SUMMARY

# 2014/48 Court should not add new words to a clearly drafted restrictive covenant (UK)

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**Summary**

The Court of Appeal has overturned a decision of the High Court to add words into a non-competition covenant in an employee's contract so that it could be enforced by the employer. Where the meaning of a restriction is clear a court should not interpret it by adding additional words, even if this means the covenant will not be enforceable.

**Background**

In the UK, the legality of restrictive covenants seeking to prevent employees from carrying out certain activities after their employment has ended is governed by the common law rather than statute. Contractual terms which prevent an ex-employee from dealing with certain customers, working in certain areas or working for competitors are potentially void for being in restraint of trade and contrary to public policy.

A clause of this nature will only be enforceable if the employer can show that it has a legitimate interest it is seeking to protect and that the restriction itself extends no further than is reasonable, having regard to the interests of the parties and the public interest. In essence, the narrower the restriction, the more likely it is to be enforceable. This means employers will

usually try to ensure that the wording of a restrictive covenant goes no further than necessary, by limiting matters such as the time for which the restriction lasts and the activities covered. If a covenant is too wide, the courts will not re-write it to make it enforceable.

**Facts**

Prophet plc was a software developer operating in the fresh produce industry. The company sought to enforce a non-competition covenant against its sales manager, Mr Huggett, when he left the business to join a competitor.

The covenant in question prevented Mr Huggett from being involved with any business which competed with Prophet by providing computer software systems to the fresh produce industry, for a period of 12 months after the end of his employment. However, this restriction only applied "*in any area and in connection with any products in, or on, which [the employee] was involved whilst employed hereunder*".

This wording caused Prophet a potential problem. The nature of the business meant that its software products were unique, so a competitor would never be involved with selling the same products as Mr Huggett had been involved with at Prophet. They might be similar and competing products, but they would be different ones. The wording only appeared to stop Mr Huggett from working with Prophet's products after he left their employment. This suggested the covenant did not protect Prophet at all, as he was free to work for the competitor without being in breach of his contract.

Nonetheless, Prophet applied to the High Court to obtain an injunction preventing Mr Huggett from working for his new employer or any other competitor for 12 months.

**High Court Judgment**

The High Court agreed that the wording of the covenant was problematic for Prophet. Read literally, it would provide the company with no protection at all, because no competitor would be involved with supplying Prophet's products.

However, the High Court felt that this did not reflect the parties' intentions at the time when they agreed the contract and there had effectively been a drafting error. The judge decided that he could correct this error by adding the words "or similar thereto" to the end of the clause. This would mean the clause reflected the probable true intention of the parties and was the minimum change necessary to produce a commercially sensible result.

Mr Huggett appealed to the Court of Appeal against this decision.

**Court of Appeal Judgment**

The Court of Appeal recognised that, if a clause was ambiguous, the courts should interpret it in such a way as to produce a commercially sensible solution. However, in this case, the meaning of the clause was clear. The natural meaning of the words "any products" could only mean the Prophet products with which Mr Huggett had been involved when he worked there.

The Court recognised that the person who drafted the covenant may not have thought through the extent to which the wording would be likely to achieve any practical benefit to Prophet, but nothing had "gone wrong" with the drafting. There had been no basis for the judge to add words to the clause to make it commercially effective: "*It was not for the judge nor is it for this court to remake the parties'…bargain. Prophet made its…bed and it must now lie upon it*".

The Court therefore allowed Mr Huggett's appeal and held that the covenant was void for restraint of trade and unenforceable.

**Commentary**

The High Court's decision in this case prompted surprised reactions and criticism from commentators. Although there had been previous cases in which courts had interpreted ambiguous wording in an employer's favour, it was highly unusual to add words to a clause that on the face of it was drafted quite clearly. The Court of Appeal's ruling therefore restores the legal status quo, making clear that courts should only interpret restrictive covenants in a commercially effective way if they are drafted ambiguously. Where the wording is clear, the employer will be stuck with the clause even if it fails to achieve what was really intended.

Unfortunately for Prophet, its attempt to draft Mr Huggett's non-competition restriction so that it was enforceable went too far. It avoided having a clause that was too wide to be enforceable, but ended up with wording so narrow that it was unlikely to be of any practical use.

Accordingly, employers need to think carefully about the precise wording of restrictive covenants included in employees' contracts to ensure it achieves their objectives. The restriction should be drafted as narrowly as possible to minimise the risk it will be unenforceable as being in restraint of trade, but not to the extent that it defeats the employer's primary purpose.

**Comments from other jurisdictions**

*Austria (Martin Risak)*: In Austria the use of restrictive covenants is regulated by law (§ 36 Act

on White-Collar Workers, *Angestelltengesetz* and § 2c Act to Adapt Employment Contract Law, *Arbeitsvertragsrechtsanpassungsgesetz*). The law forbids restrictive covenants made with minors and otherwise provides that the restraint cannot last for more than one year after the end of the employment relationship. Only activities in the previous employer's line of business can be forbidden to employees. In addition, restrictive covenants are only valid if the employee's wages exceed € 2,567. Finally, in respect of the type of activity, the time period and geographical area in relation to the employer's business interests, the agreement may not unreasonably impede an employee's advancement (e.g. a ban on subsequent activities, irrespective of location). Further, the employer may not be able to enforce a restrictive covenant if the circumstances leading to the termination of employment were caused by the employer. For example, this would be the case if the employer delayed in paying remuneration or terminated the employment without just cause, though in the latter case the employer may still use the restrictive covenant if it is willing to carry on paying the former employee for the period of the restrictive covenant.

If, as is often the case, a contractual penalty has been agreed in order to ensure the restrait is observed, the employer may only demand payment of the penalty. There is no complementary right to contractual performance. The agreed penalty may also be reduced in court based on the principle of equity.

When it comes to interpreting restrictive covenants the general principles for interpreting contracts apply. According to § 914 Civil Code, an ambiguous statement made by one party must be interpreted to the detriment of the party who relies on it. As it is generally the employer who drafts the clause, restrictive covenants are usually interpreted restrictively. However, the courts tend to assume that parties do not agree clauses that have no legal effect and therefore will reformulate them in a way that leaves at least some room for application.

*The Netherlands (Peter Vas Nunes)*: I feel sorry for Prophet. A Dutch court would have ruled in its favour.

Under Dutch law, agreements are interpreted purposively, even where they are not ambiguous (although ambiguity and the level thereof do play an important rule). Although the courts can and frequently do strike down or water down restrictive covenants that are unreasonable, they reject the argument that such covenants should be construed restrictively rather than purposively if that is detrimental to the (former) employee. Personally, I advise employers to limit the scope of restrictive covenants in order to increase their enforceability, by:

limiting them in time (12 months is most common, but in many instances six months is

sufficient);
where appropriate, limiting them in geographical scope;
limiting them in terms of what the former employee may not do, where possible specifying the prohibited competitors.

Additionally, I sometimes add a clause entitling the former employee to compensation (e.g. 50% of last-earned salary) for each month that the covenant is likely to prevent him or her from accepting switchable alternative employment, even though this is not required by law.

*Subject: Contracts of employment; restrictive covenants*

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