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Resigning to Work for a Competitor? Damages could follow...

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The High Court has ruled in *Kynixa Limited v Hynes & others* [2008] EWHC 1495 (QB) that substantial damages were payable by three key employees who did not warn their employer that they were going to work for a subsidiary company of a competitor. The employees were not subject to any post termination restrictive covenants in their employment contracts. However, the court held that the employees deliberately misled their employer regarding their intended resignation, thereby breaching the implied term of good faith and fidelity. The court further held that two of the employees, who were shareholders and held the position of director and head of business development respectively, were also in breach of their fiduciary duty by failing to disclose this information and in breach of the restrictive covenants in the shareholders agreement.

The High Court ruled the three employees positively misled their employer with regard to their intended resignation because at no time prior to or after their resignation did they volunteer the fact that they would be working for a subsidiary of a competitor even though all three employees had negotiated and signed contracts of employment with their new employer before they left Kynixa Limited. The court further held that two of the employees breached their fiduciary duty by failing to act in the best interest of their employer because they failed to report that the employees were in negotiations with a competitor group.

The court also held that although the covenants in the shareholders agreement were drafted fairly widely they were still enforceable against the two employees because they were reasonable given that the two employees were party to trade secrets which could cause significant harm to Kynixa Limited if disclosed to a competitor. The court took into account the fact that shareholders have significant bargaining powers when entering into a shareholders agreement where they stood to make significant financial gain.

The decision in this case places a positive duty on employees with fiduciary duties to disclose their wrongful activity and those of other employees. It also demonstrates that in addition to relying on post termination restrictive covenants in an employment contract or shareholders' agreement, an employer can seek damages through other implied terms of the employment contract.

Conclusion

Whilst employers should always have precisely drafted restrictive covenants in employment contracts to stand the best chance of protecting their legitimate business interest and limit competitive activity by a former employee, the decision in this case enables the employer to cast the net wider and take action against the employee using other implied terms in the contract or other agreements where there is no express restrictive covenant in an employment contract. Given that employees generally sign a contract with a new employer before they hand in their resignation to the current employer, this case should serve as a warning to senior or key employees that they risk being in breach of their duty of good faith and fidelity or fiduciary duties if they are going to work for a competitor and fail to disclose this information to their current employer when they resign.