Economy booster or disaster for employers? What to make of UK government proposals to limit enforceability of non-competition clauses

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Non-competition clauses have become a common feature in employment contracts; they aim to protect employers by preventing departing employees from joining rival companies or starting their own competitive ventures for a specific period. The UK government, however, has announced it intends to limit the enforceability of non-competition clauses in contracts of employment and worker contracts in the UK to a maximum of three months.

Current landscape

Non-competition clauses have long been used by employers to safeguard their interests, in particular in relation to trade secrets and confidential information, and client relationships. As with other restrictive covenants, non-competition obligations will only ever be enforceable if they go no further in scope and duration than is necessary to protect an employer's legitimate business interests and are reasonable, having regard to the interest of the parties and the public interest; if the covenant is considered to go too far, it will be void.

As a general rule, the longer a covenant is, the more onerous and so the less likely it is to be enforceable, but in each case, this will be considered in all the circumstances taking into account factors such as the shelf-life of any confidential information, the nature of the business (including typical development or sales cycles), and the role of the employee.

As a result, the duration of these restrictions can vary significantly. Current practice is that, in the employment context, 12 months is typically considered to be the maximum period of enforceability one can expect; as was the case in Thomas v Farr plc and Hanover Park Commercial Limited where a 12 month non-compete was valid in respect of an insurance broker.

However, in Quilter Private Client Advisers Ltd v. Falconer and another the High Court held that a nine month non-compete covenant in respect of a financial adviser was unenforceable. Government research indicated that the most common duration of covenants is 6 months (approximately half of businesses), followed by 12 months (one third of businesses).

Critics argue that non-compete clauses can be unfair to employees and unduly restrict their professional development and opportunities for advancement and can be bad for the wider economy by limiting competition and innovation. As a result, the UK government opened a consultation in 2020 to explore measures to strike a better balance between protecting employers' interests and ensuring fair competition and employee mobility. That consultation offered two broad options: to require payment for non-compete clauses (similar to the approach in some European jurisdictions) or to ban such restrictions (as is the case in California). Ultimately, the government decided against both of these options in favour of a three-month limitation, which it hopes will boost flexibility and dynamism in the labour market.

Intended limitation

The three-month limitation would only apply to non-competes and would not affect other post termination covenants such as non-solicitation clauses (which prevent departing employees from soliciting their former clients or employees) and non-dealing covenants (which prevent departing employees from contracting with their former clients).

The government states that this change will apply to all employment contracts and worker contracts, but not to "wider workplace contracts" such as LLP agreements and shareholder agreements. In some industries, in particular some financial and professional services, LLP structures are common and so longer non-competes may be permissible for partners.

The government has not however addressed the fact that case law has established that some LLP members are also workers. It is also unclear whether these obligations will apply to non-competes agreed as part of a settlement agreement or included in employer share plans. We will need to wait for the draft legislation to see how wide the net is cast. The legislation will not apply to Northern Ireland.

The UK government has said it will introduce legislation to implement these changes when parliamentary time allows. Therefore, we do not anticipate that this will occur imminently and given the short time until the next election they may not be introduced at all. However, employers should take this opportunity to consider how they would be impacted and make sure they are prepared in case the legislation does come into effect.

Where does this leave employers who want to protect their business interests?

Some financial service employers already have relatively short non competes agreed with their employees and therefore they could seek to continue to rely upon their existing obligations if they are for a duration of no more than three months; provided, of course, that the scope of the non-compete is justifiable.

For those employers who have agreed longer non-compete obligations with their employees, all is not lost. We would suggest that employers take the opportunity to review their current garden leave and notice period obligations with key employees.

While the government's response to its 2020 consultation states that it does not want to see an increase in the use of garden leave as a result of the changes to non-competes, it does not propose to limit the use of garden leave and in practice this is the most effective way to secure a period of non-competition - albeit this is more expensive than relying upon non-competition covenants (for which the employee is not normally paid in the UK).

The duration of a period of garden leave is limited by the length of the employee's notice period and so employers may want to ensure that contracts with key employees contain express garden leave clauses and appropriate notice periods.

What is not clear is whether any garden leave period will need to be offset against the maximum three-month non-compete period. Case law has found that if periods spent on garden leave are not set off against any non-compete period, this could affect the reasonableness of the covenant and therefore increase the likelihood of unenforceability.

Current practice is therefore to typically offset garden leave against the duration of the covenant. If this practice continues there would be no non-compete after three months of garden leave, but we may see employers starting to reconsider this practice. For example, they might only set off garden leave after a certain period has been served if they consider that the covenant would still nevertheless be reasonable without a full offset. It remains to be seen what view the courts would take of this.

Aside from garden leave clauses, it would be advisable for employers to consider what other protections they have agreed, or can agree, with their employees. Other post termination restraints such as non-solicitation and non-dealing clauses may still be used to protect trade secrets, confidential information, and client relationships. It would therefore be sensible for employers to ensure that they include a full suite of well drafted post-employment protections in their employment contracts.

The proposed restrictions may also see a greater focus on whether departing employees have breached confidentiality obligations or other express or implied contractual obligations such as the obligations of fidelity and trust and confidence and an increased use of springboard injunctions.

Springboard injunctions are most usually granted in cases where an employee unlawfully takes their employer's confidential information during employment and seeks to use that information to compete after employment. These types of injunctions restrict employees conduct after employment e.g., by preventing them from dealing with clients to neutralise the unfair advantage that the former employee had obtained as a result of misusing the confidential information.

Finally, we anticipate that we will see an increased use of indirect non-compete covenants such as provisions in incentive compensation plans which provide for forfeiture or clawback of awards if an employee competes during a period after employment. The government's response to consultation contemplates that there may be an increase in the use of such provisions and so it seems they do not intend the three-month restriction to apply to such provisions.

Such provisions will not stop any future employer from "buying out" lost compensation under a plan, but it may give an employee pause for thought before seeking to compete. Incentive plans would in any case need to be carefully drafted to ensure that they are enforceable under existing restraint of trade principles and do not fall within the scope of the government's proposal.

International context

This proposal appears to be part of a growing global trend to move away from non-competes. Some U.S. states, such as California, already ban non-competes. The U.S. Federal Trade Commission has proposed a more wide-ranging complete ban on non-competes.

The proposal is subject to consultation, but if this goes ahead this would prevent U.S. employers from using non-competes and enforcing existing non-compete provisions in respect of its U.S. employees, though businesses could still seek to enforce a non-compete covenant agreed in the context of a business sale where a shareholder stays on as an employee.

Similarly, in 2021, the Ontario government introduced comparable legal requirements, though it does allow for enforceable non-competes with specific senior managements engaged at board level. The Federal Government in Australia is also reviewing the impact of non-competes.

It remains to be seen whether the proposals will be implemented and whether they will achieve the policy objective of increasing competitiveness or have adverse effects such as shifting research and development to jurisdictions which allow non-competes.

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