

Restraint of Trade Clauses in Employment Contracts

1. INTRODUCTION

Employment Contracts commonly include a restraint of trade – namely a clause that aims to prevent the employee from engaging in an activity after the employment ends.

At law, it is considered in the public interest that restraints of trade are void except to the extent they reasonably protect legitimate business interests.

This results in a test which has two parts:

- (a) Does the employer have an interest to protect?
- (b) Is the restraint worded such that it covers what is reasonably necessary to protect those interests?

By its very nature, restraints protecting an employer from a departing employee can only reasonably be for a shorter period than restraints in favour of the purchaser of a business.

2. LEGITIMATE BUSINESS INTERESTS TO PROTECT

The employer must be able to identify a particular business interest that it legitimately seeks to protect. It is not enough to simply seek to stop former employees from working for a competing business.

Generally, the following business interests have been identified by courts:

- Confidential information

This relates to information which by its nature is confidential, such as customer lists and contact details, pricing schedules, and detailed product information. The mere fact that a former employee had access to confidential information is not, in itself, sufficient to justify a restraint.

- Customer connections

Clauses to protect the employer's customer base usually seek to prohibit solicitation – namely approaches by the employee seeking to entice the customer to change supplier.

This is significant where the employee has had involvement with customers such that the employee has connections which might affect business in the future – such as a sales person.

The risk of solicitation of customers occurring is generally high in professional businesses, such as accounting, legal, and broker firms. This is because the employee has the opportunity, and the obligation, to develop a personal relationship with clients.

- Poaching of the Employer's staff

An employer clearly has an interest in maintaining a stable workforce. Accordingly, most restraint clauses seek to prohibit solicitation of staff.

The enforceability of the restraint clause depends upon the duties performed by the employee and his or her position overall in the organisation. For a business interest to be capable of protection, the employer must be able to demonstrate that it will suffer real harm if the employee is not restrained.

Once a business interest has been identified and is considered capable of being protected, it is necessary to consider what is reasonably necessary to protect this interest.

3. IS THE RESTRAINT REASONABLY NECESSARY TO PROTECT THOSE INTERESTS

The restraint must be reasonable in all circumstances. This is assessed as at the time the employment agreement was entered into. Therefore, it is important to consider the role in which the employee was being employed, and whether it was anticipated that this role might develop.

This might be affected if new contracts have been signed at each change in role.

4. WHAT IF THE RESTRAINT IS TOO WIDE?

As the starting point is that a restraint that is wider than reasonably necessary is void, the consequence of a restraint clause which is drafted too widely is that it is void.

Often drafters fall into the trap of drafting a very wide provision, seeking to protect the employer's interest. However, overreaching can mean destroying any chance of protection.

For example:

- If the employer only trades in South-East Queensland, there is no business interest to protect outside that area.
- If supply to customers occurs monthly, there might be no need to prevent the employee from competing for 12 months. That is, if the employer cannot form a new business relationship with a customer over a number of dealings, then it has no real interest to protect.
- If the role which the employee had was sales, but the new role will be helpdesk support, with no contact with prospective customers, then seeking to prevent the employee from working in any role might be too wide.

5. CASCADING CLAUSES AND SEVERENCE

It is now common for restraints to be drafted with cascading provisions, such as:

- The restraint is for 12 months;
- If that is void, then it is for 6 months;
- If that is void, for 3 months;
- If that is void, for 1 month.

Cascading clauses in relation to geography are commonly worded in this manner:

- The restraint covers all of Australia;
- If that is void, then all of Queensland;
- If that is void, then South-East Queensland;
- If that is void, then Brisbane.

There is commonly a clause which provides that any part of the restraint which is considered void can be severed, and the remaining clause stands as valid.

This type of clause has been held by courts to be valid, and as a consequence, now commonly appears in restraints. The result of this however, is that the contract is not clear as to what in truth is the restraint which is objectively reasonable.

6. COMMENT REGARDING NSW LAW

In New South Wales, the *Restraints of Trade Act 1976* (NSW), allows the court to ignore the fact that the restraint goes beyond what is reasonable, provided the restraint can be enforced to the extent that is reasonable.

This is not the law in Queensland.

7. ENFORCING THE RESTRAINT

An employer seeking to enforce a restraint must act without delay and seek an injunction (on an interim basis, known as an interlocutory injunction) to restrain the other party. Otherwise, seeking to enforce the restraint can become redundant.

In order to obtain an interlocutory injunction, the employer must establish a serious question to be tried (that is, demonstrate that the court is likely to find the restraint is reasonably necessary to protect the legitimate business interests of the employer). The employer must also prove that the balance of convenience favours the injunction being granted and that they will suffer irreparable injury for which damages are not an adequate remedy, if the injunction is not granted.

When seeking an interlocutory injunction, the employer will almost always need to provide an undertaking as to damages. That is, if there is a subsequent trial, and the employer is unsuccessful, it agrees, by way of undertaking, to pay all damages which flow from that interlocutory injunction having been granted.

8. RESPONDING TO AN APPLICATION FOR INJUNCTION

The employee will clearly seek to demonstrate that there is no risk that harm will be suffered by the employer. That is, an injunction is a discretionary remedy, and if there is no need to grant an injunction, then it should not be granted.

There might also be a legal argument available where an employer has unlawfully terminated the employment of the employee, or has breached the employment contract and the employee terminates the contract in reliance on that breach. That is to say, if the employer breaches the employment contract such that it is not relying upon it, it can hardly then seek to enforce the restraint.

9. CONCLUSION

Both enforcing a restraint of trade and opposing an application seeking one can be a costly exercise, involving a significant time commitment which tends to distract both parties from their continuing business affairs.

However, from the employer's perspective, if there is a real risk that its business will be damaged, then circumstances might dictate that for business reasons, the employer must commit to protecting itself.

From the employee's perspective, if you receive a demand that will prevent you from being able to work, you might be forced into the position of protecting your livelihood.

The result is that critical analysis should be undertaken at an early stage to understand your rights and duties.

10. HOW WE CAN HELP YOU

Our team can advise throughout the entire employment relationship, from drafting the employment contract, through to advice when the employment relationship ends and, if there is a need, to acting and appearing in litigation or other dispute resolution to protect your interests and income.