

Business briefing: Restrictive covenants in employment contracts

Employment

This business briefing provides an overview of the law in this area and explains what restrictive covenants are, when they are likely to be enforceable and their use in employment contracts to protect a business' interests.

You should talk to a lawyer for a complete understanding of how it may affect your particular circumstances.

What is a restrictive covenant and when will it be enforceable?

A business can use restrictive covenants (sometimes referred to as "post termination restraints") to protect its interests by restricting an employee's activities for a period after their employment has ended.

A restrictive covenant will only be enforceable if it protects a legitimate business interest, otherwise it will be regarded as an unlawful restraint of trade. The only recognised business interests are:

- trade connections (including the relationship between the business's customers and its workforce); and
- trade secrets and confidential information.

If the business has a legitimate business interest to protect, the restriction will be enforceable, provided it is no wider than is necessary to protect that interest. The covenant must be limited in terms of the restrictive activities themselves, and also apply:

- for a limited time; and
- within a limited geographical area (if appropriate).

Ensure restrictive covenants are drafted carefully

Restrictive covenants must be drafted carefully so that they:

- Accurately reflect each employee's role.

- Reflect the circumstances of the business.
- Go no further than is necessary.

The business should regularly review contracts that include restrictive covenants and check whether they require updating (for example, if the employee's role has changed).

There is little point in an employer seeking to impose blanket and uniform restrictive covenants on its entire workforce since, in all likelihood, they could not be considered as reasonable restrictions to impose on every employee, especially those who might have limited or no access to the employer's customers and confidential information. Putting restrictive covenants in an employee handbook, for example, would be pointless. The better practice is to reserve restrictive covenants for those employees, in all likelihood the more senior ones, who will have access to the employer's confidential information and trade secrets and a close working relationship with the employer's customers and clients.

Give careful to what periods of restraint might be appropriate and reasonable in the case of each individual employee. Whilst restrictive covenants might be justified in the contracts of employees' A and B, a longer period of restraint might be justified for B than for A if B holds a more senior position than A and/or has closer connections with customers than A and greater access to the employer's confidential information and trade secrets.

Non-solicitation restrictive covenants

Customers

A business can include a covenant in an employee's contract preventing them from soliciting customers after they have left the business. This type of covenant will be particularly useful if the employee has a strong relationship with certain customers.

Generally, the covenant should be restricted to customers that the employee had contact with during a specified period before they left. There are a number of factors the business should

consider when trying to establish the length of this period, including:

- the amount of time it would take for the employee's successor to gain influence over the business contacts;
- the employee's seniority within the business;
- the extent of the employee's role in securing new business;
- the loyalty (or otherwise) of customers in the particular market; and
- the length of similar restrictions in the employment contracts of competitors.

Potential customers

A restrictive covenant that attempts to extend the restriction to potential customers will be harder to enforce. However, if accurately defined, it may be possible to protect an interest in genuine prospective customers.

Other employees

A restrictive covenant preventing a former employee from poaching your existing employees can be, in principle, enforceable, as the stability of the business's workforce is a legitimate business interest. However, the covenant should usually be limited to those employees at the same level as the former employee and those more senior to them. Any clause that attempts to prohibit the poaching of employees will need to consider:

- How long the former employee's influence over the other employees will last.
- The roles of the employees over whom the influence exists.

Non-dealing restrictive covenants

A restriction on the solicitation of customers can be extended to cover not only enticement or interference (where active steps are taken by the former employee), but also the provision of services where no active steps are required (for example, where the customer approaches the former employee), known as a non-dealing covenant.

This type of covenant has a clear advantage as it avoids the need to prove that the former employee made an approach, which is usually difficult to show. However, it does broaden the prohibition and consequently may make it more difficult to enforce.

The enforceability of a non-dealing covenant will depend on the interest the business is trying to protect (for example, enforcement may be more likely if the business can establish a substantial personal connection between the former employee and the business's customers).

Non-competition restrictive covenants

Employees cannot disclose confidential information amounting to a trade secret (for example, a manufacturing process) after they leave your business. A business can also include express confidentiality provisions in their employment contract to protect the information. Therefore, additional restrictive covenants may be regarded as unnecessary, and non-competition restrictions in particular can be hard to enforce.

However, there are circumstances in which a non-competition restriction is likely to be enforced. For example, where the former employee's influence over customers or suppliers is so great that the only effective protection is to ensure they are not engaged in a competing business in any way.

We frequently act for employers and employees in drafting, advising on and resolving disputes concerning restrictive covenants.

Call us for more information
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