Private action

This private action note concerns common law proceedings and not an action brought under the Trade Practices Act. The note highlights that common law actions continue to have an important role in competition law.

Rentokil Pty Ltd v Lee

Restraint of trade: *restraint of trade clause in employment contract; common law principles.*

Supreme Court of South Australia
Doyle CJ, Matheson and Debelle JJ
Judgment delivered 2 November 1995

Background

The action arose from a deed restraining an employee's involvement in certain business.

The respondent, Lee, was employed by Rentokil as a sales consultant in South Australia in the area of sanitary hygiene. She was required, inter alia, to secure contracts with potential customers and to renew contracts with existing customers, in each instance for periods of about two years. Her various designated territories covered a large proportion of South Australia. In the course of her employment, Lee dealt with thousands of Rentokil's existing and potential customers and had access to commercially sensitive confidential information of the company in the nature of client files, price lists and computer lists of customers. Lee knew and understood that such information was highly confidential.

Shortly after joining the Healthcare division in January 1993 she entered into a written agreement — a non-competition deed for restraint of trade. It included a non-disclosure clause which provided that after termination of her employment with Rentokil, Lee would neither disclose to any unauthorised person any confidential information which she may have received in the course of her employment, nor would she use or attempt to use any such information in any manner which may cause or be calculated to cause injury or loss to Rentokil.

Clause 2 dealt with non-competition both during and after termination of employment. Effectively, Lee was restrained from working 'in any capacity' in certain streams of business. The term 'capacity' was defined in clause 1.1 to mean any capacity including, without limitation, as principal, agent, director, employee, shareholder or unitholder, partner, joint-venturer, member, trustee, beneficiary, financier, guarantor, adviser or consultant. Clause 4 dealt with severability and provided that any provision which became unenforceable did not invalidate the other provisions of the deed. The period of restraint was for one year and the area of restraint was the State in which the employee was employed at the date of termination, in this case South Australia.

Lee resigned from her employment with Rentokil on 14 April 1994 and commenced employment with one of the appellant's principal competitors in South Australia four days later as a sales consultant in the area of sanitary hygiene where she was engaged in activities similar to those in which she had been employed by the appellant. In the course of her new employment she canvassed, solicited and approached clients of the appellant's Healthcare division and attempted to induce them away from the appellant.

Rentokil instituted proceedings in the District Court alleging that Lee's actions were in breach of clause 2 of the deed.

The decision at first instance

The trial judge found that Rentokil's customer lists, price lists and sales leads were so commercially sensitive as to make each of them highly confidential and entitle the plaintiff to

have each of them protected by an appropriate covenant in restraint of trade.

However, it was held that the provision contained in the 'non-competition deed' which restrained the employee, after termination of her employment, from involvement in certain types of business was not enforceable. Although it was reasonable as to area and duration, it was too wide in relation to the range of activities restricted by the provision. The restraint afforded more than adequate protection to the party in whose favour it was imposed, and hence, applying common law principles relating to restraint of trade clauses, it was unenforceable.

Issues on appeal

Rentokil appealed against the trial judge's finding that the deed was too wide as to the activities restrained and sought declarations that clause 2 was valid and enforceable and that the respondent was in breach of the clause.

The respondent cross-appealed against the decision that the deed was reasonable as to area and duration.

The appeal turned principally on the provisions of clause 2 and the definition of 'capacity'.

Held

The appeal was allowed.

All three judges found that the trial judge erred in his approach to the interpretation of the restraint. They found that such a restraint was reasonable and therefore the deed was enforceable.

Rationale

The area and duration of the restraint

It was noted that questions relating to unreasonable restrictions as to geographic extent and duration were frequently related: the more limited the geographic area the longer the period which was justifiable. Given that Lee's operations did cover a large area of the State, all three judges agreed that the trial judge was correct in determining the area of restraint to be reasonable. That conclusion was reinforced by the fact that the restraint operated for only 12 months.

The restraints both as to area and duration were not contrary to the public interest. The respondent was at liberty to seek employment as a salesperson in any kind of business which did not compete with the appellant. There would have been many other kinds of business in which the respondent would have been able to utilise her skills as a sales consultant.

The activities the subject of the restraint

The reasoning as to whether the activities restrained were reasonable differed.

Doyle CJ

Doyle CJ saw the issue as whether the restraint was shown to be no more than was reasonable in the interests of the parties and in the interests of the public, notwithstanding the operation given to it by the definition of 'capacity' in clause 1.1 of the deed.

His Honour agreed with Debelle J that the courts should take a broad approach when examining such provisions; they should not take an approach which would make it almost impossible to draft a clause which, from the employer's point of view, provided appropriate protection in a range of circumstances which could not be foreseen with any precision by the employer when the contract was entered into.

Doyle CJ believed that most terms used to define 'capacity', such as employee, principal and director, identified an involvement in a competitive business which gave rise to a real risk of infringing or damaging the employer's protectable interest. As such it was permissible for the employer to restrain the employee from involvement in a competitive business in those capacities.

However, he believed that if the term 'capacity' applied to shareholder or unitholder, financier or guarantor, there was no basis for saying that involvement in a competitive business in those capacities would ordinarily give rise to any real risk of damage to the employer's protectable interest and the mere possibility of that occurring was not sufficient to justify the restraint.

In Doyle CJ's opinion, the principle underlying the cases was that an employer with a relevant protectable interest could restrain an employee from accepting a position the nature of which was such that the employee would be likely to

utilise confidential information or trade connections which had been acquired in the course of employment. But if the employer identified positions which did not give rise to the relevant risk as being subject to the restraint, then on its face the restraint had gone too far. For these reasons His Honour believed that the deed provided protection which was more than reasonable, to the extent that it restrained the employee from being involved in a competitive business merely by virtue of being a shareholder or unitholder, financier or guarantor.

However, Doyle CJ stated that the fact that in this respect the deed provided more than reasonable protection to the employer did not invalidate the deed as a whole. Clause 4 of the deed manifested an intention on the part of the parties that a provision which became unenforceable was to be ineffective only to the extent of the unenforceability. Severance could take place provided that to do so did not alter the scope and intention of the agreement.

In His Honour's opinion the expressions which he had identified as providing more than reasonable protection to the employer could be severed from the meaning given to 'capacity'. What remained was a workable agreement, consistent with the underlying intention to protect the employer against activities of the employee which would infringe or damage the employer's protectable interest.

Matheson J

Matheson J reached the conclusion that the relevant provision was aimed at restraining active participation by the respondent in a business of sanitary hygiene in South Australia in a way that was *directly connected* with sanitary hygiene. His Honour did not think it was aimed at employment of, for example, a cleaner in such a business, or at a small shareholder of a company whose business included sanitary hygiene.

For these reasons he upheld the deed.

Debelle J

Debelle J considered it quite impossible for the employer to know how a former employee might seek to avoid a restraint of trade agreement. Therefore, it was not unreasonable for an employer to draw an agreement in terms which were wide enough to include activities which on their face appeared to go beyond the kind of activity in which the employee had been engaged.

His Honour believed the preferred approach when interpreting such an agreement was to have regard to the object and intent of the parties and read down the deed to give effect to that object and intent. If, on a strict construction, the words of the deed applied to cases which could not reasonably be supposed to have been contemplated by the parties and which on a rational view of the deed were outside its intended scope, the Court would not invalidate the agreement but, instead, would refuse to enforce it only so far as it was *really* unreasonable.

Debelle J believed the list of proscribed activities in the definition of 'capacity' was in large part clearly reasonable. Those activities which were not on their face reasonably proscribed were shareholder or unitholder, member, financier and guarantor. However, His Honour believed it reasonable to include financier and guarantor. The clear intention was that the appellant did not seek to prevent the respondent from acting as a financier or guarantor in any circumstances other than as financier or guarantor of a business which competed directly with the appellant. Similarly, it was also reasonable to proscribe the respondent from being a member, shareholder or unitholder in a company or unit trust which competed with the appellant.

It must be recognised that the expression 'in any capacity' might inadvertently include activities which were outside the contemplation of the parties. Consequently, it was held that the respondent could be employed by a competitor of the appellant in a way which neither brought her into contact with former clients of the appellant nor which would give her the opportunity of disclosing confidential information.

Debelle J concluded that the deed was reasonable and, therefore, valid.

Both Matheson and Debelle JJ saw it as possible to reach the same conclusions by severing the definition of 'capacity' from the deed.