

TOWARD A MODERN REASONED APPROACH TO THE DOCTRINE OF RESTRAINT OF TRADE

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ABSTRACT

There are sufficient problems with the doctrine of restraint of trade to warrant its wholesale reconsideration. These problems are seamlessly interconnected. The first problem lies in its jurisprudential history: it provides no clear guide as to the public policy and economic purposes that justify the approach of the courts to contractual clauses subject to the doctrine. If a clause is found to be unenforceable under the doctrine, the purchaser's protection of the goodwill for which they paid valuable consideration is effectively lost. There is no explanation as to why the balance of public policy is so firmly tilted against the purchaser in a case of poor drafting. The second problem flows from the first: the very description 'restraint of trade' obscures the purpose of a valid restraint. It over-emphasises what the clause is intended to prevent rather than the legitimate interest that it is designed to protect. This leads to the third problem of the windfall gain resulting from a clause being struck down and the vendor being able to reclaim the very asset that they had sold and possibly even retaining the consideration paid. The next problem is the advent of the so-called 'ladder clause'. Devised to avoid the harsh consequences of not correctly anticipating what a court may think is reasonable as a restraint despite what the parties have agreed, the intention of the parties has been substituted with a drafting exercise that has nothing to do with intention but everything to do with avoiding the harsh operation of the doctrine. Each of the problems arises because the validity of the clause is an all or nothing proposition. Courts will not generally amend, read down or re-draft a clause. This lays a heavy burden on the shoulders of the draftsman in striking the right balance between protection and restraint and,

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ultimately, upon counsel in finding in that drafting a reasonable (and thus valid) operation within the parameters of time, distance and subject matter. The time is therefore ripe for a reconsideration of the doctrine of restraint of trade without a presumption of invalidity by reference to public policy. Not only does commercial life depend upon the existence of such clauses, but the competition policy enshrined in statute assumes that valid clauses are essential exceptions to the prohibitions against horizontal restraint. Once it is accepted that there is strong commercial demand for valid clauses, the doctrine can be reviewed for its legal basis so that it makes modern commercial and economic sense and operates fairly to both parties.

I INTRODUCTION

Restraint of trade clauses have an image problem. They suffer bad press like few other contractual terms. Courts label them ‘void’ and ‘contrary to public policy’ and will not enforce them unless ‘special circumstances’ show them to be ‘reasonable’. Added to this is the complication that a clause may, in some instances, be an ‘exclusionary provision’¹ prohibited by s 45 of the *Competition and Consumer Act 2010 (Cth)* (‘CCA’). Covenantors, previously happy enough to agree to the clauses, frequently turn on them, trying to exploit the difficulties posed in enforcement. Not the best of starts in life for any contractual term!

With so many hurdles to vault, the question could be asked, why would anyone bother with restraint of trade clauses at all? Should they not be relegated to the same drafting scrapheap as are covenants in furtherance of a crime² and contracts with belligerent aliens?³

¹ See *Competition and Consumer Act 2010 (Cth)* (‘CCA’) s 4D.

² For nineteenth century examples of the application of the maxim *ex turpi causa non oritur actio*, see *Everet v Williams* (1893) 9 L.Q. Rev. 197 (the *Highwaymen Case*); *Scott v Brown Doering McNab & Co* [1892] 2 QB 724. As to the modern operation of the Australian doctrine of illegality and public policy, see: *Brooks v Burns Philp Trustee Co Ltd* (1969) 121 CLR 432; *Yango Pastoral Co Pty Ltd v First Chicago Australia Ltd* (1978) 139 CLR 410; *Nelson v Nelson* (1995) 184 CLR 538; *Fitzgerald v F J Leonhardt Pty Ltd* (1997) 189 CLR 215. In the context of

Therein resides the irony. The clauses are judicially deprecated as being prima facie ‘void’ and ‘contrary to public policy’, and not ‘enforceable’ unless shown to be ‘reasonable’. However, this type of clause is *de rigueur* in contracts for the purchase of shares and businesses, employment agreements and in covenants to protect confidential information, trade secrets and know-how.⁴ In fact, commerce considers them so important that the lawyer who fails to advise on and draft an enforceable clause may well be considered negligent. While there are public policy arguments against *invalidating* clauses, there is strong commercial demand for *valid* clauses.

Both the image problem and the irony have various causes.

First, the history of contractual restraint of trade provides an unclear guide as to public policy and economic purposes.⁵ Emphasis has too often been on the protection of the rights of the restrained party. There has not been sufficient focus on the rights of the party seeking to restrain⁶. In a business sale case, for instance, the balance of ‘reasonableness’ may be against the purchaser of the business because the restraint is too long or geographically too broad. An opportunistic vendor may invoke the

the particular statutory prohibitions under the CCA, see ss 4L, 4M and 87; see also *SST Consulting Services Pty Ltd v Rieson* (2006) 225 CLR 516.

³ See *Ertel Bieber & Co v Rio Tinto Co Ltd* [1918] AC 260; *Hirsch v Zinc Corp Ltd* (1917) 24 CLR 34.

⁴ At common law, the restraint of trade doctrine applies to contracts. Contrast the position under the CCA, where the statutory prohibitions apply to contracts as well as “arrangements or understandings”. See the discussion below as to the application and exemptions imported by s 51 (2) (b), (d) and (e) under which provisions the notion of reasonableness is imported to protect restraints in certain contracts, arrangements and understandings relating to service, sales of business and to protect goodwill.

⁵ As Heydon notes, judicial development of the restraint of trade doctrine has not always been consistent: John Dyson Heydon, *The Restraint of Trade Doctrine* (LexisNexis Butterworths, 3rd ed, 2008) 2.

⁶ See Michael J Trebilcock, *The Common Law of Restraint of Trade: A Legal and Economic Analysis* (The Carswell, 1986) 142–51.

doctrine if the clause is either temporally or geographically excessive. Refusal to enforce is not on terms of doing equity. It is an absolute. If the clause is found to be unenforceable, the purchaser's protection of the goodwill is effectively lost. The vendor would be free to spirit away customers.

The second cause flows from the first: the very description '*restraint of trade*' obscures the purpose of a valid restraint by emphasising what the clause prevents rather than the legitimate interest that it is designed to protect. Whether that is goodwill, client lists, confidential information or a trade secret,⁷ the purchaser will usually have paid substantial sums for the commercial advantages that exploitation of that asset or right brings when it is to the exclusion of the vendor or covenantor.

Thirdly, the confusion as to history and purpose is often reflected in the drafting, resulting in clauses being struck down and the vendor being able to reclaim the very asset that they had sold and possibly even retaining the consideration paid.

At common law, as mentioned, the validity of the clause is an all or nothing proposition. Courts will not generally amend, read down or re-draft a clause. This lays a heavy burden on the shoulders of the drafter in striking the right balance between protection and restraint and, ultimately, upon counsel in finding in that drafting a reasonable (and thus valid) operation within the parameters of time, distance and subject matter.

⁷ The capital comprising goodwill will not necessarily have been paid to the party to be restrained. In the case of an employment contract, the employee will be granted access to material essential to the building and maintenance of goodwill. In this regard, there may be both express covenants and implied obligations of loyalty that prevent dealing in certain types of information after termination. See *Faccenda Chicken v Fowler* [1987] 2 Ch. 117; Robert Dean, *Employers, Ex-Employees and Trade Secrets* (Lawbook Co, 2004) 4; Heydon, above n 5, 114.

The 'all-or-nothing' approach of the common law has contributed to the innovation in the so-called 'ladder clause', which presents a cascading set of variables in time, distance and subject matter. Properly drafted, this type of clause may present a range of options that the parties consider reasonable, but which can be severed to the extent that the court considers necessary. Poorly drafted, they may present too many variables and permutations to be capable of being reasonable, or may be considered to be so vague as not to represent any agreement on restraint at all. If a ladder clause is drafted so that it presents a single restraint, it will be considered uncertain and be struck down. If it contemplates a combination of separate restraints, severing those that are unreasonable, then it is less likely to be struck down.

There has been much written on restraint of trade in an effort to present a comprehensive and rational treatment. It has been the subject of entire volumes dedicated to its unravelling, not to mention many articles and judicial considerations of various aspects of its operation. While no single paper could present the doctrine of restraint of trade in any manner that could be considered to be comprehensive, the current purpose is to present some insights into its history, rationale and the basic elements of its modern operation that will assist those called upon to draft, defend or attack a clause.

II MODERN DOCTRINE

The image problem surrounding restraint of trade clauses is evident in the seminal case expressing the modern doctrine, *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Company*.⁸ *Nordenfelt* involved the sale of a worldwide armaments business, pursuant to which the defendant

⁸ (1894) AC 535.

had agreed not to compete with the plaintiff anywhere in the world for a period of 25 years. Interestingly, the covenant was held to be reasonable and enforceable. Customers of the company were situated throughout the world. The worldwide restraint covenant was found to be reasonably necessary for protection of goodwill.⁹ Despite this finding, in *Nordenfelt*, Lord Macnaghten¹⁰ expressed the modern doctrine in negative terms, stating that:

The public have an interest in every person's carrying on his trade freely: so has the individual. All interference with individual liberty of action in trading and all restraints of trade 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 special circumstances of a particular case.¹¹

This statement of principle attempts to balance freedom of contract and the freedom of trade, two of the interests in conflict in the context of restraint of trade. *Nordenfelt* represents the modern articulation of the doctrine: rather than prohibiting clauses outright, it justifies judicial interference with freedom of contract where a restraint is unreasonable. If a restraint of trade clause is found unreasonable, it will be found to be contrary to public policy; freedom of contract will be trumped by the overriding freedom to trade.¹²

⁹ See David M Meltz, *The Common Law Doctrine of Restraint of Trade in Australia* (Blackstone Press Pty Ltd, 1995) 31.

¹⁰ [1894] AC 535.

¹¹ (1894) AC 535, 565 (Lord Macnaghten).

¹² David M Meltz, *The Common Law Doctrine of Restraint of Trade in Australia* (Blackstone Press Pty Ltd, 1995) 4, 157. In *Peters American Delicacy Co Ltd v Patricia's Chocolates and Candies Pty Ltd* (1947) 77 CLR 574, 590, Dixon J (as his Honour then was) noted how *Nordenfelt* removed the tendency of 'placing the public policy of securing an ample freedom of contract and enforcing obligations assumed in its exercise in opposition to the public policy of preserving freedom of

Lord Macnachten's statement of the principle may be regarded as encapsulating the doctrine as it had developed in English authority up to that point. The situation is more nuanced. Earlier authorities, with their origins in attempts by guilds to establish monopolies and increase barriers to entry for 'foreigners' or guild non-members, the interference with food supplies by middlemen, or royal grants of monopolies, were reconciled under the rubric of reasonableness.¹³ Reasonableness introduced an avenue by which properly drawn restraints could survive. Despite what may appear in *Nordenfelt* to have been a softening of the position that previously obtained, it can be said that previous authority at least had the hallmark of predictability. Monopolies were prima facie bad, even if the economics of protectionism justified them. Parties were not able to contract away the right to trade freely without pointing to an established custom that permitted the creation of a monopoly.¹⁴ It was only later in the development of the doctrine that reasonableness began to find favour. Examples include:

In *Dyer's Case*,¹⁵ the defendant, Dyer, had entered into a bond not to ply the trade of dyer in a certain town for six months. Hull J held that the

trade from unreasonable contractual restriction'. Discussed in *Peters (WA) Ltd v Petersville Ltd* (2001) 205 CLR 126, [37] (Gleeson CJ, Gummow, Kirby and Hayne JJ).

¹³ Although Lord Macnachten's statement provides the modern articulation of the doctrine of restraint of trade, the common law developed similar principles prior to *Nordenfelt*, including for the preservation of access to necessary goods and facilities. Such access was protected by the doctrine of prime necessity, which has since been codified in *Sherman Antitrust Act* (USC) (1890), §§ 1 and 2; *Clayton Antitrust Act* (USC) (1914), §§ 14 and 18; *Trade Practices Act 1974* (Cth) ss 45-46; and now CCA, Part IIIA (access to services/essential facilities) (are you sure that this does not include Part IV CCA?). See Philip Clarke and Stephen Corones, *Competition Law and Policy: Cases and Materials* (Oxford University Press, 1999) 6-8. See also Heydon, above n 5, 1-9.

¹⁴ Heydon, above n 5, 5.

¹⁵ 2 Hen 5, f 5, pl 26 (1414).

obligation was illegal and thus void,¹⁶ as the common law at that time prohibited *all* contracts in restraint of trade.¹⁷

Davenant v Hurdis, (*The Merchant Tailor's Case*),¹⁸ involved a dispute between two guilds over control of the cloth-finishing trade. Sir Edward Coke argued on behalf of the plaintiff that 'by-laws that establish monopolies are against common law and void'.¹⁹ The Court, accepting the argument, held that 'a rule of such nature as to bring all trade and traffic into the hands of one company or one person to exclude all others is illegal'.²⁰ The decision was against the monopolistic power of the guilds.²¹

In *Darcy v Allen*²² (*The Case of Monopolies*),²³ Queen Elizabeth had granted Darcy, her groom, a patent for a monopoly over the manufacture and importation of playing cards. Allen infringed the grant by making, importing and selling playing cards. The Court extended the principle in *Davenant v Hurdis* regarding corporate by-laws to a Crown grant²⁴ and invalidated a royal grant by patent, both at common law and under statute. Popham CJ held that the monopoly conferred by grant was

¹⁶ Trebilcock, above n 6, 8.

¹⁷ Philip Clarke and Stephen Corones, *Competition Law and Policy: Cases and Materials* (Oxford University Press, 1999), 2.

¹⁸ (1598) Moore KB 576. See also *Gowbry v Knight* (1601) Noy 183; *The Ipswich Tailors' Case* (1614) 11 Co Rep 53a.

¹⁹ Trebilcock, above n 6, 7.

²⁰ (1598) Moore (KB) 576, 591. See also Michael J Trebilcock, *Historical Evolution of Common Law of Restraint of Trade* (Carswell, 1986), 7.

²¹ However, Heydon, referring to *Hutchins v Player* (1663) O Bridg 272 and *City of London's Case* (1610) 8 Co Rep 121b, notes that the general rule which developed in the 17th century was that by-laws in restraint of trade were valid if based upon a valid custom and beneficial to the public, though not if they rested on a royal grant: Heydon, above n 5, 5.

²² Referred to by Philip Clarke and Stephen Corones as *Darcy v Allein*, but by Heydon as *Darcy v Allen*.

²³ (1602) 11 Co Rep 84b.

²⁴ Heydon, above n 5, 7.

contrary to common law as it deprived other existing or potential card manufacturers of their living and prejudiced the public generally by raising the price of the cards and lowering their quality.

A different approach began to emerge in *Mitchel v Reynolds*.²⁵ Reynolds agreed to assign a bakehouse to Mitchel for a period of five years, and agreed to refrain from engaging in the trade of baking within the same parish for that five year period. Parker CJ, in reconciling the earlier ‘jarring opinions’ regarding restraint of trade,²⁶ identified three kinds of involuntary restraints: Crown grants, which were generally void; restraints contained in customs, which were valid when they benefited persons who traded for the advantage of the community; and restraints contained in by-laws, which were valid when supported by a reasonable custom to the same effect and where it bettered government and regulation of it or improved the commodity.²⁷ Further, Parker CJ discussed voluntary restraints, finding that while ‘general restraints are all void’, where a restraint of trade ‘appears to be made upon a good and adequate consideration’, so as to make the restraint reasonable and useful, it was enforceable.²⁸ In the circumstances, the Court found that the restraint was reasonable and did not prejudice the public interest, and therefore held that it was valid. Thus, restraints of trade were found not to be prohibited by the common law where they were reasonable. This approach laid the foundation for what is essentially the position of the common law under the modern doctrine of restraint of trade.

The English line of authority was considered in the United States only a few years prior to *Nordenfelt* being handed down. United States common

²⁵ [1558 – 1774] All ER Rep 26.

²⁶ *Mitchel v Reynolds* (1711) 1 P Wms 181, 182-4 (Parker CJ).

²⁷ Heydon, above n 5, 11-2.

²⁸ *Mitchel v Reynolds* (1711) 1 P Wms 181, 185-6 (Parker CJ).

law, which had developed similarly to the common law in England,²⁹ had proved insufficient to regulate the anti-competitive conduct of the railways and the ‘monolithic’ trusts³⁰ that were regularly employed by monopolists and oligopolists.³¹ As a consequence, the US courts took a more rigorous approach, particularly after the introduction of the *Sherman Antitrust Act* 1890, ss 1 and 2 of which illegalised monopoly and restraints of trade.

Under the antitrust legislative regime, J D Rockefeller’s empire, the pinnacle of which was Standard Oil, was dismantled by the US Supreme Court in *Standard Oil Co of New Jersey v United States*.³² To ameliorate the unyielding impact that the legislation might have, in *Standard Oil* the Supreme Court adopted what has become known as the ‘rule of reason’: namely, that restraints of trade would only violate the *Sherman Act* if they reduced competition to an unreasonable extent.³³

Under the antitrust legislative regime, Standard Oil, along with sixty-five companies under its control, and a number of individuals including J D Rockefeller, were charged before the Supreme Court with ‘monopolizing the oil industry and conspiring to restrain trade through a familiar litany of tactics: railroad rebates, the abuse of their pipeline monopoly, predatory pricing, industrial espionage, and the secret ownership of ostensible competitors’.³⁴

²⁹ Heydon, above n 5, 22.

³⁰ Namely, an arrangement whereby shareholders transferred securities to trustees in return for the entitlement to a share of pooled earnings: see Clarke and Coronas, above n 17, 6.

³¹ Clarke and Coronas above n 17, 6.

³² 221 US 1 (1911).

³³ Clarke and Coronas, above n 17, 6 – 7.

³⁴ Ron Chernow, *Titan: The Life of John D Rockefeller, Sr* (Vintage, 2nd ed, 2004), 537.

Previously in an exposé that would be used as the template for the antitrust legislation, Ida Tarbell, one of Rockefeller's most ardent critics, denounced 'the deceit of an organisation that operated through a maze of secret subsidiaries in which the Standard Oil connection was kept secret'.³⁵ Tarbell had chronicled Standard Oil's collusion with the railroads, the 'intricate system of rebates and drawbacks', and suggested that the rebates violated the common law.³⁶ She exposed many abuses of power by the Standard Oil pipelines, which used their monopoly to favour the Standard Oil refineries,³⁷ and recorded the means by which Standard Oil's subsidiaries induced retailers to exclusively stock their products.³⁸

The *Sherman Act* was later followed in the US by the more comprehensive *Clayton Antitrust Act 1914* (US). The *Sherman Act* influenced legislative regulation of restraints of trade and competition in Australia from an early time. With the *Australian Industries Preservation Act 1906* (Cth), ss 4, 5, 7 and 8 the federal parliament attempted to implement the proscriptive approach of the *Sherman Act*.³⁹ This early imitation of the *Sherman Act* failed. The High Court found parts of the *Australian Industries Preservation Act 1906* (Cth) unconstitutional.⁴⁰ Ultimately,⁴¹ provisions, now well-known to Australian competition lawyers, in Part IV of the CCA and its predecessor, the *Trade Practices Act 1974* (Cth), together with Part IIIA of each of those Acts, were

³⁵ Ibid 444.

³⁶ Ibid 443.

³⁷ Ibid 444.

³⁸ Ibid.

³⁹ Clarke and Corones, above n 17, 8.

⁴⁰ *Huddart Parker and Co Pty Ltd v Moorehead* (1909) 8 CLR 330; see also Clarke and Corones above n 17, 8.

⁴¹ Clark and Corones observe that TPA 1974 adopts a proscriptive approach of the US and the *Australian Industries Preservation Act 1906*, rather than following the more prescriptive UK position: Clarke and Corones, above n 17, 10.

introduced to give effect to what has been a workable competition policy in Australia that has operated and developed since 1974.⁴²

As a matter of Australian common law, *Nordenfelt* has subsequently been followed by a line of Australian cases.

In *Peters American Delicacy Co Ltd v Patricia's Chocolates & Candies Pty Ltd*,⁴³ Peters and Patricia's Chocolates entered into an agreement for Peters to supply Patricia's with ice-cream to be sold at Patricia's premises for a period of sixty months. The contract included a clause whereby Patricia's agreed not to sell, serve, supply or vend any ice-cream other than the ice-cream manufactured by Peters at Patricia's premises or within a distance of five miles from that premises during that sixty month period. The High Court found that the restraint imposed by the clause was reasonable in the interests of both parties and not injurious to the public, and therefore held it to be valid.

*Buckley v Tutty*⁴⁴ involved a footballer who was a member of the NSW Rugby Football League. The rules of the League contained provisions regarding the retention and transfer of players. As the plaintiff had been placed on the club's 'retain list', under the rules the plaintiff was prohibited from playing for another club without the consent of his club. This prohibition was effective for as long as the plaintiff was on the 'retain list', and applied whether or not he continued to play for the club. The High Court found that the club's retain and transfer rules went further than necessary to protect the reasonable interests of the League, particularly given the lack of time limit and the applicability of the rules regardless of how short the player's employment with the club and how

⁴² See Clarke and Corones, above n 17, 8.

⁴³ (1947) 77 CLR 574.

⁴⁴ (1971) 125 CLR 353.

much time had expired since that period of employment. Therefore, the High Court held the rules to be void as an unreasonable restraint of trade.

Another such case is *Amoco Australia Pty Ltd v Rocca Bros Motor Co Engineering Pty Ltd*.⁴⁵ In *Amoco*, an owner of land entered into an agreement with a petrol company to erect and operate a service station on the land, which would be leased to the petrol company for a period of fifteen years. Under this agreement, the petrol company was also to grant the owner an underlease for fifteen years. The underlease contained a covenant which required the owner to exclusively purchase petrol and oil from the supplier, and to sell only the supplier's products at the service station, except in special circumstances. The High Court found that it had not been shown by the supplier that the restrictions imposed on the owner were reasonably necessary to protect the supplier's interests, and thus the covenant was held to be void.

The modern approach to the doctrine in Australia is illustrated in a recent High Court decision and a single Judge decision of the Supreme Court:

In *Peters (WA) Ltd v Petersville Ltd*,⁴⁶ a restraint was imposed in connection with the rights to use the brand name '*Peters Ice Cream*'. The Western Australian company covenanted away its right to sell or supply ice-cream in Western Australia entirely. The High Court held that the restraint, which applied for 15 years, was broader than necessary to protect the goodwill acquired by the recipient of the restraint, sterilised the capacity to trade,⁴⁷ was unreasonable, and therefore unenforceable.

⁴⁵ (1973) 133 CLR 288.

⁴⁶ (2001) 205 CLR 126.

⁴⁷ See discussion regarding the Court's take on *Esso* in *Peters v Petersville*, below in franchise discussion.

In *Hydron Pty Ltd v Harous*,⁴⁸ Bleby J considered three restraints (in separate agreements) that were to operate on the covenantor defendant in different capacities. One was as vendor of shares under a share option agreement; one was as director of the company selling its business; and another was as an ongoing employee of the purchaser of the shares and business. Because of the breadth and diversity of the restraint of trade clauses, all three were held to be invalid for being unreasonable.⁴⁹

Whilst the *Nordenfelt* test operated to invalidate restraint of trade clauses, the cases turn very much upon their own facts and, of course, the terms of the contract containing the restraint. Asking what is in the interest of public policy may in fact show that there are also strong economic reasons in *favour* of restraint of trade clauses. The original expression of the doctrine in *Nordenfelt* accepts as a silent premise that restraint of trade clauses are essential for allowing purchasers and covenantees to protect their interests. Just how that balance is to be struck is not clearly articulated in the oft-cited dictum and has rarely been the subject of detailed abstract analysis. But their justification in protection of legitimate interests goes almost without saying. Without such clauses, vendors could continue to exploit a client base and covenantors could capitalise on the confidential information of their previous employer, rendering the business of the covenantee ineffectual.

⁴⁸ (2005) 240 LSJS 33.

⁴⁹ Other cases also applying the restraint of trade doctrine as established in *Nordenfelt* include *Cream v Bushcolt Pty Ltd* [2002] WASC 100; *Labouchere v Dawson* (1872) LR13Eq 322; *Trego v Hunt* [1896] AC 7; *Geraghty v Minter* (1979) 142 CLR 177; *Bridge v Deacons* [1984] 1 AC 705; *Crouch v Shields* (1984) ATPR 40-481; *Optical Prescriptions Spectacle Makers Pty Ltd v Vlastaras* (1991) ATPR 41-150; *Fisher v GRC Services Pty Ltd (No 1)* (1988) ATPR (Digest) 46 – 180; *Synavant Australia Pty Ltd v Harris* [2001] FCA 1517; *Maggbuty Pty Ltd v Hafele Australia Pty Ltd* (2001) 210 CLR 181.

In a subsequent decision Lord Macnaghten explored these types of questions through the prism of contractual principles. In *Trego v Hunt*,⁵⁰ his Lordship considered regarding goodwill by reference to the implied obligation not to derogate from the grant:⁵¹

‘A man may not derogate from his own grant; the vendor is not at liberty to destroy or depreciate the thing which he has sold; there is an implied covenant, on the sale of goodwill, that the vendor does not solicit the custom which he has parted with: it would be a fraud on the contract to do so ... It is not right to profess and to purport to sell that which you do not mean the purchaser to have; it is not an honest thing to pocket the price and then to recapture the subject of sale, to decoy it away or call it back before the purchaser has had time to attach it to himself and make it his very own’.⁵²

As such, the modern restraint of trade doctrine, which aims to encourage competition and preclude monopoly,⁵³ requires a balancing between the employee’s right to work and the employer’s right to protect trade secrets and know-how, the vendor’s right to trade and the purchaser’s right to goodwill. In the context of post-employment covenants, Trebilcock recognises that to enforce a broad covenant may risk ‘inflicting injustice on the employee’, whereas to refuse to enforce the covenant at all may

⁵⁰ [1896] AC 7.

⁵¹ NB: Lord Macnaghten also defined ‘goodwill’, a definition which has been widely accepted: ‘It is the benefit and advantage of the good name, reputation, and connection of a business. It is 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’: *I R Comrs v Mller & Co’s Margarine Ltd* [1901] AC 217, 223-4 (Lord Macnaghten). ‘It is the very sap and life of the business, without which the business would yield little or no fruit. It is the whole advantage, whatever it may be, of the reputation and connection of the firm, which may have been built up by years of honest work or gained by lavish expenditure of money’: *Trego v Hunt* [1896] AC 7, 24 (Lord Macnaghten) Quoted in Heydon, above n 5, 191-2.

⁵² [1896] AC 7, 25 (Lord Macnaghten).

⁵³ Meltz, above n 9, 165.

‘risk inflicting injustice on the employer’.⁵⁴ However, as the court’s role in moderating such covenants is at common law restricted to severance where possible, the onus lies on the drafter to steer the correct, or ‘reasonable’, path between balancing the rights of covenantor and covenantee. Striking the correct balance can only be achieved if the drafter understands the rationales behind restraint of trade clauses, both historical and economic.

And thus there is a need to reconceptualise this balance without the opprobrium of *prima facie* invalidity as a matter of public policy. Surely the reference to public policy in this context of the common law is anachronistic when such clauses are considered so essential to the protection of proprietary and commercial interests. Instead, the emphasis needs to be upon a valid restraint of trade clause protecting a legitimate interest: such clauses should be perceived to be valid. It should be a burden for the objecting party to point to an excess sufficient to invalidate. Certainly there will still be a balancing: as long as they are reasonable in the interests of both parties, it need not be struck down as void. But to start from the position that all clauses are contrary to public policy except where special circumstances so require must be regarded as an artifice, if not a fiction. Restraint of trade clauses should be regarded as the protection of intangible proprietary interests (in the form of goodwill or the value of shares transferred), as covenants not to use or disclose confidential information or trade secrets or know-how, or as provisions to prevent former employees or contractors from deriving an unfair advantage from a contract.

It should not be understood from the foregoing that the poorly drafted restraint, perhaps borrowed from precedents without regard to the instant

⁵⁴ Trebilcock, above n 6, 145.

commercial needs should be permitted to pass muster without careful scrutiny. But that is true of any contractual clause. But a bespoke clause drafted with the actual parties and transaction in mind should not have to start from a position of presumed invalidity.

In light of these observations, it is now useful to survey recent authority on the operation of the doctrine of restraint of trade at common law. First, particular focus will be given to the concept of ‘*reasonableness*’. Secondly, it is useful to address the manner in which courts approach severance and reading down provisions, particularly in light of recent authorities. Thirdly, the paradigm shift required in relation to restraint of trade clauses will be illustrated by reference the franchise model of clauses to protect interests. Fourthly, the problem of uncertainty which results from the misconception of restrictive trade clauses will be addressed. Finally, this paper deals with the interaction between the common law doctrine of restraint of trade and the operation of ss 4D and 45 under s 51 of the CCA.

A *Reasonableness*

There are of course threshold issues as to whether there is, in fact, a restraint at all and⁵⁵ whether it is a restraint of trade⁵⁶ to which the doctrine applies.⁵⁷ The following observations from Clark and Corones and Meltz point out the need for these considerations:

‘Most commercial contracts restrain trade to some degree. Consequently, the courts have distinguished between restraints of trade that should come within the doctrine of restraint of trade and

⁵⁵ See Heydon, above n 5, 51.

⁵⁶ Ibid.

⁵⁷ Ibid.

those which should not.⁵⁸ However, there are many categories which remain uncertain as to whether they fall within the restraint of trade doctrine or not.⁵⁹

‘...in effect all trading agreements are really restraints of trade; however only those which the Courts perceive as containing a fetter outside normal commercial arrangements should be subject to the doctrine’.⁶⁰

As is clear from the preceding discussion, the modern doctrine of restraint of trade is premised on the test of reasonableness: that all restraints on trade are contrary to public policy and void unless they can be justified as being reasonable.⁶¹

Lord Macnaghten’s test in *Nordenfelt*, expressed above, may be broken down into two propositions:

Restraints of trade are presumed ‘void’ as being contrary to public policy;

Yet this presumption can be rebutted, and the restraint enforced, where the restraint is reasonable in the interests of the parties and in the public interest.⁶²

As Lord Macnaghten continued:

‘It is 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

⁵⁸ Clarke and Corones, above n 17, 19.

⁵⁹ Ibid 19–20.

⁶⁰ Meltz, above n 9, 159, citing J G Collinge ‘The Modern Doctrine of Restraint of Trade’ 41 *Australian Law Journal* 410, 418.

⁶¹ *Nordenfelt v Maxim Guns and Ammunition Co Ltd* [1894] AC 535, 565 (Lord Macnaghten); *Amoco Australia Ltd v Rocca Bros Motor Engineering* (1973) 133 CLR 288, 315 (Gibbs J); *Peters (WA) Ltd v Petersville Ltd* (2001) 205 CLR 126, 139 (Gleeson CJ, Gummow, Kirby and Hayne JJ).

⁶² Clarke and Corones, above n 17, 32–3.

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'.⁶³

Therefore, 'reasonable' means that the restraint affords no more than adequate protection to the covenantee while at the same time not being injurious to the public interest.⁶⁴

As a result, a restraint of trade that is more than is required is void as a matter of public policy because the deprivation of liberty to trade is detrimental to the public interest.⁶⁵

Yet despite the emphasis in the test on 'public policy' or the 'public interest', various authors have suggested that in practice this element is lacking.

According to Heydon, the public interest does not have a large role to play in restraints on employees, the sale of goodwill by owners or partners in a business. However, it may play a more predominant role in trade association cases, sole supply (exclusive dealing) agreements and the like.⁶⁶

⁶³ *Nordenfelt v Maxim Guns and Ammunition Co Ltd* [1894] AC 535, 565 (Lord Macnaghten).

⁶⁴ *Amoco Australia Pty Ltd v Rocca Bros Motor Engineering Co Pty Ltd* (1973) 133 CLR 288, 307 (Walsh J).

⁶⁵ *Amoco Australia Pty Ltd v Rocca Bros Motor Engineering Co Pty Ltd* (1973) 133 CLR 288, 307 (Walsh J); *Peters WA v Petersville* (2001) 205 CLR 126, 139 (Gleeson CJ, Gummow, Kirby and Hayne JJ). See also *TW Cronin Shoes Pty Ltd v Cronin* [1929] VLR 244.

⁶⁶ Heydon, above n 5, 34–5.

On the other hand, Clark and Corones argue that courts have been reluctant to examine the economic impact of a restriction to determine whether it is contrary to the public interest.⁶⁷

Similarly to Clark and Corones, Meltz recognises that the courts have largely ignored the second limb of *Nordenfelt*, regarding public policy.⁶⁸

On this basis, it may be better to articulate the test of reasonableness as it has alternatively been described: ‘reasonableness’ entails a balancing act between the situations of both the covenantor and covenantee, so as to ensure that the restraint of trade is justified as reasonable in the interests of both parties, according to the respective situations that they occupy.⁶⁹

The validity of the restraint must be decided as at the date of the agreement imposing it.⁷⁰ Nevertheless, facts occurring after the date of the restraint may be relevant if they throw light on the circumstances existing at the date of the restraint.⁷¹

Similarly, the reasonableness of a restraint must be tested not by reference to what the parties have actually done or intend to do, but by what the restraint requires or entitles the parties to do.⁷²

⁶⁷ Clarke and Corones, above n 17, 52, 69. As discussed in *Texaco Ltd v Mulberry Filling Station Ltd* [1972] All ER 513.

⁶⁸ Meltz, above n 9, 6, 91.

⁶⁹ *Peters American Delicacy Co Ltd v Patricia’s Chocolates & Candies Pty Ltd* (1947) 77 CLR 574, 590 (Dixon J); see also Russell V Miller, *Miller’s Australian Competition and Consumer Law Annotated* (Thomson Reuters (Professional) Australia, 34th ed, 2012) 700.

⁷⁰ *Hydron Pty Ltd v Harous* (2005) 240 LSJS 33, [86] (Bleby J); *Amoco Australia Pty Ltd v Rocca Bros Motor Engineering Co Pty Ltd* (1973) 133 CLR 288, 318.

⁷¹ *Amoco Australia Pty Ltd v Rocca Bros Motor Engineering Co Pty Ltd* (1973) 133 CLR 288, 318 (Gibbs J).

⁷² *Adamson v NSWRL* (1991) 31 FCR 242.

Trebilcock has suggested that this may not be the best approach, and that the actual breach of the covenant, rather than the covenant's hypothetical limits, should be the focus of the court.⁷³

Under the current doctrine, espousing the opprobrium of public policy mentioned above, the party seeking to maintain the benefit of the covenant has the onus of establishing reasonableness.⁷⁴

Notionally, the party contesting enforceability then has the onus of showing the restraint is not in the public interest⁷⁵ (where the public interest is a relevant consideration).⁷⁶ By 'notionally' what is meant is that there is a distinction in onus between 'reasonable' and 'public interest' which is becoming less clear and harder to justify.

In practical terms, the court looks at the agreement as a whole and its surrounding circumstances.⁷⁷

The question of reasonableness is a question of law for the court,⁷⁸ although it involves mixed elements of facts and law, and ultimately depends upon 'a judgment the reasons for which do not admit of great elaboration'.⁷⁹

⁷³ Trebilcock, above n 17, 144–6.

⁷⁴ *Buckley v Tutty* (1972) 125 CLR 353, 377 (Barwick CJ, McTiernan, Windeyer, Owen and Gibbs JJ).

⁷⁵ *SA Petroleum Co. Ltd v Harper's Garage (Stowport) Ltd* [1968] AC 269, 319; see also *Mason v Provident Clothing and Supply Co Ltd* [1913] AC 724, 733, 741; *Herbert Morris Ltd v Saxelby* [1916] 1 AC 688, 700, 706–7 and 715; Heydon, above n 5, 33.

⁷⁶ Heydon, above n 5, 34–5.

⁷⁷ See *Hydron v Harous* (2005) 240 LSJS, 50, [80], citing *SA Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269 and *Herbert Morris v Saxelby* [1916] 1 AC 688.

⁷⁸ *Amoco Australia Pty Ltd v Rocca Bros Motor Engineering Co Pty Ltd* (1973) 133 CLR 288, 317 (Gibbs J).

⁷⁹ *Amoco Australia Pty Ltd v Rocca Bros Motor Engineering Co Pty Ltd* (1973) 133 CLR 288, 308 (Walsh J).

Put another way, the question for the Court is whether it is satisfied, the onus being on the covenantee, that the restraint provides no more than adequate protection.⁸⁰ Thus, the party wishing to rely on the restraint of trade clause will need to prove the special circumstances from which reasonableness can be inferred by the judge as a matter of law.⁸¹

Additionally, while reasonableness is a question of law, courts have regard to agreements that are current in the relevant industry and evidence from persons active in that industry to assist in determining what level of protection is reasonably necessary to protect the interests of covenantees and others having regard to the nature of the relevant industry.⁸²

Covenants of restraint to protect goodwill receive different treatment depending upon whether they are found in contracts of:

1. Employment; or
2. Sale of business;⁸³
3. The Courts treat them as follows:⁸⁴

In contracts of employment, the restraint on an ex-employee will be construed strictly so as to favour the employee's liberty to pursue his vocation, and to exploit what may be their only asset, without unreasonable impediment. That translates into restraints being held to be

⁸⁰ See *Amoco Australia Pty Ltd v Rocca Bros Motor Engineering Co Pty Ltd* (1973) 133 CLR 288, 308 (Walsh J).

⁸¹ Heydon, above n 5, 35.

⁸² *Haynes v Doman* [1899] 2 Ch 13, 24, (Lindley MR), cited in Heydon, above n 5, 41, note 50. See also *Hydron v Harous* (2005) 240 LSJS 33, [8]-[9], 34; [123]-[125], 58-9 (Bleby J).

⁸³ In *The Restraint of Trade Doctrine*, (LexisNexis Butterworths, 3rd ed, 2008), Heydon adds two categories: vertical and horizontal non-ancillary restraints: Chapter 9.

⁸⁴ See *Hydron v Harous* (2005) 240 LSJS 33, 51, [85] (Bleby J), citing *Lindner v Murdock's Garage* (1950) 83 CLR 628, 653.

invalid unless they are reasonably necessary to prevent disclosure of trade secrets or in connexion with customers of the business;⁸⁵

In the case of a sale of business, restraints are construed less strictly. They are enforced to the extent that is reasonably necessary to protect the goodwill of the business sold

In cases where there is an employment or services contract *and* ownership of part of the business, such as partnership⁸⁶ or shareholding,⁸⁷ the courts first characterise the restraint by asking whether it is directed to the protection of goodwill or the restraint of employment.⁸⁸ The clause is then examined for its enforceability by ascertaining what legitimate interests the clause seeks to protect⁸⁹ and then to see whether the restraints were more than adequate for that purpose.⁹⁰

Bleby J in *Hydron Pty Ltd v Harous* said:

The courts in general take a stricter and less favourable view of covenants in restraint of trade entered into between an employer and an employee than of such covenants entered into between a vendor and a purchaser. This is probably because there are different interests to protect. In the case of sale of a business, the purchaser is entitled to protect himself against competition on the part of the vendor, in order to observe, for a reasonable time, what it is that he has bought. With an employee, the emphasis is not so much on restriction of the activities for which the employee is trained and which might be competitive with those of the employer, but on the

⁸⁵ Heydon, above n 5, 86, 91-4.

⁸⁶ Ibid 91-4. See, eg, *Bridge v Deacon* [1984] AC 705.

⁸⁷ Heydon, above n 5, 91-4. See e.g. *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co Ltd* [1894] AC 535.

⁸⁸ *Hydron v Harous* (2005) 240 LSJS [92] (Bleby J).

⁸⁹ *KA & C Smith v Ward* (1998) 45 NSWLR 702, 722.

⁹⁰ *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269, 301.

use of information obtained about the employer's business which would be of subsequent use to the employee or to the employee's new employer.⁹¹

It should further be noted that employee restraints also entail a certain difficulty in distinguishing between protectable proprietary interests, such as trade secrets and customer connections, and the personal skills of the employee, which cannot be protected.⁹²

The concept of reasonableness in a restraint involves a balancing of the competing considerations of, on the one hand, the quantum of benefit received by the covenantee for the restraint and, on the other hand, the effect of the restraint on the covenantor.⁹³

In considering the protection afforded to the covenantee by the restraint and the effect of the restraint on the covenantor in determining if the restraint is excessive, it is well established that it is relevant to have regard to: the period of the restraint; the geographic scope of the restraint; and the subject matter of the restraint or the activity to be restrained.⁹⁴

The more onerous the restraint, the more difficult it is for the covenantee to satisfy the Court that it was no more than reasonably necessary for the protection of the covenantee's interests.⁹⁵ Indent this para back one?

⁹¹ (2005) 240 LSJS 33; [2005] SASC 176, [85] (Bleby J).

⁹² Trebilcock, above n 6, 146. See also Heydon, above n 5, 115.

⁹³ *Amoco Australia Pty Ltd v Rocca Bros Motor Engineering Co Pty Ltd* (1973) 133 CLR 288, 306 (Walsh J), 316 (Gibbs J); *Adamson v NSWRL* (1991) 31 FCR 242, 266 (Wilcox J); see also John Dyson Heydon, *The Restraint of Trade Doctrine*, (LexisNexis Butterworths, 2nd Edition, 1998), 166.

⁹⁴ Extends beyond the context of the sale of a business to employee covenant (in relation to customer connection and trade secrets/confidential information/know-how) and to goodwill: Heydon, above n 5, 147, 148–72, 202–13.

⁹⁵ *Adamson v NSWRL* (1991) 31 FCR 242, 266 (Wilcox J).

The fact that the parties have agreed that the restraint was reasonable is not conclusive.⁹⁶ Thus, in assessing validity, the court is not constrained by the fact that the restraint is consensual.⁹⁷

Further, the amount paid for goodwill may be relevant to reasonableness, although it is not decisive.⁹⁸ Furthermore, there is no requirement that promises be commensurate or proportionate to the restraint.

Heydon suggests that there is no doctrine of ‘*commensurateness*’ or ‘*proportionality*’ which would call for substantial equivalence between the reach of the restraint and what the covenantor received for entering it.⁹⁹

Heydon summarises that ‘it would seem that the safe course is to assume that the primary test on reasonableness remains what it has been for many

⁹⁶ *Amoco Australia Pty Ltd v Rocca Bros Motor Engineering Co Pty Ltd* (1973) 133 CLR 288.

⁹⁷ See *Amoco Australia Pty Ltd v Rocca Bros Motor Engineering Co Pty Ltd* (1973) 133 CLR 288, 307 (Walsh J), 315-8 (Gibbs J).

⁹⁸ *Cream v Bushcolt* (2004) ATPR 42-004. Note that even where a substantial amount is paid under a contract by way of consideration, the covenantee bears the burden of demonstrating that a component of the consideration was to purchase the restraint: *Hydron v Harous* (2005) 240 LSJS 33, 51-53, [87] to [97], at 58, [120]-[124] (Bleby J). See also Walsh J in *Amoco* at 306: ‘a restraint will not be enforceable, unless it affords no more than adequate protection to the interests of the covenantee in respect of which he is entitled to be protected. If the court is not satisfied on that question it is immaterial, in my opinion, whether the covenantor has received much or little by way of benefits from entering into the transaction. ... Nevertheless, I am of the opinion that the quantum of the benefit which the covenantor receives may be taken into account in determining whether the restraint does or does not go beyond adequate protection for the interests of the covenantee.’ See also Gibbs J in *Amoco* at 316: ‘it is established that the court is not entitled to inquire into the adequacy of the consideration for a restraint, that is, the court may not weigh whether the consideration is equal in value to that which the covenantor gives up or loses by the restraint’.

⁹⁹ Heydon, above n 5, 183, citing *Allied Dunbar v Weisenger* [1988] IRLR 60, 65 (Millet J).

years, namely, whether the restraining is no more than reasonably necessary to protect the interests of the covenantee'.¹⁰⁰

Heydon notes that there is one statement which would suggest otherwise, which was enunciated by Lord Diplock in *A Schroeder Music Publishing Co Ltd v Macauley*.¹⁰¹ Lord Diplock stated that:

The test of fairness is ... whether the restrictions are both reasonably necessary for the protection of the legitimate interests of the promisee and commensurate with the benefits secured to the promisor.¹⁰²

Meltz, when considering Lord Diplock's statement in *Schroeder*, does not dispute Heydon's approach to proportionality. Rather, Meltz refers to Lord Diplock's comment to argue a different point, based on its first limb. Meltz contends that disparate bargaining power between the parties must be taken into account in determining whether a restraint is reasonable and thus valid, or tainted by oppression and 'possible unconscionability'.¹⁰³

While the involvement of a party (or lack thereof) in negotiating a restraint may influence the court,¹⁰⁴ it is unlikely under the current law that any inequality in bargaining power would lead to a restrictive clause

¹⁰⁰ Heydon, above n 5, 183, quoting *Brightman v Lamson Paragon Ltd* (1914) 18 CLR 331, 335.

¹⁰¹ [1974] 3 All ER 616.

¹⁰² [1974] 3 All ER 616, 623-4 (Lord Diplock).

¹⁰³ Meltz, above n 9, 8, 160. Meltz seems to use the word 'unconscionability' in the broader sense of the term. At 165, he states that: 'If, in the current version of the doctrine, one must consider the question of 'oppression', in looking at the reasonableness of a restraint, it must be inferred in the context that 'oppression' seems more akin to 'unfairness' than 'unconscionability'. Support for this view is found in Lord Diplock's judgment where, despite his use of the word 'unconscionable', the test he lays down looks at the fairness of the contract, opening the door to the argument that he has used the term 'unconscionability' in the wider sense'.

¹⁰⁴ Clarke and Corones, above n 17, 38.

being rendered void, unless the oppression was of such gravity as to be unconscionable.

Heydon considered that, if Lord Diplock's approach were to be defended not on restraint of trade grounds but on the basis that the bargain was unconscionable:

'Unconscionable conduct could not be found merely in a lack of commensurateness between the restrictions on the covenantor and the benefits secured for the covenantor: a gross disparity would be necessary before conscience would be shocked'.¹⁰⁵

Finally, in determining reasonableness, the courts look carefully to see which business is being protected.¹⁰⁶ The protection of *other* businesses owned by a purchaser or companies associated with the purchaser will *not* be a legitimate interest to be protected by a covenant in restraint of trade.¹⁰⁷

Various remedies exist for where a covenant is found to be unreasonable at common law. In the case of an employment restraint, one remedy which exists is damages for disclosure or abuse of confidential information.¹⁰⁸ Alternatively, an account of profits may be made.¹⁰⁹ However, damages may be more appropriate than an account of profits where the damage to the employer extends beyond the profits obtained by

¹⁰⁵ Heydon, above n 5, 182-3.

¹⁰⁶ See *Hydron v Harous* (2005) 240 LSJS 33.

¹⁰⁷ *Cream v Bushcolt* (2004) ATPR 42 -004. See also Heydon, above n 5, 148.

¹⁰⁸ Heydon, above n 5, 108; *Robb v Green* [1875] 2 QB 315; *Greenwood and Batley Ltd v West* (1951) 69 RPC 268; *Nicrotherm Electrical Co Ltd v Percy* [1957] RPC 207, 213-4; Robert Dean, *The Law of Trade Secrets and Personal Secrets* (Thomson Lawbook Co, 2nd ed, 2002), 322-37.

¹⁰⁹ Dean, *Employers, Ex-Employees and Trade Secrets*, above n 7, 64; Dean, *The Law of Trade Secrets and Personal Secrets*, above n 109, 335.

the former employee.¹¹⁰ Another available remedy is an injunction (which may be permanent, interlocutory or temporary) against future breaches.¹¹¹ Yet injunctive relief is an ill-suited sledgehammer, the application or non-application of which substantially burdens the losing party.¹¹² As such, a more nuanced approach is necessary. The principal problem surrounding employment restraints is converting suspicion of a breach of a covenant into evidence. Certain possibilities to achieve this include *Anton Piller* orders, pre-action discovery, remedies under the *Copyright Act* and cognate legislation.

The reasonableness test has been applied in a number of recent cases.

In *Hydron v Harous*,¹¹³ the three restraints considered by Bleby J were expressed as ladder clauses. As mentioned above, all three restraints were held to be invalid because they were unreasonable. Although the covenantor received a substantial sum in consideration for the sale and purchase of shares, that was not sufficient to justify the restraint as reasonable. The covenantee did not demonstrate separate consideration for the covenant. The extent of the sale and purchase covenants could not be justified in their temporal or geographical aspects. Further, the employment restraint was held to be unreasonable because it commenced its operation from the indeterminate date of cessation of employment without being tied necessarily to the protection of interests that would then fall to be protected.

¹¹⁰ Heydon, above n 5, 109; Dean, *Employers, Ex-Employees and Trade Secrets*, above n 7, 64; Dean, *The Law of Trade Secrets and Personal Secrets*, above n 109, 335, 337–41.

¹¹¹ Heydon, above n 5, 109; *Yovatt v Winyard* (1820) 1 Jac & W 349; *Merryweather v Moore* [1892] 2 Ch 518; *Lamb v Evans* [1893] 1 Ch 218; *Robb v Green* [1895] 2 QB 314; Dean, *The Law of Trade Secrets and Personal Secrets*, above n 109, 296–322.

¹¹² Trebilcock, above n 6, 148.

¹¹³ (2005) 240 LSJS 33.

*Peters (WA) Ltd v Petersville Ltd*¹¹⁴ was also decided upon the issue of reasonableness. The High Court adopted and accepted the approach of Walsh J in *Amoco v Rocca Bros*;¹¹⁵ endorsed *Nordenfelt*,¹¹⁶ subject to the observations of Walsh J;¹¹⁷ endorsed the approach that restraints of trade are *prima facie* unenforceable; and accepted that the onus was on the covenantee to show that the restraint was reasonable.¹¹⁸ The High Court found that the covenant ‘sterilised’ capacity to trade,¹¹⁹ and therefore held

¹¹⁴ (2001) 205 CLR 126.

¹¹⁵ (1973) 133 CLR 288.

¹¹⁶ [1894] AC 535, 569.

¹¹⁷ Gleeson CJ, Gummow, Kirby and Hayne JJ in *Peters v Petersville* at [27]: Walsh stated that ‘at the root of the rule that agreements in restraint of trade are, *prima facie*, unenforceable lies public policy. His Honour referred to the well-known formulation by Lord Macnaghten in *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co Ltd* respecting, first, reasonableness in the interests of the parties and, secondly, the absence of injury to the public. Walsh J saw considerations of public policy in both branches of the *Nordenfelt* formulation. His Honour said:

[I]f a restraint is imposed which is more than that which is required (in the judgment of the court) to protect the interests of the parties, that is a matter which is relevant to the considerations of public policy which underlie the whole doctrine, since to that extent the deprivation of a person of his liberty of action is regarded as detrimental to the public interest.

Referring to *Buckley v Tutty* at 306: ‘a restraint will not be enforceable, unless it affords no more than adequate protection to the interests of the covenantee in respect of which he is entitled to be protected’.

‘If [a] restraint does not exceed what is reasonably adequate for the protection of the covenantee, then it may be regarded as reasonable so far as the interest of the covenantor is concerned’: 306.

There are two branches of test: ‘the restraint must be reasonable in the interests of the parties in that it affords no more than adequate protection to the covenantee “while at the same time it is in no way injurious to the public”: 307.

¹¹⁸ See *Nordenfelt v Maxim Nordenfelt Guns & Ammunition Company* [1894] AC 535, 565 (Lord Macnaghten); and *Amoco Australia Pty Ltd v Rocca Bros Motor Engineering Co Pty Ltd* (1973) 133 CLR 288, 305-8 (Walsh J) and 315-8 (Gibbs J, as he then was).

¹¹⁹ See discussion re the Court’s take on *Esso* in *Peters v Petersville*, below in franchise discussion.

that the covenant was unreasonable and thus unenforceable under the doctrine as laid down in *Nordenfelt*.¹²⁰

III ALL OR NOTHING: SEVERANCE AND READING DOWN

In considering the discussion below regarding ladder clauses, it is useful to bear in mind the common law principles relating to severance. Where a restrictive clause is found to be unreasonable or uncertain, (as is discussed below), there is little scope at common law for the courts to rewrite the clause. A fundamental principle under the modern doctrine is that it is for the parties to agree the terms and extent of any restraint. Thus, the Court will not amend a restraint to conform with what it considers to be reasonable.¹²¹ It follows that a restraint is an all or nothing proposition. Where a clause is rendered invalid, there will be little that a covenantee can do to prevent the covenantor from taking or using the asset sought to be protected by the clause.

Even where there is an agreement to read down an offending clause, the expression of the restraint may appear to give little scope for a court acting conformably with principle as enunciated at common law.

¹²⁰ (2001) 205 CLR 126, 141-143 [34]-[39] (Gleeson CJ, Gummow, Kirby and Hayne JJ). Further examples of particular applications of the principles discussed above include: *Aussie Home Loans v X Inc Services* (2005) ATP R 42-060; [2005] NSWSC 285; *Hankinson v Brookview Holdings Pty Ltd* (2005) ATPR (Digest) 46-262; [2004] WASCA 279; *Cream v Bushcolt Pty Ltd* (2004) ATPR 42-004; [2004] WASCA 82; and *Idamenco (No. 123) Pty Ltd v Ticco Pty Ltd* (2004) ATPR (Digest) 46-257; [2004] NSWCA 329. Other South Australian authorities, not specifically discussed here, include *Rentokil v Lee* (1995) 66 SASR 301; *Avellino v All Australia Netball Association Ltd* [2004] SASC 56; *M E Perry Ltd v Judge* [2002] SASC 312; *Hahndorf Golf Club In. v John Nitcshke Nominees Pty Ltd* [2003] SASC 280; *Kerol Pty Ltd v Eldic* [2002] SASC 181; *NP Generation Pty Ltd v Feneley* [2000] SASC 240; *Dunning v Slimtone Spa International* [2002] SASC 12.

¹²¹ *Peters Ice Cream (Vic) v Todd* [1961] VR 485, 490 (Little J), cited with approval in *Hydron v Harous* (2005) 240 LSJS 46, [63] (Bleby J). See also *Lindner v Murdock's Garage* (1950) 83 CLR 628, 658-9. See also Walsh J in *Amoco*, 306-7: 'The court will not readily substitute its own views as to what is reasonable for those of the contracting parties'.

An exception applies where a restraint may be severed, which is particularly the case with ladder or cascading clauses. A clause may be severed where its severance does not materially change the intent of the contract, where the offending provision does not go to the heart of the contract, and where the court can infer an intention of the parties that the agreement remains valid in the absence of the offending provision.¹²²

Heydon recognises two conditions that must be satisfied before a restrictive covenant may be severed at common law.¹²³

The first condition is compliance with the ‘blue pencil’ test. That is, severance may only occur where the amendments are made by running a blue pencil through the offending parts.¹²⁴ In the words of Sargant J in *S V Nevanas & Co v Walker and Foreman*, severance is only possible in ‘cases where the two parts of a covenant are expressed in such a way as to amount to a clear severance by the parties themselves, and as to be substantially equivalent to two separate covenants’.¹²⁵ Thus, the blue pencil test is particularly applicable to ladder clauses which are presented as a combination of separate restraints. The second condition is that severance must not alter the nature of the original contract,¹²⁶ as recognised above.

¹²² Paterson, Robertson and Duke, *Principles of Contract Law* (Thomson Reuters (Professional) Australia, 3rd ed, 2009) [6.05], [6.65]; see also *Carney v Herbert* [1985] AC 301; *McFarlane v Daniell* (1938) 38 SR (NSW) 337; See also Miller, above n 70, 329.

¹²³ Heydon, above n 5, 285-6. Heydon goes on to discuss the desirability of these rules, and the arguments for and against a narrow or wide approach to severance: see 285-96.

¹²⁴ Ibid 285.

¹²⁵ [1914] 1 Ch 413, 423 (Sargant J), approved by Lord Sterndale MR in *Attwood v Lamont* [1920] 3 KB 571, 578.

¹²⁶ Heydon, above n 5, 286.

However, where the construction of the clause allows no scope for severance, the court is left with no option but to render it unenforceable, due to the all or nothing approach.

Thus, at common law, it would appear that a contract containing a taint of illegality or statutory prohibition would be '*illegal, void and unenforceable*',¹²⁷ unless a severance clause could be found valid work to do.¹²⁸

Heydon summarised the position that, 'where an unenforceable promise is contained in a contract and is severed from it, the rest of the contract remains in force and either party can rely on its terms'.¹²⁹

However, under the CCA, the position is quite different where clauses offend the prohibitions contained in s. 45.

Miller explains that 'where s 4L applies, having regard to the above construction, the second part of the section (that s 4L only applies if the making of the contract contravenes the Act) becomes relevant. That central proposition is the direct opposite of the ordinary rule that a contract whose making is illegal will not be enforced.'¹³⁰

In *SST Consulting Services*¹³¹ it was explained that central proposition (under s 4L, that nothing in this Act affects the validity or enforceability of the contract) is the direct opposite of the ordinary rule that a contract

¹²⁷ *Yango Pastoral Co. Pty Ltd v First Chicago Australia Ltd* (1978) 139 CLR 410, 430 (Jacobs J).

Mason J in *Yango* distinguishes between a statutory intent to render void an illegal contract, and a statutory intent merely to penalise the individual.

¹²⁸ *Carney v Herbert* [1985] AC 301.

¹²⁹ Heydon, above n 5, 304.

¹³⁰ Miller, above n 70, 329.

¹³¹ *SST Consulting Services Pty Ltd v Rieson* (2006) 225 CLR 516, [34].

whose making is illegal will not be enforced. As was said in *Yango Pastoral*:

When a statute expressly prohibits the making of a particular contract, a contract made in breach of the prohibition will be illegal, void and unenforceable, unless the statute otherwise provides either expressly or by implication from its language.¹³²

The majority in *SST* cited from *McFarlane* the dictum from Jordan CJ as to the applicable rule as being: ‘If the elimination of the invalid promises changes the extent only but not the kind of the contract, the valid promises are severable.’¹³³

But, as noted in *SST*, different circumstances may arise in cases of *illegality* from those that fall for consideration when the enforcement of certain provisions is *contrary to public policy*. That is why it is necessary to distinguish between cases in which a promise made by a party to a contract is void or unenforceable, but not illegal, and cases in which the contract or the performance of a promise would be illegal’.¹³⁴

On illegality, Heydon expresses the view that: ‘sometimes the covenant is described as ‘illegal or ‘unlawful’. However, the covenant is not illegal or unlawful in the sense of being criminal or tortious’.¹³⁵ However, he does not go on to discuss whether restraints are merely contrary to public policy. He does, however, note that restraints of trade are not ‘void at common law but merely unenforceable at law’.¹³⁶

¹³² *Yango Pastoral Co. Pty Ltd v First Chicago Australia Ltd* (1978) 139 CLR 410, 430 (Jacobs J).

¹³³ *McFarlane v Daniell* (1938) 38 SR (NSW) 337, 345 (Jordan CJ).

¹³⁴ *SST Consulting Services Pty Ltd v Rieson* (2006) 225 CLR 516, [48].

¹³⁵ Heydon, above n 5, 278.

¹³⁶ *Ibid* 279.

Clark and Corones express the view that '[t]he common law doctrine of restraint of trade makes illegal, and hence unenforceable, contractual or other provisions that impose a restriction upon a person's freedom to trade or engage in employment, unless that restriction can be shown to be 'reasonable'.¹³⁷ 'If a restriction consists of severable parts, it may be possible to enforce those parts that are reasonable while leaving the remainder void'.¹³⁸

Where the CCA applies, s 4L automatically operates to sever the elements of a contract that contravene the CCA, but to otherwise preserve the subject matter of the contract.¹³⁹ Yet, as is discussed below, s 4L also has an additional, unique, operation, whereby it not only allows the court to amend an offending provision of a contract, but mandates it – the opposite of the position at common law. Further, s 4L operates subject to any order made under s 87 CCA. Therefore, the common law rules regarding severance have no application where s 4L applies.¹⁴⁰

IV THE FRANCHISE MODEL

A covenant taken from a franchisee against competition when the franchise agreement is terminated is similar to the employment, goodwill and partnership covenants discussed above.¹⁴¹

The franchise model provides an example of the ideal approach to restrictive clauses, illustrating the paradigm shift which is necessary in respect of restraint of trade generally. Rather than presenting restraint of

¹³⁷ Clarke and Corones, above n 7, 18.

¹³⁸ Ibid 57.

¹³⁹ Miller, above n 70, 328.

¹⁴⁰ *SSL Consuling Services Pty Ltd v Rieson* (2006) 225 CLR 515, [24], [40]–[51] (Gleeson CJ, Gummow, Hayne, Heydon and Crennan JJ); see also Miller, above n 70, 329.

¹⁴¹ See also Heydon, above n 5, 93.

trade clauses as ‘void’ and ‘contrary to public policy’ unless reasonable, in favour of the covenantor, the courts consider restraint of trade clauses in the light of the franchisee’s, or covenantee’s, legitimate right to protect their business.

The traditional approach has been to view franchise agreements as ‘*very different to an agreement by the owner of a business*’.¹⁴²

However, under the modern view, demonstrated in *Prontaprint PLC v Landon Litho Ltd*,¹⁴³ the relationship of franchisor and franchisee was described as being closer to that of vendor and purchaser of a business than to that of employee and employer.

The circumstances of *Prontaprint* were that the defendant decided not to exercise an option to renew and then argued that restraints which became operable upon the expiry of the term were unenforceable. Whitford J considered that:

Quite plainly, if a covenant of this kind is unenforceable, as soon as they have managed to get going on the expertise, advice and assistance given to them by the plaintiffs, other franchisees are going to either withdraw or not renew their agreements and franchising will, effectively, become inoperable. That is the position of the plaintiffs. They say that this is a perfectly reasonable restriction to protect the interest which they legitimately have in running a franchising business because, without a restraint of this kind, effectively running a franchising business is going to become impossible.¹⁴⁴

¹⁴² *Budget Rent a Car International Inc v Mamos Slough Ltd* (1977) 121 Sol Jo 374 (Lord Denning MR).

¹⁴³ [1987] FSR 315, 324; *Dyno-Rod PLC v Reeve* [1999] FSR 148, 153; *Convenience Co Ltd v Roberts* [2001] FSR 625.

¹⁴⁴ *Prontaprint PLC v Landon Litho Ltd* [1987] FSR 315 (Whitford J).

Further support for the modern approach that a franchise agreement is to be treated in a way similar to that of a vendor and purchaser of a business, rather than an employer and employee, comes from *Kall Kwik Printing (UK) Ltd v Rush*:¹⁴⁵

One way perhaps of looking at a franchise agreement is that this is a form of lease of goodwill for a term of years, with an obligation on the tenant, as it were, to retransfer the subject matter of the lease at the end of the lease in whatever state it is. To that extent there is an obligation to transfer goodwill in a particular form which is much more akin, I think, to the goodwill cases than to the servant cases.

As to the duration of the restraint in a franchise agreement, Austin J in *K A & C Smith Pty Ltd v Ward* stated that:¹⁴⁶

In my opinion the restraint clause is not unreasonable by virtue of its duration, as such ... to preserve the franchisor's 'goodwill' (referred to above as an interest in the patronage of the franchised business and the confidentiality of products and processes), a franchisor needs time to obtain a substitute franchisee to work the franchise area, and the new franchisee needs time to become established. Direct competition by the former franchisee would be likely to damage the transition process. Given the nature of the business and the expertise which needs to be acquired by tuition or self-teaching or both, a two year restraint is appropriate.

The capacity to continue to operate may not be 'sterilised' in the sense of what Lord Pearce said in *Esso Petroleum v Harper's Garage (Stourport) Ltd*.¹⁴⁷ That is, that Lord Macnaghten in *Nordenfelt* 'did not intend the

¹⁴⁵ [1996] FSR 114, 119.

¹⁴⁶ (1998) 45 NSWLR 702, 723G–724A (Austin J).

¹⁴⁷ [1968] AC 269, 328 (Lord Pearce). See also *Peters (WA) Ltd v Petersville Ltd* (2001) 205 Ch R 126, 141–3, [34]–[39] (Gleeson CJ, Gummow, Kirby and Hayne JJ).

words ‘restraints of trade’ to cover ‘any contract whose terms, by absorbing a man’s services or custom or output, in fact prevented him from trading with others’. Rather, ‘it was the sterilising of a man’s capacity for work and not its absorption that underlay the objection to restraint of trade’.¹⁴⁸

Thus, as these cases recognise, the franchisee, or covenantee, has every right to protect their business interests by way of a reasonable restraint of trade clause in the face of the franchise being rendered ‘inoperable’ by the conduct of an opportunistic franchisor.

The modern doctrine of restraint of trade would be enhanced by the adoption of such an approach to restraint of trade generally. The franchise model presents restraint of trade as a positive doctrine which exists to protect the legitimate interests of the covenantee, rather than a negative doctrine in protection of the covenantor and the public interest. Such an approach to the modern doctrine would balance the rights of covenantor and covenantee as effectively as under the current position, yet such a reframing would significantly assist the drafter in comprehending what exactly is being protected by a restraint of trade clause.

V UNCERTAINTY

Having understood the doctrine of severance, it is critical that the drafter understand that the doctrine of restraint of trade as the positive protection

Yet *Peters* at 39 criticises sterilisation ‘test’ in *Esso*: ‘The “test” upon which Peters WA relies should not be accepted in Australian common law’. Heydon also notes the various criticisms of the *Esso* ‘sterilisation’ test in *The Restraint of Trade Doctrine*, and refers to *Peters*, including the HC’ declined to accept Lord Pearce’s test as part of Australian law: see Heydon, above n 5, 67–76. He also noted that a narrower version of Lord Pearce’s test was rejected by Gibbs and Walsh JJ in *Amoco*: Heydon, above n 5, 76.

¹⁴⁸ *Esso Petroleum v Harper’s Garage (Stourport) Ltd* [1968] AC 269, 328 (Lord Pearce).

of the covenantee's legitimate interests will only protect what is certain. These interests may be protected by a set of variables in time, space, and subject matter in a ladder clause. Properly drafted, a cascading clause may present a range of such variables that the parties consider reasonable, which may be severed to the extent that the court considers necessary and the rest preserved.

Yet one of the major consequences of the failure to understand restraint of trade as the right of covenantees to protect their legitimate interests is the drafting of ladder clauses which attempt to achieve the widest possible number of combinations, in hope that one will be held to be reasonable. Zealous attempts to draft cascading clauses to offer the widest possible protection of the covenantee's right often result in clauses which are not only unreasonable, but also uncertain.

Further, in such clauses, the parties cannot be said to have come to a true agreement. The clause is not so much an expression of the parties' intent, but a multiple choice quiz. Where this becomes an exercise in multiple choice for the courts, or where the parties have 'left to the court the task of making their contract for them',¹⁴⁹ the courts are reluctant to rewrite the clause and are likely to render it unenforceable for uncertainty. The more permutations, the more likely a clause will be held to be uncertain under regular contractual principles.¹⁵⁰

Clark and Corones summarise the position:

¹⁴⁹ *Peters Ice Cream (Vic) Ltd v Todd* [1961] VR 485, 490 (Little J), referred to in *Hydron v Harous* (2005) 240 LSJS 33, [63] (Bleby J).

¹⁵⁰ Under general contractual principles, if a contract is so vague, imprecise, or uncertain that the court cannot attribute a meaning to the contract, it is unlikely to be enforced. This is particularly the case where the uncertainty goes to the heart of the agreement: Paterson, Robertson and Duke, *Principles of Contract Law*, (Thomson Reuters (Professional) Australia, 3rd ed, 2009) [6.05], [6.40].

If a ladder clause is drafted so as to contemplate a single restraint, it is liable to be struck down on grounds of uncertainty unless it provides a means by which to choose which of the combinations is to apply. On the other hand, if the clause contemplates all of the combinations applying, with severance of those found to be unreasonable, no uncertainty exists. Therefore, the clause will not be at risk on that ground.¹⁵¹

In *Seven Network (Operations) Limited & Ors v James Warburton (No 2)*,¹⁵² Pembroke J stated the following regarding cascading clauses:

Restraint of trade clauses, with an ever diminishing and cascading series of restraints based on different restraint periods and geographical areas, have become a modern phenomenon. This is evident from a consideration of recent decided cases, most of which are collected in *Hanna v OAMPS Insurance Brokers Ltd* ... the legal doctrine of uncertainty does not depend on mere complexity. Nor is opacity, obscurity or vagueness sufficient by themselves. There must be such a lack of clarity that the clause is unworkable: that it cannot be given effect in a meaningful way. Lord Denning once said that before a clause is held to be void for uncertainty, it must be ‘utterly impossible’ to put a meaning on the words: *Fawcett Properties Ltd v Buckingham County Council* [1961] AC 636 at 678.¹⁵³

Yet His Honour concluded that:

There may be a case, as Allsop J observed in *Hanna v OAMPS*, where a complex and difficult restraint of trade clause, with multiple

¹⁵¹ Clarke and Corones, above n 17, 58–9.

¹⁵² [2011] NSWSC 386.

¹⁵³ *Seven Network (Operations) Limited & Ors v James Warburton (No 2)* [2011] NSWSC 386, [36]–[37] (Pembroke J).

combinations and permutations, is so impenetrable as to lack coherent meaning. But this is not such a case.¹⁵⁴

In *Hanna v OAMPS Insurance Brokers Ltd*,¹⁵⁵ two arguments were raised in the Court of Appeal as to the uncertainty of a particular ladder clause.

The first of these arguments was the ‘one covenant’ argument. That is, on a proper construction, the restraint clause was a single covenant which contained mutually inconsistent obligations.

Allsop P (Hodgson JA and Handley AJA agreeing) referred to what is a relatively common clause in the document which stipulated that the various periods and areas were part of separate and independent provisions, and stated that:

Thus there were nine restraints, from the widest (15 months in Australia) to the narrowest (12 months, in Mr Hanna’s case, in the metropolitan area of Sydney). All were binding. Taken as individual covenants, all capable of being understood by the use of clear words and all being capable of being complied with without breaching any of the others, the one covenant argument must fail.¹⁵⁶

The second argument was that of the ‘hierarchy argument’ – that even if the restraint deed contained more than one covenant, it was uncertain because it was not stated which one applied or in what order they applied.

Yet Allsop P stated that:

¹⁵⁴ Ibid [40] (Pembroke J).

¹⁵⁵ [2010] NSWCA 267.

¹⁵⁶ *Hanna v OAMPS Insurance Brokers Ltd* [2010] NSWCA 267, [11] (Allsop P).

It may be that if multiple obligations on the same subject matter so conflict that a contracting party cannot know what it is to do, such clause, or the contract in which it is found, is uncertain and void.¹⁵⁷

Allsop P went on to say that:

No such difficulty arises here. Compliance with any relevant clause will not lead to breach of any other clause. All bind, but at one level of practicality the most relevant is the widest. Nevertheless, all are binding.¹⁵⁸

Their Honours also raised a third argument, regarding the public policy behind complex ladder clauses. They held that:

...clauses between employer and employee should exhibit a reasonable attempt to identify a clear and agreed reach for any post-employment constraint. Clauses which seek to establish a multi-layered body of restraints are complex (even if certain) are against public policy.¹⁵⁹

Allsop P went on to find that ‘complexity and repetition, if unreasonable, are against public policy...’ However, ‘this restraint deed is not capable of being so characterised. The operation of the clauses is tolerably clear... The restraint deed is not against public policy by reason of the multiple and several operation of cll 2 and 4’.¹⁶⁰

The issue of uncertainty in the context of ladder clauses was also dealt with by Bleby J in *Hydron Pty Ltd v Harous*.¹⁶¹

¹⁵⁷ Ibid [12] (Allsop P).

¹⁵⁸ Ibid.

¹⁵⁹ Ibid [16] (Allsop P). This argument was addressed in the context of the *Restraints of Trade Act 1976* (NSW).

¹⁶⁰ Ibid [17] (Allsop P).

¹⁶¹ (2005) 240 LSJS 33.

In his reasoning, His Honour referred to the judgment of Little J in *Peters Ice Cream (Vic) Ltd v Todd*¹⁶² in the Supreme Court of Victoria.¹⁶³ *Peters v Todd* involved a covenant (which was not a ladder clause) not to sell certain products ‘within a reasonable distance’ from the defendant’s present place of business for a period of five years. Little J held that:

The parties have not, in my opinion, by the use of the imprecise language employed, defined the promisor’s obligation, or defined it in such a way that the court can determine whether it exceeds or does not exceed the protection to which it may find the promisee was in fact entitled. They have, I think, left to the court the task of making their contract for them, and of carving out from time to time a distance which, within the restraint of trade doctrine, is reasonable. It is not for the court, however, to determine what protection could have been validly agreed upon between the parties. The function of the court is to determine whether a protection agreed upon between the parties is in law valid. The clause is, therefore, in my opinion, void.¹⁶⁴

Bleby J refused to find the relevant ladder clauses in *Hydron v Harous* void for uncertainty, as he found that they were not inconsistent and were cumulative. His Honour found that the agreements expressly stated that the respective clauses were to have effect as if they were separate covenants consisting of the several combinations, and indicated an intention for all combinations to apply, subject to severance of any combination which became invalid or unenforceable. Further, His Honour found that the clauses agreed to by the parties did not leave to the court the ‘task of making their contract for them’,¹⁶⁵ but rather appeared

¹⁶² [1961] VR 485.

¹⁶³ *Hydron v Harous* (2005) 240 LSJS 33, 63 (Bleby J).

¹⁶⁴ *Peters Ice Cream (Vic) Ltd v Todd* [1961] VR 485, 490 (Little J).

¹⁶⁵ *Hydron v Harous* (2005) 240 LSJS 33, 74 (Bleby J) quoting Spender J in *Lloyd’s Ship Holdings Pty Ltd v Davros Pty Ltd*.

to be a genuine attempt to define the covenantee's need for protection. Therefore, the severance provisions could be seen as a precaution against the 'all or nothing' nature of the reasonableness test, and were not void for uncertainty.¹⁶⁶

Thus, framing the modern doctrine of restraint of trade in positive terms, namely in protecting the covenantee's legitimate interest to protect goodwill, client lists, confidential information or trade secrets, will greatly assist the drafter in creating a clause which is reasonable and certain in the interests of both parties (and in the public interest), and therefore valid. For a clause is only unenforceable inasmuch as it is unreasonable or uncertain.

VI CCA AND ITS INTERACTION WITH THE COMMON LAW

There is a divergence between the approach to restraint of trade at common law and that which is enshrined in the CCA. Whilst the relevant provisions in the CCA have been held to encapsulate the common law position,¹⁶⁷ the image problem haunting restraint of trade at common law has been eschewed under the CCA.

Sections 45(1) and (2) CCA prohibit the making of, giving effect to, or enforcement of a provision of a contract, arrangement or understanding if that provision is either an exclusionary provision or has the purpose or has or is likely to have the effect of substantially lessening competition.

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¹⁶⁶ (2005) 240 LSJS 33, 73, 75–6 (Bleby J).

¹⁶⁷ *IRAF Pty Ltd v Graham* [1982] 1 NSWLR 419, (Rath J). See Millers, above n 70, 700.

¹⁶⁸ Similar prohibitions apply by operation of s 75B of the CCA and under the equivalent provisions of the *Competition Code* with respect to natural persons.

A contract has been taken to have the ‘ordinary meaning of something that is enforceable at law’.¹⁶⁹ This includes formal and informal contracts, both express and implied.¹⁷⁰ However, it does not include contracts that are void, voidable or unenforceable.¹⁷¹ However, the CCA modifies the meaning of ‘contract’ for the purposes of s 45 by means of s 4H, which provides that ‘contract’ includes a reference to a lease or licence in respect of land or a building, and s 45(5)(a) and (b), which provide that ‘contract’ is not to include covenants affecting land that are within the scope of s 45B.¹⁷²

An ‘arrangement’ or ‘understanding’ is an agreement which is less formal or imprecise than a contract. For an ‘arrangement’ or ‘understanding’ to exist, there must be a meeting of the minds of the parties.¹⁷³ (In *Morphett Arms Hotel Pty Ltd v TPC* (1980) 30 ALR 88, the Full Court held that mutuality of obligation is not required for an understanding to exist).

An exclusionary provision is defined in s 4D CCA as one arrived at between persons who are competitive with each other which in a contract, arrangement or undertaking has the purpose of preventing, restricting or limiting the supply of goods or services to, or the acquisition of goods or services from, particular persons or classes of persons.¹⁷⁴

¹⁶⁹ *Hughes v Western Australian Cricket Association (Inc)* (1986) 19 FCR 10, 32 (Toohey J).

¹⁷⁰ Clarke and Corones, above n 17, 200.

¹⁷¹ Ibid.

¹⁷² Ibid.

¹⁷³ Ibid.

¹⁷⁴ In such a case, the issue of markets in which they would have been competitive does not arise: *News Ltd v Australian Rugby Football League* (1996) 64 FCR 410. See also *Peters (WA) Ltd v Petersville Ltd* (2001) 205 CLR 126; *Visy Paper Pty Ltd v ACCC* (2003) 216 CLR1. Note that *SST Consulting Services Pty Ltd v Riesen* (2006) 80 ALJR 1190 only criticised *News Ltd* on the construction of s 4L. See also discussion on s 4D in See also Russell V Miller, *Miller’s Australian*

However, s 51(2) CCA carves out certain exceptions to various provisions in Part IV, including s 45. Of particular relevance are ss 51(2)(b), (d) and (e), which provide exceptions in the case of employees, partnerships and goodwill.¹⁷⁵ Section 51 provides that, in considering whether a contravention of s 45 has been committed, regard shall not be had to these exceptions. Thus, as we will see below, they fall to be determined by the common law doctrine of restraint of trade.

S 51(2)(b) provides an exception to s 45 in the case of an agreement relating to restrictions of employment during or after the termination of a contract of employment.

S 51(2)(b) contains three requirements:

- 1) That the restraint is directed at serving the legitimate interests of the employer;
- 2) That those interests are in restraining competition by an employee after termination of the employment contract; and
- 3) That the restraint is to protect the employer against the employee using the connection with customers and clients that the employee might acquire by reason of the employment.¹⁷⁶

Section 51(2)(d) relates to an agreement between partners relating to the partnership, or to competition with the partnership during or after a partner ceases to be a partner. It provides an exception to s 45 where provisions of a partnership relate to the terms of the partnership, the

Competition and Consumer Law Annotated (Thomson Reuters (Professional) Australia Limited, 34th ed, 2012), 303-8.

¹⁷⁵ Philip Clarke and Stephen Coronos, *Competition Law and Policy: Cases and Materials* (Oxford University Press, 1999), 24-6.

¹⁷⁶ *Lindner v Murdock's Garage* (1950) 83 CLR 628; *Synavant Australia Pty Ltd v Harris* [2001] FCA 1517; *Rentokil Pty Ltd v Lee* (1995) 66 SASR 301. See also Miller, above n 70, 698-9.

conduct of the partnership business, or restrictive covenants on partners while they are members of the partnership or after they cease to be a partner.

Section 51(2)(d) does not apply to incorporated partnerships or bodies corporate. The partnership must be determined in accordance with the definition in the *Partnership Acts*, to mean ‘carrying on a business jointly with a view to profit’.¹⁷⁷

Section 51(2)(e) provides that, in considering whether a contravention of s 45 has been committed, regard should not be had, in the case of a contract for the sale of a business or shares in the capital of the body corporate carrying on a business, to any provision of the contract that is ‘solely for the protection of the purchaser in respect of the goodwill of the business’.

If a restraint is outside a s 51(2)(b), (d) or (e) protection, it falls to be interpreted as an exclusionary provision under s 4D and is prohibited by, and hence unenforceable under, s 45. In such a case, the conduct is amenable to remedies under Part VI of the CCA, including declaratory relief,¹⁷⁸ injunctive relief¹⁷⁹ and recessionary remedies.¹⁸⁰ Damages may also be awarded.¹⁸¹

Thus, on its face, the CCA also relies upon common law notions of public policy. The CCA mirrors the common law by specifying that, in the determination of whether a contravention of s 45 has occurred, regard ‘shall not be had’ to the exceptions in ss 51(2)(b), (d) and (e). In doing so,

¹⁷⁷ Miller, above n 70, 701.

¹⁷⁸ CCA s 163A.

¹⁷⁹ Ibid s 80.

¹⁸⁰ Ibid s 87.

¹⁸¹ Ibid s 82.

it leaves those matters enumerated in ss 51(2)(b), (d) and (e) to be determined by the common law. Thus, restrictive clauses that fall outside of the prohibitions are, broadly those permitted under the common law when they are found to be reasonable and certain.

Miller explains that s 51:

has been drafted carefully to ensure that the exemptions it provides for are not interpreted as having a broad application. For that reason, the drafter has adopted the technique of stating that for the purpose of determining whether or not a contravention has occurred the specific matters enumerated in s 51 shall not be regarded, as opposed to the broader drafting style of providing general exemptions.¹⁸²

However, upon closer consideration, it is clear that the CCA provides a positive expression of the doctrine. It does so in that ss 51(2)(b), (d) and (e) is framed as protecting the legitimate interests of employers, partners and ‘the purchaser in respect of the goodwill of the business’, thus expressly recognising those matters which are ignored by the common law. The effect of ss 51(2)(b), (d) and (e) is that this protection is available where reasonable, for these exceptions are ultimately dealt with under the common law, yet the test is articulated in a positive sense, expressly recognising the legitimate rights of the covenantee that require protection.

In positively protecting the legitimate rights of the covenantee, the CCA contemplates an additional issue of public policy that has been overlooked by the common law doctrine: the public policy behind economic outcomes under competition policy.

¹⁸²

Miller, above n 70, 695-6.

This public policy is reflected in the object of the CCA, contained in s 2, to ‘enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection’.

By the promotion of competition, what is meant is ‘a process of rivalry in a market for goods or services whereby firms strive to meet the needs of consumers through constantly improving the price, quality and service of their products’.¹⁸³

This competition is enhanced where the legitimate interests of the covenantee are recognised and upheld: the employer can protect trade secrets, confidential information and know-how; the partner can protect the partnership; and the purchaser can protect the goodwill of the business – just as the franchisee can ensure that their franchise is not rendered ‘inoperable’ by an opportunistic franchisee at common law.

Thus, although the CCA is founded on the common law doctrine, it has the benefit of positively protecting the legitimate interests of various covenantees. It recognises the purchased interests that require protection if they are to confer any commercial advantage on the covenantee, and, in doing so, circumvents the image problem which afflicts the common law doctrine of restraint of trade.

The CCA also operates differently from the common law in one other important respect.

Under the CCA, s 4L acts as an exception to the general rule that the courts will not amend or read down a restrictive clause. It not only endorses the amendment of a restrictive clause in a contract by the courts,

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Clarke and Corones, above n 17, 116.

but mandates it. Further, s 4L operates subject to any order made under s 87.¹⁸⁴

Section 4L was introduced to the *Trade Practices Act 1974* (Cth) (now CCA) in 1977¹⁸⁵ following the Swanson Report, which suggested that s 4L was intended to harmonise the operation of the CCA and the common law rules of severance of void provisions in a contract.¹⁸⁶ However, it is now clear that the common law rules regarding severance have no application where s 4L applies.¹⁸⁷

In *SST Consulting Services Pty Ltd v Rieson*,¹⁸⁸ the High Court held that s 4L, as enacted and in the overall context of the CCA, went further than the common law. The High Court held that s 4L required, rather than merely permitted, severance of offending provisions when CCA jurisdiction was enlivened and that ‘severance’ in this context really meant a form of ‘reading down’.¹⁸⁹

This interpretation has the potential to impose on a court the impossible task of doing the parties’ work of rewriting a restraint clause within acceptable limits, a task which courts adjudicating upon restraints at

¹⁸⁴ *Fadu Pty Ltd (ACN 007 815 090) v ACN 008 112 196 Pty Ltd as Trustee of the “International Linen Service Unit Trust”* [2007] FCA 1965, 11, 16, 134 (Finn J). See also *SST Consulting Services Pty Ltd v Rieson* (2006) 225 CLR 516, [51] (Gleeson CJ, Gummow, Hayne, Heydon and Crennan JJ).

¹⁸⁵ See *ACCC v Baxter Healthcare* (2007) 237 ALR 512, 519 [17].

¹⁸⁶ See *SST Consulting Services Pty Ltd v Rieson* (2006) 225 CLR 516, [38] (Gleeson CJ, Gummow, Hayne, Heydon and Crennan JJ). See also Australia, Trade Practices Act Review Committee, *Report to The Minister for Business and Consumer Affairs*, August 1976 at 18-19, pars 4.31-4.33.

¹⁸⁷ *SSL Consulting Services Pty Ltd v Rieson* (2006) 225 CLR 515; See also Russell V Miller, *Miller’s Australian Competition and Consumer Law Annotated* (Thomson Reuters (Professional) Australia Limited, 34th ed, 2012), 329.

¹⁸⁸ (2006) 80 ALJR 1190.

¹⁸⁹ *SSL Consulting Services Pty Ltd v Rieson* (2006) 225 CLR 515, 52 (Gleeson CJ, Gummow, Hayne, Heydon and Crennan JJ).

common law will not do, due to the all-or-nothing approach discussed above.

However, *ACCC v Baxter Healthcare*¹⁹⁰ imposed an important qualification on the decision in *SST Consulting* and the operation of s 4L. The High Court held that ss 87 and 87A qualified s 4L.¹⁹¹ In other words, if a court finds that a provision contravenes s 45, if the provision is in a contract, and if the court decides ‘severance’ within the terms of s 4L is simply not possible, then the court may simply declare the provision void pursuant to s 87.

In *Fadu Pty Ltd (ACN 007 815 090) v ACN 008 112 196 Pty Ltd as Trustee of the ‘International Linen Service Unit Trust’*,¹⁹² Finn J applied s 4L and the reasoning of the High Court in *SSL Consulting Services*. His Honour similarly held that s 4L on its proper construction mandates the severance or reading down of offending provisions,¹⁹³ and also found that s 4L operates subject to any order made under s 87.¹⁹⁴

Under s 4M CCA, the common law relating to restraints of trade continues to operate to the extent that it is capable of operating concurrently with the CCA. Thus, the common law doctrine of restraint of trade is capable of operating side by side with, or being superimposed

¹⁹⁰ (2007) 237 ALR 512.

¹⁹¹ *ACCC v Baxter Healthcare* (2007) 237 ALR 512, [22].

¹⁹² [2007] FCA 1965.

¹⁹³ *Fadu Pty Ltd (ACN 007 815 090) v ACN 008 112 196 Pty Ltd as Trustee of the “International Linen Service Unit Trust”* [2007] FCA 1965, 11, 16, 134 (Finn J); referring to *SST Consulting Services Pty Ltd v Rieson* (2006) 225 CLR 516 at [51] (Gleeson CJ, Gummow, Hayne, Heydon and Crennan JJ).

¹⁹⁴ *Fadu Pty Ltd (ACN 007 815 090) v ACN 008 112 196 Pty Ltd as Trustee of the “International Linen Service Unit Trust”* [2007] FCA 1965, 11, 16, 134 (Finn J). A slightly more nuanced approach is contained in *Restraints of Trade Act 1976* (NSW), which also departs from the common law all-or-nothing position, yet in a less radical way in granting the court the option to rewrite offending restrictive clauses.

on, the CCA prohibition in s 45, limited as that prohibition is by the exception in s 51(2)(e).

Clark and Corones explain:

The scope of the restraint of trade doctrine is preserved, but significantly curtailed, by s 4M CCA. However, the operation of the restraint of trade doctrine in the three areas in which it has been most often used is given primacy under the CCA by ss 51(2)(b), (d) and (e).¹⁹⁵

Subject to s 51, the effect of s 4M is to preserve the doctrine, but only insofar as it is 'capable of operating concurrently' with the CCA. This means that restrictions involving conduct that is prohibited by the CCA will be illegal, regardless of whether they would have been so at common law' ... Yet the legality of restrictions not caught by the CCA remain governed by the restraint of trade doctrine, under which they will be held valid if they are reasonable and certain.¹⁹⁶

Although the doctrine of restraint of trade has a notional operation in other areas, it is primarily limited to the three kinds of restrictions listed in ss 51(2)(b), (d) and (e). These are restrictions binding employees, partners and sellers of goodwill. Restrictions of this kind are exempt from the operation of the competition law provisions of the CCA, other than s 48, and thus fall to be determined under the common law doctrine of restraint of trade.¹⁹⁷

In *Peters (WA) Ltd v Petersville Ltd*,¹⁹⁸ the High Court held:

First ... developments in the common law will not affect the interpretation of the [now CCA]. Secondly, the common law is free

¹⁹⁵ Corones and Clarke, above n 17, 24.

¹⁹⁶ Ibid 25.

¹⁹⁷ Ibid 26.

¹⁹⁸ (1999) 205 CLR 126.

to develop independently of the statute, provided always that the common law is capable of operating concurrently with the statute. Thus, the common law may strike down a restraint which falls outside the operation of Pt IV.¹⁹⁹

Thirdly, the High Court noted that in the independent development of the common law, the courts may have regard to the CCA and ‘what the Parliament had determined to be the ‘appropriate balance between competing claims and policies’.²⁰⁰

The High Court also held that:

The Full Court collectively held that there had been no error by Carr J in his decision that the restraint imposed by Art 7.1 was one to which the common law doctrine applied. That being so, the decision that the restraint is void stands. That outcome makes it unnecessary to determine in this Court a further point raised by Peters WA. If the restraint survive the application of the common law doctrine, then it would be necessary for Peters WA to withstand the attack sought to be made upon it under ss 45 and 47 of the [now CCA]. For that attack, Peters WA had pleaded an answer under part (e) of s 51(2) of the [now CCA]. Given the outcome of this litigation with respect to the common law doctrine the occasion in this Court for any determination respecting the construction of this provision falls away.²⁰¹

In *ACCC v Baxter Healthcare*,²⁰² the High Court said nothing to indicate that the CCA pre-empted the common law in a case where the applicant

¹⁹⁹ *Peters v Petersville* (2001) 205 CLR 126, 141 [32] (Gleeson CJ, Gummow, Kirby and Hayne JJ).

²⁰⁰ *Peters v Petersville* (2001) 205 CLR 126, 43,228, 43, 229. See also Miller, above n 70, 329.

²⁰¹ *Peters v Petersville* (2001) 205 CLR 126, 146 [46]–[47] and [49] (Gleeson CJ, Gummow, Kirby and Hayne JJ).

²⁰² (2007) 237 ALR 512.

had sought relief at common law and it was possible that both the common law norm and a Part IV norm had been contravened.

If a restraint of trade provision is capable of being held to be unreasonable at common law, and in contravention of s 45, there is no reason to accord the *CCA* some kind of precedence in a case where both contraventions are properly agitated and before the Court.

VII CONCLUSION

It would seem that the time is ripe for a reconsideration of the doctrine of restraint of trade without a presumption of invalidity by reference to public policy. Not only does commercial life depend upon the existence of such clauses, but the competition policy enshrined in the *CCA* assumes that valid clauses are essential exceptions to the prohibitions against horizontal restraint. The very description ‘*restraint of trade*’ obscures the purpose of a valid restraint by emphasising what the clause prevents rather than the legitimate interest that it is designed to protect. The common law has developed without the benefit of an overall view being taken on the continued necessity for the presumption of unenforceability on public policy grounds. Instead, clauses that improperly drawn can be shown not to warrant the status afforded legitimate clauses, placing the burden on those who attack them rather than those who seek to enforce. Once it is accepted that there are public policy arguments against *invalid* clauses, but strong commercial demand for *valid* clauses, the doctrine can be reviewed for its legal basis so that it makes modern commercial and economic sense.