



# Update

Commercial Dispute Resolution

25 January 2012

## Protecting your business' interests using restraints of trade



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This article provides tips on how to better protect your business interests after a contractual relationship ends. The article aims to provide some insights to help you to review the restraint clauses that you may have in place and to consider what restraint clauses you may wish to use in future.

Restraints of trade are used in commercial and employment contracts to restrict the freedom of parties after a contractual relationship ends. Restraints are critical where a business has legitimate business interests to protect, for example, confidential information, customer connection and goodwill and connections with employees and contractors. Courts are more willing to find that restraints are reasonable in commercial dealings.

However, there is a common law presumption that restraints are invalid unless proved otherwise. Restraints may be enforced if they go no further than is reasonable to protect the legitimate business interests of an employer.

### Protecting your interests with cascading clauses

The best way to ensure that a restraint is enforceable is to use cascading or "stepped" restraint clauses. Cascading clauses provide for a series of separate, severable obligations of diminishing scope in relation to post-contractual activities for certain restricted periods and in certain restricted locations. While cascading clauses have been controversial in the past, courts have shown a willingness to enforce them, provided that they are drafted carefully.

Most importantly, cascading restraint clauses must be clear and must not contain conflicting obligations. A court may find that a restraint is void for uncertainty if a restraint provides for a number of different possible combinations in relation to activities, time and geography but does not provide a mechanism by which a court can determine which combination was intended by the parties.[1] In *Hanna v OAMPS Insurance Brokers Ltd (ACN 005 543 920) (OAMPS)*,[2] the Court noted that phrases like "the maximum enforceable area" and "maximum enforceable period"[3] should not be used to select the outer limits of operation of a cascading clause as they make it difficult for employees to know the restraint period and area that is binding upon them. If an employer does not provide a mechanism for selecting a valid operation of the restraint clause, then a clause may be found to be a single covenant with inconsistent obligations.[4] Such a clause would be unenforceable due to uncertainty.

Employers can generate a range of alternative covenants of varying degrees of complexity in an attempt to provide a reasonable restraint on a former employee. In *Seven Network (Operations) Ltd and Ors v James Warburton (No 2) (Warburton)*,[5] Pembroke J agreed with the Court in *OAMPS*, that mere complexity will not make a cascading clause void because of uncertainty. His Honour stated that to lack adequate certainty the clause must be "so impenetrable as to lack coherent meaning".[6]

This does not mean that employers have the ability to generate any number of possible covenants and expect that a court will take the time to determine which of the many covenants may reasonably apply. Courts have found that if an employer mechanically and indiscriminately generates a range of possible covenants within a restraint, then the clause may not amount to a genuine attempt to choose which of the covenants are intended to operate.

### Key tips for your restraint clauses!

If the steps below are not taken, then a restraint may not be enforceable due to uncertainty or the public policy that it is up to the parties to make their contracts and not courts.[7]

- You cannot use restraints to protect your business from competition from a good and reputable ex-employee. You can only enforce restraints to protect your legitimate business interests e.g. confidential information or customer goodwill.
- The covenants must be stated to be cumulative, that is simultaneously operating, but also separate from each other such that each covenant may be severed if found to be invalid or unenforceable for any reason. This requires clear, plain English drafting of the covenants and the severance provision.
- Be careful not to turn the restraint provision into a single omnibus clause with various inconsistent provisions coupled with an exhortation to the Court to in effect read down or pencil out parts of the clause that are unreasonable. It is clear that a Court will simply draw a line through the entire clause.

Finally, it is important to understand that the perfectly drafted restraint clause will still not give you certainty in protecting your business from harm inflicted by an ex-employee. Given the costs and risks associated with restraint litigation, a well-designed restraint clause will rarely offer more than mere leverage in dealings with an ex-employee and his or her new organisation.

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[1] *Austra Tanks v Running* [1982] 2 NSWLR 840.

[2] *Hanna v OAMPS Insurance Brokers Ltd* (2010) 202 IR 420.

[3] *Brendon Pty Limited v Russell* (1994) 11 WAR 280, cited in *Hanna v OAMPS Insurance Brokers Ltd* at [29].

[4] *JQAT Pty Limited v Storm* [1987] 2Qd R 162 [164]-[165] (Connolly J); [166]-[167] (Williams J) (cited in *Hanna v OAMPS Insurance Brokers Ltd* (2010) 202 IR 420 [24]).

[5] (2011) 206 IR 450.

[6] *Seven Network (Operations) Ltd v Warburton (No 2)* (2011) 206 IR 450 [40] (citing *Hanna v OAMPS Insurance Brokers Ltd* (2010) 202 IR 420 [14] (Allsop P)).

[7] *Lloyds Ships Holdings Pty Ltd v Davros Pty Ltd* (1987) 17 FCR 505, 523.

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