Employee competition: mitigating the risks

Toni Lorenzo, Partner at Lewis Silkin LLP, explores the main competitive risks posed by a business' relationship with its employees and ex-employees, and proposes practical solutions for reducing an organisation's exposure

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.

In this article we deal with the basic concepts and issues which arise in this fiercely litigated area. We consider the position from the point of view of the employment relationship, although similar considerations do also arise in cases involving departing partners and LLP members and selling shareholders.

Contractual duties

A well-drafted contract of employment (service agreement for senior staff) 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 - this 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. These require an individual to act in the best interests of the company at all times, even at the expense of his or her own interests.

However, to rely on implied protections alone where valuable staff are concerned would be to take a significant 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 terms which are really quite onerous for an employee to comply with, and granted employers relief when employees have breached these requirements.

A non-exhaustive list includes obligations:

- to act in the employer's best interests at all times;
- to report his or her 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); and
- to disclose the identity of a potential new employer once an offer is received.

Practical obligations – such as requiring employees to deliver up all IT equipment on termination of employment, delete the employer's information from their own equipment, and permit the employer to verify that they have done so – can also be very useful in a threat scenario.

The same is true of remuneration structures: deferred compensation which is conditional upon compliance with obligations of fidelity, or 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.

"Trade secrets" are typically limited to things like confidential algorithms, designs, formulae and (possibly) highly secret business strategies. In reality, most businesses do not have "trade secrets". This 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 express provisions ensuring that confidential information is protected both during the employment relationship and, still more importantly, after it ends. A well drafted express provision should protect business information which does not amount to "trade secrets".

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 such a definition 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. However, the express provision should not seek to protect also publicly available information since that may invalidate the entire clause.

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;
- committing to a social media policy which sets out the employer's rules on the use of networking sites such as LinkedIn, making it clear, for example, that client contacts remain the employer's property; and
- 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.

Finally, data protection legislation can also be both relevant and helpful here. Under section 170 of 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 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 could, and should, be reminded of this provision in relevant policies, and IT policies should prohibit the forwarding or copying of information to personal devices or accounts.

Where an employee does breach these rules by sending information containing personal data to a private email address (for example) 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 loss of that data, depending on the circumstances.

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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 the notice period.

In many cases, when an employee gives or receives notice to terminate the employment contract, the employer may want the employee to stay away from the office for all (or part) of his or her 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 restrictive covenants (see below), it can provide an alternative means of ensuring effective protection against competitive threats on termination of employment.

However, there may be 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 he or she has been constructively dismissed

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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 ("post-termination restraints")

Restrictive covenants (or "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 at all – 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, or trying to persuade other employees to leave, or assisting others (such as a new employer) to do so;
- A non-dealing restriction: This type of clause prohibits an ex-employee from having any dealings with clients or prospective clients;
- A non-interference restriction: This will prevent an employee from seeking to divert supplier relationships away from their old employer, typically for the benefit of a new one.

The duration of non-compete, non-solicitation, non-dealing and non-interference covenants 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.

There is no requirement to pay the ex-employee in return for compliance with covenants.

The scope of protection

It is common to hear employees say that unpaid post-termination restrictions are not enforceable. That is not the case. Only 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 particular business and the employee's role. Particular care must be taken when considering the duration, the geographical extent of the restriction, and the extent to which the employee has had dealings with particular clients or influence over particular colleagues.

Importantly, the Courts judge the reasonableness of the restriction at the point at which it was entered into and not when the employment ends. This means that covenants can become out of date: employers should regularly review restrictive covenants, to ensure that those they have in place give adequate protection as employees rise through the ranks.

Promotions and salary increases provide good opportunities to agree new restrictive covenants or to reaffirm existing provisions.

Enforcement

If an employee breaches – or threatens to breach – his or her duties or restrictive covenants, it is important for an employer to act quickly to minimise potential damage to the business.

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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 his or her obligations until trial, or limiting the impact of damage already caused by an employee's breaches (an interim injunction). This can be obtained on an urgent basis – within a matter of days.

The High Court will typically be asked either:

- to enforce express restrictive covenants and other ongoing obligations in the employee's contract of the type described above; and / or
- to order "springboard" relief, a discretionary remedy intended to cancel out an unfair advantage which an employee (or a competitor) may have gained as a result of an employee's breach of legal obligations, for example the duty of fidelity or obligations in relation to confidential information. Applications for springboard relief typically turn on evidence of misconduct, and it is critical for an employer to know

what steps to take swiftly in order both to preserve and to search potential sources of such evidence – while at the same time complying with its own obligations under the GDPR and Data Protection Act 2018, Computer Misuse Act and Regulation of Investigatory Powers Act

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 the new employer as well – for the tort 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

Care should be taken when recruiting senior individuals and teams from their competitors. Such activities can pose significant legal risks:

- for the individuals themselves who may face enforcement action aimed at preventing them from working for their new employer or seriously limiting their effectiveness in the new role; and

- for the new employer itself, which may be on the receiving end of a lawsuit for inducing a breach of contract.

Important steps before embarking on the formal recruitment process include:

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

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

Preventing breaches of obligations when recruiting a team is extremely difficult both legally and in practice. The aim is to recruit the team as a series of individuals without reference to each other. In practice, that rarely happens.

Equally, if an employer is faced with a team leaving its business, it should work to uncover evidence of breaches which will result in the best possible outcome (whether that be a commercial outcome or retaining some of the team).

Conclusion

Clearly, a business faces a number of important risks at the hands of its employees and ex-employees, and in the employment environment generally. However, careful management of the conditions of employment, and a thoughtful on-going policy of reviewing contract terms, can significantly mitigate those risks.

The law governing the protection of business interests can often be turned to the employer's advantage to minimise damaging employee activities. There are also clear opportunities for businesses to reduce exposure further by ensuring that the terms of internal policies that govern the employment relationship remain dynamic and relevant to the changing business environment.

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