Getting your restrictive covenants right – a cautionary tale

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Getting your restrictive covenants right – a cautionary tale

A recent High Court decision reminds employers of the importance of tailoring restrictive covenants to the employee. In Quilter Private Client Advisers Ltd v Falconer, the employer had legitimate business interests worthy of

protection, but the post-termination restrictions it had put in place were unreasonable.

What does the law say?

Restrictive covenants are used by employers to protect their interests once an employee has departed the business. These may take the form of:

- non-competition clauses, which prevent an employee from working in a competing business for a period of time usually in a particular role and sometimes confined to a geographical area;
- non-solicitation clauses, which prevent an employee from soliciting specified clients or customers for a period of time; and
- non-dealing covenants which prevent an employee from dealing with specified clients or customers of the business for a period of time.

The starting point is that such covenants are treated as an unlawful restraint of trade unless they protect a legitimate proprietary business interest of the employer. Any restraint that is to overcome this hurdle must be reasonable and go no further than is necessary to protect the employer's legitimate interests. It is for the employer to show that the restraint is reasonable.

What happened in this case?

Ms Falconer was employed by Quilter as a financial adviser, taking over an existing client base from a retiring adviser. Her contract of employment contained several post-termination restrictions, including a nine-month non-compete clause and 12-month non-solicitation and non-dealing clauses.

Ms Falconer did not enjoy working for Quilter and resigned after six months to work as a self-employed adviser for an organisation called Continuum. As she was still within her

probationary period, she was subject to a two-week notice period only.

Ms Falconer took confidential information belonging to Quilter regarding various clients whom she wished to engage in her new role. Quilter sued Ms Falconer for breach of contract and sought an interim injunction (and ultimately a final injunction) to enforce the restrictive covenants. Quilter alleged that Ms Falconer had breached the implied duty of fidelity and the express terms of her employment contract by:

- not showing Continuum her Quilter employment contract containing the restrictive covenants;
- contacting Quilter's clients during her period of garden leave without Quilter's permission; and
- taking confidential information before she left Quilter's employment.

Quilter also sued Continuum for inducing Ms Falconer to take the confidential information in breach of contract.

What was decided?

The High Court granted an interim injunction against Ms Falconer requiring her to abide by the covenants until the earlier of the date by which they expired and a full trial. In many cases that would have ended the dispute. However, in this case, a full trial did go on to take place.

The High Court dismissed the claim of inducement against Continuum. Ms Falconer was engaged as an independent contractor and she had (unbeknownst to Continuum) uploaded the confidential material she had taken from Quilter onto a portal provided by Continuum. Merely facilitating a breach of contract (without knowing about it) was not enough to amount to inducement.

Ms Falconer was found to have breached her contract in the following ways:

- she had scanned confidential client information onto her personal laptop;
- she had not shown Continuum her contract of employment with Quilter (in breach of an express clause);
- she had attended Continuum's induction course while still employed by Quilter; and
- she had contacted Quilter's clients during her garden leave with a view to transferring their business without permission.

However, the High Court went on to decide that the restrictive covenants were invalid. Although Quilter had legitimate business interests worthy of protection, the restrictions went too far.

The non-competition clause

The Court said that the non-compete went beyond what was reasonably necessary. Quilter's legitimate interests were the protection of its goodwill and confidential information, but this could have been achieved by way of non-dealing and non-solicitation covenants and confidentiality clauses. The covenant was not saved by its geographical limitations because it covered wider areas than those that Ms Falconer had covered (and even if it had covered the correct area, it may not have come to Quilter's rescue).

The Court also took into account Ms Falconer's length of service. The nine-month non-compete applied no matter how long Ms Falconer had been employed by Quilter. No adjustment had been made for employees leaving during their probationary period and/or after only a short period of employment. The Court considered that in her short period of employment Ms Falconer would not have been able to establish long-term relationships with clients.

In addition, the Court noted that the length of the notice period can be an indication of the unreasonableness of the

length of the restraint. The shorter the notice period (here, it was 2 weeks), the less important the employee's services appear to be to the employer and, therefore, the harder it is to persuade the Court that nine months of non-competition is reasonably necessary to protect business interests. Moreover, a much more senior employee in the business was subject to a shorter non-compete restriction of six-months.

Taking all of this together, the High Court found the non-compete restriction to be void.

The non-solicitation and non-dealing clauses

Ms Falconer's contract also had 12-month non-solicitation and non-dealing clauses which restricted her from soliciting, or providing financial services to, anyone who had been a Quilter client in the 18 months before her employment ended and with whom she had had material personal contact or had been materially concerned with during that time.

However, the drafting of the covenants meant that the restrictions were not, in fact, limited to clients that she had dealt with, or to those who had been clients during the course of her employment. Quilter also failed to give evidence to support why an 18-month backstop was necessary, particularly in an environment where clients had bi-annual reviews. A six-month or 12-month backstop might have been reasonable.

The Court concluded that these restrictions were wider than necessary and, therefore, void.

What are the learning points?

Like many other cases before it, this decision highlights the importance of avoiding a blanket approach when drafting post-termination restrictions. It is important to look at the specific circumstances before putting pen to paper. Where non-compete restrictions are concerned, it is also important

to tailor these to reflect the length of the employment relationship and importance of the employee's role. Such covenants should be benchmarked against similar covenants in place for more senior employees.

The Government is consulting on whether non-compete restrictions should be banned altogether, or subject to new rules placing limits on the length of the restriction and requiring employers to compensate the employee during any restricted period. If taken forward, employers will need to adjust, or even remove, non-compete restrictions and consider strengthening other post-termination restrictions where possible.

BDBF can help you prepare an appropriate suite of covenants for your employees. If you would like to discuss this, please contact Amanda Steadman (amandasteadman@bdbf.co.uk) or your usual BDBF contact.

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