Post-termination restrictive covenants - Do yours hold up to the scrutiny of the Court?

By Lisa Rix - 31 January 2018

Earlier this month, the Supreme Court heard the appeal in *Tillman v Egon Zehnder Ltd*, in which a six-month non-compete restrictive covenant was found to be invalid. The restriction, which sought to prevent a former employee from being "concerned or interested" in any competing business, was deemed impermissibly wide because the phrase "interested in" included holding one share in a publicly quoted company – this was despite a reference to shareholding in the clause already being removed by the court. This will be the first case regarding the construction of an employment restrictive covenant to be decided by the Highest Court in the Land in over a century. Its progress has been keenly tracked by many; see our previous article on this case here.

Whilst awaiting the Supreme Court's final say on the enforceability of post-termination restrictive covenants ("PTRs") such as this, we have set out below the critical issues that employers need to consider when reviewing the drafting of their own PTRs.

Give them Legitimacy

The starting point is that any PTR is void for being in restraint of trade and contrary to public policy.

Nonetheless, they can be enforced if the employer can show that: (a) it has a legitimate business interest that it is appropriate to protect; and (b) the protection sought is no more than is reasonably necessary having regard to the interests of the parties and the public interest.

What exactly are 'legitimate business interests'? They include:

a. protection of trade connections (with clients or customers) and goodwill;
b. protection of confidential information or trade secrets; and
c. stability of the workforce.

Most employers will be able to show they have some legitimate interest to protect.

Have Reasonable Expectations

Assuming you get over the legitimate interests test, you then have to assess whether the protection is no more than is reasonable. The bottom line is that you cannot stop your employee from dealing with the world. Instead, the courts will consider a number of factors when considering enforcement:

a. If the business' interests can be protected by less onerous means. For example, if your business' key concern is the protection of its clients, then a court might find that a non-compete is too onerous on the employee, when a non-solicit restriction might suffice.
b. The length of the restriction. If confidential information goes 'stale' after 3 months, a 6- or 12-month restriction will likely be considered too long. A common approach is to set off part of the period of the restriction against garden leave, in order to ensure that the period of the restriction is not too long.
c. Geographical scope. Restrictions should be limited to the appropriate locations, such as the cities or countries, where your clients/employees are actually based.
d. Personal involvement of the employee. Restrictions to protect against ALL clients/employees of the company will be difficult to enforce. The courts are more likely to uphold a restriction concerning clients/employees the employee had material dealings with towards the end of their employment.
e. Consistency across your restrictive covenants. Restraints on junior employees should reflect their position compared to senior employees. A common mistake is to have the same restrictions for large swaths of your employee population. Such approaches may undermine the court's view of the legitimacy of your business necessity if you simply impose blanket rules regarding non-dealing or non-solicitation.

Time is of the Essence

Restrictions are judged at the time the contract of employment is entered into, not at the time the current employer is seeking to enforce the restrictions. Therefore, restrictions should be drafted to be appropriate for the role the employee is being hired for. As the employee gets more senior or gets promoted, the employee should sign up to new restrictions.

Having employees sign up to new restrictive covenants as they get promoted is important, as the promotion is usually seen as adequate consideration for the restrictions being signed. But beware, annual or guaranteed pay rises may not be suitable for the same purpose.

Cut your Losses

Ensure severance clauses are drafted into your contracts to allow a court some flexibility if they need to 'blue pencil' anything. It is better to have the court cull some of your PTRs than strike the whole section down as unenforceable.

In situations where it is business-critical that certain restrictions are enforceable, seeking legal advice is the best course of action. The excitement of bringing on a 'star performer' can mask the difficulties than can lie ahead when employment relationships break down acrimoniously. PTRs are tricky and require a lot of tailoring. However, it is hugely expensive and damaging to get them wrong. Have solid post-termination restrictions to avoid certain post-termination pain.

Related articles:

How easy is it for your team to get out of their non-competes on a technicality?

Restrictions on restrictive covenants

Making covenants bite. Courts give answers to burning questions on restrictive covenants!

Fighting farmers unable to make hay

Ex-employee ordered to pay £30,000 in damages and held to covenants