



## Is a bonus clawback provision a restraint of trade?

In a reassuring decision for employers, the High Court has confirmed that an employer's use of a contractual provision to clawback an employee's bonus was lawful. The ruling in *Steel v Spencer Road LLP* provides helpful guidance on the circumstances in which a bonus clawback will not constitute a restraint of trade, though employers should be mindful that not all such provisions will be enforceable. In this article, we summarise what this judgment means for employers who offer or would like to offer incentive schemes where an employee is expected to pay back some of their reward in certain circumstances.

### What to consider when drafting clawback provisions

A "clawback" is a contractual provision under which an employer seeks to recover money it has paid to an employee where certain conditions are or are not met. Often, as happened in this case, a term will provide that an employee must return all or part of their bonus if the employee gives or receives notice to terminate their employment within a specified timeframe after receipt of the bonus.

As a general rule, contractual terms that prevent an employee's ability to work for another company will be unenforceable as a "restraint of trade".

We set out the facts of the case below, but the key takeaways for employers are:

- A well-drafted clawback clause requiring an employee to repay their bonus should not constitute a restraint of trade and should be enforceable.
- There is no precise definition of when a clause will be a "restraint of trade" but a disincentive to resign will not automatically turn a clause into one.
- The key factor when assessing whether a clawback is enforceable is the practical effect the clause has on the individual. In particular, does it prevent the employee from working elsewhere?



## Background to the case

Mr Steel participated in a discretionary bonus scheme at the global executive search firm where he worked. Under the bonus scheme, Mr Steel received substantial bonuses that were significantly higher than his basic salary. The bonuses were conditional on him remaining in employment, and not having given or received notice, for three months from the payment date.

In January 2022, Mr Steel was paid a bonus of £187,500 (compared to a basic salary of £65,000). This was the biggest bonus he had received to date. He then resigned in February 2022. He refused to pay back the bonus when he was requested to, so the employer served a statutory demand for the bonus plus their legal fees.

Mr Steel applied to the courts to have the statutory demand set aside – he claimed that the clawback provision was unenforceable because it was an unreasonable restraint of trade and/or a penalty clause.

## What does the judgment tell us?

Having lost in his arguments at the first instance court, Mr Steel appealed to the High Court. The judge at first instance stated that the argument that the clawback was a penalty clause had no real prospect of success. Mr Steel did not appeal this finding and instead focused his appeal on the clause constituting an unreasonable restraint of trade. Unfortunately for Mr Steel, the High Court did not uphold any of his four grounds of appeal.

The High Court found that the clawback provision was not a restraint of trade for the following reasons:

- There is a distinction between a disincentive to resign and a restriction on finding new work.
- Simply losing a benefit if an individual leaves employment does not mean there is a restraint of trade. This will clearly be a disincentive to resign, but unless there is a specific restriction on where an individual might work after they resign, then it is not a restraint of trade. In this regard, the judge relied on the decision in *Tullett Prebon v BGC Brokers LP [2010]*, which Mr Steel had argued was wrongly decided in light of earlier cases.
- There is no need to consider the effect of the bonus provision in conjunction with other provisions of the employment contract in deciding whether it is a restraint of trade. The fact that Mr Steel would effectively need to remain employed for six months in order to retain his bonus (i.e. the combination of the three month clawback period and his three month notice period) had no bearing on the enforceability of the clawback provision.

## As an employer, what should I be doing now?

The judgment in this case does not set out any new legal principles but it does confirm some helpful pointers when assessing whether a clawback clause is likely to be enforceable.

Employers should:

1. Check the drafting of any clawback provisions in their contracts and/or bonus/commission schemes.
2. Think about the practical impact the clause will have on the individual.
3. Ask: does the provision simply act as a disincentive to resigning or does it restrict where the individual could work next?
4. If in doubt, seek legal advice!