-3-16) when it issued its final order in May 2007 (Order 2007-5-11) which I have set out in emphasis at paragraph 11 above," after "(Order 2007-3-16). This came after the TMLA had been concluded in revised form on 9 April 2007 but confirmed the significance of the extract from the March SCO.

88. Virgin contended that the above was confirmed by Mr Quinn's evidence that the point on which he was advising his client at the time, was that there should be no royalty obligation <u>on revenues not derived from use of the Virgin brand</u>. Virgin also suggested that the evidence of Mr Podberesky and Mr Lehman was to the same effect.

89. Overall, since Clause 3.7 did not change in the Current TMLA, Virgin contended that its meaning could not have changed and that there was no evidence to suggest it did.

90. Instead, it was said that the evidence of the negotiations leading to the Current TMLA made clear that Virgin America needed to secure an extension of the term of the 2007 TMLA which was not subject to a revenue test. However, it was said, Virgin was not happy simply to agree a substantial extension without some kind of protection of its revenue from the Virgin brand in that period. The email exchanges at the time very clearly showed that the Minimum Royalties were being sought by Virgin Group "*to give us comfort over the scale of the business/our return against the backdrop of a longer term licence with no break clause.*"

91. Virgin went on to contend that the 2014 DOT approval process took matters no further, for the following reasons:

(1) The simple fact was that Virgin America made a substantial change filing with the DOT, and drew to its attention a number of documents, including the proposed new TMLA. The DOT saw the proposals in redline form (in fact, in two different redline forms), was specifically aware of the introduction of a Minimum Royalty, and blessed the Current TMLA. The DOT noted the continuing presence of a permission to operate independent of the Virgin Names and Marks without the obligation to pay royalties.

(2) There is no evidence that the DOT was given any specific information about how the Current TMLA would function in the event of a total cessation of use of the Virgin brand. It appears that the Minimum Royalty provisions were not discussed at the first meeting, and there is no (reliable) evidence they were discussed specifically at the second either. Mr Varley's evidence on this should be rejected.

(3) The court is therefore left without any evidence as to the DOT's understanding, and trying to second guess what the DOT thought beyond what is contained in the October 2014 Letter. The Court is being asked to engage in pure speculation for which there would be no warrant. It is impossible to see how such speculation could be relevant evidence in determining the proper interpretation of the Current TMLA.

(4) The expert evidence is not helpful on this point.

(5) Alaska's only remaining argument on this point appears to be that there was a <u>risk</u> that the DOT would have concluded, had they been made aware of Virgin's interpretation of the Minimum Royalty Obligation, that Virgin America was no longer a US citizen, and that this risk was enough that Virgin's interpretation would or should have been raised specifically with the DOT if it were the correct one. This argument is wrong:

(a) The argument must be that an objective reader at the time of the Current TMLA would have assumed that if the contract meant what Virgin says it did, that would need to be specifically flagged in detail to the DOT, which it was not, and therefore the objective reader would not have interpreted it in this way. But each of the premises of this argument is flawed: it would <u>not</u> need to be specifically flagged to the DOT; it was in any event flagged; nor is it at all clear that an objective reader would have formed these assumptions.

(b) As regards the supposed 'need' to flag Virgin's interpretation to the DOT, in fact there was no need because the interpretation is consistent with the previously imposed Condition 3.a.i. The history set out above shows that Condition 3.a.i was intended to cover royalties on Non Virgin Activities, or NVA. Since the Minimum Royalty is a royalty due in consideration of the right to conduct Virgin Activities, or VA (this is referred to also as "branded activities", with revenues derived from such activities "branded revenues" or "Virgin branded revenues"), it is not within the scope of Condition 3.a.i. As a result, there is simply no basis to assume that there was any risk that the DOT would object to Virgin's construction of the Minimum Royalty Obligation.

(c) Further, there is no merit in the argument that all risks would be mentioned specifically to the DOT. Even on Alaska's interpretation of the Minimum

Royalty, it represented a substantial change in Virgin America's operations. Virgin America was no longer able to, for example, halve its royalty obligation by halving its Virgin branded operations. On Alaska's case, Virgin America was placed into a position where it could only stop the royalty by totally ceasing its use of the Virgin brand. Evidently, that represented a fetter on Virgin America's decision-making capability. However, this point was not specifically flagged to the DOT either.

(d) The key point is that all Virgin America was obliged to do, and what it in fact did do, was set out the change for the DOT in the course of a substantial change filing. It was not obliged to go through and explain all the differences and how the new clause might play out in various scenarios.

(e) Mr Podberesky's evidence on this was clear: the fact of the change needed to be explained, but there was no requirement to explain the differences before and after to the DOT beyond that. Virgin submitted that I should accept that evidence.

(f) Further, the argument ignores the fact that the change was clearly flagged to the DOT. A redline of the Current TMLA was specifically sent to the DOT, allowing the DOT to form its own opinion on the effect of the Minimum Royalty.

92. Virgin's interpretation, it was contended, was also supported by the *commercial setting* in which the Current TMLA was concluded:

(1) Virgin was agreeing to grant a 25 year license without a break clause. At the same time it was losing a raft of rights it previously had to block a potential full or partial take-over of Virgin America by a competitor, whereas any competitor would evidently have its own commercial imperatives in respect of the Virgin brand.

(2) Further, the parties would or could have been well aware that using the Virgin brand in the US airline industry, particularly using it to generate a substantial annual royalty of the same scale as the Minimum Royalty, was something which was likely to be difficult and risky. This proposition is supported by the material relating to the initial licensing of Virgin America, as well as by the evidence of Dr Dempsey and Ms Daniels, which I have already considered and which Virgin submitted I should accept.

(a) The DOT raised numerous objections to the TMLA between Virgin and Virgin America, and imposed conditions on its terms. Were Virgin to seek to use the Virgin brand with another licensee US carrier, there was of course a substantial risk that similar issues would arise.

(b) Further, as noted above, Dr Dempsey explained that the airline industry is cyclical, and even if one assumes that Virgin had full confidence in its ability to use the Virgin brand in the US airline industry in 2014, it does not follow that such a conclusion would hold good 12 months later. Nor does it show that using the Virgin brand would be 'risk free'. There was, at the very least, a risk that the new licensee would not be in a position to pay the same level of royalty.

(3) Virgin's case was that given the risk that the IPO would create of a de-brand by a competitor (which was admitted and which was confirmed by Mr Varley), it was perfectly logical to bargain for a Minimum Royalty which did not simply cease to be payable if usage of the Virgin brand ceased. Indeed, Virgin submitted, the level of the Minimum Royalty was to increase with inflation (CPI) throughout the longer term, which tended to indicate that it was intended to continue to be payable throughout the term.

93. Alaska's case to the contrary, Virgin argued, made little commercial sense. The effect of the Current TMLA would be that Virgin America had an option to cease all use and stop paying the Minimum Royalty, leaving Virgin with nothing except the right to recover the Virgin brand. In effect, this was on Alaska's case a termination right in favour of Virgin America, but not one which was spelled out expressly. However, this right was of no interest <u>to Virgin America</u> in 2014. Virgin America, as the documents show, was seeking an *extended* term to secure its right to use the Virgin brand. The reality is that an option to cease use was in the interests of a third party, such as Alaska, who might want to take Virgin America out of the market. It would be an extraordinary commercial strategy for Virgin and Virgin America to bargain with a view to protecting the interests of a competitor third party.

94. In this connection, Alaska has suggested that it makes no sense for Virgin America to have agreed to pay $8 million per year for a brand for which there was no ready market. This ignores the fact that the Virgin brand was very valuable <u>to Virgin America</u>. Virgin America was a US citizen with existing DOT certification and an existing and successful business using the Virgin brand. It was critical to Virgin America to be able to continue using the Virgin brand, and to exclude others from using the Virgin brand. Virgin America was by no means a disinterested third party in respect of the brand. So much is entirely obvious. However, the Virgin brand was not nearly so valuable if Virgin America were to be taken out of the equation. The IP rights were unique property, and their value depended on Virgin America continuing to use them or, if it did not, on managing to find another entity that would do so on acceptable commercial terms. In those circumstances, it was entirely logical to bargain to protect their value in the event Virgin America was acquired by a competitor who decided to cease using them.

95. Virgin also argued that the *factual material* supported Virgin's arguments as to the meaning of Clause 3.6:

(1) Delta made the DOT aware of the potential conflict of Clauses 3.6 and 3.7, and noted that Clause 3.6 must have been retained for a reason.

(2) The DOT noted the possible conflict in its final order, but nonetheless approved the 2007 TMLA. The DOT did not impose a condition requiring the removal of Clause 3.6.

(3) The obvious inference is that the DOT was content with the residual impact of Clause 3.6.

(4) This accords with commercial sense and with the evident wish of the parties to include IP protections for Virgin within the TMLA. If use of the Virgin brand totally ceased, its "Virgin America" marks would be vulnerable to revocation. However, if use in commerce was made of the marks this would not be the case.

Accordingly, the obligation to continue to make more than *de minimis* use made sound commercial sense. As Mr Quinn explained, protections for the Virgin brand were to both Virgin's and Virgin America's benefit.

96. Alaska argues that Clause 3.7 "*expressly provides that Alaska has complete freedom, at any time, to choose to perform its operations … without paying royalties – all it needs to do is not use the Names or Marks*".

97. However, Virgin argued, the words, and also the history, of Clause 3.7 demonstrate that it is concerned to allow Virgin America the freedom to perform NVA – as Mr Quinn put it, an airline within an airline – without having to pay royalties in respect of them. What Clause 3.7 does not do, it is contended, is to provide that if there are no VA, i.e. only NVA, then all royalty obligations cease, whether or not they are royalties on NVA.

98. Alaska's argument to the contrary was, Virgin submitted, misplaced.

(1) As a preliminary and perhaps fatal point in respect of this argument, it was said that it can hardly be called unconvincing to say that the royalties are payable in consideration for the grant of the rights, when that is literally what the contract says in terms.

(2) Alaska went on to say that if the payments are in consideration of the rights "*one would expect an annual flat fee*". But an annual flat fee is payable as a minimum, the Minimum Royalty. That only serves to support Virgin's case.

(3) Next Alaska says that "*it is commercially unrealistic to consider that a licensee would consider paying such a royalty simply for the benefit of the grant of* right *rather than for* use". Of course a licensee wishing to use the Virgin brand would pay for the right to use, because they intend to exercise that right. In fact, the Current TMLA grants an exclusive right to use. Virgin America clearly did consider the rights it acquired to be valuable rights. It had a business with a turnover of around $1.5 billion[5] predicated entirely on the use of the Virgin brand. It was evidently valuable to Virgin America to have the right to use the Virgin brand and to exclude others from it. Moreover, in this regard, the Minimum Royalty was not a significant percentage of Virgin America's revenue: it was fixed at 0.56%[6] of Virgin America's 2013 revenue. It is of course no surprise whatsoever that Virgin America was willing to pay this amount commercially, given the centrality of the Virgin brand to its business, and the requirement to secure the Virgin brand long-term as part of the IPO.

(4) What Alaska really means is that it would make no sense for Alaska to have agreed to pay the Minimum Royalty. Even this is not clear, because the Virgin brand rights are plainly valuable even when not used: the value of excluding a brand from the market is shown by existing airlines' trenchant position to Virgin America seeking to enter the market in 2007; precisely how much the Virgin brand rights are worth is not relevant since the court's role is not to correct a bad bargain. But leaving that point aside, the Current TMLA was agreed between Virgin America and Virgin, at a time when Alaska was a third party competitor. The repeated attempt to argue the

[5] Virgin America's 2013 revenue is said to have been $1.425 billion.
[6] 80% multiplied by 0.7%.

commercial rationality points by reference to Alaska's position is nonsensical and should be rejected.

(5) Finally, Virgin drew attention to Alaska's argument that the right to terminate in Clause 3.7 is inconsistent with the royalty payments being in consideration for the mere grant of the rights. Virgin has, it said, never argued that the Current TMLA "*was about*" solely the grant of IP rights. In fact it is a major part of Virgin's case that the Current TMLA placed an obligation on Virgin America to exercise the IP rights, under Clause 3.6. The only point of relevance for these purposes is that the royalty payments are, expressly, payments in consideration of the grant of the rights. The only trigger for their payment is that the rights are granted. But the Current TMLA is of course "*about*" far more than just this simple point, Virgin had a right to terminate for non-use (also indeed, for a decrease in use below 80% of total revenues) is entirely consistent with Virgin's case.

99. Virgin contend that the heart of Alaska's DOT case as regards the meaning and purpose of Clause 3.7 is that "*[t]he DOT was absolutely clear that revenues derived without using the Names or Marks should not attract royalties, and it inevitably follows that if no use is made of the Names or Marks, no royalties should be payable*."

100. This is, Virgin contended, quite clearly a non-sequitur. It jumps between two distinct propositions. The first proposition is 'in respect of NVA revenues, no royalty can be due'. The second proposition is 'if there are no VA revenues, no royalty can be due'. However, the second does not follow from the first. The key reason that the second proposition does not follow from the first is that there is of course the possibility of a royalty which does not depend on there being any VA revenues, but which is also not a royalty in respect of NVA revenues. The Minimum Royalty is such a royalty. It is due in consideration of the grant of the IP rights, and it bears no relation whatsoever to NVA.

101. Virgin then went on to address Alaska's argument that because the DOT referred to the requirement for Virgin America to be able to operate "*completely free*" of the Virgin brand in 2007, Clause 3.6 cannot be read as Virgin suggests, and Alaska's further reliance on Condition 3.a.i, which referred to "*any*" operations. Virgin contended that the proper interpretation of the DOT's statements was that the DOT was concerned that Virgin America should be entitled to conduct any particular operations completely without using the Virgin brand. However, the DOT never said, and it was never part of any condition imposed by the DOT, that Virgin America should be free to conduct <u>all</u> operations free of the Virgin brand. If the DOT truly wanted Virgin America to have the ability to conduct "*any and all*" operations free of the Virgin brand, it would have said so, particularly given it was alerted to the role of Clause 3.6 by Delta. The proper inference from the documents is that the DOT was aware of the obligation to conduct some operations under the Virgin brand pursuant to Clause 3.6, and was happy with that obligation.

102. This conclusion, it was contended, is only reinforced by the fact that the DOT saw the Current TMLA in redline, noted the Minimum Royalty, noted the continuing effect of Clause 3.7, and approved the arrangement. As a result, the parties did not even take a risk on the point: they told the DOT and the DOT approved.

103. Virgin went on to address the question of whether, if there was some conflict between Condition 3.a.i and the terms of the Current TMLA, Condition 3.a.i was binding, and whether, if it was binding, it was superseded by the October 2014 Letter.

104. Alaska, it was said, said that paying for non-use is a surprising construction, which would have to be clearly marked out. Virgin contended that both aspects of this are incorrect:

    (1) Virgin conferred valuable and exclusive rights on Virgin America. Agreeing to pay a minimum fixed fee was perfectly logical (and the amount was small as a percentage of revenue, albeit that the court is not here to judge whether it was a good bargain). Virgin had, following the IPO, little or no control over whether Virgin America continued to use the Virgin brand, because Virgin America was vulnerable to being taken over. A fixed fee was an obvious solution to that issue.

    (2) It was clearly marked out. The terms of Clause 8 are very clear indeed.

105. Next, Virgin addressed the argument that a minimum royalty would be unreasonable and that the risk of the de-brand increases the unreasonableness, contending that this argument was ill founded for a number of reasons. They argued that this was simply to view the position from Alaska's point of view as a third party to the contract at the time it was agreed; that viewed from Virgin's perspective, the minimum royalty was a logical and reasonable protection against a possible de-brand by an acquiring competitor; that agreeing a longer term, and minimum royalties in return, was perfectly reasonable for Virgin America, as Mr Varley confirmed in cross-examination, since Virgin America itself wanted to go on using the Virgin brand, and sought a longer term as part of the IPO process, and since the Virgin brand was evidently very valuable to Virgin America. Virgin America's entire successful business was predicated on the Virgin brand, with the result that it was logical to agree a minimum fee, which constituted only around 0.56% of 2013 revenues.

106. The only persons with any material interest in preserving the right to de-brand 'for free' were competitors such as Alaska, and it is common ground that there was a materially increased risk of an acquisition and de-brand by a competitor. However, Virgin contended, it would be commercially absurd for the parties to the Current TMLA to bargain to protect the rights of competitor third parties.

107. Moreover, if they in fact had wished to protect third parties, a far more logical way to do so would be via an express right of termination. Instead, on Alaska's interpretation, Virgin America was granted effectively a tacit termination right, a unilateral right to cease use and cease paying anything (whereas Virgin still retains a right to put an individual on Alaska's board).

108. Virgin then referred to Alaska's reliance on the termination right given to Virgin in Clause 3.7, contending that this was plainly not sufficient comfort for Virgin, and that Virgin required the additional protection of the Minimum Royalty. They argued that Alaska's argument failed to recognise the unique position in which Virgin America came to be, as a large-scale successful US citizen airline operating under the Virgin brand. The suggestion by Alaska that "*Virgin could terminate the Current TMLA, and then generate such value from the Names or Marks as the market placed upon them*" did not take account of the fact that nobody else in the US airline market would be likely to place the same value on the Virgin brand that Virgin America placed on it, since nobody else had

a successful business predicated on the Virgin brand, with the result that nobody else in the US airline market would be likely to be willing to replicate the Minimum Royalty Obligation.

109. Virgin summarised its position by reference to four scenarios, which it had set out in opening.

110. "**Scenario 1**" was the position of Virgin America immediately after the IPO. In this scenario, Alaska continues to use the Virgin brand for all Licensed Activities (i.e. all airline operations in the Territories covered by the Current TMLA).

(1) In such a scenario, all airline revenues (i.e. all Gross Sales) are derived from use of the Virgin brand.

(2) In each Quarter, Alaska will pay the relevant percentage (0.7% or 0.5% as the case may be) of all Gross Sales to Virgin as royalties pursuant to Clause 8.1.

(3) At the end of the year, Alaska will submit a Reconciliation Statement. If the total amount of royalties paid is below the Minimum Royalty, a Top Up payment is due. If the total amount is above, there is no requirement for a Top Up.

(4) There is no dispute between the parties as regards the operation of the Current TMLA in Scenario 1.

111. "**Scenario 2**" was approximately the position after Alaska merged with Virgin America in 2018, but before Alaska completed its de-brand. In this case revenues are derived both from use of the Virgin brand and also without use of the Virgin brand.

(1) In Scenario 2, not all Gross Sales are derived from use of the Virgin brand.

(2) Absent Clause 3.7, percentage revenues would be due in each Quarter on all Gross Sales (included non-branded revenues). However, there is no dispute that the effect of Clause 3.7 is to exclude non-branded revenues from the operation of Clause 8.1.

(3) As a result, in each Quarter, Alaska will be obliged to pay the relevant percentage of all the Gross Sales derived from the use of the Virgin brand.

(4) At the end of the year, the position is exactly the same as in Scenario 1. The Reconciliation Statement will record the total Gross Sales derived from the use of the Virgin brand, and the amount of royalty paid. A Top Up will or will not be due depending on whether this exceeds the Minimum Royalty.

(5) This is true wherever there are any Virgin-branded revenues at all, even a very small amount of Virgin-branded revenue.

(6) Again, there is no dispute between the parties as regards the operation of the Current TMLA in Scenario 2.

112. "**Scenario 3**" is where Alaska elected to wind down all operations.

(1) In Scenario 3, Alaska would not be generating any revenues at all.

(2) In such a situation, in each Quarter, there would be no payment due under Clause 8.1. However, at the end of each financial year, the Minimum Royalty would be due.

(3) Virgin argued that Alaska cannot deny this: Alaska's argument is that Clause 3.7 entitles it to conduct operations outside the Virgin brand without paying royalties in respect of them, and so where there are non-branded revenues, but no branded revenues, the Minimum Royalty 'latches on' to the non-branded revenues in breach of Clause 3.7 (and is thus is not due). However, Alaska's argument cannot apply where there are no non-branded revenues at all. In such a situation, the Minimum Royalty cannot 'latch on' to non-branded revenues in breach of Clause 3.7. Accordingly, on Alaska's own case, the Minimum Royalty would be due and payable in Scenario 3.

(4) On Virgin's case, this conclusion is perfectly reasonable: the parties bargained for a Minimum Royalty to which there were no exceptions. Therefore, this particular situation is entirely consistent with all the other situations in which at least the Minimum Royalty is payable.

113. "**Scenario 4**" is identical to the instant case. It is the position where Alaska winds down all use of the Virgin brand, but continues Licensed Activities under another brand.

(1) On Virgin's case, the Minimum Royalty is due each financial year, just as in every other situation. There would be no quarterly percentage-based payments, because there are no relevant revenues: revenues generated without use of the Virgin brand are excluded by virtue of Clause 3.7. Nonetheless, a Top Up equal to the full Minimum Royalty would be due at the end of the year.

(2) On Alaska's case, there are also no relevant revenues, and therefore no quarterly payments. However, at the end of the year, Alaska says that no Top Up payment is due in this situation. Despite the fact that Clause 3.7 has already discharged its role, by excluding all Alaska's non-branded revenues (i.e., in this situation, all revenues) from the quarterly royalty calculation, Alaska's case is that it then has another function at year-end, namely to prevent any Top Up / Minimum Royalty payment being due.

(3) It is very unclear why Alaska says that Clause 3.7 develops this additional, entirely unstated, role. As noted above, the rationale appears to be that a Minimum Royalty, were it to be payable, should be treated as 'latching on' to the non-branded revenue. However, that is simply re-writing the entire contract. It is inconsistent with the words of Clause 8, which make clear that the royalties are due in consideration of the grant of the Airline Rights, and it is inconsistent with the role of Clause 3.7, which is to exclude non-branded revenues from the calculation of royalty payments.

114. Virgin contended that these illustrations demonstrate that Alaska's interpretation generates illogical anomalies. For example:

(1) A comparison between Scenario 3 and Scenario 4 shows that, on Alaska's case, whether or not the Minimum Royalty is due is purely a function of the Alaska group's corporate structure. If, for example, rather than merging Virgin America

with Alaska, the Alaska group had chosen to keep the entities separate, transferring Virgin America's assets to Alaska, and winding down Virgin America's operations, that would generate Scenario 3 rather than Scenario 4, and on Alaska's interpretation the Minimum Royalty would still be due. It is purely as a result of Alaska's decision to structure the business by merging the two entities that has resulted in Scenario 4, rather than Scenario 3. It is inherently unattractive and contrary to business common sense to interpret a contractual payment obligation as purely contingent on the chosen corporate structure of the obligee.

(2) A comparison between Scenario 2 and Scenario 4 also illustrates that Alaska's interpretation is anomalous. Alaska's case is that in Scenario 2, as long as there is <u>some</u> branded revenue, the whole Minimum Royalty will be due each year (as a Top Up payable at the end of the year). For example, if Alaska chose to keep operating a single Virgin branded route because that had a particularly loyal customer base, but only generated $10 million in revenue, only $70,000 of percentage-based royalty would be due by way of four quarterly payments. More than $7.9 million would be due as a Top Up, even on Alaska's case. And yet Alaska says that the minute the branded route is closed and use ceases entirely, <u>none</u> of the Minimum Royalty is due.

(3) Further, as has already been noted Alaska's interpretation results in Clause 3.7 having a different meaning in the 2007 TMLA and the Current TMLA, despite the words being the same in the two contracts. On Virgin's case this anomaly does not arise:

(a) Virgin says that in the 2007 TMLA the function of Clause 3.7 was to permit non-branded activities, and to make clear that the revenue from such activities was to be excluded from all royalty calculations. When the 2007 TMLA was agreed, there was no discussion around minimum royalty payments. The only royalties being considered were revenue-based payments, and Clause 3.7 excluded all non-branded revenues from the calculations. Virgin says that precisely the same is true of Clause 3.7 of the Current TMLA. As noted above, Clause 3.7 still plays the same important role in excluding all non-branded revenues from the percentage-based royalty calculations, which take place quarterly under Clause 8.1. However, Clause 3.7 is irrelevant insofar as the annual Top Up / Minimum Royalty Obligation is concerned, because that is not concerned with a percentage royalty on revenues.

(b) Alaska agrees with this analysis up to the final sentence. However, Alaska's case is that Clause 3.7, without any amendment to its wording, nonetheless gained an important additional function: preventing the Minimum Royalty from being due in Scenario 4 (but in Scenario 4 only). Given the history of the Current TMLA, this is plainly an anomalous conclusion. Virgin's interpretation is far more consistent with the factual background to the Current TMLA.

(c) Such anomalous results would require clear wording, but no such wording can be found in the Current TMLA.

115. There is only one other important argument of principle on which Alaska relies. Alaska points to the fact that under the 2007 TMLA, the "*no use of name, no royalty*" principle held good. It appears to derive from this fact a wider general principle that such must have been the purpose and meaning of Clause 3.7. This argument is also manifestly wrong:

(1) It is perfectly true that the consequence of the terms of the 2007 TMLA was that, if all use of the Virgin brand ceased, so would all royalty payments. The obligation in Clause 8 of the 2007 TMLA was to pay a percentage royalty calculated by reference to Gross Sales. However, revenues derived without use of the Virgin brand were excluded from Gross Sales for this purpose, pursuant to Clause 3.7. Therefore, if Virgin branded revenues fell to zero, so did royalties. This was true irrespective of whether there were or were not any non-branded revenues.

(2) This was purely the practical consequence of Clause 8 as it was in the 2007 TMLA as modified by Clause 3.7. It constitutes a substantial leap of logic to move from this single fact about the operation of Clause 8 of the 2007 TMLA, to a general conclusion that Clause 3.7 should be read as meaning "*no use of name, no royalty*" irrespective of what both Clause 3.7 and the remainder of the amended contract says. In other words, Alaska seeks to argue that because of one practical example of the operation of the 2007 TMLA, the meaning of Clause 3.7 must be adapted from what it actually says ('Alaska can do NVA without paying royalties') to mean what it does not say ('if Alaska does not do VA, it does not have to pay royalties'). That is obviously flawed logic.

(3) To illustrate this point, under the 2007 TMLA, if Virgin branded revenue reduced by 50%, so did the royalty amount. It would of course be nonsensical to derive from this single example under the 2007 TMLA a general proposition that Clause 3.7 required the royalty amount to halve if revenues halved, irrespective of what the other Clauses of the contract said following amendments in the future.

(4) The reality is that Clause 8 changed substantially in the Current TMLA. Therefore, the question of what the royalty obligation would be when use of the Virgin brand halved, or when it ceased, is entirely at large and cannot be answered by reference to what would have been the case under the 2007 TMLA. To answer a question about the Current TMLA by reference to what would have been the case under the 2007 TMLA is just as flawed in relation to a 100% fall in usage as it is to a 50% fall in usage. Indeed, that is clear from the fact that, even on Alaska's case, royalties do not halve under the Current TMLA just because branded revenue halves. Rather, the Minimum Royalty would remain payable on any view.

Alaska's case in outline.

116. Alaska submitted that Issue 1 turns on the proper construction of the Current TMLA in general, and Clause 3.7 of the Current TMLA in particular. They made their submissions under the following headings:

(1) The ordinary and natural meaning of the words in Clause 3.7;

(2) The contractual context;

(3) The purpose of Clause 3.7;

(4) The factual background;

(5) Business common-sense and the reasonableness of the results produced by the parties' constructions.

117. In relation to the *ordinary and natural meaning of the words*:

(1) Alaska started with Clause 3.7, which I have set out above, and which they submitted, is a well-drafted, sophisticated and complex contractual agreement that was prepared with the assistance of skilled professionals is decisive. They submitted that the words in the first sentence of Clause 3.7 were critical.

(2) The language used in Clause 3.7 tracks that used in Clause 8.6, demonstrating that Clause 3.7 frees Alaska of any obligation under Clause 8.6 in respect of operations outside the Virgin brand. In particular both clauses use the term "royalties", which Clause 8.6 makes clear includes the "Minimum Royalty" (as the Minimum Royalty is one of the two options for the payment of "royalties" identified by Clause 8.6).

(3) Clause 3.7 enables Alaska to elect to perform all of the activities described in Schedule 1 or any other activities without paying royalties so long as it does not use the Names or Marks while undertaking such activities.

(4) It inevitably follows that if the Names or Marks are not used by Alaska at all, Alaska cannot be obliged by the Current TMLA to pay any royalties – including the Minimum Royalty.

(5) Virgin is wrong to suggest the following:

(a) There is some significance in the distinction between royalties paid for the <u>use</u> of the Names or Marks, and the payment of royalties for the <u>right to use</u> the Names or Marks. <u>First</u>, that distinction is an artificial one so far as the Current TMLA is concerned. <u>Second</u>, and in any event, Clause 3.7 is clear – if there is no use, no "*royalties*" are payable. That broad term necessarily encompasses the "*Minimum Royalty*", which as its very name identifies <u>is a royalty</u>. The term "royalties" is not defined in the Current TMLA, and there is no reason why it should not be given its usual and ordinary meaning which would encompass the "*Minimum Royalty*".

(b) Nor is Virgin correct to say that Clause 3.7's effect is somehow limited to affecting the true meaning of the term 'Gross Sales'. Alaska again pointed to the opening words of Clause 3.7, i.e. "*[n]otwithstanding any other provision of this Licence*" and "*nothing in this Licence shall prohibit*" the right of election Clause 3.7 provides. Clause 3.7 therefore, it was said, trumps every other provision of the Current TMLA, not just some of the other provisions.

(6) The second sentence of Clause 3.7 only confirms Alaska's analysis of the first sentence because it gives <u>Virgin</u>, and not <u>Alaska</u>, the ability to terminate the Current TMLA if the Names or Marks are not used in a 'material manner', and therefore to avoid any loss from their non-use.

(7) Clause 3.7 creates a very straight forward, common sense and easy to apply regime: if Alaska does not use the Names or Marks it does not pay any royalties in respect of the Names or Marks.

(8) Virgin's contention that Clause 3.7 cannot have the meaning Alaska suggests because it introduces difficulties where usage ceases part way through a year, or where usage ceases and then resumes, is unconvincing:

(a) A de-brand was a significant exercise. The idea that usage would cease then restart (let alone do so repeatedly) is a possibility more imaginary than real. The absence of any contractual mechanism which specifically deals with that eventuality says nothing about the plausibility of Alaska's construction. Virgin's argument also ignores the second sentence of Clause 3.7; if there ceases to be "*use in a material manner*" then written notice may be given and, on a failure to cure, the licence may be terminated. This is the mechanism that the parties chose to use in order to deal with all forms of 'insufficient' use.

(b) Alaska's construction of Clause 3.7 does not create uncertainties or difficulties as to what should happen when all use of the Names or Marks ceases.

(i) Clause 3.7 establishes the basic principle that if the Names or Marks are not used then no royalties are payable.

(ii) Clause 8, which provides for the payment of Minimum Royalty therefore must be read accordingly. Clause 8.6 requires that if the Names or Marks are used, Alaska must at a minimum pay the Minimum Royalty.

(iii) The simple, and straight forward way for those two provisions to operate consistently is to pro-rate the Minimum Royalty over the days when the Names or Marks are used, and to charge <u>no</u> sum once use ceases. That result follows inevitably from the language of the Current TMLA, and is a solution which is neither difficult or unreasonable to apply, and which accords with business common-sense.

118. Turning to the *contractual context*, Alaska addressed the significance of the following other clauses of the Current TMLA, namely Clause 3.6, Clause 8 and Clause 11.

119. Dealing first with the interrelationship between Clauses 3.6 and 3.7of the Current TMLA, Alaska contended that its construction of Clause 3.7 does not make Clause 3.6 redundant. Properly construed, Clause 3.6 of the Current TMLA (and its forerunner in the 2007 TMLA that was not changed by the parties) provides protection for Virgin in the event that Virgin America / Alaska made any (e.g. minimal) use of the Names in a way which damaged or degraded their value and / or was inconsistent with Virgin America's "*reasonable efforts*" obligation. <u>If</u> (but only if) Virgin America / Alaska used the Names, Clause 3.6 required that use could not be *de minimis*; but Clause 3.6 does not, on its proper interpretation, <u>require</u> the Names to be used as it is "*[s]ubject to Clause 3.7.*".

120. Secondly, Alaska argued that even if Clause 3.6 is rendered surplusage on Alaska's construction of Clause 3.7, that does not mean Alaska's construction is wrong. In this regard, they contended that the presumption against surplusage is a weak one, the importance of which should not be overstated. Ultimately, they contended that the Court must give effect to the language of the parties' agreement. If that language means that one clause in the agreement is surplusage, then that is still the proper construction of the parties' agreement.

121. In this case, it is critical to recognise that (a) Clause 3.7 expressly provides it is to apply notwithstanding any other provision of the Current TMLA and (b) Clause 3.6 is expressly, "*[s]ubject to Clause 3.7*." Whatever might be the case in contracts which do not provide a hierarchy of provisions (where perhaps the argument against surplusage might have more force), the Current TMLA expressly provides for Clause 3.7 to trump all other provisions in the contract. The Current TMLA therefore expressly contemplates and accepts the possibility that Clause 3.7 would render other clauses surplusage – including in particular Clause 3.6 which is expressly subject to it.

122. Turning to Clause 8, while Virgin has suggested that Clause 8 is the "*critical clause*", Alaska argued that it is not. Clause 8 is, as Clause 3.7 makes expressly clear, subject to the right of election afforded to Alaska by Clause 3.7. The critical clause in this case is Clause 3.7, not Clause 8. In short, given that Clause 8 is subject to Clause 3.7, it cannot require Alaska to pay the Minimum Royalties if the Names or Marks are not used.

123. Finally, Alaska dealt with Clause 11 of the Current TMLA, which they said has no bearing on Clause 3.7.

124. Alaska then argued that its textual analysis of the Current TMLA is consistent with, and supported by, the *fundamental purpose* of Clause 3.7 Current TMLA which is to ensure that if the Names or Marks are not used no royalties are to be paid to Virgin.

125. It was said to be common ground that the effect of Clause 3.7 of the Current TMLA is the same as the effect of Clause 3.7 of the 2007 TMLA. Alaska argued that the purpose and effect of Clause 3.7 of the 2007 TMLA is apparent from the following evidence:

    (1) Even before the DOT had raised the issue of royalties being paid on revenues derived without using the Names or Marks as a concern, Mr Quinn had identified this as a serious problem in advice he gave to Virgin America and Virgin.

    (2) In Virgin America's January 2007 submissions to the DOT, prior to the March SCO, Virgin America, despite Mr Quinn's advice, decided to maintain the royalty provision which Mr Quinn had advised the DOT would object to.

    (3) Virgin America did however concede and explain that:

        (a) It intended to eliminate "*any restriction on Virgin America's licensed activities if it does not use the 'Virgin' trademark*".

        (b) It "*proposes to amend the License Agreement so as to expressly preserve Virgin America's ability to operate 'completely free of the Virgin Brand…'*". (see paragraph 11 above). That submission is of particular importance in this case, as it was a clear representation to the DOT that the purpose of the

amendments being made to the 2005 TMLA was to enable Virgin America to operate "completely free of", i.e. without using at all, the Names or Marks.

(4) As Mr Quinn had predicted, the DOT in the March SCO identified as problematic the payment of royalties where the Names or Marks were not used. The DOT's conclusion in the March SCO (as set out in paragraph 11 above) was that: "…*we see no reason why the applicant's operations outside of the license should still be subject to a royalty obligation to the Virgin Group*".

(5) The DOT thereby said in terms that activities that did not use the Names or Marks must be royalty free. That, combined with Virgin America's representation to the DOT that the revised TMLA would enable it operate 'completely free' of the Names or Marks (an amendment which the March SCO expressly recorded was made "*[i]n response to the Department's concerns…*"), inevitably meant that the DOT required that Virgin America was free to perform all operations without using the Names or Marks, and without paying royalties if it did so.

(6) Virgin has sought to contend (i) that the DOT's concern was only on ensuring "*revenues not derived from use of the brand name*" were royalty free, and (ii) that the DOT did not say anything about a situation where all use of the Names or Marks ceased. Alaska argued that that contention was unsustainable once it is recognised that the DOT had accepted Virgin America's concession to be able to operate "completely free" of the Names or Marks. Where Virgin America operated completely free of the Names or Marks, which is a scenario the DOT expressly contemplated, it is nonsensical to suggest that the DOT's March SCO (or its final order (Order 2007-5-11)) was consistent with Virgin America having to pay multi-million dollar royalties until 2039 if it ceased using the Names or Marks entirely.

(7) Following the March SCO:

(a) On 30 March 2007, Mr Quinn wrote to Ms Frances Farrow, CEO of Virgin USA Inc., and specifically highlighted the amendments needed to the 2005 TMLA in light of the March SCO.

(b) On 3 April 2007, Virgin America wrote to VALTM3 (the signatory to the 2005 TMLA) enclosing a copy of the March SCO, identifying the changes to the 2005 TMLA that were required by the DOT, including its third condition, as set out in subparagraph (4) above. Virgin America sought VALTM3's consent to a revised version of the 2005 TMLA, which included amending Clause 3.7 to the form in which it appeared in the 2007 TMLA (and the Current TMLA).

(c) On 10 April 2007, Virgin America confirmed to the DOT in its comments on the March SCO, filed, that the changes which the DOT had required to the 2005 TMLA had been made.

(8) On 18 May 2007 the DOT issued a "final order" in which it found that, subject to fulfilling certain conditions, Virgin America would be a US citizen and fit, willing and able to engage in interstate scheduled air transportation. One of those was the condition in paragraph 3.a.i of Appendix A to that final order.

126. Those events show that the purpose of Clause 3.7 of the 2007 TMLA, which was created entirely as a result of regulatory requirements, was:

     (1) To enable Virgin America to operate completely free of the Names or Marks. Complete freedom can only mean the freedom not to use the Names or Marks at all if Virgin America so wished; and

     (2) To ensure that if Virgin America did not use the Name or Marks it did not have to pay any royalties (i.e. to be completely free). It inevitably follows that if Virgin America did not use the Names or Marks at all, it did not have to pay any royalties at all.

127. Stepping back, Alaska submitted, that is all wholly unsurprising. The DOT was concerned about foreign control of Virgin America, and ensuring it had the independence and freedom to act as any other US citizen could. A regime which imposed heavy financial penalties on Virgin America if it chose not to use the Names or Marks at all would obviously be inconsistent with that aim – it would hamstring Virgin America's US management to use a foreign owned and controlled brand and to make payments to that non-US citizen, even when the US citizen no longer wished to use the Virgin brand.

128. Alaska submitted that Virgin's case that the DOT's only concern was ensuring that royalties were not payable on non-branded revenues, by contrast, makes little sense:

     (1) If the DOT wanted to ensure that royalties were not payable on non-branded revenues, it inevitably followed that the DOT wanted to ensure that if there were no non-branded revenues at all then no royalties whatsoever were payable. The latter follows inevitably from the former.

     (2) The more one considers the mechanics of Virgin America having to pay a minimum royalty when it makes no use of the Names or Marks, the more obviously unacceptable to the DOT that situation would be. If Virgin America had to pay a minimum royalty when it made no use of the Names or Marks, then necessarily the money to pay the minimum royalty would have to originate from non-branded revenues. That means that, in substance, Virgin America would be paying Virgin a royalty from non-branded revenues. That result was clearly unacceptable to the DOT, and demonstrates why Virgin's case makes little sense.

129. Drawing the threads together, the result is that:

     (1) For the reasons above, the purpose of Clause 3.7 of the 2007 TMLA was to ensure that if no use was made of the Names or Marks, no royalties would be payable.

     (2) On its true construction, Clause 3.7 of the 2007 TMLA reflected that purpose.

     (3) All of the material discussed above was known to the parties at the time they concluded the 2007 TMLA, and the Current TMLA. It is admissible as evidence of the objective aim of the transaction in general and Clause 3.7 in particular. Alaska's case does not, as Virgin suggests, involve any speculation about what the DOT subjectively thought; rather Alaska's case is based on an objective interpretation of the DOT's orders and communications with Virgin America (in which Virgin were closely involved).

(4) It is common ground that the effect of Clause 3.7 of the 2007 TMLA and Clause 3.7 the Current TMLA was the same.

130. Next, Alaska argued that there are, in summary, three broad pieces of *admissible factual matrix* relevant to the construction of the Current TMLA:

(1) The parties knew or could reasonably have known that Virgin America's initial certification process had been difficult and protracted; in 2014, the parties were seeking to ensure that the Virgin America IPO proceeded successfully and without the DOT objecting; amending the 2007 TMLA so to oblige Virgin America to pay the Minimum Royalty even if the Names or Marks were not used was a matter that Virgin America should have notified the DOT of; failing to notify the DOT of a substantial change would be a breach of Virgin America's statutory obligations, and could precipitate adverse action by the DOT, to the detriment of Virgin America generally, and the orderly progression of the IPO in particular; there was no discussion between the parties in July to November 2014 of whether Virgin America was obliged to notify the DOT that the 2007 TMLA was being amended to require it to pay royalties even if no use was made of the Names or Marks, or whether Virgin America could run the risk of not telling the DOT expressly about this change.

(2) The parties knew, or could reasonably have known, that what the DOT was expressly told by Virgin America in 2014, and what the DOT understood, prior to the parties concluding the Current TMLA was that, "*…the amended TMLA will continue to permit Virgin America the ability to operate independent of the "Virgin" names and marks without the obligation to pay royalties.*" The DOT's understanding was never corrected by Virgin America.

(3) The parties knew, or could reasonably have known, at the time they concluded the Current TMLA that:

(a) The DOT was never expressly told that the parties were proposing to amend the 2007 TMLA so as to require Virgin America to pay royalties (i.e. the Minimum Royalty) even if it made no use of the Names or Marks. Thus, for example, this fact was not expressly referred to in the slide decks put before the DOT;

(b) If that change was objectively intended by the parties, Virgin America would have (irrespective of its legal obligations) informed the DOT of that change.

131. Alaska relied on the following evidence in support of these propositions.

132. As regards the first factual point, in outline, Alaska says that the parties knew, or could reasonably have known that Virgin America's initial certification process was difficult and protracted, as Mr Podberesky accepted. The parties were seeking to ensure that the Virgin America IPO proceeded successfully and without the DOT objecting. Alaska did not understand there to be any dispute that the parties were seeking to ensure that the Virgin America IPO proceeded successfully and without the DOT objecting. Insofar as necessary, this is demonstrated by:

(1) The 26 June 2014 email from James Cahillane, to Mr Varley in which he said, "*[g]iven that there will be changes to the TMLA post-IPO, are you intending to include something on these in your presentation to the DOT? I think both VEL and VX will want comfort that there will be no DOT issues with the TMLA changes post-IPO*" (emphasis added)

(2) The close involvement of Virgin in reviewing and discussing Virgin America's submissions prior to the IPO to the DOT.

(3) The time critical nature of an IPO, and the advantages to both sides of a successful IPO.

133. As to the second point:

(1) On 26 June 2014, i.e. shortly before the 8 July 2014 presentation to the DOT, James Cahillane, General Counsel at Virgin Management USA Inc, emailed Mr Varley and said, "*[g]iven that there will be changes to the TMLA post-IPO, are you intending to include something on these in your presentation to the DOT? I think both VEL and VX will want comfort that there will be no DOT issues with the TMLA changes post-IPO*" (emphasis added). Virgin therefore expressly identified that both parties would want comfort that the DOT would be content with any changes to the 2007 TMLA.

(2) Similarly Virgin America was, in consultation with Virgin, at great pains to identify to the DOT material changes which would affect Virgin America post-IPO: see §51-53 Alaska's Skel. There is no reason why they would have failed to draw clearly and expressly such an important change to the 2007 TMLA to the attention of the DOT.

(3) US carriers are at pains to maintain good relations with their regulator, the DOT, including by ensuring the DOT considers them to be forthright. It would be inimical to that well known goal of maintaining positive relations with the DOT for Virgin America to have failed to mention a significant change to an important document like the 2007 TMLA to the DOT.

(4) In addition, the DOT is a powerful institution, which expects close co-operation with the carriers to which it has granted a CPCN and expects carriers to be professional and conduct themselves with honour and dignity. As was made clear in evidence, "*…if there is any question with respect to what a carrier is going to be doing vis-à-vis their authority, they should contact DOT informally to find out what DOT's opinion is.*". Moreover, no carrier wants to end up in the DOT's bad books, or to have to reverse a transaction or be the subject to adverse action by the DOT, particularly in the context of US citizenship and fitness.

134. The DOT's October 2014 Letter records that the DOT was told that:

> "*In addition to the ownership changes noted above, you have also stated that Virgin America intends to amend its Trademark License Agreement ("TMLA") with the Virgin Group. Specifically, you note that the term of TMLA would be extended for 25 years and the TMLA would no longer be subject to minimum revenue thresholds… The amended TMLA would also require Virgin America*

> *to pay the Virgin Group a minimum royalty payment if Virgin America's royalty payment from licensing fees would otherwise be less than that minimum payment.…You also note the amended TMLA will continue to permit Virgin America the ability to operate independent of the "Virgin" names and marks without the obligation to pay royalties.*"

135. Against that backdrop, Alaska contended, the parties knew, or could reasonably have known, that the DOT (i) was told only what was set out in its October 2014 Letter so far as the Minimum Royalty was concerned, and (ii) consequently understood the Current TMLA would have the effect described in its letter. That is significant because:

   (1) The DOT did not suggest that it was told or knew that in fact Virgin America's ability to operate independently of the Names or Marks (the requirement that the DOT had imposed in 2007) was limited by the fact that it had to pay the Minimum Royalty even if no use was made of the Names or Marks.

   (2) To the contrary, while the DOT understood that when the royalties derived from continued use of the Virgin brand were below the Minimum Royalty, the Minimum Royalty would be paid instead, it still clearly believed that "*…the amended TMLA will continue to permit Virgin America the ability to operate independent of the "Virgin" names and marks without the obligation to pay royalties*". That would not be true if in fact the Minimum Royalty was objectively intended by the parties to be due even if no use was made of the Names or Marks.

136. Alaska further contended that it is important to bear in mind the genesis of the amendments to the 2007 TMLA and the objective aim of the transaction.

   (1) Initially, Virgin had suggested that amendments be made not out of a desire to reshape the form of Virgin's licensing arrangement with Virgin America but rather to "*get everything into one agreement*" based on "*[its] expectation…that the licence should effectively continue on the same terms as today, so I have limited the exercise to consolidation*"**.**

   (2) Substantive amendments only came to be suggested by Virgin America as a result of concern from the investment bankers who were "*concerned that investors would be worried that the agreement might terminate, and so they suggested that…we extend the term*". These concerns prompted the request from Mr Varley that a longer term be included, along with the elimination of the revenue threshold for term extension. Those changes came at a price: namely, the introduction of a Minimum Royalty as well as an increase in the royalty rate until a revenue threshold was reached.

   (3) The objective aim of the transaction is therefore clear: to give certainty to Virgin America as to a term extension for its use of the Names and Marks, where such extension was previously dependent on a revenue target that was unlikely to be met and to give a higher and consistent return to Virgin (a higher share of revenue and a minimum royalty in the event that its Names and Marks were used).

   (4) To that end, the parties were not interfering at all with the *status quo* in relation to the position where the Names and Marks were not used. Although (as explored with Mr Varley in XX) Virgin did attempt to introduce a change to the existing

position (a "*must exclusively use*" provision), Mr Varley told Virgin that this would be a "*fundamental change to the existing license agreement*" and altering language that had been structured to address DOT concerns; the parties then agreed to stick with the 3.6/3.7 regime where Clause 3.6 remained expressly "*subject to Clause 3.7.*".

137. Thus, viewed objectively, the changes that were made to the 2007 TMLA were not directed at altering the *status quo* in relation to the situation of non-use. Rather, they were directed at ensuring, in the context of an IPO where investors wished to ensure that the business had the opportunity to use the Names and Marks as long as it desired to do so, that if the Names and Marks were used by Virgin America (given the term extension), a particular return would be achieved by Virgin. This is entirely consistent with the presentations that came to be made to the DOT in July and September 2014, and was ultimately reflected in the DOT's October 2014 Letter.

138. In the light of the expert evidence of Mr Podberesky, it was submitted that there is no dispute but that:

    (1) Carriers must be US citizens, and therefore must not be under the actual control of foreign citizens. Whether a carrier is under the actual control of a foreign citizen is determined by applying the 'totality of circumstances' test.

    (2) Carriers have an obligation to notify the DOT of any changes which substantially alter the factors on which the DOT's latest fitness finding was based.

139. Alaska submitted that amending the 2007 TMLA so as to require the payment of a multi-million dollar royalty until 2039 even if no use was made of the Names or Marks, would, at the very least, have been something (i) that Virgin America should have notified to the DOT and (ii) would have been a cause of concern to the DOT. That is because of the provisions of paragraph 3.a.i of Appendix A to the final order (Order 2007-5-11). Even after a TMLA in accordance with paragraph 3.a.i of Appendix A to the final order (Order 2007-5-11) was submitted to the DOT, paragraph 3.a.i continued to have ongoing significance. In this regard, Mr Podberesky accepted that a carrier could not comply with a condition like that in paragraph 3.a.i of Appendix A to the final order (Order 2007-5-11) by submitting a suitable TMLA to the DOT; obtain the DOT's approval and an effective CPCN; and then immediately alter the TMLA such that it no longer complied with paragraph 3.a.i. Rather, in that situation, the carrier would have to notify the DOT of a substantial change.

140. In this case, it was submitted that the condition that the TMLA must allow Virgin America to operate without paying royalties if it did not use the Names or Marks was a very important condition to the DOT, as was apparent from the evidence of Mr Quinn; the terms of the DOT's March SCO, with its reference to conditioning the certificate on the amendment to allow certain activities to occur without royalty obligation; paragraph 3.a.i of Appendix A of the DOT's Final Order; and the DOT's October 2014 Letter, which stated that "*…the amended TMLA will continue to permit Virgin America the ability to operate independent of the "Virgin" names and marks without the obligation to pay royalties.*"

141. Alaska also submitted that Mr Podberesky had accepted in cross-examination that one of the factors which would be considered as part of the 'totality of circumstances' test is a

carrier's obligation to pay funds to non-US citizens. Payment of millions of dollars to non-US citizens in respect of IP rights which a US carrier was not even using, and had no intention to ever use again, would be a transfer of funds which could concern the DOT.

142. Accordingly, it was said, if the parties to the 2007 TMLA really had objectively intended to amend the 2007 TMLA so as to require Virgin America to pay substantial royalties even if no use was made of the Names or Marks, Virgin America should have informed the DOT. Such a change would be a major change to an important condition on which the effectiveness of its CPCN originally depended, and as such amounted to a 'substantial change' which Virgin America was obliged to notify the DOT of. That was something which the parties knew, or could reasonably have been aware of, since it follows from undisputed principles of US aviation law and the DOT's orders and October 2014 Letter, which both parties had. If Virgin America had an obligation to notify the DOT of an amendment to the 2007 TMLA that would result in it paying royalties even if it made no use of the Names or Marks (because that would be a 'substantial change'), then inevitably a failure to do so by Virgin America would be a breach of its obligation under 14 CFR 204.5 and paragraph 8 of the Terms, Conditions and Limitations attached to the effective CPCN made under cover of Order 2007-8-17. A breach of Virgin America's obligations would obviously prejudice its relationship with the DOT. Moreover, if the breach was viewed as egregious, it could precipitate enforcement action by the DOT, as Mr Podberesky agreed in cross-examination. And, if a breach meant that the DOT required further filings from Virgin America, and time to review what, if any, steps to take against Virgin America, that news could delay or affect the IPO.

143. Alaska submitted that there was no evidence whatsoever that the parties were content to run the risk that the DOT might take action against Virgin America, and it is unlikely, given the impending IPO and the centrality of the CPCN to Virgin America's operations, that they would have done so. They further maintained, as I have already noted, that there was no evidence of any discussion of whether the DOT needed to be informed expressly of a change to the 2007 TMLA that would require the payment of a multi-million dollar royalty until 2039 even if the Names or Marks were not used; what the ongoing significance of paragraph 3.a.i of Appendix A to the final order (Order 2007-5-11) was, and what it might effectively oblige Virgin America to do; and whether the parties were willing to run the risk either:

(1) Of not telling the DOT that the 2007 TMLA was being amended so as to require the payment of royalties even if the Names or Marks were not used; or

(2) Of Virgin America either prior to or after the IPO, facing action from the DOT as a result of either (i) failing to notify the DOT of the change to the 2007 TMLA or (ii) the change itself.

144. Finally, there was no evidence of any discussion of whether the changed circumstances between 2007 and 2014 meant that the DOT would not bring an enforcement action as a result of a change to the 2007 TMLA which resulted in royalties being payable even if the Names or Marks were not used.

145. In conclusion, Alaska's construction, it was said, is the only one consistent with the factual background. It is highly unlikely, given the importance of the IPO, the CPCN and Virgin America complying with its US law obligations and maintaining good relations

with the DOT, that the parties would have agreed a substantial change to the 2007 TMLA without (i) expressly notifying the DOT (formally or informally) and (ii) discussing the issue amongst themselves.

146. Next, Alaska relied on considerations of *business commonsense*. They argued that Virgin's construction produces the unreasonable result that Virgin America breached its obligations to the DOT by failing to notify the DOT of a "substantial change" to the 2007 TMLA and its fitness condition. The Court should avoid a construction which produces that unreasonable result.

147. They also relied on the increased likelihood of a de-branding exercise following the conclusion of the Current TMLA. In the face of an increased likelihood that at some point in the future Virgin America would cease to use the Names or Marks entirely it was said that it makes no sense for Virgin America to have agreed to pay millions of dollars a year to Virgin whether or not it used the Names or Marks. Such an arrangement (as opposed to one which allows Virgin to terminate the Current TMLA if insufficient use of the Names or Marks is made) makes no commercial sense, in particular given Virgin's own case that it could not readily relicense the Names or Marks for the Licensed Activities (such that they had limited market value).

148. In this regard, Alaska contended that there was a fundamental tension in Virgin's case on business common-sense:

(1) On the one hand Virgin says it could not readily relicense the Names or Marks. But on the other Virgin simultaneously seeks to say that Virgin America would have paid the Minimum Royalty in order to prevent others in the market using the Names or Marks (an argument premised on Virgin's ability to relicense readily the Names or Marks).

(2) Whichever way that tension is resolved, Alaska's construction of the Current TMLA is the correct one:

(a) The suggestion that Virgin could readily relicense the Names or Marks is consistent with, for example, Ms Daniel's evidence that the Virgin brand is seen within the business as a strong and valuable brand.

(b) The suggestion that they could not highlights the fact that there is no reason why Alaska would pay nearly US$8 million per year for the Names or Marks even if it did not use them (which Virgin contends is the true effect of the Current TMLA).

149. Finally, Alaska contended that Virgin's assertion that other Virgin entities at one time invested significant sums in the creation and establishment of Virgin America was of no significance, all the more so given Ms Daniels has confirmed that the Virgin Group has made a 1.5 to 2 times return on its investment in Virgin America.

Issue 1: Discussion and conclusions.

150. I turn to my conclusions on this issue.

151. In my judgment, it is important to approach this matter chronologically, in view of the way in which the points have been argued.

152. I start with the position as at the submission to the DOT in 2007. I accept, in the light of the evidence of Mr Podberesky and Mr Lehman, that the question for the DOT was whether Virgin America was a US citizen. I also accept that, in this regard, the corporate and financial arrangements relating to Virgin America were relevant, and, in particular, I accept Alaska's contention that the DOT were concerned in relation to the question of whether Virgin America was obliged to pay royalties to Virgin for earnings made from non-branded activities. This is clear from the correspondence with the DOT referred to above, and also from the evidence of Mr Quinn, which I accept.

153. The question would therefore arise, in the context of construing the 2007 TMLA, of how to construe Clauses 3.6 and 3.7. As to this, I would conclude as follows:

(1) In my view, it is necessary to read these clauses together and to seek to give content to both, if that is possible.

(2) It is also necessary to take a step back and to ask, in the context of the agreement viewed as a whole, what the likely purpose of these Clauses was. The overall purpose of the agreement was to enable Virgin America to use the Virgin brand. Whilst it is true that they were to be free to fly without using the Virgin brand and without paying royalties on such flights, it is clear that this was a subsidiary matter. What was important was that Virgin America should be free to use the Names and Marks. That is what they were bargaining to be free to use.

(3) It is also clear that where they did not in fact use the Virgin brand, they would not pay royalties. This is because of the mechanics of the calculation of amounts payable; but the point goes no further than this.

154. However, perhaps the most important question is whether the construction of the 2007 TMLA is of any real relevance in the context of the issue before me, which has to do with the proper construction of a different agreement in different terms, namely the Current TMLA. In my judgment, the earlier agreement is admissible, but of little real relevance, in this regard. It is admissible because it forms part of the factual background reasonably available to both parties. It is of little relevance because the Current TMLA contains a new set of provisions, which have to be construed as a whole, and which differ in material respects from the earlier contract. It is also of little relevance because matters had moved on between 2007 and 2014 as a matter of fact.

155. I turn to the construction of the Current TMLA. I have already noted that there is very little between the parties as to the relevant principles of contractual construction, and I apply the well known principles set out in Wood v Capita and Arnold v Britton, set out above.

156. As to the question of surplusage, I have dealt with the interrelationship of Clauses 3.7 and 3.6 above in the context of the 2007 TMLA. In my view, those Clauses fall, in my judgment, to be construed together with the totality of the remainder of the Current TMLA, against the background facts reasonably available to both parties as at the date of conclusion of the Current TMLA.

157. Dealing first with those background facts, then I accept much of what Alaska has said about what the parties both knew. Thus, in particular:

    (1) The parties did know that the process of getting approval from the DOT in 2007 was a protracted and difficult one.

    (2) The parties also knew that the DOT in 2007 had been concerned to ensure both that Virgin America had the ability to carry out flights which would be independent of the association with Virgin, and that such flights would be free of any royalty payments to Virgin.

    (3) I accept that Clauses 3.6 and 3.7 had been inserted into the 2007 TMLA to meet these concerns.

158. However, I also accept several of the relevant factual background matters relied on by Virgin.

    (1) It is clear that, by virtue of the IPO and the reduction in Virgin's rights of control associated with the renegotiations in 2014, Virgin were giving up valuable rights which were material to the issue of whether Virgin America were to be regarded as a US citizen.

    (2) It is also clear that, by virtue of the changes in the control structure, the risk of a de-brand was increased.

    (3) It is, in my view, clear that the prolongation of the term of the agreement was thought to be in Virgin America's interest, and it is further the case that Virgin America's bankers wished for this.

159. Turning to the facts relating to the presentation to the DOT at the time of the 2014 TMLA, then it is indeed clear that this renegotiation involved a substantial change which required DOT approval. I do not think that either expert challenged this proposition. However, in any event, on the factual evidence before me, I find that the DOT was closely involved in 2014.

160. The documentary factual material relating to what was presented to the DOT has been summarised above. On the basis of that material, as well as the evidence of the witnesses from whom I heard oral evidence, I find as follows:

    (1) The DOT were fully apprised of the terms of the Current TMLA, having been provided with red-lined versions of that document by the parties.

    (2) As regards the evidence of Mr Varley that it was made clear at the meetings that Virgin America had with the DOT that no royalties would be payable if there was no use of the Virgin brand, I do not accept that evidence. Whilst I do not find that Mr Varley was deliberately trying to mislead me, then I take the view that he was led to give evidence which went beyond his true recollection. Certainly there is nothing in the contemporaneous documents to support his evidence, which was (taken overall) not very clear in any event; and his witness statement did not reflect his oral evidence in this regard.

(3) The DOT came back, after their consideration of the TMLA and the meetings with Virgin America, with their letter of 20 October 2014. Each party relied on different parts of that letter. In my judgment, whilst it made reference to the right to fly free of the payment of Royalties, it was also clear that the DOT understood that the TMLA provided for the payment of a Minimum Royalty. I do not think that there is anything in this correspondence which really assists me in relation to the proper construction of the Current TMLA, which I must simply construe by reference to the words used by the parties.

161. Against this background, I turn to the actual provisions of the Current TMLA. I have concluded that Virgin's arguments as to the proper construction of the agreement are to be preferred. I reach this view for the following reasons.

(1) In my judgment, the start point must be the words of the Current TMLA, and in particular Clause 8. I have set out the relevant clauses above. I have concluded that these words are clear. The Minimum Royalty is a defined term, and is a set sum payable for every year of the contractual term, regardless of the level of usage of the Virgin brand. That is clear from the definition of the term, and from the clauses setting out how that sum is to be calculated. Just as that minimum sum falls to be paid if some royalties (not a defined term) are earned in a year but fall short of the Minimum Royalty, so, if no royalties are earned, it remains the case that the minimum sum has to be paid.

(2) I do not think that the fact that the minimum sum is expressed as a "Minimum Royalty" means that it must be derived from royalties in fact earned. Alaska itself contended that for Virgin to be correct, the Minimum Royalty would have to be a flat fee rather than a royalty. In my judgment, that is exactly what the Minimum Royalty is. It is a flat fee payable for the <u>right</u> to use the Virgin brand, whether or not that right is taken up. Again, in that regard, I accept Virgin's submissions.

(3) In my judgment, this conclusion is supported by what I regard as the most important aspect of the factual matrix, namely the degree of uncertainty introduced by the other changes to the 2007 TMLA in 2014 and the risks undertaken by Virgin as a result of these changes. It is clear that, viewed from the perspective of Virgin America, the extension to the right to use the Virgin brand was a valuable one. It is also clear that Virgin was losing a substantial number of rights of control and that there was, as a result, an enhanced risk of a de-brand. In these circumstances, I think that it is a reasonable commercial conclusion to reach that Virgin would wish to assure themselves of a guaranteed minimum income going forward.

(4) Conversely, I do not regard the factual background matters put forward by Alaska as of any great force, and indeed it is not clear what principle of construction is being relied on in this regard.

(a) The nub of the argument advanced appears to be that, in view of the difficulties that had been experienced in relation to the payment of royalties in 2007, the parties would not have agreed any provision for ongoing royalties where the Virgin brand was not used in 2014, and hence that, even if the agreement might have been construed in such a way, it should not be so construed, since this would mean that Virgin America and Virgin were to be treated as having agreed a provision that they knew might imperil the DOT

approving the arrangement. As I understood the argument, it was that Virgin's construction was thereby rendered commercially unreasonable.

(b) I have already set out my factual findings as to what the DOT was in fact told in 2014. The factual position in 2014 was of course different from that which appertained in 2007. I have concluded that the full terms of the proposed TMLA were put before the DOT in 2014. In my judgment, the question of construction that remains for me is what, against the background of those facts, the proper construction of the Current TMLA is. That is a matter of the consideration of the words used by the parties.

(5) Overall, I have concluded that, quite clearly, on the wording of the Current TMLA, the parties did in fact agree that Virgin America should pay a continuing minimum fee for the right to re-use the Virgin brand (whether or not they chose to do so).

162. I should perhaps add a few other points.

(1) First, I agree with Virgin that the question must be approached from the perspective of Virgin and Virgin America as at the date of the agreement, and not from the perspective of Alaska.

(2) Secondly, viewed against this background, it was clearly the case that Virgin America wished to continue to have the right to use the Virgin brand, and was prepared to pay for this.

(3) Thirdly, it was in Virgin America's interests (and in those of its bankers) to have a long term relationship with Virgin.

(4) Fourthly, it was also relevant to note that Virgin would wish to have some form of comfort to ensure that it was remunerated for giving this approval.

(5) Fifthly, I accept that Virgin's ability to re-use the Virgin brand in the US was limited, whereas Virgin America's right was established.

(6) Sixthly, I do not accept that there was any question of Virgin America acting in breach of its statutory obligations. As I have said, the approval of the DOT was necessary. The full terms of the Current TMLA were put before the DOT, who approved that document. Their letter does, it is true, make reference to the right not to use the Virgin brand; but it also makes reference to the fact that a Minimum Royalty is to be paid.

163. In the light of my conclusion on this first issue, it is, strictly speaking, unnecessary for me to consider the second and third issues. However, in case this matter goes further and because the points have been fully argued, at least in writing, I do so.

Issues 2 and 3: Part years

The parties' respective contentions.

Virgin's case.

164. Virgin's case is that, even if it is wrong about the Minimum Royalty being payable even where use of the Virgin brand ceases entirely, it is clear nonetheless that if some use is made of the Virgin brand during any given year, the Minimum Royalty will be due <u>in full</u> during that year.

165. This, it was argued, followed from the mechanics of Clause 8, which made it clear that the Minimum Royalty Obligation required an annual Top Up where the quarterly payments are below the Minimum Royalty amount. Even if, contrary to Virgin's case, Clause 3.7 dictates that where there is <u>no</u> use of the Virgin brand, no royalty will be payable, in years where there has been some use of the Virgin brand this cannot apply: the Minimum Royalty is an annual minimum amount which is payable, on Alaska's case, where there is <u>some</u> use of the Virgin brand. Where it has been used in the year, it is due, because there has been use of the Virgin brand. There is simply no language in the contract which would lead to any other conclusion.

166. As regards Alaska's counter arguments, Virgin divided these into three.

(1) First, Alaska pointed to the definition of Minimum Royalty which refers to a pro rata amount in respect of part years. However, Virgin contended that this was plainly intended to deal with part years at the beginning and end of the term. Whilst, Virgin said, Alaska argued that "*[t]here is no meaningful difference between the Current TMLA ending in the middle of a financial year (where pro-rating is expressly provided for), and Alaska ceasing any use of the Names or Marks in the middle of a financial year*", this was incorrect. In point of fact, there were multiple meaningful differences between part years at the beginning and end of the term (which were a necessary consequence of the Current TMLA being executed, and the IPO taking place, in November) and part years of usage. During part years of the term, Alaska would not be the beneficiary of the grant of the <u>right</u> during the whole year. Therefore it was entirely sensible for the fees to be pro-rated. That is not true of part years of usage. Whether to use the Virgin brand on any given day was a matter entirely in Virgin America's gift, subject to the obligations under Clause 3.6. Further, pro rating for part years of the Term of the Current TMLA was expressly provided for, whereas no such provision was made for part years of non-usage.

(2) Second, Virgin sought to deal with Alaska's reliance on the Apportionment Act 1870. They argued that it did not assist Alaska to say that the Minimum Royalty is apportioned if it was still due for the remainder of the year where there has been use during the year. In this regard, it was submitted that the Apportionment Act 1870 was brought in to deal with the problem of part-earned consideration. It allows a claimant in certain circumstances to claim part of the consideration where part of the performance due under the contract has been rendered. In this case, apportioning the payment leaves open the question of whether it is due during the part-year for which no use has been made. It is notable, Virgin argued, that Alaska has never gone so far as to say that no consideration is given for the Minimum Royalty in a non-usage year; Alaska's argument are all of the nature that the price is too high. In fact, Virgin argued, the Apportionment Act 1870 is not applicable. The Minimum Royalty Obligation is not a periodical payment in the nature of income, such as a salary. The Minimum Royalty is simply a minimum figure. The amount due may be more than the Minimum Royalty, if the four quarterly payments due under Clause 8 amount to more than the Minimum Royalty. Further,

the amount of the Top Up necessary to meet the obligation to pay at least the Minimum Royalty will vary depending on how much revenue is generated during any given year. This will not be known till the end of the year. This indicates that it is not possible to pro-rate the Minimum Royalty on a daily basis, because the amount due as a Top Up (if any at all) depends on events taking place during the year. Finally, the express provisions of Clause 8, requiring a Top Up at the end of the year, are inconsistent with the application of the Apportionment Act 1870 in the manner which Alaska suggested.

(3) Finally, the argument was put forward that requiring the full Minimum Royalty irrespective of the number of days of use was commercially unreasonable. However, this was not the case, because, as noted above, Virgin's argument was that the right to use the Virgin brand was valuable consideration.

Alaska's case.

167. Issue 2, Alaska argued, only arose if Alaska had succeeded on Issue 1. Therefore, at this stage of the analysis the Court will have accepted that Clause 3.7 applies in priority to all other clauses in the Current TMLA (including the Minimum Royalty provisions in Clause 8) and that it confers a right on Alaska to perform the Licensed Activities without paying royalties if it makes no use of the Names or Marks.

168. If that is the starting point when considering Issue 2, Alaska argued that it was unclear what (if any) answer Virgin has to Issue 2. Virgin's analysis as to why the Minimum Royalty should not be pro-rated does not take as its starting point the axiom that Alaska does not have to pay royalties (including the Minimum Royalty) if it makes no use of the Names or Marks. It therefore addresses Issue 2 on a false premise, and is irrelevant.

169. In contrast, Alaska's case not only proceeds from the correct starting point that if Alaska makes no use of the Names or Marks it pays no royalties but is consistent with both the wider contractual context and business common-sense. Indeed it would be bizarre, given the purpose of Clause 3.7, and the regulatory pressure which led to its creation, if the parties were, by the back door and without having discussed it with the DOT (or even having expressly appraised the DOT of it), creating via Clause 3.6 a minimum use obligation which would have the effect of always requiring (i) the Names or Marks to be used and (ii) the Minimum Royalty to be paid.

Discussion and conclusions.

170. I have concluded that Virgin's arguments are to be preferred. I reach this conclusion for the following reasons:

(1) I accept that this issue does not arise if Virgin is correct on Issue 1. Since, as I have indicated already, it is my view that it is, then this issue becomes an irrelevance.

(2) However, I do not accept that this issue is irrelevant if Virgin is wrong on Issue 1. That is because this issue looks to the question of whether, if Alaska has made some use of the Names or Marks (whether or not it had to) Virgin is entitled to the Minimum Royalty. In my judgment, where some use has been made of the Names or Marks, then, on the true construction of the contract, the Minimum Royalty is payable.

(3) I reach this conclusion, essentially, for the reasons set out by Virgin, which I have outlined above. Both the manner in which the Minimum Royalty is calculated, and the definition of that sum, indicate that where some use is made of the Names or Marks, then the Minimum Royalty is payable; and I accept that the Apportionment Act 1870 is irrelevant (for the reasons argued) and that the provisions for partial use in the contract relate to the years in which partial use is of necessity, given the timing of the contract.

Issue 3:

The parties' contentions.

Virgin's case.

171. Virgin's case under this head complemented its case in relation to Issue 1. It argued that even if there was no debt due in the amount of the Minimum Royalty, as was its case under Issue 1, then, nevertheless, Alaska, under Clause 3.6, was bound to make some use of the Virgin brand. In this regard, it repeated its submissions as to the proper interrelationship between Clauses 3.6 and 3.7, namely that Clause 3.7 did not entirely negate the obligation in Clause 3.6. The analysis was then that Alaska was liable in damages, with the measure of damages being such sum as would be necessary to place Virgin in the same position as it would have been in absent breach. Had some use of the Virgin brand been made, then that in turn would have meant that the Minimum Royalty would have been payable. Accordingly, Virgin argued, the same result was reached via the analysis under Issue 3 as that reached under Issue 1.

Alaska's case.

172. As with Issue 2, Alaska contended that Issue 3 only arose if Alaska succeeded on Issue 1. Therefore, at this stage of the analysis, it was argued that I must either have accepted Alaska's interpretation of the obligation imposed by Clause 3.6, or accepted that it is to an extent surplusage and does not trump the right afforded to Alaska to perform the Licensed Activities without using the Names or Marks, or paying royalties. Both of those are fatal to Virgin's case on Issue 3, which depends on establishing that Clause 3.6 imposes an obligation on Alaska to use the Names or Marks.

173. Alaska therefore contended that the reality was that because Virgin relies on Clause 3.6 in support of its case on Issue 1 and the true meaning of Clause 3.7, if Virgin lost on Issue 1 its defeat on Issue 3 was assured.

My conclusions.

174. I agree that this issue does not really matter in the light of my conclusions on Issue 1. However, I would conclude in any event that Alaska (or more accurately Virgin America) were obliged to use the Names or Marks under Clause 3.6, at least to some extent. It logically follows that in ceasing to do so, they acted in breach of contract. I accept, too, that the measure of loss for such breach is the amount of the Minimum Royalty, payable as damages rather than as a debt.

175. Accordingly, I find in favour of Virgin on this aspect as well.