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**BRIEFING NOTE  
RESTRICTIVE COVENANTS:  
SHARE PURCHASE AGREEMENTS AND  
TERMINATION OF EMPLOYMENT**

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JOELSON WILSON LLP  
Solicitors  
30 Portland Place  
London W1B 1LZ

**T:** (+44) (0)20 7580 5721  
**F:** (+44) (0)20 7580 2251  
**E:** [info@joelsonwilson.com](mailto:info@joelsonwilson.com)  
**W:** [www.joelsonwilson.com](http://www.joelsonwilson.com)  
**DX:** 9001 West End

## **Restrictive covenants in share purchase agreements and termination of employment.**

**What happens to restrictive covenants in an SPA when an employee sells shares under an SPA but his employment contract terminates afterwards by compromise agreement?**

### **Share options**

Mr Mitchell was an employee of Rent a Crate Ltd. He had share options in Rent a Crate granted to him in 2004 and again in April 2007.

The options crystallized on the sale of shares in Rent a Crate to Personnel Hygiene Services Ltd in July 2007. Mr Mitchell was therefore party to the share purchase agreement (SPA) in July 2007.

Six weeks later, Mr Mitchell's employment terminated. He signed a compromise agreement in late August 2007 with Rent a Crate and Personnel Hygiene Services, which was by now the holding company.

### **Restrictive covenants**

Mr Mitchell's service contract with Rent a Crate had post termination restrictive covenants of 6 months preventing Mr Mitchell from working in the UK for a competitor for 6 months. The compromise agreement terminated the service contract. The compromise agreement set out some new covenants, which were a bit wider than the covenants in the service agreement, but were not as wide as the covenants under the SPA. The covenants under the SPA were for a period of 3 years.

After 6 months, Mr Mitchell wanted to work for a competitor. Personnel Hygiene Services decided to get an injunction to stop him. Mr Mitchell argued that the compromise agreement concluded all of the restrictive covenants in the service contract and those in the SPA. He tried to argue this because the compromise agreement had a clause, called an 'entire agreement' clause which, Mr Mitchell argued, included not only the service contract but also all the restrictive covenants in the SPA.

The High Court agreed with him, so Personnel Hygiene Services appealed to the Court. of Appeal.

The Court of Appeal decided that the High Court judge was wrong. Even though the compromise agreement had an 'entire agreement;' clause, the compromise agreement was clearly intended to terminate only the employment relationship. Furthermore, the new covenants in the compromise agreement were intended to replace the restrictive covenants in the service contract, not those in the SPA. The issue of whether the restrictive covenants in the SPA had been terminated by the compromise agreement was now decided: they had not been terminated.

Restrictive covenants cannot be wider than the interests they seek to protect, but generally, shareholder covenants on sale of a business can be much wider in scope

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than those on termination of employment. The Court of Appeal therefore sent the case back to the High Court, for that court to decide whether or not the SPA covenants were reasonable and therefore enforceable.

## **Conclusion**

The Court of Appeal treated the two sets of restrictive covenants differently. Covenants that relate to the sale of goodwill in a business (through, for example a share purchase agreement) are not viewed in the same way as restrictive covenants on termination of an employment relationship and it is possible to have both sets of covenants running concurrently.

If the parties want to terminate restrictive covenants in an SPA or indeed, any other parts of an SPA, the compromise agreement needs to set that out expressly. If the compromise agreement does not, then provisions of an SPA, such as restrictive covenants, will continue.

This is good news for companies as the Court of Appeal has now clarified that SPA covenants can outlast termination of employment even where a compromise agreement has been entered into. The wording of the compromise agreement is very important, however and the parties (and therefore the compromise agreement) should be clear and precise as to those obligations which are terminating and those which are continuing.

*Personnel Hygiene Services Limited v Mitchell [2009] EWCA Civ 1047*

## **Need to know more?**

**Ask us. For information/advice on employment issues, please contact:**

**Jennifer Maxwell-Harris**  
**Joelson Wilson LLP**  
**30 Portland Place, London W1B 1LZ**  
**Telephone: + 44 (0) 20 7580 5721**  
**Fax: + 44 (0) 20 7580 2251**  
**E-mail: [jmh@joelsonwilson.com](mailto:jmh@joelsonwilson.com)**  
**Web: [www.joelsonwilson.com](http://www.joelsonwilson.com)**

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