Legitimate Interests and Unfair Terms: the other threshold test

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Abstract: The Australian Consumer Law provides protection to Consumers against unfair terms. The rule includes elements that are a familiar part of the common law of contract in the rule against the restraint of trade. The case law and academic writing on restraint of trade focuses on the reasonableness of the protection provided by the term. Whereas the other part of the rule: the legitimacy of the protected interest, receives less attention. Given the relatively smaller impact of consumer transactions it is suggested that the legitimacy of the protected interest is a more important test under the unfair terms rule.

INTRODUCTION

The Australian Consumer Law ("ACL") is the product of a long review process that attempted to address many issues in the regulation of consumer transactions. One of the many issues that the process and the ACL was intended to address was the creation of a new standard in consumer transactions[1]: unfairness, in the unfair terms rule (the "UFT")[2]. The objective was to create a clear rule that would prevent the creation of unfair terms before harm was caused to a consumer, rather than wait until the damage is done to provide the consumer with a remedy, and the business with a penalty.[3] The problem with new standards and particularly with one as context dependant as unfairness, is creating a definition that can provide, or at least allow for "[c]lear objectives, with observable outcomes".[4] If the rule is to be effective, it must be one that can generally be understood by both businesses and consumers. If the rule can be easily understood then businesses either will not create unfair terms, or if the terms are created they will used with caution as the business will be aware that regulators and consumers can easily recognise a term that infringes the UFT. The formula that was chosen was based in part on a rule that is familiar: the rule against restraint of trade. However, many of the cases decided under that rule are in circumstances that do not relate easily to

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1 Productivity Commission, *Review of Australia's Consumer Policy Framework* (Productivity Commission Inquiry Report, 2008), Recommendation 3.1 discussed further in Chapter 3 of the review, and Recommendation 7.1 discussed in Chapter 7.

2 Part 2-3 of the Australian Consumer Law, enacted by the Competition and Consumer Act 2010 (Cth), Schedule 2.

3 Productivity Commission, *Review of Australia's Consumer Policy Framework* (Productivity Commission Inquiry Report, 2008), 165-168.

4 Productivity Commission, *Review of Australia's Consumer Policy Framework* (Productivity Commission Inquiry Report, 2008), 39.

consumer transactions. The purpose of this paper is to reexamine some of these cases for guidance on the limits of the UFT. The cases show an approach that is very useful in the context of consumer transactions where the rule should protect the vulnerable on both sides of the transaction fairly, to encourage fair trade and limit and discourage unfair trade.

The common law doctrine against restraints of trade has ancient origins[5], and was clearly intended to democratise commercial opportunity. It is a rule that enables the training of apprentices and other employees, and the sale of businesses as continuing enterprises. It is therefore a rule that promotes the interests of the weak and the strong alike with a view to improving the immediate parties and the betterment of the community generally. The rule against restraints of trade has been applied in different ways over time, and much has been written about it.[6] The restraint of trade cases apply elements expressly employed in the UFT. The interest to be protected must be "legitimate" and the protection must be "reasonable". The cases tend to focus on the reasonableness of the protection, afforded by the clause. This paper will focus on the other side of the formula, specifically: what can the restraint of trade cases can tell us about the legitimacy of the protected interest?

It is suggested that while a general idea of unfairness may be unfamiliar in Australian contract law, this version of unfairness is one that is well established and one that could be usefully applied more liberally than the current provision allows.

Parties

In the interests of simplicity this paper will refer to the person who drafts the terms and provides the goods or services as the "Vendor", and the person who passively accepts the terms and receives the goods or services as the "Consumer". The claimant will therefore be the Consumer and the person who seeks to protect their interests by enforcing the term is the Vendor. Though we should note that the UFT's protection is not restricted to that unidirectional relationship, it is likely that Vendors seeking relief against the discretion of Consumers will be rare cases.

UNFAIRNESS AND LEGITIMATE INTERESTS

Part 2-3 of the ACL provides relief to a person who can marshal the various elements of the UFT. Broadly, the term (or the contract it is found in) must be:

5 *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269, 317: Lord Hodson suggests that the origin of the rule may be in the Magna Carta, referring to *Mitchell v Reynolds* (1711) 1 P Wms 181, 188 (Lord Parker CJ).

6 Harlan M Blake, Employee Agreements not to Compete (1960) 73 *Harvard Law Review* 625; John Dyson Heydon, *The Restraint of Trade Doctrine* (Butterworths, 3rd Ed, 2008); Michael Trebilcock, *The Common Law of Restraint of Trade: A Legal and Economic Analysis* (Law Book Company, 1986) among others.

1. A consumer contract[7]; and
2. A standard form contract[8]; and the term must
3. Create, or document, a significant imbalance in the parties' rights or obligations[9]; and
4. Cause a detriment to a party[10]; except if
5. the term defines the subject matter[11] of the contract, or the upfront price[12]; or (relevantly) if
6. the term is not reasonably necessary for the protection of the legitimate interests of the party who has the benefit of the term[13].

Based on these elements, we can see that even with the protection provided under the UFT, a Vendor can use a standard form contract, that provides a significant imbalance between the parties and which may cause detriment to the Consumer as long as it is either in the basic bargain between the parties (the subject matter, or what is provided to the Consumer, compared to the "upfront price") or if it is for the "reasonable protection" of "legitimate interests" of the Vendor. This question matters because commerce has a built in feedback mechanism. While the regulation of consumer transactions is often presented as the unilateral protection of Consumers, Vendors can and generally do, fund the protection of one Consumer by raising the prices for all Consumers.[14] That may be beneficial to the complaining Consumer, but it is not beneficial to the community of Consumers generally. The question therefore is what interests can the Vendor protect over the objection of the complaining Consumer: localising the cost of the complaint to the Consumer rather than taxing the community of Consumers generally? The answer is: a legitimate interest.

LEGITIMATE INTERESTS

The UFT uses the term "legitimate interest" without defining it. The restraint of trade cases generally also ignore this question.[15] However, while the cases often pass over the legitimacy of the protected interest, they do generally at least give us an account of the interests that have been found to be worthy of protection, and therefore impliedly "legitimate". It is the subsequent attention to the reasonableness of the protection that we must accept as proof that the interest was legitimate.

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7 ACL s23(1).
8 ACL s23(1)(b).
9 ACL s24(1)(a).
10 ACL s24(1)(c).
11 ACL s26(1)(a).
12 ACL s26(1)(b).
13 ACL s24(1)(b).
14 Productivity Commission, *Review of Australia's Consumer Policy Framework* (Productivity Commission Inquiry Report, 2008), 155.
15 John Dyson Heydon, *The Restraint of Trade Doctrine* (Butterworths, 3rd Ed, 2008), 269.

In the few cases where the nature of the interest has been considered, beyond the fact of the existence of the interest, parts of the following test have been applied:

1. The interest must be not illegitimate[16]; but otherwise
2. It must be determined based on the evidence and common knowledge of:
   a. the instant businesses, and its relationships; and
   b. the industry generally.[17]
2. The determination is made on what the parties:
   a. are entitled to do; not
   b. actually do; or
   c. intend to do.[18]
3. The public interest: is the public interest either in the:
   a. policy implication of the private interests of the parties; or
   b. the community's interest in the arrangement between the parties; and the courts also have regard to
4. Reasonableness.

Not illegitimate

An interest cannot be a legitimate interest, and therefore be protected, if it is illegitimate. Illegitimacy can be divided into two classes, interests that are against:

1. Law, including statutory law; or
2. Public Policy.

Against Law

The leading cases in this area are now some decades old and in the years since they were decided parliaments have been at work on statutory rules that regulate commercial parties and their conduct to enhance the operation of the market or otherwise benefit the community generally or some part of it. In this country the Trade Practices Act 1974 (Cth), now the Competition and Consumer Act 2010 (Cth) among others are important. This legislation now limits or prohibits contracts and other conduct that were previously lawful and enforceable.[19] Such interests are not legitimate.

The inverse does not automatically follow. In Vancouver *Malt and Sake Brewing Co Ltd v Vancouver Breweries Ltd*[20] (the "Vancouver Brewing Case") the Privy

16 *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269 and *Nordenfelt v Maxim Nordenfelt Co Ltd* [1894] AC 535.

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

18 *Curro v Beyond Productions Pty Ltd* (1993) 30 NSWLR 337, 344 (Meagher JA, Handley and Cripps JJA).

19 for example: *Dunlop Pneumatic Tyre Company Ltd v New Garage and Motor Company Ltd* [1915] AC 79 and *Petrofina (GB) Ltd v Martin* [1966] 1 Ch 146.

20 [1934] AC 181.

Council noted that while Vancouver Malt and Sake Brewing Co Ltd had a legal right to brew beer, that right had never been used and that the legal right, without a business was not a legitimate interest that could be protected.[21]

Against Public policy

The restraint of trade cases provide an interesting window into the use and object of policy in commerce. Public policy relevantly provides that an interest is illegitimate if it breaches the following rules:

1. An individual cannot bind themselves such that their labour is a securitised property right;[22] and
2. An individual cannot bind themselves such that they cannot "reasonably" earn a living;[23] together: Freedom of Trade. However:
3. individuals can freely enter any legal contract, unless subject to an incapacity;
4. individuals must honour their binding obligations;[24] together: Freedom of Contract. Further,
5. the common law disapproves of monopolies and arrangements that reduce competition.[25]

Freedom of Trade

The restraint of trade cases look at parties dealing in commercial settings in which terms of a contract (or other legally binding arrangement) are being used to protect an interest, at the cost of a vulnerable party. The rule was once very simple: covenants in restraint of trade were void and unenforceable.[26] Later it was recognised that such covenants are commercially and socially valuable. No tradesperson[27] would train an apprentice if they had no protection from the competition that the newly created tradesperson would present.[28] No business person at the end of their career (or the end of their tether) would be able to sell the

21 *Vancouver Malt and Sake Brewing Co Ltd v Vancouver Breweries Ltd* [1934] AC 181, 189 (Lord Macmillian for the Board).

22 *Horwood v Millar's Timber and Trading Co Ltd* [1917] 1 KB 305, 311 (Lord Cozens-Hardy MR).

23 *Herbert Morris v Saxelby* [1916] AC 688; *Perls v Saalfeld* [1892] 2 Ch 149 and many others.

24 *Esso Petroleum Co Ltd v Harper's Garage* (Stourport) Ltd [1968] AC 269, 304 (Lord Morris Both-y-Gest).

25 *Attorney General (Cth) v Adelaide Steamship Co* (1913) 18 CLR 30.

26 Harlan M Blake, Employee Agreements not to Compete (1960) 73 *Harvard Law Review* 625, 631.

27 It should be noted that the cases in this area assume that apprentices and employees will be male and refer to them relevantly as "tradesmen". However the better view of the judgements is that they are not concerned with gender, or even with the specific employee in them selves, but with the employee as the source of income for a family, see *Mitchell v Reynolds* (1711) 1 P Wms 181 or *Herbert Morris v Saxelby* [1916] AC 688 as examples.

28 *Mitchell v Reynolds* (1711) 1 P Wms 181, 191 (Lord Parker CJ).

goodwill of a business if the buyer could not obtain and enforce some protection against competition from the Vendor.[29] In other businesses support and assistance has been provided from one part of the industry to another in exchange for restraints of trade that secure the parties in a stable relationship for the benefit of both.[30] Therefore, an absolute rule against a restraint of trade is no more beneficial to the community than absolute freedom to trade.[31] These cases therefore canvas both the practical requirements of commerce in a changing world, but also the basic values that underpin contract law. While the cases do not engage with fairness directly, they do deal with power imbalance, detriment and the practical needs of business; therefore they relate to the issues raised by the UFT.

There are many cases on the contractual restraint of employees in their career. There are two things that we can observe from these cases:

1. The implications, economic, domestic and social for the employee, are often very serious[32]; and that

2. the employer has an interest in the future and concurrent employment of its employees that can be protected.

While the broad outline of the relationship of employer to employee has similarities to the Vendor to Consumer relationship the seriousness of the relationships and closeness of connection are generally on very different scales. Though employers and Vendors make the rules and exercise discretion, the impact of those choices on employees will often be much greater than on a similarly placed Consumer. Further, while the actions of the employee can have as strong an impact on the employer, i.e. giving a competitor access to technical information, business practices or key relationships in important commercial partners, Consumers individually cannot have such a strong impact on the business of the Vendor. In the employment cases that impact provides a very clear interest that courts have found legitimate, even if the attempted protection was too broad to be reasonable. That said, the employees in these cases are generally high level employees, who could act at a lower level while at least subsisting. However, that option is not even canvassed.[33] It is clear from these cases that protection can be granted despite the gravity of the harm to the employee though it is constrained by the extent of the interest of the employer that is at risk.

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29 *Mitchell v Reynolds* (1711) 1 P Wms 181, 191 (Lord Parker CJ).

30 Examples include: *Esso Petroleum Co Ltd v Harper's Garage* (Stourport) Ltd [1968] AC 269; *Petrofina (GB) Ltd v Martin* [1966] 1 Ch 146; *McEllistrim v Ballymacelligott Cooperative Agricultural and Dairy Society Ltd* [1919] AC 548.

31 *Mitchell v Reynolds* (1711) 1 P Wms 181, 190-192 (Lord Parker CJ).

32 *Herbert Morris v Saxelby [1916] AC 688:* moving to another country or leaving the industry; *Mitchell v Reynolds* (1711) 1 P Wms 181 and *Perls v Saalfeld* [1892] 2 Ch 149: moving to another town.

33 *Herbert Morris v Saxelby* [1916] AC 688; *Nordenfelt v Maxim Nordenfelt Co Ltd* [1894] AC 535; *Perls v Saalfeld* [1892] 2 Ch 149; *Curro v Beyond Productions Pty Ltd* (1993) 30 NSWLR 337; *Emeco International Pty Ltd v O'Shea (No2)* [2012] WASC 348.

Applying that test to Consumer transactions would provide a broad scope for protection of business interests. Despite the serious implications for the employee and their future employment, in the restraint of trade cases courts have found that the interest to be protected is broad. Virtually any interest that the business deems worthy of having protected[34] can be legitimate. The relatively modest harm of a Consumer transaction suggests that it is more likely that the protection would be found reasonable. If this is the way that courts see the cases, then the legitimacy of the protected interest becomes a more important test and the breadth of established legitimate interests suggests that Vendors have little to fear from the UFT.

Freedom of Contract

The personal autonomy of the individual is one of the common law's most important values.[35] Though freedom is never absolute, it must be balanced with other factors.[36] In contract law that value is expressed in the freedom of the capable individual to bind themselves to any legal contract.[37] The primacy of freedom of contract has come to the fore in the restraint of trade cases, as the rule has developed. When the rule was first applied it was used to strictly void all restraints of trade unless they fell within one of the exceptions.[38] As the commercial world has evolved more complex relationships the exceptions have been broadened to accommodate businesses on a scale that would be been unimaginable in late Tudor England when the rule was settled.[39] The rule continues to balance the freedom of the parties with the practical needs of the parties and the benefit of the community more broadly.[40]

The Productivity Commission in its Review of Australia's Consumer Policy Framework, while not addressing the policy value of freedom of contract, notes that one-sided contracts can be necessary for the effective operation of some industries, or to deal with unexpected conduct.[41] Therefore, unless Consumers were able and prepared to accept "one-sided"[42] contracts, some industries would

34 *Kores Manufacturing Co Ltd v Kolok Manufacturing Co Ltd* [1959] 1 Ch 108.

35 *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269, 323 (Lord Pearce).

36 *Petrofina (GB) Ltd v Martin* [1966] 1 Ch 146, 181 (Lord Diplock).

37 *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269, 304 (Lord Morris Both-y-Gest).

38 *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269, 295 (Lord Reid).

39 *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269, 324 (Lord Pearce).

40 *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269, 306 (Lord Morris Both-y-Gest) referring to *Herbert Morris v Saxelby* [1916] AC 688, 716 (Lord Shaw); *Vancouver Malt and Sake Brewing Co Ltd v Vancouver Breweries Ltd* [1934] AC 181, 189 (Lord Macmillian for the Board).

41 Productivity Commission, *Review of Australia's Consumer Policy Framework* (Productivity Commission Inquiry Report, 2008), 151 and 155.

42 Productivity Commission, *Review of Australia's Consumer Policy Framework* (Productivity Commission Inquiry Report, 2008), 151.

not be workable, at least not in their present form. In this way Consumers and employees, such as apprentices, are in a similar position.

Monopolies and Competition

Trade is the "lifeblood" of a community.[43] The public has a direct interest in the promotion of trade both socially as expressions of personal autonomy, and economically in the spread of prosperity in the community generally by means of the market. While theories on how trade should be managed vary over time, the broad direction is consistent: trade should be free but balanced with measures that limit or diminish the associated harm.[44]

Part of the policy behind the development of the rule against restraint of trade, was the common law's disapproval of monopolies.[45] While a monopoly can be used as a device to effectively open new markets, which can be good for the community, they generally do so by raising prices or by the imposition of unfavourable terms at the cost of the community. Therefore competition should always be preferred as a matter of public policy.[46] However, this argument itself shows that the reduction of competition is a valuable interest, that a commercial party would wish to attain.[47] Beyond this, monopolies or cartels on a more modest scale can be used to manage risk and make a business or an industry workable for the benefit of the community. In the *English Hop Growers Ltd v Dering*[48] Dering signed and later tried to escape a contract to sell his hops to English Hop Growers Ltd on several grounds including that the clause was void as a restrain of trade. It was noted that growing hops, or any crop, is subject to a fluctuating market price and in that case marketing arrangements that might under other circumstances be a monopoly or cartel may have to be accepted in order to spread the risk and stabilise the market so that the industry can continue.[49] The court held that while generally, courts should always be wary of monopolies, where there was no evidence of harm to the public, and the parties to the arrangement benefited, freedom of contract should prevail.[50] This interest, though seemingly a simple agreement to reduce competition was a legitimate interest. The Productivity Commission took a similar view of "one-sided" Consumer contracts.[51]

43 *Petrofina (GB) Ltd v Martin* [1966] 1 Ch 146, 175 (Lord Harmon).

44 *Petrofina (GB) Ltd v Martin* [1966] 1 Ch 146, 181 (Lord Diplock).

45 *Attorney General (Cth) v Adelaide Steamship Co* (1913) 18 CLR 30, 34 (Lord Parker of Waddington for the Board).

46 *Attorney General (Cth) v Adelaide Steamship Co* (1913) 18 CLR 30, 32 (Lord Parker of Waddington for the Board).

47 *McEllistrim v Ballymacelligott Cooperative Agricultural and Dairy Society Ltd* [1919] AC 548, 563-564 (Lord Birkenhead LC) and, 579 (Lord Atkinson).

48 [1928] 2 KB 174.

49 *English Hop Growers Ltd v Dering* [1928] 2 KB 174 181 (Scutton LJ). In a different setting the same idea was applied in *Buckley v Tutty* (1971) 125 CLR 353, 377 the High Court considered the need for the New South Wales Football League to stabilise the rules for the transfer of players to facilitate the operation of a reasonably competitive competition.

50 *English Hop Growers Ltd v Dering* [1928] 2 KB 174, 187 (Sankey LJ).

51 Productivity Commission, *Review of Australia's Consumer Policy Framework*

Reduction of competition among Vendors is therefore a valuable and real interest, though generally not a legitimate one without some further benefit or interest.[52] Whereas the policy debate around restraint of trade tends to centre on the "freedoms" of contract and trade, there is a further interest, a community interest in the free operation of the market, red in tooth and claw, regardless of the harsh effects of competition on otherwise socially beneficial enterprises.[53]

Shifting focus to Consumer transactions, Vendor-to-Vendor competition is generally not going to be a relevant issue. A person who is a Consumer in one part of their life, clearly leaves that behind before they can compete as a Vendor.[54] However, competition has another role in the assessment of the legitimacy of protected interests. The competition that the Vendor faces against other members of its industry for connection with Consumers, is a factor that has to be accepted in determining the legitimacy of an interest.[55] As the size and structure of the Vendor's business will often be dependant on the population who consumes the Vendor's products, the competition for the connection to those Consumers may be a legitimate interest, grounding a term that limits the Consumer's ability to leave the Vendor's business.[56]

"To be determined" with reference to the circumstances and evidence

If an interest is not illegitimate, it may be legitimate. The cases show that courts take a permissive view. If the interest is one that is recognised by law or equity or by either party as being worth protection, that seems to be enough. The cases are largely centred on restraint of employees (current and former) and the sale of businesses, particularly the sale of goodwill. The interests to be protected are

(Productivity Commission Inquiry Report, 2008), 151.

52 *McEllistrim v Ballymacelligott Cooperative Agricultural and Dairy Society Ltd* [1919] AC 548, 579 (Lord Atkinson) and *English Hop Growers Ltd v Dering* [1928] 2 KB 174, 187 (Sankey LJ) and *Buckley v Tutty* (1971) 125 CLR 353 in this case the High Court recognised that reducing competition as a means of allowing the development of a stable competition could be legitimate, though they noted that the players, whose freedom was directly effected, were also the beneficiaries of the operation of stable clubs whose existence was dependant of the prosperity of the league as a whole.

53 *McEllistrim v Ballymacelligott Cooperative Agricultural and Dairy Society Ltd* [1919] AC 548, 562 (Lord Birkenhead LC) and 579 (Lord Atkinson).

54 The ACL defines a consumer in s3, though Part 2-3 is not limited to the protection of consumer as defined in s3. The UFT addresses "parties" and "consumer contracts". Therefore, the protection of Part 2-3 is not limited to consumers, though by implication the UFT only applies to a contract that includes a consumer. This would seem to be similar to the position under the Trade Practices Act 1974 (Cth) where the protection would run in both directions but the conduct had to engage a corporation on at least one side of the conduct, for example s51AC.

55 *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269, 312 (Lord Morris Both-y-Gest).

56 *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269, 312 (Lord Morris Both-y-Gest); *Petrofina (GB) Ltd v Martin* [1966] 1 Ch 146, 173-174 (Lord Denning MR).

generally so unlike the interests of Vendors and Consumers that they are unlikely to assist in determining the legitimate interests of Vendors under the UFT. There is a fundamental difference to the intimacy of employment and consumer relationships. However, the cases do address interests that are likely or at least possible, in a Consumer contract.

Collateral arrangements

In small business franchise systems it is common for the franchisor to provide collateral, or additional benefits to franchisees for either the advancement of the business and/or to cement the franchisee into the franchise system.[57] The benefit may take the form of a better than usual wholesale price,[58] or a loan on either better than market terms or just a loan where no other lender would provide it.[59] In such cases the franchisor's object is in part to increase sales by improving the franchisee's facilities, but it is also significantly to hold the franchisee, or at least their business in the franchise system. The drafting of the contracts both the general franchise agreement and the instant loan and security documentation will be designed to protect this interest, and so can be a restraint of trade. The cases show that such interests are legitimate interests, in that they can be reasonably protected. The protection can be as much as is required to secure the full value of the collateral interest, for example the amount of the loan, though not to protect the restraint in itself.[60] Such collateral benefits are common in at least some Consumer transactions, i.e. the lease of a phone that goes with a fixed term contract.

The needs of the Business

The cases show that the practical needs of running the business structure are legitimate interests that can be reasonably protected. Such needs include:

1. Limiting the right to end the relationship to provide the Vendor with a stable demand for its products: the Stable Relationship interest;
2. Limiting competition between parties within the Vendor's business structure, the Business Structure interest;
3. Providing support for:
   a. new investments, products; or
   b. new entrants into a market, the New Entrant interest;

57 for example: *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269; *Petrofina (GB) Ltd v Martin* [1966] 1 Ch 146, *Alec Lobb (Garages) Ltd v Total Oil Great Britain Ltd* [1983] 1 WLR 87.

58 *Petrofina (GB) Ltd v Martin* [1966] 1 Ch 146.

59 *Alec Lobb (Garages) Ltd v Total Oil Great Britain Ltd* [1983] 1 WLR 87; *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269.

60 *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269; *Petrofina (GB) Ltd v Martin* [1966] 1 Ch 146.

Stable Relationship Interest

Most, if not all businesses, have a supply chain. They commit to the purchase, production or resourcing of a system that produces one or more products at a certain rate. The volume of production being dictated by the demand for the product in the market. That demand is supported by the connection that the Vendor has to its Consumers. A clause that protects the supply chain by limiting a person's right to depart from the system, has been considered and found enforceable, and therefore the protection of the supply chain at least can be a legitimate interest.

In *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd*[61] ("Esso v Harper") the House of Lords had to consider an agreement that tied Harper's Garage (Stourport) Ltd ("Harpers") to Esso Petroleum Co Ltd ("Esso") for an extended period. The case considered two factual applications of a restraint of trade including the Kidderminster Site. The court considered the nature of the interest that Esso was trying to protect:

1. Esso was a foreign company investing in petrochemical infrastructure in the UK.

2. The nature of the industrial processes required:
   - **a.** very large investments in plant;
   - **b.** forward purchases on various precursors for the refining processes.

2. The business required a stable volume of production.

3. The scale of the business required a large distribution system.[62]

This interest, though not referred to expressly as a legitimate interest was certainly considered one that Esso could properly act to protect. At the Kidderminster site, the dealer agreement provided a five year term.[63] The House of Lords noted that, without making any general rule about duration, five year terms meant that only 20% of the dealer group was able to turnover each year. That gave Esso a manageable level of change in its distribution system, and that was an interest that Esso could protect.[64] While the departure of any one site from the distribution system would not have a great impact on Esso's business, the imposition on each member was part of the protection of the legitimate interest of the Vendor in the stability of the whole system.

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61 [1968] AC 269.

62 *Esso Petroleum Co Ltd v Harper's Garage* (Stourport) Ltd [1968] AC 269, 302 (Lord Reid).

63 *Esso Petroleum Co Ltd v Harper's Garage* (Stourport) Ltd [1968] AC 269 303 (Lord Reid). His honour noted that the other site at Stourport-on-Severn which had a 21 year restraint was too long though it failed on the basis that it was unreasonably long, not that the interest was not one that could be protected.

64 for a similar argument, on the other side of the supply chain see: *McEllistrim v Ballymacelligott Cooperative Agricultural and Dairy Society Ltd* [1919] AC 548, 567 and 572 (Lord Finlay).

In *Esso v Harper*, *Petrofina (GB) Ltd v Martin*[65] ("Petrofina") and *McEllistrim v Ballymacelligott Cooperative Agricultural and Dairy Society Ltd* [66] ("McEllistrim") the courts expressly considered the significance of stability of business relationships to the Vendor. In each case the business had a supply chain that required a supply of inputs that must be secured some time ahead of production placing the Vendor's business at risk if the supply chain was subjected to an irregular or unpredictable supply of inputs or an inability to sell its products in a timely manner relative to production.[67]

It was noted in Petrofina that each site in the relevant systems was both important to the operation of the business in that it supported the creation of the franchisor's production business, but also it was valuable in that there was a limited supply of suitable sites.[68] Each business site that was presently in existence could only be created with a considerable investment in money (to secure the use of the site) and time (to obtain the necessary local government approvals).[69] Given the nature of the business, with noise, large vehicles and dangerous chemicals, the approvals would not be granted on many sites that also have the requisite proximity to the consumers that the site depends upon.[70]

While the cost and delay associated with the commissioning of a service station may not seem to be very directly referable to a Consumer entering a contract for a loan, lease, phone or other service contract, in basic ways there is a considerable similarity if we accept that the margin for the Vendor will be similarly limited in comparison to the cost of finding a replacement Consumer.

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65 [1966] 1 Ch 146.

66 [1919] AC 548.

67 Though *McEllistrim v Ballymacelligott Cooperative Agricultural and Dairy Society Ltd* [1919] AC 548 considered this problem from the supply side: the issue arose between the providers of the input (the dairy farmers) and the manufacturer, in *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269 and *Petrofina (GB) Ltd v Martin* [1966] 1 Ch 146 the same problem, supply chain stability, was considered in relation to the output side of the process, specifically members of the distribution system. The management of supply chains and product distribution is now a great interest of industrial producers, see for example Toyota Motor Company's "Kanban" philosophy.

68 *McEllistrim v Ballymacelligott Cooperative Agricultural and Dairy Society Ltd* [1919] AC 548; *Esso Petroleum Co Ltd v Harper's Garage* (Stourport) Ltd [1968] AC 269 Lord Reid, 302, 312 (Lord Morris Both-y-Gest).

69 *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269, 302 (Lord Reid).

70 This argument applies to *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269 and *Petrofina (GB) Ltd v Martin* [1966] 1 Ch 146, as both turned on the relative scarcity of petrol station sites in the UK. *McEllistrim v Ballymacelligott Cooperative Agricultural and Dairy Society Ltd* [1919] AC 548 addressed a similar problem, the limited supply of dairy farms in the region of the Coop, though the other industrial problems were different, turning on the quality of the milk.

Business Structure Interest

The commercial world is increasingly complex. Supply chains that stretch around the world, and distribution systems that seem to be unified but are actually franchise systems with many more or less separate members are more the norm than the exception. Even shopping centres where individual retailers are presented as separate businesses are subject to terms that require the tenant to provide information and cooperation to the landlord that far exceed traditional leases. Any or all of these ties can be the source of a legitimate interest that can be protected. Though their legitimacy is no more than that an obligation exists, created by a contract agreed by parties, one member of which then enters the consumer contract, where the Consumer will rarely have notice of the term, or even the contract creating the obligation.

In *Curro v Beyond Productions Pty Ltd*[71], Tracy Curro ("Curro") a journalist wanted to leave an existing employer (Beyond Productions Pty Ltd, a sub-contracted supplier to the Seven Network: "Beyond") to take up a more desirable position with a competing employer: the Nine Network. Curro claimed that the contract under which she was tied to Beyond was void as a restraint of trade, preventing her from appearing for the Nine Network. Beyond had an obligation in its contract with the Seven Network that required Beyond to prevent its on-air employees, including Curro from appearing on a competitor without Seven's consent.[72] The court reviewed the terms of Beyond's obligations with respect to its on-air employees. The court accepted that the obligation was a legitimate interest.[73]

In *Buckley v Tutty*[74] a player in the NSW rugby league (the "League") was bound by a contractual term that provided that he could not play for another club within the league, or any club in certain other significant leagues without the consent of the League.[75] It was argued that this restraint of trade was necessary to protect the League from internal competition among its clubs for the most able players. The restraint, it was argued, though clearly unfair to the best players, who were deprived of the chance to access the market and obtain the best reward for their skills, was necessary for the League to operate. The League argued that their business was the promotion and operation of a competition between local clubs and that a reasonable equality between the clubs was essential for this business to exist. Otherwise the richer clubs would buy the services of the better players and the competition would become unbalanced, the results of the games too predictable and the public would lose interest in the League. The court accepted

71 (1993) 30 NSWLR 337.

72 *Curro v Beyond Productions Pty Ltd* (1993) 30 NSWLR 337, 345 (Meagher JA, Handley JA and Cripps JA).

73 *Curro v Beyond Productions Pty Ltd* (1993) 30 NSWLR 337, 345-6 (Meagher JA, Handley JA and Cripps JA).

74 (1971) 125 CLR 353.

75 *Buckley v Tutty* (1971) 125 CLR 353, 357.

that this interest could be protected.[76]

A similar issue arose in *Kores Manufacturing Co Ltd v Kolok Manufacturing Co Ltd*[77] ("Kores"). In this case two companies whose businesses employed similar industrial processes meant that their employees where largely interchangeable. When for a period they operated from neighbouring premises putting the two companies in at least potential competition for the same employees, they formed a binding agreement not to employ any person who had recently been an employee of the other firm.[78] The court considered the interests that this agreement was to protect:

1. The adequate supply of employees;
2. The stability of each company's workforce, here meaning that the employees had been in place long enough to perform their role without ongoing training;
3. Confidential commercial information. While the industrial processes were similar the businesses were not identical and so taking over an employee could mean taking on commercially valuable information; and
4. Stable employment conditions. The court noticed that if the two companies competed for the employees of the neighbouring firm then wages and other working conditions could become the basis of competition.[79]

Though the restraint would fail in *Kores*, it was not because these are interests that cannot be protected, it was because the protection provided was not reasonable: the protection continued even after the geographic proximity that gave rise the covenant ended.[80] While in *Buckley v Tutty* and *Kores* the relationship in question was an employment relationship, it was not the intimacy of the relationship that was protected, but the stability of the business. That stability is directly referable to the interests of Vendors in Consumer transactions. Therefore, a term that limits the movement of a Consumer from the business of the Vendor, if the goods or services relevant to the contract can be related to the needs of the business structure can be a legitimate interest.

New Entrant Interest

76 *Buckley v Tutty* (1971) 125 CLR 353, 377-8 (Barwick CJ, McTiernan, Windeyer, Owen and Dixon JJ), though the court found that the actual protections were not reasonable.

77 [1959] 1 Ch 108.

78 *Kores Manufacturing Co Ltd v Kolok Manufacturing Co Ltd* [1959] 1 Ch 108, 121 (Jenkins LJ).

79 *Kores Manufacturing Co Ltd v Kolok Manufacturing Co Ltd* [1959] 1 Ch 108, 122 (Jenkins LJ).

80 *Kores Manufacturing Co Ltd v Kolok Manufacturing Co Ltd* [1959] 1 Ch 108, 124-5 (Jenkins LJ).

Stability of business relationships or of the business structure are relevant where an existing business simply wishes to continue. However, where a business is trying to enter a market, or to grow in a market they are already part of, different interests have been found legitimate.

In *Petrofina* the Court of Appeal considered agreement very like the one in *Esso v Harper*. In this case the agreement was entered originally by a prior owner, but continued by Ronald Martin when he took over the business that was subject to the restraint. The clause bound Martin until the site delivered 600,000 gallons of fuel. This was estimated to take 12 years if the site delivered fuel at its break even point: 50,000 gallons per year.[81] The site failed to meet the expectations of Martin or Petrofina in first 8 weeks that Martin operated the site. The business ran at the same rate it had run for the prior two owners, at approximately 30,000 gallons per year, and therefore at a loss. After the first 8 weeks Martin contacted a competing supplier (Esso) and obtained a new agreement, with a better discount and a 2 year term. Petrofina objected, and the matter came before the courts.

Petrofina claimed that the clause represented their legitimate interest in that, like Esso, they needed a stable dealer group to facilitate their business. There were few existing free dealers remaining in the market, and the delay and cost associated with the establishment of new sites would prevent Petrofina, a new and small player in the motor fuel business, from establishing itself in competition with existing businesses such as Esso's.[82] Lord Denning MR was prepared to accept that, while a clause with the object of avoiding, or removing competition was not enforceable, a clause that was for the promotion of competition prima facie would be enforceable.[83]

In this case Petrofina's claim failed, but not because they lacked a legitimate interest.[84] From this case we can assume that where a new entrant to a market imposes stricter terms than more established Vendors, that interest can be protected if it represents the more vulnerable interests of a new entrant to a market.

In *McEllistrim* we can see a similar problem: developing an existing business with a new project. In this case the Ballymacelligott Cooperative Agricultural and Dairy Society Ltd (the "Coop") had an existing relationship with the dairy farmers of its region in Ireland. Its rules provided that it would buy the milk of its members and from that milk it would produce and sell butter and cheese. The Coop resolved to build an additional creamery to increase production. To secure the increased supply of milk necessary for this development it resolved to change

81 *Petrofina (GB) Ltd v Martin* [1966] 1 Ch 146, 167 (Lord Denning MR).
82 *Petrofina (GB) Ltd v Martin* [1966] 1 Ch 146, 174 (Lord Denning MR).
83 *Petrofina (GB) Ltd v Martin* [1966] 1 Ch 146, 174 (Lord Denning MR).
84 *Petrofina (GB) Ltd v Martin* [1966] 1 Ch 146, 174 (Lord Denning MR): While Martin was required to bear the burden of any negative change, Petrofina was not. Petrofina could draw the relationship to a close if it chose while Martin could not.

its rules (under a power provided by the existing rules) to prevent its members from diverting their production to other creameries who might offer better terms. Prior to the change the Coop could enforce against a breaching member by forfeiture of their membership (their interest in the Coop), subsequently the penalties could be much more onerous. This led to a discussion of the validity of the two sets of penalties, before and after the change. While most of the court found that the prior punishment (forfeiture of membership) was at least potentially acceptable[85], the latter more onerous system was not in the view of the majority.[86]

The court considered the legitimacy of the interest was the first issue to be determined.[87] That the stable supply of milk was an interest could be protected was accepted. Further, that the Coop, managed by a committee of members, could plan for expansion and introduce rules to facilitate the expansion was accepted. The new formula of protection failed in the view of the majority, not because the interest it protected was not legitimate, but because the extent and nature of the protection was not reasonable.[88] Therefore, the Vendor can include the needs of expansion in their account of the legitimate interests of the business, not just the preservation of the existing business.

Reasonableness and legitimacy

While the reasonableness of the restraint overshadows the legitimacy of the interest protected in the cases, the two ideas are connected.[89] A promise not to compete may be a valuable interest. The wider the promise the more valuable the interest.[90] A promise not to compete in a region may be accepted as an effective restraint of trade, and therefore be a legitimate interest, where a restraint over a much broader area would not be accepted.[91] While the language of the cases tends to characterise the failure of the covenant as turning on the reasonableness of the restraint, that quality, the "reasonableness" is itself constrained by the extent or the legitimacy of the interest that it protects. Therefore a discussion that is overtly a review of reasonableness can provide some insight into the extent of legitimacy.

85 *McEllistrim v Ballymacelligott Cooperative Agricultural and Dairy Society Ltd* [1919] AC 548, 568 (Lord Finlay), though Lord Atkinson found even that protection unreasonable, 582.

86 *McEllistrim v Ballymacelligott Cooperative Agricultural and Dairy Society Ltd* [1919] AC 548, 560 (Lord Birkenhead LC), 568 (Lord Finlay), Lord Parmoor was in dissent.

87 *McEllistrim v Ballymacelligott Cooperative Agricultural and Dairy Society Ltd* [1919] AC 548, 563 (Lord Birkenhead LC), impliedly see 567-8 (Lord Finlay).

88 *McEllistrim v Ballymacelligott Cooperative Agricultural and Dairy Society Ltd* [1919] AC 548, 565 (Lord Birkenhead LC).

89 *Vancouver Malt and Sake Brewing Co Ltd v Vancouver Breweries Ltd* [1934] AC 181, 191 (Lord Macmillian for the Board).

90 *Nordenfelt v Maxim Nordenfelt Co Ltd* [1894] AC 535; *Vancouver Malt and Sake Brewing Co Ltd v Vancouver Breweries Ltd* [1934] AC 181, 191 (Lord Macmillian for the Board).

91 *Nordenfelt v Maxim Nordenfelt Co Ltd* [1894] AC 535, 550 (Lord Herschell LC), though in this case a global restraint was allowed given the nature of the contract and the interests involved; *Vancouver Malt and Sake Brewing Co Ltd v Vancouver Breweries Ltd* [1934] AC 181, 191 (Lord Macmillian for the Board).

In the *Vancouver Brewing Case,* the Privy Council as prepared to accept the possibility of an effective 15 year restraint that covered the city of Vancouver, or possibly the province of British Columbia, however in this case the restraint covered the whole world, and that was too broad. While the court used the language of reasonableness, it might as easily have said that such a broad interest, under the circumstances, was simply too broad to be legitimate. Vancouver Malt and Sake Brewing Co Ltd had a right to brew beer (and related products), however had never done so. It had a great need of funding, so it agreed to "sell" its beer brewing business (more accurately its legal right to brew beer) to Vancouver Breweries Ltd.[92] The transaction, while apparently the sale of the business, was actually an agreement not to compete given by a party who had a legal right to compete but nothing more. In the earlier case of *Nordenfelt*, the House of Lords considered another world wide restraint and given the circumstances found it legitimate. In *Nordenfelt*, Thorsten Nordenfelt had agreed to a restraint for the world, as Vancouver Malt and Sake Brewing Co Ltd had; however, in *Nordenfelt* the business was actual rather than potential and the interest was therefore legitimate.

Conclusion

One of the difficulties in trying to draw a unifying principle from the restraint of trade cases is that they span a wide range of circumstances.[93] Despite being primarily commercial, and largely centred on contracts, they deal with many relationships that are very different to the consumer contracts that the UFT addresses.[94] However, there is enough overlap that we can take some useful guidance from them.

In the restrain of trade cases, the economic implications for the affected party can be grave. Yet, despite the very serious effect of the restraint, the courts have been very permissive in finding interests that can be protected. By comparison, while Consumer transactions can have serious implications they are unlikely to have negative effects on the scale of depriving a person/family of their income in a period with no general government unemployment benefit system, or effectively forcing the employee and their dependant family to leave their home and wider family to try to establish themselves in a new community. If the gravity of the harm caused by the clause is any guide then courts should be more permissive in finding contractual protection of interests reasonable in UFT cases than in the restraint of trade cases. If that is the case, then the question of the legitimacy of the interest becomes more important.

92 *Vancouver Malt and Sake Brewing Co Ltd v Vancouver Breweries Ltd* [1934] AC 181, 190 (Lord Macmillian for the Board).

93 Harlan M Blake, Employee Agreements not to Compete (1960) 73 *Harvard Law Review* 625.

94 John Dyson Heydon, *The Restraint of Trade Doctrine* (Butterworths, 3rd Ed, 2008), 269.

If courts accept this view, that a key part of the test for access to the UFT should be modelled on the restraint of trade cases, that puts the test on a well understood and accepted footing in our legal tradition. It allows a novel protection for Consumers, while allowing businesses a reasonable protection of their interests. It is on this view a very practical and commercially appropriate test, and one that could safely have been applied more broadly, as the rule against restraint of trade already does.