

Restrictive Covenants in Employment Contracts

Introduction

There are four main types of Restrictive Covenants:

- **Non-competition Covenants** – these place restrictions on an employee to prevent them working for a direct competitor in a similar position
- **Non-solicitation Covenants** – these prevent employees from contacting customers, suppliers and other contacts of their former employer with the intention of ‘poaching’ their business.
- **Non-dealing Covenants** – these prevent employees from having any direct contact with their former employer’s clients, customers or suppliers, even if the customer, supplier or client initiated the contact in the first place.
- **Non-poaching Covenants** – these are similar to non-solicitation covenants but are specifically designed to stop former employees from ‘poaching’ other employees from their previous company. So this effectively stops an ex-employee ‘taking someone with them’ when they leave.

What Are Restrictive Covenants There To Protect?

1. The Purpose of Restrictive Covenants in a contract of employment must be at the forefront of the court’s mind when deciding whether to enforce them. The starting-point is to identify the interests which the covenant is designed to protect. Claimant employers in the usual way rely on the twin heads of the protection of confidential information and the protection of trade connections.
2. So far as confidential information is concerned, if the employee had access to confidential information about the employer’s confidential information such as pricing, sales prospects and plans for future products, which would be of some interest and perhaps value to competitors, and some at least of which might have the character of a trade secret.
3. As for trade connection, it is of course often the essence of the employee's role as a salesperson and manager of salespeople to maintain and develop good personal relationships with the employer's customers, The employer will be entitled to some protection against that connection developed for its benefit

being unfairly exploited for the benefit of a competitor before it had had the chance to vest its relationship in different employees.

4. For a covenant in restraint of trade to be treated as reasonable in the interests of the parties 'it must afford no more than adequate protection to the benefit of the party in whose favour it is imposed: *Herbert Morris Ltd v Saxelby* HL [1916] 1 AC 688.
5. How long is it likely to be valid for?

Implied terms of confidentiality

Faccenda Chicken v Fowler [1987] Ch 117, [1986] 1 All ER 625 Neill LJ

6. The appellant plaintiff company had employed the defendant as sales manager. The contract of employment made no provision restricting use of confidential information. He left to set up in competition. The company now sought to prevent him using confidential information for this purpose.
7. The court held that the information and the advantage flowing from it was obtained through dishonesty. The court set down the obligations of employees after leaving their employment with regard to confidential information acquired by them.
8. Except in special circumstances, there is no general restriction on an ex-employee canvassing or doing business with the customers of his former employer.
9. The employer can only succeed on the basis of an implied term if he can show improper use of confidential information tantamount to a trade secret. The court must consider: '(a) The nature of the employment. Thus employment in a capacity where 'confidential' material is habitually handled may impose a high obligation of confidentiality because the employee can be expected to realise its sensitive nature to a greater extent than if he were employed in a capacity where such material reaches him only occasionally or incidentally. (b) The nature of the information itself. In our judgment the information will only be protected if it can be properly be classed as a trade secret or as material which, while not properly to be described as a trade secret, is in all the circumstances of such a highly confidential nature as to require the same protection as a trade secret. . (c) Whether the employer impressed on the employee the confidentiality of the information . . (d) Whether the relevant

information can be easily isolated from other information which the employee is free to use or disclose.’ and ‘It is clearly impossible to provide a list of matters which will qualify as trade secrets or their equivalent. Secret processes of manufacture provide obvious examples, but innumerable other pieces of information are capable of being trade secrets, though the secrecy of some information may be only short-lived. In addition, the fact that the circulation of certain information is restricted to a limited number of individuals may throw light on the status of the information and its degree of confidentiality.’

10. Neill LJ restated the classification provided at first instance. ‘(1) Where the parties are linked by a contract of employment, their obligations are governed by the contract between the employee and the employer.

(2) In the absence of an express term, the obligations of the employee in respect of the use and disclosure of information are governed by implied terms.

(3) While the employee remains in the employment of the employer, the implied obligations impose a duty of good faith or fidelity on the employee. The extent of the duty of good faith will vary according to the nature of the contract. The duty of good faith will be broken if the employee makes or copies a list of the customers of the employer for use after his employment ends or deliberately memorises such a list, even though (except in special circumstances) there is no general restriction on an ex-employee canvassing or doing business with customers of his former employer.

(4) After the termination of employment, the implied obligations becomes more limited in scope. A former employee is not allowed to use or disclose information which is of a sufficiently high degree of confidentiality so as to amount to a trade secret. The obligation does not extend to all information obtained during his employment and in particular may not cover information which is only confidential in the sense that unauthorised disclosure of such information to a third party while the employment subsisted would be a breach of the duty of good faith.

(5) In determining whether any item of information is protected by the implied term after termination of employment, all the circumstances would be taken into account and in particular the following factors would be considered :

(a) The nature of the employment-If the employment is in a capacity where confidential material is habitually handled this may impose a high obligation of confidentiality because the employee could be expected to realise the confidential nature of the information.

(b) The nature of the information itself-The information is only protected if it can properly be classified as a trade secret or material which is in all the circumstances of such a highly confidential nature as to require the same protection as a trade secret.

(c) Whether the employer impressed on the employee the confidentiality of the information. The attitude of the employer towards the information provides evidence which may assist in determining whether or not the information can properly be regarded as a trade secret.

(d) Whether the relevant information can be easily isolated from other information which the employee is free to use or disclose.

11. The Court did disagree with Goulding J that an employer can restrain the use of information in his second category (namely confidential information) by means of a restrictive covenant. A restrictive covenant will not be enforced unless it is reasonably necessary to protect a trade secret or to prevent some personal influence over customers being abused in order to entice them away.

When Was the Covenant Entered Into?

12. The recent decision in Patsystems Holdings Ltd v Neilly [2012] EWHC 2609 QB the High Court by Underhill J reaffirmed the principle from the CA in Commercial Plastics Ltd v Vincent [1965] 1 QB 623 that the reasonableness of a restrictive covenant must be judged at the time a contract is entered into. Gledhow Autoparts Ltd v Delaney [1965] 1 WLR 1366 at 1377D-E: "A covenant of this kind is invalid ab initio or valid ab initio. There cannot come a moment at which it passes from the class of invalid into that of valid covenants."

13. He said that the post termination obligations in the form of a non competition clause were the most powerful weapons in the armoury of the employer, seeking as they do to exclude the employee from his chosen field of work for a significant period of time. In determining that a 12 month clause was void, the Judge said that the employer should always consider and reconsider the necessity for such a clause, because if it cannot show that the clause is necessary in order to protect the competitive advantage that the Defendants are seeking to protect, rather than simply being a means to control the former employee the courts would be very slow to uphold it.

14. D began work for C, a company selling software to the financial trading industry, in 2000 as an account manager earning £35,000 per annum. His

contract provided for a one month notice period and a 12 month non-compete restriction. He was promoted to Director of Global Accounts in 2005 and signed a letter agreeing that, save for a salary increase to £80,000 and an increase in his notice period to three months, all other terms and conditions in his original contract remained unchanged.

15. In 2012, D resigned and indicated his intention to work for a competitor of C. When C sought to enforce D's 12 month non-compete restriction, the Court held that it could not be justified given D's responsibilities and status in 2000. C had not given D new restrictions to sign in 2005, and could not rely on the original restriction. The letter stating that the terms of the previous contract continued to apply was not enough to bind D.
16. Also the judgment in *Thomas v Farr plc and another* [2007] EWCA Civ 118, IRLR 419, makes it clear that when assessing whether a non-compete covenant should be enforced, Courts will first consider whether a non-solicitation clause alone would have provided adequate protection.
17. This affirms the comments of Sir Christopher Slade in *Office Angels v Rainer-Thomas* [1991] IRLR 215 'The court cannot say that a covenant in one form affords no more than adequate protection to a covenantee's relevant legitimate interests if the evidence shows that a covenant in another form, much less far-reaching and less potentially prejudicial to the covenantor, would have afforded adequate protection.'
18. The court nevertheless identified a prototype non-solicitation covenant likely to be effective in most cases where there was a need to protect a client connection or a goodwill: 'At least at first sight, a suitably drafted covenant precluding the defendants, for a reasonable period of time after the termination of their employment, from soliciting or dealing with clients of the plaintiff with whom they had dealt during the period of their employment would appear to have been quite adequate for the plaintiff's protection in this context.'
19. Sir Christopher Slade said: 'The employer's claim for protection must be based upon the identification of some advantage or asset inherent in the business which can properly be regarded as, in a general sense, his property, and which it would be unjust to allow the employee to appropriate for his own purposes, even though he, the employee, may have contributed to its creation.'

Varying Contracts Of Employment To Include A Restrictive Covenant

20. In *Willow Oak v Silverwood* [2006] CA Civ 660 The employer appealed a finding that he had been unreasonable in seeking to vary the employment contracts of his staff by adding post employment restrictive covenants, and that the consequent dismissals were unfair. Copies of the new contracts had been handed to employees without prior notice and with an instruction to sign the within thirty minutes. After an extension, management retained an aggressive attitude, and did not make it clear that dismissal would follow if the new terms were not agreed.
21. Held: The procedure adopted was procedurally unfair. The general approach and the failure to mention that dismissal would follow made it necessarily so. This decision affirmed that of the EAT that “Where employees are dismissed for refusal to sign a new contract containing proposed covenants in restraint of trade, the test is no different from that in respect of dismissal for refusing to sign a fresh contract.

How Long will the Covenant be valid for?

22. The Courts will only uphold a restrictive covenant for as long as is realistically necessary to protect a commercial advance or “edge”.
23. In *Prophett PLC v Huggett* [2014] EWCA Civ 1013 The Court of Appeal allowed the employee’s appeal against the upholding of a 12 month restrictive covenant that had been incorrectly drafted but reinterpreted at first instance and given effect. The CA held that 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.
24. 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 the court's view, however, this was manifestly not such a case. The drafting was unambiguously clear and something clearly had gone wrong, but that was that the draftsman did not think through to what extent his chosen restriction would be likely to achieve any practical benefit to Prophet upon the claimant's departure to a competitor. In other words, he did not think through the concept underlying his chosen words. In the words of the court: 'Prophet made its clause 19 bed and it must

now lie upon it.' I am confident that the court is unlikely to view the twelve month period as being necessary to protect the Defendant.