EMPLOYEE COMPETITION: COVENANTS, CONFIDENTIALITY, AND GARDEN LEAVE

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INTRODUCTION

1. This paper is divided into two main parts:

   1.1. Part One considers the international dimension of employee competition, in particular jurisdiction and choice of law in the enforcement of restrictive covenants.

   1.2. Part Two considers the general principles of employee competition relating, in the main, to restrictive covenants, confidentiality and garden leave.

2. Part One covers issues which are the focus of the ELA/ABA conference in London on 18 May 2009. Part Two has a broader compass and is written by reference to recent cases. Both parts describe the law as it is applied in the UK[1].

3. The topics covered in this paper are considered in detail in the book *Employee Competition: Covenants, Confidentiality, and Garden Leave*.[2] The book examines the law and practice relating to competition by employees, directors, partners and others.

PART ONE: THE INTERNATIONAL DIMENSION[3]

4. Given the international nature of business and the increased mobility of the workforce, it is not uncommon for action to be taken in more than one country or which has an effect across borders.

5. What is, perhaps, surprising is the paucity of case law in this area, although two recent decisions help to fill this gap and set out important principles for future cases.

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[1] A version of this paper discussing recent cases on employee competition is updated and distributed annually. If you would like to receive it, but do not currently do so, please contact me at paulgoulding@blackstonechambers.com

[2] *Employee Competition: Covenants, Confidentiality, and Garden Leave*, Goulding (ed), published by Oxford University Press (2007), written by members of Blackstone Chambers and Olswang Solicitors (hereafter *Employee Competition*). More details can be found at http://www.oup.com/uk/catalogue/?ci=9780199208623

[3] See, further, *Employee Competition* (fn 2 above), chapter 7.

A FAMILIAR PROBLEM

6. The problem addressed in this section is a familiar one. A hypothetical scenario is described in the case study for the ELA/ABA conference.

7. Anne-Marie, a French national, was employed by CAPCO Ltd (a UK subsidiary of a New York corporation) as VP Corporate Strategy, based in London. Her employment contract is stated to be governed by New York law subject to the exclusive jurisdiction of the English courts. Anne-Marie participated in CAPCO Corporation's Senior Executive Incentive Plan (SEIP) which was governed by New York law. She has handed in her 3 months' notice in order to join a rival company (NEWCO). CAPCO wants to enforce the confidentiality and post-employment restraints contained in her employment contract and the SEIP.

8. This situation gives rise to two principal issues of conflict of laws: the issue of jurisdiction (where can proceedings be brought), and the issue of choice of law (which law governs the relationship).

JURISDICTION

9. In considering the issue of jurisdiction, it is necessary to consider relevant legal rules and their interpretation by the courts.

Council Regulation (EC) 44/2001 (the Judgments Regulation)

10. Of principal importance, where a party is domiciled in a Member State of the European Union is Council Regulation (EC) 44/2001, better known as the Judgments Regulation.

11. A detailed examination of the Judgments Regulation is beyond the scope of this paper[4]. So, for example, the issue as to whether the Regulation applies at all, which is a necessary initial consideration, is not discussed in any depth here. It is assumed, for present purposes, that it does.

[4] See *Civil Jurisdiction and Judgments*, 4th ed, by Briggs and Rees, for a comprehensive exposition.

12. Section 5, comprising Articles 18-21, deals with jurisdiction over individual contracts of employment. Where the claim arises out of a contract of employment, these provisions identify the courts which alone have jurisdiction.

13. Section 5 of the Judgments Regulation provides as follows:

"*Section 5: Jurisdiction over individual contracts of employment*

Article 18

1. In matters relating to individual contracts of employment, jurisdiction shall be determined by this Section, without prejudice to Article 4 and point 5 of Article 5.

2. Where an employee enters into an individual contract of employment with an employer who is not domiciled in a Member State but has a branch, agency or other establishment in one of the Member States, the employer shall, in disputes arising out of the operations of the branch, agency or establishment, be deemed to be domiciled in that Member State.

Article 19

An employer domiciled in a Member State may be sued:

1. in the courts of the Member State where he is domiciled; or

2. in another Member State:

   (a) in the courts for the place where the employee habitually carries out his work or in the courts for the last place where he did so, or

   (b) if the employee does not or did not habitually carry out his work in any one country, in the courts for the place where the business which engaged the employee is or was situated.

Article 20

1. An employer may bring proceedings only in the courts of the Member States in which the employee is domicile.

2. The provisions of this Section shall not affect the right to bring a counter-claim in the court in which, in accordance with this Section, the original claim is pending.

Article 21

The provisions of this Section may be departed from only by an agreement on jurisdiction:

1. which is entered into after the dispute has arisen; or

2. which allows the employee to bring proceedings in courts other than those indicated in this Section."

14. There are no relevant Court of Justice cases on Section 5

The *Samengo-Turner* case

15. In *Samengo-Turner & others v J & H Marsh & McLennan (Services) Ltd and others* [2007] EWCA Civ 723, [2008] ICR 18, the Court of Appeal granted an anti-suit injunction to restrain proceedings brought in New York against employees domiciled in London on the basis of the Judgments Regulation.

Facts

16. The claimants, Messrs Samengo-Turner, Whyte and Hopkins, were domiciled in England and employed as reinsurance brokers by the first defendant, J & H Marsh & McLennan (Services) Ltd (MSL). MSL is an English company and part of the Marsh McLennan group (MM group) of companies of which the third defendant, Marsh & McLennan Companies Inc (MMC), based in New York, is the holding company and the second defendant, Guy Carpenter & Company LLC (GC) forms part.

17. The claimants held senior executive positions and were eligible to participate in the MMC Incentive and Stock Award Plan. Awards under the Plan were administered in New York, and were largely subject to New York law and exclusive jurisdiction. Awards were made to the claimants which were payable in cash in instalments over a number of years (the bonus agreements). But they were subject to cancellation and rescission if the recipient engaged in detrimental activity. Before termination such activity was defined to include attempting to recruit or solicit fellow employees to work for a competitor.

18. One of the terms of the bonus agreement was a co-operation covenant in the following terms:

> "You agree that both during and after your employment with the company, regardless of the reason for your termination, you will provide to the company such information relating to your work for the company or your other commercial activities as the company may from time to time reasonably request in order for the company to determine whether you are in compliance with your obligations under this agreement."

19. In April 2007 the claimants each gave MSL six months' notice to terminate their contracts of employment and disclosed that they intended to work for Integro, one of the MM group's competitors.

20. The defendants suspected that the claimants had solicited other employees to leave MSL and join Integro. They started proceedings in New York to enforce the co-operation covenant so as to find out what had gone on. The New York judge rejected a challenge to the jurisdiction of the New York courts and made orders for expedited discovery, interrogatories and depositions.

21. The claimants commenced proceedings in the High Court in London. They applied for an anti-suit injunction to restrain the New York proceedings. The claim was based on Section 5 of the Judgments Regulation. Their principal contention was that the Regulation requires such proceedings to be brought only in the courts of their domicile.

<u>The decision of the Court of Appeal</u>

22. Tuckey LJ (with whom Longmore and Lloyd LJJ agreed) began by considering the objectives of the Regulation: [25]. Having regard to the recitals, the Regulation is obviously designed to avoid jurisdiction disputes. In matters relating to contracts of employment, the employee can only be sued in the court of his domicile (article 20) unless he has agreed to some other jurisdiction *after* the dispute has arisen (article 21(1)). These special provisions meet one of the objectives of the Regulation which is to protect employees who are regarded as the weaker party in the employment relationship from a socio-economic point of view.

23. The first question, within the meaning of article 18(1), was whether the claim made in New York was a matter relating to the claimants' individual contracts of employment. The contract of employment was made between MSL and the claimants. It was, rather, the bonus agreement made between MMC and GC, on the one hand, and the claimants, on the other, which was sought to be enforced in the New York proceedings. Tuckey LJ could not see how it could be said that the claimants' bonus agreements did not relate to their contracts of employment. They were part of them. One could not ascertain the terms upon which they were employed without looking at both the original contracts and the bonus agreements: [29]-[31].

24. The second question was whether given that the claim in New York related to the claimants' individual contracts of employment, it had been brought by "an employer" within the meaning of article 20(1). The New York proceedings were brought by MMC and GC. They were not the claimants' employer. MSL was. Tuckey LJ also answered this question in the claimants' favour. MMC and GC were only able to sue in the right of and as if they were the employers because of the wide definition of "the company" in the bonus agreement and so should be regarded as employers for the purpose of Section 5: [32]-[37].

25. The third and final question was whether the English court should grant an anti-suit injunction. An anti-suit injunction is not a remedy to be dispensed lightly, particularly where the defendants sought to be restrained have brought proceedings in courts of high repute in a friendly foreign state. The injunction is of course directed at the litigating party and not the court.

26. The injunction was granted. Tuckey LJ concluded that the only way to give effect to the English claimants' statutory rights was to restrain the New York proceedings: [38]-[43]. He explained at [43]:

> "A multinational business must expect to be subject to the employment laws applicable to those they employ in different jurisdictions. Those employed to work in the MM group in London who are domiciled here are entitled to be sued only in the English courts and to be protected if that right is not respected."

27. *Samengo-Turner* has already been cited in the New York courts in support of a jurisdiction challenge there.

CHOICE OF LAW

28. The second issue which commonly arises in covenant cases involving an international dimension, is which law governs the dispute. Assuming that the English courts have jurisdiction, the choice of law question is determined in accordance with the Rome Convention which has recently been interpreted and applied to a restrictive covenant dispute by the English High Court.

Rome Convention on the Law Applicable to Contractual Obligations 1980 (the Rome Convention)

29. Under section 2(1) of the Contracts (Applicable Law) Act 1990, the question of which law governs restrictive covenants in a contract before the English courts is determined by the provisions of the Rome Convention (now to be known as the Rome I Regulation, but referred to below as the Convention).

30. Article 1 of the Convention makes clear that the rules of the Convention apply to contractual obligations in any situation involving a choice between the laws of different countries.

Article 3: Freedom of choice

31. Article 3 allows the parties to express a choice of law to govern their contract. Thus Article 3(1) provides:

> "A contract shall be governed by the law chosen by the parties. The choice must be express or demonstrated with reasonable certainty by the terms of the contract or the circumstances of the case. By their choice the parties can select the law applicable to the whole or a part only of the contract."

Article 6: Individual employment contracts

32. Article 6 is concerned with individual employment contracts. The right of the parties to choose the proper law under Article 3 applies to employment

contracts, subject to a protection in respect of "mandatory rules". Thus, Article 6(1) provides:

"Notwithstanding the provisions of Article 3, in a contract of employment a choice of law made by the parties shall not have the result of depriving the employee of the protection afforded to him by the mandatory rules of the law which would be applicable under paragraph 2 in the absence of choice."

33. Thus, if mandatory rules would apply absent the parties choosing the proper law, then an employee cannot be deprived of those mandatory rules by the parties' choice of law. Article 6(1) was considered in the *Duarte* case discussed below.

34. Article 6(2), which applies in the absence of choice by the parties, provides as follows:

"Notwithstanding the provisions of Article 4, a contract of employment shall, in the absence of choice in accordance with Article 3, be governed:

(a) by the law of the country in which the employee habitually carries out his work in performance of the contract, even if he is temporarily employed in another country; or

(b) if the employee does not habitually carry out his work in any one country, by the law of the country in which the place of business through which he was engaged is situated;

unless it appears from the circumstances as a whole that the contract is more closely connected with another country, in which case the contract shall be governed by the law of that country."

Article 16: public policy

35. Article 16 is also important in international cases concerning restrictive covenants. It provides:

"The application of a rule of the law of any country specified by this Convention may be refused only if such application is manifestly incompatible with the public policy of the forum."

36. Article 16 was also the subject of consideration in the *Duarte* case.

The *Duarte* case

37. *Duarte v The Black and Decker Corporation* [2007] EWHC 2720 (QB) is an important decision concerning the enforcement in the UK of restrictive covenants governed by foreign law.

Facts

38. Mr Duarte was employed by Black & Decker, latterly as Vice President of a Professional Special Business Unit (SBU) concerned with industrial power tools in Europe, the Middle East and Africa (EMEA).

39. He participated in a long-term incentive plan (LTIP) as part of which he entered into a restrictive covenant whereby not to accept employment with any of the companies included in a Schedule for two years following termination from Black & Decker by his own choice or for cause. The Schedule stated that "Competitor companies include the following, along with any of their parents, subsidiaries, affiliates and successors", then proceeded to list 12 companies.

40. The LTIP agreement provided that it was to be governed by the laws of the State of Maryland.

41. Duarte resigned to take up employment with a subsidiary of one of the companies included in the Schedule. He commenced proceedings in the High Court for a declaration that the covenants are void and unenforceable.

The decision of Field J

42. Three main issues arose for determination.

The choice of law question

43. The issue of general importance concerned whether English law of restraint of trade trumps Maryland law.

44. Pursuant to Article 3(1) of the Convention, the parties having chosen Maryland law to be the governing law, the validity and enforceability of the

covenants is prima facie to be decided in accordance with that chosen law: [46].

45. However, Article 6(1) also needed to be considered (see para 33 above).

46. Two questions arose in relation to Article 6(1). First, was the LTIP a contract of employment? Field J decided that it was for this purpose, relying on the reasoning of the Court of Appeal in *Samengo-Turner* (above): [50]-[53].

47. Secondly, does English law on restrictive covenants in employment contracts consist of "mandatory rules" which afford protection to an employee for the purpose of Article 6(1). Field J concluded that it does not. In his opinion, the mandatory rules referred to in Article 6(1) are specific provisions such as those in the Employment Rights Act 1996 and the Factories Acts whose overriding purpose is to protect employees. The law governing the enforceability and validity of restrictive covenants in employment contracts is of an altogether different character. It is part of the general law of restraint of trade which in turn is part of the general law of contract. Accordingly, Article 6(1) provided no justification for applying English law in preference to Maryland law in deciding whether covenants are enforceable: [54]-[55].

48. The Judge then turned to consider Article 16 of the Rome Convention (see para 36 above).

49. Whilst the interplay between the English law of restraint of trade and foreign restrictive covenants had been canvassed in some earlier case law[5], the courts had not ruled on the application of Article 16 in this area. Field J referred to the classic statement of public policy underlying the law of restraint of trade given by Lord Macnaghten in the *Nordenfeldt* case [1894] AC 535, 565. He held that this public policy is directly engaged if the covenants are enforced by an English court applying Maryland law when they would be unenforceable under English law. In other words, the result

[5] See, for example, *Rousillon v Rousillon* (1880) LR 14 Ch D 351; *Holding TFS v Cantor Fitzgerald* (unrep); *Kuwait Airways Corp v Iraqi Airways Co* [2002] 2 AC 883 per Lord Nicholls.

of the application of the specified law would be "manifestly" incompatible with the public policy of the forum: [56]-[63].

Was the non-compete covenant enforceable under Maryland law?

50. For anyone interested in the Maryland law of restrictive covenants, Field J discusses the key principles and case law based on the expert evidence of two Maryland lawyers: [64]-[103].

51. Field J concluded that, although Maryland law appears to be somewhat less severe with restrictive covenants in employment contracts than is English law, the non-compete covenant would not be held to be enforceable against Duarte under Maryland law.

52. B&D's core protectable interest in respect of Duarte was its confidential information relating to Professional SBU – EMEA. Interestingly, Field J concluded that valid protection of that interest was achievable by a covenant barring Duarte from working for any industrial power tool business within EMEA for two years after termination. But the LTIP non-compete covenant went much farther than this, barring Duarte from working for any of the 500 or so companies covered by the Schedule anywhere in the world and regardless of whether the companies sold industrial or consumer power tools or was even competing with B&D: [79]. Neither were the offending parts of the covenant severable so as to render it reasonable [83]-[98].

Was the non-compete covenant enforceable under English law?

53. It was strictly unnecessary to decide this issue, since English law only became potentially applicable if the covenants were enforceable under Maryland law, but Field J dealt with it nonetheless: [104].

54. Having set out relevant principles derived from *Office Angels Ltd v Rainer-Thomas & O'Connor* [1991] IRLR 214 and *TFS Derivatives v Morgan* [2005] IRLR 246, Field J found that, for the same reasons that he held it was unenforceable in Maryland law, the non-compete covenant was unenforceable as a matter of English law. To say the least, if a 2 years non-

compete covenant was going to be upheld in English law, the scope of the balance of the covenant has got to be narrowly drawn, which was not the case here: [107]-[111]. Field J was also of the view that the covenant could not be rendered enforceable under the doctrine of severance: [112]-[114].

PART TWO: GENERAL PRINCIPLES OF EMPLOYEE COMPETITION

DUTIES[6]

55. What can an employee legitimately do to prepare for future competition whilst remaining in his current employment? This question has been considered in a number of cases over the years, some of the more important of which include: *Balston Ltd v Headline Filters Ltd* [1990] FSR 385 (Falconer J), *Lancashire Fires Ltd v S A Lyons & Co Ltd* [1997] IRLR 113 (CA), *CMS Dolphin v Simonet* [2001] 2 BCLC 84 (Lawrence Collins J), *British Midland Tool Ltd v Midland International Tooling Ltd* [2003] 2 BCLC 523 (Hart J), and *Item Software (UK) Ltd v Fassihi* [2005] ICR 450, [2004] IRLR 928 (CA).

Good Faith and Fidelity

56. The question involves consideration of a number of difficult issues including:

- what does an employee's contractual duty of good faith entail?
- when does an employee owe fiduciary duties?
- how do fiduciary duties differ from the contractual duty of good faith?
- how is the line to be drawn between permissible preparatory acts for future competition and impermissible competitive acts?

57. The first three of these issues were comprehensively considered by Elias J in *Nottingham University v Fishel* [2000] ICR 1462, [2000] IRLR 471. All of these issues have recently been the subject of detailed examination in two recent cases: *Shepherds Investments Ltd v Walters* [2006] EWHC 836 (Ch), [2007] IRLR 110 (Etherton J), and *Helmet Integrated Systems Ltd v Tunnard* [2006]

[6] See, further, *Employee Competition*, chapter 2.

EWCA Civ 1735, [2007] IRLR 126 (CA)[7]. These recent cases demonstrate, in the words of the editor of the IRLR, "that this has become a fluid area of the law".

Shepherds Investments Ltd v Walters [2006] EWHC 836 (Ch), [2007] IRLR 110

58. This decision of Etherton J followed the trial of an action brought against three former employees and directors. They were held to have acted in breach of their fiduciary duties and duty of fidelity in setting up a competing business. The claimants failed to establish that they had suffered loss which had been caused by these breaches but they were entitled to an account of profits made by the defendants from their breach of fiduciary duties.

The facts

59. The Shepherds group provided an investment opportunity in traded life policies (TLPs) through the purchase of interests in a number of different life policies which had been acquired (fractionalised policies).

60. There were three individual defendants:

- Walters was finance director of one of the Shepherds companies (Financial) from 5 November 2001 until 7 May 2004;
- Hindle was investment director of Financial from 2 September 2002 until 10 October 2003;
- Simmons was an employee of another Shepherds company (Investments) from 29 May 2002. The claimants alleged that Simmons was a de facto director of Investments (although never formally appointed a director). The date of termination of his employment was disputed (it was either late September or early October 2003).

61. In the first half of 2003, the Shepherds group began to consider investing in whole life policies and produced a report into the TLP market (the Costello

[7] See also *Kynixa Ltd v Hynes & Ors* [2008] EWHC 1465 (QB) (Wyn Williams J).

report). Thereafter, the individual defendants took a number of steps leading to the establishment of a competing business. These included the following:

- By early May 2003, the individual defendants had begun to discuss between themselves the idea that they might establish for their own benefit a new investment fund which would invest in whole life policies.

- On 13 July, they produced a draft business plan for their proposed new business. It identified themselves as the team behind the new business, Barings as the possible administrator, and Close as possible custodian and banker.

- By 13 July, they had prepared financial predictions for their proposed new business for its first three years of operation, including a cash flow summary.

- On 12 August, Walters contacted Cayman Islands attorneys (Soloman Harris) about the proposed new business.

- On 13 August, Walters confirmed to Soloman Harris that, for tax reasons, Simmons would be their client (Simmons was living outside the UK).

- On 15 August, Soloman Harris sent Simmons information about the Cayman Islands' regulatory regime relevant to the proposal for the new business.

- By letter dated 19 August, Soloman Harris confirmed to Simmons that it would accept instructions from him for the new business.

- On 26 August, Soloman Harris approached Ernst & Young to see if they would act as auditors.

- On 29 August, Soloman Harris sent Simmons a draft offering memorandum.

- Between then and early October, successive drafts were prepared of the offering memorandum, an escrow agreement with Close, an administration agreement with Barings, a custodian agreement with Close and Barings, an investment advisory agreement, and the memorandum and articles of association of new companies. They were circulated for consideration of the individual defendants.

- Simmons and Hindle resigned as directors and employees, their employment terminating with effect from 10 October 2003.

- The companies for the new business were incorporated on 10 October 2003.

- On 14 October, the final draft of the offering memorandum had been prepared.

- On 28 November, the custodian agreement, escrow agreement and administration agreement were executed.

- There was a special launch offer for investment in the new business from 30 November.

- In January 2004 printed promotional literature for the new business was ordered and received.

- In February the first agreements for supply of whole life policies for the new business were put in place.

- In May 2004, Walters ceased to be an employee and director of Financial.

- In June 2004, the first purchase was completed of a whole life policy for the new business.

62. Proceedings were commenced against the individual defendants and their two new companies on 17 August 2004.

The decision of Etherton J

63. The judge considered four legal issues relevant to liability before turning to remedies.

Did Simmons owe fiduciary duties?

64. Etherton J held that Simmons was a de facto director of Shepherds Investments even though not formally appointed as such. He cited with approval a statement of Millett J in *Re Hydrodam (Corby) Ltd* [1994] 2 BCLC 180:

> "A de facto director is a person who assumes to act as a director. He is held out as a director by the company, and claims and purports to be a director, although never actually or validly appointed as such. To establish that a person was a de facto director of a company it is necessary to plead and prove that he undertook functions in relation to the company which could properly be discharged only by a director. It is not sufficient to show that he was concerned in the management of the company's affairs or undertook tasks in relation to its business which can properly be performed by a manager below board level."

65. Etherton J relied on the fact that, from a certain date, Simmons was one of a very limited number of senior managers who was responsible for Shepherds' TLP investment business, he described himself as sales director on business cards and in letters, he was encouraged by the managing director to hold himself out as a director, and was described as a Shepherds director in the business plan for the new business.

Was there a breach of duty in setting up a competing business?

66. It was common ground that:

- there is implied in every contract of employment an obligation to serve the employer with "good faith and fidelity": *Robb v Green* [1895] 2 QB 315, 320 (AL Smith LJ);

- a director is under a fundamental duty to act in what he in good faith considers to be the best interests of the company: *Item Software (UK) Ltd v Fassihi* [2005] ICR 450, [2004] IRLR 928 at [41]-[43] (Arden LJ).

67. The claimants relied on the reasoning and decision of Hart J in *British Midland Tool Ltd v Midland International Tooling Ltd* [2003] 2 BCLC 523 who described the fundamental duty of a director of a company as to "do his best to promote its business and to act with complete good faith towards it" ([81]). He also said ([89]):

> "A director who wishes to engage in a competing business and not disclose his intentions to the company ought, in my judgment, to resign his office as soon as his intention has been irrevocably formed and he has launched himself in the actual taking of preparatory steps."

68. The defendants referred to Falconer J's approach in *Balston Ltd v Headline Filters Ltd* [1990] FSR 385. Having considered the no conflict principle (namely, "that a man must not be allowed to put himself in a position in which his fiduciary duty and his interests conflict"), Falconer J said (p412):

> "In my judgment an intention by a director of a company to set up business in competition with the company after his directorship has ceased is not to be regarded as a conflicting interest within the context of the principle, having regard to the rules of public policy as to restraint of trade, nor is the taking of any preliminary steps to investigate or forward that intention so long as there is no actual competitive activity, such as, for instance, competitive tendering or actual trading, while he remains a director."

69. Etherton J considered that both the decision and reasoning of Hart J in *British Midland Tool* were correct and, in so far as there is any conflict between them and the decision and reasoning of Falconer J in *Balston*, the approach of Hart J is to be preferred ([105]).

70. In Etherton J's judgment, it was plain that the necessary starting point of the analysis is that it is the fiduciary duty of a director to act in good faith in the best interests of the company, that is to say to do his best to promote its interests and to act with complete good faith towards it, and not to place himself in a position in which his own interests conflict with those of the company. It is difficult to see, he added, any legitimate basis for "trumping" of those duties by rules of public policy as to restraint of trade as suggested by Falconer J in *Balston* ([106]-[107]).

71. He continued ([108]) that what the cases show is that the precise point at which preparations for the establishment of a competing business by a director become unlawful will turn on the actual facts of any particular case.

> "In each case, the touchstone for what, on the one hand, is permissible, and what, on the other hand, is impermissible unless consent is obtained from the company or employer after full disclosure, is what, in the case of a director, will be in breach of the fiduciary duties to which I have referred or, in the case of an employee, will be in breach of the obligation of fidelity."

72. Having approved the reasoning of Hart J in *British Midland Tool*, Etherton J then appeared to cast some doubt on a central part of Hart J's reasoning ([108]):

> "…Hart J may have been too prescriptive in saying, at paragraph [89] of his judgment, that the director must resign once he has irrevocably formed the intention to engage in the future in a competing business and, without disclosing his intentions to the company, takes any preparatory steps."

73. He added, however, that on the facts of *British Midland Tool*, Hart J was plainly justified in concluding, in paragraph [90] of his judgment, that the preparatory steps had gone beyond what was consistent with the directors' fiduciary duty in circumstances where the directors were aware that a determined attempt was being made by a potential competitor to poach the company's workforce and they did nothing to discourage, and at worst actively promoted, the success of that process, whereas their duty to the company required them to take active steps to thwart the process ([108]).

74. On the facts before him, Etherton J held that by 12 August 2003, when Walters was in contact with Soloman Harris, but not before, all the individual defendants had formed the irrevocable intention to launch the new business. From that date, the individual defendants acted in such a manner as to bring about a plain conflict between their personal interests, on the one hand, and the best interests of the Shepherds group, on the other.

75. Further, each of the individual defendants was obliged, by 12 August 2003 at the latest, to disclose to Financial or Investments, as the case may be, the actual and threatened activity of the others to set up the competing business. If and so far as necessary, like Hart J in *British Midland Tool*,

Etherton J would distinguish *Balston* on the facts on the ground that the intention to compete in *Balston* does not appear to have been formed in that case prior to the resignation of the second defendant as director ([128]).

76. Following Arden LJ in *Item Software*, Etherton J held that there is no separate and independent duty of disclosure ([132]):

> "In the context of the director's own acts to promote a competing business, the breach of fiduciary duty is to carry out the impermissible acts of promotion without first disclosing the intention to do them and obtaining permission to do so. There is a breach because the director's conflict between his personal interest and his duty to the company has not been authorised after full disclosure to, and informed consent by, the company. In the case of the acts of his fellow directors in promoting a rival business, the breach of fiduciary duty of the director is failing to disclose matters which are of relevance and concern to the company and which, if acting in good faith in the best interests of the company, the director would disclose. Those are straightforward applications of ordinary principles of equity concerning fiduciary duties."

Diversion of a maturing business opportunity

77. The claimants further relied upon the principle that a fiduciary may not retain a profit which he makes from the use of property subject to the fiduciary relationship or which he otherwise makes by reason of his fiduciary position, and that, by analogy, a director who exploits after his resignation a maturing business opportunity of the company is to be treated as appropriating for himself property of the company in relation to which he had fiduciary duties. He is, accordingly, just as accountable as a trustee who retires without properly accounting for the trust property. In the case of the director, he becomes a constructive trustee of the fruits of his abuse of the company's property, which he has acquired in circumstances where he knowingly had a conflict of interest and exploited it by resigning from the company. Reliance was placed on *CMS Dolphin v Simonet* [2001] 2 BCLC 84, especially [84] and [96], as authority for these propositions.

78. Etherton J held that the *Dolphin* principle applied to the resignations of Simmons and Hindle to enable them to establish and promote the business of investing in whole life policies. Such a business opportunity was under consideration by the Shepherds group during 2003 and no final and firm

decision had been taken against the exploitation of such a business by those companies prior to the resignations of Simmons and Hindle. Walters was in a different position as far as this claim was concerned and was not liable for diverting a maturing business opportunity.

Express terms of employment contracts

79. The claimants also alleged that Walters and Hindle were in breach of the express term of their contracts of employment prohibiting them from being "at any time, without the written consent of the company,…directly engaged, concerned or interested in or connected with any other company, business or concern".

80. Those words seemed to Etherton J to be directed at a business enterprise which, if not in full operation, had nevertheless reached a stage at which it was conducting some kind of business activity ([140]). In so stating, he distinguished *Ward Evans Financial Services Ltd v Fox* [2002] IRLR 120, on the ground that the wording there not to "hold any material interest" in any company which "impairs or might reasonably be thought by the company to impair his ability to act at all times in the best interests of the company" was much wider than the contractual term in the present case ([137]-[139]).

81. Etherton J upheld this claim against Walters who, unlike the defendant in *Saatchi & Saatchi Co plc v Saatchi* (13 February 1995) was assisting the activities of the new companies whilst still employed by the Shepherds group.

Damages

82. The claimants sought damages for the loss said to have been caused to it as a result of the loss of business allegedly suffered by them in consequence of the establishment of the new companies at an earlier period of time than would have been the case had the individual defendants not been in breach of duty (cf *Coleman Taymar Ltd v Oakes* [2001] 2 BCLC 749).

83. Etherton J found the period of unlawful activity to be from 12 August 2003 until the respective resignations of the individual defendants. The critical

period was from 12 August to 10 October 2003. However, he rejected this claim to damages. In so doing, he stated ([150]):

> "It is critical that, in order to establish a claim for damages, the loss allegedly suffered by Financial and Investments is linked to the individual defendants' unlawful acts rather than the mere fact of loss of senior management personnel and sales people. The individual defendants were entitled to resign. In general, there is no legal impediment to a number of employees deciding in concert to leave their employer and set themselves up in competition."

Account of profits

84. In view of the judge's finding that the individual defendants committed breaches of their fiduciary duties, the claimants were entitled to an account of the profits made by them in consequence of their unlawful conduct in promoting after 12 August 2003 the establishment of the new business: see *CMS Dolphin* ([163]). This account was to be taken following the trial and is not the subject of further discussion in the judgment.

Helmet Integrated Systems Ltd v Tunnard [2006] EWCA Civ 1735, [2007] IRLR 126

85. A later decision of the Court of Appeal suggests a more generous approach to preparing for future competition may be adopted where an employee acts on his own and consistently with his express contractual obligations.

<u>The facts</u>

86. Helmet Integrated Systems Ltd (HISL) produces and sells protective equipment. It successfully marketed the F600 helmet after 1998, its largest customer being the London Fire Brigade.

87. Tunnard was a senior salesman for HISL. In 2001 he hit upon an idea for a new helmet, primarily, but not exclusively, for firefighters. He believed that his employers were not interested in developing a new helmet, particularly on the European market, where he perceived there to be a gap.

88. Between September 2001 and 28 February 2002, Tunnard took certain steps to advance his idea:

- He applied for and obtained (on 7 November) a SMART award, to provide some DTI funding to advance his project. In his application, he identified Lion, the UK subsidiary of a rival US company engaged in the manufacture and supply of safety equipment and clothing, as his preferred option for a partnership agreement; he identified Modular Helmet Systems Ltd (MHSL), a company he incorporated after leaving HISL, as the business he would use to develop the idea; and, importantly, he identified HISL as a competitor.

- On 19 November, he instructed product designers, AME, to proceed with the design of a new helmet and for that purpose handed over a number of competitors' helmets including HISL's F600.

- In November and December, Tunnard met AME and, on 20 December, AME showed him initial concept drawings with a product realisation plan, which it had prepared.

- On 1 February, Tunnard tendered his resignation. He was asked to work out his notice which he did until he left on 28 February.

- In February, Tunnard considered AME's concept with a friend (Tyrrell), a consultant to Lion (the competitor). On 12 February, Tyrrell sent some of AME's drawings, under confidential cover, to Lion's corporate counsel.

89. After his departure from HISL, Tunnard took the following stapes:

- He incorporated MHSL on 30 April 2002, two months after leaving HISL.

- Shortly thereafter, Lion took up a majority shareholding in the new company, MHSL.

90. The judge in the Patents County Court rejected HISL's claims for infringement of design right (which was not appealed), breach of duty of fidelity and fiduciary duties (a decision which was appealed). In doing so, he stressed ([16]):

- there was no misuse of confidential information;
- there was no breach of any restrictive covenant;
- no other HISL employee was involved;
- Tunnard carried out his activities in his own time without use of any HISL property;
- there was no commercial agreement or arrangement made before Tunnard left and no actual competition;
- Tunnard was neither a director nor an employee of similar rank, he was a middle-ranking senior salesman.

The decision of the Court of Appeal

91. The Court of Appeal dismissed the company's appeal.

Tunnard's duties and rights as employee

92. Tunnard's contract provided:

> "there is a duty upon the employee to act at all times with the best interests of the company in mind"
>
> and
>
> "no employee will be permitted to undertake any work or arrange the undertaking of any work which can be seen to affect adversely or be in competition with the company"

93. His job specification, provided at a time when Tunnard was international sales manager, stated that it was his duty

> "to advise on competitor activity and pricing structures"

94. Having summarised the trite law regarding an employee's duty of fidelity, Moses LJ observed that the freedom to compete, once an employee has left, unrestrained by any enforceable covenant, carries with it a freedom to prepare for future activities, which the employee plans to undertake, once

he has left. He noted ([27]) that in *Robb v Green*, Hawkins J (the first instance judge)

> "observed, in words echoed frequently thereafter, that each case would depend upon its own circumstances and there will be cases where an employee may legitimately canvass, issue circulars, have a place of business ready and hire employees. The Court of Appeal made no observation suggesting disagreement when it affirmed Hawkins J's conclusion."

95. Moses LJ stated that the battle between employer and former employee, who has entered into competition with his former employer, is often concerned with where the line is to be drawn between legitimate preparation for future competition and competitive activity undertaken before the employee has left. But in deciding on which side of the line the employee's activities fall, it is important not to be beguiled into thinking that the mere fact that activities are preparatory to future competition will conclude the issue in a former employee's favour. He cited *British Midland Tool* and *Shepherds Investments* as examples of cases where work of preparation constituted breaches of fiduciary duties and (in *Shepherds Investments*) the implied duty of fidelity. It is insufficient to cloak activities with legitimacy by describing them as preparatory ([28]-[32]).

Fiduciary duties

96. Given the difficulties of proving loss and, hence, of recovering compensatory damages, from a breach of the contractual duty of good faith, the appeal turned on HISL's ability to establish a breach of fiduciary duties.

97. Citing Elias J's analysis in *University of Nottingham v Fishel* [2000] ICR 1462, [2000] IRLR 471 as the clearest analysis of the distinction between the employee's duty of good faith and a fiduciary's duty of loyalty, Moses LJ stated that ([36]):

> "The distinguishing mark of the obligation of a fiduciary, in the context of employment, is not merely that the employee owes a duty of loyalty but of single-minded or exclusive loyalty."

98. Moses LJ accepted that ([42]-[45]):

- if Tunnard had learned that a competitor of HISL proposed to develop a helmet which was a rival to the F600 produced by HISL and was in the process of preparing a preliminary concept of such a helmet, he was under an obligation to report that information (it would be "competitor activity" within the meaning of the job specification);

- a "competitor" within the meaning of the job specification might include a third party which had never previously competed but proposed to do so;

- Tunnard would be under an obligation to deploy such information exclusively in the interests of his employer;

- if Tunnard used information about such activity either for the benefit of someone other than HISL or for his own benefit he would be in breach of a fiduciary obligation. This is because HISL would have no control over how Tunnard deployed what he learned as a salesman, and would be dependent on him to pass on the information. Such vulnerability was what Lord Millett in *Equity's Place in the Law of Commerce* (1998) 114 LQR 214, 219 described as a "defining characteristic" of a fiduciary relationship.

99. But, according to Moses LJ, HISL's argument broke down at the conclusion sought to be drawn from the premise. It did not follow from the above that Tunnard was under any obligation, be it fiduciary or otherwise, to inform HISL of his own activities or such activities undertaken on his own behalf. There were two fundamental reasons why this was so. First, the words of the job specification did not restrict Tunnard's freedom to prepare for competition on leaving. Secondly, he was under no relevant fiduciary obligation to HISL ([46]-[47]).

100. Moses LJ (with whom Lloyd and May LJJ agreed) concluded ([51]):

> "The true reason, as I see it, why Mr Tunnard's activities did not amount to a breach of any obligation to HISL lies in the fact that HISL had not restricted the freedom which Mr Tunnard had to prepare for future competition on his departure."

Foster Bryant Surveying Ltd v Bryant [2007] EWCA Civ 200, [2007] IRLR 425

101. This decision of the Court of Appeal attempts to reconcile earlier authorities on preparing to compete and an employee/director's duties, and states an importance principle in that process.

The facts

102. Mr Bryant and Mr Foster were chartered surveyors, operating through the claimant company pursuant to a shareholders' agreement. Alliance Leisure Services (Alliance), managed by a Mrs Watts, was its main client.

103. Following a falling out between Mr Bryant and Mr Foster, the former resigned. He told Mrs Watts that he had resigned. She asked him if he would carry on working for Alliance and agreed to do so under a retainer arrangement. Mr Bryant incorporated a company (Savernake) on 18 January 2005, his notice period expired on 28 January, and he started to work for Alliance thereafter.

104. The claimant sued Mr Bryant for breach of fiduciary duties as a director during his notice period.

The decision of Judge Seymour QC

105. The judge decided that Mr Bryant had been excluded from his role as a director following his resignation, and that there had been no breach of duty by him in going along with Alliance's proposal that he establish his own company and work for it.

The decision of the Court of Appeal

106. The Court of Appeal dismissed the company's appeal.

107. Rix LJ at [8]-[10] reviewed the law on a director's fiduciary duties, citing with approval the analysis in *Hunter Kane Ltd v Watkins* [2002] EWHC 186 (Ch), [2003] All ER (D) 144 (which was taken largely from the *Simonet* case, para 24 above).

108. At [48]-[77] Rix LJ examined the leading authorities, including the recent *British Midland Tool* and *Shepherds Investments* cases (above). Having done so, he drew a number of conclusions: [76]-[77]:

108.1. Whether a retiring director has breached his fiduciary duty is highly fact sensitive.

108.2. The twin principles, that a director must act towards his company with honesty, good faith and loyalty and must avoid any conflict of interest, are firmly in place, and are exacting requirements, exactingly enforced. Whether it remains true to say that these principles are (always) "inflexible" and must be applied "inexorably" may be in doubt.

108.3. Where directors retire, the circumstances in which they do so are so various, that the courts have developed merits based solutions.

108.4. At one extreme (*In Plus Group v Pyke*) the defendant is director in name only.

108.5. At the other extreme, the director has planned his resignation having in mind the destruction of his company or at least the exploitation of its property in the form of business opportunities in which he is currently involved (*IDC, Canaero, Simonet, British Midland Tool*).

108.6. In the middle are more nuanced cases which go both ways: in *Shepherds Investments v Walters* the combination of disloyalty, active promotion of the planned business and exploitation of a business opportunity, all while the directors remained in office, brought liability; in *Umunna, Balston,* and *Framlington*, however, where the resignations were unaccompanied by disloyalty, there was no liability.

109. Moses and Buxton LJJ agreed that whether or not a retiring director breaches his fiduciary duty is fact-sensitive: [98]-[101].

Economic Torts and the Liabilities of Third Parties

Mainstream Properties Ltd v Young [2007] UKHL 21, [2007] 2 WLR 920, [2007] IRLR 608

110. The recent decision of the House of Lords in the cases of *OGB Limited & Ors v Allan & Ors; Douglas & Ors v Hello! Limited & Ors; Mainstream Properties Ltd v Young & Ors* is an important decision on the scope of the economic torts.

Facts

111. Mainstream was a residential property development company. Two employee directors of Mainstream set up a competing property investment business funded by a Mr De Winter. The new company undertook two developments as a joint venture with Mr De Winter on sites identified by the employees as suitable for Mainstream's purposes.

112. Mainstream commenced proceedings against all three individuals. As against the directors, it was alleged that they had breached their contractual and fiduciary duties owed to Mainstream. As against Mr De Winter, it was alleged that he had induced the employees' to breach their contracts of employment with Mainstream.

113. The Judge found that Mr De Winter sought and had been given an assurance by the employees that there was no conflict of interest with Mainstream because they did not wish to develop the site (even though this was untrue), and that he had accepted and relied on the answers given to his questions. He dismissed the claim against Mr De Winter, a decision that was upheld by the Court of Appeal.

The decision of the House of Lords

114. The House of Lords dismissed Mainstream's appeal. Lords Hoffmann, Nicholls, Walker, Brown and Baroness Hale each gave a speech. Lord Hoffmann's speech is considered below.

Economic torts: general

115. Lord Hoffmann considered the development of the economic torts and, in particular, the two torts of (i) inducing breach of contract, and (ii) causing loss by unlawful means.

116. Liability for inducing breach of contract was established by the famous case of *Lumley v Gye* (1853) 2 E&B 216. The court based its decision on the general principle that a person who procures another to commit a wrong incurs liability as an accessory: [3]-[5].

117. The tort of causing loss by unlawful means differs from the *Lumley v Gye* principle, as originally formulated, in at least four respects:

117.1. Unlawful means is a tort of primary liability, while *Lumley v Gye* created accessory liability, dependent upon the primary wrongful act of the contracting party.

117.2. Unlawful means requires the use of means which are unlawful under some other rule ("independently unlawful") whereas liability under *Lumley v Gye* requires only the degree of participation in the breach of contract which satisfies the general requirements of accessory liability for the wrongful act of another person.

117.3. Liability for unlawful means does not depend upon the existence of contractual relations.

117.4. Although both are described as torts of intention, the *results* which the defendant must have intended are different. In unlawful means the defendant must have intended to cause damage to the claimant. Under *Lumley v Gye,* on the other hand, an intention to cause a breach of contract is both necessary and sufficient: [8]

118. Lord Hoffmann traced how these torts were kept separate in *Allen v Flood* [1898] AC 1 (HL), were then confused in *Quinn v Leathem* [1901] AC 495 (HL), and finally were unified in *Thomson Ltd v Deakin* [1952] Ch 646 (CA).

He concluded that the unified theory (i.e. one genus tort of unlawful means of which inducing breach of contract was a species) had been a source of confusion and should be abandoned in favour of the two torts identified in *Allen v Flood*: [9]-[38].

Inducing breach of contract: elements of the Lumley v Gye tort

119. Lord Hoffmann identified the elements of the tort of inducing a breach of contract (otherwise known as the *Lumley v* Gye tort) at [39]-[44]. These are:

119.1. Knowledge that a breach will be induced. A conscious decision not to enquire into the question whether a breach will occur ("recklessness") is treated as equivalent to knowledge.

119.2. Intention to induce a breach. This is satisfied if breach is an end in itself or a means to an end. However, a mere foreseeable consequence which is neither an end in itself nor a means to an end is not intention for this purpose.

119.3. Actual breach of contract. Mere interference with performance less than breach is insufficient.

Causing loss by unlawful means: elements of the tort

120. The essence of this tort is ([47]):

120.1. a wrongful interference with the actions of a third party in which the claimant has an economic interest, and

120.2. an intention thereby to cause loss to the claimant.

121. The most important question concerning this tort is what should count as unlawful means. Lord Hoffmann concluded that unlawful means consists of acts intended to cause loss to the claimant by interfering with the freedom of a third party in a way which is unlawful as against that third party and which is intended to cause loss to the claimant. It does not include acts which may be unlawful against a third party but which do not affect his freedom to deal with the claimant: [51].

122. As with the *Lumley v Gye* tort, there is the question of intention. In the *Lumley v Gye* tort, there must be an intention to procure a breach of contract. In the unlawful means tort, there must be an intention to cause loss. The ends which must have been intended are different. But the concept of intention is in both cases the same.

123. In both cases it is necessary to distinguish between ends, means and consequences. One intends to cause loss even though it is the means by which one achieved the end of enriching oneself. On the other hand, one is not liable for loss which is neither a desired end nor a means of attaining it but merely a foreseeable consequence of one's actions: [62].

The decision on the Mainstream appeal

124. On the facts, Mr De Winter honestly believed that assisting Messrs Young and Broad with the joint venture would not involve them in the commission of breaches of contract. Neither was he indifferent to whether there was a breach of contract or not, nor had he made a conscious decision not to inquire in case he discovered a disagreeable truth. He therefore did not intend to cause a breach of contract and the conditions for accessory liability under the *Lumley v Gye* tort were not satisfied: [66]-[72].

CONFIDENTIAL INFORMATION AND THE DATABASE RIGHT[8]

Database protection

PennWell Publishing (UK) Ltd v Ornstien [2007] EWHC 1570 (QB), [2007] IRLR 700

125. This case concerned the right of an employee, after his employment terminated, to access a database of his contacts which he had created and maintained in his employer's Outlook system. This involved consideration of the general law and the Copyright and Rights in Databases Regulations 1997 ("the 1997 Regulations")[9].

[8] See, further, *Employee Competition* (fn 2 above), chapter 3.
[9] See, also, *Crowson Fabrics Ltd v Rider* [2008] IRLR 288; [2007] EWHC 2942 (Ch) per Peter Smith J at [114]-[120].

Facts

126. The employee, a journalist, had brought his own contacts list to his employer, Pennwell. He made further contacts during the course of his employment, details of which were recorded in his employer's Outlook system. On occasion, the employee would export the Outlook contents into his own contacts list, and then import the updated list back to Outlook. Thus, on termination, the Outlook contents contained details of a range of contacts including those made by the employee prior to his employment, those made during his employment, and those that were purely personal. The employee took the entirety of the Outlook contents with him on termination.

127. At the heart of the case was the question whether this contacts list belonged exclusively to the employer, or the employee, or was jointly owned by them.

The decision

128. The Judge (Justin Fenwick QC) stated his conclusions as follows ([107]):

128.1. where a database is made by an employee in the course of his employment, his employer is to be regarded as the maker of the database subject to any agreement to the contrary (reg 14(2) of the 1997 Regulations);

128.2. otherwise, the maker of the database is defined by reg 14(1) which provides that "the person who takes the initiative in obtaining, verifying or presenting the contents of a database and assumes the risk of investing in that obtaining, verification or presentation shall be regarded as the maker of, and having made, the database";

128.3. thus, if the database was assembled by the employee privately and for his own purposes, he would be treated as the maker of that database under reg 14(1) but if it could be said that the database was made in the course of his employment, then ownership would be that of the employer;

128.4. for a relevant property right in a database to exist, there must be a substantial investment in obtaining, verifying or presenting the contents of a database under reg 13.

129. The Judge was satisfied that where an address list is contained in Outlook or some similar programme which is part of the employer's email system and backed up by the employer or by arrangement made with the employer, the database or list of information (depending whether one is applying the Database Regulations or the general law) will belong to the employer ([127]).

130. On the facts, it was held that the ownership in the database in question was with the employer but that the employee had an implied right to remove private contacts and extract information about key journalistic sources which could properly be described as his personal sources as well as copying any information which he had put on to the system from his own previous resources ([136], [146]).

GARDEN LEAVE[10]

RDF Media Group Plc v Clements [2007] EWHC 2892 (QB), [2008] IRLR 207

131. What is the effect of garden leave on the mutual duty of trust and confidence between employer and employee? Can an employee accept an employer's breach of the duty of trust and confidence when the employee is already, unbeknownst to the employer, in breach of that duty himself? These two important questions are addressed in *RDF Media v Clements*[11].

Facts

132. RDF is in the business of the acquisition and distribution of television content, mainly in the factual entertainment, comedy, drama and children's programming genres.

[10] See, further, *Employee Competition* (fn 2 above), chapter 4.
[11] An appeal was due to be heard by the Court of Appeal in April 2008, but the case settled before the appeal hearing.

133. RDF entered into a Sale and Purchase Agreement (SPA) for the purchase of IWC Media Ltd (IWC) for approximately £10-14m. The defendant, Mr Clements, was one of the shareholders of IWC and entered into a service agreement to work as Director of Content of IWC for an indeterminate period terminable on 6 months' notice.

134. In exchange for almost £2m in cash and shares, Clements entered into a number of restrictive covenants with RDF including one not to compete for a period of 3 years following completion of the sale and purchase. This 3-year restriction was to be reduced to 2 years if Clements was unlawfully dismissed.

135. Just 16 months into the 3-year term, Clements resigned and indicated that he intended to take up employment with SMG, a competitor, and sought a reduction in his notice period to enable him to start within weeks. RDF responded that it intended to hold him to his covenants for the full period and intended to put him on garden leave during his notice period.

136. Given the media interest in the story (Clements is married to the TV journalist and presenter, Kirsty Wark), something of a media battle broke out between RDF, Clements and SMG, with the press being briefed both on and off the record. After a period of time, Clements purported to resign with immediate effect contending that media reports prompted by RDF amounted to a breach by his employer of the duty of trust and confidence. He claimed that he was unlawfully dismissed and that the non-compete period was reduced from 3 to 2 years as a consequence. RDF sought relief to enforce the covenant.

<u>The decision of Bernard Livesey QC</u>

137. Bernard Livesey QC sitting as a High Court judge made detailed factual findings. He also addressed some important legal issues which have hitherto not been definitively resolved in the context of garden leave.

Garden leave and duties owed by employer and employee

138. The judge accepted RDF's submission that the effect of placing an employee on garden leave is to alter the nature and content of the implied obligation of trust and confidence. Whether there has or has not been a breach is a question of fact which must depend on the balance which is struck between the interests of the employer and those of the employee; where the balance is to be struck in any given case will depend on all the circumstances subsisting at the time in question and whether an employee is on garden leave must be a relevant circumstance: [106].

139. RDF also argued that duties of trust, confidence and good faith are either brought to an end or attenuated by garden leave, relying on Scott VC in *Symbian v Christensen Ltd*. The judge declined to express a conclusion on this argument save to note that a distinction may need to be drawn between implied obligations of loyalty and good faith, on the one hand, and obligations of trust and confidence on the other.[12]

Nature of the duty of trust and confidence

140. The judge recited the classic formulation of the duty of trust and confidence: the employer shall not, without reasonable and proper cause, conduct itself in a manner calculated or likely to destroy or seriously damage the relationship of confidence and trust between employer and employee: [100].

141. The burden lies on the employee to prove breach on a balance of probabilities. This means, according to the judge, where the employer claims that he had reasonable and proper cause for his conduct, that the employee must prove the absence of reasonable and proper cause. The judge also held on the basis of first principles that whether there is reasonable and proper cause must also be determined objectively; and the subjective intentions of the employer, though admissible in evidence, are not determinative of the issue: [103].

[12] Citing *Employee Competition*, at para 4.111.

142. The test whether there is a breach or not is a severe one. It is not enough to prove that the employer has done something which was in breach of contract or 'out of order' or that it has caused *some* damage to the relationship; there is a need to prove that the conduct of the employer is sufficiently serious and calculated or likely to cause such damage that it can fairly be regarded as repudiatory of the contract of employment, that is to say, so serious that the employee is entitled to regard himself as entitled to leave immediately without notice: [105].

143. Where comments are expressed between members of the board of directors of a company which is the employer, it is difficult to conceive of circumstances which can give the employee the right to complain of a breach of the duty of trust and confidence. That is because the board of directors is the controlling mind of the company and comments between individuals on the board is merely equivalent to the company thinking aloud to itself. "It is not yet the law that an employer is prohibited from thinking even negative and unworthy thoughts about an employee on his payroll": [113].

144. The judge concluded that the statements in a Sunday Herald article constituted a serious attack on Clements' character and, whether true or not, constituted conduct beyond what was reasonable or proper, by RDF which was calculated or likely to destroy or seriously damage the relationship of trust and confidence between it and Clements. The fact of garden leave did not entitle the employer to require the employee to be bound by a contract of employment with him while he subjects the employee to what became at its climax a campaign of vilification in the Press: [132]-[134].

Can an employee in breach of the duty of trust and confidence rely on his employer's breach?

145. The judge held that, before termination of his employment, Clements had transferred his loyalties from RDF to SMG. He worked contrary to the interests of RDF in ways that constituted acts of disloyalty which amounted to a breach by Clements of the mutual duty of trust and confidence and/or his duty of loyalty and fidelity.

146. In these circumstances, that is where the employee was himself already in breach of the mutual duty of trust and confidence, the question arose whether the employee could rely on the employer's breach of that duty by its conduct in relation to the press article.

147. The judge decided that he could not. He accepted RDF's argument on the basis of authority *Bremer Vulcan v South India Shipping* [1981] AC 909, 986B-D, 987G and *Paal Wilson v Partenreederei Hannah Blumenthal* [1983] 1 AC 854, 909C-D, that where as here the defendant was himself in repudiatory breach of a mutual obligation he was not entitled to accept any repudiation by RDF by reason of his own breaches: [140].

148. An alternative way of looking at it was to say that, as a matter of causation, the relationship was destroyed not by RDF but by Clements as a result of his anterior breach of the mutual obligation. It would also be inequitable for Clements if he were able to claim that RDF caused serious damage to the relationship where the relationship in question was already seriously damaged or destroyed by his own conduct: [141][13].

149. As a result, Clements' employment ceased by reason of his voluntary resignation and the covenant (which was not challenged as to its enforceability) remained valid for 3 years.

RESTRICTIVE COVENANTS[14]

150. One of the most effective means of protecting the business from competition is to ensure that employees are bound by enforceable post-termination restrictive covenants.

Incorporating and Changing Restrictive Covenants

151. But what is the position where an employer comes under a competitive threat and seeks to introduce restrictive covenants for the first time (or to amend existing covenants)? Can the employer insist on an employee

[13] Cranston J expressed doubts about this conclusion in *SG&R Valuation Service Co LLC v Boudrais* [2008] IRLR 771, an important case which also demonstrates that a garden leave clause is not necessarily a pre-requisite to placing an employee on garden leave.
[14] See, further, *Employee Competition* (fn 2 above), chapter 5.

accepting the covenant in such circumstances? If the employee refuses and is dismissed, is the dismissal fair or unfair?

152. These questions arose in the *Willow Oak* case discussed below.

Willow Oak Developments Ltd (trading as Windsor Recruitment) v Silverwood [2006] ICR 55, [2006] IRLR 28 (EAT); [2006] EWCA Civ 660, [2006] ICR 1552, [2006] IRLR 607 (CA)

The facts

153. The employer, Windsor Recruitment, specialised in the supply of agency workers for health services. It had 10 branches nationwide, and employed about 50 consultants. The claimants worked at the Leeds branch as "consultants" in the health care sector, responsible for recruitment and placing of staff in health care posts, including in the NHS.

154. In 2003 and 2004 two senior employees of Windsor Recruitment, one in Birmingham and one in Bristol, left and set up rival businesses. They took with them a significant number of other employees, with the loss to Windsor of much client and candidate information, leading to a reduction in Windsor's business. Further poaching was attempted by the rival businesses leading Windsor to decide that it had to take action to protect itself against further attacks.

155. Windsor decided that all staff would be asked to sign detailed restrictive covenants, and that any who refused to do so would be dismissed. On 19 May 2004, an operations director (Watson) attended at the Leeds office without prior warning and (in his own phrase) "handed copies of the covenants to each employee as one might deal out a pack of cards. He told each employee that they had 30 minutes in which to consider whether to sign" ([10]). He was generally offensive in his dealings with the employees, although he did agree to a request for more time to consider the covenants. One employee was told that if she did not sign, the company might have to "force the issue", though dismissal itself was not threatened. By the deadline, only 7 of 26 consultants had signed the covenants. The remainder

were dismissed. They were offered "alternative employment", although the employment tribunal found the offer to be confusing.

The decision

156. The employment tribunal upheld the claimants' complaints of unfair dismissal. It decided that the covenants were so unreasonable that dismissal for refusing to agree to them could not amount to some other substantial reason which could potentially justify the dismissal within the meaning of section 98(1) of the Employment Rights Act 1996; alternatively, the dismissals were procedurally unfair. In adopting this approach, the tribunal followed the reasoning of the EAT (Rimer J presiding) in *Forshaw v Archcraft Ltd (Note)* [2006] ICR 70.

157. The EAT in this case disagreed with that approach, which disqualifies any unreasonable covenant from counting as a reason that comes within the terms of s98(1) (SOSR). The Court of Appeal agreed with the EAT. The clue to this issue, according to Buxton LJ, is that the question asked by s98(1) is whether the employer's reason is *of a kind* such as to justify the dismissal ([15]). Buxton LJ explained:

> "But if, as in our case, the category into which the reason falls, an employee's refusal to accept covenants proposed by the employer for the protection of his legitimate interests, is one that can in law form a ground for dismissal, then it is necessary to proceed to the second stage of considering whether the employer has, under section 98(4)(a), acted reasonably or unreasonably in treating that reason as a sufficient reason for dismissing the employee."

158. At the second stage, the tribunal's finding that the dismissal was unfair could not be impugned. It found that the unreasonableness of the way in which the covenants were introduced on 19 May set the tone for all the future discussions; and, most importantly, it also found that there had been no warning that failure to agree to the new terms would or might result in dismissal. In the judgment of Buxton LJ (with whom Neuberger LJ and Sir Martin Nourse agreed) "That last fact alone justified, indeed made inevitable, a finding that the dismissals had been procedurally unfair" ([29]).

Repudiation

159. See *RDF Media Group Plc v Clements* [2007] EWHC 2892 (QB) discussed above in the context of garden leave.

Enforcing Restrictive Covenants

160. The most draconian form of restrictive covenant is one which prohibits competition altogether for a period of time. Cox J recently enforced a non-compete covenant following a trial in *TFS Derivatives v Morgan* [2005] IRLR 246. The Court of Appeal has now followed suit.

Thomas v Farr Plc [2007] EWCA Civ 118, [2007] ICR 932, [2007] IRLR 419

161. In *Thomas v Farr Plc*, the Court of Appeal enforced a 12-month non-compete covenant against the former Managing Director of a firm of insurance brokers. The decision contains useful guidance on the approach to be adopted when assessing whether the protection of confidential information provides a sufficient legitimate interest to justify an onerous restraint of this nature[15].

The facts

162. Farr is an insurance broker which specialises in providing services for providers of social housing, in particular housing associations. Thomas had been employed in the insurance industry for 10 years before joining Farr. He progressed up the ladder at Farr serving as account director, director, operations director and, ultimately, managing director. In that position, his salary was £176,900 and he had the benefit of a bonus scheme.

163. The insurance market in social housing is a small and specialist market. There are in all about 1500 housing associations, of whom 350 were Farr's clients. About 20% of those clients were responsible for 80% of Farr's income.

[15] Applied by Tugendhat J in *Extec Screens & Crushers Ltd v Rice* [2007] EWHC 1043 (QB).

164. Thomas resigned because he was unhappy about the consequences of a proposed restructure on his employment. He accepted an offer of employment from a company which intended to compete with Farr. Farr had about one third of the market share of housing association work in England and Wales. Thomas' proposed employer was a new entrant to the market.

The non-compete covenant

165. Thomas' proposed employment was in breach of a non-compete covenant in his employment contract, if that covenant was enforceable.

166. In essence, the covenant provided that Thomas would not, for 12 months from the date of termination of his employment, be engaged in any business which is the same as or in competition with the Business anywhere in the Restricted Territory.

167. For this purpose, the "Business" meant the business of providing property and buildings insurance and risk management and training, carried on by Farr as at the termination date and during the 12 months prior thereto. The "Restricted Territory" meant any geographic area in which any company in the Group conducts the Business and for which Thomas was responsible or to which he rendered services in the 12 months preceding the termination date.

168. There were also non-solicitation and confidentiality covenants in the employment contract.

The proceedings

169. Unusually in a dispute about the enforceability of a restrictive covenant, it was the employee who commenced proceedings. Thomas claimed against Farr damages for breach of contract, a declaration that he had been constructively dismissed, and a declaration that the non-compete covenant in his contract was an unreasonable restraint of trade and unenforceable.

170. The issue as to unreasonable restraint of trade was tried as a preliminary issue. Farr's case was that the clause was necessary to safeguard it against the risk that on taking up employment with a competitor, Thomas would misuse information confidential to Farr, wittingly or unwittingly, to Farr's detriment and the competitor's advantage. Thomas accepted in evidence that he had received information which he would regard as confidential, but he denied that he had any information which would be of any continuing interest or relevance to a competitor.

The decision of the judge

171. The judge, Ramsey J, found that Thomas was privy to all major and strategic operational decisions made by Farr, and in his role as Operations and later Managing Director he had overall responsibility for all of Farr's existing business. Whilst he would not recall every detail, he had and would continue to have a recollection of major matters to a considerable level of detail.

172. Having reviewed a number of the leading authorities, the judge found that Thomas had confidential information, which Farr had a legitimate interest to protect, within the following categories:

- business development through the use of a captive insurer;
- exploitation of new areas of business within social housing;
- exploitation of new geographical markets;
- business development through acquisition of other businesses; and
- pricing and financial information relating to clients and insurers.

173. The judge held that the clause was enforceable. He concluded that a clause which precluded Thomas from operating as an insurance broker in the social housing sector in England and Wales, but which permitted him to operate in all other sectors of the insurance industry, was a reasonable

limitation to impose in all the circumstances, and that a period of 12 months was also a reasonable period.

The decision of the Court of Appeal

174. Thomas appealed to the Court of Appeal, which dismissed his appeal. There were four grounds of appeal.

175. First, it was argued that Farr had failed to adduce sufficiently clear and cogent evidence to establish that Thomas ever had, or was likely to have, any information which Farr could require to be treated as confidential after the termination of Thomas' employment. Toulson LJ gave a timely and striking reminder that the enforceability of a covenant in restraint of trade is to be judged at the time the contract is entered into. He explained that in order to establish that the inclusion of a non-compete clause in an employment contract was reasonably necessary for the protection of the employer's interest in confidential information, the first matter which the employer obviously needs to establish is that ([41])

> "at the time of the contract the nature of the proposed employment was such as would expose the employee to information of the kind capable of protection beyond the term of the contracts (ie. trade secrets or other information of equivalent confidentiality."

176. The degree of the particularity of the evidence required to establish that matter must inevitably depend on the facts of the case. Citing Aldous LJ in *Scully UK Ltd v Lee* [1998] IRLR 263 at [23], the judge considered that sufficient detail must be given to enable it to be decided whether there was confidential information which the employer was entitled to protect but no more was necessary.

177. Provided that the employer overcomes that hurdle, it is no argument against a restrictive covenant that it may be very difficult for either the employer or the employee to know where exactly the line may lie between information which remains confidential after the end of the employment and the information which does not. According to Toulson LJ ([42]), with whom Scott Baker and Chadwick LJJ agreed, the fact that the distinction can be very hard to draw may support the reasonableness of a non-compete

covenant, relying on the well-known observation of Lord Denning MR in *Littlewoods Organisation v Harris* [1977] 1 WLR 1472 at 1479 and also of Waller LJ in *Turner v Commonwealth and British Minerals Ltd* [2000] IRLR 114 at [18]. It is because there may be serious difficulties in identifying precisely what is or what is not confidential information that a non-compete covenant may be the most satisfactory form of restraint, provided that it is reasonable in time and space.

178. There was ample evidence to support the judge's conclusion that in the nature of things Thomas' appointment as Farr's managing director exposed him to information which Farr was entitled to require to be kept confidential after the termination of his employment. The clearest example was pricing and financial information.

179. Interestingly, Toulson LJ noted that if it had been the case that, as events turned out, Thomas was unable to recall any truly confidential information after leaving Farr, that could afford a reason for the court not granting an injunction in support of the non-compete clause. It would not follow that the clause was unreasonably in restraint of trade at the time of his appointment ([47]).

180. The second ground of appeal was that the non-solicitation and confidentiality clauses provided adequate protection for Farr. The Court of Appeal disagreed for a number of reasons, one of which was the "self evident" practical problems of trying to police a non-solicitation clause ([48]).

181. Thirdly, it was argued for the employer on appeal that the non-compete clause was too wide in preventing Thomas from engaging in competition with Farr in any place where it had conducted business in the 12 months prior to termination. The Court of Appeal again disagreed, pointing out that the clause would not prevent Thomas from acting as an insurance broker in sectors other than social housing, nor would it prevent him from acting for insurers in that sector as long as he did not do so in a way which was in competition with Farr.

182. Finally, it was submitted that the non-compete clause ought in principle to be shorter than the non-solicitation covenant, whereas the duration of each was 12 months. The Court of Appeal failed to see the logic of that submission. Neither did it accept the more general point that Farr had failed to justify a 12-month restriction on competition. There was evidence that information, for example, about arrangements with insurers or planned business developments could often remain confidential for more than a year. In the circumstances, 12 months was reasonable.

Allan Janes LLP v Johal [2006] EWHC 286 (Ch), [2006] ICR 742, [2006] IRLR 599

183. Are solicitors a special case when it comes to restrictions on competition? This suggestion has surfaced periodically in the past and makes an appearance again in the first instance decision in *Allan Janes v Johal*. The case also considers the importance issue of whether an employee must have had past dealings with clients with whom he is not to deal in the future.

Facts

184. Allan Janes LLP, the claimant, is a small firm of solicitors with offices in High Wycombe. It had 5 partners, and between 5 and 7 assistant solicitors, one of whom was Ms Johal, the defendant.

185. The firm had on its database the names of about 2,000 clients who had given instructions over the period 2002-5. In the year 2004-5, it opened files on about 750 new matters for about 650 different clients. Of these, the defendant dealt in that period with 64 as the solicitor handling the matter and a further 34 when covering for an absent colleague. There were 45 or so firms of solicitors with offices in the area.

186. The defendant qualified as a solicitor in 1989. She specialised in commercial property. She was offered a position with the claimant by a letter which stated "this is a senior position which we hope would lead to an offer to join the partnership after a suitable period of assessment on both sides."

187. A little over 5 years after joining, the defendant resigned, working out her three months' notice. During her period of notice, the defendant seriously

abused her position and breached the express and implied terms of her contract. This included working for other firms, diverting business from the claimant to the new partnership which she was to join, and taking with her a soft copy of a list of clients prepared for a marketing exercise by the claimant. In the week after her employment came to an end, the defendant began soliciting clients of the claimant for her new practice in High Wycombe.

188. There were two restrictive covenants to which the defendant was subject: an area covenant, and a non-dealing covenant.

The area covenant

189. The defendant agreed not for 12 months after termination to practise as or do the work of a solicitor within a radius of 6 miles from the claimant's office. Excluded from this restriction was work in fields in which the firm did not practise as at her termination date and work for specified types of clients.

190. The first task was to construe the wording of the covenant. The defendant argued that the clause did not restrict her, provided she had a place of practice outside the area, from doing work within the area. The judge disagreed. The words "or do the work of a solicitor" were intended to add something to the words "to practise". Doing the work of a solicitor within the area included visiting within the radius and even delivering a letter of advice either personally or by post.

191. As to reasonableness, the judge concluded that an area clause which was not limited to the clients of the firm was wider than was necessary to protect the firm's legitimate interests. Having regard to the size of the population within a radius of six miles of the firm's offices, a radial restriction would serve mainly to protect the firm from competition for the business of a very large number of commercial entities which were not, or had well and truly ceased to be, clients of the firm. The claimant was not entitled to that sort of protection.

The non-dealing covenant

192. The defendant also agreed not for a period of one year post-termination to act as a solicitor or do the work of a solicitor for any person who shall have been a client of the firm in the previous 12 months. Curiously, this non-dealing covenant was further limited by reference to geographical area around High Wycombe.

193. The central argument of the defendant was that the non-dealing covenant was unreasonable in that it was not limited to clients with whom she had personally dealt. She pointed to the fact that she had direct dealings with only 9-10% and indirectly (by provision of holiday cover) with a further 5% of those clients for whom the firm did work in the last 12 months of her employment. In support of her argument, she relied on a number of authorities: *Office Angels Ltd v Rainer-Thomas* [1991] IRLR 214, per Sir Christopher Slade at [45]; *Wallace Bogan v Cove* [1997] IRLR 453, per Potter LJ at [19]; *Dentmaster (UK) Ltd v Kent* [1997] IRLR 636, per Waite LJ at [17]; *Marley Tile Co Ltd v Johnson* [1982] IRLR 75, at [14]-[17]; *Austin Knight (UK) Ltd v Hinds* [1994] FSR 52,58.

194. The judge (Bernard Livesey QC) recognised that the fact that the restriction was not limited to those clients with whom the defendant had personal contact in the period of one year prior to termination was an important consideration which significantly widened the restriction; attempts to justify it must therefore be carefully considered. After due consideration he concluded that the width of the clause was not fatal to its reasonableness: [62].

195. According to the judge, the emphasis on the statistics of personal client dealings in the last year of employment was superficially attractive but fundamentally misconceived for the important reason that it neglects the importance of judging the reasonableness of the restriction as at the date when the contract was made and not when it came to an end.

196. It was within the contemplation of the parties when the contract was made that, in pursuance of the objective of developing the relationship of the

claimant with the defendant to the doors of partnership, she would be introduced widely to a large proportion of the firm's key clients. The judge added at [63]:

> "Her very presence as a respected member of the firm in which the partners had trust endowed her with a special status on which she could rely vis-à-vis even those clients with whom she had no prior contact."

Solicitors – a special case?

197. The judge firmly decided that solicitors are not a special case in the sense of being immune from the principles in this branch of the law applicable generally to employees, relying on the decision of the Court of Appeal in *Wallace Bogan v Cove* [1997] IRLR 453, especially per Leggatt LJ at [12].

Beckett Investment Management Group Ltd & Ors v Hall & Ors [2007] EWCA Civ 613, [2007] ICR 1539, [2007] IRLR 793

198. The recent Court of Appeal decision in *Beckett Investment Management Group Ltd & Ors v Hall & Ors* provides useful guidance on the construction, enforceability and breach of non-dealing covenants, particularly in the context of group companies.

Facts

199. Beckett Investment Management Group Ltd (BIMG) was the holding group within a group of companies (the Beckett Group) which provided financial services. Beckett Financial Services Ltd (BFS) was a subsidiary which provided advice and services to clients. Beckett Asset Management Ltd (BAM) was another subsidiary which provided investment advice and management services. BIMG did not deal directly with clients and provided no direct financial advice. This was all done by BFS.

200. Mr Hall and Mr Yadev were independent financial advisers with expertise in investment advice and pensions. Both had been employed within the Beckett Group for some years before entering into employment contracts with BIMG on 1 January 2004, as sales director and financial consultant respectively. Their employment contracts contained restrictive covenants, including both non-solicitation and non-dealing clauses.

201. Mr Yadev's employment with BIMG terminated on 31 May 2006. Shortly thereafter, Mr Yadev established his own business. Mr Hall's employment subsequently terminated on 11 August 2006, and he joined Mr Yadev's business three days later.

202. BIMG, BFS and BAM issued proceedings against Mr Hall and Mr Yadev alleging conspiracy, misuse of confidential information, breach of fiduciary duties and breach of the restrictive covenants.

The non-dealing covenant

203. The employment contracts of Mr Hall and Mr Yadev contained identical non-dealing clauses, which provided that the employees would not, for 12 months immediately following the termination of their employment with the company, directly or indirectly deal or attempt to deal with any relevant client for the purpose of supplying prohibited services.

204. "Prohibited services" were defined as meaning "the provision of advice in relation to pensions, life assurance, investments and other advice of a type provided by the company in the ordinary course of its business at the date of termination of the employee's employment with it".

The decision of the judge

205. His Honour Judge Seymour QC accepted the evidence of Mr Hall and Mr Yadev and made unchallenged findings of fact in their favour. In view of those findings, much of the claimants' case fell away, leaving the sole issue of the alleged breach of the non-dealing clause.

206. The judge considered the construction of the non-dealing clause. He found that the word "deal" meant "do business with" and did not encompass any interaction at all with someone. He also considered the meaning of a "client". In his judgment, in this context, to be a "client" is not a status, but a description of a contractual relationship, past or present. Thus, a "client" of a professional person describes someone for whom for the time being the professional person is in a contractual relationship under which he is to provide some service. Those findings were unchallenged on appeal.

207. On the question of the construction of "prohibited services", the judge found that the words "of a type provided by the company in the ordinary course of its business" qualified everything that went before in the definition. As "the company" was BIMG, and BIMG did not provide advice about anything to anybody but simply acted as a holding company, the judge's construction led him to conclude that the restriction on dealing was of no practical utility whatsoever.

208. In the event that he was wrong, the judge went on to find that the non-dealing clause was unenforceable because BIMG had no legitimate interest to protect by a restrictive covenant, and that it failed the test of reasonableness because the period of 12 months for which the restraint was sought was arbitrary.

The decision of the Court of Appeal

209. The Court of Appeal overturned the judge's findings on construction and enforceability of the non-dealing clause.

210. Maurice Kay LJ (giving the only reasoned judgment) held that, given Mr Hall and Mr Yadev were aware of the roles of the holding company and the subsidiaries when they entered into the contracts, the Court should not uphold a construction which deprived a covenant of all practical utility. The Court of Appeal held that the definition of "prohibited services" applied to advice provided by BFS, even though the clause referred only to BIMG: [17].

211. In doing so, the Court of Appeal rejected a 'purist' approach to corporate personality. Maurice Kay LJ relied on the guidance of Lord Denning in *Littlewoods Organisation Ltd v Harris* [1977] 1 WLR 1472 at 1482 that the law has regard to the realities of big business and takes the group as being one concern under supreme control: [18]. He also relied on the judgment of Lord Wilberforce in *Stenhouse Australia Ltd v Phillips* [1974] AC 391, in which the Privy Council held that the subsidiary companies were merely agencies or instrumentalities through which the holding company directed its

business: [19]. Thus, the fact that the clients dealt with BFS rather than BIMG was not fatal to the non-dealing covenant.

212. The Court of Appeal went on to find that the non-dealing covenant was enforceable. BIMG had a real interest in protecting the businesses of the subsidiary companies and therefore had a legitimate interest to protect by a restrictive covenant: [23].

213. Further, Maurice Kay LJ found that the 12-month duration of the non-dealing clause was reasonable having regard to Mr Hall's and Mr Yadev's "enormous importance" to the success of the business, to the difficulty in replacing them, and to the uncontradicted evidence of an industry standard of 12 months for such restrictions. The Court of Appeal did not accept that the client's choice was constrained: during the period of restriction, the client was not compelled to remain with the covenantee and could seek the advice of any other service provider: [29].

214. The final issue in the case concerned whether the extended definition of "client", being at least in part unreasonable because it prevented individuals acting on behalf of another from seeking advice in their personal capacity, was severable from the primary definition. The judge had concluded that severance was not possible. The Court of Appeal disagreed. It applied the threefold test set out in *Sadler v Imperial Life Assurance Company of Canada Ltd* [1988] IRLR 388, which stated that a contract is enforceable if:

- The unenforceable provision is capable of being removed without the necessity of adding or modifying the wording of what remains;
- The remaining terms continue to be supported by adequate consideration;
- The removal of the unenforceable provision does not so change the character of the contract that it becomes not the sort of contract that the parties entered into at all.

215. Applying that test, the Court of Appeal had no difficulty in concluding that the definition of "client" was properly severable, and therefore that the non-dealing clause (as modified by severance) was valid and enforceable.

216. This decision will assist employers operating in a group company structure. It reflects the reality that the business interests of a holding company may include the business interests of its subsidiaries. Nevertheless, employers who wish to protect the business interests of subsidiaries should ensure that restrictive covenants are drafted broadly enough to include them within their scope.

Restrictive Covenants and TUPE[16]

217. Para 5.302 of *Employee Competition* notes the "potentially far-reaching" consequences of an employee's right to object to a transfer as far as the enforceability of restrictive covenants is concerned. This observation is borne out by a recent decision on the interplay between TUPE 2006 and restrictive covenants.

New ISG Ltd v Vernon & Ors [2007] EWHC 2665 (Ch); [2008] IRLR 115

218. This case contains an important interpretation of the right to object to a transfer enshrined in reg 4(7) of the Transfer of Undertakings (Protection of Employment) Regulations 2006.

Facts

219. A recruitment agency provided white and blue collar workers to the rail industry. The agency went into administration and its business was sold to the claimant, New ISG, which was a wholly owned subsidiary of UKRS, one of the agency's competitors.

220. The employees were not told the identity of the claimant transferee prior to the transfer. Nevertheless, a number of them signed new contracts of employment with the claimant containing restrictive covenants. However, those employees then resigned and starting working for a competitor in

[16] See, further, *Employee Competition* (fn 2 above), paras 5.285-5.303.

breach of those covenants. The claimant sought injunctions until trial enforcing those covenants.

221. An issue arose as to whether the employees had effectively exercised their rights to object to the transfer, with the result that they did not become employees of the claimant who was unable to enforce the covenants against them.

The decision

222. The judge made the following important observations on the right to object:

222.1. There is a requirement on the part of a transferor to identify the transferee to employees. Otherwise, the employees would not have the necessary material to decide whether to object under reg 4(7) (56]).

222.2. The court should adopt a purposive construction to reg 4(7). It should be construed as applying to an objection made after a transfer provided the objection is made before it can be said that the employee had, by conduct in working for the transferee, made clear that there was no objection ([64]).

223. It was held that the employees' letters of resignation were to be construed as objections within the meaning of reg 4(7) ([77]). Even if this purposive construction were not adopted, the judge was prepared to hold that the claimant was estopped from denying that the employees had exercised their rights timeously ([75]).

DAMAGES AND OTHER REMEDIES[17]

224. It is often difficult to prove that a victim of unlawful competition has suffered financial loss, for example, from breach of a restrictive covenant. In those circumstances, damages calculated on the traditional compensatory basis may be nominal.

[17] See, further, *Employee Competition* (fn 2 above), chapter 10.

225. However, since the decision of the House of Lords in *Attorney-General v Blake* [2001] 1 AC 268, the possibility of seeking an account of profits for breach of contract has emerged. See, for example, Lord Nicholls' speech at 284H-286F.

226. The Court of Appeal has recently considered the nature and scope of such a remedy in *WWF – World Wide Fund for Nature v World Wrestling Federation Entertainment Inc* [2007] EWCA Civ 286. The Court's decision identifies two distinct remedies in this context, namely:

226.1. damages calculated on a *Wrotham Park* basis in an amount assessed as the sum which the court considers it would have been reasonable for the covenantor to pay and the covenantee to accept for the hypothetical release of the covenant: see Chadwick LJ at [53]; and

226.2. an account of profits, as awarded in *AG v Blake*.

227. It is to be noted that the Court cited a passage from the decision of Jacob J in a related application which suggests that an account of profits is not available for a breach of an employment covenant, relying on Lord Nicholls' speech in *AG v Blake* referred to above: see Chadwick LJ at [68], referring to [63] in the judgment of Jacob J. However, it is doubtful whether Lord Nicholls observations about negative covenants at 286D-E of his speech in *AG v Blake* support the unqualified proposition apparently advanced by Jacob J.

PRACTICE AND PROCEDURE[18]

Disclosure

228. In *Samengo-Turner* (above), the defendants enforced the co-operation covenant in the bonus agreement to obtain disclosure from the defendants about their activities in assisting and planning to join a competitor. The New York court made orders for early disclosure, interrogatories and depositions. The information obtained through this process assisted in the

[18] See, further, *Employee Competition* (fn 2 above), chapter 11.

formulation of claims for pre-termination breaches of duties of good faith by assisting a competitor which were subsequently made against the employees in UK proceedings.

229. Notwithstanding the anti-suit injunction granted by the Court of Appeal to restrain the New York proceedings, Tuckey LJ expressed the view that there was nothing to prevent enforcement of the bonus agreement in the UK: [43].

230. This example invites consideration of what processes for early disclosure of information and documentation might be available solely in the context of UK proceedings. Three means suggest themselves: an application for pre-action disclosure of documents pursuant to CPR rule 31.16[19], enforcement of a *Marsh*-type cooperation covenant in employment contracts, and enforcement of the obligation to disclose a competitive threat as an incident of the implied duty of good faith (see, for example, *Item Software v Fassihi* [2005] ICR 450 (CA)).

231. For another illustration of specific disclosure in the context of employees leaving to join a competitor, see *Tullett Prebon Group Ltd v Davis* [2007] EWHC 2739 (QB).

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[19] See *Hays Specialist Recruitment (Holdings) Ltd v Ions* [2008] IRLR 904 (David Richards J).