PERSPECTIVES

PROTECTING THE CROWN JEWELS: THE USE OF RESTRICTIVE COVENANTS AND CONFIDENTIAL INFORMATION PROVISIONS GLOBALLY

BY **MATTHEW HOWSE AND SARAH STOCK**
> MORGAN LEWIS

As globalisation and employee mobility continue to increase, we are frequently asked by employers whether a non-compete or other restrictive covenants (such as a covenant against the non-solicitation of customers or employees) is enforceable in a particular jurisdiction.

The issue arises in a variety of contexts, including when a company is considering hiring a candidate whose employment contract includes restrictive covenants, whether to include restrictive covenants in an executive employment contract or other employment agreement (such as a share or bonus plan) and, increasingly as the economic situation improves, whether a non-compete or other restrictive covenant can be enforced against a departing employee. As the war for talent increases, many employers understandably wish to protect themselves against the risk that their employees

will – after building valuable relationships with customers or having access to the employer's confidential information and intellectual property – go to work for a competitor.

The first step for many employers is to ensure that employees are not tempted to leave by keeping them motivated and appropriately remunerated. In addition, however, most employers will also adopt defensive measures – such as contractual confidentiality provisions and restrictive covenants – to protect their business.

A global form of restrictive covenant?

Multinational employers like to have documents and policies that are consistent and similar in all of the countries where they operate so as to reduce the administrative burden and to foster a common culture and approach. Accordingly, such employers are often tempted to roll-out globally the form of restrictive covenant and confidential information provisions that are used in the 'home' jurisdiction. While such an approach meets the desired aim of consistency and can have a deterrent effect on employees, such an approach is very risky from an enforcement perspective.

The reason for this is that the enforceability of restrictive covenants usually depends on the law of the jurisdiction where the employee works. Restrictive covenant enforceability standards vary widely from country to country, as every jurisdiction seeks to balance the competing interests of an employee's right to work and an employer's right to protect its business interests. With each jurisdiction balancing these interests in its own particular way, a multinational employer has to accept that a 'global' non-compete will be unenforceable in many jurisdictions as it will encounter a wide variation of restrictive covenant enforceability standards across its worldwide operations.

Accordingly, the best approach for an employer that wishes to impose restrictive covenants that are likely to be enforceable on its employees is to have carefully drafted restrictions for each separate jurisdiction. Because enforceability rules differ markedly across jurisdictions, standard restrictive covenant provisions that are perfectly appropriate for one place will not necessarily be enforceable even within a geographical region.

Common threads

That said, there are common themes across jurisdictions and regions. In most countries, an employer looking to enforce restrictive covenants will need to show that they are seeking to protect legitimate business interests such as customers, employees and confidential information. Similarly, the duration of the restriction is an important consideration, although what is considered reasonable and therefore permissible varies widely from jurisdiction to jurisdiction. Another important factor is whether payment is required for duration of restriction.

A multinational employer should start by analysing whether the proposed restriction is enforceable at all in the relevant jurisdiction. For example, in a number of jurisdictions, non-competes in an employment context are void. As a general principle, even in jurisdictions where non-competes are permissible, the courts will more readily enforce non-solicitation of customers covenant than a pure non-compete. Even if a particular type of restriction is capable of being enforceable in a certain jurisdiction, it is important to ensure that it is tailored to the relevant type of business or industry and to the type of employee. In very few, if any, jurisdictions will one form of restrictive covenant be suitable for all employees. A restrictive covenant suitable for an executive is unlikely to be enforceable against a more junior employee.

Garden leave as an alternative?

Some employers are looking to use a technique that has become common in the UK to sidestep restrictive covenant enforceability barriers.

Restrictive covenants are designed to apply after the employee's employment has terminated. The technique – known as 'garden leave' – effectively converts post-termination restrictions into 'during-employment' restrictions. This involves keeping the employee employed and continuing to provide pay and benefits from but excusing the employee from their work duties and responsibilities for the proscribed period which thereby allows the employee time to spend in his garden. As the employee remains employed, the employer can forbid them from competing, soliciting or contacting customers and fellow employees and stop their access to confidential information.

In the UK and some other countries which have notice periods in the employment contract, the garden leave period equates to the employee's notice period. In the US, it is a period equivalent to the non-compete period after what would otherwise have been the employee's separation date. The theory behind garden leave is that the courts in many jurisdictions look more favourably on restrictions during employment than after and that garden leave therefore simplifies restrictive covenant enforcement. The clear downside, however, is that it is expensive – the employer has to continue to provide salary and benefits for the garden leave period but gets no work in return.

A quick world tour

As we discuss above, the law on restrictive covenants varies from country to country but it is possible to highlight in very broad terms the key issues in various regions.

"It is clear that restrictive covenants are a vital tool for multinational employers in a world where employee mobility gathers pace."

Europe. In most European jurisdictions, restrictive covenants are considered to be a restraint of trade unless they are considered reasonable in the circumstances. To assess reasonableness, a four-stage test is usually applied and a restrictive covenant will only be enforceable if it is: (i) limited in geographic scope; (ii) limited in duration although the permissible duration varies from country to country; (iii) seeks to protect a legitimate business interest such as confidential information or customer connection; and (iv) ongoing compensation is paid during the restricted period. The amount of compensation required, however, varies among

countries and is not necessary at all in the UK or Switzerland.

Asia. In most Asian countries, post-termination restrictions are typically enforceable provided they are reasonable. The reasonableness considerations are similar to those applied in Europe. Ongoing compensation during the restricted period is typically not required in most Asian countries although compensation of between 20-60 percent of the employee's salary is required in most Chinese provinces. What is considered a reasonable duration for a restrictive covenant varies so that, for example, in Singapore a restricted period of one year may be enforceable but only three months would be considered reasonable in Hong Kong.

Latin America. In Latin America, there are wide differences in approach to restrictive covenants from country to country. For example, non-compete covenants are likely to be enforceable in Argentina, Peru and Venezuela if they are restricted in time and the employee receives reasonable consideration for temporarily waiving his or constitutional right to work but are void in Mexico, Chile and Colombia. Although non-competition and non-solicitation covenants are becoming more common in Brazil, they are not regulated expressly by the Labor Law. Brazilian case law has held that non-compete clauses can be valid for up to 24 months provided that the employee is reasonably indemnified (at least 50 percent of the last monthly salary) for the non-compete period.

Middle East. In Saudi Arabia, restrictive covenants (including non-competes) are enforceable up to two years in duration and there is no need for payment of compensation. In the UAE injunctive relief is unobtainable from UAE courts, so restrictive covenants are of little use, although it is possible to use Ministry of Labour administrative processes to prevent an employee from working. If the business operates in the DIFC or other free zones, restrictive covenants can be enforced in the DIFC and other free zone courts.

United States. The law on restrictive covenants is a matter of state, not federal, law. Restrictive covenants are liberally enforced in some states but are considered void in some other states such as California. Most states recognise as valid and will enforce a covenant not to compete, solicit or deal, provided that the covenant is: (i) supported by adequate consideration; (ii) necessary to protect a legitimate business interest such as trade secrets or customer connection; and (iii) reasonable in time, subject matter and geography. There is generally no requirement to pay an employee while they are subject to a restrictive covenant.

Conclusion

It is clear that restrictive covenants are a vital tool for multinational employers in a world where employee mobility gathers pace. But an employer seeking to draft enforceable restrictive covenants across national boundaries will have to be willing

to accept that this is an area of law which does not allow for a common approach. The large variation among jurisdictions regarding the enforceability of restrictive covenants means that a multinational employer will confront a wide variety of restrictive covenant enforceability standards. The most practical strategy is to draft restrictive covenants to conform to the various jurisdictions in which it operates. The employer should focus on where its employees are actually working as this is where it will likely want to be enforcing the restrictive covenants. CD

Matthew Howse
Partner
Morgan Lewis
T: +44 (0)20 3201 5670
E: mhowse@morganlewis.com

Sarah Stock
Associate
Morgan Lewis
T: +44 (0)20 3201 5557
E: sstock@morganlewis.com