Restrictive covenants: our clients' views

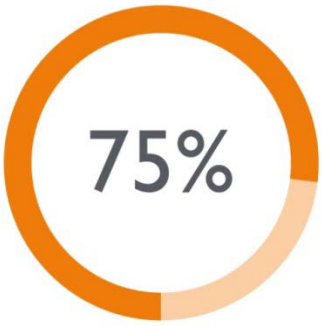
Restrictive covenants – your views

We recently sought our clients' views on the government's proposal to legislate on restrictive covenants. This proposal was made back in May alongside a raft of other measures which, the government says, will promote innovation and flexibility within the labour market through The National Innovation Plan.

Mishcon de Reya was a member of the Employment Lawyers' Association's working party which in July produced a comprehensive response to the government's call for evidence from employment law practitioners.

In the employment context, restrictive covenants are contractual provisions designed to prevent employees from competing with their former employer for a limited period after they leave. Restrictions take different forms and include restrictions on working for a competitor, soliciting clients and poaching employees. Case law has shaped the rules around enforceability over a number of years, establishing that restrictive covenants are only valid if they are necessary to protect a legitimate interest and go no further than is reasonable.

While the details of the government's intentions remain unclear, its central premise is that restrictive covenants may "stifle innovation". We believe that this only addresses one perspective: that of the entrepreneur setting up a new business. Encouraging innovation is important, but without restrictive covenants, how can those entrepreneurs protect what they have created when they become established employers? We therefore surveyed two categories of our clients: established employers and entrepreneurs.



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Do restrictive covenants stifle innovation?

Over three quarters of our respondents disagree with the government's premise that restrictive covenants stifle innovation. In fact, all the entrepreneurs surveyed recognise that restrictive covenants are valuable in protecting businesses from unfair competition, and only 6% of respondents consider that covenants do not offer such protection.

73% of the entrepreneurs we surveyed fear that government intervention in the use of restrictive covenants would impact on the attraction or retention of investment in their businesses.

The vast majority of entrepreneur respondents fear that government intervention in the use of restrictive covenants would impact on the attraction or retention of investment in their businesses. This indicates that, far from promoting innovation, the government's plans might have the opposite effect and actually threaten investment in entrepreneurial start ups. Nearly three quarters of entrepreneurs surveyed believe that restrictive covenants are important to attract business partners such as co-founders or funding via private equity. Nearly half have given restrictive covenants themselves as part of a joint venture, and two thirds have given restrictive covenants on a business or company sale.

Employers agree that limiting the use of restrictive covenants would put businesses at risk: around 80% fear clients, staff and teams could be poached.

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A mistaken emphasis on IP

The government's call for evidence focuses - wrongly in our view - on the protection of intellectual property. Our employer clients share our view that IP is not the central concern here. Only 50% of employers who responded believe that IP could be put at risk if restrictive covenants were less available. Duties of confidentiality and IP provisions in contracts play a central role in protecting business information. However, these sorts of restrictions are outside the scope of the government's review.

76% of respondent employers fear that data could be taken if the use of restrictive covenants is limited.

Conversely, the protection of business information that cannot be classified as intellectual property may well be threatened by limiting the use of restrictive covenants. Our survey reflects this, with 76% of employers fearing that data could be taken to a competitor which would put their business at risk. Non-compete restrictions are often imposed on senior employees for a period immediately after their departure to protect the confidential, financial and strategic data and information that is in their heads. If that employee were to walk straight into a job with a competitor, there is a risk that information could be shared, even if inadvertently. In such cases, a reasonable restraint on joining a competitor to allow the information to go 'stale' may be justifiable, and is often the only way to police the protection of the employer's confidentiality.

How enforceable are your covenants?

One legitimate concern the government touches upon in the call for evidence is certainty. Restrictive covenants are notoriously uncertain, precisely because the courts work hard to weigh up the interests of both parties - and public policy - when considering enforceability. Our research shows that employers still have work to do to ensure their covenants go no further than necessary and that their restraints are reasonable. Only half of all the clients we surveyed who have had restrictive covenants imposed on them personally believed those covenants to be enforceable. This emphasises the importance of meticulously thought out and drafted contractual provisions that are tailored to the threat that each employee might pose.

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Before entering into contracts with staff, particularly with senior or key employees, it is essential that employers carefully consider the restrictions that may be required in relation to each individual. What would be at risk if the particular employee were to leave in the future? Will they have relationships with clients, or assert influence over other staff? And will their knowledge and position in the business also threaten its goodwill or confidentiality if that individual left to join a competitor or set up in competition? If so, for how long? By addressing these questions and drafting accordingly and within the tested parameters, restrictions will be more likely to be enforceable. For the time being at least, both established employers and entrepreneurs are well advised to make the most of the protections that properly drafted restrictive covenants can afford.

What next?

The political landscape has changed since the former Business Secretary Sajid Javid launched the call for evidence back in May. With post Brexit uncertainty, political priorities have also been shaken up, and whatever intervention the government had in mind may now never materialise. As far as both Mishcon's entrepreneurs and employers are concerned, it seems that this can only be a good thing.

In the meantime, the uncertainty generated by the ambiguous intent of the call for evidence may already be putting investment in British business at risk. Our survey results reinforce our view that a change to the law is unnecessary, and could even be counterproductive. We will continue to monitor the government's position if it does choose to pursue this agenda.

If you would like to understand more about the progress of the consultation, or for advice on your restrictive covenants, please contact Jennifer Millins on +44 20 3321 7137 or on jennifer.millins@mishcon.com

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