



Law Society
of Scotland

Consultation Response

Non-Compete Clauses

February 2021



Introduction

The Law Society of Scotland is the professional body for over 12,000 Scottish solicitors.

We are a regulator that sets and enforces standards for the solicitor profession which helps people in need and supports business in Scotland, the UK and overseas. We support solicitors and drive change to ensure Scotland has a strong, successful and diverse legal profession. We represent our members and wider society when speaking out on human rights and the rule of law. We also seek to influence changes to legislation and the operation of our justice system as part of our work towards a fairer and more just society.

Our Employment Law sub-committee welcomes the opportunity to consider and respond to the Department for Business, Energy and Industrial Strategy consultation on measures to reform post termination non-compete clauses in contracts of employment.¹ The sub-committee has the following comments to put forward for consideration.

General Comments

General observations

The consultation proposal document states that the law applicable to non-compete clauses is part of English common law. Whilst it is acknowledged that the proposal is to create a UK statutory framework for non-compete clauses, it is important to note that Scotland is subject to its own civil jurisdiction and that there are in fact some key differences between the current law relating to restrictive covenants in Scotland and that of England & Wales, which are noted below.

There are also of course significant differences between the two jurisdictions as concerns the enforcement of restrictive covenants given that Scotland has its own civil court procedures.

Consideration - A key difference between Scottish law and English law is that Scots law does not require consideration for restrictive covenants to be valid as a matter of contract law. How that then interacts with a proposed requirement to compensate an individual for the duration of any non-compete clause (Option 1) in Scotland is unclear.

Mutuality of obligation - There are also some differences between Scottish and English law as concerns mutuality of obligation.

Mutuality of obligation is considered to be of fundamental importance in Scots contract law and it requires contractual obligations to be reciprocal. In Scotland, employers are therefore often warned about the danger of terminating contracts of employment in breach of contract as this may then release the employee

¹ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/941110/non-compete-consultation-document.pdf

from any term of the contract that is intended to survive termination, as is the accepted position in English case law. That being said, there have been varying interpretations of the extent of the doctrine in recent Scottish case law, with some cases adopting a narrower approach to mutuality of obligation, such that it is by no means the definitive, accepted position that in the context of employment contracts a restrictive covenant and termination provisions would always be viewed as reciprocal.

Potential consequences of compensation/ban

Requiring payment of compensation for non-compete clauses or indeed banning non-compete clauses altogether is likely to lead to greater reliance on notice and/or garden leave provisions to achieve a similar outcome for the employer. This could in turn lead to a potential skills atrophy for the employee.

This may also result in a greater reliance on non-solicitation and non-dealing provisions in contracts. These would of course still be subject to the reasonableness test but employers may seek to expand their scope.

When investing in companies, often the value of the investment lies to a large extent in the particular skills and experience of key individuals in the business. If therefore the purpose of the proposals is to encourage investment in UK businesses, it should be considered whether investors will be prepared to make the desired investment without the protection offered by restrictive covenants, and in particular non-compete clauses, in terms of discouraging those key individuals from leaving and taking the value of their skills and experience with them.

Post-Brexit, this may also push businesses to shift operations away from the U.K. Businesses employing highly skilled employees could, for example, relocate to Ireland where there is no consideration requirement (unless a standalone restrictive covenant document outwith the employment contract) and no compensation requirement.

Our general view therefore is that more thought should be given to the detail and unintended consequences of the proposals, with particular consideration of the context in which these situations arise.

Consultation Questions

1. Do you think the Government should only consider requiring compensation for non-compete clauses or do you think the Government should consider requiring compensation where other restrictive covenants are used? Please indicate below.

In our view, if it is to be considered at all, compensation should be considered for non-compete clauses only. Non-compete clauses represent the greatest uncertainty and greatest restriction of trade. It is unlikely that a non-solicitation or non-dealing restriction would significantly impact on an individual's ability to find work or prevent them from setting up their own business.

We would note however the existence of restrictions that are not non-compete restrictions in the traditional sense, but operate to restrict team moves. Under these covenants, employees are prevented from working with their former team members at a new employer or in a new venture. We note that these do not appear to be covered by the proposals in the consultation.

2. If you answered 'non-complete clauses and other restrictive covenants', please explain which other restrictive covenants and why.

N/A

3. Do you foresee any unintended consequences of limiting the scope of reform to non-compete clauses? If yes, please explain your answer.

No, although in relation to the potential consequences of reforming non-compete clauses in general, please see general observations noted above.

4. Do you agree with the approach to apply the requirement for compensation to contracts of employment?

We note that the requirement for compensation has the potential to provide for greater certainty in the law. At the moment there is arguably a lack of certainty as concerns, for example, the enforceability of restrictive covenants.

Furthermore, in reality most employees are not in a position to negotiate these provisions at the start of employment and it represents a significant cost to the employee to legally challenge the enforceability of a restriction thereafter.

Consideration should perhaps also be given the principle of freedom of contract, however it is worth noting that the law has moved quite far from that in many other areas, such as discrimination, unfair dismissal and working time, for example.

Ultimately, whilst businesses want certainty, non-compete restrictions also have a direct and very real impact on the individual. The payment of compensation arguably represents a sensible compromise between employer and employee interests.

The details of the potential statutory framework and implementation will however be critical. For example, where will the employee be required to raise a claim if the required compensation is not paid? Presumably the Employment Tribunal should be given jurisdiction, at least in part due to costs to the employee.

5. Do you think the Government should consider applying the requirement for compensation to wider workplace contracts?

Restrictive covenant provisions are of course also found in other types of contracts besides employment contracts, such as partnership agreements, LLP agreements, and shareholder agreements.

Whilst we recognise that there are fundamental differences between employment contracts and those other types of contracts, for example in that there is more likely to be a power imbalance in relation to employment contracts, any commentary on the application of a requirement to pay compensation to a broader range of contracts requires a wider analysis of those types of contracts and the applicable body of caselaw in each case, which is outwith the scope of this consultation.

6. Do you think the proposed reform to non-compete clauses in contracts of employment could have an impact on the use of, and/or the enforceability of, noncompete clauses in wider contract law? If yes, please explain how and why.

If the proposals are implemented in relation to employment contracts only, this may create anomalies where other restrictions also apply. For example, an employee may be both an employee and a shareholder at the same time and therefore a party to both an employment contract and a shareholder agreement. If the proposals under Option 1 intend to cover both types of contract, businesses may then require to make consideration for the same type of protection under two separate agreements. On the other hand, if the proposals only apply to employment contracts, then for those individuals who are party to both types of agreement, they may still end up subject to restrictions through the use of restrictive covenants in their shareholder agreement for example, even though they are not subject to those restrictions as an employee. The end result may therefore be the same and the purpose of the proposals defeated.

It is arguably more likely that employers may seek to use non-compete provisions in those other types of contract more often in the event the proposals are implemented. However, a non-compete provision in a Share Options Agreement, for example, is less likely to prevent the employee from going to work for another business.

It is also worth noting that these types of contracts (eg share options) are likely to only apply to those employees at the top end of employment relationships – ie those who are in high-earning, high-responsibility roles. This is likely to be less of an issue for lower to mid-level employees.

If the proposals are implemented, this may ultimately force employers to carefully consider whether they really need post-termination restrictions in individual contracts, rather than inserting them as a standard approach.

7. Please indicate the level of compensation you think would be appropriate:

The level of compensation should be at a level that provides the employee with sufficient means, but equally careful consideration should be given as whether a level as high as 100% achieves the purpose of the proposal as employers may well consider in those circumstances to simply have longer periods of notice or garden leave.

Many other jurisdictions have imposed levels of compensation around the 50% mark.

Consideration should also be given as to what exactly is meant by weekly earnings. For example, should this include the employee's annual bonus, and what reference period is to be used? Again, careful thought needs to be given to the detail and implementation of any proposal.

8. Do you think an employer should have the flexibility to unilaterally waive a noncomplete clause or do you think that waiving a non-compete clause should be by agreement between the employer and the employee? Please indicate your answer below.

We would make the following observations:

A drawback for the employee, if the decision was employer only is that it may put the employee off seeking a new job or starting a new business even in circumstances where the employer may never intend to actually enforce the non-compete provision.

There is also the principle of contract to consider as to whether it is valid for the employer to have the sole right to unilaterally waive a provision that potentially benefits both parties.

On the other hand, there is some benefit of clarity once the waiver has been exercised and in such an event, the employee is free to find alternative employment or set up their own business without fear of the restriction being enforced by the employer.

In any event, any compensation should be front-loaded at the outset of the contract.

9. Do you agree with this approach? If not, why not?

See above.

10. How long do you think the time period within which the employer must waive the restriction before the termination of employment should be?

It is not entirely clear how a waiver prior to termination of employment would operate in practice. It seems unlikely that an employer would be considering the application of the restriction if it had not already made a decision to dismiss the employee.

We would suggest that any waiver, if implemented, should only be permitted once notice to terminate the employment has been given. It may be appropriate to allow a mechanism for the employer to then serve notice of waiver of the restriction, but further thought should be given as to the appropriate length of this notice.

Questions 11-17

As these questions are specifically for employers, we do not have any comments.

18. Would you support this measure to improve transparency around non-compete clauses? If not, please explain why not.

We note that whilst the proposed measure will potentially give greater certainty in this area of law, the alternative argument is that it does interfere with the doctrine of privity of contract. Careful consideration as to the benefits and potential consequences of such a measure should therefore be given.

19. Have you ever been subject to a non-compete clause as an employee or limb(b) worker? If yes, were you aware of the non-compete clause before you accepted the offer of employment?

As these questions are specifically for employees, we do not have any comments.

20. Has a non-compete clause ever prevented you from taking up new employment in the past and/or prevented you from starting your own business? Please explain your answer.

As these questions are specifically for employees, we do not have any comments.

21. Do you have any other suggestions for improving transparency around noncompete clauses?

Potential options to consider could be a requirement for employers to review restrictive covenants on an annual basis to ensure that they remain relevant to the employee and their role, or a requirement for employers to set out a list of competitor companies. However, the implementation of such a measure in practice may be difficult to monitor. Also, if an annual review of employee restrictive covenants is either required or recommended, this presents challenges for smaller employers.

A further point for consideration might be to provide the employee with a cooling off period in which they can raise questions about or challenge a restriction, following commencement of the employment relationship. For example, this could potentially align with confirmation of probation.

22. Would you support the inclusion of a maximum limit on the period of noncompete clauses?

We would support a maximum limit on the period of non-compete clauses, on the assumption that the existing tests for enforceability still applied, within that limit.

23. If the Government were to proceed by introducing a maximum limit on the period of non-compete clauses, what would be your preferred limit?

We consider that a maximum limit of either 12 or 18 months would be preferable. This should be a top end limit that is still open to the employee to challenge as being unreasonable.

Please explain in further detail the reasoning behind your preferred limit.

For the vast majority of employers, 12 months should be sufficient as a maximum limit, which reflects current practice. However, we recognise that in certain limited circumstances, a higher limit may be appropriate and we accordingly recommend that the government take this into account.

24. Do you see any challenges arising from introducing a statutory time limit on the period of non-compete clauses? If yes, please explain.

Some employers would have otherwise been able to successfully enforce a non-compete restriction in excess of the statutory time limit. Setting an arbitrary limit may therefore reduce the protection available to certain sectors of the economy.

Careful consideration should also be given as to whether a statutory time limit suggests that anything at or below that limit must always be reasonable, which will not always be appropriate. There should therefore still be mechanism for employees to challenge the reasonableness of the restriction.

25. What do you think could be the benefits of a ban on non-compete clauses in contracts of employment? Please explain your answer.

The benefit of ban is that it gives absolute certainty as to the law. We also note again the imbalance of power at the start of an employment relationship, as well as the significant cost to employees of defending an alleged breach of restrictive covenants.

However, as against that, an unintended consequence could be that employers are then discouraged from investing in people without the protection of non-compete provisions, which is explained further below.

26. What do you think might be the potential risks or unintended consequences of a ban on non-compete clauses? Please explain your answer.

By getting rid of non-compete provisions altogether, consideration should be given as to whether this provides businesses with sufficient protection over their confidential information. Non-compete clauses are used to bolster the protection over business's confidential information, trade secrets, and/ customer contacts that standard confidential information provisions arguably do not offer.

Additionally, if non-compete clauses were banned altogether, businesses may well be inclined to simply increase notice periods and/or the use of garden leave to get around this. Therefore, if the purpose of the proposal to ban non-compete clauses is to allow for an increase in innovation, consideration should be given as to whether that purpose will be achieved if the workaround for businesses is to simply increase

notice and/or garden leave periods, such that the individual is restricted in any event for the same length of time.

Consideration should also be given as to whether such a result would be advantageous for the UK economy in circumstances where individuals with key skills are prevented from utilising those skills in the wider market. Similarly, consideration should be given to the personal impact on the individual who could theoretically be restricted from any work for a significant period of time by way of extended garden leave periods.

27. Would you support a ban on non-compete clauses in contracts of employment? Please explain your answer.

It was previously noted in a response to call for evidence in 2016:

“The common view across the majority of responses was that restrictive covenants are a valuable and necessary tool for employers to use to protect their business interests and do not unfairly impact on an individual’s ability to find other work. Common law has developed in this area for over a century and is generally acknowledged to work well.

Having built up a picture of the UK experience via this call for evidence, we have decided it is not necessary to take any further action at this stage.”²

In general, we would not support a complete ban on non-compete clauses. As noted in our general observations at the outset of this response, government should give careful consideration to the context and potential unintended consequences of the proposals.

28. If the Government introduced a ban on non-compete clauses, do you think the ban should extend to wider workplace contracts?

Whilst this is difficult to comment on without conducting a wider assessment of, for example, partnership and corporate law, our general position is that we would not support a ban in wider workplace contracts for the same reasons noted in relation to employment contracts.

² See: <https://www.gov.uk/government/consultations/non-compete-clauses-call-for-evidence>

29. Do you think a ban should be limited to non-compete clauses only or do you think it should also apply to other restrictive covenants? If the latter, please explain which and why.

The fundamental issue as we see it is the imbalance in employment contracts in relation to non-compete provisions. Broadly speaking, we do not support a ban of non-compete restrictions, nor therefore do we consider that a ban should apply to any other type of restrictive covenant.

30. If the Government introduced a ban on non-compete clauses in contracts of employment, do you think there are any circumstances where a non-compete clause should be enforceable? If yes, please explain.

There may well be circumstances in which it may be preferable to restrict the application of non-competes to those who are in a position in which protection of confidential information is most important, for example those earning over a certain threshold limit or those who are statutory directors.

31. Are there options short of banning non-compete clauses which would limit their enforceability in the interests of spreading innovation? Please explain your answer.

Options to consider may be:

- Limiting geographical scope by statute;
- Limiting the length of the restrictive covenant relative to time employed;
- Limiting the application of restrictive covenants to higher earners; or
- Limiting the application of restrictive covenant to certain sectors.

However, in relation to whether or not there should be a financial limit on the application of non-competes (i.e. for this only to apply to those earning above a certain salary level), we would observe that whilst this would appear on its face to be attractive from a fairness perspective, we note that this would be difficult to apply. In particular, consideration may need to be given to the application of country or regional weighting and annual increases, as well as the question as to whether or not the salary should be assessed at the point the contract was entered into (which may give rise to evidential issues if records are lost) or at the point of enforcement. In general terms, we would note that it is difficult to draw a direct parallel between salary level and the level of protection required in respect of the particular legitimate business interest.

An additional point for consideration may be whether or not the application of non-compete restrictions should differ depending whether or not the employee has resigned or has been dismissed. In the former situation, the employee is able to plan for the future taking into account the limitations they are under. In the latter situation, the employee has less time to prepare and in the absence of consideration during the restricted period may face a period without remuneration once notice ends.

32. Are you aware of any instances where a non-compete clause has restricted the spread of innovation/innovative ideas? Please explain your answer.

N/A

33. If you are aware of any literature, research, or evidence from your own business experience that looks at the impact of non-compete clauses on competition, innovation, or economic growth please list the publications below.

N/A

Questions 34-27

As these questions are specifically for employers, we do not have any comments.

For further information, please contact:

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