Proskauer

newsletter

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in this issue

A monthly "best practices" alert for multinationals confronting the challenges of the global workplace.

This Month's Challenge

Losing an employee to a competitor is an unpleasant distraction, but losing a key group of employees in a "lift-out" can be a major disaster. Protecting your company from raiders can be critical to your success, but finding effective legal weapons to achieve this task is difficult.

Best Practices Tip of the Month

Recent cases in the UK have pointed to a number of innovative tools that can help an employer keep the marauders at bay. In addition, periodic review and adjustment of restrictive covenants are key elements of a successful defense program.

Tip of the Month

Protecting Your Business against Raiding and Lift-Outs in the UK

When the Vikings roamed the North Sea, a deep moat, a high wall and a vat of boiling oil were essential tools to keep raiders at bay. Unfortunately, these tools are not as effective at keeping corporate competitors from raiding a company's key employees, leaving employers to search for new and more suitable weapons. In several recent decisions, UK courts have given approval to some important and controversial techniques to keep teams of key employees from joining a competitor. In particular:

> In *Item Software Ltd v. Fassihi*, the Court of Appeal held that, in certain circumstances, employees owe implied duties to disclose to their employer their own competitive activities. This decision has been questioned by a number of practitioners, who have expressed the view that it overextends the concept of implied duties.

> In the Court of Appeal decision in *Farr v. Thomas,* a twelve-month non-compete clause was held to be enforceable at a time when many practitioners believed that such a period of time was too long to be enforceable.

> In *UBS v. Vestra*, the court enjoined a team of employees from dealing with their former clients. The significance of the decision was that the injunction was not based on contractual restrictions. Rather, the court granted a "springboard injunction" — relief that is designed to deprive an employee from benefiting from any headstart derived from his or her own wrongdoing. The significance of the *UBS* decision was that until that case there was authority that springboard relief should be confined to cases where the wrongdoing involved misuse of confidential information, but the UBS held that the relief was available to protect against any wrongdoing by employees. However, a more recent decision in the case of *Vestergaard Frandsen v. Bestnet*, which did not refer to *UBS*, has raised some questions as to the availability of springboard relief.

> Most recently, the High Court handed down a 200-page judgment in the case of *Tullett Prebon v. BGC,* which held, among other things, that contractual provisions that require employees to report to their employer an approach by a competitor are enforceable (thus enabling companies to use express contractual terms to banish uncertainty about the scope and applicability of implied terms to confess to any competitive activity). However, arguably, an unusual fact pattern made it far easier for the court to enforce such a contractual term in *Tullett* than would generally be the case.

These decisions remain controversial, and practitioners and scholars debate the extent to which they will be applicable in less favourable scenarios, but there is little doubt that cumulatively they provide employers with a robust framework for protecting themselves against raiding and lift-outs. However, in order to benefit as fully as possible from these protections, there are a number of steps and strategies that employers should adopt.

Restrictive Covenants

Have you got them right?

Restrictive covenants are enforceable in the UK, provided they go no further than is reasonably necessary to protect a legitimate business interest (such as misuse of confidential information or client connections). This creates a danger that across-the-board covenants will be unenforceable, especially where no proper consideration has been given to what restraints are necessary to protect a business in respect of a particular employee. We would recommend tailoring covenants to individuals as far as is possible, where the differences in the circumstances warrant differences in restraints.

On the other hand, it is not uncommon, especially in companies formed through mergers and acquisitions, for comparable employees to have different restrictions in their contracts of employment in circumstances where there is no good reason for the difference. Such irrational differences can undermine the enforceability of the more onerous restraints.

The enforceability of a restrictive covenant is based on the state of affairs at the time at which a covenant was agreed (rather than when a company seeks to enforce the covenant). This can cause a situation where an employee who has been promoted through the ranks over a number of years has a covenant that may be appropriate, and would have been enforceable, if obtained in the context of the employee's current role, but which is unenforceable because of the more junior position the employee held when the restrictive agreement was signed.

Conversely, reviews of contracts often reveal employees who have been promoted through the ranks attaining senior positions while remaining employed under the terms of junior contracts of employment without any restrictive covenants.

Changing, renewing and entering into new covenants

As a result of theses issues, we recommend that employers carry out regular audits of the covenants contained in the employment contracts of their workforce so that they can identify any problems with covenants and make appropriate changes. This then raises the issue of how to address any deficiencies identified, especially because it often can be difficult to persuade employees to enter into new or amended covenants.

In our experience, one effective strategy for dealing with this is to make promotions or payrises contingent upon an employee renewing, changing or entering into new, restrictions. Employees generally are willing to enter into restrictions in such circumstances; moreover, connecting the covenants to a payrise or promotion also satisfies the legal requirement for consideration to pass to an employee in order for a covenant to be enforceable.

Contractual Duties To Confess

On the basis of the *Tullett* decision, provisions in contracts of employment requiring employees to actively disclose information about competitive activities (including their own activities) are enforceable, even where they go beyond duties that would otherwise be implied in a contract of employment. It is possible that *Tullett* will not be the last word in relation to this — some commentators maintain that the reasoning in that decision was highly fact sensitive.

However, there is no doubt that, insofar as such contractual terms are enforceable, they provide companies with a powerful shield against raids and lift-outs. If employees comply with them, the resulting knowledge can be used to persuade employees to stay, as well as enabling a company to be extra vigilant at an early stage to protect against some of the problems associated with raids — such as misuse of confidential information and solicitation of customers. Moreover, such terms provide companies with greater scope to protect their business without having to resort to litigation. Instead, more subtle means can be used to persuade employees to remain loyal to a business, such as incentive arrangements, assurances about the employee's value to the business and selling a vision about the future potential of the business.

If employees do not comply with the disclosure agreement, it enables a company to point to specific breaches of contract, which can be used as a basis for damages claims, or, in light of the *UBS* decision, a springboard injunction.

Similarly as to covenants, one strategy for inserting such terms into the contracts of existing employees would be through making payrises and promotions contingent upon accepting such terms.

Recruiting Teams

The corollary of the above is that the current state of UK law means that extreme caution is needed when trying to recruit a team of employees from a rival. Practical considerations include:

- Ensure information is only provided on a strictly need-to-know basis — people are not under a duty to disclose what they do not know;
- When recruiting or hiring employees from competitors, make sure they give you full disclosure of the contractual restraints that currently apply to them; and
- Make it clear to these prospective employees that they should not breach their obligations to their current employer, including those relating to confidential information and solicitation of business.

Indeed, there is an increasing view among practitioners that the current state of the law, with its potent combination of contractual and implied duties to confess, and the willingness of courts to enforce restrictive covenants and grant injunctive relief even in the absence of contractual post-termination restrictions, affords so much protection to employers that it is practically impossible for a team of employees to move to a competitor. Given the controversy that has surrounded some of the more recent decisions and the increasing concerns that, cumulatively, they stifle legitimate competition, it is conceivable that the current position represents a high-water mark for employer protection. We will keep you updated about any further developments.

Proskauer Rose LLP's International Labor and Employment Law Practice Group counsels companies doing business globally in connection with the employment issues they face in their workplaces around the world.

For more information about this practice, click here or contact:

Bettina B. Plevan
212.969.3065 – bplevan@proskauer.com

Aaron J. Schindel
212.969.3090 – aschindel@proskauer.com

Howard Z. Robbins
212.969.3912 – hrobbins@proskauer.com

Yasmine Tarasewicz
33.1.53.05.60.18 – ytarasewicz@proskauer.com

Anthony J. Oncidi
310.284.5690 – aoncidi@proskauer.com

Jeremy M. Mittman
310.284.5634 – jmittman@proskauer.com

Allan H. Weitzman
561.995.4760 – aweitzman@proskauer.com

Daniel Ornstein
44.20.7539.0604 – dornstein@proskauer.com

Boca Raton | Boston | Chicago | Hong Kong | London | Los Angeles | New Orleans | New York | Newark | Paris | São Paulo | Washington, D.C.

www.proskauer.com