RESCUING RESTRAINTS OF TRADE

Tillman v Egon Zehnder Ltd: The English Supreme Court re-examines the enforcement of restrictive covenants - in favour of employers

15 August 2019

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Competition is the life-blood of a free market economy – that is until competition inhibits trade. While employees have the right to work, the English courts have long-recognised that employers have legitimate business interests which may justify placing contractual restrictions on their employees. This is a key concept as English jurisprudence is typically considered by the Bermuda courts to be of persuasive authority.

In legal practice, such contractual restrictions are known as “restrictive covenants”. These covenants are considered against public policy and unenforceable unless drafted no wider than reasonably necessary for the protection of legitimate business interests *and* appropriate in the context of the employment contract as a whole. One example of a restrictive covenant is where a non-compete clause seeks to prevent a former employee from joining a direct competitor almost immediately after the termination of their employment.

What happens when a restrictive convenant goes too far?

Most recently, the English Supreme Court considered a non-compete clause which went beyond what was reasonable by prohibiting a high-ranking employee who was employed as a Managing Director from having shareholdings in a competitor business. In *Tillman*, the employer was originally successful in obtaining an injunction to restrain the former employee’s entry into the proposed employment with a direct competitor. This injunction, however, was set aside by the Court of Appeal when the former employee highlighted the excessive restrictions within the clause and argued that the overreaching effect of those restrictions voided the employer’s entire non-compete clause.

Before the English Supreme Court, the enforcement of restrictive covenants (and the extent to which a Court could assist an employer by striking out an offending portion of their restrictive covenant and leaving the remainder valid and enforceable) was re-examined.

The Court formally determined that the clause was too wide, and therefore was an unreasonable restraint of trade. Notwithstanding this, the Court ruled that it could sever the restrictive covenant to remove the offending language *without changing the meaning or effect of the clause*. On that basis, the Court permitted the remainder of the clause to be enforced by the former employer and ordered a restoration of the injunction.

In reaching its determination, the Court noted that high-ranking employees *can* do particular damage to the legitimate interests of their employers and that when high-ranking employees enter into restrictive covenants, they are able to negotiate with their employers *on nearly an equal footing*.

What does this determination mean for Bermuda employers?

While this determination has yet to be considered by the Supreme Court of Bermuda, key points for Bermuda employers to focus on at this stage are:

- The English Supreme Court was only agreeable to severing the offending language from the restriction on the basis that this could be done *without changing the meaning or effect of the clause*. This means that, in practice, only certain restrictive covenants *may* benefit from this form of Court intervention.

- The English Supreme Court also took the view that while high-ranking employees may be able to look after themselves in contractual negotiations, the real sanction arising from restraint of trade clauses is the "terror and expense of litigation". In such situations, *the average employee is usually at a great disadvantage in light of the greater financial means of the employers.* Accordingly, the Court confirmed that a cautious approach to the severance of post-employment restraints must continue to be adopted by the English judiciary.

A sting in the tail

The English Supreme Court warned that employers should not necessarily expect to recover their legal costs (or all of them) where they win in cases only as a result of being rescued by the Court's severance of their restrictive clauses.

In *Tillman*, legal costs were incurred by the employer before the court of first instance, the Court of Appeal and the Supreme Court. In this respect, the Court noted that the unreasonable parts of post-employment restrictions had cast an unfair burden on others to clear them up and that the clearing up of such "legal litter" by the Courts may be taken into account when considering whether to allow a successful employer to recover their legal costs from an unsuccessful employee.

The final word

Notwithstanding this overall win for employers, clarity remains the best policy when drafting post-termination restrictions. With this in mind, Bermuda employers should re-visit their restrictive covenants before incurring the expense of asking the Bermuda Courts to apply their own interpretation to the enforcement of the same.