Tillman v Egon Zehnder Ltd [2019] UKSC 32: The Supreme Court gives its view on restrictive covenants

By Daniel Brown

3PB Barristers

Introduction

Ms Tillman signed an employment agreement with Egon Zehnder Ltd ('the company') on 10 December 2003. Her employment with the company terminated on 30 January 2017. Ms Tillman shortly thereafter informed the company that she intended to commence employment with a firm in competition with them. The company issued proceedings on 10 April 2017 and applied for an interim injunction to restrain Ms Tillman from entering into the proposed employment. The company relied on clause 13 of its agreement with Ms Tillman, which was entitled 'COVENANTS'. Central to the proceedings was clause 13.2.3, by which Ms Tillman covenanted that she would not:

> directly or indirectly engage or be concerned or interested in any business carried on in competition with any of the businesses of the Company or any Group Company which were carried on at the Termination Date or during the period of 12 months prior to that date and with which you were materially concerned during such period.

Ms Tillman's position was that clause 13.2.3 was an unreasonable restraint of trade and therefore void.

The company's application for an injunction was heard by Mann J. By the time of the hearing, the argument between the parties was focused on the covenant not to be '*interested*' in any of the specified competing businesses. Ms Tillman argued that the clause was unreasonable as it prevented her from holding even a minority shareholding in a specified competing business. (It was agreed to be irrelevant that Ms Tillman had no aspiration to hold any shares in any of the specified competing businesses). The company

argued that the clause did not, on a proper construction, prohibit Ms Tillman from holding a minority shareholding. Mann J agreed with the company and granted an injunction.

The Court of Appeal rejected Mann J's reasoning and allowed Ms Tillman's appeal. The company appealed to the Supreme Court.

All references to paragraph numbers below are to paragraphs of the Supreme Court's judgment in this case.

The issues

Lord Wilson set out the issues as follows at (para 2):

> (A) The hypothesis in Issue (A) is that the employee's construction of the part of the covenant alleged to be in unreasonable restraint of trade is correct. Here the company contends that the impugned part falls outside the doctrine against restraint of trade ("the doctrine") and that it is therefore irrelevant that, had it fallen within the doctrine, it would have been in unreasonable restraint of it.
>
> (B) The hypothesis in Issue (B) is that the employee's construction of the impugned part is incorrect. Here the company contends that, upon a correct construction of it, it is not in unreasonable restraint of trade.
>
> (C) The hypothesis in Issue (C) is that, as in Issue (A), the employee's construction of the impugned part is correct; but that, contrary to the company's contention in Issue (A), it does fall within the doctrine. Here the company contends that, although it is in unreasonable restraint of trade, the impugned part should be severed and removed from the remainder of the covenant, which would therefore survive so as to prohibit the employee's entry into the proposed employment.

The nub of the company's argument in respect of issue A was that a prohibition against holding shares is not a restraint of trade and that, therefore, the restraint of trade doctrine, on which Ms Tillman relied in order to argue that the clause was void, simply did not apply (para 18). By way of example, the company asked, what if Ms Tillman had agreed not to play mah-

jong (a tile based game of Chinese origin) for six months following the end of her employment (para 18)?

Notably, issue A was not raised below. The company wrongly believed that the lower courts would have been bound to reject the argument by *Scully UK Ltd v Lee* [1998] IRLR 259 (para 19). Lord Wilson took the opportunity to observe that in *Scully* there had not been a focussed determination on the point in issue and that, when a court makes an assumption about the law rather than reaching a focussed determination in relation to it, its decision does not carry binding authority under the doctrine of precedent (para 21).

Issue B is the argument advanced at first instance. In short, the word 'interested' did not prohibit Ms Tillman from holding shares. The company argued that Mann J was right and the Court of Appeal was wrong (para 35).

Issue C: if the prohibition against being '*interested'* in a specified competing business is an unreasonable restraint of trade, can it be blue pencilled out?

The Supreme Court's judgment

Lord Wilson delivered the judgment of the Court (Lady Hale, Lord Kerr, Lord Briggs and Lady Arden agreed and there were no dissenting judgments).

Issue A

At the outset, Lord Wilson noted that the doctrine of restraint of trade 'is one of the earliest products of the common law' (para 22):

> It epitomises the nation which developed it: a nation which has ascribed central importance to the freedom of all of us to work – in the interests both of the self-sufficiency of ourselves and our families and of our common prosperity. (Para 22)

Lord Wilson's judgment itself is a fine piece of legal archaeology, starting with cases decided in 1414 and 1601. His Lordship observed that by 1711 the concept of reasonableness was 'authoritatively grafted on to' the doctrine of restraint of trade (para 25).

Lord Wilson moved on to consider the case of *Proactive Sports Management Ltd v Rooney* [2012] IRLR 214 (CA). That case concerned a contract related to Wayne Rooney's image rights and the right to exploit his image for promotional/sponsorship purposes. It was argued that Wayne Rooney's trade was as a footballer and that the exploitation of his image rights formed no part of his trade. Gross LJ held that Wayne Rooney's activities on-field and off-field were both part of a single trade and that the court should adopt a 'broad, practical, rule of reason approach' to determining the applicability of the restraint of trade doctrine. Lord Wilson adopted that approach (para 30).

In deciding issue A, Lord Wilson noted that the company's proposition was 'curious' in that it contended that the rest of the provisions of the covenant are only valid if reasonable but that the restraint provided for by the word 'interested' was valid although unreasonable (para 31). His Lordship noted that clause 13.2 included an acknowledgment that 'the provisions of this clause 13 are fair and reasonable'; that is hard to explain unless the law required them all to be fair and reasonable (para 32). Moreover, clause 13.4 provided that if any restriction in clause 13 is invalid (on the ground that it went beyond what was reasonable) it should be severed. Lord Wilson took the view that this represented a clear acknowledgment that all of the restraints fall within the doctrine of restraint of trade (para 32).

Finally, Lord Wilson noted that there was nothing surprising about the company aspiring to prohibit Ms Tillman from holding shares in a potential competitor; even a minority shareholding would enable her to direct the competitor's operations (para 33). Top executives such as Ms Tillman are frequently subject to conditions that they should hold shares in their employers or be remunerated partly in its shares, or options to purchase them (para 33).

In light of the above, the Court held that, on the assumption that the word '*interested*' purports to restrain Ms Tillman from holding shares in specified businesses, it falls within the doctrine of restraint of trade (para 34).

Issue B

Lord Wilson pointed out that the company 'cannot have it both ways: it cannot sensibly argue that the word "interested" covers a large shareholding but not a small shareholding. It is all or nothing. The company contends for nothing.' (para 37). The argument was as follows.

First, the company pointed to the fact that Ms Tillman was permitted, by clause 4.5 of her employment agreement, to hold up to 5% of publically issued shares in the specified competing businesses during her employment: it would be anomalous if, after permitting Ms Tillman to hold a limited number of shares in specified businesses during her employment, the parties should be taken to have agreed that she would be prohibited from doing so in the immediate aftermath of her employment by the use of the word 'interested' in clause 13.2.3 (para 44). This was the argument that found favour with Mann J.

Second, the introductory words of clause 13.2 refer to different types of status namely 'principal, manager, employee, contractor, consultant, agent or otherwise howsoever'. Notwithstanding the catch-all words at the end, the company pointed to the omission of the word 'shareholder' (para 45).

Third, the company argued that the prohibition in clause 13.2 was for Ms Tillman not to be interested 'in any *business'*. The company argued that the word 'business' connotes an active interest, rather than the passive interest of a shareholder in a '*company'* (para 46).

Dismissing the company's argument on issue B, Lord Wilson held that (para 53):

> the natural construction of the word "interested", consistent with long-standing authority, is that it covers a shareholding; that the three features of the present agreement on which the company relies are insufficient to require a different construction to be placed on the word when found in clause 13.2.3; that the company fails to establish even a realistic alternative construction of it which would engage the validation principle

Issue C

Lord Wilson explained that public policy considerations 'drove the evolution of the doctrine under common law that post-employment restraints of trade were, unless reasonable, void' (para 55). But early 'in the last century, however, a much more restrictive view was suddenly taken of the availability of severance in post-employment covenants' (para 56).

After an insightful discussion of the earlier case law, Lord Wilson turned to *Attwood v Lamont* [1920] 2 KB 571 (para 61). On the facts of Attwood, the employee had covenanted to not at any time trade as "a tailor, dressmaker, general draper, milliner, hatter, haberdasher, gentlemen's, ladies' or children's outfitter" within ten miles of Kidderminster. The conclusion of the Court of Appeal in *Attwood* was unanimous but their lordships arrived at their conclusions by different routes. The binding judgment was that of Younger LJ (Atkin LJ agreed with it). Younger LJ held, inter alia, that (para 65):

(a) severance of a covenant is only available where there is "not really a single covenant but in effect a combination of several distinct covenants";

(b) the list of prohibited trades amounted to one covenant;

(c) severance should be confined to the trivial and the technical and that a partly unreasonable restraint should be entirely void, even if grammatically severable; and

(d) severance should not generally be allowed

Lord Wilson moved to a number of subsequent authorities before arriving at *Sadler v Imperial Life Assurance Co of Canada Ltd* [1988] IRLR 388 (para 70). In *Sadler*, subject to a proviso, an employee was entitled to receive commission for ten years in respect of policies which he (as an insurance agent) had procured. The proviso was that the commission payments would stop if the employee began to work for another insurance company. The employee did so and his former employer refused to pay him further commission. He brought a claim for the commission, contending that the proviso was void as it amounted to an unreasonable restraint of trade. The claim succeeded; it was held that the proviso could be severed and removed for three reasons:

(a) there was no need to add or modify the remaining wording;

(b) the remaining wording continued to be supported by adequate consideration; and

(c) the removal did not "so change the character of the contract that it becomes 'not the sort of contract that the parties entered into at all'"

Lord Wilson observed that those three criteria for severance were applied in *Marshall v NM Financial Management Ltd* [1995] 1 WLR 1461 (para 71). In *Marshall,* the court suggested a fourth criterion: that severance be consistent with the public policy underlying avoidance of the offending part.

Lord Wilson noted that the three criteria identified in *Sadler* and applied in *Marshall* received approval from the Court of Appeal in *Beckett Investment Management Group Ltd v Hall* [2007] ICR 1539 (para 73).

Lord Wilson then took the time to discuss a number of authorities following *Beckett* before addressing the reasoning of the Court of Appeal in the present case (para 80).

In the Court of Appeal, Longmore LJ held that the clause 13.2.3 had to be read as a whole and could not be severed. It was a single covenant. The company's submission that the correct approach was to apply the three criteria approved in *Beckett* was rejected. In addressing that submission, Longmore LJ held that 'it must always be doubtful whether parts of a single covenant can be deleted without the contract becoming "not the sort of contract that the parties entered into at all"' (para 80).

Lord Wilson referred to the words of Denning LJ in *M&S Drapers v Reynolds* [1957] 1 WLR 9, 19: 'A managing director can look after himself [but] a traveller is not so well placed to do so. The law must protect him.' Lord Wilson took account of the fact that:

> It is clearly common practice for an employer to present a prospective employee with a substantial written contract, many terms of which, including those imposing post-employment restraints, are derived from books of precedent. It is as valid in 2019 as it was in 1913 to infer that most prospective employees will not be able, even if

> minded, to decline to accept such terms, still less, following the end of their employment, to defend a claim that they are in breach of them. The courts must continue to adopt a cautious approach to the severance of post-employment restraints. (Para 82)

Lord Wilson went on to analyse the effect of the three criteria indorsed in *Beckett* (para 85). His lordship referred to the first criterion as the "blue pencil" test. Lord Wilson recognised that it can work 'capriciously' but the word "severance" itself means cutting things up and does not extend to adding things in; his Lordship held that 'although it can work arbitrarily, it is in my view an appropriate brake on the ability of employers to secure severance of an unreasonable restraint customarily devised by themselves' (para 85).

Lord Wilson took the view that the second criterion, that the remaining terms be supported by adequate consideration, will not be a relevant consideration in 'the usual post-employment situation' where an employer is seeking to restrain a former employee (para 86). Indeed, this requirement was born out of the fact that in *Sadler* and *Marshall,* it was employee who sought severance and it was therefore necessary for the court to be satisfied that if the unreasonable obligation was removed, there would nevertheless remain consideration for the obligation the employees were seeking to enforce (para 86).

The third criterion, that 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" is the 'crucial criterion' (para 87). Lord Wilson held that the third criterion was 'rightly imported into the general jurisprudence by the *Beckett* case and has rightly been applied by our courts ever since then, otherwise than in the decision under appeal' (para 87). His lordship did, however, hold that the criterion would be better expressed as being whether:

> the removal of the provision would not generate any major change in the overall effect of all the post-employment restraints in the contract. It is for the employer to establish that its removal would not do so. The focus is on the legal effect of the restraints, which will remain, not on their perhaps changing significance for the parties and in particular for the employee. (para 87)

Lord Wilson then applied the test to Ms Tillman's case (para 88):

> First, the words "or interested" are capable of being removed from the non-competition covenant without the need to add to or modify the wording of the remainder. And, second, removal of the prohibition against her being "interested" would not generate any major change in the overall effect of the restraints. So those words should be severed and removed.

Notably, the Court of Appeal also reasoned that if the words "or interested" are removed then the clause would become that Ms Tillman would not "directly or indirectly engage or be concerned… in any business" and that by holding shares Ms Tillman would be "indirectly… concerned" in such a business (para 89). Lord Wilson held that although the words "or interested" were to be severed and removed, they were still relevant to the construction of the remaining words (para 90). Further, '[c]onventional principles of construction require value to be attributed, if possible, to each word of an agreement' (para 90). And if the word 'concerned' were to be construed as including a shareholding then 'what value would be left to be attributed to the word "interested" [in Ms Tillman's case]?' (para 90).

Accordingly, the appeal was allowed and the injunction was restored, although the contractual period of the restraint in question had long expired (para 91).

For the avoidance of doubt, Lord Wilson made it clear that *Attwood* was overruled (para 91).

Comment

The Supreme Court's judgment in this case attempts to strike a balance between two competing policy considerations that are present throughout the field of employment law: firstly, the aim of protecting employees, who rarely have the bargaining power required to refuse to agree to post-employment restrictions drafted by their employers, and, secondly, the need to ensure that business is able to effectively safeguard its legitimate interests.

The Court's pragmatic clarification of the law on severance may well embolden employers to seek injunctions where they believe former employees to be harming their businesses. But caution is advised; Lord Wilson appeared to hint that, even when they can be severed, there may be 'a sting in the tail' in terms of costs for employers who are found to have littered the employment contract with unreasonable post-employment restrictions (para 92).

Daniel Brown
Barrister
3PB Barrister
020 7583 8055
daniel.brown@3pb.co.uk