

HR Guidance

Restrictive covenants in employment contracts

This business guide explains what restrictive covenants are, when they are likely to be enforceable and how they can be used in employment contracts to protect a business's interests.

Redundancy

Fairways HR guidance only provides an overview of the law in this area. For a complete understanding of how it may affect your particular circumstances in the workplace please contact one of our Consultants.

What is a restrictive covenant and when will it be enforceable?

- A business can use restrictive covenants to protect its interests by restricting an employee's activities for a period of time after their employment has ended.
- A restrictive covenant will only be enforceable if it protects a legitimate business interest, otherwise it will be regarded as an unlawful restraint of trade. The only recognised business interests are:
 - » trade connections (including the relationship between the business's customers and its workforce); and
 - » trade secrets and confidential information.
- If the business has a legitimate business interest to protect, the restriction will be enforceable, provided it is no wider than is necessary to protect that interest. The covenant must be limited in terms of the restrictive activities themselves, and also apply:
 - » for a limited time; and
 - » within a limited geographical area (if appropriate).

Ensure restrictive covenants are drafted carefully

Restrictive covenants must be drafted carefully so that they:

- Accurately reflect each employee's role.
- Reflect the circumstances of the business.
- Go no further than is necessary.

The business should regularly review contracts that include restrictive covenants and check whether they need to be updated (for example, if the employee's role has changed).

Non-solicitation restrictive covenants

Customers

- A business can include a covenant in an employee's contract preventing them for soliciting customers after they have left the business. This type of covenant will be particularly useful if the employee has a strong relationship with certain customers.
- Generally, the covenant should be restricted to customers that the employee had contact with during a specified period before they left. There are a number of factors the business should consider when trying to establish the length of this period, including:
 - » the amount of time it would take for the employee's successor to gain influence over the business contacts;
 - » the employee's seniority within the business;
 - » the extent of the employee's role in securing new business;
 - » the loyalty (or otherwise) of customers in the particular market; and
 - » the length of similar restrictions in the employment contracts of competitors.

Potential customers

A restrictive covenant that attempts to extend the restriction to potential customers will be harder to enforce. However, it may be possible to protect an interest in genuine prospective customers if they are accurately defined.

Other employees

A restrictive covenant preventing a former employee from poaching your existing employees is likely to be enforceable, as the stability of the business's workforce is a legitimate business interest. However, the covenant should usually be limited to those employees at the same level as the former employee and those more senior to them. Any clause that attempts to prohibit the poaching of employees will need to consider:

- How long the former employee's influence over the other employees will last.
- The roles of the employees over whom the influence exists.

Non-dealing restrictive covenants

- A restriction on the solicitation of customers can be extended to cover not only enticement or interference (where active steps are taken by the former employee), but also the provision of services where no active steps are required (for example, where the customer approaches the former employee). This is known as a non-dealing covenant.
- This type of covenant has a clear advantage as it avoids the need to prove that the former employee made an approach, which is usually difficult to show. However, it does broaden the prohibition and consequently may make it more difficult to enforce.
- The enforceability of a non-dealing covenant will depend on the interest the business is trying to protect (for example, enforcement may be more likely if the business can establish a substantial personal connection between the former employee and the business's customers).

Non-competition restrictive covenants

- Employees are prohibited from disclosing confidential information amounting to a trade secret (for example, a manufacturing process) after they leave your business. A business can also include express confidentiality provisions in their employment contract to protect the information. Therefore, additional restrictive covenants may be regarded as unnecessary, and non-competition restrictions in particular can be hard to enforce.
- However, there are circumstances in which a non-competition restriction is likely to be enforced. For example, where the former employee's influence over customers or suppliers is so great that the only effective protection is to ensure they are not engaged in a competing business in any way.

The contract (continued)

Probationary periods

- A probationary period can be included in the contract. This will enable the business to assess the employee and vice versa. It also gives it the flexibility to dismiss someone using a shorter notice period of at least one week.
- Probationary periods typically last between three to six months and can be extended with the consent of the employee at the end of the term (for example, if the employee was sick and the business was unable to adequately assess their performance, it may want to extend the period).