THE EFFECT OF EXISTING EMPLOYMENT NON COMPETITION COVENANTS WHEN SETTING UP YOUR OWN BUSINESS IN COMPETITION WITH A FORMER EMPLOYER *Posted on September 17, 2012 by srlaw*

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This is a preliminary note and is no substitution for the taking of detailed legal advice. However this article does provide focus to one of the potential key issues which may arise when an employee is setting up his/her own business in competition to the business of his former employer.

It is not uncommon for employees to wish to set up their own business, in competition to their employer.

They may feel that they are successfully making profits for their current employers and that they are not being rewarded enough for their efforts or that the true value of their work is not appreciated by their employers. Additionally they may feel that they no longer wish to be subject to the control of an employer. This situation is fairly common.

Employers do endeavour to protect their business by non competition covenants, some of which are drafted in fairly onerous terms.

These will typically prevent a member of staff from setting up a competing business for a certain period of time and within a specified geographical area. Further covenants may endeavour to prevent employees within a certain period from soliciting clients/customers of the employment business and also seeking to entice away staff members.

Quite commonly such covenants are signed by incoming members of staff without considering or thinking about the same and they find themselves subject to very onerous covenants which (if legally enforceable) may lock them out of the market (or severely restrict their business activities) for a specified period of time.

Employee non competition covenants are only legally enforceable if considered by the Court to be reasonable. They are presumed to be unreasonable and hence unenforceable. This is the starting point.

The legal test utilised by the Court has two parts:

- The first is that to be enforceable the covenant must be no wider than reasonably necessary for the protection of the legitimate business interests of the employer
- Secondly to be enforceable the Court must not consider the covenant to be against or contrary to the public interest

Litigation involving non competition covenants can be relatively expensive. Such legal action frequently result in an application for a pre-trial injunction (which will involve at an early point in time one or more Court appearances). Accordingly legal costs can escalate very quickly and it is not uncommon for such costs to initially mount up to significant sums.

The eventual winning party will make a claim for costs as against the other party.

Former staff setting up a new business normally have cash flow issues. The establishment of a new venture can be relatively costly and also a new business will commonly receive only a limited flow of income for some while. As this is the case the former employer has the tactical advantage due to the fact that litigation can be very expensive- especially in terms of the very large amount of adverse legal costs which may be claimed as against an unsuccessful opponent.

However the position is all not one sided in favour of the former employer. Employers who try to place in employment agreements very onerous covenants will find that they have weakened their position. Covenants preventing employees from setting up competing businesses (non-compete covenants) are generally only enforced by the Court within relatively narrow limits.

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Each case will be decided upon its own merits but in general to be on the safe side an employer should not require general non compete covenants to last no longer than 3 months from the date of termination of employment and also should only require such covenants to apply to within a defined geographical area in the vicinity where the employer's business operates.

In relation to non solicitation/non dealing covenants with clients/customers, again an employer should impose limitations upon the duration and scope of such covenants. Our usual advice to employers is that such covenants should generally not be longer than six months and only relate to clients/customers with whom the employer has dealt with for a period of say 6 or 12 months prior to the end of the employment relationship.

We also further generally advise employers (when acting for them) that time periods for non solicitation/non dealing of co workers should not extend for more than six months only and relate to staff whom the employer has influence over/has dealt with say 6 or 12 months prior to the ending of the employment relationship.

Covenants more onerous than those stated above may be enforced by a Court, and it will be up to the judge to decide such issue, if the matter should proceed to a contested trial.

Each case is different and will possess background circumstances and it is advisable for legal advice to be taken for each separate matter.

It is not uncommon to find employers trying to enforce 1 or 2 year covenants which they may find to be relatively difficult to enforce.

As explained, an employer may try to obtain a pre-trial injunction, and there are stated legal tests as to whether such injunction should be granted or alternatively whether the Court should order what is known as an expedited or speedy trial. A material issue on whether such injunction should be granted is the balance of convenience between the parties and also the view of the Judge as to the likelihood that the covenants will be enforced at a contested trial.

A pre trial injunction if granted would normally be required to be supported by a cross undertaking in damages on the part of the employer. If the employer should lose at trial such cross undertaking will form the basis of a claim to the Court for compensation by the employee. The employee can claim such damages as the Court may consider just for being restricted by the grant of the pre trial injunction.

If you have non-competition covenants which if legally unenforceable will create difficulties with your start-up business, then you should seek legal advice as soon as reasonably possible.

If you wish to be very aggressive and you can apply to Court for a declaration that the relevant covenants are not legally enforceable. This is quite a powerful way forward and automatically you will be on the attack against your former employers in relation to any potential attempts on their part to stop you setting up your competing business. However such action should only be taken with the benefit of counsel's advice that it will possess reasonable prospects of success.

In our experience, an aggressive stance may result in a compromise deal with the former employer whereby it is agreed that the covenants would be enforced for a lesser period and/or within a reduced scope or that you will only agree not to deal with or solicit certain specified clients for an agreed period of time.

Duty of Fidelity

Employees have a duty of fidelity. This includes not taking with them client lists or contact details of clients/customers when they leave. This duty is frequently breached and it is not uncommon for employees when they leave to have customer contact details on their personal mobile telephones or their personal computers etc. It is essential to destroy and not to take with you any such details. If you have been dealing with clients/customers and you know who they are, it may be possible to ascertain their contact details post termination of employment via the internet, telephone directory,

third party enquiries etc. There is no need to take client lists or other confidential information away with you and if you do so this may cause endless potential legal problems.

We in fact have acted for an employer where we had managed to secure a pre trial (springboard) injunction against a former employee for e-mailing a client list to his personal email account. This turned out to be a disaster so far as the former employee was concerned.

This note just sets out some of the key issues. In each situation the position will be different and separate legal advice should be sought.

We finally end this note by mentioning that there can be nothing more devastating to a new business start-up when a former employer applies to the Court to endeavour to injunct the business to stop it trading.

Hence the need to deal with the issues raised in this note seriously and endeavour to overcome any potential difficulties before the business materially commences to trade.

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