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Spring into Action

As bonus time looms for many employers, and especially those in the Square Mile, employees start casting around for alternative options in case their variable remuneration doesn't meet their expectations - or living costs. The time is therefore rife for individual and team moves – both defections and hires – and a couple of recent cases have highlighted some important lessons and tactics for both the outgoing and incoming employer.

Springboard Relief

Both recent cases concern team moves and applications by the outgoing employers for "springboard" injunctive relief. This is a rather dramatic type of injunction application which is used to prevent employees essentially from benefitting from the unfair "springboard" advantage or head start which they have gained, in relation to setting up their new business, by having breached their duties to their former employer. The purpose of the relief is to negate the damage done to the old employer's business and to put the former employees back in the position in which they would have been, had they not breached their express or implied contractual duties, such as fidelity, confidentiality, good faith etc.

In practice it is most useful for employers who either did not have post-termination restrictive covenants in their employees' contracts or whose covenants would not be sufficient to protect them, for example because their confidential information was now in the public arena as a result of the employees' unlawful activities. Ultimately, a springboard injunction will often go further and have a more draconian effect than express post-termination covenants would have, often extending for 12 months post-termination. It might prevent an employee and/or his new employer from dealing with any customers on a stolen customer list (even if their details were otherwise publicly available) or from hiring any employees from the former firm (even where the express covenants did not extend that far) or simply from competing with the former employer through the use of its confidential information (where otherwise there are no post-termination non-compete covenants).

In the past, it was used only very sparingly by the courts since it imposes fairly harsh and continuing obligations on the employees, after the event, to which they did not agree at the outset of the contract – however, these cases and our recent firsthand experience demonstrate that they are increasingly willing to grant such relief, where there has been apparent employee foul play.

Team Move to Start Up Venture with Competitor

In the most recent case of *QBE Management Services (UK) Ltd v Dymoke and others [2012] EWHC 80,* earlier this month, QBE was granted 12 months of springboard relief from the date of its employees' resignations, in order to remedy the advantages the employees had gained through their unlawful conduct while they were still employed. The conduct related predominantly to influence used over other employees and clients and use of confidential information, all whilst they were still employed by QBE but preparing to start the new venture. They benefitted from their seniority and access to information in this respect, whereas if QBE had known of their plans (which the Court

found they had a duty of fidelity to disclose), it would have taken steps to prevent them, such as putting them on garden leave.

The case concerned three key employees who were head-hunted by a competitor of QBE, to start up a new competitive venture in marine insurance. A further eight employees later followed them. Initially, QBE was granted an interim injunction to enforce the terms of one employee's six month garden leave clause and the other two's post-termination non-competes (for six and nine months respectively), as it believed they had been headhunted by its competitor. In the course of the disclosure exercise for the initial application, QBE discovered the further alleged breaches by the key employees, including solicitation of each other and of the other employees and of clients and the use of its confidential information to set up the venture and secure financial backing. On that basis, QBE subsequently applied for an extension of the springboard relief.

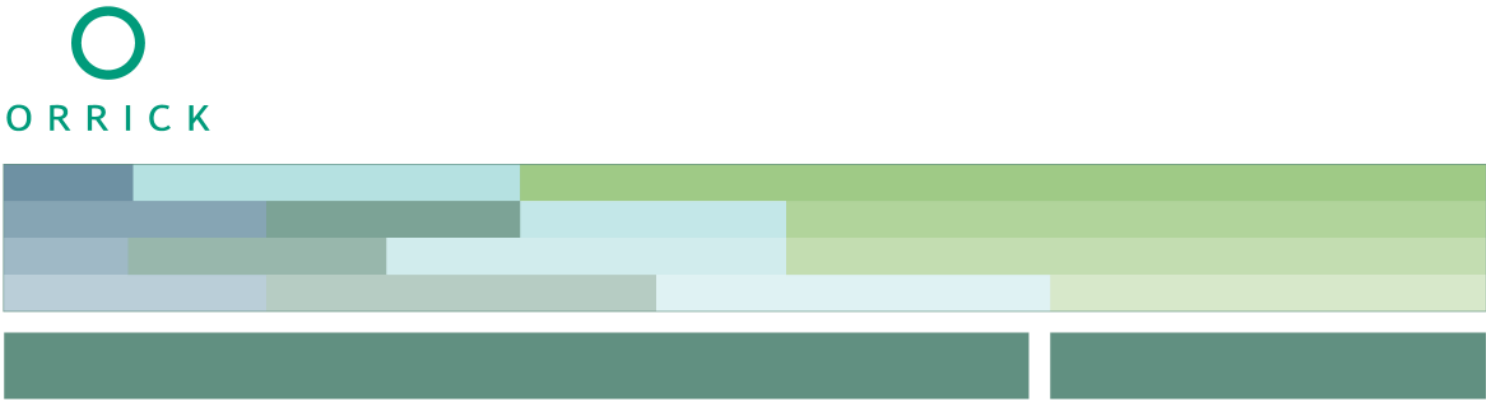
The case reached full trial within only seven months and the Court agreed to extend the relief, preventing the individuals (and by extension, the competitor company, which was responsible for inducing the breaches of contract because it knew of the restrictions but proceeded regardless), from competing until the 12 month anniversary of their resignations (i.e. between three and six months beyond their contractual obligations).

Notably, in an area where damages are typically very difficult to quantify, the Court also awarded damages of £314,000 to cover QBE's cost in relation to pay rises and retention bonuses to keep remaining staff, recruitment expenses for the replacements of the defectors and temporary employment costs in the meantime.

Prevention of Defection to Competitor

The other case, *Clear Edge UK Ltd and another –v- Elliot and others [2011] EWHC 3376*, also centred on confidentiality and solicitation of employees but in this case, much focus was placed on the employees' implied duties and particularly confidentiality and the duty of fidelity owed by the employees to their employer, as well as their fiduciary duties. For certain very senior or important positions, such as Board directors, there will also be fiduciary duties owed to the employer and these go so far as to require that employee to put the employer's interests ahead of their own and effectively to report their own planned competition.

The three employees in this case had worked for the employer (Clear Edge) for 20 years and had developed a very niche specialism relating to the Clear Edge's "Cerafil" gas filtration products business. In September 2011, each employee resigned (separately and on different days) and announced that they would be joining Topsoe, a supplier business, which had tried to buy the Cerafil business earlier that year. Two of the employees had 6 months' notice provisions and the third was due to finish the following month. Clear Edge immediately requested the return of its mobile phones and laptops and had them forensically examined. The results of the examination showed that the machines had been cleaned, deleting user data – this provided Clear Edge with the hook to apply for injunctive relief (suspecting misuse of confidential information via those machines) to prevent the employees from joining the new employer, Topsoe, for 6 months.



The Court agreed at the interim hearing to order the springboard non-compete injunction and prevent the employees from joining the competitor. The decision was based on the case that the employees had given themselves an unfair competitive advantage by virtue of their past and threatened misuse of confidential information and their co-ordinated defection.

The misuse of confidential information is one thing – and is perhaps the most common reason for springboard relief being granted in this type of case – but what is most interesting from a team move perspective is the reference to co-ordinated defection. This was considered arguably to be a serious breach of the duty of fidelity and, particularly in the case of the "ringleader" employee, a breach of fiduciary duties. The Court distinguished between discussions between close friends and business colleagues regarding plans to leave their employment and actual solicitation between them to defect together. It was noted that one of the employees had been negotiating on behalf of all three employees, that they had been involved in the previous offer of a management buyout of the Cerafil business and that this appeared to be a carefully co-ordinated defection.

All three employees were therefore prevented, by the interim injunction, from joining Topsoe for 6 months, pending the full hearing of the case. The full hearing (which will consider whether the above arguable points are conclusive and as such whether further injunctive relief and/or damages are appropriate) was due to take place last month but has been pushed back until next month.

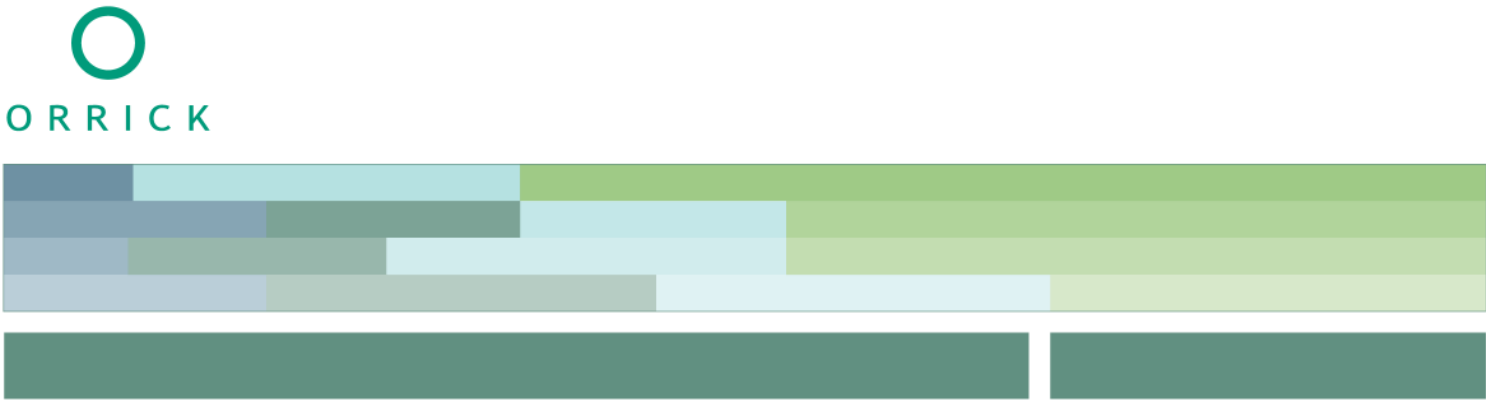
Planning Ahead

There is a very fine and much litigated line between working in a competing business whilst still employed (breach of duty) and taking preparatory -- but not active -- steps to set up in a competing business in future once the employment has ended (permitted). Where that line falls will generally be very fact specific and this can be problematic for employees in particular because they have no certainty that any steps which they take will not be considered to be a breach if the employer subsequently litigates. Similarly, the risk is high for the hiring employer/investor - if it is aware of the employee's steps and employment duties (as it inevitably will be), it is likely to be joined to the action for inducing the employee's breach. The only 100% safe option therefore is to do nothing until after the employment has ended but this is generally not commercially feasible, especially for the employee(s) in start up situations, who will not be earning anything pending the establishment of the competing business. Employers who are losing teams should be aware of these issues and potential strategies they can use to best protect their business in these scenarios.

Practical Tips

Whilst there is never a readymade solution to these situations and it will always be a balance between legal risks and commercial benefits, employers should have the following red flags in mind when a key team defects or, conversely, where they are looking to hire a team from another organisation:-

- **Constructive dismissal/breach of contract allegations** – exiting employees will be on the lookout for an excuse to allow them to break with their contracts and avoid their notice periods and obligations. Any behaviour on the part of the old employer which might be alleged to constitute a breach of contract or even constructive dismissal, will allow them to evade their confidentiality and restrictive covenant obligations – as long as they are not already in breach. Typical examples include sending employees on garden leave where there is no express contractual right to do so and/or no arguable case for it, aggressive or overtly hostile reactions to the resignation and also conduct prior to the resignation which would entitle the employees to consider themselves constructively dismissed (unjustifiably reduced bonus provision/unilateral change of job title or description/reduction in remuneration etc).
- **Necessity of "clean hands"** – particularly where the employee is seeking to try a breach of contract/constructive dismissal argument (as above), the Court will expect them to have "clean hands" i.e. not to have been obviously guilty of misdeeds themselves whilst still employed. Identifying potential future office premises may be a relatively anodyne step but actively soliciting fellow employees or clients for future business (even if they are not actually operating that business at the time and do not have post-termination non-competes) will be absolutely unacceptable. Any suggestions that they have been plotting (such as wiping computer equipment) will damage their credibility. Hiring employers should warn of this and outgoing employers should be on the lookout for it on their systems.
- **Disclosure exercise, forensics and paper trails** – injunction applications are expensive to fight and risky – even if an interim injunction is granted (on the basis of there being an arguable case, as in *Clear Edge* above), it may be overturned in the full hearing and then the employer will be responsible for damages to the employee(s) and new employer for any damage caused by that injunction (e.g. 6 months' loss of business) as well as their legal costs. The employer must therefore be very sure of wrongdoing to apply for the relief in the first place and must have sufficient evidence to support the application. Whilst there is rarely a "smoking gun", examination of hard copy diaries, files and notes, email trails, mobile phones and handheld devices and laptops will often provide enough of a picture to decide whether to proceed and the employer needs to start this manual and forensic discovery exercise as soon as possible to maximise the capture of data. Many companies now specialise in providing this service to employers and can retrieve far more than most in-house IT capability could. Hiring employers should be equally mindful of this, not only in their communications with their potential employees but also warning the employees in relation to their own communications and actions. As seen in *Clear Edge,* even the action of wiping hardware clean will be sufficient to highlight potential wrongdoing. Another classic is the discovery that the employee was downloading reams of information in the days/weeks prior to resignation – a good potential hook for a confidentiality-based injunction, even if the actual downloading was innocent.



- **Disclosure and Fidelity Duties** – the above exercise should also highlight (and/or the hiring employer should advise the employees to avoid) suggestions that there has been employee solicitation within the team move. Any concerted negotiations on behalf of the whole team (again, as in *Clear Edge*) could in itself result in a springboard injunction on this basis. A typical suggestion around this in the past has been to place an external advert and/or engage a head-hunter and arrange for the employees all to apply separately and without apparent communication – in practice, however, the disclosure exercise and/or ultimate witness evidence will highlight that this was a sham so at best it will only provide a potential deterrent to litigation being issued in the first place. The only way to avoid this type of allegation is genuinely to deal separately and individually with each employee, with no collaboration between them. In business terms, this may mean that the new employer is not able to recruit the whole team at the same time and/or to guarantee how much business it is likely to secure. This makes such an approach commercially unattractive – and yet that is precisely what a Court would expect to see because by ensuring the group move and co-ordinated business, the new employer/team has gained itself an unfair advantage on the old employer before the employees have left their employment. As a compromise position, hiring employers and teams should at least avoid appointing a "ringleader" employee and should ensure that communication and negotiations appear to be conducted separately with each employee, even if the employees then in practice communicate amongst themselves unofficially as to whether they will join en masse – again, this will not be foolproof in the event of litigation but it might at least act as a deterrent to the old employer deciding to apply for an injunction.
- **Undertakings** – it is advisable, before starting litigation, to seek to avoid it by asking the employees to provide binding undertakings in relation to their actions and intentions i.e. they have not stolen confidential information/they do not intend to use it/they will return it if they already have it/they have not and will not solicit staff or clients or divert business etc. Such undertakings have significant weight in any future litigation if they are discovered to have been breached. In *Clear Edge*, this approach was taken and the employees provided only partial and limited assurances in response – the Court was much persuaded by that point in relation to whether the employer had an arguable case as to the employees' actual and intended misdeeds.
- **Negotiate with outgoing employer** - given the uncertainty and expense of springboard and any injunctive applications, a hiring employer would be well advised to at least consider negotiating a (without prejudice) deal with the outgoing employer (usually at the stage where undertakings are being sought and/or as part of those undertakings) if there is good foundation to the allegations that the employees have been in breach of their employment duties or they have binding post-termination covenants. This might result in a reduced non-competition period, an earlier start date, the ring fencing of certain employees and clients and even paid compensation to "buy out" the business in effect. It will, of course, always be circumstance specific and detailed advice should be taken on the approach in advance of any such negotiations, not least of all because it may give credence to the allegations that there has been wrongdoing or intentions to compete by the employees, if a deal cannot be reached.

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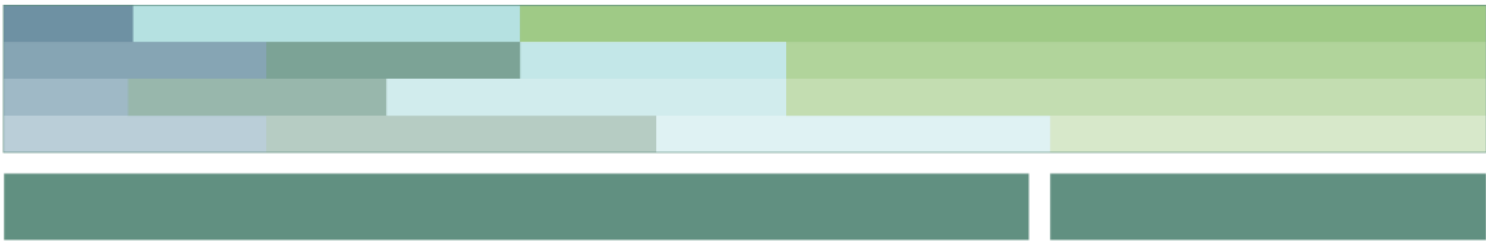

- **Including the new employer in the litigation** – finally, it is fairly standard to include the new employer/investor in the litigation on the basis that they have induced the breach by the employees. This imposes greater commercial pressure and the new employer typically has deeper pockets for damages than individual employees would have. However, this is an important tactical consideration and advice should be taken in each case depending on what exactly the outgoing employer wants to achieve – in the *Clear Edge* case, the new employer was not joined because it was an existing supplier to the business but the decision not to join them had a dual effect, namely that damages would have been more likely to be awarded if the action was against a corporate body and so conversely, an injunction was more likely to be granted if they were not joined.

NEWSFLASH:

And finally, it's that time of year again – as of 1 February 2012, unfair dismissal maximum compensatory awards increased to £72,300 and the weekly maximum for basic awards and statutory redundancy payments increased to £430.

If you would like to discuss any aspect of this alert or require further information on the matters referred to please contact Nicola Whiteley on +44 (0)20 7862 4670, Mandy Perry on +44 (0)20 7862 4637 or Stephen Cope on +44 (0) 20 7862 4611.