Restrictive covenants

A contractual term restricting an employee's activities after termination is void for being in restraint of trade and contrary to public policy unless the employer can show that:

- It has a legitimate proprietary interest that it is appropriate to protect.
- The protection sought is no more than is reasonable having regard to the interests of the parties and the public interest.

General

An employer cannot impose a covenant merely to stop someone competing, but it can seek to stop that person using or damaging something which legitimately belongs to it. This type of restriction is to be distinguished from the duty of confidentiality that an employee owes to an employer. The duty of confidentiality is founded in common law and does not require an express restraint to be enforced. In principle, the duty applies whatever the circumstances of departure.

There can be no guarantee that any restrictive covenant will be enforceable and there are no general guidelines which can be specified as to what would be considered reasonable, for example in terms of time or geography. Each clause must be considered in each case by reference to the business needs of the employer imposing the restriction.

Protection?

To determine what rights may require protection; the employer must look at the nature of its business and the employee's position in that business.

In broad terms, the rights that a court will allow to be protected fall into two categories:

- Trade connections (with suppliers or customers) and, more generally, goodwill.
- Trade secrets and other confidential information.

As regards trade connections, an employer must be careful to distinguish its own customer connections from the personal qualities of the employee. The employer has to establish a

proprietary right that was capable of being protected. For example the success of the business may solely be due to the employee's personal qualities and skills.

As regards trade secrets, it is uncertain how "confidential" a piece of information must be for it to constitute a proprietary interest that it is appropriate to protect. The courts have accepted that a secret manufacturing process is a legitimate business interest (depending on the precise circumstances). Price lists, sources of supply and customer lists are more contentious. If the information is generally known to the world at large, or if its disclosure to a third party is unlikely to be in any way damaging to the employer, it is very unlikely that it would form the basis for a protective restrictive covenant. If it is genuinely "secret" it will be sufficient.

An employer should distinguish between information and knowledge that the employee has acquired during the course of employment and information or knowledge that may be regarded as the employer's property. The courts will not prevent an employee from using experience and skill gained on the job.

If there is a legitimate interest to protect, the employer should only impose a restriction that is no wider than reasonably necessary to protect that interest. This will involve limiting the covenant not only by reference to the restricted activities themselves but also by reference to the period and (if appropriate) the geographical extent of its application. Failure to do so will probably result in the covenant being treated as having too wide a scope and being, therefore void.

Non-solicitation covenants

Customers

An employee's personal influence over customers may be dealt with by a covenant preventing an employee from soliciting the customers of the employer. The covenant should be restricted to customers with whom the employee had contact during a specified period before termination.

A sensible way to establish the length of this period may be the amount of time that it would take for the employee's successor to gain influence over the business contacts. Other relevant factors may include the employee's level of seniority in the business, the extent of their role in securing new business, the loyalty or otherwise of customers in the relevant

market and the length of similar restrictions in the employment contracts of competitors.

A clause which attempts to extend the restriction to potential customers will be harder to enforce. Nevertheless, it is in principle possible to protect an interest in genuine prospective customers if they are sufficiently defined.

A non-solicitation restriction need not be limited to customers with whom the individual had direct contact. It can include those of whom the employee was aware, if it is intended to protect either the general customer base (where the identity of the employer's customers is not public knowledge but is known to the individual) or the general goodwill of the business (where that attaches specifically to the individual). If this is the aim, the restriction should be limited to:

- The period that the identity of customers will remain secret; or
- The period that it will take for the individual's knowledge to go out of date; or
- The time until the goodwill ceases to attach to the individual but reverts to the employer.

Existing employees

It is now reasonably well accepted that preventing a former employee from soliciting other employees may protect a legitimate interest in the stability of the workforce.

Accordingly, any clause that seeks to prohibit the poaching of employees will need to consider how long it will be before the influence over existing employees will be eliminated and replaced, and the scope of the classes of employees over whom such influence will exist.

Although the ability of employees to give notice and to leave the employer tends to reduce the effectiveness of this type of clause, attempts are sometimes made to protect employers further by including a clause that limits the freedom of an employee to join former colleagues.

Non-dealing covenants

A restriction on the solicitation of customers can be extended to cover not only enticement or interference (where active steps are required by the individual) but also the provision of services (where no active steps are required: the customer could approach the individual).

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This is known as a non-dealing covenant and has clear advantages as regards enforceability, because it avoids the need to prove that the individual made an approach, which is usually hard in practice. However, it does significantly broaden the prohibition, not only to affect the rights of the employee in question but also those of third parties, so a court is more likely to be cautious about enforcing it.

The enforceability of a non-dealing covenant will depend on the interest being protected. Enforcement may be more likely where the employer can establish a substantial personal connection between the employee and the relevant customers and where the business environment is such that overt solicitation is not necessary for the employer to be exposed to significant loss of business.

The non-dealing covenant will not be enforceable if it prevents any contact with the relevant business contacts. The restriction must be focused on contact with those business contacts that would affect the employer's business.

Non-competition covenants

Employees are restricted as a matter of general law from disclosing confidential information amounting to a trade secret (for example, a manufacturing process) after termination and can be made subject to express confidentiality provisions. Any additional restrictive covenant may be viewed as unnecessary. In light of this, a non-competition restriction has traditionally been harder to enforce than a non-solicitation restriction, since it represents a greater infringement of the general principle that covenants in restraint of trade are illegal.

However, a non-competition restriction is likely to be enforced in certain circumstances:

It may not be possible to give the legitimate proprietary interest, for example a manufacturing process or confidential trade secret, sufficient protection through the implied and express confidentiality terms. A restriction against carrying out the activity is then more realistic, and easier to police.

The individual's influence over customers or suppliers may be so great that the only effective protection is to ensure that they are not engaged in a competing business in any way.

The essential elements to be effective are as follows:

- As with non-solicitation covenants, the restriction must be for a limited time. When deciding the appropriate period it is necessary to consider how long will it be before competitive activities by the individual represent less than a material threat to the legitimate interest? How long will it be, for example, before the manufacturing process changes so much that the individual's knowledge of it is out of date?

- The geographical extent of the limitation must also be considered. Worldwide covenants have been held to be enforceable but such decisions are rare. A longer lasting restriction or one that covers a wider geographical area necessarily represents a greater restriction on trading and that will be taken into account.

  Relevant factors will include:

  - Whether there is an actual relationship between the interest to be protected and any specific geographical area.
  - The area of activities of the employee.
  - The size and nature of the population of the area.

Severability

The courts will not re-write a covenant to make it enforceable if it is too broad. Neither will a court construe a wide (and void) restriction as having implied (and valid) limitations; to do so would mean that employers would have no incentive to pay attention to the accurate drafting of restrictive covenants.

However, a court will seek to interpret a covenant in a way that gives effect to the intention of the parties. For example, a court will treat separate promises as severable: so if a clause contains what, in the court's view, are two separate promises, only one of which is unenforceable, it will uphold the enforceable promise and strike out the other.

The court, in deciding whether unlawful provisions may be severed from the rest of the terms, will consider:

- If the provisions can be removed without needing to add to or modify the existing wording.
- If the remaining terms are supported by adequate consideration.

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- Whether the character of the contract is changed so that it becomes a different sort of contract.
- The need to be consistent with the underlying public policy of avoiding terms that are in restraint of trade.

Associated companies

It is unlikely that a restrictive covenant that applies to associated companies (that is, other companies in the employer's corporate group) will be enforceable.

The exception to this principle is if there is sufficient financial interest such that the performance of the associated company is likely to be adversely affected.

If the employer owns the non-employing associated company (possibly indirectly), it ought to be possible to establish a financial interest in the performance of the subsidiary.

Where the employer is a service company whose purpose is to facilitate the activities of group companies, it ought to be able to demonstrate a suitable connection.

Summary

The employer must therefore consider what aspects of its business legitimately require protection from its employees by way of restrictive covenants. It must then look separately at each employee and determine what level of protection is reasonably necessary in each case. What is appropriate for one individual may not be appropriate for another. For example, a high ranking employee may have more involvement in, and knowledge of, the employer's affairs than a low ranking employee; alternatively two employees on the same level may actually have differing influences over the customers and have varying knowledge of confidential information. The fact that the employer distinguishes between two employees on the same level may help to persuade the court that it has genuinely and reasonably sought to protect its interests.

Some employers provide that any time on garden leave is set off against post-termination restrictions. In practice this may be required when negotiating service agreements.

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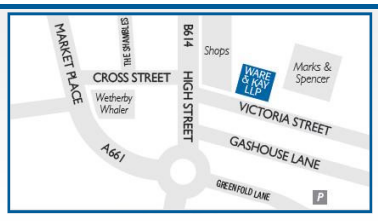

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