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Précis Paper

Enforcing and Defending Post-Employment Restraints

A discussion of the practical considerations that apply when faced with a client seeking to enforce or defend a post-employment restraint

Discussion Includes

- What is a post-employment restraint?
- Quick overview of the law relating to post-employment restraints
- Practical considerations that apply when faced with a client seeking to enforce a post-employment restraint, or a client under threat of the enforcement of such a restraint
- Determining whether a restraint is reasonable and enforceable on its terms
- Determining whether a breach has occurred
- The difference between written undertakings and Court Orders
- Whether to seek undertakings, and when that will not be appropriate
- Choosing between settling and going to Court
- Applications for interlocutory injunctions

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Enforcing and Defending Post-Employment Restraints

1. In this edition of BenchTV, Paul Moorhouse (Barrister, Frederick Jordan Chambers, Sydney) and Gerard Boyce (Barrister, Frederick Jordan Chambers, Sydney) discuss the law relating to post-employment restraints, and the practical considerations that apply when faced with a client seeking to enforce a post-employment restraint, or a client under threat of the enforcement of such a restraint.

What is a post-employment restraint?

2. A post-employment restraint is otherwise referred to as a restrictive covenant. They can be found in an employment contract, or incorporated into a deed or another signed arrangement.

3. Essentially, a post-employment restraint restricts an individual from working in competition with the former employer, and/or soliciting clients from the former employer, and/or from taking away staff from the former employer.

General legal principles that apply to post-employment restraints

4. At common law, a restraint of trade (of which post-employment restraints are a type) is void as contrary to public policy, other than to the extent that a Court considers them reasonable.

5. Broadly speaking, a post-employment restraint will only be reasonable if it is necessary to protect the legitimate interests of an employer. Legitimate interests include confidential information, customer connections, or staff connections.

6. The Bible on post-employment restraints is Justice Heydon's *The Restraint of Trade Doctrine.* Other good commentary can be found in general employment law texts such as Neil SC and Chin's *The Modern Contract of Employment*, Irving's *The Contract of Employment,* and Sappideen, O'Grady and Riley's *Macken's Law of Employment*.

What happens when an employer is seeking to enforce a post-employment restraint against a former employee?

7. In this scenario, three important questions arise:
    - Is the former employee breaching the restraint, and can evidence be provided of that?
    - Is the restraint reasonable and enforceable? (Note that the answer to this will be different in NSW as compared to other States).
    - If the answer is yes to both of the above, does the employer want to move promptly to seek injunctive relief from a Court?

8. It is advisable for legal practitioners faced with a client in this scenario to:
    - look closely at the restraint clause, and determine its meaning;
    - remember that restraint clauses, in instances of ambiguity, will be read narrowly i.e. ambiguity is likely to be read against the employer; and
    - look closely at the conduct of the former employee and determine whether it would constitute a breach of the restraint.

9. An employer seeking to enforce a restraint in Court should provide his or her lawyer with evidence of actual breaches of the restraint (suspicion or supposition by the employer will not be sufficient). For example, evidence of a former client or customer of the employer stating that they are ceasing dealings with the employer because they have taken their business to the former employee or the former employee's new business – bearing in mind that first step of these proceedings is generally an interlocutory hearing, so that hearsay evidence will be admissible.

10. A practitioner should also pay close regard to the way in which the employment came to an end. If the employment comes to an end as a result of a breach by the employer, then it is unlikely that the employer will be able to enforce any restraint.

11. It is important to consider what sort of notice to produce could be served on the other side in order to obtain documents that will show or support the case that the former employee is in breach of the restraint.

12. The former employer will have to provide affidavit evidence in order to obtain an injunction from the court. The affidavit evidence will need to include evidence of the confidential information and/or customer connections that provide a basis for the restraint being reasonable and enforceable. Because hearsay evidence is admissible at the interlocutory stage, the initial affidavit evidence can include evidence from within the former employer's organisation of breaches that they have been told about.

13. An employer should be looking to provide the Court the following documents:
    - A summons, or an application in the Federal Court, setting out the final orders sought by the employer;
    - Evidence (affidavits);
    - Short minutes of order (for the first application to the Court); and
    - A targeted notice to produce.

14. Court rules require personal service of Court documents commencing proceedings and that the matter does not come back before the Court until at least three days after those documents have been served – this is referred to as normal service. In matters where three days would be too long, the employer will apply to the Court for an order allowing the period of service to be shortened, referred to as short service.

How to determine whether the restraint is reasonable and enforceable on its terms

15. A restraint will only be enforceable if it is reasonable to protect the legitimate interests of the employer, and those legitimate interests are confidential information, or customer and/or staff connection. It is important to determine:
    - whether the confidential information and/or customer/staff connections justify the restraint;
    - how long the confidential information in question is going to remain commercially sensitive and confidential, and whether a correlation exists between that period and the period for which the employer seeks to enforce the restraint; and
    - how long it will take to build up customer connections with a replacement employee, and whether a correlation exists between that period and the period for which the employer seeks to enforce the restraint.

16. The law relating to restraints differs between States; in NSW, there is a different approach because of the application of the *Restraints of Trade Act* 1976 (NSW). The success rate for restraint cases in NSW is about 55%, whereas the success rate for restraint cases in all other States is about 33%. The statistics suggest that the NSW legislation does make a difference.

What is a cascading restraint?

17. A cascading restraint provides for multiple options in relation to the length of the restraint, the geographical area covered by the restraint, and the types of activities prevented by the restraint, with the restraint provisions providing that each combination operates as a separate restraint. This means that a Court can sever any that are considered to be unreasonable, such that a valid restraint can remain.

18. Because of the *Restraints of Trade Act* 1976 (NSW), cascading restraint provisions are not required in contracts governed by NSW law (whereas they assist the enforceability of restraints in other States). The *Restraints of Trade Act* 1976 (NSW) allows a Court in NSW to read down a restraint clause to the extent necessary, and to focus on whether the conduct that has occurred in breach of that clause is the subject of a valid restraint, rather than whether *any* potential conduct in breach of that clause can be the subject of a valid restraint.

Going to Court

19. Before deciding whether or not to go to Court, a lawyer should forms the view, after taking instructions, that:
    - the former employee has acted in breach of the restraint;
    - evidence can be lead in support of that breach; and
    - the restraint is likely to be held by a Court to be reasonable.

20. The client is then faced with deciding whether or not to go to Court. An issue emerges as to whether written undertakings should be sought from the former employee before going to Court. Written undertakings, if they can be obtained, are cheaper than going to Court. An undertaking involves the former employee giving a written undertaking not to engage in particular conduct.

21. If the former employee has given an undertaking to the employer, and then breached it, in practical terms, firstly, it will be unlikely that the employer will have to demonstrate to the Court the reasonableness of the original post-employment restraint, and secondly, it will give the employer a head start in representing to the Court the duplicitous nature of the former employee's conduct.

22. It is generally, but not always, appropriate before going to court to seek an injunction to write to the former employee seeking undertakings that the employee will not engage in

specified conduct. A court will usually expect that to have been done before an application is made.

23. It is important to take instructions about the damage that has been caused by the former employee's activity, for two key reasons:
    - to demonstrate to the Court that damages will not be an adequate remedy; and
    - to demonstrate to the Court the seriousness of the matter.

24. The balance of convenience favours an order preventing the former employee from continuing their conduct in circumstances where that conduct is causing the employer and/or his business significant damage.

25. The Court will require an undertaking as to damages as the 'price' of obtaining an interlocutory injunction. It is an undertaking that the employer will meet any damages that result from the other side being injuncted on a temporary basis, if it is ultimately determined that the other side should not be injuncted. It is critical that the lawyer explain to the employer that he or she runs the risk of meeting any damage that has resulted from the interim injunction being granted on a temporary basis, if at final hearing it turns out that an injunction should not be granted.

26. Usually, matters such as these are heard in the Supreme Court of the relevant State. It is worthwhile, however, to bear in mind that such matters can also be brought to the Federal Court if it can be properly alleged that a breach of federal law (for example, s 182 or s 183 of the *Corporations Act* 2001 (Cth)) has occurred.

<u>What happens when an employee is under threat of the enforcement of a post-employment restraint?</u>

27. Where an employee approaches his lawyer, having received a letter from their former employer threatening injunction for breach of a post-employment restraint, many considerations arise that must be taken into account by the lawyer.

28. Firstly, it is important to look closely at the factual and legal assertions made in the letter, bearing in mind that employees will often sign post-employment restraints without having any regard to their terms.

29. Statements or representations made to an employee about a restraint before he or she signs it will generally not have any effect upon the enforcement of it, and will not be taken into account by a Court. Employment contracts commonly have a provision stating that previous representations or statements made prior to the contract do not have any effect upon signing of the contract. So the Court will normally only look at the terms of the contract, and not any collateral representations.

30. There are three factual considerations that arise at the outset in these cases:
    - what the employee has done post employment, and whether he or she is in breach of the restraint provision;
    - whether there is a restraint provision in the first place, or whether any written contract has been superseded by reason of a change of position or promotion; and
    - whether there has been a repudiation of the contract by the employer such that there is a question of enforceability of the restraint.

31. Factual matters relating to customer connection and confidential information are further important considerations. For example, the extent of the former employee's customer connections, and the currency of the confidential information to which the former employee had access, will be highly relevant.

Attempting to settle without a hearing

32. There can be great benefits to settling. A big issue for an employee will be legal costs, because proceedings of this type are inherently expensive. Related to this is the fact that such proceedings are sometimes prolonged and their continuation may affect the employee's ongoing employment with the new employer. A settlement that nips the issue in the bud early on is of great advantage to an employee.

33. Two important considerations that arise where an employee is looking to settle and continue to work with the new employer are:
    - whether the employer will renegotiate the restraint; and
    - whether the employee can give some undertakings to allay the ex-employer's concerns.

Defending an application for an injunction to enforce a restraint

34. When defending an application for an interim injunction to enforce a restraint in circumstances where the employee decides not to give undertakings that will satisfy the former employer, other considerations apply. A legal practitioner can give a general overview of how legal proceedings are likely to progress; he or she cannot, however, anticipate the manner in which the other party might choose to run the litigation.

35. 'Bad behavour' by the ex-employee, such as hiding their conduct in breach of the restraint, will be looked at by a court unfavourably, and may result in the court's discretion being exercised against the employee.

Consenting to undertakings in order to allow the matter to go to final hearing expeditiously

36. When dealing with a former employee who faces an application for interlocutory orders, it is often better for the employee to have the matter expeditiously go to final hearing instead of contesting the interlocutory application. That approach will involve the employee agreeing to orders or giving undertakings on an interim basis and until the matter is heard, with the hearing to occur promptly.

37. That approach can be better for an ex-employee because of the test that applies for obtaining an interim injunction, namely that the plaintiff must show:
    - a serious question to be tried that there has been a breach of the restraint; and
    - that the balance of convenience favours granting an interim injunction.

38. That approach can be better for an ex-employee because at a final hearing, however, it is not a question of serious question to be tried or of balance of convenience – instead, the Court must decide on a final basis whether the restraint is enforceable and whether there has been a breach. The former employee therefore meets the former employer on a level playing field with respect to the contest of legal principles, and the former employer does not have the 'elevation' that they get at the interim stage.

39. In agreeing to consent orders or undertakings as part of this approach, the ex-employee will want to be certain that there can be a final hearing within a short period of time. Otherwise, the ex-employee must seriously consider whether he or she can contest the application for an injunction at an interlocutory hearing, notwithstanding the more limited test that applies at that stage.

40. The Courts are amenable to bringing on the final hearing quickly in circumstances where consent is given on an interlocutory basis, because they tend to prefer an expedited final hearing to a hearing on an interlocutory application followed by a final hearing many months later.

Contesting an application for an interim injunction

41. If an ex-employee does contest the granting of an interim injunction, it is important to make it clear to the court that at a practical level, if the interim injunction is granted, it has the effect of finally determining the proceedings against the employee. It needs to be made clear to the Court that if there is to be an application for an interim injunction dealt with promptly, the employee must be given a chance to provide all the relevant evidence, and to issue any relevant subpoenas or notices to produce.

42. The Court will be concerned at the interim stage that there is no hardship caused as a result of a decision to act or not to act on an interlocutory injunction.

43. It is worthwhile to note that if an employee puts up the best undertaking that they can offer at the time, the balance of convenience will be affected in their favour. The Court is not really interested in protecting an employer beyond his or her legitimate interests. An example of an undertaking a former employee can offer to tip the balance of convenience in their favour, in circumstances where a restraint provision prohibits the former employee from working for a competitor but that employee has already begun work for a competitor, is an undertaking not to deal with the former employer's customers until the final hearing.

Continuing the proceedings after an application for an interim injunction

44. Strictly speaking, the proceedings are not ended by the interlocutory injunction; but in practical terms, for a variety of reasons, they may well largely be resolved by the outcomes of any interlocutory hearing.
45. Once an interlocutory hearing has finished, each party must decide whether to either:
    - proceed with the case, or
    - discontinue or settle the case.

46. After an interlocutory hearing has finished, parties affected by litigation weariness and the burden of legal costs will be more willing to settle the matter on acceptable terms.

BIOGRAPHY

Paul Moorhouse

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Paul is a barrister in Sydney who specialises in employment, industrial and discrimination law. He also maintains a general civil law practice. He regularly acts for employers, employees, individuals, and small and medium enterprises, in interlocutory matters, hearings and appeals. The disputes upon which he regularly advises and appears include unfair dismissals, general protection claims, award/agreement breaches, breaches of confidentiality, restraints of trade, and claims for sexual harassment and discrimination.

Gerard Boyce

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Gerard has more than 20 years workplace relations and employment law experience. Prior to coming to the Bar, he held various senior roles in workplace relations in the mining, building, electrical and aged care industries. He is co-author of the Smokeball Employment Law Guide (published 2010) and in 2017 was named as 'Recommended' in the Doyles Employment & WHS Barrister Rankings - NSW Doyles Guide.

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