

Sharpening the Blue Pencil – Can a Court Rewrite a Non-Compete Restriction?

Speed Read

In the recent UK Supreme Court case of *Tillman v Egon Zehnder Ltd*, the Court decided to amend the wording of a non-compete restriction. It deleted words which it regarded as both unenforceable and severable from the overall restriction. The decision is interesting because it looks in detail at the so-called 'blue pencil' test. The key points from the judgment are:

- The doctrine of severability permits a court to sever or delete words from a post termination restriction but it must exercise caution in doing so;
- The unenforceable provision should be capable of being removed without the necessity of adding to or modifying the wording of what remains (the 'blue pencil' test);
- The deletion of the unenforceable part of the restriction must not change the character of the restriction so that it becomes something other than what the parties intended to agree upon;
- The deletion should not generate any major change to the overall legal effect of all of the post termination restraints in the contract;

- The Court clarified that a restriction on holding an 'interest' in a competing business includes having a passive shareholding. It noted that this is a restriction which is also void as being in restraint of trade unless it is reasonable and proportionate;
- Employers are reminded that that the Courts view non-compete restrictions as void and unenforceable because they are in restraint of trade unless the restriction is demonstrated to be reasonable; and
- A judgment of the UK Supreme Court is of significant persuasive authority before the Irish Courts and is therefore a significant decision for Irish employers.

Background

Egon Zehnder Limited recruited Ms. Tillman from JP Morgan. She was employed in the company's financial services practice area initially as a consultant but with successive promotions she became a partner and then joint global head of the financial services practice.

A condition of Ms. Tillman becoming a partner was that she would hold shares in the company's Swiss holding company. Furthermore, her employment contract permitted her to:

"hold or have an interest in, for investment only, shares... in a publicly quoted company...."

Ms. Tillman's employment contract included a relatively standard non-compete in terms that she would not for the six month period immediately following her termination of employment:

"...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 resigned from the company and later informed them that she would be moving to a competitor three months after the termination of her employment. This was an apparent breach of her six month post termination non-compete restriction. The employer successfully secured an injunction restraining Ms. Tillman from taking up employment with the competitor but that was reversed on appeal. The matter then came before the Supreme Court on appeal by the employer.

Ms. Tillman argued that the non-compete restriction in her employment contract was unenforceable because it included a reference to being prohibited from being 'interested' in any competitor business. Ms. Tillman argued that 'interested' meant having a passive shareholding which was elsewhere permitted by her employment contract during her employment with the company. In other words, (i) it was unreasonable for the company to attempt to prevent her holding a passive shareholding in any company when that was permitted during her employment; and (ii) because of this unreasonableness the whole of the non-compete restriction was unlawful and unenforceable.

The company argued that, if Ms. Tillman was correct, then the words 'or interested' should simply be deleted from the drafting by the Court and the remainder of the clause would then be enforceable. In effect, Egon Zehnder applied to the Court to use its blue pencil to give effect to the enforceable parts of the restriction.

So who was correct?

The Court accepted the employer's argument that the words 'or interested' should be deleted from the clause and that the remaining non-compete be enforced.

The Court noted that it was common to see the following wording in modern drafted non-competes: *"...directly or indirectly engage or be concerned or interested in any business...."* The Court found that 'concerned' meant an active participation in a company and that 'interested' meant a passive relationship with a company, for example, a shareholding.

It decided that the inclusion of 'interested' in the relevant non-compete in this case was unreasonable, including because the employment contract elsewhere provided that Ms. Tillman could have a shareholding in publicly quoted companies during her employment.

The Court applied the doctrine of severability to Ms. Tillman's non-compete restriction based on the facts. However it made clear that the Courts must continue to adopt a cautious approach to the amending of post-termination restrictions.

The power to amend a covenant (the doctrine of severability) applies and can be invoked but strictly subject to the following criteria:

- The Court must exercise caution in doing so;
- The unenforceable provisions or wording should be capable of being removed

without the necessity of adding to or modifying the wording of what remains (the 'blue pencil' test);

- The deletion of the unenforceable part of the restriction must not change the character of the restriction so that it becomes something other than what the parties intended to agree upon;
- Rewriting should be confined to clearly severable language;
- The deletion should not generate any major change to the overall legal effect of all of the post termination restraints in the contract; and
- The employer bears the burden of proof to show that deleting language will not change the legal effect of the restriction.

What are the key takeaways?

- It is clear from the detailed review of the doctrine of severability in this decision that the Courts will deploy the blue pencil test occasionally to delete wording which would otherwise render an entire restriction unenforceable.
- But, the Courts will not interfere with the legal effect of the clause. For example, it is commonly argued by employers that if the Court is unhappy with the duration of the restriction or if its geographical scope is deemed unreasonably wide, the Court should be allowed to vary these components to make it enforceable. The Tillman decision is a stark reminder that the Courts are very reluctant to do so and will limit their intervention to striking out wording which is clearly capable of being purged from the clause without interfering with the intended meaning of the clause.

- The Court said *"it is inherent in the word "severance" itself, which means cutting things up and does not extend to adding things in"*.
- The Court described the blue pencil test as *"a significant brake"* and an *"appropriate brake"* on the ability of employers to appeal to the Courts to re-write the restrictions that they have likely insisted on imposing on employees.
- The Court acknowledged that certain senior employees may be able to negotiate on an equal footing with employers in relation to post termination restrictions. However, in the majority of situations, the employee is unable to refuse to accept the restrictions and is in effect saddled with the post termination restrictions from the beginning of the employment relationship.
- While this is a decision of the UK Supreme Court, it is of significant persuasive authority. The Irish Courts have applied the doctrine of severability sparingly but this decision is significant in terms of clarifying the circumstances in which the Courts will intervene to sever language.

Tips for Employers

- Post termination restrictions must be tailored to individuals and their individual role, seniority and their ability to damage the employer on departure;
- The Courts will not use the doctrine of severability to substitute a more reasonable geographic scope, to amend the duration of the restrictions or to otherwise vary the legal effect of the restrictions;

- Boilerplate post termination restrictions are vulnerable to challenge because what works to protect the business in respect of one employee will not necessarily function in respect of a different employee with a different role and a different risk profile;
- Reviews of post termination restrictions should take place not just on hiring an employee but also on any significant promotion of an existing employee to a more senior role; and
- Focus on prevention by ensuring that there is an appropriate definition of confidential information in the contract and policies and also ensure that there are robust policies and practices around information security in your business. It is important to prevent leakage and theft of confidential information and company assets in the first place which could then

facilitate a departing employee competing with the former employer in breach of their restrictions.

Further Information

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