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Response to Department of Business, Energy & Industrial Strategy Consultation on measures to reform post-termination non-compete clauses in contracts of employment

February 2021

Response of the Employment Law Committee of the Birmingham Law Society to the Consultation on measures to reform post-termination non-compete clauses in contracts of employment

This response has been prepared by the Employment Law Committee of the Birmingham Law Society. The Society is the largest local law society with some 5,000 members. The response represents the collective view of its members who are specialist lawyers practising in all aspects of the employment law and from all branches of the legal profession.

1. Do you think the Government should only consider requiring compensation for non-compete clauses or do you think the Government should consider requiring compensation where other restrictive covenants are used? Please indicate below.

- Non-competes only
- Non-complete clauses and other restrictive covenants

There is no question in the Consultation as to whether consultees feel that enforceability of general non-competes through mandatory compensation (Option 1) or a general ban on non-competes (Option 2), are likely to meet the stated aims of improving innovation.

It is unclear why the Government has changed its position since the Taylor Review (Good work: the Taylor review of modern working practices (publishing.service.gov.uk) which found that general non-compete clauses did serve a useful purpose. Furthermore, it is not clear how the operation of non-competes stifles innovation, or how banning them would encourage innovation. At best, banning non-competes would allow greater movement of employees in the labour market. That may promote competition, which might lead to innovation.

Opinion is divided amongst specialist employment law practitioners as to whether there should be any ban for general non-competes. On the one hand, they have widespread use, but on the other, most practitioners find that they are generally not enforceable, and so do not prevent movement of employees in the labour market. However, it is certainly the case that many mid-level employees will react as if they are enforceable because of a threat to enforce. As a result, some practitioners believe that they should be banned, or only enforceable if the employee is paid, whilst others believe that either Option 1 or 2 would actually be counter-productive for the reasons outlined below.

There is no evidence that general non-compete clauses prevent/restrict movement in the labour market – generally employees who have experience or are experts in a certain sector will look for alternative work in the same sector, irrespective of any general non-compete clause. Nonetheless we recognise that for some of those with

20 or 30 years specialist experience and an inability to change sector the threat of enforcement may keep them from work for the period of the restrictions. If, however, there was a general ban, then it would harm business in the rare cases where a general non-compete clause would be found by a court to be enforceable. In many of those rare cases, the issue is not innovation at all, but to prevent unfair competition – e.g. to protect a local business (e.g. hairdresser, butcher or high street solicitor) losing clients to an employee who has built up client connections working for the employer, to set up in competition next door.

Of all post termination restrictions, general non-competes are the hardest to enforce, as the starting point under common law is that they are unenforceable unless reasonable in scope and duration to protect a legitimate business interest. Usually, other restrictions such as non-solicitation and confidentiality clauses will be found to be more reasonable to address any risk to legitimate business interests before any general non-compete. To deny someone's ability to work for a competitor merely because they have worked for an employer in the same sector or in competition will usually fail and the courts simply do not readily grant general non-compete injunctions. As enforcement is in the civil courts with costs risk, misuse of any such clauses is effectively policed.

Against that background, what would be the advantage of banning or modifying the law on non-compete clauses? Banning them would not make any material difference to most employees, and in the few cases where they are justified, it would potentially harm legitimate businesses. Paying someone to be bound by a non-compete would, ironically, likely lead to potentially much wider enforceable use of such clauses, which might actually inhibit movement and competition – i.e. be counter-productive.

There is case law suggesting that paying someone for a non-compete is against public policy - see **JA Mont (UK) Limited v Mills [1993] IRLR 172 (CA)** applied in **Bartholomews Agri Food Ltd v Thornton [2016] IRLR 432**. The reasoning seems to be that it is anti-competitive to pay someone to remove themselves from the market.

At present, the use of up to 12 months contractual garden leave is effectively a payment to prevent an employee competing. That is an expensive step to take for any employer, and so, an employer, acting commercially, will exercise any garden leave clause with caution. It has the negative effect of potentially causing the skills of employees with technical expertise to atrophy. To add a period of post termination restriction which is paid on top of the period of garden leave, would only make this worse.

Many practitioners consider that any outright ban of general non-competes (Option 2) would actually lead to greater use of garden leave, which applies during notice periods. Perhaps one solution is to amend the legislation allowing the employer to place an employee on garden leave during statutory or contractual notice, where there is no contractual right to do so. This in conjunction with an outright ban on general non-competes (Option 2) would balance the protection for the employer against the rights of the employee.

In summary in answer to Q.1 above, the view of the BLS is that there is no need to introduce payment for post termination non-competes (Option 1), as this is better operated through garden leave during notice. Payment for non-competes may actually lead to the opposite of the desired result – i.e. greater use, with a greater likelihood of enforceability, thereby restricting movement in the labour market, rather than encouraging it.

The position is unclear whether the same common law tests of enforceability will still apply for any general non-compete that an employer has paid for.

There was wide agreement that there should be no payment for wider post termination restrictions, such as those concerning confidentiality, intellectual property or non-solicitation of clients and staff – staff should not be paid for not misappropriating what they are not entitled to in any event.

2. **If you answered 'non-complete clauses and other restrictive covenants', please explain which other restrictive covenants and why.**

   See response to Q.1 above.

3. **Do you foresee any unintended consequences of limiting the scope of reform to non-compete clauses? If yes, please explain your answer.**

   See response to Q.1 above. There is a real risk that introducing a scheme for paid non-compete clauses will lead to an increase of enforceable use, and thereby restrict movement in the labour market, and therefore adversely affect competition and in turn innovation. If Option 2 is selected (outright ban) then it might lead to employers increasing notice periods. For very senior employees, this could lead to perhaps 18-month or 24-month notice periods.

The Government is considering applying the requirement for compensation where non-compete clauses are used in contracts of employment.

We recognise that non-compete clauses can be used in wider workplace contracts or other contracts which have a bearing on the workplace, for example in contracts for services, consultancy agreements, partnership agreements, Limited Liability Partnerships, employee share options and franchise agreements to name a few.

4. **Do you agree with the approach to apply the requirement for compensation to contracts of employment?**

   No – see response to Q.1 above.

5. **Do you think the Government should consider applying the requirement for compensation to wider workplace contracts?**

   No. Practitioners are not aware that general non-competes are used widely for workers who are not employees. However, other restrictions, such as non-solicitation and confidentiality and intellectual property clauses are regularly incorporated in worker contracts.

6. **Do you think the proposed reform to non-compete clauses in contracts of employment could have an impact on the use of, and/or the enforceability of, noncompete clauses in wider contract law? If yes, please explain how and why.**

   Potentially. Employment law is regularly seen as an exception to normal contract law principles, however, general contract law principles still apply, for example in terms of offer and acceptance, variation, and acceptance of repudiatory breach. It cannot be ruled out that a change in approach would not have an impact on restrictions in share sale agreements or other overlapping areas of law.

The Government is considering what a reasonable level of compensation would be for the period of the non-compete clause. The level of compensation needs to be high enough to deliver the aims of encouraging employers to consider whether the use of a non-compete is necessary for a particular role before inserting it into a contract, and to create a financial disincentive to their use. It should also reflect that an individual bound by a non-compete clause may be restricted from making a living in the area where their skills and expertise are most applicable and the harm this could have on competition and innovation.

To provide legal certainty, and to provide clarity to both employers and employees, the Government is considering a level of compensation that is set as a percentage of the ex- employee's average weekly earnings prior to termination of employment for the duration of the non-compete clause.

7. **Please indicate the level of compensation you think would be appropriate:**

- 60% of average weekly earnings
- 80% of average weekly earnings
- 100% of average weekly earnings
- Other (please specify and explain why)

  None of the above for reasons set out in response to Q.1 above. The appropriate mechanism is for employers to use garden leave on notice (which could be provided for under legislation), for which the employee is paid full salary and

benefits with a consequent ban on general non-competes (Option 2). In the alternative, if the proposal is adopted then 50% as in German Legislation. The Committee noted that Italy for example uses 30% and 40% compensation.

Currently in the UK an employer can unilaterally waive a non-compete clause at any point during the employment relationship. Were the Government to introduce mandatory compensation there is a risk that employers continue to use non-compete clauses broadly and then use this flexibility to remove the clause at the end of the employment relationship to avoid paying any compensation. While this would then allow the ex-employee to establish their own business in competition or to take up employment with a competitor, the existence of the noncompete clause in their contract may have affected their decision-making during the employment relationship.

8. Do you think an employer should have the flexibility to unilaterally waive a noncomplete clause or do you think that waiving a non-compete clause should be by agreement between the employer and the employee? Please indicate your answer below.

- Employer decision only
- Agreement between employer and employee
- Not sure/Don’t know

If there is to be payment for a non-compete, there is a likelihood that an employee would turn away new work. Therefore, any waiver should be either through agreement or notice, so that the employee has time to re-enter the labour market without *loss.*

Please explain your answer.

To disincentivise employers from inserting non-compete clauses and then unilaterally removing them at the end of the employment relationship, the Government could require that an obligation for the employer to pay compensation for some or all of the period of the non-compete clause is retained unless a defined period of time has elapsed between the waiving of the clause and the end of the employment relationship.

How this could work with an example of a 6-month period:

The employer could at any time during the employment relationship waive the post-termination non-compete clause in writing to the employee. In such case, the employer's obligation to pay compensation would cease to exist after 6 months have

elapsed from the day the clause was waived. Were the employer to give notice to waive the non-compete 6 months prior to the end of the employment relationship, the employer would not be required to provide the worker with any additional compensation once the employment has ended.

If, on the other hand, the employer waits to give written notice until a month before the end of the employment relationship, the employer then will be required to compensate the employee for 5 months after the employment relationship has ended. The employee would be able to compete immediately after the employment relationship has ended.

9. Do you agree with this approach? If not, why not?

Yes – see response to Q.8 above**.**

10. How long do you think the time period within which the employer must waive the restriction before the termination of employment should be?

- 3 months
- 6 months
- 12 months
- Other (please specify)

Half the period of restriction, and not less than 3 months. -i.e. for a 6 month restriction, 3 months' notice, but 6 months for a 12-month restriction.

Questions specifically for employers:

11. Do you use, or have you ever used, non-compete clauses in contracts of employment?

Yes

The terms 'employee' and 'contract of employment' have been used in this consultation on the basis that non-compete restraints are most commonly applied to employees in a contract of employment. However, the Government recognises that non-compete restraints may be being used in the contracts of workers who are not employees (as defined in section 230(3)(b) Employment Rights Act 1996) known as 'limb(b) workers'.

12. Do you use, or have you ever used, non-compete clauses in limb(b) workers' contracts?

No. See response to Q.5 above.

13. If you were required to provide compensation for the period of the non-compete clause, do you think that you would continue to use them? If yes, what kind of employees/limb(b) workers (high/low paid) would you maintain non-compete clauses in place for? Please explain your answer.

Some of our members' clients would continue to use non-compete clauses in relation to high paid employees. It is rare for employers to enforce non-compete clauses (or even include them in contracts in the first place) for low paid non-employees save in relation to high street shops such as hairdressers, solicitors etc where the risk from unfair competition is considerable but where innovation is unlikely. Many of our clients will use such clauses to protect from misuse of confidential information because it may be easier to prove. Our members and their clients would want to be clear what they received for paying compensation. If there were a breach would the employer effectively get a fast track for enforcement including the immediate return of the money paid. If not will employees simply take the compensation and compete anyway on the basis that the employer will have to spend significant sums on enforcement action.

14. If you did not use non-compete clauses, would you be content to rely on other 'restrictive covenants' to protect your business interests? If yes, do you think there would be any unintended consequences to this? Please explain your answer.

Other restrictive covenants avoid poaching of staff and customers and if non-compete clauses are not currently used it is likely to be because sufficient protection is already in place both by other covenants and by garden leave during notice periods.

15. If mandatory compensation were introduced, do you think you would increase your use of other 'restrictive covenants'? If yes, please explain why and which ones.

We think it is highly likely that there will be a greater focus on other restrictive covenants if a ban on non-competes is introduced because many businesses will want to consider how they protect their business from key individuals departing and trying to take significant parts of the business with them

16. **If you use non-compete clauses in contracts of employment, do you already pay compensation/salary to employees for all or part of the duration of the non-compete clause?**

Please explain your answer

Our members do not know of my instances where their clients pay for non-competes however there are many instances where clients will pay employees for substantial periods of garden leave.

17. **Do you think employees would be more likely to comply with the terms of a non-compete clause if mandatory compensation was introduced? If not, do you have any suggestions for increasing compliance.**

It is highly likely that compensation would persuade some employees to comply. However many will do as they have in the past and seek to compete when they believe they can escape detection by making a judgement that no proceedings will be issued or because the potential rewards are too great in their opinion to ignore. In addition, others will use their knowledge of their previous business to prepare to compete.

Complementary Measures

The following measures are being considered in addition to mandatory compensation.

To improve transparency around non-compete clauses, the Government is considering a requirement for employers to disclose the exact terms of the non-compete agreement to the employee in writing before they enter into the employment relationship. Failure to do so would mean that the non-compete clause was unenforceable.

18. **Would you support this measure to improve transparency around non-compete clauses? If not, please explain why not.**

We would support this measure. Best practice has always meant that employers will send full contracts in advance of the start date and indeed it is usual for our members to advise clients on contracts they have been offered and especially the meaning of the restrictive covenants. Quite often they will negotiate these clauses before agreeing to join the new business.

19. Have you ever been subject to a non-compete clause as an employee or limb(b) worker? If yes, were you aware of the non-compete clause before you accepted the offer of employment?

Most of the clients of our members who have been subjected to these clauses have been aware of them but there is a significant minority who have not had these drawn to their attention and simply signed the contract offered to them either before or after the offer.

20. Has a non-compete clause ever prevented you from taking up new employment in the past and/or prevented you from starting your own business? Please explain your answer.

A number of the clients of members have been dissuaded by non-compete clauses from joining new businesses or setting up in competition even when advised that the clause in question is unlikely to be enforceable.

21. Do you have any other suggestions for improving transparency around noncompete clauses?

No

The courts often consider the seniority of the employee concerned and their access to confidential information and clients when determining whether the period of the non-compete clause is reasonable. It is rare that the court will enforce a non-compete that lasts for over 12 months.

To provide certainty for both employers and employees, the Government is considering introducing a maximum limit on the period of non-compete clauses. Clauses that exceed that maximum period would automatically be unenforceable.

22. Would you support the inclusion of a maximum limit on the period of noncompete clauses?

The courts currently balance the type of business and the period necessary to level the playing field between the new replacement recruit and the outgoing employee with all the knowledge. It would be very rare in an employment contract for a covenant of longer than 12 months to be enforced. In insurance contracts a year is often enforceable because the excuse to contact the customer is at renewal date (often once a year). Equally for hairdressers etc if the customer has not returned in three months it is unlikely they remain a customer of the business. Whilst these

descriptions affect non-poaching clauses they will also to some extent affect non-competes where the risk is also from the misuse of confidential information. We would support a limit of 12 months but if it were to be a shorter period then this would need to recognise the industry in question and defining this in any comprehensive way would in our opinion be very difficult.

23. If the Government were to proceed by introducing a maximum limit on the period of non-compete clauses, what would be your preferred limit?

- 3 months
- 6 months
- 12 months
- Other (please specify)

Please explain in further detail the reasoning behind your preferred limit.

12 months for the reasons in our answer to 22 above

24. Do you see any challenges arising from introducing a statutory time limit on the period of non-compete clauses? If yes, please explain.

Please see our answer to 22 above

Option 2: Ban Non-Compete Clauses

To support the Government's commitment to unleash innovation, create the conditions for new jobs and increase competition, we are considering making post-termination, non-compete clauses in contracts of employment unenforceable. This would have the benefit of providing greater certainty for all parties and would make it easier for employees to start new businesses, find new work and apply their skills to drive the economic recovery.

However, the Government also recognises that there are arguments in favour of non-compete clauses playing an important role in protecting legitimate business interests.

25. What do you think could be the benefits of a ban on non-compete clauses in contracts of employment? Please explain your answer.

The courts uphold non-compete provisions in some circumstances and not in others. Cases are very fact based and the law is relatively complex. From an employee's (and practitioner's) perspective, enforceability can be unpredictable. There is no doubt that some employers impose non-compete provisions across a

wide spectrum of employee contracts even though, in many cases, a non-compete clause is unenforceable, particularly for junior employees. This uncertainty along with the significant cost and risk of testing enforceability in court is unsatisfactory. Our experience is that many employees will abide by restrictions that may not actually be enforceable to avoid the risk and cost of court proceedings. A ban would remove that uncertainty.

26. What do you think might be the potential risks or unintended consequences of a ban on non-compete clauses? Please explain your answer.

The risk of senior employees leaving for a competitor and taking with them knowledge of confidential information, such as upcoming product launches, marketing plans, sales campaigns, product development, other business plans, production methods etc can all be highly disruptive in certain circumstances. The original employer should reasonably be entitled to some protection and a non-compete clause is the most direct and efficient means of providing it.

27. Would you support a ban on non-compete clauses in contracts of employment? Please explain your answer.

No, because in some circumstances they are the most effective means of protection against unfair competition from departing employees. This is particularly so for high street shops but also applies to those who may remove confidential information leaving little or no evidence of having done so.

28. If the Government introduced a ban on non-compete clauses, do you think the ban should extend to wider workplace contracts?

There are no obvious reasons why not.

29. Do you think a ban should be limited to non-compete clauses only or do you think it should also apply to other restrictive covenants?' If the latter, please explain which and why.

If there is a ban, our members' view is that it should not extend to other restrictions. Indeed, employers will require other covenants, confidentiality, garden leave and intellectual property rights to be able to protect their investment.

30. If the Government introduced a ban on non-compete clauses in contracts of employment, do you think there are any circumstances where a non-compete clause should be enforceable? If yes, please explain.

If a ban were to be imposed, we would argue that it should still apply for senior employees, perhaps to directors or equivalent. A ban may be more reasonable in relation to junior staff.

31. Are there options short of banning non-compete clauses which would limit their enforceability in the interests of spreading innovation? Please explain your answer.

We are unsure that banning non-competition clauses would particularly help spread innovation. Innovation is a very broad concept, going well beyond 'intellectual property' or even 'confidential information'. We suggest that 'innovation' could not be used, without something more, to justify the enforceability of a non-compete clause and therefore to ban non-compete clauses in order to spread innovation is perhaps a step too far . We suggest that a codified set of rules (a Code of Practice) to simplify the question of enforceability might be an answer e.g. being very specific about the characteristics of the employee to whom it applies, such as those with senior managerial responsibility, or the specific business interest that it is designed to protect. They might also incorporate a geographical provision such that clauses should have no wider impact than say 20 miles of the employee's workplace. IT would also be an opportunity to explain to both parties how restrictive covenants should be used.

32. Are you aware of any instances where a non-compete clause has restricted the spread of innovation/innovative ideas? Please explain your answer.

Not so far as we are aware.

In case it is suggested that practitioners and their clients have a vested interest in maintaining the status quo, the fact is that under the current regime, cases are not typically framed around innovation and it has not been an obvious concern from the perspective of either employers or employees. When trying to take into account the wider public interest, our members do not detect a particular problem in this regard.

33. If you are aware of any literature, research, or evidence from your own business experience that looks at the impact of non-compete clauses on competition, innovation, or economic growth please list the publications below.

Not so far as we are aware. Our members would be interested to see any evidence or analysis of damage to innovation or economic growth.

Questions specifically for employers:

34. If the Government introduced a ban on non-compete clauses in contracts of employment do you think you would be able to sufficiently protect your business interests through other means, for example through intellectual property law and confidentiality clauses? If not, why not?

Our members think not.

In our experience, intellectual property is a very specific area for protection and rarely the focus of concern in most employment related competition issues. Confidentiality clauses are relevant in relation to protecting physical and electronic data, such as customer lists, but the courts accept that the knowledge an employee has gained in the course of their employment (other than where it has been deliberately memorised) is not directly capable of protection, which is where non-compete restrictions are relevant.

35. Do you think a ban on non-compete clauses in contracts of employment could benefit your business/organisation? If so, how?

Maybe, insofar as it might allow a business to recruit an employee who can give them an (unfair) insight into their competitor's business. In our members' view this would not be a sensible way to conduct business: it undermines stability and long-term business planning.

36. Do you think a ban on non-compete clauses in contracts of employment would impact your business/organisation? If yes, please explain in what ways and the severity of any impacts to your business/organisation.

Our members believe that such a ban could be damaging for some businesses. It would permit a senior employee to leave and take all their knowledge of strategic and confidential information with them to a competitor. It is well understood that this is a legitimate and protectable business interest.

Whilst confidential information can be protected contractually there is no practical protection in relation to information held in an employee's head. Inevitably a senior employee's activity working for a competitor business will be informed by that information and it is easy to see that could give an unfair advantage to a competitor. The non-compete clause is an appropriate way to provide protection.

37. How do you think your business/organisation would respond to a ban on noncompete clauses in contracts of employment? Please explain.

In some cases, practitioners may review their use of and the terms of garden leave clauses. It might be that employers decide to provide for reduced salary and benefits during the notice period. For example, it is common to see that bonus schemes cease to apply during periods of garden leave.