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Post-employment covenants, the doctrine against restraint of trade and severability

Tillman v Egon Zehnder Ltd [2019] 2 B.C.L.C. 143

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Introduction

In *Tillman* a former employee argued that a non-competition clause in her contract was void as a part of it that prohibited her from holding shares in a competing business was an unreasonable restraint of trade: the employer responded by challenging whether the part was covered by the doctrine and, if it was and was accordingly an unreasonable restraint, that it could be severed from the clause. The principal interest in the Supreme Court’s decision was on the severability issue.

The facts

The employment contract between the appellant, EZ, and the respondent, T, involved in the specialist executive search and recruitment business, contained a covenant with five restraints, all limited to six months from the end of her employment. The restraints were commonplace, being:

(i) not to entice away employees of EZ in specified senior positions, and not without prior written consent and as “principal, manager, employee, contractor, consultant, agent or otherwise howsoever”;

(ii) to solicit the custom of specified suppliers of services to EZ;

(iii) to interfere with supplies to Z;

(iv) to use a name likely to be confused with names used by EZ; and

(v) “directly or indirectly engage or be concerned or interested in any business carried on in competition with any of the businesses of [EZ] … 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” (referred to as the “non-competition covenant”).

The contract also provided that if any of the restrictions were not valid as going beyond what was reasonable to protect EZ’s goodwill and interest

> “but would be valid if part of the wording were deleted, then such restriction or obligations shall apply with such modifications as may be necessary to make it enforceable”.

During her employment T was permitted to hold up to five per cent of the total equity of a publicly quoted competitor.

T left EZ at the end of January 2017 and notified EZ that she intended to start work for a competing business three months later; the covenant would have had no effect beyond the end of July 2017. On 10 April 2017, T undertook not to enter into the proposed employment until the court had determined EZ's application for an interim injunction and EZ gave a corresponding undertaking in damages. Mann J granted the injunction after a full hearing towards the end of May 2017 and by 21 July the Court of Appeal had heard and upheld T's appeal. The parties had agreed before Mann J that, because the determination of the application would dispose of the whole claim, the inquiry should look more closely at EZ's claim than the conventional "serious question" test normally applied to an interim injunction application.

The law

Post-termination restraints in employment contracts fall within the doctrine against restraint of trade and are void unless reasonable in the interests of the parties and reasonably necessary to protect a proprietary interest of the employer. The onus is on the employer to establish reasonableness. Customer lists are proprietary interests and non-solicitation clauses are more likely to be reasonable than non-competition clauses. Precedents are not of assistance because each case turns on its own particular facts (*Safetynet Security Ltd v Coppage* [2013] EWCA Civ 1176). In *Proactive Sports Management Ltd v Rooney* [2011] EWCA Civ 1444 the Court of Appeal held at [155] that the court should adopt a "broad, practical, rule of reason approach" to determining whether a particular clause fell within the doctrine against restraint of trade.

The English "validity principle" provides that where a contract clause is capable of two equally plausible meanings, one void and one valid, the latter should be preferred: the search is for a realistic alternative construction (*Tindall Cobham 1 Ltd v Adda Hotels* [2014] EWCA Civ 1215).

The First Instance (Mann J) ([2017] EWHC 1278 (Ch)) and the Court of Appeal ([2017] EWCA Civ 1054) decisions

At first instance T argued that the effect of the part of the non-competition clause not to be interested in any competing business unreasonably prohibited her from holding even a minority shareholding in such a business. EZ argued that the clause did not, in fact, prohibit her from holding even a minority shareholding and that she was free to acquire shares in a competing business provided she did not actively participate in its business. EZ conceded that, if the clause did prohibit T from doing so, it was an unreasonable restraint of trade but argued that the words "or interested" should be severed and removed so that the remainder of the clause would be reasonable and enforceable. Mann J agreed with EZ that the word "interested" in the non-competition covenant did not prohibit T from holding shares in a competing business since the contract expressly permitted her to hold such shares when employed; although he did not need to decide the alternative "severability" argument, he did not find it appealing.

The Court of Appeal allowed T's appeal and held that the proper construction of the word "interested" was to prohibit T from holding even a minority shareholding in any of the competing businesses so that the covenant was in unreasonable restraint of trade. EZ had argued that "interested" should be construed as "actively participate in" so that a majority shareholding could be restrained since participation was inevitable whereas a minority shareholding would not depending on the facts. Longmore LJ regarded that construction as inherently unsatisfactory because it did not allow an objective measure of activity prohibited, at [24]. The court also refused to sever the word from the remainder of the clause, at [34].

The Supreme Court

Lord Wilson (Lady Hale, Lord Kerr, Lord Briggs and Lady Arden agreed) considered that the contract between T and EZ was of the classic type between employee and employer and that it provided for restraint of trade which was within the doctrine and thus void unless reasonable. He noted that EZ relied on three arguments that each depended on a different hypothesis: (i) assuming T's argument that the words "interested in" was an unreasonable restraint of trade, those words fell outside the doctrine against restraint of trade; (ii) assuming T's construction of "interested in" was incorrect so that it was not in unreasonable restraint of trade; and (c) assuming T's argument that the words "interested in" was an unreasonable restraint of trade and fell within the doctrine, those words should be severed and removed so that the remainder of the covenant survived to prohibit T's entry into the proposed employment.

At [30] Lord Wilson said that the only issue arising in EZ's first argument was whether an assumed prohibition against holding shares formed part of the restraint. He described as "curious" EZ's first argument that the word "interested" fell outside the doctrine against restraint of trade but the remainder fell within it; in other words, the restraints provided in the rest of the covenant are valid only if reasonable but the restraint provided by the word "interested" was valid although unreasonable. He noted that EZ had cited no authority in which a particular word in a covenant that substantially falls within the doctrine had been held to fall outside it. He also noted that, in seeking to protect itself against competing activity by T, it would be unsurprising that EZ aspired to prohibit her from holding shares in a potentially competitive business since even a minority shareholding in a business might enable her to influence its operations, for example, if it was started by her with others with a view to competing. Further, top executives were often required to hold shares as a condition of their employment, so the restraint on shareholding was part of the restraint on T's ability to work in the immediate aftermath of her employment with EZ. As a result, on the assumption that "interested" restrained T from holding shares, it fell within the doctrine.

EZ conceded that, in some contexts, a person holding shares will properly be described as being interested in it but the meaning of the word is informed by its context in the agreement as a whole. It argued that three features of the agreement, namely: the limited permission to hold shares during her employment; the absence of the world "shareholder" from the different types of status in which T was subject to the restraints ("principal, manager", etc.); and the fact that "interest" in a business suggested an active interest rather than the passive interest of a shareholder. Lord Wilson said that those features were insufficient to displace the obvious natural meaning of the word that had been included in standard precedents for non-competition covenants throughout the previous century, at [50]–[53].

On severability, after overruling the Court of Appeal decision in *Attwood v Lamont* (1920) 3 K.B. 571, Lord Wilson said that the application of the severance principle to the non-competition covenant was straightforward; the words "or interested" were capable of being removed without the need to add to or modify the wording of the remainder and removal of the prohibition against T being interested would not generate any major change in the overall effect of the restraints, so that the words should be severed and removed, at [88].

The Court of Appeal considered that, even if the words "or interested" were removed, T would still be indirectly "concerned" in a competing business by holding shares in it and, thus, still restrained. However, Lord Wilson said that "concerned" denoted working for the competing business or having some other active involvement in it and did not extend to a proprietary interest such as a shareholding, at [90].

Conclusion

The subtle distinction between being concerned in or interested in a business has been clarified by the Supreme Court but of much greater interest is the simplification of the test to be applied for severing words from a contractual provision to two questions, whether the words were capable of being removed without the need to add to or modify the wording of the remainder and whether removal of the words would not generate any major change in the overall effect of the restraints.