

## RESTRAINT CLAUSES FOR EMPLOYEES CAN BE TRICKY

The Victorian Court of Appeal in [Just Group Limited \(ACN 096 911 410\) v Nicole Peck \[2016\] VSCA 334](#) dismissed an appeal on 20 December 2016 by Just Group Limited (“Just Group”) and reached the same conclusion of the earlier Supreme Court decision ([Just Group Ltd v Peck \[2016\] VSC 614](#)) that Ms Peck was not bound by a restraint signed with Just Group. Accordingly, Peck, who previously held the senior position of Chief Financial Officer (“CFO”) with Just Group, was free to join Cotton On as General Manager of Group Finance and Treasury. Cotton On was a major rival to Just Group.

In the following paragraphs the numbers refer to the Court of Appeal judgement but we have excluded footnote references. Please click on the above link to go directly to the case.

“3        *The relevant facts can be summarised as follows:*

- (a) *On 7 December 2015, the respondent, Peck, entered into a contract of employment with Just Group, the terms of which included the following:*
  - (i) *Peck would be employed as the Chief Financial Officer (‘CFO’) for Just Group.*
  - (ii) *Peck would be paid a salary of \$450,000 in the first year of employment plus a sign on fee of \$50,000[2] and a further amount of approximately \$170,000 subject to her qualifying with the rules of the Just Group’s incentive scheme.*
  - (iii) *Peck agreed to a clause which restrained her from being engaged in certain specified activities for a period of 24 months (alternatively, depending on validity, 18 months or 12 months) after termination of her employment with Just Group. ....*

- (b) *From 6 January 2016, Peck commenced in her employment as the CFO for Just Group.*
- (c) *On 1 May 2016, Peck accepted an offer of employment as General Manager of Group Finance and Treasury (a CFO level position) with Cotton On.*
- (d) *On 2 May 2016, Peck gave Just Group one month's notice of her intention to resign.*
- (e) *On 27 May 2016, Peck informed Just Group that she had an offer of employment to work for Cotton On, starting 6 June 2016, which she intended to accept.*
- (f) *On 3 June 2016, Peck's employment resignation became effective and her employment with Just Group ended."*

Unsurprisingly, Just Group took legal action by issuing proceedings on 2 June 2016. It is interesting to note that Peck had a probationary period of 6 months from commencement in her contract with Just Group. During that period she was only required to give 1 months notice.

It is worth noting the following details, reproduced from the judgement, of the restraints in Peck's employment contract:-

***"The restraints***

- 5        *The restraint clause relied on by Just Group was entitled 'Restricted Activities – Personal Engagement' and provided:*

*You must not anywhere in the Geographic Region for the Restricted Period – Personal Engagement, engage in Restricted Activities – Personal Engagement, except with the prior written consent of JGL.*

- 6        *The terms referred to in the restraint clause were defined as follows:*

- (a) *Geographic Region means the geographic region of:*
  - (a) *Australia and New Zealand; or (if this is held to be invalid)*
  - (b) *Australia; or (if this is held to be invalid)*
  - (c) *Victoria.*

- (b) *Restricted Period – Personal Engagement means:*  
*during your employment and for the period of:*
- (a) *24 months after the Termination Date; or (if that period is held to be invalid)*
  - (b) *18 months after the Termination Date; or (if that period is held to be invalid)*
  - (c) *12 months after the Termination Date.*
- (c) *Restricted Activities ('the Restricted Activities') — Personal Engagement means directly or indirectly:*
- (a) *being engaged, concerned or interested in;*
  - (b) *assisting or advising in respect of; or*
  - (c) *carrying on any activity:*
    - 1) *which is the same as, or similar to, any part of the specialty brand and fashion business of a Group Company in which you were involved, or in respect of which you received Confidential Information, in the Connection Period ; ['the first limb'] or*
    - 2) *for or on behalf of any of the entities operating the brands listed in Annexure A [a list of 50], their assignees, successors or transmittes (from which, it is acknowledged, JGL and the Group have a legitimate interest in withholding their confidential information and their connections with customers, employees and suppliers) ['the second limb'].*

7 *'Confidential information' is defined in the contract to mean all information regarding the businesses of Just Group, and includes, without limitation:*

- *business plans, research, development and survey information;*
- *customer, staff and all other training manuals and policy manuals;*
- *planning and marketing strategies, procedures, techniques and information;*

- *accounting procedures and financial information;*
- *contracts, agreements and retainers relating to vacancies, whether oral or in writing or otherwise in the process of being implemented;*
- *client lists, candidate files and associated information;*
- *product sourcing information, product development information, design concepts and processes, branding and marketing concepts and strategies;*
- *supplier network identity and contacts;*
- *any of the above information which relates to and is the property of a client or customer of JGL;*
- *any recommendation or reports of JGL or any of its consultants or agents;*
- *any information which you may be given or which may come to your knowledge during the course of employment and which from its nature and content is or would reasonably be expected to be confidential, but does not include any information which enters the public domain other than through a breach of the terms of this agreement by you.*

8 *Clause 4 is headed 'TERMINATION' and relevantly provides:*

*Your role is subject to a probationary period of six months from the date of commencement. In this period JGL may elect to terminate your employment by giving notice of one month.*

*Subsequently, you or JGL may terminate your employment by giving 12 months' notice in writing.*

*If you or JGL give notice of termination then JGL may:*

- (a) *elect to make payment to you in lieu of notice instead of requiring you to work for part, or all, of the notice period, in which case your employment ends when the election is made ...*

9 *Clause 10 includes the following sub-clause under the heading 'Restraints are Reasonable':*

*Both you and JGL consider the restraints and notification obligations contained in this Section to be reasonable and intend the restraints to operate to the maximum extent. For the avoidance of doubt, the restraints operate in respect of each*

*maximum period and in each of the geographic regions, unless and until a court holds otherwise.*

*You specifically agree and acknowledge that:*

- (a) you have had the opportunity to obtain independent legal advice in relation to the terms and effect of this Section;*
- (b) the restrictions imposed under this Section are reasonable in terms of their extent and duration, and go no further than is necessary to protect the legitimate business interests of the Group;*
- (c) the restrictions are necessary to protect the goodwill of the business and do not unreasonably restrict your right to carry on your profession;*
- (d) the restrictions are intended to operate to the maximum extent permissible by law, and for the avoidance of doubt, the Geographic Region, Restricted Period – Personal Engagement and Restricted Period – Engagement of Others is that set out in paragraph (a) of their respective definitions unless a Court holds otherwise; and*
- (e) the restrictions under this Section may be assigned to one or more third parties as part of the goodwill of any part of the business.*

*If these restraints:*

- (a) are void as unreasonable for the protection of the interests of JGL or any entity within the Group; and*
- (b) would be valid if part of the wording was deleted or period or area was reduced, the restraints will apply with the modifications necessary to make them effective.*

*The restraints and notification obligations in this Section do not apply if you have obtained the JGL's prior written consent to act other than as required by this Section."*

A common technique used in drafting restraint clauses is to use a “cascading” form of restraint. In other words, the geographic region, the restriction period and the restricted activities are scaled down in separate elements (covenants) to assist the person relying on the restraint that a court may find reasonable. However, be warned there is a limit to the number of variables permitted as the court will not rewrite the agreement so as to make it valid.

The Court of Appeal also provided a handy summary of the principles relating to the enforceability of restraint clauses of which some are reproduced here:-

***“Principles relating to the enforceability of restraint clauses***

30 *A term in a contract, which is a restraint of trade (‘a restraint clause’), is presumed to be void as contrary to public policy.*

31 *The presumption may be rebutted if there are special circumstances that demonstrate the covenant to be:*

*(a) reasonable as between the parties; and*

*(b) not unreasonable in the public interest.*

32 *The test of reasonableness varies depending on ‘the situation the parties occupy and so recognising different considerations which affect employer and employee and independent traders or business men, particularly vendor and purchaser of the goodwill of a business’. A court takes a ‘stricter view’ of restraint clauses in employment contracts; and will more readily uphold a restraint clause in favour of a purchaser of the goodwill of a business than a restraint clause in favour of an employer. In particular, a purchaser of a business is entitled to protect itself from competition by the vendor; but an employer is not entitled to protect itself from competition per se by an employee.*

33 *A restraint clause in favour of an employer will be reasonable as between the parties, if at the date of a contract:*

*(a) the restraint clause is imposed to protect a legitimate interest of the employer; and*

*(b) the restraint clause does no more than is reasonably necessary to protect that legitimate interest in its:*

*(i) duration; or*

*(ii) extent.*

- 34 *It is well established that employers do have a legitimate interest in protecting:*
- (a) *confidential information and trade secrets; and*
  - (b) *the employer's customer connections.*
- 35 *For the legitimate purpose of protecting the employer's confidential information, a restraint clause does not need to be limited to a covenant against disclosing confidential information. It may restrain the employee from being involved with a competitive business that could use the confidential information.*
- 36 *The onus of proving the special circumstances from which the Court may infer 'reasonableness between the parties' is on the person seeking to enforce the covenant. However, if an employee or other covenantor alleges that the restraint clause is against the public interest, the burden of proving that proposition is on the employee/covenantor.*
- 37 *Once the facts that are contended to constitute the special circumstances have been established, it is a matter of law whether the restraint clause is reasonable as between the parties. Accordingly, on appeal, the trial judge's 'decision that the covenants were reasonable is not a decision of fact and an appellate court in reviewing such a decision inquires not whether it has been shown to be wrong, but simply whether it is right'.*

Frequently, it is argued that a restraint clause may be severed from the contract to give it effect. However, the clause *"must be capable of simply being removed – as if crossed out with a blue pen. A court can only remove words from a restraint clause; it cannot rewrite the restraint clause."*

Where the restraint clause contains several distinct covenants such as was attempted in the "cascading" restraint clause situation then *"the covenant to be severed must be an independent covenant capable of being removed without affecting the remaining part."*

Peck argued that the restraint clause in her contract was unreasonable. Just Group argued that the restraint was reasonable given all the circumstances but if any part was held to be unreasonable "it could be crossed out with a blue pen", that is, severed.

The Court of Appeal held that the restraint clause extended beyond what was reasonably required for Just Group's protection because:-

- (a) the first limb of the restraint clause prevented Peck from being involved in a business that competed with any part of the Just Group, regardless of whether any confidential information that she had acquired was relevant; and
- (b) the second limb of the restraint clause prevented Peck from being involved in 50 entities or brands in respect of which at least 46 of the entities or brands, there was no proof of competition or relevance of the confidential information.

The Court of Appeal also noted that it could not sever words or construe the clause so as to perfect an imperfect clause. The Court of Appeal reached this conclusion notwithstanding that Peck had agreed that the restraint was reasonable.

The Court of Appeal also affirmed that "reasonable" will be determined in the circumstances of each individual case.

Accordingly, this case is a very good example of the care, judgement and reasonableness required of restraint clauses. It is also evident, from the judgement, that the principles of law are far stricter on employee restraint clauses than they are on restraint clauses on a purchase of a business which are necessary to protect the goodwill for which a purchaser has paid a valuable price.

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