

A recent High Court case, *Plumbly v Beatthatquote.com Limited* (2009) EWHC 321, has emphasised how important it is for start-up companies to think carefully about the terms on which they grant share options to employees and the cost of getting it wrong.

Mr Plumbly was the first employee of Beatthatquote.com Limited ("BTQ") apart from BTQ's founder, original sole shareholder and MD. BTQ was established to develop a comparison website offering comparative data on mortgages and loans and earning commission from brokers who secured business users of the site.

Prior to joining BTQ Mr Plumbly had created and was operating a website described as an information resource about buy-to-let investment, All About Buy to Let ("AABTL"). AABTL included a link to another website which provided mortgage quotations. AABTL received some commission from this mortgage quotation site for referrals from AABTL.

Mr Plumbly was required to sign a contract of employment with BTQ when he joined it and that contract contained a standard non-competition covenant. Being concerned about AABTL, which he intended to continue to operate, Mr Plumbly obtained a side letter from BTQ which allowed him to continue operating AABTL providing that it did not compete directly with BTQ.

Mr Plumbly was also granted an option to subscribe at nominal value for 100 1p ordinary shares at any time from the first to the third anniversaries of the date of grant of the option. The option included the statement that it was "to represent 10% of the ordinary shares" of BTQ.

BTQ's business flourished and new employees were taken on. As the first anniversary of the date of grant of Mr Plumbly's option approached the relationship between Mr Plumbly and the MD/owner of BTQ deteriorated, partly because of issues over Mr Plumbly's bonus entitlement but also because

BTQ proposed to grant share options to the new employees which, in Mr Plumbly's view, represented an unlawful dilution of his proposed 10% interest in BTQ.

Mr Plumbly exercised his option as soon as he could and then resigned from his employment. BTQ refused to allot the shares to Mr Plumbly on the grounds that Mr Plumbly had, through AABTL, been directly competing with BTQ whilst he was employed by BTQ and had committed breaches of contract and fiduciary duties.

Mr Plumbly sued BTQ in the High Court for breach of contract and won. Although Mr Plumbly originally sought either an order for specific performance forcing BTQ to honour its commitment to issue shares to him or damages for the breach of contract, at the trial itself he elected to receive damages. Those damages were in the order of £500,000, a very significant sum for an early stage company to have to find.

What lessons can be drawn from the case?

- 1) The choice of remedy for a breach of contract lies with the claimant and not with the defendant. A company in BTQ's position should therefore think very carefully about which is the lesser of two evils: having to pay out £500,000 in damages or having a minority shareholder who is no longer actively involved in the business.
- 2) The period in which Mr Plumbly could exercise his option - from the first to the third anniversaries of the date of grant - was unusual. In most high growth start-ups, option holders usually only exercise their options upon some form of exit event such as a sale of the company or a listing. If Mr Plumbly's option had been exercisable only from, say, the third anniversary of the date of grant or upon a sale of BTQ then he might well have resigned from his employment before his option had become exercisable and would thus have lost the right to exercise his option.

3) BTQ could have avoided the problems it encountered by ensuring that its Articles of Association contained a provision whereby if an employee became a "Bad Leaver" e.g. because he resigned from his employment or was lawfully and fairly dismissed for a breach of his contract of employment, then he could be required to offer his shares for sale at their nominal value or at least at a price which was less than their market value. This would have reduced Mr Plumbly's damages considerably.

4) In an option agreement don't include statements about what percentage of the share capital the shares under the option represent. Just state the number of shares under option. Mr Plumbly's views about non-dilution were unrealistic but the fact that the statement had been made contributed to the deterioration of his relationship with BTQ.

5) Even if no compulsory transfer provision such as that referred to in paragraph 3 above is included in the company's Articles of Association make sure that the Articles of Association are worded in such a way that a disgruntled ex-employee shareholder cannot thwart the legitimate desires of the majority shareholders e.g. include a "drag-along" provision whereby the majority can force the minority to join in a bona fide sale of the company.

If you require any further advice or assistance please do not hesitate to contact Patrick Baddeley.

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This briefing note is intended merely to provide a summary of the law in this area and is not a comprehensive guide. It is not intended to provide legal advice for specific cases. The law and practice in this note is stated as at May 2009.

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