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MAKE IT HARD FOR FORMER EMPLOYEES TO COMPETE WITH YOU

Management

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The message is clear – most contracts of employment do not go far enough to protect employers' legitimate business interests.

In the recent High Court case of Towry E J Limited v Bennett and others, over 400 clients followed seven former employees to a competitor.

The Court said that the wording of the restrictive covenants contained in the former employees' contracts of employment did not help Towry.

The employees' contracts of employment with Towry contained clauses preventing "solicitation" of customers after their employees had left Towry.

In the absence of clear evidence of persuasion by the former employees, the Court found there had been no solicitation of customers. If the contracts had included a covenant preventing the employees from dealing in any way with identified customers for a limited period, the former employees' activity may have been effectively restrained by the Court.

Better still, a non-dealing covenant of itself might have deterred the former employees from post-termination activity.

We have seen employers attempting to rely on inadequate confidentiality provisions to prevent employees working for competitors or with suppliers in circumstances where to do so is likely to undermine the commercial relationship between the supplier and former employer or damage the former employer's customer connections.

Well drafted confidentiality obligations have a valuable role to play but they are not the answer to all problems, especially where confidential information is not defined, does not fall within the categories of information which an employer is legally entitled to protect after termination of an employee's employment or where there is no evidence of misuse of the information by the employee.

The hefty costs order and loss of business likely to follow an unsuccessful attempt to enforce

a restrictive covenant is a valuable lesson for employers.

Towry (unsuccessfully) claimed losses of £6 million. The transferring clients moved over £33 million worth of assets to a competitor.

To add insult to injury, because Towry could not persuade the Court that it had a right to protect its customer connections, it reportedly had to pay around £1 million in respect of the other side's legal costs. Its own legal costs probably exceeded this amount.

We are seeing employers who have good cause to restrict the choices of departing employees but who have not taken the opportunity to exercise legitimate control over employees' post-termination conduct.

The message is clear – most contracts of employment do not go far enough to protect employers' legitimate business interests.

What interests can be protected and how far can you go?

The starting point is that the law will not uphold agreements in restraint of trade. There is a distinction between protecting your business from competition per se, which you cannot do, and protecting legitimate business interests which the Court recognises as assets of the employer.

Business interests include protecting trade secrets and other confidential information, retaining customer connections, maintaining key relationships with suppliers and maintaining a stable workforce.

There is no one size fits all answer.

If at the time the contract is entered into, you can identify business interests which require protection, you should be incorporating restrictive covenants geared to protecting those interests into relevant employees' contracts. These may include: non-competition covenants, covenants preventing solicitation of or dealing with customers, covenants preventing solicitation of or dealing with suppliers and covenants preventing poaching or employment of staff

The covenants should go no further than is reasonably necessary to give effect to your business needs. In the absence of express provisions, you will have very limited protection, most of which ends on termination of employees' contracts. The Courts are consistently reminding employers that in the absence of express restrictions, they will not imply provisions into contracts or stretch the equitable doctrine of confidentiality (which will protect an employer's "trade secrets" following termination of an employment contract) to protect the employer.

Do you hand over client relationships to your employees? Do your employees have access to the business' trade secrets and other confidential information which, put to use in the wrong hands, are likely to be very damaging to your business? If the answer to these questions is "yes" you are likely to have legitimate business interests which justify introducing post-termination restrictions in relevant employees' contracts.

Tips for employers:

• At the outset of your relationship with a new employee, identify the business interests which require protection and draft covenants responding to your business needs.

• If the covenants in your employment contracts are scrutinized by the Courts, they will be judged at the time they were entered. Key employees' roles should be analysed and their contracts should be tailor-made.

• Use clauses relevant to the specific objective.

In the Towry case, a non-dealing clause might have been more effective in protecting Towry's interests, allowing a window of opportunity for Towry's remaining employees to forge relationships with customers in place of the former employees. In circumstances where employees have access to highly confidential information, a covenant preventing a former employee from dealing with identified customers and suppliers for the period until the material ceases to be confidential or of value is likely to be justified as reasonably necessary and more effective than relying on express or implied confidentiality provisions.

• Revise key employees' terms of employment on promotion of employees, as part of an annual review process, when an employee's role changes or on awarding partnership

• Consider carefully with your legal adviser the enforceability of restrictive covenants in respect of specific employees. A clause might be in there but you will be defeated at the first hurdle if a claim to enforce the covenant is frivolous or irrelevant.

What if an employee is preparing or is competing against you in breach of restrictive covenants?

Often bespoke contracts of employment incorporating enforceable restrictive covenants will have a powerful deterrent effect on a departing employee contemplating unlawful activity.

Obtaining interim injunctive relief pending trial to restrain further breaches and to prevent an employee from gaining an unfair competitive advantage is likely to be the most effective remedy available to employers. In practice, an interim injunction often becomes the final outcome of the action, forcing the parties at an interim stage to consider settlement. The following principles typically govern whether an interim injunction should be granted:

- is there a serious issue to be tried?;

- would damages be an adequate remedy for any loss suffered by the employer?;

- will it do less harm to grant an injunction which subsequently turns out to be unjustified, or to refuse one if it subsequently turns out that an injunction should have been granted?

The "serious issue to be tried hurdle" is not a high one. This may involve an investigation of the underlying merits of the employer's case and, in particular, the enforceability of the restrictive covenants and confidentiality provisions. Damages are not an adequate remedy if it can be demonstrated that damages would be difficult to quantify and that the damage to goodwill is very difficult to assess.

An employer is also required to provide an undertaking in damages which may need to be supported by security e.g. in the form of a guarantee from the bank or depositing funds with the Court. The undertaking provides that the employer will make good in damages any loss suffered by the employee if it is later decided that the employer was not entitled to the relief.

Tips for employers:

- Act quickly – delay may be fatal to obtaining injunctive relief.

- Collate and test the evidence – a belief that the circumstances show there must have been a breach is unlikely to be sufficient and may be easily defeated on further investigation.

- Increase the pressure – consider putting the new employer on notice of your claims against your former employee and, if possible, claims against it.

- Consider other claims and strategy with your legal advisers – is there merit in a pre-action disclosure application? Do you have a claim for breach of database rights where client or customer contact lists have been misappropriated?

- Beware of the speedy trial – in an employment context, Courts will often order speedy trials to minimise damage to a restrained party if the Court was wrong to order an injunction that will result in significant costs within a short period.

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