Supreme Court rules that the “blue pencil” test can be used to remove words which would make a non-compete unenforceable
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The Supreme Court has handed down judgment in the case of Tillman v Egon Zehnder Limited; the first case on restrictive covenants to be heard by it in over 100 years. The decision resolves two competing lines of authority on the “blue pencil” test, establishing that the liberal approach, which gives the employer more flexibility, is the correct one. However, the court hinted strongly that the need to give clarity to the employer’s drafting could result in the employer bearing the cost of the litigation. This sting in the tail underlines the need to ensure that covenants are drafted in clear and unambiguous terms.

Long-standing employee moves to a competitor

Ms Tillman worked as a consultant with the executive search firm, Egon Zehnder Limited ("EZL"), for over 13 years. Following her resignation, Ms Tillman wanted to take up employment with a US competitor. Her contract of employment with EZL contained restrictive covenants, including a non-compete clause. EZL sought to enforce the covenants and obtained an injunction in the high court preventing her from breaching the non-compete.

Injunction granted by the High Court but the non-compete clause is ambiguous

The non-compete clause stated:

“You shall not … directly or indirectly engage or be concerned or interested in any business carried on in competition with any of the businesses of the Company or any Group Company …”

The case turned on the words “or interested in”. Ms Tillman argued that they prevented her from having any shareholding, no matter how small, in a competitor. The Court of Appeal overturned the High Court’s ruling. The restraint was unreasonably wide and unenforceable.
Employer seeks enforcement from the Supreme Court

Before the Supreme Court, EZL appealed the Court of Appeal’s finding that the non-compete was unenforceable. It raised three arguments: (1) the doctrine of restraint of trade could not prevent an individual from owning shares; (2) on a proper construction, the words “interested in” did not extend to owning shares, and (3) alternatively, if the words “interested in” did prevent Ms Tillman owning shares, those words could simply be severed to make the restraint reasonable.

Is a prohibition on holding shares a restraint of trade?

EZL argued that owning shares was not an activity that was capable of being prevented by a restrictive covenant. Holding shares was not a trade or occupation which could be subject to restraint. This was rejected by the Supreme Court. It outlined three scenarios in which a former employer’s business could be threatened by a former employee holding shares in a competitor: where the individual had a controlling shareholding, allowing the former employee to direct a competitor’s operations; where the individual had a minority shareholding giving the former employee influence over a competitor’s activities; and the individual being appointed to a senior position in a competitor and being remunerated in part by shares or share options. The Supreme Court held that the restraint on shareholding was part of the restraint on Ms Tillman’s work. It did fall within the restraint of trade doctrine and must be reasonable to be enforceable.

What is the meaning of the words “interested in” when used in a non-compete covenant?

EZL argued that the words “interested in” did not prohibit Ms Tillman from holding shares in a competitor. The Supreme Court rejected this approach on two grounds: first it held that the natural meaning of the words included holding shares, and second, the formulation “engaged, concerned or interested in” has been consistently interpreted by the courts as including owning shares.

Having lost on the first two arguments, EZL’s case hinged on the issue of whether the words “or interested in” could be severed from the covenant.

Can parts of a restrictive covenant be severed to make the covenant enforceable?

There are two competing lines of authority on how to approach severing words from restrictive covenants. Under the “strict” approach, parts of a single promise or obligation cannot be severed. The Supreme Court rejected this approach. Instead, it held that the three-stage “Beckett” test should be applied. Under this test, words may be deleted if:

1. No additional words need to be added;
2. There is adequate consideration for the remaining terms;
3. The character of the restriction is not changed so that it becomes “not the sort of contract that the parties entered into at all”.

Applying this test, the Supreme Court held that the words “or interested in” could be removed from the non-compete covenant, leaving it enforceable.
What actions should you take?

**Remove ambiguity** - Restrictive covenants must protect a legitimate interest and be no wider than necessary in order to be enforceable. This case turned on the ambiguity in the words "or interested in" which opened the door to an argument that the covenant was too wide to be enforceable. Are your covenants sufficiently clear and unequivocal?

**Ensure your drafting is capable of severance** – This case confirms that employers have some leeway with drafting because a covenant may be narrowed by the courts applying the blue pencil test. However, this can only be achieved if the drafting allows it. Are your covenants drafted in such a way that any restrictions which may be too wide could be deleted without having to add in words or lead to a change of meaning?

**Beware of litigation** - Although the Court found for the employer, Lord Wilson hinted strongly that the Court was likely to order EZL to pay Ms Tillman’s litigation costs. Stated in veiled terms, his point appears to be that if the courts are called upon to clarify or interpret an employer’s drafting, the employer should be obliged to bear that cost.

Please do not hesitate to contact us, if you have any questions about this topic.

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