An Introduction to the Briefing Note

This Briefing Note outlines the advantages of restrictive covenants and explores the key issues that surround them.

This Briefing Note should not be relied upon as legal advice and you should contact us for advice on your specific circumstances.

1. Background

It is a common misconception on the part of both employers and employees alike that post-termination restrictive covenants do not work, are not worth the paper they are written on, are in breach of European competition law, etc. These “urban myths” continue to hold sway with many people despite the increasing willingness of the courts to uphold and enforce restrictive covenants.

The simple fact is that a well-constructed, reasonable restrictive covenant is the single most effective means by which an employer can protect its business against future competition from departing employees and the theft of confidential data by departing employees. The courts are increasingly unwilling to afford employers the protection of implied contractual terms, where they have failed through either a combination of ignorance or laziness, to include express restraints in their employment contracts at the outset of employment.

The advantages of restrictive covenants are significant and include:

- They are far easier to police than mere confidential information clauses.
- They are far more likely to be upheld than implied contractual terms.
- They extend beyond the period of the employment contract itself.
- They can and should be specifically tailored to reflect the specific circumstances of the employer and employee.
- They have a deterrent effect by dissuading employees from joining competitors.
- They may have a similar deterrent effect on potential new employers.

2. General Approach – Will My Covenants Be Upheld?

The starting point is that a contractual term restricting an employee’s activities after termination of employment is void for being in restraint of trade and contrary to public policy unless the employer can demonstrate that:

- It has a legitimate proprietary interest to protect
- The protection sought goes no further than is reasonable having regard to the interest of the parties and the public interest.

This test will be applied on a case by case basis. It is therefore essential that employers tailor the extent of post-termination restrictive covenants to the circumstances of each individual employee. The fact that an employer has gone to the trouble of distinguishing between two employees within its organisation may help persuade the court that it has genuinely applied its mind to what it needs to protect its interests.
What then is a legitimate interest? A covenant which merely seeks to protect an employer against competition by a former employee will not be upheld, as mere protection against competition from a departing employee is not recognised as a legitimate business interest.\(^1\)

The categories of potential legitimate business interests that may be protected by a restrictive covenant are not closed but are generally accepted to be:

- Trade secrets and confidential information.
- Customer connections.
- Stability of the work force.

Note that these are the same categories of legitimate interests that may be protected by a garden leave injunction.

**Confidential Information**

In relation to the first of these, the court will still need to be satisfied that the employee concerned had access to trade secrets and confidential information which warrants protection. The confidential information must also be sufficiently described in the contract to enable the court to be satisfied that the employer has a legitimate interest to protect. However, the fact that it is difficult to draw the line between information which remains confidential after the employment comes to an end and information which does not, may actually help justify the reasonableness of a post-termination restrictive covenant, such as a non-competition clause as opposed to a mere confidential information clause,\(^2\) as it removes uncertainty and makes it easier for the employer to enforce and police.

**Customer Connection**

Trade connections, refers to connections built up between an employee and the employer’s trading partners, i.e. customers. In appropriate cases this can also extend to potential customers.\(^3\)

The reference to “customer connection” is a reference to either/or the personal knowledge or influence over customers that an employee has, such as to enable him to take advantage of this trade connection if he were to be permitted to compete. Clearly, where an employee has dealt directly with a particular customer over a period of time, he will have gained knowledge and potentially some influence over the customer who has come to rely upon the individual employee to meet the customer’s needs, rather than the employer as a whole. In many cases, this relationship will have been nurtured by use of the employer’s resources, such as an entertainment or marketing budget.

On the other hand, a sales director of manager may have less direct contact with customers but will still have extensive knowledge of them. Where the identity of customers is unknown or undocumented (e.g. in the case of hairdressers) this may, of itself, justify the use of a non-competition covenant rather than the less draconian non-solicitation or non-dealing covenants, which would plainly be ineffective.

**Stability of the Workforce**

It may also be legitimate to prevent an employee from encouraging his former colleagues to join him at his new employer or in his new business venture. After some historic debate, the courts have now concluded that an employer has a legitimate interest in maintaining a stable and trained workforce.\(^4\)

\(^1\) Herbert Morris Ltd v Saxelby [1916] AC 688, HL
\(^2\) Thomas v Farr Plc [2007] IRLR 419, CA
\(^3\) International Consulting Services (UK) Ltd v Hart [2000] IRLR 227
\(^4\) Dawan Day & Co Ltd v D’Alphen [1997] IRLR 442, CA
Introductory Language

It is regarded as good practice to introduce a restrictive covenant by the use of some wording which identifies the legitimate interest that the covenants are intended to protect. However, if this drafting method is to be used, it is essential that all potential legitimate interests are described as the absence of one that is subsequently relied upon may prove fatal to the enforceability of the covenant.  

Reasonableness

Once the employer has overcome the hurdle of establishing that it has a legitimate interest to protect, it then has to demonstrate that the clause itself is no wider than reasonably necessary to protect that interest. Another way of describing this is that the restraint must afford no more than adequate protection to the party in whose favour it is imposed.

For example, a non-competition covenant which prevented a senior employee from being “concerned or interested in” any (competing) business was found by the Court of Appeal to be too wide because the words “interested in” precluded the employee from holding even a minor shareholding in any competing business including publicly listed companies. The word “concerned” however meant something more than mere passive shareholding. Note this aspect of the decision was recently upheld by the Supreme Court, although the clause was ultimately saved by application of the blue pencil test (see below).

The reasonableness of the restrictive covenant has to be determined by reference to the circumstances of the parties at the time the covenant was entered into. In other words, the covenant has to be reasonable from its inception.

Another factor that may be taken into account in assessing reasonableness are the relative strengths of the bargaining positions between the parties. The more junior the employee, the more difficult it may be to justify a restraint, whereas more senior employees who may have negotiated their contracts on an individual basis, sometimes with the benefit of legal assistance, may be more likely to be held to their contracts.

Restrictive Covenants in business agreements

Restrictive covenants are not only found in employment contracts. They are commonly encountered in business purchase agreements, joint venture and shareholder agreements, franchise and commercial agency agreements. Whilst the aforementioned general principles still apply, the approach adopted by the courts to their enforceability is significantly different.

The legitimate interest that the purchase of a business will normally seek to protect by means of a restrictive covenant is the goodwill of the business that he is buying. Despite the fact that the goodwill may technically be owned by a limited company rather than its shareholders a court is usually willing to lift the veil of incorporation and to uphold restrictive covenants against individual shareholders who have been actively engaged in the company’s business.

There are all sorts of reasons to justify a different approach including:

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5 Office Angels Ltd v Rainer-Thomas [1991] IRLR 214, CA
6 Nordenfelt v Maxim Nordenfelt & Co [1894] AC 535, HL
7 Herbert Morris v Saxelby [1916] 1AC 688, HL
8 Egon Zehnder Ltd v Tillman [2018] ICR 574
9 Egon Zehnder Ltd v Tillman [2019] UKSC 32
10 Commercial Plastics v Vincent [1965] 1QB 623
11 Hanover Insurance Brokers Ltd v Schapiro [1994] IRLR 82, CA
Rather than fettering or restraining trade, business sale covenants can be regarded as facilitating trade.

The seller of goodwill should not be entitled to derogate from what he has sold by competing against the business that he has just sold in the immediate future.

Goodwill is clearly a proprietary interest which is being sold and it is therefore valid to protect it.

Business sales tend to be arms length, commercial negotiations, whereas there is an inequality of bargaining power in an employment contract.

Such a covenant seldom prevents a business man earning a living in the same way that it would for an employee.

In some circumstances, there can be an overlap between employment and business related restrictive covenants, such as where an employee is granted shares and required to enter into a shareholders agreement containing restrictive covenants. Such employees tend to be more senior and therefore privy to confidential information. Such employees generally have a choice as to whether or not to enter into a shareholders agreement. As shareholders, the employees also have a clear interest in the wellbeing of the company and in it taking necessary steps to protect it from competition. In such circumstances a court will be more willing to uphold restrictive covenants for longer periods than in a purely employment context

It is commonly the case that the covenants in the shareholders agreement may last for a longer period than covenants in the employment contract for the same individual. In such cases, the fact that a shorter period of restraint in an employment contract was thought appropriate to give reasonable protection cannot generally be used to demonstrate that the longer period of restraint in a shareholders agreement was unreasonable. The court will have regard to the different status of the same person in assessing the reasonableness of the covenant.

Restrictive covenants to protect the goodwill of a business being sold can be enforced against all of the sellers of the business, notwithstanding that some only had a small stake in the goodwill and the business being sold.

In order to protect the goodwill of a business, it may be legitimate to require the seller to retire completely for a period of time from any form of competing business. In a business sale case the scope of an area covenant may be much wider than would be the case in the employment context so a restrictive covenant which effectively required a seller not to compete in the financial services industry anywhere in the UK was upheld despite an argument by the Defendant that an alternative covenant not to deal with existing clients would have sufficed.

It also follows that the length of time that a restrictive covenant will be permitted to run for is far greater in a business sale context than in a pure employment one. A covenant precluding a seller from engaging in any competing electrical engineering business anywhere in the world for a period of 4 years; a 2 year non-compete clause preventing a hairdresser from working in any business in competition with the two salons in which she sold her shares; a 2 year non-competition covenant preventing a salesman from selling financial services in the UK; a covenant against competition for a period of 17 months have all been upheld. In

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13 Kynixa Ltd v Hynes [2008] EWHC 1495 (QB)
14 ibid
15 Systems Reliability Holdings v Smith [1990] IRLR 377
16 Allied Dunbar (Frank Weisinger) Ltd v Weisinger [1988] IRLR 60
17 Allied Dunbar (Frank Weisinger) Ltd v Weisinger [1988] IRLR 60
18 Emersub v Wheatley 14 July 1998
19 Rush Hair Ltd v Gibson Forbes & SJ Forbes Ltd [2017] IRLR 48
20 Allied Dunbar (Frank Weisinger) Ltd v Weisinger [1988] IRLR 60
Briefing Note: Restrictive Covenants

some of the older cases, covenants for a period of 25 years\(^\text{22}\) and a restriction without limit of time\(^\text{23}\) were also upheld but these authorities may now be less reliable.

In Cavendish Square\(^\text{24}\) a case which was subsequently decided by the Supreme Court on the question of the enforceability of penalty clauses, the High Court upheld a non-compete covenant in a Share Purchase Agreement, which lasted for 24 months or until the shareholder divested himself of the shares which in that case would prove to be eight and a half years later. It noted, strikingly, that there had been no reported decision in which a covenant in a Business Sale Agreement had been held to be unenforceable purely because of its duration. In particular it took account of the substantial consideration for the goodwill in the business, that the breadth of the restrictions had not been challenged, that the SPA was negotiated by experienced lawyers on both sides and that the risk to the purchaser was considerable due to the significant influence the seller (who would remain as non-executive chairman) had in the marketplace.

Although in the vast majority of business sale cases, restrictive covenants will be contained in the contractual documents, terms can be implied as a matter of law in particular situations. For example, it is established that when the goodwill of a business is sold, the seller is not entitled to canvass customers of his previous business and may be restrained by injunction from doing anything which may persuade a customer not to deal with the purchaser of the business\(^\text{25}\). This principle applies equally to an outgoing equity partner who has sold his share of the partnership assets to the continuing partners. He may set up in competition and even act for clients of the partnership (assuming he is not subject to any express restrictive covenants not to do so) but it is an implied term that he may not solicit the clients of the partnership to transfer their business to him.

Generally speaking, the courts will be more inclined to enforce a restrictive covenant against an equity partner who has sold his partnership share on retirement, than they would against a salaried partner who does not own a stake in the business.

An area covenant preventing a retiring doctor from practising medicine within a 10 mile radius for a period of 21 years was upheld as reasonable. The retiring doctor was relatively mobile and had the whole of the rest of the UK available to him to practice his skills if he had so chosen. He was an educated man and had been separately advised on the terms of the partnership deed\(^\text{26}\). Of course, were the GP practising in an inner city partnership, such a restriction would undoubtedly be considered unreasonable.

A 2 mile area covenant for a period of 2 years after the termination of the partnership in a 2 partner estate agency was also upheld, notwithstanding that this would have preventing the retiring partner from practising in the entirety of Christchurch and there were 23 other estate agents within that 2 mile area\(^\text{27}\).

A restrictive covenant in a partnership agreement for a firm of solicitors which prevented the retiring partner for a period of 5 years after retirement from acting for any clients of the firm in the 3 years before he retired was also upheld, notwithstanding that the firm had a number of departments and that the partner concerned would have had knowledge of no more than 10% of the firm’s clients\(^\text{28}\). What was crucial was that the retiring equity partner owned and was selling a share of the goodwill. Interestingly, an identical covenant was not upheld in a case of a salaried partner\(^\text{29}\).

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\(^\text{21}\) Systems Reliability Holdings v Smith [1990] IRLR 377

\(^\text{22}\) Nordenfelt v Maxim Nordenfelt Guns & Ammunition Co Ltd [1894] AC 535

\(^\text{23}\) Connors Brothers Ltd v Connors [1940] 4 All ER 179, PC

\(^\text{24}\) Cavendish Square Holdings BV and another v El Makdessi [2012] EWHC 3582

\(^\text{25}\) Trego v Hunt [1896] AC 7, HL

\(^\text{26}\) Whitehill v Bradford [1952] CH 236, CA

\(^\text{27}\) Espley v Williams [1997] 1 EGLR 9 (CA)

\(^\text{28}\) Bridge v Deacons (A firm) [1984] 1 AC 705, PC

\(^\text{29}\) Kao, Lee & Yip v Edwards [1994] 1 HKLR 232, HKCA
Although the covenant in the above case was found to be unreasonable there was no general rule that solicitors should be treated differently from other partners and employees simply because a restrictive covenant may limit a client’s choice of solicitor30.

It is not just in vendor/purchase and master/servant cases that restrictive covenants have been upheld. Pure investors in a joint venture agreement have been found to have a legitimate interest in protecting their investment by means of a restrictive covenant31.

A 12 month non-competition covenant under a goodwill agreement between a financial adviser and his employer, who had paid the adviser for the goodwill in the clients he brought with him, was found by the High Court to be enforceable, on the basis that it was akin to a business sale agreement.32 The Court noted that 12 month restrictions were common in the financial services industry due to the exceptionally strong relationships between the employee and the clients.

Finally, a 2 year 10 mile area covenant in a franchise agreement has been upheld on the grounds that it was more analogous to a business sale (the franchise agreement being a form of lease of goodwill) than an employment covenant and therefore the test of reasonableness was far less stringent33.

3. Have my covenants been included in the contract?

In order to be legally binding on an employee, a restrictive covenant must form a contractual term – in other words, it must be incorporated into the employment contract. Ideally, this will be achieved by the employee signing and returning a written contract containing the covenant. However, in some cases, the contractual terms can be contained in a number of documents, such as an offer letter, a statement of terms and conditions of employment and a staff handbook. This can lead to uncertainty as to whether the particular covenant has been incorporated into the contract.

Incorporation

It is seldom going to avail an employee who has signed a contract to say that he hadn’t read the particular clause or that the clause was so onerous that he should have been drawn to his attention by the employer34. However, had the restrictive covenant not actually been contained in the contractual document signed by the employee, but simply referred to in them and the employee was given limited time to sign the document, there may be some scope for the employee to argue that the covenant has not been incorporated. It is frequently the case that restrictive covenants are contained in staff handbooks. This is unwise because it suggests that the covenant applies to all employees regardless of their seniority and the nature of their role. Nevertheless, if the covenant is contained in the staff handbook it is crucial that the employee is provided with a copy and signs to acknowledge receipt and agrees to be bound by its terms.

As stated above, when considering the reasonableness of restrictions, the court will only have regard to the employee’s job title and seniority at the time of entering into the covenant and will not take into account any subsequent promotions35. In the Neilly case it was held that if a covenant was unreasonable at the time that it was entered into could not be saved by reason of a subsequent change in circumstances for the employee, i.e a promotion, as it is deemed invalid from the outset. The court said that in these circumstances, the employer should either have obtained a fresh acceptance of the covenant from Mr Neilly or asked him to sign a fresh employment contract. A general acknowledgment that “his previous terms remain unchanged” was deemed insufficient. The situation is therefore relatively straightforward when the employee is being promoted or receiving a pay increase. It is more complex when the employer seeks to impose restrictive

30 Allan Janes LLP v Johal [2006] IRLR 599
31 Dawnay, Day & Co v D’Alphen [1998] ICR 1068
32 Merlin Financial Consultants Ltd v Cooper [2014] EWHC 1196 (QB)
33 Kall-Kwik Printing v Rush [1996] FSR 114
34 Peninsular Business Services Ltd v Sweeney [2004] IRLR 49
35 WRN Ltd v Ayris [2008] EWHC 1080 and Patsystems Holdings Ltd v Neilly [2012] EWHC 2609 (QB)
covenants part way through employment without the promise of promotion or increased pay. Generally speaking, an employment contract can be amended in one of four ways:

- By containing a variation clause within it enabling the employer to make changes
- By obtaining the employee’s express agreement to the new terms, either individually or collectively
- By unilaterally imposing the change and relying on the employee’s conduct to establish implied consent
- By terminating the employment on notice and offering re-employment under new terms

The least risky option is plainly to obtain the employee’s express agreement to the new terms. This should be evidenced by the employee signing and returning a fresh contract of employment. Simply providing a new contract of employment containing restrictive covenants which, by their very nature will not have any immediate impact upon the employee, may result in a court finding that the employee is not bound by the new terms.\(^{36}\)

Where the employee seeks to introduce new covenants by terminating the old employment contract and offering re-employment on new terms, it may be open to the employee to claim unfair dismissal. Provided the employer can show a sound business reason for the change, then the dismissal will be potentially fair for some other substantial reason.\(^{37}\) Indeed, even if the proposed restrictive covenants are unreasonably wide and potentially unenforceable the dismissal could still be fair although this may be a factor going towards the fairness of the dismissal.

### Changing restrictive covenants

An employee may also be able to argue that the covenant has not been incorporated into his contract if it is only introduced after he has commenced employment – for example the contract is given to him a few weeks after starting work and the restrictive covenant is not referred to in the offer letter. The employee may then argue that no consideration has been given for the restrictive covenant and it is therefore not contractually binding upon him.

### TUPE

The Transfer of Undertakings (Protection of Employment) Regulations 2006 (“TUPE”) applies to automatically transfer all rights, liabilities and obligations relating to the employment contract when there is a transfer of a business undertaking.\(^{38}\)

Upon a TUPE transfer, any restrictive covenants will transfer to the benefit of the new employer. Given that the nature of the employer’s business post-transfer may in some cases fundamentally change, this can affect the interpretation and enforceability of the restrictive covenant. For example, a covenant which may have been reasonable in a relatively small business may be deemed to be unreasonable if that business is subsumed by a national or multinational company.

The general approach of the courts to date has been to limit the operation of the restrictive covenant just to the business or its customers that transfer.\(^{39}\)

Any attempt to impose new restrictive covenants after a TUPE transfer, even if the variation is consensual and the new package overall more favourable to the employee, will be ineffective.\(^{40}\) One option, which is

\(^{36}\) [FW Farnsworth Ltd v Lacy [2013] IRLR 198 (HC) and Tenon FM Ltd v Cawley [2018] EWHC 1972 (QB)]

\(^{37}\) [Willow Oak Developments Ltd T/A Windsor Recruitment v Silverwood [2006] IRLR 607]

\(^{38}\) [Regulation 4(2) TUPE]

\(^{39}\) [Morris Angel & Son Ltd v Hollande [1993] IRLR 169]
occasionally found in senior executive contracts, is to impose an obligation under the employee to enter into similar post-termination restrictions with a transferee following a business transfer.

Finally, if an employee objects to a TUPE transfer, their employment will end immediately by operation of law on the transfer date\(^4\). This may have the effect of nullifying any restrictive covenants as the transferee will have no legitimate interest to protect by enforcing the covenants.

### 4. How are restrictive covenants interpreted by the courts?

**Construction**

A court, when interpreting the meaning of a restrictive covenant, will adopt the following principles which merely go to underline the crucial importance of having restrictive covenants professionally drafted and tailored to the particular circumstances of the employee concerned.

If the covenant is ambiguous, the court will prefer the interpretation that is most likely to render it enforceable\(^4\). If a covenant is too wide, the court will not rewrite the contract – nor will it construe a wider restriction as having a more limited ambit\(^4\). The importance of a strict application of the test was confirmed by the Court of Appeal in 2014 when it overturned a decision of the High Court to add words “or similar thereto” into a covenant to render it meaningful. They rejected the employer’s submission that adding the words would merely correct a drafting error – the employer had simply not thought through the extent to which the words used would give it adequate protection.\(^4\)

A court will treat separate contractual obligations as severable. For example, if a non-competition clause was too wide, but a non-solicitation clause in the same contract was reasonable, the court will strike out the non-competition clause but uphold the other\(^4\). It is sometimes harder to judge whether covenants are separate where more than one promise is contained within the same clause. A clause in which a senior employee agreed not to “directly or indirectly engage or be concerned or interested in any business carried on in competition” was found by the Supreme Court to contain three separate promises, from which the words “or interested in” could be severed by blue pencilling. The Supreme Court has confirmed that the following criteria will now apply in severance cases:

- The offending words must be capable of being removed without needing to add to or modify the remaining words (blue pencilling)
- The remaining terms must continue to be supported by adequate consideration
- The removal of the words or provisions must not generate any major change in the overall effect of all of the post-employment restraints in the contract\(^4\).

\(^{40}\) Credit Suisse First Boston (Europe) Ltd v Lister [1998] IRLR 700
\(^{41}\) Regulation 4 (7) of TUPE
\(^{42}\) Turner v Commonwealth & British Minerals Ltd [2000] IRLR 114 (CA)
\(^{43}\) JA Mont (UK) Ltd v Mills [1993] IRLR 172 (CA)
\(^{44}\) Prophet plc v Huggett [2014] EWHC 615 (Ch)
\(^{45}\) Mason v Provident Clothing & Supply Co Ltd [1913] AC 724 (HL)
\(^{46}\) Egon Zehnder Ltd v Tillman [2019] UKSC 32
Briefing Note: Restrictive Covenants

Group Companies

Generally speaking, a restrictive covenant that extends to customers of an associated company, for which the employee concerned does not work, will be held to be invalid\(^{47}\). This does not, however, prevent the court adopting a commonsense approach. So, for example, where employees were employed by a holding company but their day-to-day work was for a subsidiary, the court construed reference to “customers of the employer” as being a reference to the customers of the business in which the employees worked\(^{48}\).

Careful thought needs to go into the drafting of any covenants where there is a group structure.

5. Specific types of restrictive covenants

Non-Solicitation Covenants

Other than in the case of the transfer of goodwill, there is generally no implied restriction upon an employee soliciting a former employer’s customers. The impact of an employee’s influence over an employer’s customers can be met by a covenant preventing the employee concerned from soliciting those customers post-termination. Solicitation requires something more than merely informing the customer of the employee’s departure. It requires a specific purpose and intention to obtain orders from the customer and usually it must involve the employee initiating contact with the customer for that purpose\(^{49}\). Where the customer initiates contact, the employee may be entitled to respond\(^{50}\).

It is also generally acceptable for an employee to notify customers that he has left his former employer and to give his address, although he must not invite them to contact him at that address\(^{51}\). The covenant should be restricted to customers with whom the employee had contact during a specific period before termination. In assessing what the length of this period may be, one useful rule of thumb is to consider how long it will take for the employee’s successor to establish a degree of influence over those customers but inevitably this is fact specific and much may depend upon the loyalty of the customers, the extent of the ex-employee’s role in securing that business, his seniority, etc\(^{52}\).

Generally speaking, the covenant should be restricted to customers whom the employee had contact with, although this need not always be the case provided it can be established that the employee was aware of the identity of those customers\(^{53}\). On the other hand, widening the definition of customer in this way does introduce an element of risk. Some courts will refuse to enforce covenants which go beyond the customers with whom the employee had “personal and material dealings”\(^{54}\).

It is more difficult to restrict solicitation of potential customers. Such protection is normally only appropriate where a business can demonstrate that building up a relationship with its potential customer is a long process involving significant investment in time and money. The key to such clause being upheld is ensuring that “prospective customers” are capable of being precisely defined and identified – such as customers on a specified target list or with whom the employee had provided quotations or had specific negotiations with. The High Court has upheld a covenant restricting dealings with customers with which the employer had negotiated in the 12 months before termination of employment\(^{55}\).

\(^{47}\) Business Seating (Renovations) Ltd v Broad [1989] ICR 729
\(^{48}\) Beckett Investment Management Group Ltd v Hall [2007] EWCA Civ 613
\(^{49}\) Sweeney v Astle [1923] NZLR 1198
\(^{50}\) Austin Knight (UK) Ltd v Hinds [1994] FSR 42
\(^{51}\) Taylor Stuart & Co v Croft CA, 7 May 1987
\(^{52}\) Associated Foreign Exchange Ltd v International Foreign Exchange (UK) Ltd [2010] EWHC 1178 (Ch)
\(^{53}\) Dentmaster (UK) Ltd v Kent [1997] IRLR 636, CA and Capita plc v Darch [2017] EWHC 1248 (Ch)
\(^{54}\) Capita Plc v Darch [2017] EWHC (Ch)
\(^{55}\) International Consulting Services (UK) Ltd v Hart [2000] IRLR 227
The fact that the employee initially brought customers to the employer when starting employment will not in itself preclude a non-solicitation covenant applying although this may be a factor relevant to the length of the restriction imposed. The fact that customers may no longer wish to deal with the former employer is not a relevant criteria in deciding whether or not to uphold the restriction.

Non-Dealing Covenants

A non-dealing covenant prohibits the departing employee from providing any services to the employer’s customers for a given period of time. This will apply regardless of which party approached the other and does not require enticement or interference on the part of the departing employee. This type of covenant is far easier to police than a non-solicitation covenant because it avoids the need to prove that the individual made the approach.

By the same token, it significantly increases the protection for the employer and is therefore less likely to be upheld by the courts. That being said, they are less draconian than a non-competition clause and arguably just as effective.

They are more likely to be upheld where the employer can establish a substantial personal connection between the employee and the relevant customers, such that overt solicitation may not be necessary.

Occasionally, a court will uphold a non-dealing covenant even where there is little or no personal connection between the employee and the client – particularly where a senior employee has been introduced to a large proportion of the employer’s client base.

Finally, the restriction must prohibit contact which would adversely affect the employer’s business. If the departing employee was to carry out an entirely different non-competing work, then the non-dealing covenant would not prohibit such contact.

As has previously been stated, the fact that a non-dealing covenant may restrict the customers’ choice of who it gets its services from is immaterial.

Non-Poaching Covenants

It is generally accepted that it is legitimate for an employer to protect its investment in recruitment and training of its workforce by preventing former employees from soliciting its staff. As with all other types of covenant, however, it is essential that it goes no further than is reasonably necessary to achieve its aims. Therefore, a covenant which sought to prohibit poaching of employees irrespective of expertise or seniority, including employees that had commenced employment after the defendant had left was not enforced.

The High Court has granted an injunction to enforce a covenant restricting a managing director from employing or enticing those who were employed in a senior capacity (either in the company in which he was employed or an associated company) during the last 6 months of his employment.

Again, consideration will need to be given to how long it will be before the outgoing employee’s influence over other employees has been overcome and which category of employees are likely to be susceptible to such influence. A 2 year restriction relating to all employees containing a shareholders agreement was

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56 Hanover Insurance Brokers Ltd v Schapiro [1994] IRLR 82, CA and M&S Drapers v Reynolds [1957] 1 WLR 9, CA
58 See, for example, Allan Janes LLP v Johal [2006] EWHC 286 (Ch)
59 Dunedin Independent Plc v Welsh [2006] CSOH 174
60 Hanover Insurance Brokers Ltd v Schapiro [1994] IRLR 82, CA
deemed to be unenforceable but a clause in an employment contract which applied only to directors and senior employees was deemed to be valid \(^{62}\).

Although a non-dealing clause as opposed to a non-solicitation clause may be upheld in relation to customers, the same cannot be said with employees. Whilst a non-poaching clause may be upheld, it is most unlikely that the courts would uphold a restriction on “employment, engagement or appointment” where there had been no poaching. Public policy dictates that third parties should not be restrained in their ability to seek employment elsewhere \(^{63}\).

**Non-Competition Covenants**

Non-competition covenants are the most draconian of all post-termination restraints. By their very nature, they come closest of all to infringing the restraint of trade principle. They are attractive to employers because of all covenants they are the easiest to police. They are viewed as “the most powerful weapon in the employer’s armoury” \(^{64}\).

These kinds of restrictions have conventionally been justified in order to protect confidential information \(^{65}\). A straightforward confidential information clause may not operate to prevent an employee using confidential information in future employment and this, of itself, may justify the implementation of a non-competition clause \(^{66}\). Recently Dyson Technologies was able to successfully enforce a 12 month global non-competition covenant to prevent one of their engineers, who was afforded access to high level confidential information in respect of the research and development into a design for an electric car, to prevent him going to work for Tesla \(^{67}\).

Increasingly, however, such covenants can also be justified in order to protect trade connection where the individual’s influence over customers or suppliers may be so great that the only effective protection is to ensure that they’re not engaged in a competing business in any way. That said, it remains the usual case that non-solicitation and non-dealing clauses are the preferred form of restriction to protect customer connections \(^{68}\) but it is recognised that in certain circumstances these may give inadequate protection. A 12 month non-compete clause in the case of a managing director that had sensitive confidential information that would have been helpful to a competitor he was going to work for in devising a strategy to undercut his former employer was upheld \(^{69}\). A non-solicitation covenant would have been difficult to police because the solicitation of clients was unlikely to be carried out personally by the former managing director and therefore it did not give adequate protection.

Similarly, 12 month non-competition covenants are often upheld in the financial services industry to reflect the strength of customer connection and industry standards \(^{70}\).

Where the employee is the only individual within the organisation carrying out that particular kind of work or trade, a covenant against future competition may not be upheld if the effect of the employee’s departure was to render it impossible for the employer to carry on with that business \(^{71}\).

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\(^{62}\) Dawnay, Day & Co v D’Alphen [1998] ICR 1068

\(^{63}\) White Digital Media Ltd v Weaver [2013] EWHC 1681

\(^{64}\) Per Underhill LJ in Patsystems Holdings Ltd v Neilly [2012] EWHC 2609 (QB)

\(^{65}\) Littlewoods Organisation Ltd v Harris [1977] 1 WLR 1472, CA

\(^{66}\) Printers & Finishers Ltd v Holloway [1965] 1 WLR 1

\(^{67}\) Dyson Technology Limited v Pellerey [2016] EWCA Civ 87

\(^{68}\) Office Angels Ltd v Rainer-Thomas [1991] IRLR 214 CA

\(^{69}\) Thomas v Farr PLC [2007] EWCA Civ 119


\(^{71}\) Phoenix Partners Group LLP v Asoyag [2010] EWHC 846 (QB)
Non-compete clauses need to be precise in defining the type of business in which the employee may not be engaged during the operation of the restraint. In short, it must be business of the kind in which the employee was engaged by the employer. There are many examples of covenants which have not been upheld for this reason\textsuperscript{72}.

The factors which will influence the reasonableness of a non-competition clause are multifarious. They include the following:

- The duration of the restraint, self-evidently the shorter the better. In practice a covenant of 6 months duration is the maximum – increasing to 12 months in exceptional cases for very senior employees in possession of highly sensitive confidential information.

- How wide is the restraint in geographical terms? Much will inevitably depend on the geographical reach of the business. In certain circumstances, a worldwide restraint may be upheld\textsuperscript{73}. Whereas, a 3 kilometre restraint which took out the entirety of the City of London was considered too wide\textsuperscript{74}. If a business is highly localised, then the area covenant should be tailored to reflect this. A covenant covering a radius of 25 miles where the customers were concentrated within 20 miles was struck down as being too wide\textsuperscript{75}.

- Is the business sufficiently defined? It is essential that the employee is restrained only against carrying out business of the kind that he carried out for the employer.

- Does the restraint relate only to business in which the employer was engaged at the time of termination of employment and, if so, for how long? It is sensible to specify a period, normally no more than 24 months in the period leading to termination against which this will be judged.

- Finally and crucially would a form of restraint less extensive and draconian than a non-competition clause give the employer adequate protection?

**Miscellaneous other clauses**

Some covenants include a provision for the employee to seek the consent of the former employer prior to taking up a competitive activity. The benefit of such a clause to an employer is questionable as it is always open to the employer to waive any alleged breach of contract. Such a clause runs the risk of a term being implied that such consent will not be unreasonably withheld, thereby imposing a further hurdle for the employer to clear.

Other clauses may require an employee to notify the employer of the identity of his new employer once he has accepted a position. It is also commonplace to require the employee to inform the new employer of any post-termination restrictive covenants.

The usual route for an employer to take will be to initially attempt to obtain contractual undertakings or alternatively undertakings to the court. If that fails the employer may take steps to obtain an interim injunction.

The court will consider all of the principles set out in this note and the principles applicable to the grant of an injunction generally but ultimately the court has a discretion whether or not to grant an injunction and may refuse an injunction even if the covenant is reasonable\textsuperscript{76}.

\textsuperscript{72} Norbrook Laboratories (GB) Ltd v Adair [2008] IRLR 878 and Wincanton Ltd v Cranny [2000] IRLR 276, CA
\textsuperscript{73} Commercial Plastics v Vincent [1965] 1 QB 623, CA
\textsuperscript{74} Office Angels Ltd v Rainer-Thomas [1991] IRLR 214 CA
\textsuperscript{75} Spencer v Marchington [1988] IRLR 292
\textsuperscript{76} TFS Derivatives v Morgan [2005] IRLR 246
Briefing Note: Restrictive Covenants

Some of the factors which will affect the exercise of the court’s discretion include:

- Whether the injunction will serve any useful purpose
- Whether there is evidence that the covenants will be breached
- The amount of time in which the covenant will remain in force
- Any delay on the part of the employer in coming before the court
- Whether an injunction would result in breach of contractual commitments made to an innocent third party
- Whether the damage caused by the breach of covenant can be compensated by damages or some other financial remedy, such as an account of profits.

6. Enforcing Restrictive Covenants

Joining Third Parties

In certain cases it may also be possible to bring proceedings against the employee’s new or prospective employer for one of the three available economic torts, namely:

- Inducing breach of contract
- Conspiracy
- Unlawful interference with business

It is unlawful for a third party knowingly and intentionally to procure a breach of contract – including a post-termination restrictive covenant.

The tort of inducing breach of contract requires the existence of a contract; a breach of that contract; the fact that the third party procured or induced the employee to breach his contract; the fact that the third party knew of the existence of the relevant term in the contract or turned a blind eye to its existence and finally that the third party actually realised that the conduct that it was inducing or procuring would result in a breach of that term.

The requisite elements to establishing causing loss by unlawful means requires an interference with the actions of a third party; using unlawful means with the intention to cause loss to the claimant. The claimant must show that he either has suffered damage or will do so.

Conspiracy requires an agreement or understanding between 2 individuals or entities to injure the claimant by unlawful means.

Typically, an employer might choose to join the new employer or prospective employer into the court proceedings, either because it increases the pressure on the employer to desist from breaching the contract and/or because the employer will often have greater financial resources and therefore the ability to pay costs and damages. A cautionary approach is nevertheless recommended. Joining a third party can add a large degree of complexity to the claim and the evidential burden of establishing liability, particularly due to the “knowledge” requirements of the third party are considerable.

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77 Errowstar Maintenance International Ltd v Wilson [2010] EWHC 2032 (Ch)
78 OBG Ltd v Allan [2007] IRLR 608 HL
7. Defences

Typically, the approach of a defendant in a restrictive covenant injunction case will be to put the claimant employer to proof of each and every element of the case, particularly in relation to incorporation, construction, justification and reasonableness of the covenant. It is unusual for a defendant employee to put a positive defence forward because it will be for the claimant to prove it has a good arguable case and that the balance of convenience justifies the grant of an interim injunction.

Occasionally, however, a claimant will assert that the covenants are not binding upon him because the employer has acted in a way which fundamentally breaches the contract.

Repudiation

It is a general principle of the law of contract that if an employer terminates an individual’s contract of employment in breach of its terms – for example, without giving notice – the individual is then free from any terms of the contract that are intended to survive its termination including post-termination restrictive covenants. This is one of the attractions of having a payment in lieu of notice clause in the contract. In these circumstances, a summary termination of employment, if met with a payment in lieu of notice, would not amount to a breach of the contract and the restrictions would remain in force.

This line of argument is encountered in a constructive dismissal scenario where the employee resigns in response to the employer’s repudiatory breach of contract. If a constructive dismissal is established, then the employer will not be able to enforce any of the post-termination restrictive covenants.

Employers have attempted to get round this by stipulating that the restrictive covenants will apply on termination “howsoever caused” and “whether lawful or not”. In Scotland, such wording has been found to be unreasonable and could potentially place the whole covenant in jeopardy, even if termination was actually lawful.

Nevertheless, there are limits to the doctrine of repudiation. In particular, it is unlikely to apply to traditional partnerships and to members of an LLP, where the contract or deed is between multiple parties.

If you would like to know more about this topic or our other legal services, please contact Paul Maynard paul.maynard@gabyhardwicke.co.uk

Gaby Hardwicke Solicitors
33 The Avenue
Eastbourne
East Sussex
BN21 3YD
Tel: 01323 435900
Fax: 01323 435901
info@gabyhardwicke.co.uk
www.gabyhardwicke.co.uk

79 General Billposting v Atkinson [1909] AC 118 (HL); Rock Refrigeration Ltd v Jones [1996] IRLR 675 (CA)
80 Living Design (Home Improvements) Ltd v Davidson [1994] IRLR 69; PR Consultants Scotland Ltd v Mann [1996] IRLR 188
81 Flanagan v Liontrust Investment Partners LLP [2015] EWHC 2171