

Restrictive Covenants

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What are we going to cover?

1. The default position where contract is silent
2. Restrictive covenants – general principles
3. Restrictive covenants – standard types
4. Drafting, interpreting & the ‘blue pencil’
5. Garden leave – an alternative
6. Application & enforcement

The law on one slide

Implied restrictions

- Extensive during active employment
- Notice periods / potentially garden leave – also extensive but can be enhanced
- After termination - limited to trade secrets and info of equivalent confidentiality
- Springboard relief

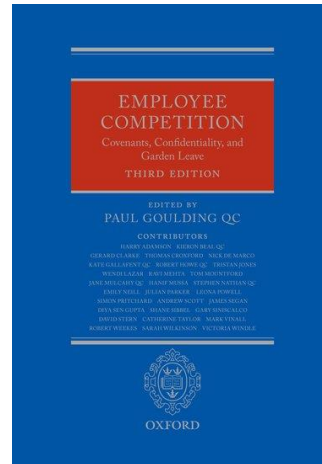
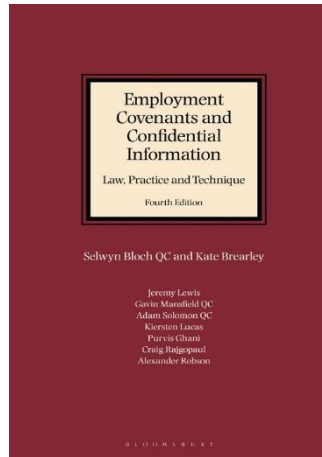
Extended protection under the contract if:

- No repudiation by the employer
- Covenants not too narrow
- Covenants not too broad
- The court may blue pencil and interpret but not re-write covenants

Enforcement

- Forum is High Court
- Injunctive relief is always discretionary
- Damages and account of profits (but not “negotiating damages”) also may be available
- Cross undertakings
- Cost shifting
- Pragmatism can be wise

Where to look for help



01

The default legal position
when the contract is silent



Restrictive covenants

During employment

- Employee is restrained from competing by the duty of fidelity

After employment

- Ex-employee free to compete (but note springboard relief issues)
- Essential to include post-termination restrictions in the employment contract

Confidential Information

During employment

- Typical to include an express term...
- ...but the implied duty of good faith and fidelity (or fiduciary duties, if relevant) often offers adequate protection

After employment

- An appropriately drafted express term can be helpful but restraint of trade principles apply – trade secrets and their equivalent are protected
- Additional protection available under the Trade Secrets (Enforcement, etc.) Regulations 2018

02

Restrictive covenants – general principles



Initial questions:

1. What protection does the employer need?
2. Will the employee agree?
3. How far can the employer go before the courts determine the clause is unenforceable?

Enforceability:

- A court will only enforce covenants in restraint of trade to the extent that they go no further than reasonably necessary for the protection of the employer's legitimate business interests as at the time they were drafted (and remain so).

General approach of courts

- (1) The court must decide what the covenant means;
- (2) The employer must show that it has a legitimate business interest which requires protection;
- (3) The employer must show that the covenant is no wider than reasonably necessary to protect its legitimate business interests, judged at the date the contract was entered into

TFS Derivatives Ltd v Morgan [2005] IRLR 246 [37]-[38]

Identifying legitimate business interests

Weakening /
limiting
competition?

Protecting
confidential
information

Relationships
with clients

Relationships
with
prospective
clients

Maintaining a
stable and
trained
workforce

Good supplier
relationships

Introducers of
work

Other categories (e.g.
candidate base for search
consultancy, deal
opportunities in private
equity, introducers of
business to a law firm)

03

Restrictive covenants – standard types



The menu of options



Non-competes – when used

- Necessary to protect confidential information (*Thomas v Farr & Hanover Park Commercial*)
- Difficult to police a lesser non-dealing / non-solicitation clause (e.g. *TFS v Morgan*, *TFS v Gamberoni*)
- More acceptable in commercial agreements / sale of business (e.g. *Hydra plc v Anastasi*; but note *Credito Marketing Ltd v Lambert*)

Drafting non-competes – what to consider

- **Length:** What is the currency of the information to be protected? What is the industry standard? (*Advanced Business Software and Solutions Ltd v Fowler, TFS v Gamberoni*)
- **Area:** What geographical limitation, if any, is appropriate? Consider the ‘functional correspondence’ with any client base (*Office Angels v Rainer-Thomas*)
- Does the restricted activity relate to the ex-employee’s work? (*Wincanton Ltd v Cranny*)

Non-solicitation of clients - when used

- Solicitation can occur even where client initiates contact (*Croesus v Bradshaw*).
- May apply even if information about customers is already in the public domain (*East England Schools CIC v Palmer*).
- No general distinction between higher/lower-paid employees – the issue is as to the value of their trade connection with customers (*Adorn SPA Ltd v Amjad*).

Non-solicitation of clients – what to consider

- **Length:** Annual renewal businesses legitimately need 12 month covenants (e.g. *Romero Insurance Brokers v Templeton*).
- Relevance of industry standards (*Croseus, Premier Model Management Ltd v Bruce*)
- **Clients:** Usually applies to clients the employee has dealt with directly. May extend to prospective clients (*Associated Foreign Exchange Ltd v International Foreign Exchange (UK) Ltd*)

Non-dealing

- Consider resources required to maintain client loyalty (*Beckett Investment Management Group Ltd v Hall*)
- Must apply reasonably to a particular class of customers (*Bartholomews Agri Food Ltd v Thornton*)

Non-solicitation of staff

- Legitimate to cover stable and trained workforce (may be just senior, may be everyone) (*Hydra v Anastasi*; c.f. *CEF Holdings Ltd v Munday*)
- Non-employ clauses might not be enforceable (*Dawnay Day*)

Confidentiality clauses

- Broad or vague definitions of confidential information will fail (*Ixora Trading Inc v Jones*)
- Don't rely on boilerplate wording in your precedent contract – ask client to identify the specific material they regard as confidential
- Fully particularised particulars of claim may be required when pursuing an injunction restraining the misuse of confidential information (*Caterpillar Logistic Services (UK) Ltd v Huesca de Crean*)

04

Interpretation, drafting and the 'blue pencil'



Ambiguous provisions

Bad drafting e.g. *Prophet v Huggett*:

“The Employee shall not... for 12 months... be interested in any business which competes with the Company provided that this restriction shall only operate to prevent the Employee being so... interested in connection with any products which he was involved with whilst employed hereunder [or similar thereto].”

... Too narrow?

Ambiguous provisions

Rimer LJ, Court of Appeal:

“If faced with a contractual provision that can be seen to be ambiguous in meaning, with one interpretation leading to an apparent absurdity and the other to a commercially sensible solution, the court is likely to favour of the latter. Such an approach can, however, only be adopted in a case in which the language of the provision is truly ambiguous and admits of clear alternatives as to the sense the parties intended to achieve ... In my view, however, this is manifestly not such a case.”

“Blue pencilling”

- Can words be severed without adding or changing the language?
- Is there still consideration for what remains?
- Can the offending wording be removed without changing the character of what survives, which remains the sort of agreement the parties originally entered into?

Tillman v Egon Zehnder Ltd [2019] UKSC 32

Can you blue pencil this?

*“You shall not directly or indirectly, either alone or jointly, with or on behalf of any third party and whether as principal, manager, employee, contractor, consultant, agent or otherwise, at any time within the period of 6 months from the Termination Date directly or indirectly engage or be concerned **or interested** in any business carried on in competition with any of the businesses of the company which were carried on at the Termination Date.”*

Which is better?

You will not poach...

...any person with whom you have had material dealings in the twelve months prior to the Termination Date employed at the level of paralegal, trainee, junior associate, senior associate, managing associate, salaried partner or equity partner

Or

...any legally qualified person with whom you have had material dealings in the twelve months prior to the Termination Date

05

Garden Leave – an alternative



Garden leave

- Employer can only require an employee to take garden leave where there is either:
 - An express term permitting them to do so, or
 - No implied right to work
- Safest to draft in garden leave provisions but the position is not hopeless without a clause
- Employees refusing to work are in breach of contract, have no right to payment and may still be held to covenants

Garden leave

- Reasonableness considered *as at the date when the relevant party is seeking the injunction* (not as at date contract is drafted) (*Tullett Prebon Plc v BGC Brokers LP*)
- Court has discretion over length of enforcement
- Garden-leave ‘set-offs’ common following *Credit Suisse Asset Management Limited v Armstrong*

06

Application & Enforcement



Getting the employee signed up

- The potential importance of having a signature (*Jones v Associated Tunnelling*)
- Employees can usually only impliedly accept terms having immediate effect, but see *Farnsworth v Lacy*
- Covenants in a signed contract which gave a pay rise may still be unenforceable due to lack of consideration (*Reuse Collections v Sendall*)

The danger of repudiation and affirmation

- *General Billposting v Atkinson* (affirmed in *Brown v Neon Management Services Ltd*)
- Typical repudiatory breaches by employer: Implied term of mutual trust and confidence, Gross misconduct dismissals / dismissals without contractual notice, PILON where no PILON clause, Garden leave where no garden leave clause
- Employee will affirm by giving notice (unlike constructive unfair dismissal)
- Courts closely scrutinise allegations of repudiatory breach by employees who secured alternative employment prior to resigning (particularly in team move cases)
– *Tullet Prebon*
- *Square Global v Leonard (HC)* – (Obiter) – Can defendant rely on a repudiatory breach which s/he did not resign in response to?

Enforcement pre-action

Gather evidence quickly



Unless going without notice, seek undertakings quickly as part of a pre-action letter



If no satisfactory response, make a decision about whether it makes commercial sense to pursue this



Instruct Counsel

Emergency relief application

- Options re notice to the other side
 - On formal notice
 - With informal notice
 - Without any notice
- You will need
 - claim form
 - application notice
 - draft order – don't forget the penal notice - Counsel will draft
 - witness statement in support
 - a cross undertaking and exhibit with latest accounts
 - full and frank disclosure where application without notice
- Court Fee
- Schedule of Costs

Process

If proceeding without formal notice, directions for the return day normally 3 working days later (don't forget to serve a schedule of costs 24 hours in advance)



Interim relief granted/refused (discretionary, usually based on *American Cyanamid*, unless interim relief would effectively dispose of the entire action)



Directions for a speedy trial



Settlement discussions likely



Don't forget to file POC/a defence

Questions?



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