PJH LAW'S EMPLOYERS GUIDE TO RESTRICTIVE COVENANTS

WHAT IS A RESTRICTIVE COVENANT?

A restrictive covenant is a contractual clause which restricts the post-employment activities of a worker for a limited defined period after the employment relationship finishes in order to protect the employer's legitimate business interests.

WHY HAVE RESTRICTIVE COVENANTS?

Employees may acquire knowledge of things which are key to a business such as the names of clients, future business strategy, pricing, suppliers and knowledge of the workforce. They may then use this knowledge after their employment has ended, either in business on their own account or to further the interests of a new employer who may be a competitor. Many employers, therefore incorporate post-termination restrictive covenants into employment contracts to help protect their businesses from such threats.

WHAT TYPES OF RESTRICTIVE COVENANTS ARE THERE?

1. **Non-competition restraints –** these clauses prevent the employee from working in that industry as a whole, or at least with named competitors. These are the most draconian clauses and are viewed with great suspicion by the courts as they can affect a person's ability to make a living.

2. **Non-dealing restraints** – these clauses prevent employees accepting business from or conducting business with former clients or specifically named clients. These clauses are still treated carefully by the courts as they affect 3rd party rights e.g. if a former customer prefers to take their business to the employee in the new job rather than continue dealing with the employer any action by the employee may amount to a breach of contract.

3. **Non-solicitation restraints** – these clauses prevent employees from initiating contact with former clients, though not barring the employee from dealing with such clients who transfer their business without solicitation. These clauses are usually less dramatic in their effect and therefore usually received more sympathetically by the court.

4. **Non-poaching restraints** – these clauses prevent the employee from soliciting former colleagues to join him or her in the new venture.

THE LEGAL STARTING POINT

The general starting point is that a restrictive covenant is seen as a restraint of trade and is therefore presumed by the courts to be void unless the employer can show that the clause is **reasonable**. Reasonableness is assessed in three stages, firstly that the employer has a **'legitimate interest'** to protect and secondly that the clause is **reasonable** in its wording and drafted as narrowly as possible to protect that interest and thirdly that the restraint is **not contrary to public policy**.

1. WHAT IS A LEGITIMATE INTEREST

A legitimate interest is a legitimate proprietary business interest that is capable of being protected by a restraint clause.

Things that are legitimate to seek to protect include: connections with clients and customers (can include prospective clients and customers), stability of the workforce, trade connections with suppliers and confidential information (including, but not limited to, trade secrets). A protectable interest in relationships can still, in exceptional circumstances, exist where the relevant information is in the public domain (including on social media). This list is not exhaustive and so other business interests may potentially be legitimate and therefore capable of being protected.

2. WHAT IS REASONABLE WORDING

A clause which is drafted too widely is in danger of being unenforceable and employers therefore need to consider what is reasonably necessary to protect their interest, the narrower the scope of the clause the better. Things considered by the courts when deciding what is reasonable will be things such as the length of time involved, geographical area covered, nature of employer's business, and nature of the employee's role and whether a covenant is usual in the particular sector involved and the scope of the activities covered.

I. **LENGTH OF COVENANTS**.

Time is one of the key elements in relation to the protection of confidential information, the restraint can last no longer than the projected useful life of that information. An employer will usually want the length to be as long as possible to protect the interests of the business but this desire needs to be balanced with what is reasonable, as a clause which is void for unreasonableness is of no use at all.

- 6 – 12 months is the most common length for a covenant. Covenants at the higher end are more likely to be held to be reasonable for senior employees rather than lower level employees. For example, if you have a national sales director it may be reasonable to stop him/her working for a competitor for more than 6 months however it would not be legitimate to apply the same restriction on a junior sales assistant.

- Clauses over 12 months will usually be unenforceable except in very exceptional circumstances.
-

II. AREA COVERED

It is a slight oversimplification to say that the wider the area the more likely the clause is to be unreasonable, although it is a convenient rule of thumb. There have been exceptions where UK and worldwide bans have succeeded, after all, 'information' knows no bounds.

The area of the restraint must have a functional correspondence with the legitimate interest to be protected, for example, a local business which draws its customers from a radius of 5 miles from the place of business cannot justify a radial restraint of 10 miles. The area in which it is to operate is also a consideration, thus a radius of 5 miles might be justifiable in a rural area but not a major conurbation where the population is high.

Sometimes the nature of the business maybe hard to define geographically as some businesses competition can take place from any location. It is also hard to predict the expansion of any competition between the date the covenant was drafted and the date of termination of employment. With a restraint based on protecting confidential information it is most likely to be aimed at competitors benefiting from the employee's expertise. It may therefore be a better tactic to limit a restraint to named competitors within a defined area.

III. FELLOW EMPLOYEES - NON-SOLICITATION CLAUSES

For these clauses, it is wise to limit fellow employees to employees that have had material dealings with the employee in question and to make reference to seniority of fellow employees e.g. senior operational employees.

3. IS THE CLAUSE AGAINST PUBLIC POLICY

The legal position is that a restraint of trade clause is considered to be void on public policy grounds as it is deemed that, it is in the public interest, for everyone to be able to trade freely. If a restraint goes beyond the reasonable protection of a legitimate private interest it will be deemed to be void on the grounds of public policy. A clause may also be against public policy if the restraint is held to be against the public interest.

WHICH CLAUSE DO YOU USE?

The type of covenant needed will depend upon what the employer is trying to protect. If, for example, it is a customer contact list which needs protecting then a non-solicitation and a non- dealing clause may be appropriate. Employers need to ask themselves what level of protection is necessary to protect interests with non-solicitation clauses as a starting point then moving onto non-dealing and then non-competition.

It is wise to use different clauses for different levels of staff as it would, for example, be hard to justify a non-competition clause for a junior member of staff who poses little risk to the company.

DOES THERE NEED TO BE ANY CONSIDERATION?

The party benefiting from the restrictive covenant must supply consideration for the covenant to be enforceable. If the covenant is in the employee's contract of employment or service agreement, then usually there are forms of consideration in these, such as, salary or benefits. If the covenants are contained in a separate agreement, then consideration is needed. The law does not make it clear how much consideration is necessary.

BLUE- PENCILLING

This means that the courts may, to a certain extent, remove any words or sentences that are felt to make the clause unreasonable. They have no general power to rewrite a restraint, they can, however, edit (blue pencil) the clause and remove wording so that the remaining part of the clause is allowed to stand and be effective. The wording must be able to be removed without the need to add or modify the remaining part and the removal of the words can't change the character of the clause. The remaining terms also must be supported by consideration.

GARDEN LEAVE CLAUSES AND RESTRICTIVE COVENANTS

Garden leave clauses can be used in conjunction with restrictive covenants for the employer to have two options to protect their interests. The benefit of a garden leave clause is that it prevents the employee from taking up other employment with a competitor whilst allowing the new employee to develop relationships with the employee's customers and contacts. Whilst on garden leave the employee is also no longer privy to the company's confidential information and what information they do have will hopefully become out of date. If a restrictive covenant is used with a garden leave clause then the restrictive covenant should be reduced by the amount of the time spent on garden leave. It is worth noting that a garden leave clause is less likely to be scrutinised by the court.

BREACHES OF CONTRACT BY THE EMPLOYER.

If a contract is terminated by a repudiatory breach by the employer, then any restrictive covenants maybe unenforceable. To guard against this some contracts contain a statement that the restraint clause will be binding after termination however termination comes about. Although these terms are largely ineffective the presence of such a clause does not does not invalidate the restraint generally. It has been held that an exclusion clause in a contract could survive a fundamental breach and that 'perhaps' a restraint clause can survive a wrongful dismissal.

UPDATING COVENANTS

If an employee changes role or gets promoted an employer should take the opportunity to update covenant if necessary so that legitimate interests continue to be protected. When an employee leaves they should be put on notice of what restrictions apply to them.

CONFIDENTIALITY

There is an implied duty for employees not to make use of or disclose confidential information acquired about his/her employer's business during the course of his/her employment. The information needs to be of an obvious confidential nature. It can take many forms such as client databases, secret formulae, manufacturing processes and pricing structures.

After employment ends the duty usually only protects trade secrets or high level confidential information. It can also extend to confidential information used by the employee to compete with the employer. This problem can be overcome by having a reasonable **express** clause (restrictive covenant) in the contract to protect confidential information which falls short of this implied protection.

BREACH OF CONFIDENTIALITY AND ENFORCEMENT OF RESTRICTIVE COVENANTS

If there is a breach of either an express or an implied term of confidentiality an employer can apply for an interim injunction to prevent the former employee or the competitor from using the confidential information to establish an unfair competitive advantage. This is often referred to as a springboard injunction.

It is also possible to seek an injunction if you feel that an employee has breached their restrictive covenants. If the court is satisfied that there is a serious question to be tried it may make an interlocutory injunction pending a full trial. The claim has to have a reasonable prospect of being upheld at trial and another consideration is whether the balance of convenience favours the granting of the injunction i.e. whether more harm will be done by granting or refusing an interim injunction and whether damages would be a sufficient remedy at trial this would not be the case where damages are unquantifiable or the employee doesn't have the means to pay

Damages can also be brought for financial loss suffered as a result of a breach of confidentiality or restrictive covenant. But an employer will have to prove the loss and this can be difficult to do.