Court of Appeal confirms that cases on breach of directors' duties will be highly fact-sensitive

In the recent case of *Cheshire Estate & Legal Limited (CEL) v Blanchfield & Ors* the Court of Appeal considered the issue of whether two directors were in breach of their statutory and fiduciary duties in preparing to set up a new competitor firm prior to resigning.

What happened in this case?

Mr Blanchfield and Mr Montaldo (the **Directors**) were Directors of CEL, a corporate firm of solicitors. Prior to resigning from their positions, the Directors had taken preparatory steps to set up a new law firm in competition with CEL, including:

- registering a trading name;
- incorporating a corporate vehicle for the new company;
- seeking professional indemnity insurance for the new company;
- applying to the Solicitors Regulation Authority (the **SRA**) to register the company;

- setting up a website;
- opening a bank account; and
- entering discussions with litigation funders, including one with whom the Directors had previously negotiated with on behalf of CEL (albeit those negotiations had failed with CEL entering into an exclusive deal with another funder).

Upon discovering this, CEL applied for an interim injunction. This was granted pending an expedited trial of the issues. At that trial, the judge found that the Directors' preparatory steps had not "crossed the line" or put them in a position of conflict so as to breach their fiduciary duties, and that there was no conspiracy between them or intention to injure the firm. CEL appealed to the Court of Appeal.

What was decided?

The appeal judge considered the case law in this area, which suggested that a director should resign as soon as his intention to compete becomes irrevocable. The judge concluded that this was too prescriptive. Instead, the court needed to consider whether preparatory steps, short of active competition, are consistent with a director's fiduciary duty to the company. This would be highly fact-sensitive in every case.

The judge described a spectrum with at the one end, discussing an intention to compete with friends and family (clearly consistent with a fiduciary duty) and at the other, actively soliciting clients from the company and diverting them to the director's new competing business (clearly inconsistent with a fiduciary duty). The court's role is to map the facts of the particular case onto this spectrum and make a decision accordingly as to whether the director is in breach.

In this case the appeal judge agreed with the trial judge that the Directors' actions had not crossed the line into breach of fiduciary duty. This was because:

- trading of the new company was not expected to start until six months after the Directors resigned;
- the venture was only capable of proceeding after getting clearance from the SRA;
- the Directors resigned four days *after* getting that clearance; and
- in the meantime, they served CEL faithfully and carried out all their duties.

CEL also failed to establish that the Directors' negotiations with the litigation funder were a conflict, as by that point CEL had entered into an exclusive relationship with a different funder and, in any event, the first litigation funder could have worked with both CEL and the Directors' new company.

What does this mean for employers?

This case does not fundamentally change the law on directors' duties but is potentially unwelcome for employers as it illustrates how surprisingly far directors can go in taking preparatory steps to compete before they are deemed to be in breach of their fiduciary duties.

Given how fact-sensitive these cases are, companies will need to produce comprehensive evidence to persuade a court that there has been a breach and that the company has, or will, suffer loss.

Companies should also consider whether the restrictive covenants in directors' service agreements provide adequate protection against this kind of scenario and ensure these are regularly reviewed so they are relevant to the individuals' positions in the company.

Cheshire Estate & Legal Limited (CEL) v Blanchfield & Ors

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Unusual and onerous non-compete restriction is potentially enforceable – but the employer's delay ruled out an interim injunction

The High Court has held that an unusual non-compete covenant lasting for a period of up to 12 months at the employer's discretion may, in principle, be enforceable, even where the employee had already spent 12 months on garden leave. However, the Judge declined to award an interim injunction due to the employer's excessive and unreasonable delay.

What happened in this case?

Mr Couture began working for Jump Trading International Ltd (**Jump**), a leading trading and investment firm, in June 2016. He worked as a quantitative researcher in Jump's London-based trading team. His employment contract contained a non-compete restriction preventing him from engaging in "competitive activity" during the "non-compete period". Unusually, the contract gave Jump discretion to set a non-compete period of up to 12 months within 20 days of notice of termination being given. Further, the contract bucked the trend of setting off time spent on garden leave against the non-compete period. Instead, the non-compete period would start *after* the end of the garden leave period.

On 23 March 2022, Mr Couture accepted a job offer from Verition Advisers UK Partners LLP (**Verition**). On 30 March 2022, Mr Couture resigned on notice, however, he did not tell Jump that he was intending to work for Verition. Jump told Mr Couture that he would be placed on garden leave for the duration of his 12-month notice period.

On 31 March 2022, Verition received advice from its lawyers than the non-compete restriction in Mr Couture's contract was not enforceable. On the same day, Jump told Mr Couture that after his garden leave had ended he would be subject to a 12-month non-compete period, expiring on 30 March 2024. Mr Couture said this was not acceptable.

On 12 July 20222, Mr Couture told Jump that he intended to work for Verition after his garden leave had ended. Jump's position was that this would be competitive activity and breach the non-compete restriction. Attempts were made at resolving the dispute, but, ultimately, these fell flat.

On 17 November 2022, Mr Couture wrote to Jump stating that he would join Verition in April 2023, but that for the first 12 months he would be writing software rather than trading, which he did not believe amounted to competitive activity. Mr Couture also said that, in any event, he did not believe the non-compete restriction was enforceable. Jump eventually replied on 6 March 2023, reiterating its position that Mr Couture would be in breach of the restriction if he went to work for Verition.

On 14 April 2023, Jump sued Mr Couture for breach of the non-compete restriction and Verition for inducing Mr Couture to breach the non-compete restriction. Jump sought an interim injunction to prevent Mr Couture working for Verition pending the outcome of the full trial.

This briefing covers the decision of the High Court in relation to the interim injunction application only. The full trial is due to take place in either late June or early July 2023.

What was decided?

When deciding whether to grant an interim injunction, the Court has to address a number of key questions.

Was there a "serious issue" to be tried?

Employers wishing to obtain an interim injunction need show only, so far as its prospects of success in the full trial are concerned, that there is a "serious issue" to be tried. This is a relatively low hurdle to get over – the employer does not need to show that it is "likely" or "probable" that they would succeed at trial.

Here, it was agreed that Jump had legitimate interests to protect, and that Mr Couture had had access to confidential information. Given the difficulties of policing the use of confidential information, a non-compete restriction could, in principle, be justified. However, Mr Couture argued that the non-compete was unenforceable and so there was no serious issue to be tried.

First, it was argued that the uncertainty in the length of the restriction meant that it was unenforceable. However, the Court was persuaded that the clause itself provided a means for resolving that uncertainty (by allowing Jump to decide the length), albeit that this did not address the issue of certainty at the time the contract was entered into. The Judge said that *"…although the clause's temporal extent was not known at the time the contract was entered into, the fact that it had a maximum duration of twelve months and a mechanism by which the employee would know its extent once an election was made does not necessarily make it unreasonable for the purpose of the restraint of trade doctrine".* Acknowledging that there was no direct authority on the validity of this type of non-compete restriction, the Court said there was a serious issue to be tried.

Second, it was argued that a 12-month non-compete restriction on top of a 12-month garden leave restriction was unreasonable. Jump argued that confidential information remained confidential for two years, therefore, justifying the overall amount of time that Mr Couture would be prevented from working for a competitor. The Court said there were issues about whether the length of the clause should be assessed in light of the garden leave period, or separately from it. The Court agreed that a 12-month non-compete coupled with a 12-month garden leave period seemed long, but, ultimately, this was a fact-specific issue and could not be resolved at the interim stage. Therefore, there was a serious issue to be tried.

Third, it was argued that the clause was too wide in scope. In particular, the definitions of "competitive activity" and "competitive entity" were defined in broad and non-specific terms. For example, "competitive activity" referred to "similar services" to the services that Mr Couture had provided to Jump, without explaining what this meant. However, the Court said the scope was not so obviously wide that it could conclude at the interim stage that there was no serious issue to be tried.

Overall, the Court concluded that there *was* a serious issue to be tried in respect of the enforceability of the non-compete restriction against Mr Couture. However, the Court said there was no serious issue to be tried in respect of the inducement to breach claim brought against Verition, on the basis that it had received legal advice that the non-compete clause was unenforceable. Following the Court of Appeal's decision in Allen t/a David Allen Chartered Accountants v Dodd & Co Ltd, this was sufficient to defeat a claim of inducement to breach. This was the case even though the advice Verition received was *"short and not unequivocal"*.

Would damages be an adequate remedy for either party?

In deciding whether to grant an interim injunction, the Court must also consider whether damages would be an adequate remedy for the employer if it went on to succeed at trial. If damages would be an adequate remedy for an employer, then an injunction would not normally be granted. Here, the Court accepted that if the clause was enforceable and Mr Couture went to work for Verition, then an award of damages would *not* be an adequate remedy for Jump.

The Court must also consider whether an award of damages would be sufficient protection for the employee if an injunction was granted but not upheld at the full trial. If damages *would* be an adequate remedy for an employee in this situation, then this would weigh in favour awarding an injunction. Here, the Court said that if an injunction was granted which prevented Mr Couture from working for Verition, then damages would *not* an adequate remedy for him given the overall amount of time he would have been prevented from working and using his skills in such a “dynamic area”.

What would be the “balance of convenience” if the injunction was granted?

The Court should then weigh into the mix other relevant factors such as any delay in seeking the injunction and the overall merits of the case.

Here, it held that Jump had known about Mr Couture’s intentions since 12 July 2022. It had taken over nine months to issue proceedings and seek an injunction. Moreover, after Mr Couture had set out his detailed position in the letter of 17 November 2022, it took Jump over three months to even muster a reply and then another month and a half to seek the injunction. This delay was unreasonable and excessive and Jump simply had no explanation for it.

If Jump had moved more quickly, a speedy trial could have been ordered to take place before Mr Couture’s intended start date with Verition. This would have avoided the need for an interim injunction application altogether. On top of this, Mr Couture’s employment contract contained an arbitration clause, meaning that the dispute could have been resolved via arbitration, which, again may have avoided an interim injunction application.

On the basis of the considerable delay, the Court decided it would be unjust to grant an interim injunction at such a late stage. However, it is worth noting that the Judge said that if it had been necessary to do so, he would have weighed into the balance the overall strength of the case, noting that the long duration and wide scope of the restriction indicated that Mr Couture's and Verition's arguments were stronger.

What are the learning points for employers?

It remains to be seen whether this unusual discretionary non-compete restriction with no provision for setting off time spent on garden leave will be enforced. If it is, this may embolden some employers to adopt a similar approach. However, it should be remembered that these cases tend to be fact-specific, turning on the nature of the employee's role, their seniority, the market practice in the industry they work in and the proposed role with the competitor employer. Further, the Government has [recently announced](#) plans to limit the length of non-competes to a maximum of three months. Therefore, even if upheld, this decision may be of limited value to employers wishing to follow suit.

The other very important learning point for employers who utilise post-termination restrictions is to act without delay where there is reason to believe that a restriction has been, or will be, breached. Here, the employer had known about the employee's detailed plans for almost five months before it applied for an injunction to restrain him. This was simply too long and meant it would have been unjust to award an interim injunction. The result is that the employer walked away without the injunction and, perhaps more importantly, without a precedent to be used to deter other workers from doing the same thing. Instead, it is faced with preparing for a full trial in short order, no doubt with the Judge's comments about the relative weakness of their case ringing in their ears.

Jump Trading International Ltd v (1) Damien Couture (2) Verition Advisors (UK Partners) LLP

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Some further details published on proposal to limit non-compete clauses to three months

On 12 May 2023, the Government released some further details about its plans to limit the use of non-compete clauses in employment contracts. In this briefing, we round up the key points to note.

On 10 May 2023, the Government announced plans to legislate to limit the use of non-compete restrictions in employment contracts to three months. You can read our detailed briefing on that announcement here, where we outlined a number of "known unknowns" about the proposals. Since then, the Government has published its response to the consultation on reform of non-competes (Response), which closed on 26 February 2021. The Response provides more information about the proposals and answers some, but not all, of the known unknowns.

The Response confirms the following points:

- **The proposed reforms will apply to workers engaged under a worker contract.** The initial announcement referred to "employment contracts" and "employees" only and made no reference to individuals classified as "workers" who worked under a contract to work or perform services for the employer. The Response confirms that the proposed reforms will apply to worker contracts.

- **The proposed reforms will not apply to wider types of workplace contracts.** It was unclear whether the proposed reforms would apply to other types of agreements connected to the workplace e.g. LLP agreements, shareholders' agreements or long-term incentive plans. The Response confirms that the limitation will not apply to non-compete clauses used in such agreements, on the basis that the bargaining power between the parties is different. However, it is worth noting that the Response is silent about whether the limitation will apply to a non-compete restriction contained in a settlement agreement. The Response also appears to overlook the fact that LLP members can be classified as workers depending on the circumstances.

- **The proposed reforms will apply to non-compete clauses only and not to other types of covenants.** The initial announcement suggested that the limitation would not apply to other types of post-termination restriction, such as non-solicitation, non-dealing or non-poaching clauses. The Response clarifies that this is the case. Therefore, other types of post-termination restriction may run for longer than three months and will be upheld provided that they are reasonable and go no further than necessary to protect the employer's legitimate business interests. The logic for this distinction is that such restrictions do not have such a significant impact on an individual's ability to earn a living in their chosen profession.

- **Guidance to be published.** The Response also states that the Government plans to enhance transparency by producing guidance on the use of non-competes and the law underpinning them.

However, there are still a number of questions yet to be answered:

- **Will the law apply to existing employment contracts?** It is still not clear whether the new law will apply retrospectively or only to new contracts. In the event that it applies retrospectively, will an existing non-compete restriction which is in excess of three months be deemed to be void in its entirety? Or will it be potentially enforceable, but only up to the three-month cap? If it would be deemed void, employers will either need to agree changes to the employment contracts of affected employees or accept the loss of the non-compete protection.

- **How will the new law work alongside garden leave clauses?** The initial announcement says that the reforms will not affect an employer's ability to use paid notice periods or place employees on garden leave. However, the risk is that employers will respond to the loss of longer non-competes by extending periods of notice in order to place the employee on garden leave and keep them out of the market that way. Further information about the interplay between non-competes and garden leave is awaited.

- **When will the reforms come into force?** The Government has said the legislation will be introduced *"when Parliamentary time allows".* At the time of writing, no timeline for the introduction of the new law has been given.   With a General Election looming, it remains to be seen whether the proposal will ever make its way on to the statute books.

BDBF is a law firm based at Bank in the City of London specialising in employment law. If you would like to discuss any issues relating to the content of this article, please contact Managing Associate Tom McLaughlin (tommclaughlin@bdbf.co.uk), Principal Knowledge Lawyer Amanda Steadman (amandasteadman@bdbf.co.uk) or your usual BDBF contact.

Non-compete clauses: Response to the Government consultation on measures to reform post-termination non-compete clauses in contracts of employment – 12 May 2023

High Court upholds a one year non-compete restriction against a solicitor

In the recent case of Law by Design v Ali the High Court upheld a 1-year non-compete restriction preventing a solicitor from going to work for a competitor

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Look both ways before you

cross the road: top tips for senior executives thinking of changing roles in 2022

It’s the start of another year and thoughts naturally turn to the new challenges and adventures that lie ahead – including in the world of work. You may be thinking about looking for a new role, or perhaps a job offer is already on the horizon.

Non-Compete Clauses Consultation – BDBF Response

As mentioned at our recent webinar, the government has launched a consultation about regulating the use of non-compete restrictions in employment contracts.

Getting your restrictive covenants right – a cautionary tale

A recent High Court decision reminds employers of the importance of tailoring restrictive covenants to the employee. What does the law say?

Government announces new consultation on restrictive covenants

Does the current law on non-compete clauses stifle the creation of start-ups? And should the law be changed?