An Update to Restrictive Covenants: Tillman v Egon Zehnder Ltd

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> Restrictive covenants are a common feature in employment contracts. Their aim and purpose is to protect the employer's clients, customers and its business. Tillman v Egon Zehnder Ltd was the first Supreme Court decision in almost 100 years to consider restrictive covenants. The judgment has changed the accepted interpretation and overrules the previous Attwood decision.

Tillman v Egon Zehnder Ltd [2019] UKSC 32[1] was a recent Supreme Court decision which considered restrictive covenants and has helped clarify the legal position in relation to the severability of phrases. Ms Tillman left her employment with a global recruitment firm Egon Zehnder Ltd (EZ), and agreed to comply with all covenants in her contract apart from a non-competition covenant which stated that she should not "directly or indirectly engage or be concerned or interested" in any competing business. EZ applied to the High Court for an interim injunction to enforce this protection and the firm was successful at first instance. Ms Tillman alleged that this covenant was an unreasonable restraint of trade and thus void and the Court of Appeal found in her favour.

The case progressed to the Supreme Court which overturned the Court of Appeal's decision.

Background of Tillman v Egon Zehnder Ltd

Ms. Tillman was employed by EZ. Her employment contract, dated 2013, contained post-termination restraints. She was the global head of EZ's financial services practice area. Her 2013 employment contract was never updated except for changes in terms relating to her remuneration.

The key issue related to Clause 13 of her agreement which set out five restraints on the activities of Ms Tillman for 6 months following termination of her employment. The restraint that is key is clause 13.2.3 which sets out that Ms Tillman agreed that she would not:

"*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's resigned from EZ in 2017 and she argued that her non-compete clause was unenforceable as the phrase 'interested in' prevented her from holding shares in a rival company, no matter how small. Therefore, the clause was void as an unreasonable restraint of trade.

Supreme Court's judgement

The Supreme Court had 3 key issues to decide on in this case

1. Whether the doctrine of restraint of trade applies in this scenario;

[1] http://www.bailii.org/uk/cases/UKSC/2019/32.html

2. The proper construction of the term 'interested'; and
3. The test for severance

The Doctrine

The doctrine of restraint of trade is the principle that renders a contractual term relating to a restrictive covenant void unless it is designed to protect legitimate business interests and is no wider than reasonably necessary.

The Supreme Court in Tillman rejected EZ's argument that the doctrine of restraint of trade did not apply at all to a prohibition on ownership interests, such as shareholding. It held that this clause is a common clause between employer and employee. There was no basis for EZ's argument that a particular word in a covenant otherwise subject to the doctrine would fall outside it. This rejection of the argument is unsurprising because even a minority shareholding in a competitor's company by Ms. Tillman would allow her to influence its operations.

The Construction

The next issue for the Supreme Court to decide was the construction of the term 'interested in'. EZ argued, following the 'validity principle', that clause 13.2.3 should be construed as valid and on the basis that 'interested in' does not extend to shareholding.

However, the Supreme Court rejected this argument and held that the natural construction of the term 'interested in' is required, and consistent with long-standing authority, and that this covers a shareholding. In order for the 'validity principle' to be considered, a realistic construction of 'interested in' is required, which EZ failed to present. Hence, the phrase 'interested in' is able to cover shareholding, regardless of the size of shareholding.

Test for severance

The Supreme Court established a tripartite test for severance of a phrase, overruling the previous Court of Appeal authority – Attwood v Lamont [1920] All ER Rep and affirming Beckett Investment Management Group Limited and Others v Hall and Others [2007] EWCA Civ 613.

Firstly, the Supreme Court explained that the 'unenforceable provision had to be capable of being removed without the necessity of adding to or modifying the wording of what remains'. This first limb is a reiteration of the well-known 'blue-pencil' test.

Secondly, the remaining terms have to be supported by adequate consideration.

Thirdly, the removal of the unenforceable provision does not so change the character of the contract that it becomes not the sort of contract that the parties entered into at all.. The criterion is whether removal of the provision would not generate any major change in the overall effect of all the post-employment restraints in the contract. It is for the employer to establish that its removal would not do so.

The Supreme Court held that on the test, the phrase 'interested in' was severable.

Implications of the Tillman decision

Tillman has provided a straightforward test for severability and has helped to clarify the area of law surrounding restrictive covenants. Terms that are considered to be too wide are subject to being severed. As a result, more covenants may now include specific provisions commenting on the fact that the non-compete clause incorporated does not prevent shareholding in another company, to circumvent the suggestion that the clause is too wide.

Although an employer-friendly decision, the Supreme Court has explicitly stated that 'the Courts must continue to adopt a cautious approach to the severance of post-employment restraints' and employers should still carefully consider the manner in which they rely on these restrictions and how they are constructed.

What does this mean for employers?

We would advise employers to:

- review regularly the post-termination restrictions in standard employment contracts and make sure they go no further than is reasonably necessary to protect their business from departing employees.
- always be clear about what they intend by the language used and to tailor the restrictive covenant to individual circumstances.
- offer a pay rise or introduction of a new benefit in return for agreeing to new restrictive covenants.

If you would like any additional information on any of the areas discussed in this article please contact Marina Garston or David Coupe on **0203 553 4888**.

About the authors

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