

The Big Chill on Non-Competes

Legal principles, strategy and changing political landscape in the US and UK

Wednesday, March 8, 2023

Thursday, March 9, 2023

Sophie White

Partner, UK – Eversheds Sutherland

Bonnie Burke

Senior Attorney, US – Eversheds Sutherland

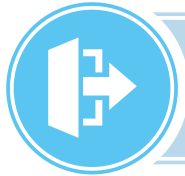


Agenda

-  Types of Protection
-  Garden Leave
-  Confidentiality
-  Restrictive Covenants
-  Global Non Competes
-  Proposed Changes
-  Remedies



Types of Restrictions



Garden Leave



Confidentiality



Non-competition



Non-solicitation of customers



Non-dealing with customers



Non-interference with customers



Non-solicitation of key employees



Non-employment of key employees
(NB: enforceability)



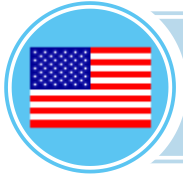
Non-interference with suppliers



*Fundamental to understand what it is
the business needs to protect*

Garden leave

Is it lawful? Impact on restrictive covenants?



US

- Infrequently used in the US – industry specific
 - May not be able to continue participation in medical benefits, 401(k) contributions due to terms of the plan documents
 - May create potential exposure to liability because employee is employed by the employer during this time



UK

- Lawful if expressly in contract
- If breach contract, covenants fall away
- Covenants should be reduced by time spent on garden leave (However, see Square Global Limited v Leonard)



Confidential Information vs. Confidentiality Clauses

- As restrictive covenants become more difficult to assert in contracts with employees, having robust confidential information protections becomes more important.
- Carefully craft language to include all items to be protected
 - Confidential, proprietary information
 - Trade secrets
 - Intellectual property
- Trade Secrets are usually governed by state laws, which provide protections – do not limit based on confidential information provisions
- Take steps to protect:
 - Train employees
 - Mark documents
 - Create safe storage – password protect, limit access, break apart projects
 - Mark third party confidential documents, or take other precautions and alert employees when they are coming in contact with third party confidential documents/information
 - Remind employees upon exit



Confidential Information vs. Confidentiality Clauses

- Confidentiality Clauses – in employment agreements and separation agreements
- NLRB decision in *McLaren Macomb* February 21, 2023
- Confidentiality clause in a separation agreement was too broad
- Violated employees' Section 7 rights to engage in protected concerted activity
- Also decided that the non-disparagement provision was too broad and also interfered with employees' Section 7 rights.



Confidentiality

UK



- Classification of confidential information:
 - Trade secrets
 - Mere confidential information
 - Employee's skill and knowledge
 - Public information
- Express obligations still important – guidance for Court, deterrent value
- Interplay with restrictive covenant cases – consider in each case which of these areas is engaged
- Limitations on use of “gagging” restrictions post #metoo



Restrictive Covenants

US – Basic principles



- Differs by state
- General limitations are reasonableness of scope, geography, duration
 - Governed by legitimate business interest
- State Trends:
 - Initially, limitations on duration
 - Prohibiting restrictive covenants entirely: CA, ND, OK
 - Note: Criminal penalties may be assessed for giving an agreement with restrictive covenants to an employee in California
 - CA: prohibition includes non-disparagement clauses
 - Creating salary thresholds and protections for lower wage earners
 - FTC's NPRM (discussed later)

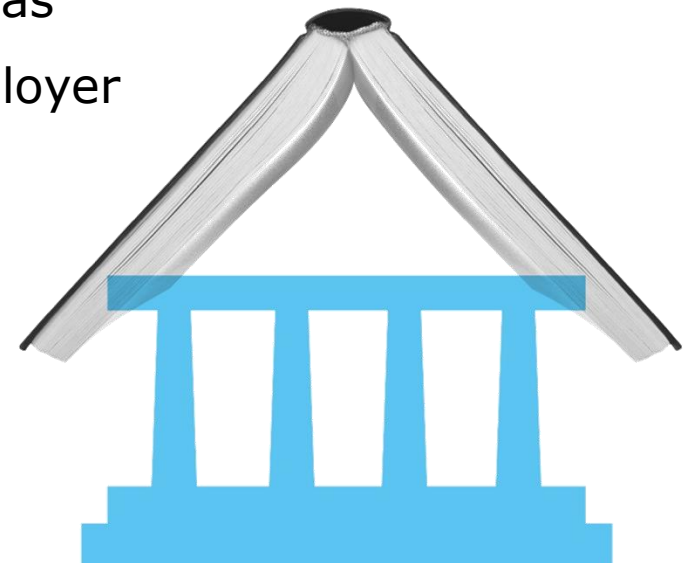


Restrictive Covenants

UK – Basic principles



- Court's starting point is that restrictions are **void as a restraint of trade**
- Only enforceable if go **no further than reasonably necessary** in protecting a **legitimate business interest**
 - What is the legitimate business interest? Protecting customer relationships/stability of workforce/confidential information
 - Are the restrictions reasonable in their scope? eg the restricted activities, the customers/employees referred to, duration, geographic areas
- Not enforceable in the event of repudiation of contract by employer
- Introduction of new covenants for existing employees requires consideration – align with promotion/pay review/bonus?



Restrictive Covenants

UK Recent cases



Tillman v Egon Zehnder [2019] UKSC 32

- The words “interested in” were unreasonably wide as they connected share ownership and would prevent even a minor shareholding in a competing business.
- Supreme Court found the words “interested in” should be severed from the remaining, reasonable parts of the covenant. Affirmed the “blue pencil” test.
 - Unenforceable provision must be capable of being removed without the necessity of adding to or modifying the wording which remains.
 - Remaining terms must continue to be supported by adequate consideration.
 - Removal of the offending provision must not generate any major change in the overall effect of all the post-employment restraints in the contract.



Restrictive Covenants

UK Recent cases



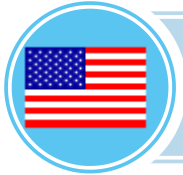
Quilter Private Client Advisers Ltd v Falconer [2020] EWHC 3294 (QB)

- Impact of shorter notice periods during probationary periods
- *"the threat of a departing employee requires less protection if she has had less of an opportunity to build such a relationship with the clients. Having access to client-related documentation does not of itself build a strong client relationship"*
- Does the contract contain a probationary period where a shorter notice period applies **and** restrictive covenants from day one? Should we remove the probation period or apply no/a shorter period of restriction during that time?



Restrictive Covenants

Global non-competes – are they possible?



US

Yes, provided usual tests are met (ie, the restrictions go no further than reasonably necessary to protect legitimate interests)

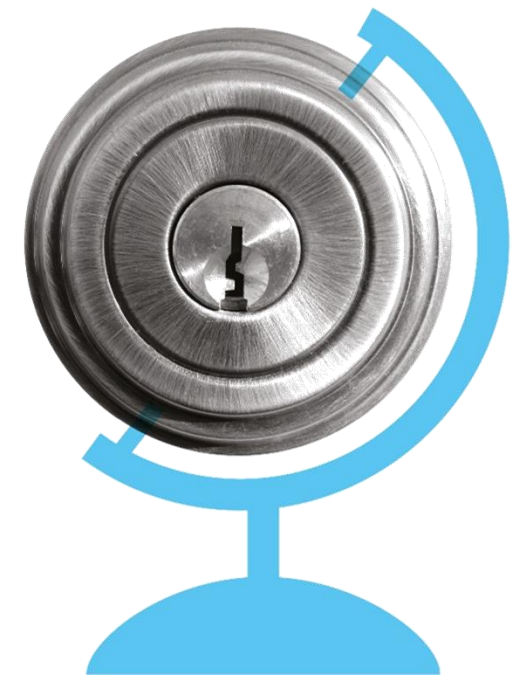


UK

Yes, provided usual tests are met (ie, the restrictions go no further than reasonably necessary to protect legitimate interests)



Note: Unclear who will have jurisdiction to enforce a restrictive covenant that included “the Universe” or whether that was too broad



Political changes

What's on the horizon?



US

The FTC's Notice of Proposed Rulemaking (NPRM)

- Upon effective date of Final Rule, would ban all non-compete clauses and functional equivalents thereof
- Employer obligation to notify all employees and former employees – individually – that any non-compete clauses or functional equivalents are void and unenforceable
- Definitional items to note:
 - **Non-compete clause** means a contractual term between an employer and a worker that prevents the worker from seeking or accepting employment with a person, or operating a business, after the conclusion of the worker's employment with the employer.
 - **Functional test for whether a contractual term is a non-compete clause.** The term non-compete clause includes a contractual term that is a *de facto* non-compete clause because it has the effect of prohibiting the worker from seeking or accepting employment with a person or operating a business after the conclusion of the worker's employment with the employer.
 - **Employer** means a person, as defined in 15 U.S.C. 57b-1(a)(6), that hires or contracts with a worker to work for the person.

Political changes

What's on the horizon?



US

The FTC's Notice of Proposed Rulemaking (NPRM)

- **Worker** means a natural person who works, whether paid or unpaid, for an employer. The term includes, without limitation, **an employee, individual classified as an independent contractor, extern, intern, volunteer, apprentice, or sole proprietor who provides a service to a client or customer**. The term worker does not include a franchisee in the context of a franchisee-franchisor relationship; however, the term worker includes a natural person who works for the franchisee or franchisor. Non-compete clauses between franchisors and franchisees would remain subject to Federal antitrust law as well as all other applicable law.
- Carve-out for transactions:
 - **Substantial owner, substantial member, and substantial partner** mean an owner, member, or partner holding at least a 25 percent ownership interest in a business entity.
- Will pre-empt state laws.
- Comment period extended until March 20, 2023 (as of March 6, more than 8,000 comments)

Political changes

What's on the horizon?



UK consultation on non-competes

- Government “*championing a flexible and dynamic labour market*”
- **Option 1** – Mandatory compensation (European model), complementary measures (disclosure to employee in offer letter/maximum periods)
- **Option 2** – Ban non-compete (Californian model)



Restrictive Covenants

Practical steps when employee announces resignation



Act quickly and decisively



Check contract – garden leave?

- Instruct not to contact customers/employees/suppliers
- revoke IT/security access
- request return of property?



IT to check for any unusual activity over previous weeks e.g., emails to personal accounts/significant downloads



Remind employee of contractual obligations



Commercially, consider how to secure relationships



If working notice:

- can you give them work that does not involve exposure to confidential information/customers? (can this be done in line with contract? Note implied duty of trust and confidence)
- monitor for suspicious behaviour (working late/IT access/photocopying/requests for business information from support teams)

Gathering evidence

What are the potential sources of evidence?



Preliminary considerations



What does the business want to achieve?



Is immediate relief required to protect the business?



Or are you satisfied with claiming damages?



What evidence of breach is there?



Are the covenants likely to be enforceable?



What are the likely costs?



Who to sue?



Only the (ex) employee
or new employer as well?



Advantages of suing
the new employer?



Disadvantages of suing
the new employer?

Remedies – US

When an employee breaches a restrictive covenant



Cease and Desist to
employee and possibly to
new employer



Injunction



Litigation and damages

Remedies – UK

What remedies are available?



- Injunction to restrain breaches of restrictions
- Injunction to enforce garden leave
- Injunction to enforce confidentiality obligations, including springboard relief
- Injunction to restrain knowing inducement of breach by third party
- Orders for affidavit evidence
- Orders for delivery up
- Search orders

Remember cross-undertakings in damages will need to be given!



Obtaining an interim injunction

The test

- Discretionary remedy
- *American Cyanamid* guidelines:
 - Is there a serious issue to be tried?
 - Where does the balance of convenience lie?
- Serious issue to be tried (low threshold)
- Balance of convenience
 - would damages be an adequate remedy?
 - is the applicant good for the cross-undertaking in damages?
 - balance of harm/preserving the status quo?
 - strength of the evidence?
 - other factors: delay, clean hands



Questions?



Click to edit contact title

Click to add name

Click to add job title, contact phone and e-mail address

Click to add address

eversheds-sutherland.com

This information pack is intended as a guide only. Whilst the information it contains is believed to be correct, it is not a substitute for appropriate legal advice. Eversheds Sutherland (International) LLP can take no responsibility for actions taken based on the information contained in this pack.

© Eversheds Sutherland 2023. All rights reserved.