Global Restrictions

Introduction

The impact of today's global economy is becoming increasingly noticeable, not least in the context of employment law. Multi-national companies require executives to travel and conduct business in multiple jurisdictions which has, and will continue to, raise unforeseen difficulties. A major area of concern is the effect and enforcement of restrictive covenants.

Historically employment lawyers advising a UK-based senior executive with restrictions in his contract could be confident that their advice was dependant upon the shifting pattern of English case law. Some restrictions would fail and others would on their face be more likely than not to be enforced. Foreign restrictions were generally more onerous than English ones and so unlikely to be enforced.

The situation today is not that simple. Executives in a multi national company may find that lengthy restrictive covenants which are subject to the jurisdiction of a country which is not their home base can have a significant impact on their ability to take up senior positions with other international businesses.

The Problem

Imagine this; an English executive is awarded share options which are subject to restrictions lasting for a year. Over a period of time, he cashes them in. The share option scheme requires the executive to agree to repay the monies if, after his employment ends, he breaches the restrictions. The executive resigns and takes up a new position with a competitor. If he works and has his assets located in the United Kingdom there will be no money to repay as the English courts will refuse to enforce the restrictions. However, in the global economy, the executive may have been recruited to work in the United States for another international employer, or he may have investments and assets in the United States, or perhaps further monies due to him from his previous employer. In each situation he faces a risk. This is because if the executive fails to comply with the non-competition restriction in the share option program, the American courts may enforce the restrictions, at least to the extent of requiring him to forfeit and repay to the company benefits accrued (such as an increase in share value after exercising the option). The Executive may, therefore, find himself considerably less well off than if he had stayed in the UK and been subject to English law.

A recent case where Microsoft set out to enforce the restrictive covenants against an employee who went to work for Google gives a further indication of the types of problems that can arise. The press comment indicated that the employee had failed to seek a release from the covenants and had assumed that they would not be enforced. However, the growing business environment means that companies are sometimes prepared to spend a great deal of time and money on litigation to enforce restrictive covenants, particularly in relation to key executives whose skill and knowledge can have a real impact on their organisations. According to press reports Microsoft succeeded in obtaining a restraining order from a US court prohibiting the employee from performing duties at Google's China-based research centre that were similar to those he performed at Microsoft until a full hearing early next year.

English Perspective

In England the archetypal forms of restrictive covenants are undertakings not to compete with the employer, not to encourage clients to abandon the employer (non-solicitation of clients) and not to encourage other staff to quit (non-solicitation of employees). There is no legislation setting out the acceptable wording of the covenants. Instead, the law is found in a series of cases decided by the courts over the years. This can make the analysis and drafting of the covenants particularly complex.

As a starting point, the covenant should always be drafted as narrowly as possible. This is because the case law on restrictive covenants has focused on a whole range of matters designed to show that as drafted, the covenant in question is wider than necessary. Covenants have been held to be unenforceable where, for example, the geographical area in a non-compete clause extended too far or when the covenant lasted for too long a period of time. Similarly, non-solicitation of client clauses have been rejected where they applied to clients with whom the executive had no recent business relationship. Where a covenant is flawed, the English courts will sometimes delete a few words but usually the entire covenant fails and is unenforceable.

The duration of the restriction also needs to be carefully thought out and correlate precisely to the business interest being protected. For example, if it is a non-competition restriction which is dependent on confidential information, the shelf life of that confidential information will have a real bearing on the enforceable period of the restriction. Companies and their lawyers rarely have time to perform the lengthy analysis required when drafting service agreements and so companies have been encouraged to keep the restrictions to a short period of time because in England (unlike America) a restrictive covenant that is too long will not be enforced at all. In consequence, most restrictions are expressed to apply for no more than six months and even that can be too long in some cases.

It is also important to understand that there is technically a presumption against enforcing restrictive covenants in the English courts. This is because the basic proposition is that restrictive

covenants are a restraint of trade. The courts have, however, accepted that some restrictions should be enforced. Their argument is that they should only enforce those covenants which are the narrowest restriction necessary to protect what is described as the employer's legitimate business interests.

Legitimate business interests sounds a reasonable concept but in practice they are assessed strictly by the courts. The employer generally needs to prove that: (1) there is confidential information at stake in order to justify a non-competition covenant; (2) client relationships are involved in order to justify a non-solicitation of customers restraint; and (3) a skilled and trained workforce are at stake when the restriction prevents poaching of employees. An example is as follows; where the problem is one of client relationships, a non-solicitation clause will address the problem but will leave the employee free to work with other clients in the same type of business in the same area. In that situation, a non-competition clause will not also be enforced unless the employer can show that there was, in addition to the client relationship problem, confidential information at stake.

Notwithstanding the difficulties highlighted above, in many English cases, where the covenant is carefully drafted and the relevant business interest can be identified, the courts will enforce them as they did in the recent case of *TFS Derivatives v Morgan* which involved equity derivatives employees. In this case, the court upheld a six month non-compete restriction which prevented the employee from working with a business which was in competition with any part of the employer's business with which the employee had been materially involved. However, a six month covenant is not likely to cause irreparable harm or end the employee's career.

American Perspective

American courts, like English courts, look for a legitimate business interest which is being protected when assessing the legality of a non-competition covenant, but take a much more pragmatic approach to enforcement. If the clause is too wide, rather than to invalidate it as is the English rule, American courts are likely to enforce it to the extent reasonable.

Similarly, American courts tend not to be concerned with whether a similar restriction has been judicially enforced against other former employees. This is in direct contrast to the English position where an employer's failure to enforce restrictive covenants in the past might be taken into account when determining whether those covenants could be enforced in the future.

Also, if the prerequisites of enforcement are satisfied, court enforced restrictions are likely to last longer in America, up to as much as a year (and sometimes more). Although this depends on the particular industry for example, there is some tendency in American courts not to enforce a restriction for more than six months in the technology industries where confidential information grows stale quickly.

Another special feature of American law is the deference given to restrictive covenants that are made part of a share-option or other deferred compensation program. If, for example, the employee agrees not to compete in exchange for a share option, pension or other benefit, American courts will typically enforce the restriction even without regard to its reasonableness if the executive quits his position and goes to work for a rival, at least to the extent of requiring a forfeiture of the gain obtained in breach of the restrictive covenant.

Conclusion

An English employee faced with lengthy covenants would traditionally be unconcerned, knowing that an English court would have difficulty enforcing the covenant and that in practice it will have little or no effect on them. However, for a modern globe trotting executive the situation may be very different, as in America, for example, an excessively long or geographically far-reaching covenant might still be partially enforced.

So what impact does this have on the recruitment of internationally mobile executives or indeed on multi national companies? First, recruiters and their clients alike have to be alive to the possibility of there being some restrictions which could prevent their ideal candidate from joining them or could lead to difficult litigation. Secondly, there is a growing awareness amongst the executives that benefits they are being offered have a substantial downside if their career prospects are at risk. We have yet to see whether executives will have the strength of bargaining position to insist that only restrictive covenants applied to them meet with UK standards or whether, at a global level, the broader perspective on the restrictive covenants will win the day.

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