The Life of Riley

It is common to see benefit repayment provisions in employment contracts and sale and purchase agreements. These provisions are usually designed to encourage the employee’s continued employment in return for some form of financial or other benefit provided by the employer. As a general rule, repayment provisions should not be so harsh that they amount to a penalty but otherwise it is not easy to challenge a repayment clause, unless it could be said to be a restraint of trade. A recent High Court case (20:20 London Limited v Peter Riley) has suggested that consideration needs to be given to the disincentive effect of any repayment provision. If it is strong enough to deter an employee from terminating their employment, it may amount to an unlawful restraint of trade and so be judged by the stricter standards applied to such clauses.

The facts

Mr Riley, a high-flying digital marketing entrepreneur, wanted to improve the prospects of his own company by securing a deal with a much larger agency, Digital Marketing Group (DMG). On 11 December 2009, Mr Riley agreed to sell his business to 20:20 London Limited (20:20), a subsidiary of DMG. As part of the deal, £1.5 million in cash consideration was paid into an Escrow Account to cover Mr Riley’s potential liabilities to creditors (the Retention Fund). Under the terms of the SPA, Mr Riley was entitled to the balance of the Retention Fund provided he remained employed by 20:20 for more than three years, or his employment was terminated within this period as a “good leaver”. A “good leaver” meant incapacity to work, death, change of role, or unfair dismissal. A “bad leaver” meant anything other than a “good leaver”. Mr Riley simultaneously entered into a service agreement with 20:20.

In August 2011, Mr Riley was made redundant. He lodged a claim for unfair dismissal in the Employment Tribunal. 20:20 retaliated by suing for the repayment of the Escrow. In the High Court Mr Riley alleged that the obligation to repay such a substantial sum was so strong a disincentive to terminating his employment that it constituted a block on his ability to leave and work elsewhere (in other words, he alleged it was an unlawful restraint of trade). The fact that Mr Riley did not resign but was made redundant was irrelevant, he claimed. He raised a number of other potential defences too, but these were all rejected by the judge.

The decision

The Judge determined that Mr Riley had some prospects of proving his case at trial and so ordered a full hearing to determine the issue. In essence, Mr Riley was able to show that it was arguable the repayment term of the Repayment Fund constituted an unlawful restraint of trade by virtue of its deterrent effect.

Impact

This case has potentially significant implications when dealing with provisions which are designed to encourage an employee’s continued employment in return for some form of employer-provided benefit. This can arise in the context of the following, for instance:

- earn-out provisions in commercial SPAs;
- good leaver/bad leaver provisions in employee share option, bonus or other incentive schemes, if tied into repayment obligations; and
- training cost and relocation reimbursement agreements.
The High Court in *Riley* approached the issue by looking objectively at what impact the repayment provision is likely to have on Mr Riley. Although the Judge said “the restraining effect of a repayment clause cannot... necessarily be assessed by reference to its size alone”, one would assume the greater the value of the potential repayment, the more likely it could be deemed to be a strong deterrent (and so, a restraint of trade). This case suggests that each case has to be looked at objectively based on the employee’s particular circumstances. So, in theory, a training costs repayment provision amounting to a few thousand pounds could potentially amount to unlawful restraint of trade if it concerns a low-paid employee with no other means to make repayment.

The other important point to bear in mind about the *Riley* case, is to look at what it did not decide. It did not determine that the clause was invalid. It merely acknowledged that it was arguable that it was a restraint of trade, and if so, the court would then have to evaluate the legitimacy of the interest it was protecting and whether this clause was a reasonable way of protecting that interest.

However the case is an important one, because it acknowledges the possibility that these clauses are a restraint of trade. As such, it is likely that employers will become increasingly aware of what, until now, has been a relatively unknown route to challenge repayment and similar provisions. Therefore we recommend that employers, when they are looking to put in place clauses which either defer payments for a prolonged period or, in particular, when they require repayment of sums, consider the drafting of these provisions very carefully. It may be quite difficult to convince the court that the clauses are entirely outside the restraint of trade doctrine, particularly if the reality is that they will deter an employee from leaving. Indeed, clauses which are tied into continued compliance with restrictive covenants, or which have a particular detrimental effect if an individual goes to work for a competitor, are very likely to be within the restraint of trade doctrine.

As a general rule, “repayment” clauses should be drafted on the basis that they might be challenged as unlawful restraints. Therefore the clauses should be designed to pass the more stringent test applicable if they have to be evaluated under the restraint of trade doctrine.

### Recommendations

We would suggest bearing in mind the following:

- Ensure repayment provisions are well-drafted to reflect the legitimate interests of the business. Give particular thought to the length of the period for which the repayment provision applies. If a benefit is payable provided an individual remains employed for a period, or a repayment is due if an employee leaves before a particular period, the employer should always consider whether to have the sum forfeited or repayable reduced pro-rata to the amount of time the employee remains with the employer. In other words, if an employee has remained with the employer for 90% of the relevant period, is it appropriate for the employee to forfeit 100% of the benefit or have to repay 100% of the benefit if the employee then leaves early? It may be possible to justify this, but the employer should certainly consider the answer to this question when drafting the provisions of the relevant clauses;

- Disputes in this context can often arise where the employee claims they have been unfairly dismissed. If a repayment provision turns on the cause of the employee’s exit, take special care. In *Riley*, the difference between unfair dismissal and redundancy amounted to £1.5 million;

- If the employee is legally represented and the repayment terms are negotiated, this might help to show the repayment provision was fairly negotiated between the parties; and

- If faced with an employee who alleges that a repayment provision amounts to a restraint of trade, we would recommend taking legal advice. It may be that evidence can be obtained to demonstrate that objectively, the repayment provision should not be so strong a disincentive as to prevent the employee from resigning.

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