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Protecting your business: confidential information, restrictive covenants and team moves

Inside

Introduction

Protecting your business from competitive threats is vital.

Losing a team or a key employee to a competitor can be extremely damaging. You may lose clients, prospects and other staff. Your valuable confidential information may be put at risk.

It is critical to put effective protections in place from the outset of the employment relationship and keep them up-to-date. Training can ensure that you are ready to take appropriate action when threats arise.

This Inbrief focuses on defending competitive threats to your business, such as the departure of key employees, and managing risks when you are recruiting employees from your competitors.

This Inbrief provides a general introduction to a number of the basic concepts and issues that arise in England and Wales in this fiercely litigated area. It considers the position from the point of view of the employment relationship, although similar considerations can also arise in cases involving departing partners and LLP members and shareholders.

This guide does not consider the legal position in respect of independent contractors.

Contractual duties

A well-drafted contract of employment (sometimes referred to as a "service agreement") is essential. It should clearly set out the employee's obligations, both during and after employment.

Some terms are implied into all employment contracts. For example, all employees owe an implied duty of fidelity to their employer, which means they must have regard to their employer's interests and serve the business loyally. Some senior staff (statutory directors, and others in a position of trust in relation to their employer's assets or employees – a hotly contested category) also owe fiduciary duties. This requires such individuals to act in the best interests of the company at all times - even at the expense of their own interests.

However, to rely on implied protections alone where valuable staff are concerned would be to take a significant and unnecessary risk. Employers can, and should, add to these implied protections by including express terms in employment contracts. Helpfully, in recent years the courts have shown an increased willingness to enforce onerous terms against employees. They have been prepared to grant employers relief when employees have breached these express contractual requirements. A non-exhaustive list includes obligations:

- to act in the employer's best interests at all times
- to report their own and others' actual or prospective wrongdoing
- to disclose any information which may adversely affect the company's interests (e.g. plans to compete or approaches from competitors).

Practical obligations can also be very useful in a threat scenario. These might include requiring the employee to deliver up all IT equipment on termination of employment, or to delete the employer's information from their own equipment and permit the employer to verify that they have done so. The same is true of remuneration structures: deferred compensation (or repayment requirements) that is conditional upon compliance with contractual obligations, including not engaging in competitive activity, can be an effective form of protection.

Confidential information

Employers only benefit from very limited implied protection for their confidential information. For example, after termination of employment, implied duties will only protect "trade secrets" from misuse. These are typically limited to things like confidential algorithms, designs, formulae and (possibly) highly secret business strategies. Trade secrets are now also protected by a statutory regime set out in the Trade Secrets (Enforcement, etc) Regulations 2018, which include a statutory definition of "trade secret" and operate in parallel with the common law duty of confidentiality.

This limited implied protection after termination for mere confidential information leaves departing employees potentially free to use other types of business information - pricing, details of customers, marketing plans, products in development, what other people are paid - for the benefit of themselves or their new employer.

It is therefore important for employers to include well-drafted express provisions to ensure that confidential information is protected both during the employment relationship and, more importantly, after it ends. Such clauses should include clear definitions of what is considered to amount to "confidential information" in the context of the business in question: a failure to do this can also have serious consequences. Typically, a definition of "confidential information" would include lists and details of clients and prospects, terms of business, pricing strategies, marketing plans, forecasts and pitches – together with any other specific, sensitive information to which the employee in question has access.

The following practical steps to protect confidential information are also strongly advisable:

- labelling commercially sensitive information as "confidential"
- password protecting devices and documents which contain confidential material
- introducing a "Bring Your Own Device" policy which sets out clear rules on the circumstances in which employees may connect their own devices to the employer's system, the access which the employer is permitted to have, and the security measures that must be taken
- adopting a social media policy which sets out the employer's policy on the use of networking sites such as LinkedIn, making it clear that client contacts remain the employer's property
- on termination of employment, requiring employees to return company property, including hard and soft copies of specified documents, memory sticks and devices, and to permanently delete any company documents stored on personal devices or email at the employer's direction.

Intellectual property

If an employee (whether current or former) uses any inventions, works, designs, databases or names of the business without authorisation, issues may arise around infringement of the employer's intellectual property (IP) rights. Employers for whom IP ownership is a crucial part of their enterprise should seek specialist legal advice to understand fully how IP rights arise and should be protected in all areas of their business.

Although the rules for IP rights vary, generally in the UK an employer will automatically own any IP in works created by its employees in the course of their employment. There are, however, exceptions to this rule and its application will turn on the circumstances of each case. Outside the UK (particularly in civil law jurisdictions), IP ownership rules tend to be more pro-author and less generous to employers, which may be relevant where an employee works abroad.

Irrespective of the employer ownership principle, it is therefore be helpful to include express wording in the employment contract about IP rights in case there is any ambiguity or dispute about ownership later. As a minimum, the contract should state that any works and inventions created by an employee in the course of employment or in connection with it (and IP rights in them) belong to the employer from the date of creation. Further clauses should be considered for any employees who are likely to create valuable IP as part of their role and/or who work largely outside the UK (for example, an assignment of IP rights to the employer with assurances, a waiver of moral rights and an obligation to disclose inventions).

Data protection

Finally, data protection legislation can also be relevant in this area. Under the Data Protection Act 2018, it is a criminal offence for a person to knowingly or recklessly obtain or disclose personal data without the consent of the data controller. A similar provision existed under earlier legislation and led to the conviction of an employee for unlawfully taking the personal data of customers when moving to a competitor. Employees should be reminded of their obligations in relevant policies, and IT policies should expressly prohibit the forwarding or copying of such information to personal devices or accounts.

Where an employee does breach these rules by sending information containing personal data to a private email address, the employer may have a duty to protect that information by taking steps to prevent its misuse. It may also have a duty to report the incident to the Information Commissioner's Office depending on the circumstances.

Notice periods and garden leave

It is important to have well-drafted, clear provisions in employment contracts giving the employer control over the departing employee's activities during their notice period.

In many cases, when an employee gives or receives notice to terminate the employment contract, the employer may want them to stay away from the office for all (or part) of their notice period. This enforced period away from work is often referred to as "garden leave".

Garden leave can be used by a business to minimise or mitigate the damage that could be caused by the employee in question. For instance, a new executive could be brought in to manage and/or develop a particular client relationship while the departing employee is kept "out of the market". As garden leave is generally easier to enforce than post-termination restrictive covenants (see below), it can provide an alternative means of ensuring effective protection against competitive threats.

There is, however, no automatic right to place an employee on garden leave. Requiring an employee to remain away from the office during a period of notice in the absence of an express garden leave clause may lead to an employee arguing that there has been a breach of contract, with the consequence that they have been constructively dismissed and discharged from ongoing obligations to the employer. Should such an argument succeed, it could have serious adverse consequences for the employer's ability to protect itself.

Restrictive covenants

Restrictive covenants, also known as "post-termination restraints" (PTRs), are designed to protect the employer and its affiliates against competitive activities by former employees. They typically include:

- a **non-compete** restriction: this is intended to prevent a departing employee from engaging in competitive activities, which for practical purposes will often mean not starting work with a competitor during the term of the covenant
- a **non-solicitation** restriction: this is intended to stop a former employee from seeking business from specified clients or prospective clients
- a **non-dealing** restriction typically prohibits an ex-employee from having any dealings with clients or prospective clients
- a **non-poaching** restriction prevents the individual from employing, engaging or enticing certain colleagues to join the competing business
- a **non-interference** restriction: this will prevent an employee from seeking to divert supplier relationships away from their former employer, typically for the benefit of a new one.

The duration of such PTRs is typically somewhere between three and 12 months, depending on the circumstances of the employer's business and what may be considered reasonable in any given case.

The scope of protection

Any post-termination restrictions on an ex-employee's activities that go further than reasonably necessary to protect a "legitimate business interest" will be void for being in restraint of trade and unenforceable. Legitimate business interests can include protecting confidential information and trade secrets, client contacts, goodwill, relationships with suppliers and maintaining a stable workforce.

What is "reasonable" will depend on the circumstances of the business and the employee's role. Special care must be taken when considering the duration of the restriction, its geographical scope, and the extent to which the employee has had dealings with specific clients or influence over particular colleagues.

Importantly, the courts consider the reasonableness of the restriction at the point at which it was entered into. This means that covenants can become out of date: employers should regularly review restrictive covenants to ensure that they continue to give adequate protection as employees rise through the ranks. Promotions and increases in salary provide good opportunities to agree new restrictive covenants or to affirm existing provisions.

Team moves

When two or more departing individuals leave a business at the same this is often referred to as a "team move". If this is organised while the individuals are still working for the existing business, it is likely to involve breaches of both express and implied obligations.

Some businesses have express anti-team move PTRs in their contracts designed to prevent more than one departing individual from working together in a competing business. This type of restriction has not yet been properly tested in the courts, so there is a debate over whether

such clauses go beyond the necessary protection of legitimate business interests.

Enforcement

If an employee breaches – or threatens to breach – their duties or restrictive covenants, it is important for an employer to act quickly to minimise potential damage to the business and to avoid arguments that it has unreasonably delayed.

Typically, it can take many months to reach a full hearing in litigation. However, it is possible to apply to the courts for an order restraining an employee or former employee from acting in breach of their obligations until trial or limiting the impact of damage already caused by their breaches (an 'interim injunction'). This can be obtained on an urgent basis, potentially within a matter of days. The court will normally be asked to:

> enforce express restrictive covenants and other ongoing obligations in the employee's contract of the type described above, and/or

> order "springboard" relief, a discretionary remedy intended to cancel out the unfair advantage which an employee (or competing business) may have gained as a result of the employee's breach of legal obligations, for example obligations in relation to confidential information.

Applications for springboard relief typically turn on evidence of misconduct, so it is critical for the employer to take swift steps to preserve and search potential sources of such evidence. In so doing, it must comply with its own obligations under data protection law, the Computer Misuse Act 1990 and the Regulation of Investigatory Powers Act 2000.

The courts have broad powers to grant a variety of orders, from restraining a former employee from starting work with a competitor to forcing the return of confidential information. An important tactical decision for an employer to take is whether to initiate action only against the departing employee (or employees), or against their new employer as well – for example for the "tort" (civil wrong) of inducing breach of contract.

Seeking an injunction does not limit other legal action which may be available, such as a claim for damages or an account of profits (where applicable).

Recruitment

As well as advising employers on how to protect their interests when key employees depart, we frequently work with businesses when recruiting senior individuals and teams from their competitors. Such activities can pose significant legal risks. The individuals themselves may face enforcement action aimed at preventing them from working for their new employer or seriously limiting their productivity. And the new employer may be on the receiving end of legal proceedings.

Important steps include:

> understanding what express and implied restrictions the would-be recruits are subject to, and thus where potential areas of vulnerability lie

> ensuring the individuals themselves do not cross the line when making preparations for their own departure – such as encouraging colleagues to leave or making copies of confidential materials in breach of duty.

We can assist in developing a carefully planned strategy at the outset of recruitment on an individual basis, which can be vital in navigating this tricky area. (See also our Inbrief *Setting up a competing business*, on practical issues for entrepreneurs and managers who are seeking to start a competing business.)

How we can help further

> *Recruitment:* we can advise senior managers and HR on how to stay on the right side of the line in your recruitment activities.

> *Contracts:* we can audit and update business protection clauses in employment contracts and service agreements, to ensure they are "state of the art" and contain the type of protection that courts have found to be enforceable. We can help identify and address existing gaps in protection: senior employees who have never been asked to sign restrictions; or those who were only asked to do so when more junior and the restrictions are no longer enforceable. This will equip you to take action to address potential future threats. We can take account of the most recent developments in case law, and in response to government consultations.

> *When competitive threats arise:* if employees leave to set up in competition (individually or en masse), steal or misuse confidential information, or poach clients and/or other staff, our market-leading High Court employment team offers a rapid response service, including taking urgent enforcement action where necessary.

> *Reputation management:* in high-profile disputes, we work closely with our specialist defamation and reputation management lawyers (plus experts in other fields such as public relations) so we can respond rapidly and robustly to achieve our clients' desired outcomes.

> *Training:* we offer practical, case study-based training on how you can strategically plan to defend threats to your business, such as the departure of key employees, and how to manage risks when recruiting employees from your competitors. Our training is designed for lawyers, HR professionals and executives who grapple with these issues from time to time.

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