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PROMOTING BEST PRACTICE: WHY IT'S IMPORTANT NOT TO FORGET THE LITTLE THINGS

EMPLOYMENT

We all like being promoted, and in the excitement employers often get new business cards and email signatures set up, but fail to pay enough attention to the state of their contractual documentation. Hedge funds typically have relatively small administrative resources, and are rightly focused on their commercial aims. Protection of a fund's client or investor contacts and proprietary information is, however, equally important.

THE PROBLEM

Most well-drafted contracts, especially for senior employees, will contain restrictive covenants which impose limitations on what an employee may do when he leaves his employer for pastures new. The basic principle is that post-termination restrictions will be treated by the Courts as an impermissible restraint of trade unless they go no further than is necessary to protect a legitimate business interest. Legitimate interests have been held to include:

- the protection of customer connections;
- maintaining the stability of the workforce; and
- protecting confidential information which might include a fund's trading strategies or modelling software.

Importantly, the Courts will judge whether a restriction is reasonable as at the date the particular covenant is entered into rather than as at the date the employee leaves the business. This means that if there have been significant changes in duties, contact with customers and clients, or access to confidential information since the employee joined, then his or her promotion should ideally be accompanied by a new employment contract with restrictions reflecting his or her new responsibilities.

The High Court has held that an employee who gradually rose through the ranks in a trading software company from account manager to "Director – Global Account Management", was not bound by his various post-termination restrictions because, although they might have been appropriate for the Director role, they had been too wide for the junior role he started in, and had never been reaffirmed in any of the promotions.[1]

THE SOLUTION

It is vital that employment contracts and job descriptions are reviewed regularly throughout the employment life-cycle, and especially on promotion. If there is a risk that the restrictions (or any other aspect of the documentation) could be said to have been unreasonable at the point they were originally signed, a promotion gives an employer the chance to remedy this. In those circumstances, employers should:

- insist that the employee signs a new service agreement with the revised terms; or
- expressly repeat in full the original restrictive covenants in a promotion letter.

WHAT IF AN EMPLOYEE FAILS TO SIGN THE NEW AGREEMENT?

It is not all bad news for employers. In another 2012 case, the High Court found that an employee who failed to sign his new contract nevertheless became bound by the post-termination restrictions in it.[2]

He had accepted some of the benefits only available in his new promoted role, which the Court concluded was enough to show that he had accepted all the terms of the promotion, including the restrictive covenants.

While having the employee expressly sign up to new terms is by far the best approach, funds may wish to consider including a benefit requiring positive acceptance in their promotion package, just in case the new agreement never gets signed.

LLP AND LP STRUCTURES

Funds structured as LLPs or LPs should note that similar rules will apply to members and partners. The Courts are generally more willing to uphold restrictive covenants contained in LLP or LP agreements, as there is normally greater equality of bargaining power than in the employment context, but the need to demonstrate legitimate business interests in need of protection will still be critical to enforcing a restriction.

Where members change in seniority over time, consideration should always be given to whether restrictions should be revised.

[1] *PAT Systems v Neilly* [2012] EWHC 2609 (QB)

[2] *FW Farnsworth Ltd & Anor v Lacy & Ors* [2012] EWHC 2830 (Ch)

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OCTOBER 2013

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