

Departing
Employees –
Protecting the
Family Silver

DILLON  EUSTACE

DUBLIN CORK BOSTON NEW YORK TOKYO

DEPARTING EMPLOYEES – PROTECTING THE FAMILY SILVER

Introduction

An issue which frequently arises for companies is what do if an employee goes to a competitor or decides to set up on their own in competition to their previous employer. This is particularly serious if the employee concerned is a senior person with influence over customers or fellow employees. In some cases the loss of a key employee to a competitor can result in significant damage to the business. In the financial services sector this can be a real problem due to the fact that many valuable relationships are to some extent personal between the client and the employee when a rapport and reliance on advice has built up over a considerable period. It would not be unusual for a client to deal exclusively with a particular individual within a company. Recent years have seen whole teams leave one company and go to work for the competition. As well as the obvious loss of this resource, the company may suffer from a failure of confidence amongst clients who may perceive that there may be a fundamental problem in the company to result in a mass walk out. The bigger the numbers leaving or the more influential the personnel involved, the more likely there is to be publicity whether in the general media or in more specialised publications.

At a time like this a company will have to rely on any non-competition/non-solicitation clauses there may be in the employee's contract of employment. If there are no such clauses then there is nothing the employer can do. These are known as restrictive covenants and fall into two categories:

Non Compete Clauses

The wider version, the non compete clause prohibits the employee working within a territorially defined area for an organisation in which he will carry on the same function that he is currently engaged to do.

Non Solicit Clauses

The narrower version, the non-solicit or non dealing covenant either forbids the employee soliciting the former employer's employees or customers or dealing with the former employer's customers.

As a matter of public policy, the law does not approve of restrictions on the rights of individuals to earn a livelihood and therefore a restrictive covenant negotiated between employer and employee, limiting the post employment activities of a former employee may be presumed void for being in restraint of trade unless the employer seeking to uphold it can prove:-

1. that it has a legitimate interest deserving protection;
2. that the covenant is reasonable as between the parties in terms of duration and geographical location in regard to the nature of the commercial interest where the covenant is not otherwise contrary to the public interest.

The Courts will differentiate between clauses in ordinary employment contracts and circumstances where an employee enters into a restraint in return for some particular consideration, the clearest example being on the sale of a business. Where a person sells a business and as part of the deal agrees not to compete then the Courts are much more willing to entertain an action where there is a breach.

In essence a non-compete clause must not exceed what is necessary to protect the employer's client base. A restrictive covenant must define the territorial limits of its operation. A restrictive covenant which does not define the extent of its operation will as a matter of law be presumed to be world wide and world wide restriction will hardly ever be enforceable.

The covenant cannot include areas where the business never had any custom.

A restrictive covenant should not exceed the time necessary for the employer to re-establish a client profile with the former client base. The extent of the time required to re-establish client hold may vary according to the circumstances of each case.

Non solicit clauses must be restricted in their application to those clients/prospective clients/employees with whom the ex-employee exercised actual influence and must only prevent soliciting / dealing in the line of work carried out with the ex-employer.

A non solicitation clause is valid only to protect the employer's interests over clients with whom the employee has had contact and influence. A non solicit clause which prevents an employee dealing with any clients of the employer would usually not be upheld since it may have the effect of including persons with whom the employee never dealt.

Not only must the non-solicit clause be restricted to the client base with whom the employee dealt, it must also be restricted to soliciting in the trade or business in which the employee was engaged by the employer. The employer may have a legitimate interest in preventing the employee approaching its clients in its line of business.

In a High Court Judgement given in June 2005, the Judge stated that the test seems to be "as to whether in all the circumstances of the case both the nature of the restriction and its extent is reasonable to protect the goodwill of the employer. Clearly certain clauses which preclude solicitation come within that definition provided that they are not excessively wide....but it is clear that the duration of the prohibition and the geographical scope of same are important matters to be considered having regard to the nature of the work in question and the structure of the business". The Judge went on to say that "Covenants against competition by former employees are never reasonable as such. They may be upheld only where the employee might obtain such personal knowledge of and influence over the customers of his employer as would enable him if competition were allowed to take advantage of his employer's trade connection."

Merely because a restraint of trade clause states that the terms are accepted by the employee as reasonable this does not mean that a Court will enforce it.

It is important to remember that if a restraint clause is held to be unreasonable it is void and will not be enforced by a Court. This may be avoided by use of a "severance clause" which allows a Judge to alter the duration of the restraint or its geographical area to what the Judge considers reasonable. For example, the severance clause might allow the Judge to substitute a 6 month period for a 12 month period and then enforce the clause. Sometimes clauses contain several elements and if a Judge were to hold that any of the restrictions go too far then it would fall and cannot be amended.

Each term would be looked at by a Court against the particular facts of a case so it is not possible to say that a given period will be held to be reasonable. In general, it seems to be accepted that unless the circumstances are exceptional, twelve months would be the longest period which a Court would uphold. One would have a little more optimism in looking for six or perhaps nine months.

To have any prospect of being enforced, the clause must contain a territorial or geographical limit otherwise one may have to argue that the clauses themselves make it clear that it refers to a particular area (say Ireland) but one would have to persuade an unsympathetic Court.

The main difficulty which usually arises in practice is that departing employees may have removed information by copying databases or other commercially sensitive information well in advance of telling their employer of their intention to leave so that it is practically impossible to prove that information has been removed. In some cases a forensic examination of computer equipment may disclose whether information has been transferred. Some careless employees may have emailed contacts while still employed telling them of their impending move. Evidence of this should be retrievable from computers. A further difficulty of course is that much knowledge is carried around in the employee's head so they do not need too much hard copy data.

Given that the new employer is not going to tell the new employer what they have learned they have no way of gathering any evidence despite what they might well believe to be the truth. One of the best hopes an employer may have would be that an existing customer might contact them to let them know that he has been approached either directly by the employer by someone from the new employer who appeared to have commercially sensitive information. If that customer were prepared to swear an Affidavit as to what happened then the employer's case may be strengthened.

An employer who apprehends that his departing employee may breach a non-compete clause may decide to write to both the employee and to the new employer and point out the content of the relevant clauses of the employee's contract and call upon both of them to confirm in writing that they will not do anything to breach the terms in default of which the employer will take immediate legal action. It is hard to predict the response which will be received as this will depend on the employer.

If an employer believes that there is a real risk of serious commercial damage as a result of this defection it could consider taking legal action. The company could issue proceedings against both the employee and the new employer seeking a prohibition on the employee breaching the restraints. If the employer thought that the damage would be severe and that waiting for a trial would effectively defeat the purpose because the damage would have been done before they got to Court, they could apply straight away for an injunction. If such a step were to be taken the employer would need to move quickly since any material delay may defeat an injunction application.

At the injunction stage the Court would have to decide first of all whether there is a “fair issue to be tried” which is a reasonably straightforward hurdle to overcome. If it agrees then it would have to decide where the “balance of convenience” lies, since its decision is bound to inconvenience one of the parties. An issue which would be relevant on this point is whether damages would be an adequate remedy for the employer if it ultimately wins. If the employer can persuade a Court that monetary damages would not be an adequate remedy because so much damage will be done during the period before the trial then that increases the chances of obtaining an injunction. Whether an injunction is granted in a particular case is at the entire discretion of the Judge and it would be vital to be able to make the strongest possible case preferably with evidence from customers rather than simply making some vague allegation of a fear that damage may result. If there were particular potential clients who the company had targeted and spent money on developing then that might help the cause. Any particularly key prospects should be identified.

A very important fact to be aware of is that if a party seeks an injunction it must be prepared to give an undertaking as to damages. This undertaking is given to the Court and means that if it gets an injunction stopping the employee working until the trial and it ultimately lose the case and the trial Judge finds that the injunction should not have been granted, then it will be liable to pay the defendant(s) in respect of any loss they suffered as a result of the injunction. This could be a significant sum and would be in addition to paying legal costs.

From a wider perspective, challenging a departing employee will send a signal to other employees who might be contemplating a similar move. The difficulty in issuing proceedings which do not succeed is that the remaining employees will have less to fear about their own situation – although depending on who they intend to move to the cases may not be exactly identical. On the other hand if the company is seen to make it difficult to leave that point might have some value in keeping others in check. There would of course be a significant level of legal costs involved in any Court action.

Date: September, 2005
Author: John Doyle

CONTACT US

Our Offices

Dublin

33 Sir John Rogerson's Quay,
Dublin 2,
Ireland.
Tel: +353 1 667 0022
Fax.: +353 1 667 0042

Cork

8 Webworks Cork,
Eglinton Street,
Cork, Ireland.
Tel: +353 21 425 0630
Fax: +353 21 425 0632

Boston

26th Floor,
225 Franklin Street,
Boston, MA 02110,
United States of America.
Tel: +1 617 217 2866
Fax: +1 617 217 2566

New York

415 Madison Avenue
15th Floor
New York, NY 10007
United States
Tel: +1 646.673.8523
Fax: + 1 646.683.8524

Tokyo

12th Floor,
Yurakucho Itocia Building
2-7-1 Yurakucho, Chiyoda-ku
Tokyo 100-0006, Japan
Tel: +813 6860 4885
Fax: +813 6860 4501

e-mail: enquiries@dilloneustace.ie
website: www.dilloneustace.ie

Contact Points

For more details on how we can help you, to request copies of most recent newsletters, briefings or articles, or simply to be included on our mailing list going forward, please contact any of the team members below.

John Doyle

e-mail: john.doyle@dilloneustace.ie

Tel : +353 1 667 0022

Fax: + 353 1 667 0042

DISCLAIMER:

This document is for information purposes only and does not purport to represent legal advice. If you have any queries or would like further information relating to any of the above matters, please refer to the contacts above or your usual contact in Dillon Eustace.

Copyright Notice:

© 2009 Dillon Eustace. All rights reserved.
This article was first published in Finance Magazine in September 2005.

DILLON  EUSTACE

DUBLIN CORK BOSTON NEW YORK TOKYO

33 Sir John Rogerson's Quay, Dublin 2, Ireland.
www.dilloneustace.ie

In alliance with Arendt & Medernach