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UK ENFORCEABILITY OF NON-COMPETE CLAUSES

What you need to know

The UK Government recently announced proposals to limit the duration of non-compete clauses to three months. If implemented, the UK rules will only restrict the terms of non-compete clauses included in employment and worker contracts. They would not restrict the use of such clauses in other contracts (e.g. share purchase agreements, shareholders' agreements or management equity plans). This follows similar moves by the US FTC earlier in the year. However, the US rules are cast more broadly and may prohibit the application of non-compete clauses to any individual who works for an employer.

Action required

It may be helpful to review existing arrangements with key employees to confirm the extent of non-compliance with the new rules (and identify whether parallel restrictions – e.g. under a shareholders' agreement – may apply). Alternative routes – e.g. increased use of garden leave – may provide some protection, but thought should be given to knock-on consequences under other arrangements, such as vesting terms in management equity plans.

What next

It is unclear what the jurisdictional scope of the changes will be, and whether the changes will apply retrospectively or only to new contracts. If applied retrospectively, the implications for non-compliant terms in existing employment and worker contracts containing is unclear – will longer terms be enforceable for up to three months or will non-compliant terms be wholly void?

The implementation date for these proposals is yet to be confirmed – legislation will be introduced when parliamentary time allows.

Update: Restriction on duration of non-compete clauses in employment and 'worker' contracts

The UK Government recently announced that it would limit the length of non-compete clauses to three months. The proposals are intended to promote a more competitive economy by making it easier for individuals to start new businesses and find new work, and for businesses to fill vacancies and attract better candidates. The Government's announcement follows a similar, albeit more extensive, proposal announced by the US Federal Trade Commission earlier this year to ban non-compete clauses.

There are a number of key points which can be taken from information published by the Government to date:

- The restriction will only apply to employment and "worker" contracts; it will not extend to non-compete clauses used in wider workplace contracts such as partnership agreements and shareholders' agreements. In comparison, the FTC's proposals would apply to non-compete clauses imposed on any individual who works for an employer, including independent contractors, regardless of the context.

- The restriction does not appear to extend to non-compete clauses contained in deferred remuneration schemes (such as employee share plans or carried interest arrangements). In contrast, the FTC's proposals would apply to

share incentive schemes, save for a (limited) exemption on non-completes entered as part of the sale of a business for a seller who owns at least 25% of the company.

- If a non-compete clause does not exceed three months in duration, existing English law limitations on enforceability will still apply; in other words, the non-compete will be unenforceable unless shown to extend no further than is reasonably necessary to protect the employer's legitimate business interests.

- The restriction will not affect the ability of employers to use longer (paid) notice periods or gardening leave, or to use non-solicitation clauses or confidentiality clauses, to achieve similar protections. There is currently no suggestion that the UK rules will include a "functional test" (akin to that proposed by the FTC) to extend the three-month limit to provisions that have the effect of a non-compete.

Timeline and outstanding information

There are a number of matters which are still to be confirmed by the Government, including:

- When the proposals will be implemented and take effect. The Government has stated that necessary legislation will be introduced when "*parliamentary time allows*".

- Whether employers are expected to update their employment contracts which contain non-competes exceeding three months.

- Whether the changes will apply retrospectively to existing non-competes (as is the position under the FTC's proposals in the US) or only to new contracts, and whether existing non-competes with durations longer than three months will continue to be enforceable up to the limit or be void entirely.

- The territorial scope of the proposals and the implications for UK companies with operations in, or plans to enter, the US, and vice versa. Similar issues are still to be addressed by the FTC, so the way in which the two regimes will interact remains unclear.

- What the proposals mean for settlement agreements. It is not uncommon for employers to require a new or extended non-compete with an employee as part of an agreed exit (in return for an additional payment). Although not dealt with in the proposals so far, we would expect that the new three-month limit will apply to such non-competes.

Action required

If implemented, the UK proposals will have an impact on the extent of non-compete protection that firms can obtain from middle- and lower-tier management (as well as the broader workforce of UK employees). Their practical impact is, however, likely to be less significant in the context of senior managers and other participants in management equity plans who will often have agreed to separate non-compete clauses in relevant shareholders' agreements and management equity plan documentation.

It may nonetheless be sensible to take preparatory steps to identify high-value employees who may not be subject to limited, or no, non-compete protection once the new rules come into force.

Some further actions to consider include:

- As employers will still be able to make use of notice periods and garden leave to prevent employees joining a competitor, undertake a review of template contracts and existing arrangements with employees to ensure that they contain appropriate notice periods and include flexibility to use garden leave where necessary.

- Consider the effects of garden leave on other arrangements with employees – for example, checking that relevant equity or other incentive-based arrangements allow vesting to be stopped at the point an employee gives notice or ceases active service, rather than when employment ends (which could be 12 months later if an employee with a 12-month notice period is put on garden leave for the duration).

- Consider other routes to introduce non-competes, e.g. requiring management to acquire shares and acceded to shareholders' agreements or management equity plan documentation, and make sure that the restrictions in those agreements are as robust as possible.

- Review the leaver and malus/clawback provisions in applicable incentive schemes to ensure these clauses include breaches of other restrictive covenants.

- Ensure that management equity plans include sufficient flexibility to re-designate leavers as "bad leavers" for breach of restrictive covenants other than non-competes (e.g. non-solicitation restrictions and confidentiality obligations).

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