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Non-competition clauses in labour contracts

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Introduction

The doctrine of restraint of trade is probably one of the oldest applications of the doctrine of public policy; cases go back to the second half of the sixteenth century.

The basic principle is that contracts in restraint of trade (at least in the employment field1) are unenforceable unless they can be shown to be reasonable. This, however, has to be balanced against the fact that almost any commercial contract has an element of restraint of trade. If you sell goods to A, this prevents you from selling them the B. If you enter into a contract of employment with Company A, this restricts your ability to enter into a contract of employment with Company B. It is, therefore, only certain elements of certain contracts which are unenforceable.

1. What clauses, if any, are in your country's constitution relating to covenants not to compete in labour contracts? Are there clauses relating to the freedom of occupation; protection of property (if so, does this include intellectual property and trade secrets); freedom of contract, etc. If there are such clauses, how are they applied relating to covenants not to compete? Which, if any, of the EU Directives relating to this subject are applied in your country?

   The United Kingdom has no written constitution. There is no reason to think that the principle that non-competition clauses are unenforceable is part of our constitution.

   The Human Rights Act 1998 incorporated the First Protocol to the European Convention on Human Rights which includes the right of every legal person to the peaceful enjoyment of his possessions. To my knowledge there has been no discussion about its application to intellectual property rights, or freedom of contract.

   Article 81 of the European Treaty is regarded as directly enforceable in the English courts in accordance with the Modernisation Regulation 1/2003. However, it does not appear to have any direct link with employment law.

2. Is there a statute in your country that governs the enforceability of covenants not to compete? Or, is the law governed solely by case law?

[1] Esso Petroleum v. Harper's Garage [1968] AC 269

There is no general statute dealing with non-competition clauses in labour contracts. The Competition Act 1998, amended by the Enterprise Act 2002 outlaws many restrictive practices, particularly in relation to cartels, mergers and other restrictive practices between businesses and other trading parties, but it does not deal with labour contracts.

If there is a statute, does the statute relate to specific professions or industries?

There are some statutes which prevent unqualified people from practising in certain professions, such as barristers, solicitors, doctors, nurses.

3. In general, are covenants not to compete in labour contracts enforceable in your country? Following are some possible answers:

   (a) In my country covenants not to compete are not enforceable under any circumstances.

   If they are not enforceable, explain the legal and economic basis for this rule.

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   (b) In my country covenants not to compete are enforceable under certain conditions and to a certain extent.

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   (If the answer is yes, there are further questions about the condition required for the covenant to be enforceable.)

   Covenants not to compete after the end of the employment are unenforceable unless the employer can show that they are reasonable.

   During employment, there is an implied obligation of faithful service. This means that the employee must not do anything in or out of working time which will damage his employer's business. This implied term is not regarded as being a restraint on competition.

   This obligation includes an obligation not to disclose confidential information which should properly be regarded as the property of the employer.

   It now appears probable that even specific covenants which operate only during the currency of the employment are subject to the doctrine of restraint of trade, but a much lower standard of reasonableness is required.

4. What are the employer's protected interests and how are they defined?

The legitimate interest of the employer or other person seeking to enforce the covenant after the end of employment is not the desire to avoid competition, but the proprietary or quasi-proprietary interest in his trade secrets and his business connections.

Trade secrets can be protected without a specific covenant. They have been fairly widely construed to include anything the dissemination of which is likely to harm the employer. As such it can include such things as lists of customers.

Other confidential information which requires protection similar to that of a trade secret can also be protected without an express covenant.

Quite apart from trade secrets, an employer can legitimately protect his trade connections and other confidential information by a specific covenant. The purchaser of a business has a legitimate interest to protect the "goodwill" of the business. The goodwill may rest in the trading name, the existing clients and the existing employees. As a result of covenant preventing an ex-employee from soliciting the ex-employer's existing senior employees has been upheld.

5. What is the public's interest in enforcing covenants not to compete? Is this a reason for statutes and case law?

   There is a good deal of dispute among English lawyers about the relevance of the public interest in considering whether a covenant in restrain of trade is valid. In most cases, if the court decides that it is reasonable in the interests of the parties, the question of public interest does not arise. Indeed, it is difficult for a Court to resolve matters of public interest, where the balance is between the individual liberty to enter into a contract and the public interest in freedom of trade. There are, therefore, very few cases where the "public interest" has been held to be a ground for a covenant being held unenforceable.

   In general anti-competition agreements are dealt with by investigations by bodies such as the Office of Fair Trading and the Monopolies and Mergers Commission. They have powers to override contractual agreements.

5. If covenants not to compete are enforceable in your country: what must the plaintiff show to prove the existence of an enforceable covenant not to compete?

   (a) Is a written contract required?

   There is no requirement that the covenant relied on should be in writing.

   (b) Is a trade secret required to prove the employer's case? If so, how is a trade secret defined? Does it include customer lists, price lists, systems of work?

   Trade secrets are automatically protected even without a covenant. It includes not only technical information, but also which is of such a confidential nature that it requires protection. It would, therefore, include such things as lists of customers and price lists and systems of work which are specific to the company. However, it does not include information of a general nature which the employee obtains in the normal course of his work i.e. general knowledge about how to do his job. There is some blurring of the distinction between trade secrets, which are automatically protected, and trade connection, which is only protected if there is an express covenant.

   (c) Does the employer need to give the employee consideration (in addition to a regular salary) as a condition for the covenant not to compete to be enforceable?

   There is no requirement for additional consideration. The fact that the employee is paid a salary is treated as sufficient consideration for the covenant. However, there is more willingness by the courts to decide that a covenant is reasonable where the defendant has received specific payment for the covenant, most particularly in cases of sale of business where the "goodwill" of the business is part of what is paid for.

   (d) Will geographical factors, time factors and the special characteristics of an industry be considered when deciding whether to enforce a covenant not to compete?

The geographical area of the prohibition, the length of the prohibition and the special characteristics of the industry are the key factors in deciding whether the prohibition is reasonable and, therefore, enforceable.

In exceptional circumstances a worldwide restriction may be permissible,2 but, in general the courts require clear evidence of the impact which the employee could have in a wide area to allow a wide geographical area to be upheld. This is because a large area is likely to prevent the employee from pursuing his chosen occupation for the duration of the prohibition.

As to the duration of the restriction, a covenant which puts an ex-employee at a considerable disadvantage must be restricted to a short period. In most cases, the restrictions will be for a matter of months rather than years.

(e) Must the covenant not to compete meet a "reasonable test"? If so, who has the burden of proof? How, if at all, does your case law balance between such rights as freedom of contract, property rights and freedom of occupation?

As stated above, the key test is whether the employer can show that the restriction is reasonable.

The particular factors which have to be taken into account in deciding whether a covenant is reasonable include

- whether it is solely to prevent competition rather than to protect a legitimate business interest i.e. the proprietary interest of the employer
- whether it prevents the employee from making use of skills and general knowledge that he has obtained during his employment, rather that to prevent him using specific confidential information in which the employer truly has a proprietary or quasi-proprietary interest i.e. the freedom of occupation of the employee

(f) May the new employer be sued for employing an employee who is violating the covenant not to compete in his labour contract with the former employer? If so, in which court? Is this hearing held jointly with the suit against the employee? Note: the new employer has no contract with the former employer and there is no employee-employer relation between them.

To my knowledge the only person who can be sued is the employee who is violating the agreement. The new employer cannot be sued. However, if the employer brings claim against the employee and obtains an injunction, then the new employer, once served with the injunction, is bound to comply with it and will be in contempt of court if he refuses to do so.

(g) If the employer terminates the labour contract, is the covenant not to compete enforceable? Does it matter what the reason for the dismissal is?

There has been much dispute about the effect of the employer wrongfully terminating the agreement. It appears that this does not automatically mean that the covenant is unenforceable.

7. If a covenant not to compete is held by a court in your country to be overly broad, will the court modify the covenant? What other flexibility do courts have relating to relief they can grant?

[2] Nordenfelt v The Maxi Nordenfelt Guns & Ammunition Company [1894] AC 535

The court has to interpret the clause at it is drafted. The fact that the employee would have been in breach of a more restrictive and, therefore, reasonable clause is irrelevant. If the clause is void there can be no breach of it. However, courts will interpret clauses liberally in order to give effect to their obvious intention.

This principle, however, is subject to the rule about severance. If the covenant really consists of two covenants, one of which is reasonable and one of which is excessive, the Court will, on occasions, sever the two and enforce one, but not the other.

8. Do the courts issue preliminary (temporary) injunctions for violation of covenants not to compete in labour contracts?

   Yes. Because such injunctions may have the effect of pre-judging the issue (since the period of restriction may have ended before the case is heard) the courts are more inclined to look at the weight of the evidence, rather than simply trying to retain the status quo ante as in other cases.

9. What are the remedies which courts can and do grant when an employee has violated his/her covenant not to compete?

   The principal remedies are an injunction, to restrain the alleged breach and damages.

10. Which court(s) in your country have jurisdiction over legal matters relating to covenants not to compete in labour contracts? (Labour Courts; Civil or Commercial Courts; Administrative Law Courts; Constitutional Court, etc.).

    These issues are resolved in the normal civil courts, particularly the commercial court which is part of the High Court.

11. Are there any leading or illustrative judgments that you would like to describe relating to covenants not to compete in labour contracts?

Do you have any additional remarks on this subject?
