RESTRAINTS OF TRADE:
AN IMPORTANT PROTECTION FOR EMPLOYERS

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In the last few months, we have represented a number of employers who have discovered that they do not have adequate restraints of trade in place to protect their business. Usually this occurs after an employee has left employment, and then very actively targets the ex-employer's clients in order to solicit their business.

The nature of the financial services and accounting industries is that frequently there is little in the way of hard assets which make up the value of the business. The greatest value of the business can be described as either goodwill or client lists. In an age where it is easy to download an entire client list onto a USB, this value can easily be destroyed, or at least seriously diminished. It is often a simple act to do this, and the employer usually has no knowledge that this is occuring.

Accountants are often particularly at risk because of the nature of their work. This is especially common in compliance areas where the principal or principals often have very little or no direct contact with the clients. Instead, it is the employees who have frequent client contact and have often built up good relationships with those clients.

Financial planners can be particularly at risk where clients have been purchased from a third party, or have been orphaned clients who have been distributed by a fund manager. In such a situation, the client often has no rapport with any person within the financial planning firm. That means it is virtually impossible to conserve the client if an ex-employee makes an attempt to take the client.

On a practical level, we recommend that you ensure, where possible, that the principal or principals of the firm have at least some level of contact with clients. This means that if for some reason the worst does occur, and an ex-employee starts contacting clients with adverse intentions, there is at least the possibility of directly contacting the client though someone at the firm who has some level of rapport with that client.

Some examples of common situations which give rise to restraint of trade issues are:

a) There is no employment agreement.
b) There is an unsigned employment agreement.
c) There is an employment agreement, however, the agreement has not been professionally drafted for the current situation, or is a mismatch of different agreements which someone has tried to draw together, and is otherwise inadequate or unenforceable.
d) There was an employment agreement, however, there has been a re-organisation, and the employee is now employed by a different group company, and there is no employment agreement with the new company.
e) There is an employment agreement, however, the restraint has not been properly drafted.

A common comment of employers has been words to the effect that the employer did not believe that restraints could be enforced, so there was no point in having an effective restraint. We have also observed situations where employees who were seen by the employers as ineffectual and incapable of taking clients have proven to be surprisingly adept, enthusiastic and energetic at doing so.

Consequently, the nature of the damage which is inflicted can often be in the hundreds of thousands of dollars.

Many of the misunderstandings regarding the enforceability of restraints relate to the fact that the courts fundamentally start with the principle that restraints of trade are unenforceable, as the notion goes against public policy, that there is an important public good in competition. However, that presumption can be over-come by an effective restraint of trade. In order to be effective, the restraint must give the level of protection which is necessary. So, for example, if you have a business which operates within 10 km of the CBD in Western Australia, and all of the clients are located within Western Australia, a restraint which operates throughout the world will probably not be enforceable. Likewise, the length of a restraint must be reasonable.

It is also generally the case that the court will not read down a restraint of trade. (The law is different in New South Wales, where there is a specific Restraint of Trade Act which allows the court to adjust a restraint to be enforceable).

Some examples of cases where restraints have been upheld by the courts include *Koops Martin Financial Services v Reeves [2006] NSWSC 449* (**"*Koops Martin*"**) and *Birdanco Nominees Pty Ltd v Money [2012] VSCA 64* (**"*Birdanco*"**).

In *Koops Martin*, Brereton J stated that:

> *Generally, the test of reasonableness for the duration of such a restraint is what is a reasonable time during which the employer is entitled to be protected against solicitation; that in turn depends on how long it would take a reasonably competent replacement employee to show his or her effectiveness and establish a rapport with customers... A related albeit subsidiary consideration is how long might the hold of the former employee over the clientele be expected to last before weakening.*

In *Koops Martin*, 12 months was held to be reasonable. Brereton stated (at paragraph 89) that:

> *In the present case, some of the clientele are insurance clients. Insurance business is of an annual cyclical nature, and an advisor in that setting may well have contact with clients no more than annually. With investment clients also, annual contact is a typical pattern; Mr Reeves spoke to at least his major clients annually. Documentary evidence shows that reviews of clients' investments were planned for a year ahead. Annual contact with a client is a reasonable minimum standard, and supports the view that a twelve month restraint - which would allow a replacement employee to contact all clients and demonstrate his or her effectiveness and begin to establish a rapport - a reasonable opportunity to do so.*

In *Birdanco*, Mr Money was employed by accounting firm Bird Cameron. Mr Money's employment contract provided that, if Mr Money left Bird Cameron, he could not, for a period of three years beginning on the cessation of his employment, provide accounting services to any person who was a client of Bird Cameron to whom Mr Money provided accounting services during the 3 years ending on the cessation of his employment. At first instance, the trial judge held that the restraint clause was unreasonable and therefore unenforceable. Bird Cameron appealed the trial judge's decision. On appeal, the Supreme Court of Victoria dismissed the trial judge's decision and found that the restraint of trade clause was enforceable.

Robson J (with whom the other judged agreed) stated:

> *In my view it is probable that Mr Money would still retain some material level of attachment necessarily formed with a client by providing "the Services" after an almost six year break in providing those services. Mr Money would have a degree of knowledge of the client's affairs that would avoid the client having to explain and disclose its financial structure and history, something that it would have to disclose if it retained somebody unaware of its circumstances. Part of the attraction to the client of retaining Mr Money would be the attachment that was formed when he was employed by Bird Cameron in providing "the Services" to the client.*

> *In my opinion, three years is a reasonable time during which Bird Cameron was entitled to protection against Mr Money exploiting the goodwill he created for the benefit of Bird Cameron when providing "the Services" to clients of Bird Cameron.*

The cases of *Koops Martin* and *Birdanco* illustrate how different courts and judges can find different restraint periods reasonable. In *Koops Martin*, the employee had contact with clients annually, and a period of 12 months was held to be reasonable. In *Birdanco*, the employee had an intimate knowledge of the client's affairs. It would have taken a reasonably competent replacement employee a considerable period of time to show his or her effectiveness and establish a rapport with customers. In this case, a period of 3 years was held to be reasonable.

Other examples of recent cases where restraints have been upheld by the courts include *Complete Business Strategies Pty Ltd v AFA Wealth Pty Ltd* [2013] QSC 43 where a restraint period of 2 years was held to be reasonable, and *Charltons CJC Pty Ltd v Fitzgerald (No 3)* [2013] NSWSC 1945 where a restraint period of 12 months was held to be reasonable.

It is important that the person who drafts the restraint of trade has hands on experience enforcing restraints. The older style drafting of restraints often focuses upon the ex-employee targeting the clients. More modern drafting of restraints tend to focus on whether the ex-employee provides services to the clients (who by this time may be ex-clients). These modern restraints are easier to enforce, because obtaining evidence that the ex-employee has provided services is generally much easier to obtain than trying to obtain evidence that the ex-employee actively solicited the clients.

A further important point is that even if there is no restraint in place, the situation for an employer isn't necessarily hopeless. In those situations, we sometimes find that the ex-employee has been targeting clients through information obtained while employed, and that often this information is confidential. In such a situation, various kinds of court remedies may be available. It is however definitely more difficult to prove this point and much easier to enforce a competently drafted restraint of trade.

Action for all employers: Check carefully that you have current professionally drafted employment agreements with all staff. The cost of a professionally drafted employment agreement is insignificant in comparison with the potential losses you may face if an ex-staff member targets your clients.

Action if an ex-staff member starts targeting your clients: Obtain specialist legal advice immediately. If you act immediately, it may be possible to obtain an urgent injunction to prevent further damage. We have direct experience in this area. Alternatively, you may be able to obtain damages.

We strongly advise taking action in these matters against ex-staff members, so that other staff are aware that such breaches will not be tolerated. Some large financial planning and accounting firms have a simple policy of not tolerating any breaches of restraints for this reason.

FURTHER INFORMATION

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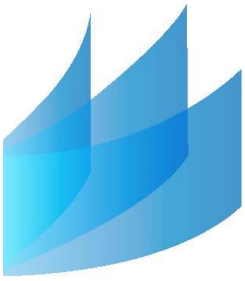
IMPORTANT INFORMATION



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