Non-Compete Clauses Call for Evidence Response Form

The Department may, in accordance with the Code of Practice on Access to Government Information, make available, on public request, individual responses.

The closing date for this consultation is: 19 July 2016

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Please select the option that best describes you from the list below.

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	Micro business (up to 9 staff)
	Start up
	Small business (10 to 49 staff)
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1. Examples of 'non-compete clauses'

There is no commonly accepted definition of a non-compete clause, and it is not a term used in UK statute. However, the term is being increasingly used in academic literature. For the purposes of this call for evidence, by "non-compete clauses" we are referring to any clause in an employment contract that seeks to restrict a worker's ability to compete against their former employer after they leave. They are often also referred to as restrictive covenants. Examples, of which we are aware, include:

a. Restrictions to an ex-worker's ability to work for a competing business.

b. Restrictions which prevent an ex-worker from having dealings with the employer's customers or clients.

c. Restrictions preventing an ex-worker from hiring workers of the former employer.

d. Restricting a worker from setting up a business in a geographical location that would disadvantage their ex-employer.

Question 1a

Are any of the examples above incorrectly being framed as a non-compete clause? If so, why?

Yes ☐ No ☒

But NB (d) is a sub-set of (a) in that if it were in a different geographical location the new business would not compete with the old one. Also (b) is usually split between a non–dealing clause as stated and a separate non-solicitation provision, usually of different durations to reflect the breadth of the restriction (i.e. non-dealing shorter than non-solicit).

NB also that non-competition provision will often also appear in investment/acquisition agreements as well as employment contracts. It would be easy to foresee a reduced willingness to invest into or acquire a start-up business if it were vulnerable to key people leaving to compete or, having left, to their soliciting other critical employees of the business. Any deterrent to investment could clearly act as a brake on the establishment and development of start-up businesses and the creation and protection of job security.

Question 1b

Are you aware of other examples of clauses in an employment contract which restrict a worker's ability to compete against a former employer? If so, please can you provide examples of these.

(a) Limitations on joining businesses to which one or more of the ex-employer's staff have already moved

(b) Indirect restrictions via the forfeiture of options or other deferred compensation in the event of competition / solicitation by the leaver.

(c) Restrictions on the movement and use of confidential information and on ownership and exploitation of intellectual property rights.

(d) Garden leave clauses.

2. The Prevalence of non-compete clauses in the UK

The UK employment framework allows employers and workers to agree and negotiate worker contracts. As a result Government does not hold any information on worker contracts or non-compete clauses. This means Government is not able to immediately see what the scale is of the use of such clauses, or where and in which circumstances they are used. There is an assumption that they tend to be used in higher skilled roles in the UK, and is why they may stifle the creation of start-ups.

Question 2a Do you have examples where non-compete clauses have been used?

We believe the use of covenants to be more or less universal outside the non-profit and blue-collar workforce. We conducted a survey of clients and contacts in June 2016 which indicated that 93% of respondent employers have covenants in their standard employment template. Our survey respondents ranged in size from fewer than 10 employees for over 2000, and in age from less than 2 years to over 25 and so we have little reason to believe those responses not to be representative.

Question 2b In your experience, are non-compete clauses particularly used in certain sectors or are they generally used across the labour market?

☐ Certain Sectors ☒ Across the Labour Market ☐ Not sure

Question 2c If you answered that non-compete clauses are particularly used in certain sectors – which ones? And what is the justification for their use in those specific sectors?

See answer to Q.2(a) above. Our survey results indicated that protection of client relationships was a key driver for the use of covenants, i.e. that sales-related companies would be particular users. That provides no limitation by way of commercial sector, but may point to more limited usage in public sector functions.

Question 2d: In your experience, are non-compete clauses used only or particularly in relation to higher skilled roles in the UK such as science or tech based jobs? If yes what are they?

Yes ☐ No ☒ Not sure ☐

We see covenants used as much to protect sales relationships as IP rights or confidentiality. Our survey indicated that nearly 100% of respondents used covenants to protect confidentiality or client relationships and about 60% for protection of the stability of their workforce. We see covenants as far more widespread than just in higher-skilled roles (see 2(a) above). Our experience is that where the employee's value is measured in <u>what</u> he knows (technical data, etc.) rather than <u>who</u> he knows (client and staff relationships), employers already use reasonably extensive confidentiality and intellectual property provisions.

3. Have you as an employer used a non-compete clause? (Employers only)

We need to understand why an employer would use a non-compete clause, and if so what the justification would be as one can only be enforceable if it protects a legitimate business interest and be for a reasonable time. For example, a drugs research business could argue that preventing one of their scientists from working for a direct competitor for two years after termination of employment is proportionate, but the same could not be said if they sought to prevent the scientist taking up a job in a bank. Even so, the employer would have to make the case that the same effect could not be achieved through other means – for instance, through a confidentiality clause.

Question 3a Have you as an employer used a non-compete clause?

☒ Yes ☐ No

Question 3b If you have used one. What was the type of job and what were the terms and restrictions you included in the non-compete clause?

Our survey did not ask for these details but we consider it generally understood that covenants must be reasonable to protect a legitimate business interest. We only rarely see covenants which seek to do anything more than this, though accept that employers do not always take a hard enough look at what their legitimate business interests actually are. Our survey responses indicated that when hiring or promoting an employee 61% and 55% respectively of employers do give specific consideration to whether their covenants are or remain appropriate to that new appointment but it is not clear that this consideration often leads to standard covenants being amended to suit particular facts.

In our own right as employer we maintain restrictive covenants against solicitation of clients (not against competition per se). These vary in length with the seniority of the employee or partner and hence the depth of client relationship they may reasonably be expected to have. We consider the protection of the firm's client base against unfair competition as being integral to the maintenance of reasonable work levels and hence remuneration and retention of our legal staff. We do not apply covenants to secretarial and junior administrative employees. Partner covenants include a prohibition on solicitation of other lawyers post-termination for the reverse reason – that loss of lawyers may prejudice some client relationships and our ability to obtain others.

Question 3c What was your justification for including a non-compete clause?

See 3(b) above.

Question 3d Do you use non-compete clauses only for certain jobs or do you use them as a blanket term across your business and worker contracts?

☒ Certain Jobs

☐ Across all contracts

☐ I don't use them

If you do use them, what jobs do you use them for?

At a 93% usage rate per our survey it is apparent that covenants are very widely used in template contracts. We anticipate that template executive service agreement covenants may often be different from the template sales associate contract (for example), but we see few white-collar and non-administrative/clerical contracts of any kind which have no covenants in them at all.

Question 3e Have you had to challenge an ex-worker you believe has breached such a clause? If so, please provide as much information as you are able to explain the issue, what action you took, and the outcome.

On behalf of clients we regularly take action to challenge former employees in relation to covenants. It is our perception that very few employers make such challenges wholly without grounds to do so and certainly not just "because it's there". It is recognised by employers that seeking to enforce a covenant is an uncertain and expensive business and so while there may be some initial angry letters between the parties we do not believe that covenants are used unreasonably or gratuitously in the vast majority of cases.

The cost to an employer of a Court ruling that its standard restrictions may be unenforceable is often too great to take the risks implicit in pursuing them. In the great majority of cases (80% per our survey) the matter is resolved either through pre-action correspondence or early in proceedings and only a very small percentage of such challenges go to a full trial. The majority of cases taken to trial by respondent employers were however successful.

4. Have you ever been subject to a non-compete clause as a worker? (Workers only)

We need to understand if workers are aware of non-compete clauses in their contracts and how transparent they are.

Question 4a Have you ever been subject to a non-compete clause as a worker?

☐ Yes ☐ No

Question 4b If you have been aware of a non-compete clause in a contract you have held with an employer, what was the job and what were the terms and restrictions of the non-compete clause?

Click here to enter text.

Question 4c Were you aware of the non-compete clause in your contract when you signed your contract, and what the implications were for you? Did your employer explain the implications? Was it transparent?

40% of the employer respondents to our survey indicated that they explained specifically to new employees the effect of the covenants in their contracts on their arrival.

Where we advise employees entering into new contracts, they will always be told of what the covenants do and do not mean. It will be borne in mind that at the point of entering a new employment most employees are not considering seriously their rights once they leave it. While we may express doubts about the enforceability of such clauses we would only rarely advise an employee to assume that they will not stick.

It is perhaps also unlikely in reality that the sort of employee whose work would create material protectable interests for the employer would regularly enter into contracts without reading them or, having read the contract, without understanding it. A restrictive covenant which is incoherent or incomprehensible risks being declared void in any event, so we see no evidence of employers wording covenants in anything but the clearest terms they can.

Question 4d Have you ever disregarded a non-compete clause? If so, please explain the issue, if your employer responded or challenged you, and the outcome.

32% of respondent employers told us that they had made a calculated decision to disregard the covenants in a new employee's previous contract. Only 12% admitted to having been challenged or sued by the previous employer and as above, around 80% of such challenges ended in an agreed settlement. 17% of respondents had taken formal court proceedings against a former employee for breach of covenant.

Question 4e Have you tried to challenge a non-compete clause, either formally or informally? If so, please provide as much information as you are able to explain the issue, what action you took, and the outcome.

Click here to enter text.

5. Have you experience of where a non-compete clause has affected or prevented the ability of workers to move from one job to another new business or employer, or hindered their ability to start up their own business?

We would like to gather evidence to understand the nature and scale of the impact of non-compete clauses

Question 5a Have you had a non-compete clause which has influenced your decision to leave or stay with an employer, or start a new business yourself?

☐ Yes ☐ No

Question 5b If yes, what was the job (where the non-compete applied), and what were the terms of the clause?

Click here to enter text.

Question 5c Have you been influenced in a decision to hire or not hire someone by the terms of an existing non-compete clause?

☒ Yes ☐ No

Question 5d If you have answered 'yes' to Q5c, please explain the terms of the non-compete clause, and the impact of the decision on the business, and the sector and specific job.

Our survey reported that 17% of respondents had not hired someone because they were bound by restrictive covenants in their previous employment contract. We cannot state whether, had those hires gone ahead, unfair damage would have been caused to the former employer. Establishing whether that would have been the case must be a pre-requisite for BIS' determining whether that statistic suggests covenants to be an unreasonable brake on employee movement.

6. Could there be any repercussions or unintended consequences if Government restricted some forms of non-compete clauses?

If Government were to find evidence to suggest non-compete clauses are stifling start-ups, or being used unreasonably, one option might be to restrict their use in certain circumstances.

Question 6a Would legislation to restrict the use of non-compete clauses in certain circumstances affect your business? If so, how?

This question is unanswerable without details of the "certain circumstances" proposed. Without prejudice to that, the Call for Evidence acknowledges that there remains a role for covenants which are reasonable in their extent, drafting and purpose. Those are the principles by which

their enforceability is already assessed by the High Court and so to a very large extent the covenant regime is self-policing. It is true that enforcement is by principles rather than definitive rules but those principles are very long-established, not complex and far more accommodating of the wildly differing circumstances they must cover than a "definitive" set of rules could ever be.

It follows that any legislative intervention into the use of covenants would represent either an extension of them into areas the Courts would currently deem unreasonable or an exclusion of them from areas where the Courts would currently consider them appropriate. Given that the thrust of the Call is to limit possible restraints on entrepreneurialism, one presumes that it would be the latter, i.e. that companies which do now benefit from covenants as a reasonable protection of their business would no longer be able to do so and would be weakened as a result by the new vulnerability of their customer base or workforce. For every business that benefits from any legislative intervention, another will suffer.

Question 6b Would legislation to restrict the use of non-compete clauses in certain circumstances affect your business? Please give information.

This is the same question as 6(a) – see above.

Question 6c Could you restrict their use in certain circumstances through non-legislative measures?

In general terms, no. We could envisage circumstances where an industry body could issue guidance to its members about appropriate covenant terms, but we do not see that realistically this could be more than persuasive in the High Court and it would not take away the need for covenants to address the specific risks of the appointment in terms of later unfair competition, which could legitimise departures from that "industry standard" in any case.

Government guidance (see below) may help improve the general quality of covenant drafting but this will improve their enforceability (to the detriment of start-ups and freedom of movement), we consider, rather than persuade employers not to use them at all or to do so in materially fewer cases.

Question 6d As an employer, would intellectual property law and confidentiality clauses suffice to protect your interests if legislation to restrict the use of non-compete clauses came into force? If not, why?

☐ Yes ☒ No

Please explain

These clauses do not provide sufficient protection against the exploitation of relationships (internal or external) built up by the employee at the request and expense of the employer for the benefit of its business. Moreover, such clauses tend to provide a remedy for certain sorts

of harm done but do not provide a means of pre-empting it in the first place (or of preventing circumstances where a breach of confidentiality or IP rights is almost inevitable but cannot viably be detected or policed or financial loss quantified).

Our survey indicated that our respondents viewed protection of client relationships as joint top reason for using restrictive covenants – while a breach of confidence action might in some circumstances limit access to a confidential client list, that does little to protect relationships where the client list cannot be proven to be confidential and where the relationship is personal rather than based wholly or mainly on possession of confidential client information.

Restrictions on the use of confidential information etc. would be subject to no less litigation than covenants, at no lesser cost to those involved and no greater certainty. They would not, if providing equivalent protection to "old" employers, give greater latitude to "new" ones.

Question 6e What types of businesses would (or ought to) benefit from additional restrictions on the use of non-compete clauses?

By definition, businesses which would benefit from limits on the use of covenants would be those wishing to do something which such clauses currently prohibit, i.e. to solicit the staff or clients of another business by using the knowledge and relationships of the incoming employee, or to damage the operations of that other business by the same means. This might include start-ups but is clearly not limited to them – indeed, there is no reason why a larger and more established business could not then take key staff or client relationships from a start-up and so destroy it. It must be borne in mind, as above, that for every business which would benefit from restrictions on the use of covenants, another one would suffer. Size is not a necessary indicator of resilience to competition.

In your experience (as an employer, individual, or in your capacity as an advisor) are non-compete clauses transparent?

It is not immediately clear how transparent non-compete clauses are to workers and whether they understand the implications. In the same way, it is not clear whether employers understand the purpose of non-compete clauses and use them appropriately and alongside intellectual property law and confidentiality clauses, which are different to non-compete clauses.

Even without non-compete clauses, intellectual property rights will protect the legitimate interests of a former employer. These rights operate independently from any contract between an employer and its workers. For example, the law of confidence will prevent current or former workers from personally using their employer's trade secrets or confidential customer lists. Similarly trade mark and passing-off law will prevent former workers from suggesting that they have a connection with the business in which they formerly worked unless the former employer agrees to this. Copyright law will prevent a former worker from copying written works created in the course of his former employment where he does not have the consent of the former employer.

However intellectual property law does not prevent a former worker from taking advantage of the general experience he has acquired in the course of a former employment. Therefore, the legislation as it stands should not act as a barrier for someone leaving one business to set up their own on the basis of their personal knowledge and experience.

Question 7a Are you aware of guidance or do you seek guidance on the use of non-compete clauses and the associated intellectual property law and confidentiality clauses? What sources do you use?

Of our survey respondents 31% take legal advice on the drafting of the covenants applied to new hires or in relation to the enforceability of restrictions in their previous contracts of employment.

Question 7b Could guidance be improved to assist both employers and workers in their understanding of how non-compete clauses should work, what business interests could legitimately be considered as justification for non-compete clauses, and how to prevent such clauses from being inserted in contracts inappropriately?

Yes. Guidance from Acas or Government which stressed that restrictions which were unclear or broader than necessary would be void (i.e. "no points for a near miss") would encourage employers to have a harder think about the extent of the protection they could reasonably seek.

It would also help for the Guidance to contain "worked examples" to identify for employers the detailed considerations they should review, the questions they should ask themselves when drafting the covenant and also examples of the challenges they might face if under cross-examination on the point.

Based on our survey results, Guidance could also usefully stress the importance of retaining records of those considerations. 90% of our respondents do not do so but the discipline would be helpful for employers both in terms of evidence in Court and because the necessity to commit one's thinking to writing could act as a brake on some of the more aspirational covenant terms.

It might also be sensible for that Guidance to receive judicial sign-off on the same principles as the Acas Code, i.e. that departure from it will not necessarily make your covenant invalid, but you will need to be able to explain convincingly why it was not appropriate in your case.

Question 7c Do you think new or improved guidance would improve confidence around the valid use of non-compete clauses and where confidentiality and intellectual property is a more appropriate way to protect business interests?

In our perception there is no lack of confidence around the use of restrictive covenants. 93% of our respondents use them as a matter of course, 59% consider them afresh for each new hire and 54% for each job change or promotion. We see the issue, to the extent there is one, as being one of over-confidence, not the opposite.

Guidance for employers, stressing the downsides of over-reaching oneself when applying and drafting covenants, could go some way to addressing this. We have considered whether such Guidance could usefully include template restrictions but on balance conclude not – experience shows that templates are often used as a substitute for the application of thought to each part

of the covenant, and the enormous variety of circumstances to which a covenant could need to be tailored militates against this suggestion also.

We do not see any widespread tendency by employers to use covenants to enforce rights more properly protected by confidentiality or IP provisions. Where there are apprehended breaches of such provisions our experience is that employers use them additionally to covenants, not in place of them, as the lines between use of confidential information and unlawful solicitation may be unclear both legally and in the facts known to the employer at the relevant time.

Question 7d If you provide advice to employers in structuring and using non-compete clauses, what principles do you consider important to take into account?

We encourage employer clients to take the most restrictive view they can of the level of protection they need. We push them to justify to us why they need a particular time period or geographical extent and how solicitation of clients or staff by a departing employee could do them harm. We stress the penalty of loss of the covenant if they over-reach themselves in any respect and do not encourage any reliance on wording which purports to permit "blue-pencilling" as this is ultimately at the Court's discretion.

We also test the clarity of each restriction and the definitions contained in it to ensure that the employer's wording is not vulnerable to being struck out for uncertainty or to being construed "contra proferentem" in a way which was not intended. To the extent that the employer is concerned about very specific risks, e.g. that the employee should not go to X company or work anywhere on Y product, we encourage express provision to that effect. We also advise against reliance on covenants alone as a protective measure – use should also be made of PILON and garden leave clauses.

Question 7e If you provide advice to workers in negotiating or challenging non-compete clauses, what principles do you consider important to take into account?

Where we advise employees entering contracts we rarely suggest that any point be taken on draft covenants – after all, the tighter and more precise they are, the better the chances that they will be enforceable against our client. We believe that a Court considering enforceability would pay particular heed to changes to a draft covenant suggested by the incoming employee and would be far more likely to find it enforceable than one in the employer's terms on which no comment had been made.

Where we advise employees on challenging covenants we look for areas of lack of clarity, excessive breadth or evidence that the restrictions are not tailored to them, e.g. a limit on soliciting clients imposed on an employee with an entirely inward-facing role. Can the employer justify the scope of the covenants relative to what is known of other covenants in the contracts of its more senior or more junior staff? Was the restriction reasonable when entered into, and not just at the point of attempted enforcement?

Please use this space for any general comments that you may have, comments on the layout

The law relating to restrictive covenants is (in its basic principles) very well settled. It is already firmly established that they will only be enforceable if they are "*justified, well-constructed, targeted and reasonable*" (the words sued by BIS to describe its aspirations form this consultation). As such it could easily be suggested that this consultation revolves around a problem which does not really exist, a theory reinforced by the lack of any stated evidence base for the views on the consultation document that covenants are "stifling start-ups" and "being used unreasonably". This is stated under Section 2 above to be an “assumption” only, based on an admitted inability on the part of Government to identify the scale of use of such clauses or where and when they are used. Without evidence that employers are currently able to enforce restrictions which they do not need on post-termination competitive activity by ex-employees, or that start-ups have any greater right than any other employer to benefit from the investments in staff or clients of a former employer, this consultation potentially lacks any real purpose.

As mentioned above, it must be borne in mind that any company benefitting from increased freedom to compete must do so at the cost of another. The presumption in the consultation document is that the company benefitting will be small and entrepreneurial and the company losing out will be bigger and able to afford it, but that is in no sense necessarily the case. There is no basis for suggesting that large and established businesses could not benefit from limits on covenant use at the expense of the very start-ups (and investments and jobs) which the consultation refers to assisting.

In addition, the consultation document refers (wrongly in our view) to equivalent or more suitable protection for employers being available through confidentiality and IP clauses and claims. That is not the case, but even if it were, the implication is that the start-ups, etc. would have no more rights than at present to compete but would just be blocked via different means. It does not in that respect represent any advance for entrepreneurialism at all. It should remain the case that a start-up has no greater rights to exploit unfairly another employer's confidential information or client connections or workforce than any other business –meaning that if its idea or invention is genuinely new and not derived from the property or investment or confidential information of others (or based on the employee’s personal skill and experience) it is already free to proceed with it.

We have considered what legislative change could be introduced to limit the use of restrictive covenants. The obvious problem is the inability of statute law or any amount of accompanying guidance to provide a definitive answer to every case. Any phrase used in either (e.g. "start-up") would necessarily be the subject of extensive litigation and potentially create more uncertainty and less transparency around whether a particular covenant works at any given point than exists at present.

The same would apply to provisions limiting the use of covenants to those earning over a particular annual package (which would be inflationary in effect and put the most strain on businesses least able to afford it, including in particular start-ups) or where the employer paid some specific consideration for the covenant period, on the European model. Again, however, that latter option does not release the employee to compete, and it would leave struggling companies and start-ups (where jobs are most at risk from client or workforce instability) least able to benefit. The same would be true if limits on covenants led to an increased use of long

notice periods and garden leave clauses – no greater ability for start-ups to compete but an increased cost to businesses generally and prospectively one that start-ups could not afford.

We do not believe there to be any merit in limiting the use of covenants to certain sectors. Almost all businesses have client and/or staff relationships worthy of some level of protection and many will also have R&D activities which would be harmed (perhaps fatally for a start-up) by the loss of key people to a competitor. The existing Court system (and the long-established principles which it applies to the facts of each case) is already fully able to accommodate variations between the needs of different sectors and industries and individual employers within them and is astute to strike out excessively restrictive clauses.

Overall it is our view at this stage that the law and practice around restrictive covenants does not need any Government intervention. While Guidance along the lines referred to above might be of assistance to employers, it could not be anything more than persuasive and would have to be broad enough in its terms to reflect the wide variety of provisions in common use.

Squire Patton Boggs (UK) LLP
14 July 2016 Ref: DHW

Thank you for taking the time to let us have your views. We do not intend to acknowledge receipt of individual responses unless you tick the box below.

Please acknowledge this reply ☒

(Respondents should be thanked for their views and we should say whether we will acknowledge individual responses. Acknowledging responses can help foster good relations with new partners, however, most of the Department's stakeholders are regular contributors to consultations and would probably consider acknowledgements to be an unnecessary expense. Current practice is to acknowledge on request only, actioned by a tick on the questionnaire using letter, postcards or e-mails)

At BIS we carry out our research on many different topics and consultations. As your views are valuable to us, would it be okay if we were to contact you again from time to time either for research or to send through consultation documents?

☒ Yes ☐ No

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