SQUIRE SANDERS

WORKPLACE VIEW

August 2013

Restrictive Covenants: Employer's legitimate business interests v Employee's liberty

Earlier this year in the case of *Wallis Nominees (Computing) Pty Ltd v Pickett* [2013] VSCA 24, the Victorian Court of Appeal held that an employer had *'gone too far'* in restraining a former employee from engaging in competitive conduct with one of the employer's clients. **The court's decision came as a timely reminder for employers to take care when drafting restrictive covenants.**

The starting position

It is common for employers to expressly limit the ability of their employees to engage in post-employment competitive conduct by including in the employment contract a restrictive covenant (or restraint of trade) clause. However, because of public policy issues such as fair competition, mobility of labour and individual freedom, the presumption is that these restrictive covenants will be null and void *unless* they are reasonable and necessary to protect the employer's legitimate business interests.

What is a legitimate business interest?

An employer has no legal right to protection against mere competition, but it does have, in certain circumstances, a right to be protected against a former employee who goes out to compete in the same marketplace. This right has to be balanced against the employee's right to freely leave their employment at any time and use their talents and experience to advance the interests of a new enterprise (including their own).

An employer can overcome the inevitable tension between its own interests and the interests of employees with a restrictive covenant which protects the employer's legitimate business interests.

Example of legitimate business interests include:

- trade secrets;
- confidential information;
- business opportunities; and
- customer connection.

'Customer connection' was the business interest in dispute in the Wallis case. The term describes the personal relationship or connection an employee develops with specific clients during the course of their employment. In Wallis, the employee was an IT specialist who had been contracted out to provide services to a client during his four years of employment with Wallis. When he left to become the operations manager for the client, Wallis attempted to stop him, arguing that the restrictive covenant in his employment contract prohibited him from providing services to all clients within 12 months of leaving the company.

At first instance, the Court ruled that Wallis had failed to identify a legitimate business interest that required protection. This was overturned on appeal with the bench of three judges finding that the IT specialist had indeed developed a connection with the client, which Wallis was entitled to protect. Ultimately, however, Wallis' legitimate business interest was not enough to uphold the restrictive covenant because it went *'too far'* in seeking to restrain the IT consultant and was struck down because of its *'unreasonable reach'*.

Assessing reasonableness

The validity of a restrictive covenant will depend on whether or not it is reasonable in the particular circumstances. In Wallis, the 12 month restraint was found to be longer than was necessary to protect Wallis' legitimate business interest. Furthermore, it sought to prevent the IT specialist from providing post-employment services to *all* clients of Wallis, which would include clients with whom he may have had only very minimal contact during his employment with Wallis.

While it is often difficult to distinguish the line between protecting an employer's legitimate business interests and an unlawful attempt to broadly restrict market competition, the courts will generally consider whether the restraint **goes beyond what is reasonably necessary** to protect the employer's interests. The onus of proving reasonableness rests on the employer.

Key considerations in assessing reasonableness include:

- **The activity that is being restrained** - restricting future participation in the former employer's industry is likely to be unreasonable. Consideration will be given to the employee's role and responsibilities.
- **The duration of the restraint** – an unlimited time restraint is likely to be unreasonable and a restraint exceeding the period necessary to protect the legitimate business interests of the employer may be deemed unreasonable (like in Wallis).
- **Geographical limitations** – a restraint which is expressed generally or beyond the area in which the employee mainly operated may be deemed unreasonable.
- **The employer's business** – the size of the business, the number of customers, and the level of interaction an employee has with them are all relevant to the question of the reasonableness of the restraint.

What should employers be doing?

To ensure a restrictive covenant is enforceable and has 'teeth', we suggest you take the following practical steps:

- ✓ Avoid the 'copy and paste' approach. Tailor each restrictive covenant to the individual employee considering the circumstances in which he\she will perform duties.
- ✓ Ensure that each clause is drafted clearly and that it identifies the legitimate interests of your business. Ensure its relevance to the employee.
- ✓ Implement cascading covenants. Restraints that are later considered unreasonable can be severed, leaving the remaining restraints enforceable.
- ✓ Contact the team at Squire Sanders or register to attend one of our L&E Seminars (details in our events section)

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CLIENT NOTICEBOARD

Client Quiz

The first correct entry emailed to isla.rollason@squiresanders.com will win a copy of our '2013 Good Food Guide' (delivery within Australia only).

In the recent landmark adverse action case, *The Board of Bendigo Regional Institute of Technical and Further Education v Barclay & Anor* [2012] HCA 32, the High Court found that, in determining whether adverse action has been taken for a prohibited reason, regard must be had to:

(a) whether the reason was a **substantial and operative factor** in taking the adverse action;

(b) whether the reason was the **primary reason** the adverse action was taken;

(c) whether the reason was the **only reason** the adverse action was taken; or

(d) none of the above.

Legislation update

Legislative instrument	Status	Key Proposed changes
Fair Work Amendment (Arbitration) Bill 2011	Currently before the House of Representatives	Amends the *Fair Work Act* 2009 to enable the Fair Work Commission to deal with disputes by arbitration, mediation or conciliation, or by making a recommendation or expressing an opinion
Fair Work Amendment Bill 2013	Passed by both houses of parliament, received assent on 28 June 2013	• Expands access to the right to request flexible working arrangements; • Requires employers to consult with employees about changes to regular rosters or ordinary work hours (effective 1 January 2014) • Gives pregnant employees the right to transfer to safe jobs regardless of their length of service • Aligns the time for making an unlawful termination application to 21 days, which is the current time frame for general protection (adverse action) dismissal and unfair dismissal applications (effective 1 January 2014)

Events

Squire Sanders Perth 2013 Australian Labour and Employment Breakfast Series

PERTH

Level 21, 300 Murray Street, Perth

- 21 August 2013, 'Executive Remuneration, Restrictive Covenants and Other Executive Issues'
- 23 October 2013 'Redundancy Refresher'

SYDNEY

Level 101 Macquarie Place, Sydney

- 4 September 2013, 'Managing Unwell Employees'

Did you know…

The Federal Circuit Court recently ruled that the *Privacy Act* 1988 (Cth) is not a 'workplace law' for the purpose of adverse action claims. A prospective employee claimed that adverse action had been taken against her after the employment offer was withdrawn following her refusal to provide a copy of her passport and electronic signature as part of a pre-employment screening process.

She claimed she had exercised a workplace right under the Privacy Act but the Court held that the Privacy Act was not a workplace law, as it was not 'primarily concerned with the regulation of the relationship between employers and employees'.

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