

H.R. Confidential

Legal news and views for employers and human resource professionals

Myth Busters!

There are several myths concerning employment law issues that we hear time and time again. In the forthcoming editions of HR Confidential, we will run a series of "Myth Busters" in an attempt to dispel several common misconceptions.

"Restrictive Covenants Are Never Enforceable in Any Event!"

We regularly hear people make unqualified statements that restrictive covenants are never enforceable. This is not at all accurate. Contrary to common belief, restrictive covenants should be enforced by the courts in the United Kingdom if the scope of the covenants is only as wide as is reasonably necessary to protect the legitimate business interests of the employer. Because of this, covenants included in contracts of employment should be drafted very carefully to cover only:

- *The business operated by the employer with which the employee has been materially concerned during the final stages of his/her employment.* For this reason, covenants often focus on the business activities that form the basis of the employee's duties during his/her last 12 months of continuous employment. It would not be advisable to attempt to cover all of the businesses being operated by an employer unless the employee will be involved in all of the businesses during the final stages of his/her employment. For example, if an employer develops and sells two completely different software products (A and B) and the employee is a salesman who has only ever dealt with sales of product A, it is unlikely to be reasonable for a non-compete clause to prohibit the employee from being involved with competitors whose business operations only relate to products that compete with product B. The employee's employment with the employer does not provide him with a competitive advantage in relation to the market for product B (unless he has some confidential information regarding product B, e.g. the employer's price lists etc).

- *The geographical area within which the relevant business is being operated by the company and in which the employee has been involved in the relevant business.* Where employers operate in a relatively small number of countries, it would not usually be reasonable to prevent the employee from joining a company selling the same types of products as the employer, but in a totally different geographical market to that of the employer. The crucial element of competition is missing. It is advisable to limit the scope of the restriction to those geographical areas in relation to which the employee has been performing duties in conjunction with the employer's business. Of course there may be situations in which the employee possesses confidential information, which could assist a competitor in countries where the employee has not been active and where a more subtle approach may be required.

- *The period of post-termination restriction reasonably necessary to protect the employer's legitimate business interests.* This is usually the shortest period during which the employee would have an unfair competitive advantage as a result of his employment with the employer. If customer relationships are easy to rebuild or the period during which confidential information is sensitive and damaging is short, then the covenants should likewise be short. It is now relatively uncommon for restrictive covenants contained in an employment contract to last longer than 12 months and it is certainly prudent to restrict the length of any pure non-compete covenants to four to six months. Although four to six months is not a long period, it is usually sufficient for the employer to recruit a replacement employee and for the replacement to build up a sound relationship with the customer. However, these are simply guides—at the end of the day each case will be decided based on its own particular facts.

Clearly there will be occasions when, for whatever reason, employers choose not to enforce covenants against departing employees. However, there are also times when an employer

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Staff Handbook

Wilmer Cutler Pickering Hale and Dorr has developed an “off-the-shelf” staff handbook, updated to reflect the raft of recent employment legislation and case law in the United Kingdom. The handbook provides HR professionals with the know-how and procedures to assist employers in maintaining compliance with the law. If you would like further details, contact Henry Clinton-Davis (henry.clinton-davis@wilmerhale.com) on +44 20 7645 2507.

needs to be aggressive and enforce its covenants through court action. This should be possible if the covenants were well-drafted in the first place, the employer has a legitimate interest it wishes to protect and the covenant goes no wider than is reasonable to protect that interest. Employers do need to beware delaying unreasonably. A failure to seek an injunction when the employer has the evidence can be grounds for the court to refuse to grant the injunction sought.

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Patent Law Amendments Favour Employee Inventors

Under English law, inventions made by employees in the normal course of employment—or as a result of specific assignments or obligations—are owned by their employers without any need to expressly assign ownership of the inventions, or even assert them in an employment contract. However, inventions falling outside these parameters are not owned by the employer, and terms in employment contracts attempting to reduce or extinguish the rights of employees in such inventions are unenforceable.

In some cases it is possible for employees to claim compensation from their employers where their inventions have been successfully exploited by the employer. Historically, though, the test has been a high one, which few employees have been able to meet. Employee inventors have had to prove one of two things: either that their employers have derived an “outstanding benefit” (in “money or money’s worth”) from a patent for the invention and it is therefore “just” that the employee should be reasonably compensated; or that the “benefit” they received from their employer for transferring their rights in such an invention was “inadequate”, given the benefit their employer subsequently derived (or might “reasonably” derive), from a patent for the invention.

On 1 January 2005, the law changed, making it easier for employees to claim compensation. For all employee inventions created on or after this date, the test for compensation will now extend to the “benefit” the employer has derived—not only from any patents relating to the invention(s), but also the “benefit” the employer has (or may reasonably derive) simply from exploitation of the invention itself.

The impact of this amendment is likely to be significant. Previously it has been very difficult for employee inventors to satisfy all the

necessary legal tests to gain compensation. By expanding the assessment to consider, in effect, all benefits derived by the employer from the invention, employers will now be limited in their opportunity to rely on arguments attributing such benefits to other factors (for example, marketing expertise, product design appeal and the opening up of new markets). In addition, employee inventors will also be entitled to compensation, even if a patent is revoked.

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Employers punished for failure to consult

The recent cases of *Susie Radin v. GMB* (2004) and *Smith v. Cherry Lewis* (2004) establish a “no tolerance” approach towards employers for failing to collectively consult with employees in collective redundancy situations. We believe the same strict approach will now be taken in commercial transactions to which the Transfer of Undertakings (Protection of Employment) Regulations 1981 (TUPE) apply, where in the past employers have often been fairly laissez faire about complying strictly with their consultation obligations.

The law

Where employers are proposing to make redundant 20 or more employees at any one establishment, the employer is required to consult the representatives of the employees about the proposed dismissals within a period of 90 days. In unionised organisations those representatives will be the union. In non-unionised organisations, the representatives will normally have to be elected specifically for the purpose of consultation. There is then a minimum consultation period: 30 days if the employer is proposing to dismiss between 20 and 99 employees, and 90 days if the employer is proposing to dismiss 100 or more employees. In TUPE situations too, certain information must be given to the employees’ representatives about the proposed transfer, and, if either transferor or transferee propose that anything should change for the employees as a consequence of the transfer, there is also an obligation to consult the representatives about the transfer as well.

If an employer fails to comply with the consultation obligations, the tribunal has the power to make protective awards to the employees – subject to a maximum of 90 days’ pay per employee in collective redundancy cases,

and 13 weeks' pay per employee in TUPE cases. The pay awarded is not subject to any kind of statutory cap for these purposes.

Case law

Up until recently, tribunals had a broad degree of discretion in how much compensation to award where employers failed to comply with their consultation obligations. It was generally assumed that the awards were not intended to be punitive, and therefore in most cases, only the most heinous cases would result in compensation at the top of the scale. However, in the latest cases, *Radin* and *Smith*, the courts have taken the opposite view, holding that in most cases an employer's failure to comply with his duties to consult will result in the maximum penalty being awarded.

Both the *Radin* and the *Smith* cases concerned employers whose businesses had gone insolvent, the business was closed and there was no alternative but to dismiss as redundant all the employees. Amongst other claims the employees claimed a protective award on account of the employer's failure to consult.

In the *Radin* case the Court of Appeal accepted the employer's argument that consultation would have been futile because it was not possible to prevent the closure of the business or to save jobs. However, the court went on to hold that the purpose of the protective award is not to compensate employees but rather to punish employers for their default in failing to consult. The Employment Appeal Tribunal in *Smith* confirmed this principle and agreed with the Court of Appeal's decision in *Radin* that the starting point for a total failure to consult would normally be the maximum award of 90 days' pay per employee affected.

Dealing with this no tolerance approach

There seems no logical reason why this no tolerance approach established in the above collective redundancy cases should not extend to TUPE transactions. After all, the case law in both areas has up to now tended to run in tandem and the legislation is expressed in very similar terms. It is therefore important that employers ensure that they factor in time to undertake meaningful consultation with employees' representatives – otherwise they are increasingly likely to face expensive compensation claims.

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STOP PRESS:

- **From 1 February 2005, the maximum compensatory award for unfair dismissal claims was increased to £56,800** (from £55,000) and the limit on one week's pay for calculating both the basic award for unfair dismissal and statutory redundancy payments is now **£280** (from £270).
- **From 3 April 2005, statutory maternity, paternity and adoption pay increased to £106** (from £102.80), or if less, 90% of average weekly pay. (The Chancellor has announced that statutory maternity will be increased from six to nine months in 2007, with a long-term aim of increasing it to one year.)
- **From 6 April 2005, statutory sick pay was increased to £68.20** (from £66.15) per week.
- **From 6 April 2005, new rules apply to the transfer of occupational pensions on a TUPE transfer.** It is no longer an option for purchasers of businesses to ignore pension plans. (The government has recently published its long-awaited changes to the TUPE regulations that are expected to take effect in October 2005. Virtually all changes of service provider will now come unambiguously within TUPE)
- **From 6 April 2005, the Information and Consultation Regulations apply to undertakings employing 150 or more employees.** (The regulations will eventually extend to undertakings with just 50 employees.) Employers should now consider the advantages of preempting employee requests for these agreements by making their own proposals.
- **From 5 October 2005, the Sex Discrimination Act will be amended** and brought into line with legislation on race and sexual orientation. Changes will include a statutory definition of sexual harassment.
- **The UK must introduce anti-Age Discrimination legislation by 1 October 2006.** The government plans to publish and consult on the draft regulations during the summer of 2005.
- **New rules came into effect on 6 April 2005, requiring employers to increase SMP** when pay rises are awarded during the period beginning shortly before employees take their maternity leave and terminating at the end of that leave.

REMINDER:

- Minimum Statutory Disciplinary Procedures now apply to all dismissals and other relevant disciplinary action. These procedures apply not just to misconduct, poor performance and ill-health dismissals but also to small-scale redundancies, the expiry of fixed-term contracts and retirement. Failure to comply in the case of employees with sufficient service will make the dismissal *automatically unfair*, and *compensation can be uplifted by between 10% and 50%*. However, employees who have reached normal retirement age or are already 65 will not be able to claim unfair dismissal.

In-house Training

We provide a variety of tailor-made training courses for line managers and HR professionals. Held at clients' offices, they are interactive, practical and fun. Recent topics include:

- Harassment at Work
- Handling Disciplinary
- Workplace Consultation

We have recently added a new topic, Corporate Governance for Non-executive Directors, which uniquely covers both UK requirements and Sarbanes-Oxley.

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