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RESTRICTIVE COVENANTS POST EMPLOYMENT

Restrictive covenants in a shareholders' agreement applied to "employee shareholders". When an individual ceased to be an employee but remained a shareholder, did the non-compete covenants still bite? This question was recently addressed by the Court of Appeal.

Bound or not? The thorny question of restrictive covenants post termination, and whether they are enforceable, frequently comes before the courts.

Guest Services Worldwide Limited ("GS") produced promotional maps for hotels. Mr Shelmerdine ("S") was the founder of GS's business, and remained working for it following its sale and purchase out of administration. Initially S was retained as an employee, and then entered into a consultancy agreement. Once that expired, he continued to carry out services but those services were terminated in early 2019.

S was also a shareholder in GS and fell within the shareholders' agreement definition of "employee shareholder". Clause 5.1 of the shareholders' agreement contained non-competition and non-solicitation covenants restricting employee shareholders from competing with the business while they were shareholders and for 12 months after they ceased to be shareholders.

After the ad hoc consultancy arrangement terminated, GS alleged that S had used one of its maps to solicit business, and sought an injunction to restrain him from breaching the post termination restrictive covenants.

In the High Court, the judge dismissed the claim, holding that the restrictions in clause 5.1 applied only to employee shareholders. They therefore ceased to apply to S once the consultancy arrangement terminated, as he ceased to be an "employee, director or agent of the business". Alternatively, the judge held that if the restrictions in 5.1 continued while S was a shareholder, they would endure longer than necessary to protect GS's legitimate business interest and were therefore unenforceable as a matter of public policy.

GS appealed on two grounds: (1) there was no reason why the clause 5.1 restraints should cease immediately on S ceasing to be an employee (the **construction issue**); and (2) if the clause 5.1 restraints continued while S was a shareholder this was no longer than was reasonably necessary to protect its legitimate business interests (the **duration issue**).

What did the Court of Appeal decide?

- **Construction issue:** Construing clause 5 in the context of the agreement as a whole, taking the objective meaning of the language used and its factual and commercial context, the restrictions were designed to protect GS, its goodwill and the value of its shares. Clause 5.1 could not have the meaning attributed to it by the judge. Although it applied to employee shareholders, it would make no sense if the restrictions were to fall away with immediate effect on the termination of a shareholder's employment, agency or directorship. Read as a whole, clause 5.1 should be properly interpreted as meaning that an employee shareholder would be subject to the restrictions until he or she ceased to be a shareholder. The provisions had to be construed in the light of the company's articles of association which required GS to purchase an employee's shares if he or she ceased to be an employee. A different construction would make no commercial sense. In all likelihood, because of the interplay between ceasing employment and the compulsory purchase of the ex-employee's shares, there would be a limited lapse of time between ceasing to be an employee and ceasing to be a shareholder.
- **Duration issue:** The duration of the covenants for 12 months should be assessed in the light of the status of the agreement: it was a shareholders' agreement and did not fall within the categories of buyer/seller or employer/employee agreement. As a shareholders' agreement made between experienced commercial parties, the restrictions agreed were likely to be enforceable. GS had a legitimate interest in seeking to prevent employee shareholders from seeking to compete with the business and soliciting clients, and a 12 month period of restraint was entirely reasonable to protect that interest.
- **Comment:** The real significance of this case lies not in judicial analysis of the drafting but in the Court of Appeal's comments on the enforceability of restrictive covenants in shareholders' agreements. The Court recognised the principle that in an agreement between shareholders in a business where all parties are generally commercially experienced and legally advised, there will be a strong presumption of the enforceability of restraints post termination.

> ""the court is less vigilant where covenants of this kind are contained in a Shareholders' Agreement or an agreement akin to it, rather than in an employment contract.""
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> Guest Services Worldwide Limited v Shelmerdine [2020] EWCA Civ 85, para 41

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