

UK Supreme Court Examines Restrictive Covenants First Time in 100 Years: A New Test for Severance

International Labor and Employment Law on **July 9, 2019**

In the case of *Tillman v Egon Zehnder* [2019] UKSC 32, the UK Supreme Court, for the first time in over 100 years, has examined the law of post-termination restrictive covenants. As well as providing clarity of the law, the decision serves as a reminder of the importance of the doctrine of restraint of trade, which, in the words of Lord Wilson, who delivered the judgement:

“is one of the earliest products of the common law. 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”

In the employment context, the doctrine of restraint of trade means that post-termination restrictive covenants will be enforceable only if they go no further than is reasonably necessary to protect the legitimate interests of a business. However, this is subject to one safety-valve for employers: where a covenant goes to go too far, a court will sometimes save it by severing offending words from it.

The most important issue examined in this case is the circumstances where severance is available to save an otherwise unenforceable restrictive covenant.

The facts

Egon Zehnder are headhunters. In January 2004, they employed Ms Tillman, who rose through the ranks from consultant to joint global head of its financial services practice group. Ms Tillman resigned and her employment came to an end in January 2017. In April 2017, she informed Egon Zehnder that she would be starting work for a competitor from 1 May 2017. Egon Zehnder considered that working for a competitor at this time would be a breach of the post-termination restrictive covenant contained in Ms Tillman's contract of employment which prohibited her, for six months from:

*“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 argued that this covenant was unenforceable because the use of the term “*or interested*” prevented her from owning even a tiny minority shareholding in a competitor, which in turn rendered the non-compete too wide to be enforceable. Egon Zehnder raised various arguments to counter this, the most significant one being as follows: even if the words “*or interested*” prevented Ms Tillman having a minority shareholding, and such a prohibition constituted unreasonable restraint of trade, it was nonetheless permissible to sever the offending words “*or interested*” from the covenant to render the remainder of it enforceable and therefore rely on it to prevent Ms Tillman from working for a competitor.

The decision on severance

Lord Wilson provided a succinct tour de force of cases on severance going back to the 1726 case of *Chesman v. Nainby* which led to the following conclusion as to the conditions necessary to enable offending words to be severed from a restrictive covenant to render it enforceable. He held that three conditions are as follows:

- The offending words are capable of being removed without the necessity of adding to or modifying the wording of what remains” (i.e. the “blue-pencil” test);
- The remaining terms of the restrictive covenant continue to be supported by adequate consideration; and
- The removal of the offending words must not generate any major change in the overall effect of the restrictive covenant in the contract, focusing on the legal (rather than the practical) effect of the covenant with the wording severed from it.

Based on the facts, the Supreme Court concluded all three conditions were satisfied and accordingly, the words “*interested in*” should be severed from the restrictive covenant to leave an enforceable restraint that Egon Zehnder could rely upon.

Analysis

There is much that can be learned from this decision.

The obvious lesson is to ensure that restrictive covenants are drafted so that they are no wider than is reasonably necessary to protect a legitimate interest. This avoids the uncertainty of having to rely on a court to determine whether offending words can be severed. Applied to this particular case, the covenant would have been enforceable if there had been a provision (of the type often seen) making explicit that Ms Tillman was permitted to have a small shareholding in a competing business (for example of up to 5%). Indeed, there was a suggestion that the need for Egon Zehnder to rely on severance (rather than the covenants as actually drafted) may have adverse cost implications for Egon Zehnder such that the general rule, that a successful party can recover a significant proportion of legal costs from an unsuccessful party, may not apply here because the litigation arose, in part, as a result of defective drafting.

The case also implicitly confirms that under English law, forfeiture provisions that are conditional upon some form of not competing (e.g. a clause under which an individual forfeits commission or a bonus if they compete after their employment ends), are considered to be restraints of trade and therefore subject to the same reasonableness requirements as pure restrictive covenants (i.e. a clause prohibiting competitive activity). This implicit confirmation derived from the reference in the decision to various cases on forfeiture for competing, where the assumption was that such provisions invoke the restraint of trade doctrine. However, not all jurisdictions take this approach. Conceptually, there is a distinction between on the one hand an absolute prohibition against competition and on the other, a choice between competing and losing a payment. This distinction was not addressed in the decision and it remains possible that future decisions may scrutinise this distinction more closely.

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