

Reasonable protection

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While regular business rivalry is healthy, restrictive covenants for employees can help companies ensure that competition takes place on a level playing field. Clare Kelly explains how such clauses work

It can be devastating for an employer when key employees resign, but even more so if they set up in direct competition and try to take their team and clients with them. However, in the absence of a contract of employment with restrictive covenants in it, there may be nothing the company can do to prevent this.

A restrictive covenant is a promise in a written contract of employment that restricts an employee's activities for a period of time when he or she leaves. It is essential that it is carefully drafted to protect the employer from the actions of departing staff. A restrictive covenant is, prima facie, unenforceable as an unfair restraint of trade. A court will only enforce a restrictive covenant if it is reasonable and drafted to protect the employer's legitimate business interests. The court will look at every clause on its own merits and in the specific circumstances of each case, so there is no magic wording to guarantee that it will be upheld.

How do you decide what is reasonable? Generally, the clause must be limited in terms of the time and location to which it applies and the activity it tries to restrict. For example, a covenant preventing someone from competing with their former company for 10 years anywhere in the world would be unenforceable.

'Reasonableness' will also depend on the nature of the business and the employee. A senior employee with high-level access to the company's best clients can be restricted for a longer period than a junior staff member who does not have a client-facing role. For many roles, there may be no need for restrictive covenants at all. If someone is promoted or moves into a role where he or she has more client contact or access to confidential company information, then a new contract with tighter covenants may be required. The reasonableness of a covenant will be assessed at the date on which it is entered into, so it is not possible to simply insert covenants suitable for senior employees into all contracts in case employees are promoted.

What can be protected?

Restrictive covenants come in different forms, but most commonly they deal with non-competition, non-solicitation of customers and employees, non-dealing and confidentiality.

The most frequent source of concern to companies is that top employees will leave and set up a competing business, taking their best clients with them. It is, of course, not possible to stop someone competing because in effect this will mean that the departing employee cannot actually make a living.

Non-competition clauses are therefore heavily scrutinised by the courts. The protection afforded by the fact that employees have a duty of confidentiality (so cannot simply share customer details, for example) may be enough.

However, there are situations where the protection offered by confidentiality is not sufficient ? for example, where a particular employee has a high level of influence over customers. In such circumstances, the court may uphold a covenant preventing competition, provided that it is for a reasonable time frame. Employers must consider how long it will take for the influence of the employee in question to wane, and for other staff members to build up client relationships to the point where the company could withstand competition. This is likely to be a period of six months to a year; attempting to restrict someone for more than 12 months would only be enforceable in exceptional circumstances.

Non-solicitation covenants prevent employees from approaching, inducing or otherwise enticing the company's customers away. To make such clauses seem more reasonable, and thus enforceable, they are often expressed to prevent employees from soliciting customers with whom they had personal dealings. The clauses also often limit the definition of clients to those who were customers for a specified period of time before the employee left the company, usually 12 months.

Again, the period of time that the restriction is to last must be reasonable. A good starting point for the calculation is how long it will take the company to establish customer links that are strong enough to negate the danger of them simply following the employee out the door. The employer should also ensure that the pre-termination period taken into account is reasonable.

Non-solicitation clauses can go further than this, though, and apply also to prospective customers, or any customers of the company ? not just those with whom the departing employee worked. In certain circumstances, this will be appropriate. For example, if it takes time to build up client relationships before obtaining any work from them, then prospective customers may be deemed just as important as current clients. In smaller companies, or in the case of senior employees expected to take part in firm-wide marketing initiatives, a restriction wide enough to cover prospective or all clients may be enforceable. These wider clauses will have to be justifiable and, in larger companies, where the departing employee had little contact with many clients, this will be very difficult.

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It is also possible to have non-solicitation clauses relating to other employees to prevent someone from leaving and taking team members with them. This may be important in a small company where the loss of several staff members would be extremely difficult to cope with, or in a larger company where the loss of a whole team could be devastating. When deciding the length of the covenant, the considerations are similar to those applied to non-competition clauses.

Non-dealing clauses have a wider scope, preventing the employee from dealing with clients even if approached directly (the employee having taken no active steps to contact the customer). To enforce a non-solicitation clause, the employer has to prove that the former employee had approached clients and this can be very difficult (especially without damaging commercial relationships), so a non-dealing clause can be very useful. However, because it gives the employer a wide level of protection, it is harder to persuade the court that it should be enforced. It will only be justifiable if, for example, the company can show such a close

relationship between the departing employee and the customer that the customer is likely to seek out the employee, causing a substantial loss of business.

To protect confidentiality, there is really no need for a separate covenant for employees, who are subject to a duty of confidentiality under common law, preventing them from revealing information about their employer while employed, and from revealing trade secrets once employment has ceased. It is worth including confidentiality clauses in the contracts of directors, partners and self-employed contractors who are not employees to protect you while they are working with you.

Once an employee leaves, or a worker stops working with you, then the duty of confidentiality only applies to trade secrets. It may therefore be sensible to include a covenant that prevents them from disclosing confidential information for a set period of time afterwards. The best way of calculating a reasonable period is to consider how long it will take for the information to be released into the public domain (in the case of accounts or sales data) or to be out of date (such as in the case of new initiatives or seasonal variations in performance).

What to do in practice

First, check whether your employment contracts contain restrictive covenants and, if so, whether they protect your business adequately and are likely to be enforceable. It is better to err on the side of caution and have a covenant that will be upheld by the court, even if it gives you fewer months' protection than you would like, than to have a costly legal battle ending in the covenant being struck out.

Also, remember to consider the appropriateness of the restriction for the employee to whom it relates. You may want to have different levels of protection in place, depending on seniority, client contact and access to confidential information.

Where employees are promoted, check the latest version of their contracts and, if necessary, ask them to sign a new one. An employee will only be bound by the covenants in the signed contract, even if it was signed 20 years earlier when they joined as a junior staff member and they are leaving after a successful career having been promoted to head of sales.

What if an employee resigns?

If someone hands in their notice, consider immediately putting them on gardening leave (if you are entitled to do this under the contract). While this is frustrating because you have to pay them not to work, it immediately prevents them having further contact with your clients, starting the process of breaking down those relationships. At the same time, the employee cannot begin working for anyone else. The contract should specify when the restrictive covenants take effect, and in most cases time on garden leave will be counted towards the time for which someone is restricted, because otherwise the period may be too long.

It is worth reminding departing employees of the restrictive covenants by which they are bound, especially if they signed their contracts some time before and may have forgotten. If they are signing a compromise agreement, it is usual to reiterate that they are bound by those.

If you are aware that someone is intending to breach their covenants (or it is highly likely that they are, because they are going to work for your largest competitor), then you may

apply for a pre-emptive injunction (also known as a springboard injunction). Alternatively, you can apply for an injunction once you become aware that a breach is taking place. Take legal advice, though, because injunction proceedings are costly and success is never guaranteed.

Competition is a fact of life in business and in a free market it cannot, and should not, be restricted. But it is important that competition takes place on a level playing field, and restrictive covenants can help to ensure that companies are protected and that the departure of a key employee is not devastating to the business.

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