

ARGYLE ADVOCATE

Put a stop to ex-employees stealing your clients

PETER SARDELIC examines how dealer groups can protect themselves from client poaching.

It is important for all dealer groups to confront the issues they face when an adviser leaves the business. Most importantly, how do you prevent your former employee from taking your clients with them?

The case study

John has decided to leave ABC Financial Planning, where he has worked for seven years, having joined when ABC was barely a business, and just



off from ABC Accounting. John helped to build ABC into a highly profitable and valuable financial planning business, and has been responsible for managing and developing half of the client base.

The owners of ABC, Adam and Bill, are annoyed with John's decision. John had no planning experience or client base before joining, and was trained at ABC's cost. Most of John's clients were introduced to him through internal referrals. It had been suggested that John become a part-owner for some time, yet John expected to be given his shareholding for free.

Now John has told them he intends to start up his own financial planning business.

The legal issues

Who owns the client base of a financial planning business? In a true legal sense, the business owner does not own its client base. That said, this doesn't stop people taking strong positions on the issue. Some business owners believe

that nobody owns the client – as such, it is up to the client to determine who will service them.

However, employers adopt a different position. They believe they own their client base and that employees are not entitled to take clients with them should they leave. Adam and Bill are of that view.

Indeed, John was asked to sign an employment contract that stated quite clearly he would not, for a period of at least six months after leaving ABC, establish, take an interest in, or become an employee of any business that competes with ABC. John also agreed he would not solicit or entice away any actual or prospective client of ABC for a 12-month period.

Will the law provide protection when an employee attempts to take clients? The answer in short is yes. First, it can protect an employer's confidential information and, second, protect any properly pre-

pared contractual rights in the nature of restraint of trade clauses.

What is confidential information?

In the case of financial planning businesses, it appears to be reasonably settled law that client lists and information are generally confidential as long as the employer makes this clear to their employees.

While they remain employed, the employee also has fidelity obligations to the employer and is strictly prohibited from competing against their employer.

Therefore, even information that is not strictly confidential, such as the names and addresses of clients,

cannot be used by the employee. The employee, while they are employed, must not contact clients to encourage them to leave when they do.

After the employment relationship is terminated, employees are generally free to recreate this client list by memory and contacting the client directly without breaching confidentiality obligations. The best way to restrain an employee from using this information is through a valid restraint of trade clause.

In ABC's case, these confidentiality rights provided little comfort. John served a one-month notice period and there is nothing to suggest he copied any client files or lists or contacted clients to seek their business. From what Adam and Bill knew, the most he had done was mention to clients in passing that he was leaving and, when the client raised the prospect of following him, he mentioned that his

duty to his employer prevented him from discussing this.

The restraint of trade provision

ABC did, however, have the restraint of trade provision in John's contract. This prohibited him from establishing or operating a similar business to, or in competition with, ABC for a six-month period after termination.

ABC's solicitors sent a letter to John demanding he honour the restraint prohibition and not open his planning practice. John's solicitors responded by pointing out that this prohibition was a restraint of trade designed to prevent competition and could not be enforced by ABC for public policy reasons.

ABC faced a common dilemma. As far as they knew, there was no copying of client files or client information nor was there any evidence that John had breached his duties of fidelity. Although he agreed not to compete, John was not bound to honour the clause.

They had their suspicions that John would take clients, however, until John had left this had not occurred. They also knew the moment John's employment ended his position would be very different. His duty of fidelity no longer applied and, as long as he was not using any client lists or files, he was not breaching any confidentiality obligations.

It is possible to restrain an employee from soliciting clients the employee had a special connection with. The restraint must not be any longer or wider in its operation than what is reasonable and necessary to protect the employer's legitimate interests, otherwise the court will say the restraint is void for public policy reasons.

Within limits, the law will prevent a former employee from exploiting any special connection with a client that developed during the time the person was an employee. However, this is not an automatic legal right. Indeed, this legal right needs to be balanced against the generally accepted entitlement that individuals enjoy their right to work, and for that right not to be hampered by past employment.

The employee must voluntarily agree to grant this right to the employer. In other words, the employee must in the majority of cases enter a contract with the employer that grants these rights, or provides these restrictions.

In very limited circumstances only, the courts will imply a restriction from the employer/employee relationship, following termination of that relationship, but only where circumstances of the prior employment justify this. However, unlike a normal contract that fully binds the parties from the time they sign the contract, the starting position for restraint of trade clauses is that they are void for public policy reasons. The onus of proof is on the employer to demonstrate to the



court that the restraint of trade clause should be enforced.

To do this, the employer needs to demonstrate that the clause does not attempt to do anything more than protect the legitimate interests of the employer. In other words, the restrictions must not be any longer or wider in their operation than what is reasonable and necessary to protect the employer's legitimate interests.

It is for this reason that a restraint can operate to prevent a former employee from exploiting a special connection with clients. However, it cannot extend to all clients of the employer or the clients with which the employee may have had contact but no special connection or influence.

After John's departure, ABC started receiving a standard letter from clients that were previously serviced by John advising that they wanted John to "continue to provide financial services to them" and have their file transferred to John.

ABC was now in a position to do something. John agreed to not solicit or entice any actual prospective clients of ABC. This prohibition operated for a 12-month period and, because John had a close relationship with its clients, ABC felt this obligation was not any wider than necessary to protect ABC's interests. ABC commenced legal proceedings against John on the basis that he breached the non-client solicitation prohibition.

The employer bears the onus of proving the non-solicitation prohibition goes no further than what is reasonably necessary to protect its legitimate interests.

ABC confronted a number of hurdles. It wanted to stop John from approaching any actual prospective clients of ABC. Yet this covered clients with whom John had no prior contract, and in the case of prospective clients, they did not even exist. They had difficulties in explaining why the 12-month restraint period was legitimate and reasonable. They were not able to point to any objective explanation or industry standard as to what was reasonable.

In a future Argyle Advocate column, we will look at how John's contract could have been better structured to protect the interests of ABC.

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