

## Welcome to our October edition

Welcome to this month's e-alert. In this issue our Q&A looks at restrictive covenants and there is our usual In Brief and Legislation Update. You can also download this e-alert as a PDF document.

### Q&A

This month's Q&A considers the issue of post-employment restrictive covenants

#### **In the most basic terms, what is a restrictive covenant?**

A restrictive covenant allows an employer to prevent competition from an ex-employee after their employment ends. If there are no post-termination restrictions in the contract of employment, the employee is free to compete with the ex-employer, solicit customers and poach staff.

Restrictive covenants are a restraint of trade. Generally speaking English law endorses the rights of an individual to work and 'ply his trade' and so restrictive covenants will only be enforceable where their scope is limited in accordance with case law. The rights of the employer are balanced with the right of the employee to work: if the effect of a restriction is to cause an ex-employee to be unable to 'ply his trade', it will not be enforceable.

#### **What ingredients are necessary to ensure a restrictive covenant is enforceable?**

First the employer must show that he has a legitimate business interest that he wishes to protect. This could be a trade secret or other information which if disclosed to a competitor, would be likely to cause real or significant damage to the employer. It is unlikely that junior members of staff would possess such information; accordingly restrictive covenants usually only appear in management and, from time to time, sales contracts.

Next, the restraint must be reasonable in terms of time and area. It must go no further or be no wider than is necessary to protect the employer's legitimate business interest. The general rule of thumb is that restrictions should not endure for longer than 12 months. However, in some cases 12 months would be an unreasonably long duration, in others it would be too short. As such, while case law provides guidelines, it is impossible to be prescriptive about what will or will not 'work' - each business and each set of facts are unique.

#### **What can I protect?**

Restrictive covenants tend to protect against three types of anti-competitive behaviour. What follows provides only the briefest guide; each different type of covenant is surrounded by its own case law:

##### *Non-competition:*

The typical non-competition clause prohibits an employee, for a specified time after the end of employment, from carrying on or being associated with the type of business in which the employer is engaged. This covenant will be tied to a specific geographical scope. For example, not to carry on or set up work as a forensic accountant within 15 miles of the ex-employer's forensic accountancy business. A non-competition provision is the most onerous form of post-termination restrictions and, accordingly should only be for a limited period of time.

##### *Non-solicitation / non-dealing:*

Non-solicitation/ non-dealing clauses prohibit the employee from seeking business from or dealing with people who were customers (or prospective customers) of the employer within a specified period prior to the employee leaving employment. This covenant is limited to those customers with whom the employee had personal contact. For example, not to deal with or solicit clients with whom the ex-employee had significant contact within the last six months of his employment with the ex-employer. Generally, a non-dealing provision should be for a shorter period of time than a non-solicitation provision, as it amounts to a more onerous restriction.

## *Non-poaching:*

A non-poaching clause, often called a non-solicitation clause, will prevent an employee from persuading other employees to go with him to a new employer. This is usually restricted to senior employees known to the exiting employee. For example, not to solicit, engage or employ any member of the sales team receiving a Grade 4 salary.

## **What about enforcing restrictive covenants?**

If the covenant is in restraint of trade, either because the employer has no business interest to protect or because it is too widely drafted, it will be void and unenforceable. The examples given above, for example would not be enforceable as they are far too generally expressed. It is worth noting that one of the main issues with restrictive covenants is that, while educated and informed decisions can underlie the drafting of a restriction, the proof of the pudding really is in the tasting - until such time as an employer comes to enforce a restriction it is impossible to be certain whether it is, in fact, enforceable. This is not, however, a reason either not to include restrictions or to include generic, ill-considered clauses. A well drafted restrictive covenant could dissuade an ex-employee from competing or could give the ex-employer a better bargaining position for agreeing a compromise.

If the clause is too widely drafted the courts may apply the 'blue pencil test' to sever that part of the clause that is too wide. The principle of the test is that if the offending words or phrases can be deleted while retaining the sense of the whole clause, the clause will be enforceable, albeit with that amendment made. Recent case law, however, has seen some judges pushing the boundaries of the blue pencil test and substituting rather than deleting offending words. However, this should not be relied on.

An employer's usual remedy when an ex-employee is in breach of an enforceable covenant is an injunction to prevent the ex-employee from carrying on the anti-competitive behaviour from which he has been prohibited. Employers may also claim damages if financial loss has been suffered and ex-employees can be compelled to hand over, for example, lists of customers and details of trade secrets. Such action usually takes place in the High Court.

## **Anything else I should know?**

An otherwise valid post-termination restriction cannot be enforced if the employee has been wrongly dismissed by the employer. For this reason employers would be wise to include a clause entitling them to pay in lieu of notice in any contract which includes restrictive covenants.

Generally, however, it is worth mentioning that this is an area of employment law on which advice should be sought. It is also worth noting that restrictive covenants should be revised and updated from time to time to ensure that the covenant still reflects the current state of the business and the reality of the employee's employment.

## **In Brief**

### **Default Retirement Age**

Judgment has been handed down in *R (on the application of Age UK) – v- Secretary of State for Business Innovation and Skills and ors*, or, as it is more commonly known, the Heyday litigation. Regular readers of the E-alert will be aware that Age UK challenged the Default Retirement Age (DRA) of 65 in the Employment Equality (Age) Regulations 2006. The High Court has held that the UK's DRA of 65 is lawful. A challenge to the lawfulness of Reg 3 of the Regulations, which allows employers to objectively justify direct age discrimination, was also rejected.

While the Government succeeded in respect of maintaining the DRA, their success was narrowly won: the Court held that although the DRA of 65 (and a DRA in principle) was both legitimate and proportionate, there were powerful reasons why an age over 65 should have been adopted.

Two days before the hearing, the Government announced that it will review the DRA of 65 in early 2010 and it seems this pledge was central to their success: the court considered that if there had been no indication of an imminent review it would have granted the application.

## **Sickness during holiday**

The European Court of Justice (ECJ) has handed down its decision in *Pereda –v- Madrid Movilidad SA*. This case is authority for the proposition that where an employee suffers a period of illness during his or her holiday, this holiday does not count towards the minimum period of four weeks paid annual leave under the Working Time Directive (WTD).

Mr. Pereda, a specialist driver, suffered an accident at work about two weeks before starting his allocated four weeks annual leave. The injury put him out of action for six weeks meaning his sick leave almost entirely overlapped with his planned holiday. He requested an additional period of annual leave, but this was refused. On these facts, the ECJ ruled that his period of sick leave should not have counted towards his holiday time.

The ruling emphasises the purpose of annual leave under the WTD which is to enable a worker to rest and enjoy a period of relaxation and leisure. As the purpose of sick leave is somewhat different, the two cannot be combined. Consequently, if a worker decides not to take annual leave during a period of illness, he must be granted a replacement holiday period to ensure that he is not deprived of his entitlement under the WTD. This principle is likely to apply whether the employee falls sick before or during the actual period of leave. Employers who enhance the WTD right and give more than four weeks holiday should be aware that this ruling only protects the WTD holiday: if an employee has six weeks holiday and is sick during one of them he or she will still receive their rights under the WTD.

## **Mitigation and Constructive Dismissal**

In *Stuart Peters –v- Bell*, Ms Bell successfully claimed constructive dismissal against her ex-employers. At tribunal she made a claim for the six months' notice pay to which she was entitled. Her ex-employer advanced the argument that in assessing how much of this notice pay should be given, they were entitled to take account of any money that she earned during this six month notice period. At first instance, applying the *Norton Tool* principle, the tribunal found that Ms Bell should receive the full six months' notice pay despite the fact she had earned money during that period.

On appeal the EAT endorsed the tribunal's decision, relying, again on the *Norton Tool* principle. The Court of Appeal (CA) has, however, overturned the Employment Appeal Tribunal's (EAT) decision, holding that the *Norton Tool* principle does not extend to constructive dismissal, and so a constructively dismissed employee must give credit for sums earned from other employment during the notice period. In so doing the CA has reversed a long standing principle – the *Norton Tool* principle was established in the early 1970s. The CA pointed out that the general rule emanating from S.123 of the Employment Rights Act is that an unfairly dismissed employee should be compensated for loss actually suffered.

Post *Bell*, *Norton Tool* does not apply in situations of constructive dismissal where the normal rules of mitigation apply. As this is an important reversal, the EAT suggested that a final ruling from the House of Lords would be welcome and it is possible that there will be a further appeal.

## **Unofficial Strikes**

The case of *Sehmi –v- Gate Gourmet London Ltd; Sandhu and ors -v- Gate Gourmet Ltd* is authority for two propositions:

- Notwithstanding the developments in human rights and the enshrining of the right to strike, the dismissal of an employee for having taken part in unprotected, or wild cat, industrial action is not automatically fair but rather is potentially fair for the reason of conduct.

- Where a trade union official is called in to mediate an unofficial strike, their presence does not mean that the action is approved by the union. Consequently, the protection afforded to those on official strikes is not necessarily extended to striking employees.

## **Breaches in Industrial Action not Protected by European Convention on Human Rights**

In *Metrobus Ltd –v- UNITE the Union*, an injunction was granted restraining a trade union from taking industrial action. The union had failed to comply with the statutory conditions for notifying Metrobus, the employer, of the numbers and categories of employees involved in the action, and had also failed to notify the employer of the outcome of the ballot as soon as was reasonably practicable. The judge held that although the statutory ballot and notice requirements are detailed, they are not so onerous as to interfere, as UNITE alleged, with the right to freedom of association contained in Article 11 of the European Convention on Human Rights (ECHR).

This is not the first time that a union had relied on the ECHR in an attempt to circumnavigate the technicalities of the statutory ballot and notice requirements, but again the court has found that the requirements pursue legitimate aims and do not make the exercise of the rights in Art 11 unduly difficult. This stance seems unlikely to change any time soon.

## **Equal Pay and TUPE**

*Guttridge –v- Sodexo* concerns the question of equal pay rights in the event of women being subject to the transfer of her employment under the Transfer of Undertakings (Protection of Employment) Regulations (TUPE). The equal pay claim was brought against the transferee in respect of a pay inequality that arose during Ms Guttridge's employment with the transferor, six months before the date of transfer.

The CA held that:

- Claims for equal pay losses, which have accumulated during employment before and up to the date of transfer, must be brought against the transferee within six months of the date of the transfer (and will otherwise be barred by limitation rules); but,
- Claims for losses after the date of the transfer are subject to the usual rules and must be made against the new employer within the six year limitation period, although these claims must be pursued within six months of the termination of employment with the transferee employer.

## **Disability Discrimination – Meaning of ‘Likely’**

In *SCA Packing Ltd –v- Boyle*, Ms Boyle suffered from a voice dysfunction that caused chronic hoarseness when she spoke. After two operations to treat the problem, on medical advice, she submitted to strict rules including not raising and resting her voice. She brought a claim alleging she was disabled in accordance with the Disability Discrimination Act 1995.

Under S.1 (1), a person is disabled if he or she has a ‘physical or mental impairment which has a substantial and long-term adverse effect on his [or her] ability to carry out normal day-to-day activities’. This definition is further supplemented by provisions in Schedule 1, which clarify the different elements necessary to satisfy the definition. Of particular relevance to this case was para 6(1) of Schedule 1. This states that an impairment which would be ‘likely’ to have a substantial adverse effect on the person’s ability to carry out normal day-to-day activities, but for the measures taken by way of correction or treatment, is to be treated as having that effect. Also of relevance was para 2(2), which provides that ‘where an impairment ceases to have a substantial adverse effect on a person’s ability to carry out normal day-to-day activities, it is to be treated as continuing to have that effect if that effect is likely to recur’.

Having been appealed, eventually, to the House of Lords, it was asked to determine whether the degree of likelihood entailed in each of these provisions means probable or 'more likely than not', or whether it simply means that it is a real possibility, something which 'could well happen'.

Having held that the word 'likely' refers to an outcome that 'could well happen' the Lordships specifically reject previous case law to the effect that 'likely' means 'more probable than not', thereby lowering the hurdle for a claimant to overcome in establishing a 'disability' within the meaning of the Disability Discrimination Act.

### **Post-termination Misuse of Confidential Information**

In *JN Dairies Ltd –v- Johal Dairies Ltd and another*, the High Court had to decide, as a preliminary matter, whether there was any actionable breach of confidence or misuse of confidential information when a former employee stole customer invoices from his former employer and gave them to a competitor.

In so doing, the Court had to consider the established principle of the CA in *Faccenda Chicken Ltd –v- Fowler*. This case held that where no enforceable post-termination restrictive covenants exist, only 'trade secrets' or information of an equally confidential nature can be protected once employment has ended. Unauthorised use of another's commercially sensitive information – such as customer pricing (which is not defined as a trade secret) - is likely to be a breach of confidence while the employee is still employed, but does not generally remain protected once the employment relationship has come to an end.

The Court held, on the facts, that the stolen invoices satisfied the test of confidentiality set down in *Faccenda Chicken* because it would give competitors a commercial advantage, the parties involved knew it was confidential, and the employer from whom it was stolen had suffered a detriment in the form of lost orders. Accordingly, the customer invoices were protected by confidentiality.

## **Legislation Update**

### **Transferring Maternity Leave to Fathers**

The Government has announced a consultation on allowing new mothers to transfer some of their maternity leave entitlement to the father. Under the proposals, mothers will be able to transfer up to six months of maternity leave to the father once the child has reached six months of age. Up to three months of that leave will be paid at the same rate as Statutory Maternity Pay if the leave is taken during the mother's 39-week maternity pay period.

Consultation on implementing regulations will begin shortly. The Government intends that the law will be in force by April 2010 and will be effective for parents of children due on or after 3 April 2011 to allow employers time to adjust to the measures. It is proposed that parents will be required to 'self certify' by providing details of their eligibility to their employer. However, employers and HM Revenue and Customs will both be able to carry out further checks on entitlement if necessary.

## **Employment team update**

We are pleased to announce that John Read has re-joined the employment team as maternity cover for Deborah West and Lucy Layet who have both recently had new additions to their families.