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Department of Business, Energy and Industrial Strategy
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By email: labourmarket.consultations@bis.gsi.gov.uk

19 July 2016

Dear Sirs,

Re: Non-Compete Clauses: Call for Evidence

The British Private Equity and Venture Capital Association ("**BVCA**") is the industry body and public policy advocate for the private equity and venture capital industry in the UK. With a membership of over 600 firms, the BVCA represents the vast majority of all UK based private equity and venture capital firms, as well as their professional advisers. Our members have invested over £30 billion in nearly 3,900 UK-based companies over the last five years. Companies backed by private equity and venture capital ("**portfolio companies**") in the UK employ around 490,000 people and almost 90% of UK investments in 2014 were directed at small and medium-sized businesses.

Non-compete clauses are an important business protection for both our members and the portfolio companies our members invest in. Such clauses protect the value of the business and prevent the loss of intangible assets through employees moving to competitors, or as part of a co-ordinated team move, which can threaten the existence of a business. Non-compete clauses, together with other restrictive covenants, are important for our members' own business, because investors are very focussed on key personnel in the fund manager team. Equally, they give our members the confidence to continue to invest in British business, because non-compete clauses are an important element of value protection when making investments and management teams are typically a material part of the investment thesis. The current legal position, in respect of the enforceability of such clauses, has evolved over a long period, and we believe it reflects a good balance between the need to protect employers' legitimate interests and the need for workforce mobility.

This submission has been prepared by the BVCA's Legal & Technical Committee, which represents the interests of BVCA members in legal and technical matters relevant to the private equity and venture capital industry. Given the likely number of responses to this Call for Evidence, we have limited our responses to those questions that we believe are of particular relevance to our members.

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1. Examples of 'non-compete clauses'

Q1a. Are any of the examples above incorrectly being framed as a non-compete clause? If so, why?

While we agree that there is no universally accepted definition and do regard all four to be examples of restrictive covenants typically found in certain employment contracts entered into by our members and their portfolio companies, we would regard only examples a ('restrictions to an ex-worker's ability to work for a competing business') and d ('restricting a worker from setting up a business in a geographical location that would disadvantage their ex-employer') as being appropriately characterised as non-compete clauses. b ('restrictions which prevent an ex-worker from having dealings with the employer's customers or clients') is a 'non dealing' clause and c ('restrictions preventing an ex-worker from hiring workers of the former employer') is a 'non-solicit'/'no poach' clause. We would also note that example d is not reflective of non-compete clauses normally seen in practice. Most commonly, a non-compete clause would combine elements of a and d (i.e. for the clause to restrict the worker from competing with the former employer for a limited period of time but only within a certain specified business description and geographical area).

As noted, we would consider examples b and c to not be non-compete clauses, but rather 'non-dealing' and 'non solicit' clauses (although this term is used extensively these are usually framed as a restriction on soliciting rather than a prohibition on hiring as noted below). This is because they do not prevent a worker from competing with their former employer, but only prevent a worker from engaging in certain specified activities that might also damage the business. We also note that, in practice, the categories of customers or clients or workers covered by clauses similar to b and c would be more limited than the examples above suggest (e.g. limited to those with which the worker subject to the restrictions had had material dealings with in the immediately preceding 12 months) and are typically limited to workers with senior managerial responsibility.

We also note that the term "non-compete clause" is also used outside of employment contracts, in the context of a seller of a business who is restricted from competing with the business that is being sold and for which value is being received. Our responses do not consider the clauses in this context and are focussed on the employment context raised in this Call for Evidence.

Q1b. Are you aware of other examples of clauses in an employment contract which restrict a worker's ability to compete against a former employer? If so, please can you provide examples of these.

Other restrictive covenants commonly found in employment contracts include:

- Restrictions preventing ex-workers from soliciting (i.e. making the first approach to) employees of the former employer, as distinct from hiring workers who approach the restricted party first;
- Restrictions preventing ex-workers from soliciting customers/clients of the former employer, as distinct from having business dealings initiated by the customer;
- Restrictions on ex-workers adversely interfering with suppliers or intermediaries/introducers of work to the former employer, where this would restrict or interfere with their relationship with the former employer;
- Restrictions preventing ex workers from contacting prospective customers/clients where the ex-worker has been involved in the relationship.

As noted previously, although the above are all forms of restrictive covenants, we would not regard such provisions as non-compete clauses, since they do not prevent a worker from competing independently or taking up employment with a competitor of their former employer.

2. The prevalence of non-compete clauses in the UK

Q2a. Do you have examples where non-compete clauses have been used?

Within our members and portfolio companies of the funds our members manage, non-compete clauses are commonly used for the senior management team and other senior or business critical personnel, but not for junior or administrative staff. Members, who are fund managers/advisers, may use partnerships in their structures with certain individuals being partners rather than employees and, if so, non-compete clauses would be used in these partnership arrangements, as well as in the employment contracts of senior employees who are not partners. In portfolio companies, senior managers would typically have non-compete provisions in their employment contracts. However, these provisions are often replicated on equivalent or more extensive terms in investment agreements to which both the fund and the senior managers are party, which govern the terms on which the managers hold equity in the relevant portfolio company, alongside the fund.

Q2b. In your experience, are non-compete clauses particularly used in certain sectors or are they generally used across the labour market?

Non-compete clauses are generally used across the labour market, in our experience.

Q2d. In your experience, are non-compete clauses used only or particularly in relation to higher skilled roles in the UK such as science or tech based jobs?

In our experience, non-compete clauses are commonly used for the senior management team and other key or senior employees of our portfolio companies, whatever their role, although they will be tailored to reflect the role. These are prevalent across all sectors.

6. Could there be any repercussions or unintended consequences if Government restricted some forms of non-compete clauses?

Q6a. Would legislation to restrict the use of non-compete clauses in certain circumstances affect your business? If so, how?

Our members regard non-compete clauses as an important business protection for their own businesses and also for the portfolio companies in which they invest. When investments in British businesses are being considered, account is typically taken of whether reasonable and enforceable non-compete provisions are in place for the key employees of a company. If they are not already in force, a change to the relevant employment agreements is typically sought.

As described above, it is also customary for a member of senior management who acquires an equity stake as part of the investment to agree to restrictive covenants, including non-compete clauses, in the investment agreement to protect the private equity investor. These are typically more extensive

(particularly in terms of duration) than non-compete clauses found in employment contracts and the law permits more extensive restrictions in an investment context than in an employment context.

While it is relatively straightforward to protect the tangible assets of a business from theft or misuse, it is much more difficult and complex to protect intangible assets. Yet these intangible assets – including confidential information, workforce stability, customer/client relationships, know-how, relationships with suppliers and intermediaries and goodwill in the business - are crucial for business success. It is important to appreciate that these intangible assets represent significant embedded cost for business, who may have invested large sums in research and development, market analysis and the time of well-paid employees to develop and maintain crucial business relationships as part of their role.

The loss of these intangible assets through employees moving to competitors or, worse, as part of a co-ordinated team move, can be seriously damaging or even life-threatening to a business. In certain sectors, particularly where knowledge and/or relationships are key business drivers (which includes our members' own business), a team move or senior departure can effectively transfer entire businesses or business units to third parties.

As such, restrictive covenants, including non-compete clauses, are an important protection in protecting the investment made by an employer and its stakeholders.

Q6b. Would such legislation lead to unintended consequences in your opinion?

We note that this Call for Evidence is premised on concern that use of non-compete clauses may be stifling innovation. We understand this concern, but it is important to bear in mind that the law (and as a consequence market practice) currently requires non-compete clauses to be restricted in time and scope. There is potential for further restriction of non-competes clauses to have precisely the opposite effect. Many innovative start-up businesses are in the technology and services sectors where their main assets are intangible. If businesses and investors cannot be confident that these intangible assets can be adequately protected through restrictive covenants, then this may deter investment or prevent start-up businesses from having the stability they need to grow.

Investment decisions are taken in a globally competitive market. The effect of the regulatory environment in a particular jurisdiction is a highly relevant factor and the ability of businesses to adequately protect intangible assets is a relatively important part of that assessment. As such, restriction of the use of non-compete clauses could make the UK a less attractive investment destination for our members. This is obviously more important than ever in light of the economic uncertainty posed by the results of the Brexit referendum.

Q6c. Could you restrict their use in certain circumstances through non-legislative measures?

This would be difficult to achieve (other than through case law).

Q6d. As an employer, would intellectual property law and confidentiality clauses suffice to protect your interests if legislation to restrict the use of non-compete clauses came into force? If not, why?

Intellectual property law and confidentiality clauses would not be adequate to protect business interests, due to two main reasons:

- restrictive covenants are used to protect important business relationships, such as those with customers/clients or key business intermediaries, as well as workforce stability and retaining key personnel. This is appropriate and necessary given the employer may have incurred significant cost in the development of these relationships, their vulnerability to inappropriate misuse, or exploitation by departing employees and the damage that can be caused by their loss. These relationships are not protected by intellectual property rights or confidential information protections.

- It can be extremely difficult in practice to detect or obtain evidence of misuse of intellectual property, confidential information, or attacks on business relationships. This is often explicitly accepted by the courts as a legitimate rationale for the use of non-compete clauses and other types of restrictive covenants.

Q6e. What types of businesses would (or ought) to benefit from additional restrictions on the use of non-compete clauses?

We consider that all types of business both benefit from, and are occasionally hampered by, non-compete clauses. The current legal position in respect of the enforceability of such clauses has evolved over a long period and we believe it reflects a good balance between the need to protect employers' legitimate interests and the need for workforce mobility. While it is true that it can be difficult for start-up businesses to dispute the application of non-compete clauses with bigger and better resourced former employers of their hires, they are also more vulnerable to damage caused by departing employees.

7. In your experience (as an employer, individual, or in your capacity as an adviser) are non-compete clauses transparent?

Q7a. Are you aware of guidance or do you seek guidance on the use of non-compete clauses and the associated intellectual property law and confidentiality clauses? What sources do you use?

We are not aware of publically available guidance. Typically, our members obtain internal or external legal advice when negotiating new non-compete clauses (other than where a standard clause is used for a particular grade of employee) and associated intellectual property law and confidentiality clauses.

Q7b. Could guidance be improved to assist both employers and workers in their understanding of how non-compete clauses should work, what business interests could legitimately be considered as justification for non-compete clauses, and how to prevent such clauses from being inserted in contracts inappropriately?

We think the legal position is relatively clear, but if further clarity were to be provided, it would be important to ensure this is limited to non-compete clauses in the context of employment relationships, and to acknowledge there are other relationships/arrangements where the law differs and, in particular, where greater restrictions are permissible.

Please feel free to contact Gurpreet Manku at the BVCA if you have any queries on this response.

Yours faithfully

Simon Witney
Chairman, BVCA Legal & Technical Committee