

Planning to leave

It is trite but true that the most important asset of a business is its employees. Equally, one of the biggest liabilities for a business is the employee who wishes to leave, either to join a competing business or to set up on his own in competition. An employee who has decided to leave may begin taking preparatory steps long before his actual departure, such as buying an off-the shelf company, setting up a bank account for the new business or briefing designers or suppliers.

A recent case in the Patents County Court is a good example of how an inadequate contract of employment can leave a business without a legal remedy when a key employee takes steps to set up in competition. The case involved Helmet Integrated Systems Limited (“HISL”), its former salesman Mitch Tunnard and, Modular Helmet Systems Limited, the company he established following his departure.

During his employment Mr Tunnard had an idea for a new helmet which he presented to HISL. They chose not to take it further so he decided to produce the helmets himself. He took preparatory steps prior to leaving HISL, including, briefing a design company and obtaining a government grant for his new enterprise. He obtained a consultants’ opinion on his idea and how best to place it in the market place.

Mr Tunnard’s actions were not in breach of the express terms of his contract of employment with HISL. In the absence of express clauses, an employer is forced to fall back on implied obligations or terms such as the duty of fidelity and fiduciary duties that an employee owes his employer. In reality these duties can provide limited protection for an employer. In this case the court decided that actual competition or misuse of confidential information belonging to the employer is necessary to show a breach of fidelity. The key is to distinguish between preparatory steps and actually competitive acts such as approaching suppliers or clients.

Protecting your business

The most appropriate method for putting protective measures in place, is to ensure that employees’ contracts of employment contain express clauses governing the employees’ use of confidential information, creation and use of IP, and actions during employment and following termination.

Express contractual terms

Express clauses should be inserted into employees’ contracts of employment, providing that: (i) the employee devote the whole of his attention and working time to the employer; (ii) the employee is prevented from holding any interest in any other business or competing business during employment; (iii) the definition of confidential information covers all key company information (e.g. methodology, price lists etc) and prevents employees using this information

following termination; (iv) the definition of IP is comprehensive (covering patents, copyright, design rights, and trade marks); and (v) key employees are covered by restrictive covenants preventing certain action following termination.

IP

Where IP or development is a key part of a business or role, the employment contract should also provide for (i) the business to own all IP created during the course of employment whether during work hours or not; (ii) IP created using business equipment or resources belong to the company; (iii) waiver of the employee's moral rights under the Copyright, Designs and Patents Act 1988; and (iv) that the rights and obligations relating to IP continue in force after the termination of employment and are binding on the employee's personal representatives.

If development is a key part of an employee's job then it is advisable to have a detailed job description annexed to the contract as evidence of activities which will be done 'in the course of employment.'

Restrictive covenants

The usual method for trying to prevent competition following termination is by including restrictive covenants in contracts of employment, covering solicitation of clients or employees, dealing with clients, moving to a competitor organisation, or setting up in competition.

These restrictions need to be carefully drafted to enable the employer to rely on them. The employer must be able to show the restriction is designed to protect a legitimate business interest, meaning a proprietary interest such as trade connections, goodwill, maintenance of a stable workforce and confidential information. The restriction must only go so far as necessary to protect the interest, be reasonable in scope (i.e. duration and geographical area) and should only cover clients or suppliers with whom the employee dealt or the poaching of senior employees or employees for whom he had managerial responsibility. As far as possible restrictions must be tailored to the employee's individual role, and it is possible to name competitors in the restrictions for whom the employee is prevented from working following termination.

Practical Difficulties

The greatest problem in enforcing a restriction post termination is the need to obtain evidence of the employee's breaches from valued clients and customers that the employee has tried to solicit their business or deal with them. Most businesses are reluctant to involve their clients in litigation and most clients, although initially willing to alert the business to the employee's activities, are extremely reluctant to become involved in any proceedings as witnesses to the alleged breaches. A difficulty for an employee is that litigation is extremely expensive and could potentially bankrupt a start up business. If the employee has moved to a competitor then

his new employer could be joined to any proceedings on the basis that they encouraged or induced the employee's breach of contract.

Garden Leave

The most effective method for preventing competitive activity is to put an employee on garden leave during their notice period- meaning that the contract continues in full force but the employee is not required to attend work (this can be expensive as the employee will still be entitled to be paid). To do so however, requires an express contractual clause. Any breach of the implied duty of fidelity or of express clauses in the employment contract would then be a disciplinary matter, a case of gross misconduct if sufficiently serious or the basis of a claim for damages against the employee.

Documentation to be reviewed

- Contracts of employment and employee handbooks.
- Monthly revenue figures for employees in a sales capacity to ensure that there is no unexplained dip in figures, indicating that the employee is not devoting his full time and attention to the business.

Key Points

- Contracts of employment should be reviewed once every one to two years to take account of legal developments.
- Breach of contract by an employer will invalidate the restrictions, e.g. failure to pay an employee his full notice pay. So an employer wishing to enforce restrictions should be careful not to breach an employee's contract and to pay all contractual entitlements on termination .

Summary

There are two lessons from the HISL case: first, make sure you listen to your employees when they have good ideas; and secondly, if you wish to prevent departing employees taking preparatory steps prior to leaving employment to ensure their future income, or competing with you after they have moved on, make sure your contracts of employment are properly drafted.

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