Bonus clawback provisions designed to disincentivise an employee from resigning were lawful and not in restraint of trade.

In *Steel v Spencer Road LLP t/a The Omerta Group*, the High Court has ruled that provisions in an employment contract requiring repayment of a discretionary bonus if the employee resigned with three months of the bonus payment date were lawful and not a restraint of trade. The result was that the employee was obliged to repay a discretionary bonus of £187,500.

What happened in this case?

Mr Steel was employed by Omerta, a global executive search firm. He was entitled to participate in a discretionary bonus scheme intended to reward good performance and incentivise staff to remain in employment. Entitlement to a bonus was conditional on Mr Steel remaining in employment and not being under notice to terminate (whether given by him or Omerta) on the bonus payment date, or in the three-month period that followed. In the event that these conditions were not met, the contract provided that Omerta was entitled to clawback the bonus as a debt. It also provided that Mr Steel would indemnify Omerta for any costs, fees and charges it incurred in enforcing recovery of the bonus payment.

In January 2022, Mr Steel was paid a bonus of £187,500 (almost three times his basic salary of £65,000). Mr Steel gave notice to terminate his contract on 22 February 2022. In line with the bonus clawback provisions in the contract, Omerta sought repayment of the bonus. Mr Steel refused to comply and Omerta served a statutory demand for the bonus monies, plus legal fees of over £12,000. Mr Steel applied to set aside the statutory demand. He argued that the bonus clawback provisions were unenforceable on the grounds they amounted to a restraint of trade (i.e. terms which restricted his freedom to work for others) and/or a penalty clause.

The Judge found that the bonus clawback provisions did not fall within the restraint of trade doctrine. In reaching this decision, the Judge relied on the decision in *Tullett Prebon v BGC Brokers [2010] EWHC 484 (QB)*. In that case, it had been held that clauses which required the repayment of retention bonuses in the event that the employee resigned before the end of specified term were not provisions in restraint of trade. This was because they did not affect an employee's freedom to take up other employment after leaving.

The Judge commented that there might be circumstances where the severity of the consequences were clearly out of all proportion to the benefit received, but this was not arguable in Mr Steel's case, where the conditions attached to the bonus payment were said to be *"very moderate".* The Judge also held that the argument that the bonus clawback provisions operated as a penalty clause had no real prospect of success.

Mr Steel appealed the decision on the restraint of trade point only to the High Court. In the meantime, he repaid the bonus to Omerta.

What was decided?

The High Court Judge noted that the restraint of trade doctrine requires a two-stage test. First, whether a particular contract is a restraint of trade. If it is, then the contract will only be enforceable if it is reasonable with reference to the interests of the parties and the public. However, this appeal was solely concerned with the first of these two questions, since if the bonus clawback provisions *were* a restraint of trade, it was not disputed that the statutory demand would fall to be set aside.

Mr Steel's primary ground of appeal was that the Judge should not have followed the decision in *Tullett Prebon* because it had been wrongly decided, and, instead, should have followed the decision in *20:20 London v Riley [2012] EWHC 1912 (Ch)*. The *20:20 London* case did not concern bonus payments in employment contracts, but whether a clause requiring a defendant to repay the proceeds of a business sale if he left the business within three years of the sale was a restraint of trade. In that case, the Judge said that the defendant's argument had reasonable prospects of success and allowed the claim to proceed to trial. Mr Steel said this decision demonstrated that a contractual financial disincentive to resign was, on its face, a restraint of trade.

The High Court Judge decided to follow the decision in *Tullet Prebon*, given that it was the only authority which directly addressed whether a bonus clawback provision in an employment contract was a restraint of trade. In contrast, the *20:20 London* case concerned a wholly different type of contractual provision. Further, the High Court Judge did not consider the reasoning in *Tullett Prebon* to be wrong, noting that there was no doubt that making a bonus entitlement conditional on

remaining in employment for a period of time would deter an employee from resigning. However, this did not mean it was a restraint of trade: an employee in this situation is still free to go and work elsewhere without restriction. Therefore, this ground of appeal failed.

Mr Steel also argued that the Judge had failed to consider the impact of other clauses in the contract which operated as a significant disincentive to resign. In particular, while the bonus clawback provisions disincentivised him from resigning within three months of the bonus payment date, he was also subject to a three-month notice period, which meant that he would have to stay in employment for a minimum of six months after the bonus payment date in order to retain the bonus. Further, he was subject to post-termination covenants, including a three-month non-compete restriction. However, the High Court Judge dismissed this ground of appeal, noting that the conclusion that the bonus clawback provisions were not a restraint of trade was unaffected by the fact there were other contractual provisions imposing other restrictions.

The High Court Judge rejected two further grounds of appeal.

What does this mean for employers?

Employers will welcome this decision, since it underlines that contractual conditions designed to deter resignation following the payment of a bonus are enforceable, provided that they do not restrict an employee's ability to work elsewhere after leaving. Furthermore, the lawfulness of such conditions is assessed in isolation, rather than looking at the cumulative

effect of all restrictions within the contract, such as notice periods and post-termination covenants.

However, employers should be mindful of the observation that if the severity of the consequences are "out of all proportion" to the benefit received, then it is possible that that such conditions could be unenforceable. The High Court did not made give examples of what it meant by this but we can surmise that if, for example, a vulnerable employee's salary was artificially suppressed and the discretionary bonus, in fact, represented what should have been their actual remuneration and the contract allowed it to be clawed back for a lengthy period post-termination, it could be argued that a bonus clawback provision effectively handcuffs the employee to the employer in order to receive their basic remuneration.

A point that did not arise in this case is the application of good leaver provisions. Senior employees will expect good leaver provisions to be carved out of bonus clawback arrangements, meaning that a bonus would not be repayable in circumstances where the employee left in the restricted period but was a "good leaver". If the good leaver provision extends to situations where the employee is terminated "without cause", employers should remember that this could potentially cover employees who resign in response to a repudiatory breach. Therefore, employers would be well advised to seek legal advice on the drafting of such provisions to make sure that they are reasonable, clear and achieve the desired effect.

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