

# ЮРИДИЧНІ НАУКИ

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## RESTRICTIVE COVENANTS OF THE EMPLOYMENT CONTRACT AFTER A REPUDIATORY BREACH

**Summary.** The employment contract defines the legal status of a citizen as a participant in certain labor cooperation. Only with the conclusion of an employment contract does a citizen become a member of the labor community and submit to his internal work schedule and labor regime. Considering regulatory and protective functions underlining the essentiality of the employment contracts and wide usage of restricting covenants in the modern-day world, a careful and proper set of actions are needed when the contract is materially breached. The study goes through the cases of repudiatory breach of the employment contracts and analyses the way restrictive covenants are affected as a result of a breach. It shows the general rule concerning the restrictive covenants and different outcomes of repudiatory breach depending on the facts of every case.

**Keywords:** termination, injunction, contracting, clause, career, restriction.

**Introduction.** Since today information can be of vital importance for the revenue-generating ability, growth and even mere existence of the businesses, employers are often interested to include in the employment contracts restrictive terms which would secure this information. Such tendency faces rapid proliferation and is widely used in many countries. Restrictive covenants are the clauses prohibiting the employee from carrying out certain activities after the termination of the employment contract. Palette of used restrictive covenants in employment contracts is extensive:

- non-compete – preventing an employee from entering competition against the employer;
- non-dealing – preventing an employee from accepting business from current or former clients;
- non-solicitation – preventing an employee from contacting current or former clients, though not preventing the employee from accepting business if the client is not induced and
- non-poaching – preventing an employee from soliciting former colleagues to join him in his new enterprise [1].

Even though employment contracts are mainly aimed to protect employees, these terms are one of few on the side of employers restricting the employee during and after the employment relationship.

Repudiation, in its broadest sense, can be attributed to the words reject and renounce. Repudiation of the contract is defined as the denial of the existence of a contract and refusal to perform a contract obligation. A breach can be labelled as repudiatory if it goes to the heart of the agreement thereby fully or mainly excluding the reason and the interest of the innocent party to continue being “loyal” and “appreciate” its terms. Such breach entitles the innocent party not only to free himself from contractual obligations but also terminate it and claim for damages for the party in breach [2].

**Research object.** Theoretical studies and legal cases concerning the repudiatory breach of the employment contract, restrictive covenants and situations where post-termination restrictions failed to survive the repudiatory breach of.

**Research aim.** To determine the effect of the repudiatory breach of the employment contract on restrictive covenants and determine the proper actions of the parties in case of such breach.

### Research objectives:

- 1) analyzing the nature and outcome of repudiatory breach and identifying the conditions giving rise for such breach;
- 2) determining the cases of repudiatory breach of the employment contract;
- 3) based on the case study analyzing the impact of the repudiatory breach on restrictive covenants.

### The effect of a repudiatory breach of the employment contract on restrictive covenants

As it was said earlier repudiatory breach of the contract is a kind of serious violation of conditions or implied terms of the contract entitling the innocent party to accept the repudiation, treat the agreement as non-existing and be freed of further following of the contract. The same rule can be freely applied to the employment contracts. Once the employer or employee is in repudiatory breach of the employment contract, the other party is freed of further compliance with the contract. Once a serious breach has occurred, and the employee has chosen to bring the contract to an immediate end s/he can be freed of own commitments. These commitments also include the restrictive covenants that would otherwise stop the employee from competing with the employer when the employment contract was terminated. As general case law principle establishes, the restrictive covenants lose their limiting power over the employee if the repudiatory breach has occurred on behalf of the employer.

This rule was first established when the preventing effect of repudiatory breach on restrictive covenants occurred in General Billposting LLC v Atkinson. The manager of General Billposting was fired by his employers with deliberate indifference and inattention regarding the terms of the contract where it was clearly shown the absence of the desire of the employer to be bound by the contract. The manager had succeeded to bring a claim for er-

aneous dismissal and then started a business on his behalf. The original employment contract had a provision preventing him from having a trade within a set area for two years after his relations with the company ceased. The employee faced an action against himself for breaching the restraint provided in the original contract. The court did not satisfy the claim of the employer [7]. The company had, in reality, repudiated the contract, and the employee 'was thereupon entitled to rescind from the contract and treat himself as absolved from the further performance of it on his part' so as no longer to be bound by the restrictive trade covenant which the employers were seeking to enforce. The decision of the House of Lords established that, if the employer commits a repudiatory breach of the contract (in other words, a serious one) in dismissing the employee, or if the employee resigns due to the employer's repudiatory breach, the employer will be precluded from relying on the post-termination restrictions in the contract [13].

This case has shown the reasonable and fair outcome of such a serious breach of the employment contract. If the employer did not respect the terms of the employment contract and had no intention to be bound by rules governing rightful dismissal, the common sense would suggest that the employee should also be freed of them [6].

This was the first case considering future existence of the restrictive covenants when repudiatory breach occurs. With the passage of time, the idea of the preventing effect of repudiatory breach on restrictive covenants was developed. Future cases showed that not every breach of the contract by the employer can be regarded as repudiatory. This issue demands the high level of exactness to be demonstrated by the employee in proving the breach by the employer. The precision in claiming a repudiatory breach by the employee is reasoned by the risk that employee bears if the repudiatory breach is not proved. Employee who claims the breach and resigns in response to it is in breach if fails to approve the repudiation properly. Therefore, an employee resigning and claiming repudiatory breach has to approach the issue with a high level of accuracy and proper proof since the contrary still keeps the restrictive covenants in force and binding. The case *Western Excavating v Sharp* sets out four key elements to be considered before claiming against the employer for repudiatory breach.

Mr Sharp, the employee of the company, had a term in his employment contract that he was entitled to have a break from work if he worked longer than was needed by the employment contract. Based on this condition, Mr Sharp was off the work and while playing a card game, he was dismissed. Mr Sharp appealed the dismissal and was recovered at his work but with a five day pay intermission in its place, which led to his financial difficulty. He tried to obtain from employers a payment for his accrued holiday in advance, and when his request was rejected, he asked for a loan of £40. The welfare office also refused his loan request but offered Mr Sharp to visit the office again for a repeated discussion of the issue. Mr Sharp was not satisfied with the offer and consequently resigned. A claim for constructive unfair dismissal was brought at the tribunal [14].

In this case, the court of appeal established three essential elements for the employee to have in order to claim repudiatory breach. These are:

- a sufficiently serious breach of the employment contract on behalf of the employer which justifies the decision of the employee to resign;
- an election on behalf of the employee to accept the repudiatory breach resign as a response to it and regard the contract as ceasing its existence;
- a timely and well-organized expression of the decision of the employee accepting the breach and resigning [10].

General Billposting rule eliminating restrictive covenants in the employment contracts was also developed [9] by a very recent case of *Brown v Neon Management Services Ltd*. The case showed that when employees resign with a long period of notice, they can be regarded as affirming the breach of the contract and bear the risk of losing the right to claim wrongful dismissal. However, if future breaches in the post-notice period occur afterwards, the employees have right to take into consideration the previous affirmed breaches of the contract and claim that together they served as a reason for the employee to resign without notice. Their restrictive terms also cease to exist [3].

Mr Brown, with his colleagues, asserted that Neon Management Services Ltd violated the terms of their employment contracts by not paying the salary increases, discretionary bonuses which were given to them. The employer also made the increases in salaries not available unless new undesirable terms of contract accepted by the employees. The claimants alleged that those violations individually and collectively can be regarded as a repudiatory breach giving the right to them to resign. The resignations took place on 16 March 2018 and were with notice periods of 6 and 12 months respectively. A few weeks later, they alleged that the employer caused other repudiatory breaches of the employment contract when they:

- defaulted on paying the compulsory salary growth and bonuses;
- defaulted on paying profit commissions;
- made ungrounded claims of misconduct by the employees without a proper investigation;
- were not paying enough attention to the managerial issues, not performing obligatory duties, telling them they had lost trust and confidence and that they had been incompetent.

This time Mr Brown and other claimant resigned with immediate effect. The third employee continued to work out his notice period. The suit was brought to The High Court, which claimed for damages declarations of wrongful dismissal, which had an effect of ceasing of post-termination restrictions set by the employment contract.

The result of the claims was successful. All claims were satisfied by the court. Mr Brown and his colleague who had resigned on 1 May 2018 won in their claims of wrongful dismissal and their post-termination restrictions no longer applied. Their colleague who resigned on notice (and indeed was still working out that notice at the time of the hearing) did not claim wrongful dismissal but nevertheless recovered damages for breach of contract in relation to the pay and commission.

It was well-established by the case that in the face of a repudiatory breach of contract, the employee must not leave it too long before resigning; otherwise, he will be taken to have affirmed. However, there were further breaches of contract entitling them to resign as a result of their employer's conduct, and two of them acted promptly in so doing [4].

This case is a vital indicator of the risks of resigning with notice period if the claimant wishes to allege repudiatory breach of the employment contract, claim for damages and to be freed of restrictive covenants. In this case, despite the fact that all three employees resigned in March since they resigned on long notice period (6 and 12 months) the court opted that this period of time was long enough to amount for affirmation of the contract.

However, after the first resignation of the employees, the employer did not stop his violations and continued to act in breach of the contract. This gave the employees the right to resign immediately and be freed of post-termination obligations. The case shows in a practical way the undesirable for the employees consequences of the long notice period. Provided that the employer was not in breach of the employment contract second time, the employees would be regarded by the court as being affirmed the breach.

It is known that restrictive covenants are the main tools to protect the interest of the employer after the employment contract is terminated. As it was seen from these cases, when the employer is in repudiatory breach of the contract, restrictive terms in it cease to exist. As a main condition, the breach must be sufficiently serious to be regarded as repudiatory, and the employee should resign in response to it. Moreover, the resignation should be submitted without long period of notice, since it can lead to affirmation of the breach.

For a more throughout development of the topic, it is necessary to analyze the cases where the repudiation occurs on behalf of the employee and existence of restrictive terms is questioned. Such issue was reflected in *Thomas Marshall (Exports) Ltd v Guinle* [12]. The court established that restrictive covenants cease to exist only if the innocent party, in this case employer, has chosen to accept the repudiation and it is not at the full discretion of the party in breach to be freed of own obligations by repudiating an agreement and benefit from this.

As this case sets the employment contract of the employee does not cease to exist simultaneously with the repudiation of the contract by the employee. The employer is able to choose the contract to continue and afterwards to gain an injunction to prevent future breaches of the employment contract. Even if the employee stopped working in the company, restrictive clauses stated can be maintained by imposing an injunction.

As employment contract stipulated Mr Guinle was the managing director of the retail company. The biggest part of Mr Guinle's work consisted of travelling abroad and arranging contracts. Accordingly, the employment contract of Mr Guinle's had restrictions, which included:

1. The managing director shall "Not at any time during the period of his appointment or after the termination thereof disclose any confidential information relating to the affairs, customers or trade

secrets of the Group of which he shall become possessed while in the service of the company".

2. "During the period of his appointment, the Managing Director shall not, save with the consent in writing of the company, be directly or indirectly engaged, concerned or interested in any other business save that of the company".

3. "If the Managing Director shall cease for any reason to be Managing Director of the company or any of its subsidiaries he shall be under no restriction in relation to any person, firm or company who was or were customers or suppliers to the company or any of its subsidiaries, any rule of law to the contrary notwithstanding, provided that he does not use or disclose any confidential information belonging to any companies in the Thomas Marshall Investments Group, nor within five years employ any person employed by the company during the last two years of his appointment".

Mr Guinle violated the employment contract by establishing own company with similar kind of business 4 years earlier of the termination of the original contract, purchasing goods to cover the needs of own business while being abroad against the interests of the employer and by poaching the clients and employees of T Marshall. The company tried to achieve interlocutory injunction in order to prevent future violations of Mr Guinle's contract. Mr Guinle's claimed that his breaches were repudiatory and since they terminated the contract, the restrictive terms were also brought to an end and consequently, he was free from following them.

The High Court satisfied the claims of the employer, and the restrictive terms in the employment contract did not cease to exist despite his repudiation of it by a violation of the contract. It was at the discretion of the employer to choose their way of reacting to the repudiation. They were entitled whether to accept his resignation or reject it by enforcing the terms of his agreement.

The case also rejected the rule which stated that employment contracts are different from others in terms of repudiation, and once they are repudiated, the contract comes to an end without the election of the innocent party. Following that rule would let a wrongdoer benefit from his or her misconduct [8].

This rule was developed and elaborated in another relevant case *Sunrise Brokers LLP v Rodgers* [11]. This case apart from proving the rules in the previous case concerning the mandatory presence of the acceptance of repudiation by the innocent party also states that non-performance of obligations by the innocent party as a response to the initial repudiation of the contract does not affect the restrictive terms and they still can be enforced.

Mr Rodgers commenced working at Sunrise Brokers LLP at the post of derivatives broker in the year of 2009. In October 2011 he signed another employment contract which required to refrain from resigning until 22 September 2014. Another term of the contract stipulated that Mr Rodgers is obliged to deliver 12 months' prior notice of his resignation in a written form in order to terminate his employment uneventfully until at least 22 September 2015. The contract also contained several restrictive covenants which obliged Mr Rodgers to avoid any form of competition with his employer and dealing with the clients of Sunrise Brokers LLP.

Mr Rodgers on 9 February 2014 without informing Sunrise Brokers LLP gave his consent at joining to a competitor of Sunrise. Mr Rodgers repudiated the contract by keeping his new job in secret and providing confidential list of clients to a party which was a competitor of his original employer on 27 March 2014 he informed his original employer about his decision to resign without notice. After this, he did not return to work at Sunrise. When it was apparent that Mr Rodgers would not return to continue his work at Sunrise, they stopped paying him his wages and bonuses in April 2014.

Sunrise had lately discovered that Mr Rodgers had the intention to start employment with EOX Holdings LLC. The firm accordingly took measures to apply at the High Court to force Mr Rodgers to comply with the terms of his employment contract and to continue working at Sunrise until the diminished period of notice would be expired on 16 October 2014. Moreover, Sunrise sought to get an injunction stopping Mr Rodgers from his work at EOX until his restrictive terms would be expired on 17 April 2015.

Mr Rodgers alleged that Sunrise itself was in repudiatory breach of the employment contract when stopped paying him his salary since April 2014 and that he was subsequently freed from his restrictive terms contained in his contract of employment.

The Court refused Mr Rodgers's claim that the ceasing his payments can be considered as a repudiatory breach of the employment contract since the duty to make payments to an employee is done as a reward for the employee's desire to execute any work given by the employer. Mr Rodgers showed quite clearly that he has no intention to return to Sunrise despite the circumstances, Sunrise consequently was not obliged to pay his salaries. The court also ruled that the non-performance of one commitment (the employer's duty to pay the employee) excuses the non-performance of the other (the employee's duty undertake work provided by the employer) does not mean that the contract of employment is terminated if those duties are not followed [5].

It can be seen from these two decisions that the court came up with a fair and reasonable decision. Firstly, it would be unreasonable to allow the employee to benefit from own breach. Secondly, non-compliance by the employer as a response to initial breach by the employee cannot give rise to repudiatory breach.

**Conclusion.** An innocent party who experiences a repudiatory breach of the contract is always in a complicated situation. On the one hand, the party is allowed to affirm the repudiation keeping contract alive. Doing this, the party agrees to embrace the undesirable consequences which were not envisaged by the original contract but still has a right to claim for damages caused by the breach. On the other hand, by terminating the contract, as a response to the breach, the innocent party takes responsibilities with regard to acting clearly and unequivocally.

These are the factors which are considered when deciding whether the restrictive covenants in the employment contracts survive a repudiatory breach. As is clear from the General Billposting rule, the employer cannot seek to enforce restrictive terms in the contract if it was the employer who repudiated the contract. In such case, the employee is always allowed to rescind from the contracts. With years this rule was made more accurate. The efficient prerequisites for a successful claim were established by the courts. It was set that the breach on behalf of the employer has to be sufficiently serious, and the employee without unnecessary delay must resign in order to terminate the contract uneventfully. As an example showing the importance of not delaying the decision, long notice period (more than six months) can be cited. Such procrastination can serve as a ground for keeping the restrictive covenants alive.

Few cases created the pattern preventing the abuse that the employees in breach could resort to. Thus, it was established that the repudiation can be terminated only by the innocent party and the employee who is in breach cannot free himself from following the restrictive terms. It fairly prevents the employees from benefiting from own breach. Moreover, responsive refusal to follow the contract by the employer as a response to the initial breach by the employee was regarded by the courts as excusable and appropriate therefore not letting the employee to terminate the contract based on employer's non-compliance with the contract.

The case law has demonstrated that when the contract is in fact repudiated by the employer, and the innocent party appropriately accepted the breach, with the termination of the contract restrictive terms of it also lose their binding power.

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