The principles that apply when determining the enforceability of restrictive covenants

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Law by Design v Saira Ali [2022] EWHC 426 (QB)

The High Court has upheld a year-long non-compete clause against an employment lawyer who left a niche firm to become a Partner with national practice Weightmans. The case provides a concise summary of the law, highlighting that enforceability of post termination restraints involves the exercise of discretion.

Background and summary

Law By Design (LBD) was established by an experienced employment lawyer seeking to provide a range of services primarily to NHS clients. Solicitor Saira Ali joined LBD in 2013 as an employment lawyer and signed a Service Agreement which contained post termination restrictions.

Things ran well and in 2016, Ms Ali was made a shareholder, entering into a shareholder agreement with LBD. The Shareholder agreement also contained covenants restraining competition.

Shortly after the departure of several fee earners, and upon learning that Ms Ali was also a flight risk, LBD offered Ms Ali a £22,000 pay increase, and issued a new Service Agreement. This Service Agreement increased the duration of the post termination restrictions from 6 to 12 months.

The Service Agreement effectively prevented Ms Ali from being involved in any business which was in competition with the parts of the firm that she had been involved to a material extent in the 12 months prior to termination.

The Service Agreement contained important limitations to the covenants, Mr Justice Beer noting that -

"The critical fulcrum around which the covenant turns is the definition of 'Restricted Business' – this limits the operation of the covenant to parts of LBD in which Ms Ali was involved to a material extent proximately to her departure from the firm.

"This device ensures that the covenant is reasonable in the scope of its operation: (i) if Ms Ali was not involved in parts of LBD to a material extent, then the covenant is not operative in relation to those parts; (ii) if Ms Ali was involved in such parts of the business to a material extent, then the covenant bites – but that is because it is reasonable to restrict her from joining a business which competes with those parts of LBD's business."

The wording in the Shareholders Agreement read differently, restraining a Shareholder from being *"engaged, concerned or interested in, or assist, a business which competes, directly or indirectly, with a business of the Company as operated at any time during the previous 12 months in a territory in which the Company has operated such business during such previous 12 months".* Accordingly, the Shareholders Agreement sought to prevent ANY direct or indirect competition. Further it lacked the 'material extent' carve out which was drafted into the Service Agreement.

Just three months after the signing the new Service Agreement, Ms Ali resigned to join Weightmans as a Partner.

Test as set out in *TFS Derivatives*

Mr Justice Beer applied the four-stage test from the earlier High Court decision in *TFS Derivatives Ltd v Morgan [2004] EWHC 3181 (QB)*. That test is as follows -

"Firstly, the court must decide what the covenant means when properly construed. Secondly, the court will consider whether the former employers have shown on the evidence that they have legitimate business interests requiring protection in relation to the employee's employment…Thirdly, once the existence of legitimate protectable interests has been established, the covenant must be shown to be no wider than is reasonably necessary for the protection of those interests. Reasonable necessity is to be assessed from the perspective of reasonable persons in the position of the parties as at the date of the contract, having regard to the contractual provisions as a whole and to the factual matrix to which the contract would then realistically have been expected to apply."

The fourth stage of the process to be applied is the exercise of discretion, namely "*… whether, as a matter of discretion, the injunctive relief sought should in all the circumstances be granted, having regard, amongst other things, to its reasonableness as at the time of trial."*

Consideration of the third stage of the test involves an assessment of matters such as duration, geographical extent, and scope of the restraint.

Different approach for Employment Contracts

The Court also noted that the enforcement of provisions in employment contracts (where it is presumed there is an inequality of bargaining power) should be more stringent. That more stringent approach was also applied to the Shareholders' Agreement because the relationship between LBD and Ms Ali was still one of employer and employee.

Decision

Applying the more stringent approach to the terms of the Shareholders' Agreement, Mr Justice Beer found that the provisions were too wide – they sought to restrain any competition, in relation to all parts of the business (not just those with which Ms Ali was materially engaged).

In relation to the provisions in the Service Agreement, and reading the restriction in terms of what was allowed, Mr Justice Beer noted that the provisions allowed Ms Ali to join a business anywhere in England and Wales, provided that it did not compete with LBD for NHS clients in the north west of England or a distinct region in Hertfordshire.

He noted that LBD had shown that it had a legitimate business interest to protect.

In relation to the third element of the test, the Court noted the limitations that had been drafted into the Service Agreement so as to reduce the impact of the restraint. As such, deciding that the restriction was set in terms that were no wider than necessary was an "*uncomplicated conclusion*". When considering duration, a year was determined to be *"a reasonable period"*. A year was *"reasonably necessary in order to find, successfully recruit, and then train/integrate a lawyer in a small firm such as LBD".* Ms Ali accepted in evidence that six months would be *"nowhere near enough time for all of that to take place"*.

An interesting aspect of the decision relates to the matters considered with regards to discretion. It was in relation to this final stage of the TFS test that the Court placed emphasis on Ms Ali's preparation of a business plan which formed part of her application to join Weightmans.

In evidence Ms Ali had advanced that Weightmans were more interested in her than the clients she would bring should she join the firm. However, her application to join the firm had included a seven-page business plan. This was disclosed as part of the proceedings and revealed proposals to 'transition' clients from LBD to Weightmans, generating fee income of approximately £250,000 per annum. It was noted that this was close to a third of LBD's turnover.

This document described her work as being 'self-generated' and Mr Justice Beer noted the somewhat proprietorial language used by Ms Ali when speaking of 'her' clients, interpreting this to mean that clients were regarded as "*personal to her, her own, and as something she was entitled to transport*". However, Ms Ali had accepted that her connections with the clients all came via LBD.

It was also relevant that Ms Ali appeared to doubt that LBD would enforce against her given that it had not enforced against others who had also left, Mr Justice Beer noting that Ms Ali "*plainly regarded it as unlikely that she would ever be held to the non-competition clause*".

Accordingly, the claim made by LBD seeking to restrain Ms Ali from breaching the terms of her Service Agreement was successful.

Comment

This case provides a useful reminder of the principles to be applied when determining the enforceability of post termination restraints in the employment context. It is also notable that a remedy was provided despite Ms Ali giving undertakings that she would not misuse confidential information and would observe the restrictions which prevented her from soliciting clients. Perhaps that followed from what was found to be an intention to shift or move clients from LBD to Weightmans as revealed by the business plan.

And while the case importantly draws attention to the disclosable nature of relevant material, it is also a very helpful reminder that steps taken to limit the effect of restraints are likely to be significant in determining whether or not the covenant will stand.

The full judgement can be found here - https://www.bailii.org/ew/cases/EWHC/QB/2022/426.html.

31 March 2022

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