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RECENT DEVELOPMENTS IN RESTRICTIVE COVENANTS

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RECENT DEVELOPMENTS IN RESTRICTIVE COVENANTS

STEP BY STEP APPROACH TO DETERMINING ENFORCEABILITY

1. The judgment of Cox J, an experienced employment lawyer, in *TFS Derivatives v Morgan* [2004] EWHC 3181 contains a helpful reiteration of the steps to be taken in determining whether a covenant is to be enforced by injunction. Cox J set out the three stage process, as follows:-

    37. Firstly, the court must decide what the covenant means when properly construed. Secondly, the court will consider whether the former employers have shown on the evidence that they have legitimate business interests requiring protection in relation to the employee's employment. …

    38. Thirdly, once the existence of legitimate protectable interests has been established, the covenant must be shown to be no wider than is reasonably necessary for the protection of those interests. Reasonable necessity is to be assessed from the perspective of reasonable persons in the position of the parties as at the date of the contract, having regard to the contractual provisions as a whole and to the factual matrix to which the contract would then realistically have been expected to apply.

    39. Even if the covenant is held to be reasonable, the court will then finally decide whether, as a matter of discretion, the injunctive relief sought should in all the circumstances be granted, having regard, amongst other things, to its reasonableness as at the time of trial.

2. There is nothing objectionable about the last sentence in the passage cited, so long as this is not taken to mean that the covenant is to be reinterpreted or re-assessed in the light of the circumstances at trial.

CONSTRUING COVENANTS

3. The House of Lords has recently clarified (or, if you prefer, confused) the law on the interpretation of contracts, in the commercial case *Sirius International Insurance v FAI General Insurance* [2004] UKHL 54. The approach should be one of commercial realism, rather than literalism.

4. This may not have much impact on covenants imposed in standard format on employees, but could be invoked in cases involving high price City employees who can negotiate their deals.

5. In *Arbuthnot Fund Managers v Rawlings* [2003] EWCA Civ 518, the Court of Appeal applied ordinary principles of construction to covenants. Note also that the Court held that the covenant should be construed at the interim stage, if possible:-

> *The first task of the court - faced with the contention that post-termination restraints on an employee's ability to engage in future business activity are not enforceable - is to construe the contract under which those restraints are said to be imposed. That, as it seems to me, is a task which the court ought to carry out on an application for interim relief (if there is one) if it can properly do so. Unless the court is satisfied that there are disputed facts which bear on the construction of the relevant contractual terms, and that those facts cannot be resolved without a trial, the court at the interlocutory stage is as well able to construe the relevant contractual terms as a court will be at a trial. There is no need to put off until trial determination of the question - what do the contractual terms mean? The court can, and should, determine the scope of the restraints which, as a matter of construction, the contractual terms seek to impose.*

Chadwick LJ paragraph 20.

6. In *FRS Derivatives*, the Court construed a covenant which read as follows

> 12.1 …you will not (except with the prior written consent of the Board) directly or indirectly do or attempt to do any of the following:
>
> (a) for 6 months undertake, carry on or be employed, engaged or interested in any capacity in either any business which is competitive with or similar to a Relevant Business within the Territory, or any business an objective or anticipated result of which is to compete with a Relevant Business within the Territory;
>
> (b) for 6 months entice, induce or encourage an Employee to leave or seek to leave his or her position with the Company or any Associated Company for the purpose of being involved in or concerned with either the supply of Relevant Services or a business which competes with or is similar to a Relevant Business or which plans to compete with a Relevant Business, regardless of whether or not that Employee acts in breach of his or her contract of employment with the Company or any Associated Company by so doing; or
>
> (c) for 6 months employ, engage or work with an Employee for the purpose of the supply of Relevant Services or a business which competes or which plans to compete with or is similar to a Relevant Business.

7. Cox J upheld the covenants as reasonable. Notably, she severed the words "or similar". This might be at odds with the approach in *Wincanton v Cranny* 2000] IRLR 276 ("any business of whatever kind within the UK which is wholly or partly in competition with any business carried on by the employer": too wide) *and* see also *Scully v Lee* [1998] IRLR 259 ("any other business competing with the business of the plaintiff": too wide).

8. Cox J also held that

Even if it were necessary to find separate or distinct covenants within clause 12.1(a) for the words to be severed, in my judgment the effect of clause 12.3 of the contract (see above) is that clause 12.1(a) can properly be construed as comprising two distinct restrictions, as follows, namely, that the defendant will not:

"(a) For six months undertake, carry on, or be employed, engaged or interested in any capacity in any business which is competitive with a Relevant Business within the Territory; and (b) for six months undertake, carry on, or be employed, engaged or interested in any capacity in any business which is similar to a Relevant Business within the Territory."

9. On that reading of the covenant, (a) was reasonable but (b) was not.

ANTI-POACHING INJUNCTIONS

10. An attempt to extend the scope of protection against poaching of staff beyond reasonable bounds was rejected in the well publicised case of *Cantor Fitzgerald v Bird* [2002] IRLR, where the Court refused to grant an injunction in the terms italicised below. This result is unsurprising, given the width of what was contended for:-

An order against the ….defendant restraining it for a minimum of six months from the date of issue of proceedings (with liberty to apply for further periods of restraint) –

a. From knowingly inducing, procuring or participating in any breach of contract by any broker employed in the claimant's interest rates division:

b. From making any offer of employment to any broker employed in the claimant's rates division the terms of which take effect before the expiry of the fixed term (or as the case may be notice period) of the employee concerned, alternatively, restraining the fourth defendant in respect of its

solicitation of such employees for such period and in such terms as the court considers just.'

THE APPROACH TO INTERIM INJUNCTIONS: LAWRENCE DAVID V LANSING LINDE

11. Notwithstanding the observation in *Arbuthnot v Rawlings* as to construing covenants at the interim stage, there has not been any striking development of the applicable principles as to the grant or refusal of interim relief, but, in practice, speedy trials are readily available, and this tends to favour employers, as interim relief is usually ordered pending such trials. See, for example, the *Cantor Fitzgerald* case, cited above.

12. That case, and *TFS Derivatives v Morgan* demonstrate that, in City cases, a trial may be a real prospect.

13. *Lansing Linde* [1991] IRLR 80 is to some extent a reflection of the state of the Court lists at the time of that decision. It will still be relevant where the period of restraint remaining at the date of the interim relief application is short.

COVENANTS AND GARDEN LEAVE

14. In *TFS Derivatives*, Cox J said that she would decline an invitation to give general guidance on the contention that covenants otherwise reasonable should be struck down because it would have been more appropriate to impose garden leave, but nonetheless went on to dismiss the contention.

Littlewoods v Harris Lives On

15. *Littlewoods v Harris* [1977] 1 WLR 1472, a case which ought to be regarded as a one-off Denning-powered lucky result for an employer, nonetheless remains as reliable an authority for employers as ever, as demonstrated in *Corporate Express v Day* [2004] EWHC 2943, which concerned a non-solicitation of customers clause, plus a targeted non-compete, naming specific business rivals of the claimant company (a detailed business sectoral restraint). The clauses were upheld.

DISCRETION

16. That was not, however, the end of the story: injunctive relief was refused on discretionary grounds. First, the covenant had almost expired, and secondly, the injunction would cause the employee to lose her job with the new employer. This is an example of a familiar employee argument, usually brushed aside, having decisive impact, even though the argument could be made in many cases (for example, in *Scully v Lee* [1998] IRLR 259, the employee's victory in the Court of Appeal was pyrrhic, as he had already lost his job).

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