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NON-COMPETE CLAUSES: A RESPONSE FROM THE EMPLOYMENT LAW BAR ASSOCIATION

This is a response to the Call for Evidence on Non-Compete clauses, issued by BIS in May 2016.

This response is on behalf of the Employment Law Bar Association ("ELBA"). ELBA represents UK barristers working in employment law and discrimination law. Many of our members advise and represent clients on matters relating to restrictive covenants in contracts of employment. Our members represent clients in a wide variety of sectors of the economy. Our members have experience both of seeking to enforce post-termination restrictions, and of opposing enforcement.

Question 1(a)

We agree that there is no statutory definition of a "non-compete" clause. Such covenants arise as a part of the common law of contract relating to restraint of trade. The relevant legal principles are clear, and the types of clauses which arise in this area of the law are well understood.

In common with the practice of English judges and the main textbook writers in this area, we would prefer to use the terms "restrictive covenants" or "post-termination restrictions". We agree that the types of clauses you refer to at sub-paragraphs (a)-(d) are all relevant as they are types of clause that are potentially in restraint of trade.

In England and Wales many practitioners would understand a "non-compete clause" to mean the type of clause referred to in (a), and possibly (d) ((d) is also often referred to as an "area covenant"), but not (b) and (c). However, usage varies in other jurisdictions, which may use "non-compete" to refer more widely to the range of different restrictive covenants, for example that is often the case in the USA.

Paragraph (b) is commonly referred to as a "non-dealing covenant", and (c) as a "non-poaching covenant". Ultimately however these are all just convenient short hand expressions. What is important is (1) the wording of the particular clause in the relevant contract of employment and (2) whether that clause operates as an unreasonable restraint of trade.

For the avoidance of doubt, in the remainder of this paper we will use the term "non-compete clause" in the broad sense in which it is used in the Call for Evidence.

Question 1(b)

First, clauses which restrict freedom to do business with customers are conventionally divided into two types. Both are often found together in a suite of post-termination restrictions. The first type of clause prevents former workers from soliciting clients of their former employer for a certain period. The second prevents the former workers from dealing with those clients for a certain period, regardless of whether they have solicited those clients.

Second, clauses which restrict ex-workers from hiring workers may cover a range of activities. Some may prevent the ex-workers from soliciting their former colleagues. Others may prevent ex-workers from hiring former colleagues for a certain period, even if there has been no solicitation.

Third, employment contracts commonly have restrictions on use of confidential information and trade secrets which may impact upon a worker's ability to compete against a former employer.

Fourth, as the Call for Evidence's opening notes acknowledge, garden leave may also restrict a worker's ability to compete.

Fifth, contracts of employment may contain indirect restraints on competition, i.e. clauses which do not prohibit an ex-worker from doing certain things, but which provide a financial disincentive from doing so. Examples include (a) clawback of advances of commission; (b) forfeiture of unvested share options or other deferred compensation; (c) clauses requiring repayment of contributions to training costs. The potential of such clauses to operate in restraint of trade is often a matter of debate in particular cases.

Question 2(a)

Our members will have many examples of non-compete clauses being used. There are many reported cases of such clauses being litigated over the last 120 years or more.

Question 2(b)-(c)

In our experience non-compete clauses are used widely across a range of sectors in the labour market. They are particularly common in sectors where:

(1) business is "relationship driven" rather than "product driven": i.e. businesses depend for their success upon the relationships their workers develop with their customers. Thus sales focussed and service focussed roles are particularly vulnerable to exploitation of customer connection by former workers.

(2) business success depends on a level of confidential information and trade secrets that falls short of something protectable as a matter of intellectual property law (e.g. by way of patent).

Question 2(d)

It is not our experience that non-compete clauses are particularly used in relation to higher skilled roles such as science or tech based jobs.

First, one of the principal interests an employer seeks to protect is its customer connection; those in the best position to exploit customer connection many not be in technical roles but instead in roles such as sales.

Second, the type of personal customer connection that creates a risk of exploitation can arise in a whole range of businesses, and has little relationship with how skilled or technical the businesses products or services are. Hairdressing, for example, has been one "everyday" trade where over the years the courts have recognised that businesses are vulnerable to workers leaving and exploiting their relationship with the business' customers.

Questions 3, 4 and 5

As we are a body which represents practising barristers, our experience is in advising and representing clients, and accordingly we have not answered questions 3, 4 and 5.

Question 6

It is highly likely that legislation to restrict the use of non-compete clauses would lead to unintended consequences. In particular, there is a risk that such legislation would stifle the entrepreneurship that the government seeks to promote.

The research to which the Call for Evidence refers looks at entrepreneurship from only one point of view: i.e. as a matter of the freedom of an individual worker to leave an established business and start their own business in the same field.

It is true that a non-compete may dis-incentivise a worker to leave their old employer. Whether or not it actually does so will depend upon the scope of the restriction, and the

period for which it is in place. The courts in England and Wales are astute to strike down non-compete clauses which they consider unreasonably broad, or which last unreasonably long after the worker's employment ends.

However, it is important to look at how that individual may want to grow the new business, and what protection they may need to be able to do so. It is unlikely that an entrepreneurial individual will plan to be a sole trader. As soon as the individual starts to grow the business, and to recruit staff to help it grow, they will face the same need to protect their legitimate interests as any other employer. They may well need the protection of non-compete clauses to make sure their fledgling business is not attacked by those who it employs. In many ways, the start-up business may be more vulnerable to attack from those who it recruits as workers than a more established business. A ban on non-compete clauses may make it more risky for entrepreneurial individuals to start-up businesses.

It is unlikely that intellectual property law and confidentiality clauses would suffice to protect employer's interests:

(1) There are many restrictive covenant disputes which are concerned entirely with protecting customer connection and goodwill, which are legitimate interests in their own right, and deserve protection irrespective of any use of confidential information.

(2) Other restrictive covenant disputes are concerned with protecting information which is highly commercially sensitive (such as business plans, or pricing details) but which is not protected under intellectual property law, as we mentioned above.

(3) The courts have repeatedly recognised that confidentiality clauses may be an inadequate protection for employers. That is primarily because such clauses are difficult to "police": it is difficult to know what confidential information an ex-worker has, and what use they have made of it. It can be a very time-consuming and expensive task to determine what an ex-worker has done with confidential information.

We have a further concern that legislation in this area would be a blunt instrument, and would be difficult to tailor to the mischief the government aims to address. Whether or not a non-compete clause is an unreasonable restraint depends very much on the facts of the particular case. What is reasonable in one set of circumstance may not be in another, even within the same business. There is no "one size fits all" approach. The courts have a well-established and sophisticated approach to determining the enforceability of these covenants. Any legislation would inevitably lead to simplification in the interests of clarity and certainty. That will impede the courts' ability to achieve justice in the circumstances of particular cases, and will lead to a cruder approach.

Further, any legislation will have wider knock on effects outside the immediate employment area. Restrictive covenants are commonly used not just in employment contracts, but in business sale and share sale agreements, partnership and LLP agreements, consultancy agreements, and in a variety of franchising and distribution agreements. Any legislation, to be

successful, will need to balance (1) a proper hesitance to rewrite the law in a large number of commercial contexts and (2) the risk of avoidance measures being taken by re-characterising the nature of the work relationship.

Question 7

The best source of guidance is the well-developed body of case law in this area. There are also a small number of excellent practitioner textbooks which deal with this area of the law. The danger of any "non-legal" guidance in this area is that it risks misleading the reader by oversimplification. There is no substitute for proper legal advice, on the meaning and effect of individual clauses.

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