U.K. Supreme Court Clarifies Test for Trimming Non-Compete Clauses

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In its recent decision in Tillman v Egon Zehnder Ltd [2019] UKSC 32, the Supreme Court of the United Kingdom delivered an employer-friendly answer to a longstanding question about when courts should save non-compete clauses by severing unenforceable terms, known in the U.K. as ‘blue-pencilling.’ Indeed, by rejecting a narrow, century-old test regarding severance and clarifying the modern approach, Tillman increases the likelihood that U.K. courts will strike invalid terms to uphold otherwise valid non-competes. As we explain below, however, Tillman does not give employers free rein to draft overly restrictive non-competes.

Background

Under U.K. law, restrictive covenants are an unlawful restraint of trade unless they go no further than is reasonably necessary to protect an employer’s legitimate proprietary interests. Tracing this doctrine’s evolution through centuries of cases involving dyers, bakers, gun-makers, and Wayne Rooney, Tillman observes it is “one of the earliest products of the common law” and “epitomises the nation which developed it: a nation which has ascribed central importance to the freedom of all of us to work.” Tillman [2019] UKSC 32 at [22].

U.K. courts have been split, however, over how to deal with a non-compete upon finding one of its terms to be unlawful. Following the century-old test adopted in Attwood v Lamont [1920] 3 K.B. 571, some courts have held severance is appropriate only where the offending term is (1) a standalone covenant, rather than part and parcel of a larger covenant; and (2) trivial or technical. See Tillman [2019] UKSC 32 at [80]. In contrast, courts more recently have found it appropriate to cut unenforceable parts of a covenant where doing so does not (1) create a need to supplement or modify the remaining wording (the “blue-pencil test”); (2) strip the remaining terms of adequate consideration; or (3) “so change the character of the contract that it becomes not the sort of contract that the parties entered into at all.” Id. at [73]-[74], [84]-[87].

Case Summary

The claimant joined Egon Zehnder in 2004 as a highly paid financial services consultant. Id. at [5]. At the time, she signed a non-compete containing five restraints on the six-month period following her termination. Id. Specifically, the plaintiff agreed not to “endeavour to entice away from the Company” employees in specified senior positions; solicit or deal with specified service suppliers; interfere with suppliers to the company; use a name likely to be confused with a company name; or to “directly or
indirectly engage or be concerned **or interested** in any business carried on in competition with any of the businesses of the Company[.].” *Id.* at [6]-[8] (emphasis added).

In 2017, after the plaintiff had been promoted to joint global head of Egon Zehnder’s financial services practice, she separated from the company and gave notice that she planned to take a job with a competitor. *Id.* at [11]. The company sought an injunction to enforce the non-compete. *Id.* at [12]. The plaintiff argued that the non-compete exceeded the company’s need to protect its legitimate proprietary interests because the words “or interested” would bar her from holding even a minority stake in a competitor’s business. *Id.* at [15]. The company, in turn, contended that even if the term was unlawful, the court should sever it in order to save the non-compete. *Id.*

The High Court/trial court held that the non-compete did not prohibit the plaintiff from holding shares in competing companies, and thus had no reason to address the question of severance. *Id.* at [16]. The Court of Appeal not only reversed the trial court’s decision, but also rejected the company’s contention that it should simply cut “or interested” from the non-compete and uphold the agreement on its remaining terms. *Id.* at [17].

On appeal, the Justices of the Supreme Court unanimously held that the non-compete, as drafted, was an unenforceable restraint of trade; but that severance of the offending term was appropriate because it could be accomplished without changing the agreement’s overall effect.

At the outset, the court held that the “or interested” language unlawfully purported to bar the plaintiff from holding any amount of shares in a competing business. *Id.* at [53].

Turning to the question of severance, the court expressly rejected “both of the requirements which were shoe-horned into the law by the *Attwood* case[,]” which the court observed had proved “instantly controversial and ultimately unsatisfactory.” *Id.* at [83].

The court then assessed the three criteria endorsed in more recent cases. As to the first—the blue-pencil test—the court noted that although application of the test could be capricious, it is “an appropriate brake on the ability of employers to secure severance of . . . unreasonable restraint[s]” that employers customarily write themselves. *Id.* at [85]. In other words, the test discourages employers who would look to the courts to save them when an overbroad or poorly drafted contract is challenged. The court reasoned, “[w]here it ever to be thought appropriate” for courts to rewrite restraints to make them lawful, “it surely would have to be achieved by legislation” such as that passed in New Zealand. *Id.* As to the second criterion—whether adequate consideration supports the remaining terms—the court noted that unusual circumstances produced the requirement and that “[i]n the usual situation the second requirement can be ignored.” *Id.* at [86]. Finally, the court opined that the third requirement—the effect of severance on the contract’s character—is the “crucial criterion.” *Id.* at [87]. However, in the court’s view, this “criterion would be better expressed as being whether removal of the provision would not generate any major change in the overall effect of all the post-employment restraints in the contract.” *Id.* Applying the first and third criteria to the facts before it, the court held that the words “or interested” should be severed, as doing so would not require adding to or modifying the remaining wording or work a major change on the overall effect of the non-compete. *Id.* at [88].
Practical Implications and Recommendations

There is no question that Tillman improves U.K. employers’ chances of enforcing a non-compete against a departing employee. However, for four primary reasons, employers should continue to carefully draft the terms of non-competes to avoid arguments over whether to sever.

1. First, it still is the employer’s burden to prove that severance would not significantly change the effect of a non-compete. See id. at [87].

2. Second, Tillman confirms that employers cannot look to the courts to rewrite problematic contracts such that they are enforceable. Thus, where a non-compete contains potentially overbroad terms, employers should pay special attention to whether those terms can be cut without the need to add to or otherwise change the contract’s wording.

3. Third, and critically, Tillman makes clear that courts considering severance must continue to exercise caution. High-ranking employees like the plaintiff, the court noted, are well-positioned to "look after" themselves in negotiating a non-compete agreement. Id. at [82]. In contrast, the court warned, most prospective employees are incapable of declining the terms commonly found in non-competes, and even less capable, following separation, “to defend a claim that they are in breach of them.” Id. Accordingly, employers should carefully consider whether the terms contained in non-compete agreements with their rank-and-file employees are necessary and defensible.

4. Lastly, as the final paragraph of the judgment makes clear, an employer may face a ‘sting in the tail’ proverbially speaking, if they take an employee to court to enforce an overly broad post-termination restriction and win the day, only to be penalized when seeking to recover their legal costs. See id. at [92].

Therefore, for all of the reasons stated above, we have long recommended that when drafting a non-compete restriction, employers should expressly exclude any minor shareholdings held by the employee as an investment.

We are available to discuss Tillman and its potential consequences at your convenience.

If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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