GOODMAN DERRICK LLP

Legal insights for businesses, entrepreneurs and directors

Enterprise

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Transactions

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> *Enormous reputational damage can result from allegations, and for big brands a public outcry and consequent fall in sales often follows.*

CORPORATE

Has #MeToo taken a seat on the board?

The effect of the #MeToo movement in the corporate world is no longer in doubt. Over the last few years Ted Baker's share price fell 13% after allegations against its founder emerged, the 'big four' accountancy firms have all admitted to partner sackings, and Google employees staged a worldwide walkout in protest at claims of sexual harassment, gender inequality and systemic racism. These are not isolated incidents of stakeholder intervention into bad corporate culture.

Practical steps

Enormous reputational damage can result from allegations such as these, and for big brands a public outcry and consequent fall in sales often follows. So it not surprising that we have already worked with a number of clients to review employee and communication policies and to advise in relation to training that may help prevent and manage the types of behaviour that may lead to claims. Even more prudent clients are reviewing their insurance policies and major contracts to be sure of protection in the event of an allegation.

"Weinstein Clauses"

We also see #MeToo concerns arising in corporate transactions, with transaction documentation used in the United States regularly including so-called "Weinstein Clauses" or "#MeToo Reps" (representations) to protect buyers against allegations of inappropriate behaviour that come to light after a sale has completed.

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Due Diligence

As with all sorts of risks in corporate transactions, the nature of the protection that is available to a buyer will vary from transaction to transaction and from risk to risk. The first step is to establish if there any issues through the due diligence process. A good buy-side lawyer will ensure that requests for information are carefully worded and, very importantly, do not include any materiality threshold. This is because the nature of these types of claims means that the true cost to the business from adverse publicity can be very high and may far exceed any damages or settlement that the company may have to pay.

Warranties

Experienced corporate heads will know that due diligence is only as good as the information provided by the sellers and may be limited to "matters of which the sellers are aware". In relation these types of risks the sellers themselves may be unaware of any issues; staff might not have not come forward or the matter may have simply not escalated within the business. Due diligence must therefore be backed up by a full set of commercial warranties and, where appropriate, indemnities. As well as providing contractual protection, the warranties will give the seller a second opportunity to disclose important information and address any concerns prior to completion. Warranties are a set of statements relating to the target business and, if it can be shown that any of them are incorrect (and the seller has not made adequate disclosure against such warranty), then the buyer has the right to bring a claim for damages against the seller. If a specific issue has been identified then the buyer should consider a specific indemnity, alongside a retention against the purchase price, or more simply a price reduction.

Very soon after the deal has completed, a sensible buyer will ensure that any issues are addressed alongside its usual integration processes. Correct procedures and policies should be put in place and any issues with corporate culture should be addressed head-on by an engaged leadership team.

Ultimately good management maximises the value of businesses and increases the chances of a successful transaction. This is as true for allegations of inappropriate behaviour as it is of any other part of the business, so it is not surprising that boards are now paying careful attention.

You may also be interested in our tip sheet for businesses trying to mitigate the effects of reputational damage, it is available here.

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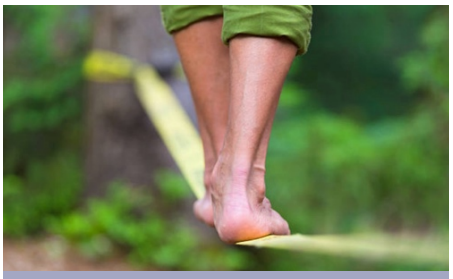

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EMPLOYMENT

Restrictive covenants: treading the tightrope between protection and exposure

Post-termination restrictive covenants are commonplace in employment contracts of senior personnel, operating as a line of defence to protect the company from harm should that employee leave to work elsewhere. However such restrictions fly in the face of public policy, which favours an individual's freedom to be employed by, trade, and deal with whoever they choose. For this reason, the law strictly limits the use of restrictive covenants and courts are willing to strike them down in their entirety if they are overly restrictive. As such, unless drafted carefully, restrictive covenants may well not be worth the paper they are written on.

In this article, we explain the basic principles governing the use of restrictive covenants and set out some practical steps for your business to follow to try and ensure that it is protected, not exposed.

For a restrictive covenant to be enforceable your business must have a legitimate interest it is seeking to protect and the covenant must be no wider than is necessary to protect that legitimate interest.

What is a post-termination restrictive covenant?

In an employment context this is typically a clause in an employee's contract which restricts their activities after their employment ends, for example not working for or being involved in a competing business or soliciting clients.

The principles

For a restrictive covenant to be enforceable your business must have a legitimate interest it is seeking to protect and the covenant must be no wider than is necessary to protect that legitimate interest.

'Legitimate interest'

The following are 'legitimate interests' which can justify protection:

your trade connections, e.g. relationships with customers, clients, and suppliers (typically protected by non-dealing covenants or non-solicitation covenants).

the stability of your workforce (typically protected by non-poaching covenants).

your trade secrets and other confidential information e.g. pricing models, design plans etc. (typically protected by non-compete covenants).

'No wider than is necessary'

Another way of explaining this is 'don't be greedy'. Any covenant needs to be carefully drafted so that the restrictive effect on the employee is

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> *Don't adopt a one-size-fits-all approach by imposing the same covenants regardless of seniority, job role etc. This is easily done when adapting template employment contracts in a rush. Remember that to stand a chance of being enforceable the restrictions must be carefully tailored to the individual employee and be justifiable.*

proportionate to what you are trying to protect. If a court finds that a less onerous restriction would have provided adequate protection then the covenant will be unenforceable.

For example, imagine you are trying to protect your business' relationship with key clients by imposing a 12 month non-dealing restriction on senior sales personnel. If your covenant is challenged and a court finds that your client connections would have been adequately protected by a 12 month non-solicitation restriction (which is narrower than a non-deal restriction) or by a shorter 6 month non-dealing restriction, then the original covenant will be unenforceable, leaving your business exposed.

To work out what is 'adequate' protection a court would take into account a variety of factors including: the covenant's duration, its geographical scope, the employee's status and position at the time the restriction was entered into, the nature of the market and the business itself etc. Broadly speaking non compete restrictions are the hardest to justify being the most onerous.

Dos and don'ts

DO

- Ask yourself what interest are you trying to protect i.e. does the employee have knowledge of confidential information, do they have client/customer contact, do they have influence over other employees or operate in a team where they could instigate a team move? This will help you determine what sort of covenants are appropriate.
- Consider how you would justify the covenant if required e.g. what is the rationale for its nature, its duration, and its geographical scope. Could a less onerous covenant provide adequate protection for your business?
- Seek legal advice when drafting covenants. Case law in this area evolves at a fast rate and simple drafting omissions can invalidate your covenants.

DON'T

- Don't adopt a one-size-fits-all approach by imposing the same covenants regardless of seniority, job role etc. This is easily done when adapting template employment contracts in a rush. Remember that to stand a chance of being enforceable the restrictions must be carefully tailored to the individual employee and be justifiable.
- Don't breach the employee's employment contract and then seek to rely on your restrictive covenants. This can be easily done. For example, if you pay an employee in lieu of notice but have no contractual ability to do so, then technically this is a breach of contract and will cause the restrictive covenants to fall away.

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- Don't forget to review the applicability of existing covenants when an employee is about to be promoted or to change roles. Consider whether it is appropriate ask them to agree to new covenants or to amend existing ones.

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DISPUTE RESOLUTION

Five tips to help you avoid costly business disputes

Legal risk can lie dormant within any business and the cause is often the underlying structures that were put in place at the very start. As any sensible adviser will tell you, growing a business without solid foundations will eventually become problematic and when it comes to legal risk this can result in costly and time-consuming disputes that will disrupt your plans and eat away at profit.

The **Goodman Derrick dispute resolution team** regularly help clients devise strategies to manage areas of risk, and in this article we have highlighted the five most common issues that give rise to problems.

Co-founders, shareholders, investors, fellow directors

Your business partners might be family, friends or colleagues who you may have known and worked with for years. Despite the bonds that have been created there is every chance that, over the lifespan of your business, you will have disagreements.

Your business and business model will also have changed since it was founded and the agreements you have in place may have their origin in an earlier, perhaps less complicated, time.

You should review your key intra-company agreements so that they remain relevant and effective now and in the future, so that if disagreements do arise you can deal with them quickly and constructively to prevent them becoming serious disputes.

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The key legal documents that you should review on a regular basis, and certainly after a period of change, are your Memorandum of Association, Articles of Association, employment and service contracts and shareholders' agreements.

Look out for our guide relating to shareholders' agreements in a future issue.

Data

If you are obtaining, storing or using data it is vital you ensure you have effective and compliant data management policies in place. The business benefits are potentially very large and if you fall foul of GDPR you will find yourself facing potentially very large fines and sanctions. These can be easily avoided if you comply with the new regulatory framework.

Our GDPR compliance guide is available here.

Ideas and intellectual property

Whether you are just about to launch an app or have developed a new product range, all of the proprietary innovation you have must be fully protected before it hits the market.

There are many ways to do this (patents, trade marks, designs or copyright) but make sure you have what you need in place from the outset to prevent others from using your ideas and hard work as if it were their own.

A thorough review of all of your intellectual property to identify and deal with any lose ends should be undertaken to protect your business going forward.

Contracts

Your business ought to have a set of structured terms and conditions of trade. These need to be reviewed regularly to make sure they remain relevant. If you do not have such terms, is that deliberate or have they been forgotten? This also applies to your suppliers - deals and agreements regularly change in scope and price and your supplier contracts should be flexible enough to cope with changes in demand and specification.

You should ask your solicitor to review your core documents and major contracts and to advise you regarding renegotiation where necessary.

People

Your people may be your biggest asset and a healthy workplace is essential to the success of any organisation. Whether you prefer contractors or employees, all of your staff need to know what is expected of them and what they can expect in return. Directors should have service contracts and all employees should have employment contracts.

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It is increasingly important to have clarity from the outset on who owns/controls any intellectual property rights that may arise as a result of employment. A clearly drafted employment or service contract will assist in resolving any issue which has arisen over ownership and use of IP rights.

This guide is for general information and interest only and should not be relied upon as providing specific legal advice. If you require any further information about the issues raised in this article please contact the author or call 0207 404 0606 and ask to speak to your usual Goodman Derrick contact.

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PROTECTION FOR DIRECTORS
Indemnities and Insurance

Breach of Directors' duties can have serious and expensive implications. Nigel Adams offers guidance on protection via indemnities and insurance.

Please click here to listen to the guide

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WILLS & ESTATE PLANNING
Should I leave my money to one child and not another?

Stephanie Brobbey answers a readers question in the Financial Times.

There is a basic principle under English law, known as testamentary freedom, which means individuals are free to leave their estate to whomsoever they wish. In theory, this means it is perfectly legal for you to leave your assets to your children in unequal shares. However, you have every reason to question whether this is a good idea.

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