

Drafting enforceable restraints on ex-employees ... the question is
“why”?

I like restraint, if it doesn't go too far.
(Mae West, American actress, 1893-1980)

The concept of restraint is used rationally and not too literally, judged by reference to its practical effect. Generally speaking, an agreement in restraint of trade is one whereby a party agrees to restrict their liberty in the future to carry on trade with others as they choose. In a contract of employment, restraints usually take expression in one or more provisions directed at restraining ex-employees from working for a competitor, or soliciting customers away from, or poaching employees of, their former employer.

The courts generally take a stricter view of restraints in contracts of employment than of similar covenants between vendor and purchaser. One reason for this is that, while a purchaser has a right to protect the goodwill for which it has paid, it is said that an employer has no right to prevent an employee from competing with it. This means that a court will usually examine a restraint carefully when called upon to enforce it.

As concerns contracts of employment, the common law applies in Western Australia. This paper approaches the topic of drafting enforceable restraints on ex-employees from that standpoint.

Only reasonable restraints are enforceable

It is notorious that, at common law:

Every restraint of trade is presumed to be void, in the sense of being unenforceable, but this presumption can be rebutted. The applicable test is that the presumption will be rebutted if the restraint is judged to be reasonable by reference to the interests of the parties concerned and reasonable in reference to the interests of the public.

It has been suggested that the rationale for the presumption that a restraint is void is public policy, it being assumed to be injurious to the interests of the state or the community because an individual's freedom to trade or work should be protected, or to provide relief from the unconscionable behaviour of those who have used their superior bargaining positions to impose restraints on others.

As for reasonableness, it was recently observed in the Court of Appeal in the Supreme Court of Western Australia that:

The test to be applied in determining the validity of a restraint of trade was stated by Lord Macnaghten in Nordenfelt v The Maxim Nordenfelt Guns and Ammunition Co Ltd ...:

"All interference with individual liberty of action in trading, and all restraints of trade of themselves, if there is nothing more, are contrary to public policy, and therefore void. That is the general rule. But there are exceptions: restraints of trade and interference with individual liberty of action may be justified by the special circumstances of a particular case. It is a sufficient justification, and indeed it is the only justification, if the restriction is reasonable - reasonable, that is, in reference to the interests of the parties concerned and reasonable in reference to the interests of the public, so framed and so guarded as to afford adequate protection to the party in whose favour it is imposed, while at the same time it is in no way injurious to the public."

Also:

... Special circumstances means no more than the facts of the particular case from which reasonableness can be inferred. The Court will judge whether the restriction is reasonable having regard to the interests of the parties concerned and to the interests of the public. If the restraint is not reasonable by reference to the interests of the parties and the public then it is contrary to public policy and void

Purpose of this paper

The principles stated above seem to sometimes get lost in “boilerplate” restraints of such complexity that they beg the question whether any reasonable person could ever understand them sufficiently to be able to agree to them in the first place. Or, the provisions are “cut-and-paste” versions from other documents, which are inappropriate for the contract in question, and which have been included without a great deal of care for whether they are truly reasonable or not.

The aim of this paper is to emphasise that, before drafting actually begins, the proposed restraint requires a detailed and considered examination of the facts prevailing at the time of the making of the contract of employment about the nature

and extent of the business of the employer and the proposed role of the new employee.

After all, this is ultimately what a court will do if called upon to enforce a restraint. It is suggested that it is far better that the task be undertaken at the time of drafting a restraint, rather than be left to when proceedings commence in court.

Onus of proving a restraint is reasonable

Furthermore, the onus of proof in establishing that a restraint is reasonable as between the parties is upon the party seeking to enforce it, namely, the employer. A clear understanding of the facts at the time of drafting the provision will aid in determining what is reasonable for the parties to agree to by way of a restraint of the employee in question. It will direct the process of drafting, and will result in a provision that will have the best chance of being enforceable by an employer.

The question, “why”

At the start then, when presented with the task of drafting a restraint on an ex-employee, it is worth asking the question, “why”? Why is it necessary to restrain the employee in question after they leave their employment, in the manner sought, taking into account what they are being employed to do in the employer’s business?

In this regard, it will be relevant to consider matters such as the interests of the employer that are sought to be protected, the duration of the proposed restraint, and the geographical area in which it will operate. For example, as to the first-mentioned of such matters, if the restraint proposed is of the proverbial tea lady, then it is difficult to see why any interest of the employer needs to be protected against her working for a competitor. On the other hand, it may be perfectly reasonable to restrain an employee who will be the recipient of commercially-sensitive information from using that information for the benefit of a competitor after they leave their employment.

When do you ask the question “why”?

As a part of a contract, if called upon to enforce it, a court will first need to determine the meaning of a restraint in the context of the contract as a whole, as it would any other contractual provision that was sought to be enforced. This process of interpretation of a contract will involve the ascertaining of the meaning which the document would convey to a reasonable person having all the background which would reasonably have been available to the parties in the situation they were in at the time of the contract.

It follows that, even though the parties intend that a restraint operate after the termination of a contract, the contractual intention of the parties about the meaning of the provision, at the time of the making of the contract, determines the nature and extent of its intended post-contractual operation. In other words, the date for the assessment of the reasonableness of a restraint is the date on which it was made. Hence the suggestion that this be the time at which the question, “why”, is asked.

“Why” relates to what is reasonable for the parties to agree

When determining contractual intention, the court will not be concerned with the subjective intention of the parties, but with the objective effect of the restraint clause. The subjective reasons of either party in seeking or agreeing to the inclusion of a restraint is irrelevant to whether it is reasonable, that being a question of law, which depends on the true construction and legal effect of the contract.

This means that the point of asking the question, “why”, is not to determine the parties’ separate subjective intentions about why they wish to include a restraint in the contract of employment (e.g. the employee may be willing to do so simply to get the job). Rather, the object is to determine what is reasonable for them to agree to at the outset of the employment relationship.

As for developments subsequent to the making of the contract (such as, for instance, increasing seniority, pay increases and promotions of the employee), they may be considered:

... not to determine whether the Agreement was reasonable as between the parties but to determine whether it was a reasonable one to make at the relevant time, having in mind the best estimate that they could make for the future.

What are the employer’s legitimate interests for protection?

Before assessing the reasonableness of a restraint, a court will first consider the range of interests relied on by the employer as said to require protection by the restraint in question in order to determine whether it was a legitimate interest for protection at all, in that it was a reasonable one by reference to the interests of the parties to the contract and the interests of the public.

As apparent from the general presumption that restraints are unenforceable, an employer’s interest in being protected from competition by an ex-employee is, of itself, not a legitimate interest. Also, simply to try and restrain an employee from working for a competitor, because they are, say, good at what they do as a result of

the skill and experience that they have acquired with the employer is not a legitimate reason for a restraint provision.

Restraining competition/non-solicitation of clients

On the other hand, where an employee is brought into personal contact with customers, then he may by agreement effectively bind himself to abstain after the term of his employment from soliciting the customers of his former employer as:

*In these cases the covenant in restraint of trade is not a covenant against mere competition but is a covenant directed to securing a reasonable protection of the business interest of the employer The interest which can be validly protected is the **trade connection, the goodwill** of the business,*

(emphasis added).

The legal meaning of “goodwill” has been stated as being:

... the attractive force which brings in custom. It is the one thing which distinguishes an old established business from a new business at its first start.

Trade (or customer) connections can be considered as a part of the attractive force (i.e. goodwill) of a business in that they bring in business. Thus, the business interests of an employer that may be legitimately protected by a restraint provision include the protection of established customer connections. An employer can impose a restrictive covenant to reasonably protect its business against ex-employees taking customers with them. Adopting the “why” approach, if the facts at the time of the making of the contract suggest that the proposed employee will be involved in a substantial way in the maintenance and development of customer connections, then it may be reasonable for the parties to agree to a restraint provision that adequately protects the employer’s interest in such connections.

By way of illustration, consider once again the example of the proverbial tea lady. It is unlikely that she would usually be involved in the maintenance and development of customer connections as such, no matter how many times she attends on them and interacts with them when they visit an employer’s business. Hence, it would be very difficult to conceive of a restraint being included in her contract for the purpose of protecting the employer’s interest in its customer connections should she leave her employment to work for a competitor.

By contrast, the matter might be quite different if the answer to the question “why” reveals that, at the time of being employed, it is contemplated that an employee will be directly involved in getting to know customers, and will build influence over them

on behalf of the employer. Protection of an employer's interest in customer connections after that type of employee leaves their employment is a legitimate interest justifying the inclusion of a reasonable restraint in their contract of employment.

By way of example, consider the following clause that was the subject of consideration in *Geraghty v Minter*:

Should the third party or the fourth party [leave] ... for any reason whatsoever then and in every such case the third party and the fourth party and each of them shall not exercise carry on or be in any manner whatsoever either directly or indirectly concerned or interested by himself or herself or in partnership with or as manager servant or agent for any other person, persons, company, corporation engaging in the trade or business of a similar nature within a radius of twenty (20) miles by the nearest practicable route by road from the corner of Sunbrite Avenue and Gold Coast Highway, Mermaid Beach aforesaid for a period of three (3) years from the date of retirement acquisition termination cessation (sic) or as the case may be.

Gibbs J said of this provision:

*The questions ... are whether the respondents had an interest that they were entitled to protect and, if so, whether the restriction imposed ... exceeded what was reasonably necessary to protect that interest. **At the time when the deed was executed,** ... It is apparent that **such a business will depend to a considerable extent - possibly to a large extent - on the personal relationship that exists between those conducting the business on the one hand and those managing the affairs of the insurance companies on the other. When the appellants were taken into the respondents' business ... on the Gold Coast,** they were placed in a position that enabled them to form their own associations with the members of the staffs of the insurance companies who were responsible for giving the instructions that led to business for the loss adjusters. **It was likely that any associations formed in these circumstances would be of great value to the appellants if they chose to set up a competing business ... on the Gold Coast.** If the appellants derived an advantage in that way, it would be to the disadvantage of the respondents' business. In these circumstances, **if the appellants had been employed by the respondents as servants ... there can be no doubt that the respondents would have had an***

*interest which they were entitled to protect by an appropriate covenant preventing the appellants from competing with them. The respondents would have been entitled to **protect their business and the goodwill attached to it, and for that purpose to prevent the appellants from misusing their acquaintance with the respondents' clients and taking advantage of the respondents' trade connexions.** A covenant such as [the one above] would in those circumstances have been upheld on the authority of a line of cases ... ,*

(emphasis added).

As is evident, when analysing the restraint, Gibbs J focussed on the facts at the time of the making of the contract, an approach consistent with the thesis that, when presented with the task of drafting a restraint, first, ask the question, “why”.

Non-solicitation of employees

Restraining an ex-employee from poaching other employees away from their former employer is not an easy matter as it is usually met with the argument that, unless proper notice of termination has not been given, an employer cannot prevent an employee from resigning to work for another (as long as the employee does not do so in breach of a reasonable restraint). Moreover, in Western Australia, it has been suggested that the impact on goodwill from the departure of an employee, of itself, is only an “indirect” impact on goodwill that is not a legitimate interest for protection by a restraint provision.

Confidential information

Despite this, it is arguable that an employer has a legitimate interest in maintaining a stable, trained workforce in highly competitive business environments and, so, should be able to protect this by a reasonable restraint if the employee in question has confidential information about other employees that they could use for the purpose of enticing the other employees away. Furthermore, in addition to trade/customer connections, an employer has a legitimate interest in protecting its confidential or other business information generally from being misused by an employee after they leave their employment because:

... as Lord Denning said in Littlewoods Organisation Limited v Harris ... experience has shown that it is unsatisfactory simply to have a covenant against disclosing confidential information, because it is difficult to draw the line between information which is confidential and information which is not, and very difficult to prove a breach when the information is of such a

character that an employee can carry it away in his or her head, so that the only practicable solution is to take a covenant from the employee by which he or she undertakes not to work for a trade rival.

It has been suggested that there are two categories of information that the courts will protect at the suit of an ex-employer, namely, information that:

- a) of its nature, is so confidential or secret (e.g. a trade secret) that the ex-employee cannot use even if not bound by a contractual restraint not to misuse information of the employer;
- b) is to a degree confidential but, because it is closely linked with know-how and experience which an employee acquires during their employment, will not be protected except where there is a valid contractual restraint on the employee (information that has no confidentiality because of its triviality or because it is in the public domain, will not be protected even if it is expressly described as confidential in a contractual restraint).

Whether information divulged to an employee in the course of employment has any confidentiality depends on a number of matters including:

- the extent to which that which is said to be confidential can be readily identified by the employer;
- the extent to which it is known outside the employer's business, and inside the employer's business;
- the extent of the measures taken to protect the secrecy of the information;
- the value of the information to the employer and its competitors;
- the amount of effort or money expended by the employer in developing the information;
- the ease or difficulty with which the information could properly be acquired or duplicated by others;
- whether it was plainly made known to the employee that the information was confidential;
- the fact that the employer reasonably believes the information to be confidential;
- the extent to which the information can be readily isolated from the employee's general know-how acquired by experience in the particular industry.

If it appears in response to the question “why” that, at the time of the making of the contract, the employee will acquire confidential and commercially-sensitive information of the type described above, a restraint provision would be reasonable for the parties to agree to, in combination with a well-drafted clause defining the information in question, for the protection of such information from mis-use by the employee post-employment. For example, in relation to the employment of a general manager of a manufacturing company, the following provisions were upheld as protecting a legitimate interest in the employer’s confidential:

"Confidential Information means all:

(a) know-how, trade secrets, ideas, concepts, technical and operational information, owned or used by the Company or any of their Related Bodies Corporate;

(b) information concerning the affairs or property of the Company or any Related Bodies Corporate or any business, property or transaction in which the Company or any of their Related Bodies Corporate may be or may have been concerned or interested;

(c) details of any customers or suppliers of the Company or any of their Related Bodies Corporate;

(d) information about the terms or effect of this Agreement;

and

(e) information which by its nature or by the circumstances of its disclosure, is or could reasonably be expected to be regarded as confidential to:

(i) the Company or any of their Related Bodies Corporate; or

(ii) any third party with whose consent or approval the Company or any of their Related Bodies Corporate uses that information,

which is not publicly available without breach of this Agreement."

...

"13. Non-Competition

13.1 Except as provided in clause 13.2, in consideration of the Salary Package, the Employee must not in the Restraint Area, during the operation of this Agreement and for the Restraint Period, without the prior written permission of the Company directly or indirectly be engaged or concerned or interested in any Competing Business.

13.2 If this Agreement and the Employment are terminated by the Company in accordance with clause 3.2(1) ... or 3.3 then, in consideration of the Salary Package, the Employee must not during the operation of this Agreement or for the period specified in Item 9 of Schedule 1 immediately following the Termination Date, without the prior written permission of the Company directly or indirectly be engaged or concerned or interested in any Competing Business.

13.3 The Agreement by the Employee in clause 13.1 and 13.2 applies to the Employee acting:

- (1) *either alone or in partnership or association with another person;*
- (2) *as principal, agent, consultant, adviser, director, officer or employee in a management position.”*

Summary regarding legitimate interests

In relation to restraint provisions in employment contracts, Lord Parker of Waddington in *Herbert Morris Ltd v Saxelby* summarised the matter as follows:

*The goodwill of ... business is ... subject to competition of all persons (including the servant ...) who choose to engage in a similar trade. The employer in such case is not endeavouring to protect what he has, but to gain a special advantage which he could not otherwise secure. I cannot find any case in which a covenant against competition by a servant ... has, as such, ever been upheld by the Court. Wherever such covenants have been upheld it has been on the ground, not that the servant ... would, by reason of his employment or training, obtain the skill and knowledge necessary to equip him as a possible competitor ... , but that he might obtain such **personal knowledge of and influence over the customers of his employer, or such an acquaintance with his employer’s trade secrets** as would enable him, if competition were allowed, to take advantage of his employer’s **trade connection or utilise information confidentially obtained.***

(Emphasis added).

Drafting suggestions

Evidence of surrounding circumstances known to both parties at the time of the making of the contract is admissible for the purpose of determining contractual intention. Such evidence is one way of establishing the interest sought to be protected by a restraint provision.

As a starting point, though, why not use the contract itself. For instance, if the facts at the time support doing so, include recitals at the start of the contract to the effect that:

- a) it is anticipated that the employee will be given the opportunity to and, so, will establish close customer connections with existing and new customers;
- b) those customer connections constitute a part of the goodwill of the employer because of their attractive force in bringing business to the employer;
- c) the employee will acquire confidential and commercially-sensitive information from the outset, and during the course of their employment;

- d) misuse of that information post-employment will be to the detriment of the employer;
- e) the restraint provisions contained in the contract are for the protection of the employer's interest in its goodwill and information.

Having it expressly stated in the contract in this fashion will assist if it is necessary to enforce a restraint that seeks to protect such interests because it immediately highlights the purpose for the restraint's inclusion in the contract, instead of the court having to determine the interest sought to be protected from extrinsic evidence only.

Width of restraint: less is more

The more widely that it is construed in its operative effect, the more likely that a restraint will be held to be unreasonable and, so, unenforceable. So, again it is necessary to ask the question "why" in the drafting process because that will inform how wide, or how extensive, the restraint proposed should be.

For instance, consider the issue of geographical operation. Generally, speaking, if it is the case that the employer's business only operates in the suburb of Osborne Park, then it is pointless to include a restraint that operates throughout the whole of Western Australia. On the other hand, a national or international business operation may justify a restraint that operates throughout a far wider area than the immediate geographical location of the employer's business.

Similarly, the length of time that a restraint is intended to operate for is relevant. For example, if the interest sought to be protected is commercially-sensitive information such as, say, pricing, it will be relevant to determine how long such information will retain its sensitivity. If it is 3 months, then it will be unreasonable to restrain a person on this basis for a period of time greater than that.

Relevant to this also is the question of the capacity of the ex-employee intended to be restrained. If it is "any" capacity, then the potential to sanitise that person's ability to earn their living is greater, with a consequentially-increased chance that the restraint will be held to be unreasonable for this reason.

In a similar vein, if the purpose of the restraint is to protect customer connections, then it is better that it be restricted to non-solicitation of customers with whom the employee had direct contact with, say over a period of 12 months prior to the termination of their employment, rather than being cast in terms of "any" customers of the ex-employer. If the restraint is to restrict the ex-employee from working with a

competitor, then it is better to express it in terms of competitors in the particular sector or industry that the ex-employee worked in, rather than competitors generally. Be mindful that all of these things work together. So, the various aspects of a restraint provision must not only be reasonable in their own right, but also one in combination with the other, including in relation back to the legitimate interest sought to be protected. So, if that interest is, say, the employer's customer connection, then it may be unreasonable to try and restrain an employee:

... for longer after the time taken for a reasonably competent new employee to master the job and be able to demonstrate to customers that he or she is effective and efficient.

It keeps on coming back to the question “why” at the outset, which will provoke the answer to whether the proposed restraint is reasonable or not.

Precision and certainty

As already mentioned, when it comes to enforcement, the first issue will always be the true meaning of the provision in question, which will require a determination of the parties' contractual intention at the time of the making of the contract. Consequently, the draftsman needs to ensure certainty in the meaning intended.

One aspect of this concerns the “blue pencil” approach to restraint provisions, that being where the restraint is cast as a number of expressed options for combination of things like time and place, with a severance clause permitting the court to sever unreasonable combinations (by the use of a “blue pencil”). But, beware, because the more numerous the potential combinations, the greater the risk that the provision will be held uncertain as not reflecting the contractual intention of the parties. Instead, it may be construed as leaving it to the court to determine what is reasonable, with the result that the restraint will be regarded as not being a genuine attempt by the parties to agree to what is reasonable, and will not be enforced for this reason.

With contracts of employment, a proper examination of the facts prevailing at the time of the making of the contract, in answer to the question “why”, should avoid the need for numerous combinations, or even any combinations at all. A thorough investigation before drafting commences of the nature and extent of the nature of the business, and the proposed role of the employee therein, will guide a determination of what is reasonable for the parties to agree to, taking into account their best estimate for the future, with possibly no need then to resort to the “blue pencil” approach.

As to the actual words used in a restraint provision, be as precise as possible. Inconsistency in the use of language undermines the credibility of a restraint provision from the start as it begs the question of uncertainty. So, consistency in the use of language is desirable. For instance, using words like “customer” and “client” interchangeably, without defining them, can lead to confusion and possible uncertainty.

Bearing in mind the centrality of the task of construction of a restraint if a court is called upon to enforce it, any uncertainty will usually be fatal to any prospects of successfully enforcing it. Therefore, when asking the question “why”, consider the actual words to be used to, for instance, exactly describe the “business” of the employer, if the word “business” is to be used in the restraint provision. In order to avoid the problems of needing extrinsic evidence to prove a matter such as this, and uncertainty in the meaning of the word otherwise, consider a definition of it. The same goes for other important words and expressions.

Why ask “why”?

In any proceedings commenced to enforce one, each word of a restraint provision may be subject to intense, microscopic textual and contextual analysis.

Asking the question “why” at the time of drafting a restraint can be time-consuming, expensive, and hard work, as it involves a thorough investigation in the manner suggested above. However, if this approach is adopted, it will inform the issue of whether a restraint will be reasonable for the parties to agree to at all. It will also highlight the nature and extent of the restraint required, and the precise words needed to adequately protect the legitimate interests of the employer in a reasonable way. Despite the effort and expense, asking “why” will greatly increase the chances of drafting a restraint that will be held to be reasonable and, hence, enforceable.

Remember, news travels fast. An employer only needs to succeed once in an interlocutory injunction to restrain an ex-employee to create the impression amongst remaining and potential employees and, importantly, its competitors and the marketplace generally, that its restraints are well-drafted and enforceable. That is to its advantage.

Conversely, bad news travels even faster, so that a loss, because a restraint is held to be unreasonable, even on an interlocutory basis, will resonate as loudly as bells in a belfry, with possible adverse consequences to the employer and the reputation of the

person who drafted the unenforceable provision. In the final analysis, if nothing else, that is why one asks the question, “why”.

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