

Restraint of Trade Clauses

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Generally

1. At common law a restraint of trade is void unless it is justified by the special circumstances of the particular case. Its enforceability depends on the plaintiff being able to point to:
 - a) a proprietary interest it is seeking to protect by means of the restraint;
 - b) the restraint being reasonable.

See *Restraints of Trade Act 1974*, s.4 (1).

2. A covenantee is not entitled to be protected against mere competition. Importantly a covenantee cannot rely on a restraint of trade clause if the contract is terminated due to its breach.
3. The validity of a restraint is to be judged at the time at which the contract is made, by reference to what the restraint entitles or requires the party to do, rather than what they intend to do or have actually done: *Nordenfelt*, 573-574; *Commercial Plastics Ltd v Vincent* [1964] 3 WLR 820, 829; *Curro v Beyond Productions*, 344; *Woolworths Limited v Olson* [2004] NSWCA 372, [40].
4. The court will read down the restraint but will not undertake a reconstruction of it. The task of the court is to define the outer limits of the restraint: *Orton v Melman* [1981] 1 NSWLR 583 at 587.
5. Where there is ambiguity, a covenant in restraint of trade in an employment contract will be construed in favour of the employee, so that a narrower construction of the scope of a restraint will be preferred to a broader construction when both are reasonably available: *Mills v Dunham* [1891] 1 Ch 576, 589-90; *Vanderwell Products Limited v McLeod* [1957] RPC 185, 193; *Littlewoods Organisation Limited v Harris* [1977] 1 WLR 1472, 1486; *Butt v Long*, 487.

Relevant Proprietary Interests

6. The usual proprietary interests sought to be protected are:

Employment Contracts

- a) Confidential information: *Wright v Gasweld* (1991) 22 NSWLR 317 at 341.
- b) Customer connection/goodwill: *ICT P/L v Sea Containers Ltd* 39 NSWLR 640 at 671.

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- c) Employee connection: *Cactus Imaging Pty Ltd v Peters* [2006] NSWSC 717, [43]-[59]; *John Fairfax Publications Pty Ltd v Birt* [2006] NSWSC 995, [32]; *McHugh Holdings Pty Ltd v Newtown Colonial Hotel Pty Ltd* [2008] NSWSC 542, [45]; *Del Casale v Artedomus (Aust) Pty Ltd* [2007] NSWCA 172; (2007) 73 IPR 326, [130].

Goodwill

7. The validity of a restraint must be determined as at the date of the agreement with the court taking into consideration future probabilities if they could have been foreseen: *Lindner v Murdock's Garage P/L* (1973) 133 CLR 288 at 318.
8. The court in construing the restraint is concerned with resolving any ambiguity not with re-writing of the covenant. Where the covenant does not specifically state the interest sought to be protected, the court is entitled to look at both the wording and the surrounding circumstances to ascertain the purpose: *Koops Martin* at [19]. Where the purpose is stated the plaintiff cannot later justify the covenant by reference to another purpose: *Koops* at [19].
9. Construction is informed by the factual matrix in particular the employer's business, the scope of which can be proved by extrinsic evidence, and the employee's role in that business: *Portal Software v Bodsworth* [2005] NSWSC 1179, at [76].
10. Importantly, the construction is performed with reference to the subject matter of the restraint. So that were words of general import are used the court will read those down so as to limit their operation to the relevant context. *Portal* at [68].
11. In *Portal Software v Bodsworth*, Brereton J considered a restraint preventing the former employee from entering the services of another company that could compete with the services and products of Portal. The meaning of the words "services and products of Portal" was established by reference to the evidence of the nature of the products and services falling within the scope of Portal's business. Further the court had to consider the meaning of 'could compete' in this context. Brereton J held that those words were only concerned with entities that were participants in the market which at the time of the alleged breach had the capacity as a matter of practical reality to compete in the market for Portal's services or products.
12. The second step is for the court to determine whether the restraint as construed is reasonably necessary to protect the plaintiff's legitimate commercial interest and is not unreasonable in the interests of the public. That naturally raises the question "what is the plaintiff seeking to protect".
13. A restraint will not be considered to be reasonable if it seeks to prevent the employee from working in an area of activity in which he had never worked before: for an example see *Portal* at [84].
14. Importantly, covenants which simply refer to 'competitors' or a particular 'business' rather than specifying particular activities, have been held to be excessive if the former employer undertakes other, non-protectable, activities in competition : *Portal* at [84].

Confidential information

15. Since the English Court of Appeal's decision in the *Faccenda Chicken* case it has been clear that confidential information can only be protected **after** employment by way of covenant: *Wright v Gasweld* (1991) 22 NSWLR 317 , 341.
16. The difficulty with relying on nothing more than a clause dealing with the protections of "confidential information" is that the plaintiff must be able to identify the confidential information with specificity (see *Amway Corp v Eurway International Ltd* [1974] RPC 82 at 86; *Corrs Pavey Whiting & Byrne v Collector of Customs (Vic)* (1987) 14 FCR 434), and having done so then point to the steps it had taken protect its confidentiality.
17. Another difficulty is that it is very difficult to prove a breach when the information is of such a character that an employee can carry it away in his/her head.
18. The remedy to these difficulties has been to take a covenant from the employee by which he/she undertakes not to work for a rival trader and/or not to contact clients of the former employer.
19. The most recent case in this area is the decision of the NSW Court of Appeal in *Dell Casale v Artedomus (Australia) Pty Ltd* [2007] NSW CA 172. The plaintiff was an importer of stone which it obtained from the Ragusa region of Italy. The source of the stone could not be easily ascertained and the plaintiff had made efforts to keep the source a secret by limiting access to a few people in the company. Two employees left. One had signed a deed covenanting to keep confidential all commercially sensitive information. One of the two set up a company and used the said information.

The judge at first instance found that the information was confidential and of a kind which equity would have protected even without the deed.

The Court of Appeal accepted that the term of the deed did apply to information relating to the source of the stone (that it was confidential) but unfortunately for the plaintiff there was no evidence to establish that the person who had signed the deed had engaged in any action in breach of the deed. In regard to the 2nd employee who had not signed the deed, the court held that the problem was that the information was difficult to separate from the employee's general knowledge. So in the absence of a contractual restraint the information could be used by that former employee.

20. General Rules Re Drafting of Confidentiality Clauses.

- Specificity: many such documents have as their hallmark a generic definition of what constitutes 'confidential information'. The adoption of such a generic description can cause significant difficulties when it becomes necessary to enforce the terms of the contract, especially in the context of employment contracts and trade restraints. As Jessup J said in *Dais Studio Pty Ltd v Bullet Creative Pty Ltd* [2007] FCA 2054 at [95]

"the confidentiality agreement was, of course, a document of Dais's own drafting. Rather than specify the separate categories of information which it desired to be covered by that agreement, Dais chose to refer to the information generically and must, I consider, live with the consequences of such ambiguity as may be involved in its choice of words."

There is also the tendency to refer to ‘proprietary information’ in such documents. Again the comments of Jessup J when confronted by that term should be taken to heart:

“There remains the question whether any of the information to which I have just referred was “proprietary information”. Information as such, of course, is not property: see TS & B Retail Systems Pty Ltd v 3Fold Resources Pty Ltd (2003) 57 IPR 530, 537, and the authorities there cited; . When information is secret or truly confidential in fact, there is a sense in which the person by whom the information is known might be said to own the information. At times, the concept of property has been used – metaphorically as I appreciate it – to describe the position existing when information cannot be used or revealed without breach of the equitable obligation of confidence: see Deta Nominees [1979] VR at 193. However, it is difficult, if not impossible, in my view, to consider how any, even metaphorical, invocation of the concept of property could be legitimately made in circumstances where there was no obligation, equitable or contractual, to keep the information confidential.”

- The restriction must be reasonable. It is unlikely to be so if it seeks to make the restraint operative in respect of public domain information or for all times.
- Canvass all types of infringing behaviour. A restraint against publication does not mean a restraint against use.

21. In *Great Southern E-Vents Pty Ltd v Peskops* [2007] NSWSC 382, the plaintiff sought an interlocutory injunction restraining the defendant from contacting customers solely based on a confidentiality clause. Senior counsel was not able to point Hamilton J to any cases where an injunction against poaching of clients had been founded solely upon a clause forbidding the use of confidential information. His Honour cited from the judgment of Palmer J in *Digital Pulse Pty Ltd v Harris* [2007] NSWSC 33 the following passage:

“When the employment ceases, the employee is free to compete with the employer unless subject to a valid contractual restraint on competition. The employee may take away and utilize the benefit of personal relationships built up with particular customers of the former employer and may solicit any customer whom the employee can recall without the aid of a list taken from the former employer and without deliberate memorization of a customer list. The employee may not, however, use for his or her own benefit confidential information of the former employer, whether to solicit business from the former employer’s customers or to carry out work for such customers even if unsolicited.”

Customer Connection.

22. An employer’s customer connection is an interest which can support a reasonable restraint of trade: *Koops* at [29]-[33]. Such a restraint is legitimate if the employee has become, vis-à-vis the client, the “human face” of the business, namely the person who represents the business to the customer: *Koops* at [34]; *Cactus Imaging Pty Ltd v Glenn Peter* [2006] NSWSC 717.

23. While the employer is not entitled to be protected against mere competition by a former employee, the employer is entitled to be protected against unfair competition based on

the use by the employee after termination of employment of the customer connection which the employee has built up during the employment. *Koops* at [30]. The restraint may have to be limited to customers with whom the former employee had a relationship. It may extend beyond customers with whom the employee has personal contact where the employee may have acquired influence over or special knowledge of the clientele as a result of the seniority of his or her position, or where the employee's role includes obtaining and extending custom for the employer's business: *Stenhouse Australia Limited v Phillips* [1974] AC 391; *Koops* at [44]].

24. Generally, the test of reasonableness for the duration of a non-solicitation covenant, when it is supported by customer connection, is what is a reasonable time during which the employer is entitled to be protected against solicitation, which in turn depends on how long it would take a reasonably competent replacement employee to show his or her effectiveness and establish a rapport with customers: *Koops* at [88]]. But where protection of confidential information is involved, considerations such as how long the information is likely to remain current and of commercial advantage will also be relevant.

Non-recruitment covenant

25. McDougall J in *Kearney v Crepaldi* [2006] NSWSC 23, expressed the view that a covenant given by an employee to an employer prohibiting the employee after termination from soliciting former fellow employees to join a new business venture may not be justified simply by the employer's interest in maintaining a stable trained workforce, but may be justified where the solicitation is based on confidential information which the former employee has concerning the relationship between the other employees and the employer (at [58]):-
26. In *Koops*, Brereton J expressed the opinion, that staff connection constitutes part of the intangible benefits, which may give a business value over and above the value of the assets employed in it, and thus comprises part of its goodwill. It is therefore amenable to protection by a covenant in a manner similar to customer connection, even in the absence of protectable confidences.
27. In the absence of confidential information, similar considerations inform the reasonableness of such a covenant in respect of its duration as are relevant to the reasonableness of a covenant protecting customer connection: essentially, how long might the hold of the former employee over the other employees be expected to last before weakening. That will be influenced, inter alia, by the seniority of the former employee. Another consideration is that it is within the capacity of an employer to ensure the stability of its workforce by offering key staff long term contracts of employment, so that solicitation of staff with such contracts would constitute the tort of inducing breach of contract.

Doctrine of restraint of trade applies during employment as well as after termination:

28. *Tullett Prebon v Simon Purcell* [2008] NSWSC 852: Employee repudiated employment contract by resignation. Employer did not accept repudiation but elected to affirm.

The cases have drawn a distinction between the contract of employment on the one hand, and the relationship of employer and employee on the other, so that although the contract survives repudiation unless and until accepted or otherwise terminated, the

relationship of employer and employee does not, because the substratum of trust and confidence inherent in that relationship no longer exists, and the obligation to render services will not be specifically enforced: *Automatic Fire Sprinklers v Watson*, 450-2, 456-7 (Latham CJ), 463 (Starke J), 469 (Dixon J), 476-7 (Williams J); *Boston Deep Sea Fishing & Ice Co v Ansell* (1888) 39 Ch D 339, 364-5; *Hill v C A Parson & Co Ltd* [1972] Ch 305, 313-4.

The doctrine of restraint of trade applies to restrictions imposed on trade with a third party during the currency of a contract: *Tullett* at [45].

Remedies

29. Even where a restraint is valid, equity retains a discretion as to whether and if so how far to enforce it, although exceptional or compelling reasons will be required to persuade the court to decline injunctive relief in relation to the enforcement of such stipulations: see *Maitland Main Collieries v Hunter Valley Coal*, [62]; *John Fairfax v Birt*, [45]; *Otis Elevator v Nolan* [2007] NSWSC 593, [17], [29], [40].
30. In exercising the discretion to grant or withhold injunctive relief, the court has regard to the circumstances as at the date of hearing (*Kone Elevators Pty Ltd v McNay (No 1)* (1997) ATPR ¶41-563).

Recent Significant Cases.

1. *Portal Software v Bodsworth* [2005] NSWSC 1179
2. *Koops Martin v Dean Reeves* [2006] NSWSC 449
3. *Cactus Imaging Pty Ltd v Glenn Peters* [2006] NSWSC 717
4. *Linwar Securities Pty Ltd v Christopher Savage* [2006] NSWSC 786
5. *Woolworths v Banks* [2007] NSWSC 45
6. *Primacy Underwriting Agency Pty Ltd (formerly Landmark Underwriting Agency Pty Ltd) v Kilborn* [2007] NSWSC 158
7. *Great Southern E-Vents Pty Ltd v Peskops* [2007] NSWSC 382
8. *Austress-Freyssinet Pty Limited & Ors v Kowalski* [2007] NSWSC 399
9. *Otis Elevator Company Pty Ltd v John Nolan* [2007] NSWSC 593
10. *Australian Regional Wholesalers v Stafford* [2007] NSWSC 572
11. *Bromhead v Graham* [2007] NSWSC 609
12. *Icetv v Duncan Ross and Ors* [2007] NSWSC 635
13. *Del Casale and Ors v Artedomus (Aust) Pty Ltd* [2007] NSWCA 172

14. *Run Corp Limited v McGrath Limited* [2007] FCA 1669
15. *Fadu Pty Ltd (CAN 007815090) v ACN 008 112 196 as Trustee of the "International Linen Service Unit Trust"* [2007] FCA 1965.
16. *Tullett Prebon v Simon Purcell* [2008] NSWSC 852
17. *IceTV Pty Ltd v Ross & ors* [2008] NSWSC 1321 (17 November 2008)
18. *Blockbuster Australia Pty Ltd v Karioi Pty Ltd* [2009] NSWSC 1089 (16 October 2009)
19. *AIIB Pty Limited v Beard* [2009] NSWSC 1001 (24 September 2009)
20. *Northern Tablelands Insurance Brokers Pty Ltd v Howell* [2009] NSWSC 426 (22 May 2009)