

2014

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# Unpacking Post-Employment Restraint of Trade Decisions: The Motivators of the Key Players

## **Abstract**

Restraints of trade are aimed at limiting the capacity of employees to move from one job to another and taking important knowledge or techniques with them (to the detriment of the first employer). The current law focuses on the reasonableness of the clause at the time of its signing. A more detailed examination of the decisions made, by the employee, around the breach of such a clause suggests that this may not be the most effective approach. This assessment is made through a consideration of the motivators of the parties, the role of the legal tests, the risks relevant to their decisions and an examination of operation of the law itself. In short, if the goal of the regulation in this area is to limit the breach of restraints, then a focus on the decision of the employee to breach (or not) the clause may be more effective.

## **Keywords**

restraint of trade, regulation, motivators, socio-legal

# UNPACKING POST-EMPLOYMENT RESTRAINT OF TRADE DECISIONS: THE MOTIVATORS OF THE KEY PLAYERS

CHRIS DENT\*

## ABSTRACT

*Restraints of trade are aimed at limiting the capacity of employees to move from one job to another and taking important knowledge or techniques with them (to the detriment of the first employer). The current law focuses on the reasonableness of the clause at the time of its signing. A more detailed examination of the decisions made, by the employee, around the breach of such a clause suggests that this may not be the most effective approach. This assessment is made through a consideration of the motivators of the parties, the role of the legal tests, the risks relevant to their decisions and an examination of operation of the law itself. In short, if the goal of the regulation in this area is to limit the breach of restraints, then a focus on the decision of the employee to breach (or not) the clause may be more effective.*

## I INTRODUCTION

Recent research has considered the regulatory aspects of post-employment restrictive covenants.<sup>1</sup> This article explores some of the factors that impact on the decisions of parties associated with litigation around restraint of trade clauses in employment contracts — in other words, the minutiae of the operation of this area of law. Briefly, post-employment restraints are clauses that seek to limit the capacity of an employee to work in a given field after her or his employment has finished. Such restraints purport to cover specified areas and to persist for a given period of time. Three key features relating to the validity of the clauses are: (1) that the covenantee must have a legitimate interest to protect;<sup>2</sup> (2) the scope of the restraint must be reasonable;<sup>3</sup> and

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\* Principal Research Fellow, Melbourne Law School. This research forms part of a larger project funded by an Australian Research Council Discovery Grant (DP0987637). I would like to thank my colleague on that project, William van Caenegem, and the anonymous referees, for their insightful comments.

<sup>1</sup> C Dent, 'The (Potential) Regulatory Function of Contractual Clauses: Restraints of Trade and Confidential Information in Employment Contracts' (2013) 26 *Australian Journal of Labour Law* 1.

<sup>2</sup> *Herbert Morris Ltd v Saxelby* [1916] 1 AC 688.

<sup>3</sup> *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co Ltd* [1894] AC 535.

(3) the assessment of validity is judged as at the time of the signing of the clause and not as at the time of its breach or enforcement.<sup>4</sup>

Much of the literature focuses either on whether restraints should be restricted, or even rendered unlawful,<sup>5</sup> or on the nature of the interests that should be protected when restraints are litigated;<sup>6</sup> the approach here, on the other hand, takes a less partisan view of the debate. This approach proceeds on the basis that all parties make reasoned decisions that take into account their own interests. That is, they are seen as calculating (but not necessarily rational) individuals who can weigh up the options that they face and choose the one that is the best (or the least worst) given their interests.<sup>7</sup> In short, individuals in this society are 'obliged to be free',<sup>8</sup> with that obligation requiring us to make choices that reflect our perceptions of what we want and need.

This article considers the different motivators that are behind the decisions of players in the disputes.<sup>9</sup> Such a framework has been applied to the creative decisions of an

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<sup>4</sup> One of the earlier articulations of this principle is in *Putsman v Taylor* [1927] 1 KB 637, 643. No case is cited by the judge, nor is there any justification for the claim made.

<sup>5</sup> Some United States commentary argues that restraints of trade are, almost by definition, bad. See, for example, V Moffat, 'The Wrong Tool for the Job: The IP Problem with Noncompetition Agreements' (2010) 52 *William & Mary Law Review* 873. In the Australian context, Riley cautions that 'Judges should be most careful not to extend fiduciary obligations to allow employers to capture more from their employees than they have contracted for': J Riley, 'Who Owns Human Capital? A Critical Appraisal of Legal Techniques for Capturing the Value of Work' (2005) 18 *Australian Journal of Labour Law* 1, 24.

<sup>6</sup> For a discussion of the benefits, and detriments, of restraint of trade clauses more generally, see R Gilson, 'The Legal Infrastructure of High Technology Industrial Districts: Silicon Valley, Route 128, and Covenants not to Compete' (1999) 74 *New York University Law Review* 575; J Riley, *Employee Protection at Common Law* (Federation Press, 2005); and W van Caenegem 'The Mobility of Creative Individuals, Trade Secrets and Restraints of Trade' (2007) 14 *Murdoch E-Law Journal* 265.

<sup>7</sup> The assertion of the individual being 'calculating' is distinct from an assumption that all individuals are rational. As the consequences may be physical, emotional, psychological or financial, the motivators and justifications that form an individual's choice may arise from the rational or emotional aspects of her or his self.

<sup>8</sup> N Rose, *Powers of Freedom: Reframing Political Thought* (Cambridge University Press, 1999) 87.

<sup>9</sup> For an in-depth discussion of the role of the motivations of individuals and the law, see Y Feldman, 'The Complexity of Disentangling Intrinsic and Extrinsic Compliance Motivations: Theoretical and Empirical Insights from the Behavioural Analysis of Law' (2011) 35 *Washington University Journal of Law & Policy* 11.

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individual.<sup>10</sup> This article advances this approach by engaging with the *interaction* of the decisions of interested individuals — predominantly, here, the different decisions of the former employee and the employer. Taken together, these aspects of the decisions of the parties involved provide a new perspective on the importance, or relevance, of the law in this area of the economy. This new perspective suggests that it may be more effective to regulate the decisions of employees at the time of potential breach of the clause rather than attempting to regulate the nature of the clause signed at the beginning of the period of employment. At one level, this article is no more than a ‘think-piece’ about the application of the framework; at another, however, it is an indication that an over-emphasis on the importance of formal sanctions risks an under-emphasis on the relevance of other factors on the decisions of (ex-) employees when faced with the possibility of breaching a restrictive covenant.<sup>11</sup>

### II MOTIVATORS BEHIND DECISIONS AROUND RESTRICTIVE COVENANTS

This part will apply the motivators framework to key points in restraint of trade disputes. Unsurprisingly, the decision of the (former) employee to be considered is that relating to the breach of the covenant while the employer’s decision centres around the enforcement of the clause.<sup>12</sup> Of course, these are not the only decisions these parties make in the disputes; however, they are sufficient to demonstrate the value of the framework.<sup>13</sup> What is less common in the analysis of legal disputes is the inclusion of the judicial process itself — here, the motivators of the presiding judge are considered in order to explore the processes by which the legal standard gets

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<sup>10</sup> See, for example, C Dent, ‘Legal Academics, Our Creativity and Why we do it: Insights from Foucault’ (2014) 48 *Law Teacher* (forthcoming).

<sup>11</sup> Further, it is also an attempt to take an individualised approach to examining the ‘cognitive infrastructures of modern markets’: A Lang, ‘The Legal Construction of Economic Rationalities?’ (2013) 40 *Journal of Law and Society* 155, 170.

<sup>12</sup> It may be noted that some support for this analysis is found in empirical data reported in C Arup et al, ‘Restraints of Trade: The Legal Practice’ (2013) 36 *University of New South Wales Law Journal* 1. Where relevant, reference will be made to these findings. It may be noted, however, that most of data reported in that publication represented the perspectives of the employers rather than the employees.

<sup>13</sup> It would, for example, be possible to consider the decision by the employee to sign the restraint in the first place. Further, it would also be possible to consider the decisions made by the company that takes on the employee putatively bound by the restraint and also any decisions by the colleagues of the employee to also change employer. There is, however, not the space here to consider all these possibilities.

enforced and, by extension, changed in its application. First, though, there needs to be a description of the three categories of motivators used in the analysis.

### *A Overview of Motivators*

Motivators here are seen as an idealised form of the factors that contribute to someone following one course of an action (or inaction) as opposed to another course.<sup>14</sup> This article sees three categories of motivator<sup>15</sup> – those internal to the individual, those external to the individual, and those that are neither fully internal nor fully external to the individual (or, those with a reputational aspect).<sup>16</sup>

#### *1 Internal Motivators*

A motivator is considered to be ‘internal’ if it relates to how an individual sees her or himself as an individual. Such a motivator relates to how the person thinks she or he should act in relation to what she or he sees as the ‘right’ thing to do – in other words, these motivators relate to the ‘proper conduct’ of the person. More specifically, how a person thinks she or he should act is a product of the norms of behaviour of society and their experiences in trying to meet those norms.<sup>17</sup> With respect to the norms, specific norms of behaviour are learnt, as is the *idea* of the norm itself – that is, we learn that there is a standard of behaviour for most, if not all, acts that relate to being human. These standards are what we are taught is proper conduct

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<sup>14</sup> This Part is a summary of the argument found in C Dent, ‘A Regulatory Perspective on the Interests and Motivators of Creative Individuals’ (2013) 23 *Asia Pacific Media Educator* 265.

<sup>15</sup> Others use different categories of motivators. Barbuto and Scholl, for example, use five in their attempt at integrating all the psychological research in the area of motivation studies: J Barbuto, and R Scholl, ‘Motivation Sources Inventory: Development and Validation of New Scales to Measure an Integrative Taxonomy of Motivation’ (1998) 82 *Psychological Reports* 1011.

<sup>16</sup> These accord with the understanding, in the psychological literature, that “individuals have a utility function with three main components: they value extrinsic rewards, enjoy doing an activity and care about their image”: U Gneezy et al, ‘When and Why Incentives (Don’t) Work to Modify Behaviour’ (2011) 25 *Journal of Economic Perspectives* 191, 192.

<sup>17</sup> A more formal definition of a norm is that it is ‘the common measure’ of behaviour and the ‘modern form of the social bond’: F Ewald, ‘Justice, Equality, Judgment: On “Social Justice”’, in G Teubner (ed), *Juridification of Social Spheres* (Walter de Gruyter, 1987) 108. This means two things: that norms are tacitly accepted by the members of that group and that it is a standard against which the actual behaviour of individuals may be judged.

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in the relevant circumstances.<sup>18</sup> Of course, our behaviour does not always meet the expected standard;<sup>19</sup> however, we know that there is a standard that we should meet.

There are two aspects of proper conduct. First, individuals do particular things because that is how they see themselves. A particular activity may be enjoyed or it may be something that should be done. This self-definition means that there is a personal standard of proper conduct that equates that course of action with behaving properly. The second aspect relates to the benefit that others may receive from a given course of action — what behavioural economists refer as ‘pro-social behaviour’.<sup>20</sup> In this type of behaviour, individuals may choose particular actions because of the benefit the action will bring to others in the community, such as volunteering. These activities are norms of behaviour that have as their target the betterment of others. That said, there is an aspect of personal benefit from both activities, as people may get a ‘buzz’ from doing things for the benefit of others.<sup>21</sup>

### 2 *External Motivators*

The second set of motivators comprises those that are external to the creative individual in that these motivators are offered by parties other than the individual her- or himself. There are both positive and negative forms of these motivators. The positive motivators are the simplest ones to understand in the employment context — such as, of course, the salary or wages paid by an employer. The fact that an employee will gain a financial benefit if she or he chooses particular actions over other actions (or inactions) is a strong motivator.

The negative external motivators involve a negative consequence that may occur if the individual does not carry out a particular action. In the employment context, the most significant formal sanctions that may befall an individual may also include

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<sup>18</sup> For example, we see going to the doctor as proper conduct for looking after our health and we see getting a job as proper conduct for looking after our financial well-being.

<sup>19</sup> Just because an individual has internalised a particular norm does not mean that she or he will comply with it. An individual may either try to comply with the norm and get close to it or the individual may ignore one norm in preference for complying with a competing norm. For a greater discussion of this, see C Dent, ‘Relationships between Laws, Norms, Practices: The Case of Road Behaviour’ (2012) 21 *Griffith Law Review* 708.

<sup>20</sup> See, for example, R Bénabou and J Tirole, ‘Incentives and Pro-social Behaviour’ (2006) 96 *American Economic Review* 1652.

<sup>21</sup> In other words, people feel good about themselves when they act as they feel they should; and, as Cruikshank has noted, “self-esteem is but one in a long line of technologies of citizenship”: B Cruikshank, ‘Revolutions Within: Self-Government and Self-esteem’ in A Barry, T Osborne and N Rose (eds), *Foucault and Political Reason: Liberalism, Neo-Liberalism and Rationalities of Government* (UCL Press, 1996) 247.

disciplinary action or dismissal. There may also be informal sanctions imposed. In these circumstances, an individual's professional or social circles may consider that the person has failed to meet a norm of that group — such as where a researcher committed to carry out a task, but in fact failed to do so. In some cases, then, the other members of the community may impose informal sanctions upon the transgressing individual. These sanctions could include harsh words, temporary shunning or a permanent refusal to collaborate. There are, of course, commonalities between these sanctions and those relating to the reputation of the individual; motivators with respect to how a person is seen by others are discussed next.

### **3 *Reputational Motivators***

The final category of motivators may be understood to be internally-based yet relate to external actors. Unsurprisingly, given the label 'reputational', these motivators relate to the role particular actions have in altering how other people react to the person concerned. The first of these relates to an interest in establishing a separation from others; that is, an individual may do something to show that she or he is a being distinct from other beings. A person may create a piece of art as an embodiment of the creator's self or experience, to demonstrate that her or his experience, or understanding, is different from that of others.

The second reputational motivator relates to doing something in order to get someone else to consider the individual as an exponent of that something. For example, an individual may create a piece of music because she or he wants a positive acknowledgment from another individual. In other words, this motivator relates to the gaining, or altering, of a reputation as a creative individual. There is, necessarily, a strong link between the motivator of 'esteem of others' and the external positive motivators — though they are different in that a desire to seek a reputation comes from within the individual, rather than an external person offering an inducement.<sup>22</sup> What is key is that individuals use their understandings of the perceptions of others when deciding on their own course of action.

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<sup>22</sup> It may be noted that creators, in other contexts, have another set of 'others'. A musician, for example, may seek to gain a reputation amongst the more experienced musicians in her or his particular style. The musician also may seek to gain a reputation amongst the broader community in order to make a living from her or his creations. Though these circumstances may apply more to freelancers and other contracted parties, there may be examples of employees who have a professional audience with which they would like to establish, and maintain, a positive reputation.

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### *B Employee*

Consider the situation where an employee, after quitting a position at one firm, is offered a job with another, and where — unfortunately for the employee — there was a six month restraint of trade clause in the first contract. The decision whether or not to take the new position may be viewed with reference to the three categories of motivator.<sup>23</sup>

Dealing with the external motivators first, a new job offers a salary which is a clear positive motivator. Litigation over the restraint, however, represents a negative motivator (assuming the employee is aware, and understands the limits, of the clause).<sup>24</sup> Much of the analysis of restrictive covenants assumes that the employee only has to balance these two motivators — a greedy employee will take the bait, while a prudent employee will wait. Such an understanding understates the complexity of an individual's decision to accept a job offer.

If the internal motivators are considered, then the tensions with the individual become more apparent. Of course, the detail of what specific people see as 'proper conduct' will vary; however, there may be significant similarities. One aspect would be a preference to be bound by the terms of a signed contract, based on the assessment of themselves as an honest or trustworthy person.<sup>25</sup> Another aspect would be a perceived need to look after themselves financially as that is the proper way of existing in a market economy, and to take the new job fulfils that need.<sup>26</sup> It is also possible that the new position allows them to carry out tasks that they see as reflecting who they are; this could also reflect proper conduct for others if their vocation was seen as being beneficial to the community (such as a medical specialist).

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<sup>23</sup> It may be noted that some employees, particularly 'well remunerated senior employees' seek legal advice in disputes over restraint of trade clauses: Arup et al, above n 12, 18. It is not clear from this research, however, whether this advice is sought prior to the decision to take a new position or only after the ex-employer has commenced proceedings.

<sup>24</sup> Further, the 'costs of litigation are not just financial ... sometimes, the employee suffers trauma as a result of the enforcement of a restraint': Arup et al, above n 12, 20. It is not clear, however, whether the employee would be aware of this possibility at the time of taking a new job offer.

<sup>25</sup> It may be noted that some work has been done into the 'ethics' of trade secrets (with ethics being a form of proper conduct) but not into the ethics of restraints of trade. See, for example, K Saunders, 'The Law and Ethics of Trade Secrets: A Case Study' (2006) 42 *California Western Law Review* 209; and Y Feldman, 'The Expressive Function of Trade Secret Law: Legality, Cost, Intrinsic Motivation and Consensus' (2009) 6 *Journal of Empirical Legal Studies* 177.

<sup>26</sup> Tied to this, of course, is the possibility that the person wants a job in order to meet the financial needs of her or his family — a form of proper conduct for others.

Further, it is possible, should the employee feel that the restraint was either not justified at all, or too onerous in reach, that she or he would 'owe it to her or himself' to not be bound by it.

Finally, reputational motivators are also relevant. Many would not like to be seen as someone who did not keep their word; however, they would also not want to be seen as people who meekly accepted the (perceived) unfair treatment of their ex-employer. There may also be positive reputational benefits in the new position (either in terms of the nature of the new employer itself or the nature of the position within the organisation). And, of course, simply being seen as being employed is better, from some perspectives, than being seen as unemployed (no matter what the reason for the unemployment).

It is possible that the reasons for the employee's resignation from the first job may be relevant here; these reasons may have a greater impact on the decision if the employee quit her or his old job in order to accept the new job (in that the decision to change may, in part, be about the new position but also, in part, about issues in the first job). That said, any new prospect will be judged against past experience. So, if the employee's role in the first company did not satisfy her or his needs with respect to their proper conduct then the employee may have felt that she or he was justified in both leaving the old job and starting the new one if the latter reflected better the image of how they saw themselves.

In short, even this simplistic understanding of the tensions within an employee suggests that the decision to breach a restraint of trade clause is not straightforward. Some motivators would draw the person to respecting the agreement while others would prioritise the taking of the new position. What it does emphasise is that it is, and can only ever be, the employee's decision. It is, however, not the only one relevant to a legal dispute over the restraint.

### *C Employer*

After a former employee is believed to have breached a restraint of trade clause, the employer has to decide whether or not to pursue the employee through the courts<sup>27</sup> — or, at least, threaten the person with litigation.<sup>28</sup> Again, the external motivators can be dealt with quickly. There will be a significant financial expense associated

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<sup>27</sup> Technically, in most cases, the employer is a company or other form of corporate organisation. An individual, however, will be responsible for the decision to enforce a restraint clause. It is assumed, for this part of the discussion at least, that the decision-maker is aware, and can act in accordance with, the interests of the organisation itself.

<sup>28</sup> It has been asserted that a 'letter threatening legal action can be enough to obtain the employee's undertaking to comply': Arup et al, above n 12, 7.

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with commencing an action<sup>29</sup> (which is a strong negative motivator) and a less clear positive motivator. That is, damages are not the usual outcome of a successful restraint action<sup>30</sup> (as most are simply for an injunction stopping the former employee taking up the new job), and so there is little actual reward to the employer for suing the employee.

With respect to the internal motivators, some employers may feel that the right thing to do is to enforce the contract.<sup>31</sup> This perspective has it that it was proper to include the clause in the original contract (on the basis that it protected an interest or asset of the employer) and, therefore, it is appropriate that the protection of the interest be furthered by litigating. It may also be that the employer sees litigation as being for the benefit of the company and, therefore, for the benefit of the other employees (proper conduct for others).<sup>32</sup>

The reputational aspects of the decision are straightforward, but conflicting. An employer may want to enforce in order to 'make it clear they are no pushover'.<sup>33</sup> Such a desire, therefore, focuses on generating, or maintaining, an uncompromising reputation with current, and prospective, employees.<sup>34</sup> Not enforcing a restraint, on the other hand, could generate a reputation for encouraging the career development of employees. Employees, however, are not necessarily the only other people whose opinion the employer is trying to change. The firm's competitors may also be an audience, with the employer wanting to discourage the poaching of its employees through tying the employee up in litigation at the time the new position is starting.<sup>35</sup>

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<sup>29</sup> 'Litigation is a high risk and high cost environment': Arup et al, above n 12, 21.

<sup>30</sup> B Creighton and A Stewart, *Labour Law* (Federation Press, 5<sup>th</sup> ed, 2010) 428. The authors, however, note the decision in *Rentokil Pty Ltd v Lee* (1995) 66 SASR 301. For a more recent case, see *Andrews Advertising v David Andrews* [2014] NSWSC 318 in which damages of \$300,000 were awarded for a breach of a restraint of trade clause.

<sup>31</sup> Tied to this is the suggestion that some disputes are litigated because the 'employer may feel the employee is being disloyal': Arup et al, above n 12, 23.

<sup>32</sup> Though this may apply more to when an employee quits a position to take up a new job, it has been suggested that 'there was more disputation when the employer needed to retain skilled people': Arup et al, above n 12, 7.

<sup>33</sup> Arup et al, above n 12, 23.

<sup>34</sup> 'Litigation is a show of strength – to scare the employee and ensure the observance of restraints. Litigation also provides a deterrent to others. News of successes disseminates through the firm and the surrounding sector': Arup et al, above n 12, 24.

<sup>35</sup> The importance of the role of future employers of the employee is highlighted, in the trade secret context, in Y Feldman, 'Experimental Approach to the Study of Normative Failures: Divulging of Trade Secrets by Silicon Valley Employees' [2003] *Journal of Law, Technology & Policy* 105.

Again, therefore, the decision of the employer, with respect to enforcing a restraint, is not necessarily straightforward.<sup>36</sup>

### **D Judge**

At first blush, the motivators of the judges are not the same as those of the employee or the employer. The judge, for example, has no financial interest in the outcome of the decision (as is proper). However, what is relevant is the fact that the motivators of the judge contribute to the resolution of the dispute between the employer and the ex-employee, and it is a reminder that the resolution is not simply in the hands of the protagonists. For simplicity's sake, the archetypal judge here is the one who hears the dispute at first instance (such as when hearing an application for an injunction binding the ex-employee) and not the judge or judges who may hear an appeal in a dispute.

The judge's external motivators only relate to the production of a judgment when required. The judiciary, of course, are paid, in part, to decide cases and there are formal disciplinary processes in place where judicial officers do not fulfil their duties appropriately.<sup>37</sup> These external motivators, therefore, do not directly contribute to the content of any decisions made by a judge.

The internal motivators may be seen to focus on the judge's decision being made properly — that is, in accordance with judicial practice around making such decisions.<sup>38</sup> Judges, in all likelihood, see the production of good decisions (whether in the form of published reasons or not) as a form of proper conduct for themselves. It is also likely that they see the production of good decisions as being in the interests of justice and, therefore, for the good of the society.<sup>39</sup> Unsurprisingly, what they see as making a decision a good one reflects their legal training and their experience as a

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<sup>36</sup> It has also been suggested that, in some industries at least, litigation over a restraint clause may alienate customers: Arup et al, above n 12, 22.

<sup>37</sup> See, for example, the Judicial Commission in New South Wales.

<sup>38</sup> For a discussion of a judge's duty to give reasons, see J Bosland and J Gill, 'The Principle of Open Justice and the Judicial Duty to Give Public Reasons (2014) 38 *Melbourne University Law Review* (forthcoming).

<sup>39</sup> *Coleman v Dunlop Limited* [1998] PIQR 398, 403 (Henry LJ).

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lawyer and a judge.<sup>40</sup> This means the decision has to reflect the relevant law and be mindful of the events and decisions that gave rise to the dispute.<sup>41</sup>

As with the employers, there are two sets of audiences that are in the judge's mind when producing a judgment — two distinct groups that would assess the decision of the judge (akin to forming an opinion about the work of the judge *qua* judge).<sup>42</sup> The first one is, of course, the parties themselves. The judgment is aimed at satisfying their need for a justified, and justifiable, conclusion to their dispute.<sup>43</sup> The second audience is that of the potential appeal judges — those judicial officers who would consider the decision should the parties not be satisfied with the judgment.<sup>44</sup> Where a written decision is produced, the appellate court would consider the judgment and decide whether it was in accordance with the law (both substantively and procedurally).<sup>45</sup> And, of course, the quality of a judge's judgments also contributes to how they are seen by the legal profession<sup>46</sup> and those who decide on promotions to appellate courts.

### III CONFOUNDING FACTORS

The above assessment of the motivators of the key players is, admittedly, simplistic. It is intended, however, to set up the model as a basis, but not a solution, for analysis.

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<sup>40</sup> This does not mean that all judges are the same. It has been suggested that one of the factors that leads to settlements in restraint of trade cases is the identity of the judge who is to hear it: Arup et al, above n 12, 11.

<sup>41</sup> Of course, there are other behaviours of judges that fall within the scope of their 'proper conduct'. These include the enforcement of the rules of the court, the regulation of evidence and the assessment of the actions of the parties to the dispute.

<sup>42</sup> There is also a separate group of people who would pay attention to the judgments — those who seek guidance as to what would count as a 'reasonable' clause. These people, however, are not assessing the decision itself and, therefore, may not engage the motivators of the judges in the same way as the other audiences may.

<sup>43</sup> *Flannery v Halifax Estate Agencies Ltd* [2000] 1 WLR 377, 381 (Henry LJ).

<sup>44</sup> Though it may be noted that as many of the disputes in this area are finalised at the interlocutory stage, judges may feel that there is little chance that their decision would be the subject of appeal.

<sup>45</sup> 'It has long been established that it is the duty of a court of first instance, from which an appeal lies to a higher court, to make, or cause to be made, a note of everything necessary to enable the case to be laid properly and sufficiently before the appellate court if there should be an appeal': *Carlson v King* (1947) 64 WN (NSW) 65, 66 (Jordan CJ).

<sup>46</sup> As an aside, lawyers in the area 'felt the judges understood the broader issues at stake and would bring their understanding to a careful consideration of the clause before them': Arup et al, above n 12, 17.

This part considers a number of aspects that adds a layer of complexity to the approach.

### A *Law*

A key function of the law is, of course, regulating the choices of the parties. It does this in at least two ways. First, as noted above, it provides a standard against which clauses are assessed — that of ‘reasonableness’ (this is, of course, in addition to the requirement that the employer have a legitimate interest to protect). However, it may be noted that the standard is not as unproblematic as it may appear. A brief historical analysis shows that it is not a stable concept; in other words, the application of the test has changed over the centuries. The second way in which the law impacts on the choice of parties is in its application, in that lawyers have a role in drafting clauses and in advising both sides. This is not to suggest that counsel manipulate outcomes — merely that the decisions of the employer and the employee are likely to be modified by the advice of a lawyer.

#### 1 *What is Reasonable?*

As mentioned above, the ‘proper’ application of the law is a key motivator of a judge deciding a restraint of trade case. Central to the law in this area is the ‘reasonableness’ of the restraint clause itself. A recent distillation of the test is:

[R]easonableness is measured by reference to the interests of the parties concerned and the interests of the public ... The requirement that the restraint be reasonable in the interests of the parties' means that the restraint must afford no more than adequate protection to the party in whose favour it is imposed.<sup>47</sup>

That decision included a list of twelve ‘principles relevant to the validity of restraint of trade clauses’. In other words, a number of factors form the basis of an assessment of the restraint. These include

The Court gives considerable weight to what parties have negotiated and embodied in their contracts, but a contractual consensus cannot be regarded as conclusive, even where there is a contractual admission as to reasonableness; an employer is not entitled to require protection against mere competition; an employer is entitled to protection against the use by the employee of knowledge obtained by him of his employer's affairs in the ordinary course of

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<sup>47</sup> *Stacks Taree v Marshall [No.2]* [2010] NSWSC 77, [44] citing *Nordenfelt v Maxim-Nordenfelt* [1894] AC 535 and *Herbert Morris Ltd v Saxelby* [1916] 1 AC 688. Technically, the quote is McDougall J's recitation of one counsel's assertions, but, with respect to these aspects of the test, neither the opposing counsel, nor the judge, disagreed with the assertions.

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trade; and an employer's customer connection is an interest which can support a reasonable restraint of trade, but only if the employee has become, vis-à-vis the client, the human face of the business, namely the person who represents the business to the customer.<sup>48</sup>

None of these factors give certainty to the employer, or the employee, in terms of the validity of the signed restraint. The test, overall, therefore, may be described as 'extremely elastic'.<sup>49</sup> Experience with, and specialist understandings of, multiple clauses allows a more nuanced assessment of a given restraint. The role of lawyers will be discussed below: however, for employees, and many employers, the application of the legal test to a clause drafted for their circumstances will render less clear any decisions they would make regarding the restraint.

### 2 *Historical aspects*

Regardless of the definition and application of the test now, it has to be noted that reasonableness has been used as a standard in restraint cases for over three centuries.<sup>50</sup> What is important, here, is that the application of the test has changed in that time. This brief overview of the history starts with the 1711 decision of *Mitchel v Reynolds* ('*Mitchel*'),<sup>51</sup> and then shifts to the use of the test in the nineteenth century.

*Mitchel*, a decision relating to a restraint that bound a baker to not work within a particular parish,<sup>52</sup> appears to have introduced the term of 'reasonableness', but it does not seem to have been used consistently enough to constitute a legal 'test'. The word was used eight times in a variety of contexts. Arguably, however, the word was being used in a couple of distinct ways. The first relates to a sense of 'fairness'; for example, one law was characterised as being 'not so unreasonable'.<sup>53</sup> The second sense is one of an almost quantitative 'balancing' of interests. This is most evident in the assessment that 'what makes this more reasonable is that the restraint is exactly proportioned to the consideration'.<sup>54</sup> There was also a more general use of the word, such as in the reference to a 'reasonable and useful contract'.<sup>55</sup>

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<sup>48</sup> Ibid [44].

<sup>49</sup> D Brennan, 'Springboards and Ironing Boards: Confidential Information as a Restraint of Trade' (2005) 21 *Journal of Contract Law* 71, 85.

<sup>50</sup> This section is taken from C Dent, '*Nordenfelt v Maxim-Nordenfelt: A Modern or Pre-Modern Decision?*' (2015) 36 *Adelaide Law Review* (forthcoming).

<sup>51</sup> (1711) P Wms 181; 24 ER 347.

<sup>52</sup> It should be noted that the restraint was tied to the assignment of a lease and was not, properly, a post-employment restraint.

<sup>53</sup> (1711) 1 P Wms 181, 191; 24 ER 347, 351.

<sup>54</sup> Ibid 352.

<sup>55</sup> Ibid.

In the nineteenth century, reasonableness had developed into a test for the validity of the restraint. To take a couple of examples: as far back as 1831, it was stated in *Horner v Graves* that

we do not see how a better test can be applied to the question whether reasonable or not, than by considering whether the restraint is such only as to afford a fair protection to the interests of the party in favour of whom it is given, and not so large as to interfere with the interests of the public.<sup>56</sup>

And, of course, there is the test from *Nordenfelt v Maxim-Nordenfelt (Nordenfelt)*:<sup>57</sup>

It is a sufficient justification ... if the restriction is reasonable — reasonable, that is, in reference to the interests of the parties concerned and reasonable in reference to the interests of the public, so framed and so guarded as to afford adequate protection to the party in whose favour it is imposed, while at the same time it is in no way injurious to the public.<sup>58</sup>

Famously, that decision upheld a 25 year restraint that had, on paper at least, a global reach.<sup>59</sup>

The outcomes of nineteenth century restraint decisions,<sup>60</sup> and the clauses that were upheld,<sup>61</sup> suggest that the reasonableness of a covenant in that century focused on the protection of the interests of the covenantee and not the covenantor. This is evident in the contemporaneous assessment of *Nordenfelt* as holding the ‘test of the validity of a contract in restraint of trade is its reasonableness in the interests of the

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<sup>56</sup> *Horner v Graves* (1831) 7 Bing 735, 743; 131 ER 284, 287 (Tindal CJ).

<sup>57</sup> *Emeco International v O’Shea (No. 2)* [2012] WASC 348, [4]. Commentators, such as Trebilcock, consider *Nordenfelt* to be the ‘case that ... ushered in the modern era in England’: M Trebilcock, *The Common Law of Restraint of Trade: A Legal and Economic Analysis* (Carswell, 1986) 43. For Heydon, the decision included the first ‘statement of the doctrine in modern form’: J D Heydon, *Restraint of Trade Doctrine* (LexisNexis Butterworths, 3<sup>rd</sup> ed, 2008) 21.

<sup>58</sup> [1894] AC 535, 565 (Lord Macnaghten).

<sup>59</sup> The *Nordenfelt* decision related to a restraint signed as part of a deal to sell a business. The restraint prevented Nordenfelt, the man, from working in the field of guns and munitions for a period of 25 years.

<sup>60</sup> According to Matthews and Adler, only 24% of the pre-*Nordenfelt* nineteenth century decisions held the covenant to be void. This figure is calculated from the information that 12 of the 83 decisions they list were decided in favour of the covenantor: J Matthews and H Adler, *The Law Relating to Covenants in Restraint of Trade* (Sweet & Maxwell, 1907) 224–5. It may be noted that the restraints considered by Matthews and Adler included all categories of restraints and, therefore, were not limited to post-employment restraints.

<sup>61</sup> Of the restraints upheld, 26 had no limit of time specified and a further 12 were limited to the life of the covenantor.

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covenantee, to which the proviso is added that the covenant must not otherwise offend against public policy'.<sup>62</sup> The test of reasonableness, therefore, does not seem to be an assessment of what a reasonable person would consider to be an appropriate restraint on the covenantor.

It is arguable, at least, that the application of the word 'reasonable' in nineteenth century restraint of trade cases may be better understood from a moral perspective than one of balancing probabilities or assessing the perspective of a reasonable person. This possibility arises from the use of 'reasonable' in the concept of 'reasonable doubt'.<sup>63</sup> The history of this concept indicates that there was a strong moral aspect to the assessment of guilt in the criminal law of the nineteenth century and before. This means that the use of the term 'reasonable' was not an indicator of a rational understanding of the doubt.<sup>64</sup> A reasonable restraint, then, would be a restraint that a judge could assess, with a 'satisfied conscience',<sup>65</sup> as being proper in the circumstances of the case. Such an assessment accommodates the high rate at which restraints were upheld.<sup>66</sup> It was seen as proper that the owner of a business be given the protection of the law on the basis that restraints 'encourage, rather than cramp the employment of capital in trade, and the promotion of industry'.<sup>67</sup> The general restraint in *Nordenfelt*, then, may be seen as 'reasonable' in the nineteenth century understanding of the word—that it was, in fact, a 'proper' restraint given the circumstances.

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<sup>62</sup> Matthews and Adler, above n 60, 39–40.

<sup>63</sup> Given that the first use of this phrase in England predated the use of the concept of the 'reasonable man' it may be the better indicator of the understanding of the term in law. Phrases such as 'reasonable cause for doubt' were used in eighteenth century decisions (J Whitman, *The Origins of Reasonable Doubt* (Yale University Press, 2008) 198–9.), whereas the first use of the phrase 'reasonable man' was in the mid-nineteenth century (*Blyth v Birmingham Waterworks* (1856) 11 Ex 781, 784; 156 ER 1047, 1049 (Alderson B)).

<sup>64</sup> Reasonable doubt was any doubt that would 'preclude the jurors from being morally certain': S Sheppard, 'The Metamorphoses of Reasonable Doubt: How Changes in the Burden of Proof have Weakened the Presumption of Innocence' (2003) 78 *Notre Dame Law Review* 1165, 1201. This quote is in reference to a United States articulation of the test; however, Starkie, the noted English lawyer and commentator, also 'equated moral certainty with absence of reasonable doubt': *ibid*, 1196. See also J Whitman, *The Origins of Reasonable Doubt: Theological Roots of the Criminal Trial* (Yale University Press, 2008).

<sup>65</sup> For Shapiro, 'by the late eighteenth century, the satisfied conscience and beyond reasonable doubt standards had become explicitly linked': B Shapiro "Beyond Reasonable Doubt" and "Probable Cause": *Historical Perspectives on the Anglo-American Law of Evidence* (University of California Press, 1991) 25.

<sup>66</sup> See above n 60.

<sup>67</sup> *Homer v Ashford* (1825) 3 Bing 322, 327; 130 ER 537, 538 (Best CJ).

### 3 *Role of lawyers*

In terms of what constitutes a reasonable clause in the twenty-first century, attention must be paid to who writes them. It is not clear how many restraint of trade clauses are drafted by employers themselves; it is likely, however, that lawyers are called in to produce a significant number of them. In the latter case, the clause may have been written specifically for the employer; alternatively, the clause may have been taken, with little reflection, from another employment contract. An earlier contract may have been produced for a specific employee who was to take on a specific role or it may just have been a modified form of one legal firm's precedent contracts. These possibilities increase the likelihood of any particular clause not being crafted to suit the circumstances of a given position in a given firm.

It should also be noted that the lawyer called in to defend a clause may not be the same lawyer (or from the same firm) as the one that produced the clause. Further, the lawyers who carry out the dispute will be considering the circumstances the parties were in at the time the clause was signed and not the time the employee (allegedly) breached the restraint. Finally, the law is not precisely known, even to lawyers, when it comes to the limits of what restraints are reasonable.<sup>68</sup> Of course, experience in the area may offer significant guidelines but this is not the same as clarity. While one lawyer may be 'confident that a six month restraint period would almost always be enforced',<sup>69</sup> this is not the same as knowing whether a given clause will be upheld by a court.<sup>70</sup> Any advice offered, therefore, has to be tempered by the uncertainties in the mind of the lawyers. Any hedging of the accuracy of what is told either to the employee or to the employer may further confound their decision.

### *B Risk Assessment*

The second set of confounding factors relates to the fact that the choices of the parties are not made in ideal circumstances. Parties, for example, do not know the precise status of a restraint of trade clause, particularly if it is a cascading clause.<sup>71</sup> Further,

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<sup>68</sup> Lawyers, of course, know the language of the test, but cannot predict, with absolute certainty, whether a particular restraint will be held to be valid or invalid – unless it is manifestly unreasonable (such as the restraint in *Nordenfelt*).

<sup>69</sup> Arup et al, above n 12, 13;

<sup>70</sup> For another lawyer, the 'reasonableness of the clause depended on the nature of the industry': Arup et al, above n 12, 13.

<sup>71</sup> Some employers use 'cascading' restraint of trade clauses. A cascading clause may read that the employee undertakes to not compete with the employer for the periods of: i) 2 months; ii) 3 months; iii) 6 months; and in the following areas: i) Australia; ii) Victoria, New South Wales and Queensland; iii) Victoria, New South Wales; iv) Victoria. The clause operates on the basis that the court, if the clause was litigated, would choose the

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the nature of that which the employer wants to protect is not entirely delimitable. Second, neither party can be completely sure how the other party will react. In short, much of the decision-making in this area is, in fact, an exercise in risk assessment.

### 1 *Imprecise limits*

The above analysis about the motivators of the parties assumes that the knowledge the employee and the employer has around the facts behind, and the outcomes of, their decisions is either precise or certain (or both).<sup>72</sup> Leaving aside the high level of uncertainty posed by cascading clauses (the matrix of possible permutations of space and time provides no certainty to the employee), a key aspect that relates to imprecise knowledge is the legal status of the restraints clause. Of course, the 'elasticity' of the reasonableness test is discussed above. It is, therefore, simply enough to say that, to the extent that the two parties consider the validity of the clause, they cannot be certain that it would withstand legal challenge. Where the employer has doubts about the reasonableness of the clause, the proper conduct may be to not attempt to enforce it as there may be too great a risk that the firm's money will be wasted. On the other hand, if the employer is convinced that the restraint clause is reasonable (and the employee may be equally sure that it is not), then the parties may not see there being any risk associated with relying on (or ignoring) the clause. Further, in New South Wales, there is legislation that gives judges even more discretion than they had under the common law; judges in that jurisdiction may rewrite a clause to make the 'restraint a reasonable restraint',<sup>73</sup> thereby giving the employer some, but not all, of the protection that the firm thought it had.<sup>74</sup>

A second aspect of imprecision lies in the perceived purpose of a restrictive covenant. Restraint of trade clauses are not aimed at protecting well-defined interests of a firm. Physical assets are protected by theft and fraud laws; patents, copyright and trademarks are controllable through the intellectual property statutes, and confidential information is an asset, defined in law, that is also protectable through

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period and geographical area that was reasonable in the circumstances. Such clauses do not give the employee certainty as to her or his post-employment obligation in this area. See generally, G Pivateau, 'Putting the Blue Pencil Down: An Argument for Specificity in Noncompete Agreements' (2008) 86 *Nebraska Law Review* 672.

<sup>72</sup> For a greater discussion of the uncertainties, in practice, of restraints, see Arup et al, above n 12, 17–24.

<sup>73</sup> *Restraints of Trade Act 1976* (NSW) s 4(3).

<sup>74</sup> The Act allows the NSW 'courts to rescue restraint of trade clauses that otherwise were void'; though Jackson also notes that the judges' discretion in the area is 'not unfettered': R Jackson, *Post-Employment Restraint of Trade* (Federation Press, 2014) 59.

litigation.<sup>75</sup> Restraint of trade clauses, however, protect less well-defined things such as 'know-how' and 'customer connection'. A restraint clause attempts to protect these intangibles by limiting the opportunities for the employee to share any knowledge with a competitor of the ex-employer.

There may, however, be no certainty as to the extent to which enforcing the restraint will protect the interest that the clause was drafted for. This could be because the employee was not privy to the know-how that was, in fact, valuable to the firm (but may have been privy to less valuable knowledge). Further, the clause may have been drafted incorrectly. The know-how, for example, could be seen as more commercially sensitive at the time of the breach than it was at the time of the drafting of the clause; if that is the case, then the employer may fight harder for the clause than if the clause was seen to be overly protective. Of course, the perceived value of the know-how may impact on the employee's attractiveness to a new employer and on the extent to which the employee will fight the enforcement of the clause.<sup>76</sup>

Uncertainties also impact on the decisions of the judges. Judges who hear cases cannot be sure that the upholding of a restraint will, in fact, balance the interests of the employee and the employer, and the judge will run the risk of unfairly privileging one set of interests over the other. The judge is also faced with the assessment of the reasonableness of the clause at the time of its signing, rather than at the time of its breach.<sup>77</sup> This raises risks associated with evidence of decisions that were made, potentially, years before the dispute takes place. Of course, judges are trained, or at least have practice, in dealing with these uncertainties. It would, nonetheless, be an incomplete analysis if they were not raised here.

## 2 *Interaction*

Finally, it is obvious that the decisions made by the employer and the employee are not made in isolation. The calculations of each are made in the knowledge that the other party may react to the first party's decision, and the second party's reaction

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<sup>75</sup> For a discussion of confidentiality as it applies to employees; see R Dean, *The Law of Trade Secrets and Personal Secrets* (LawBook Co, 2<sup>nd</sup> ed, 2002); 'Searching for Balance in the Employment Relationship' in M Richardson et al, *Breach of Confidence: Social Origins and Modern Developments* (Edward Elgar, 2012); and the relevant sections of T Aplin et al, *Gurry on Breach of Confidence* (Oxford University Press, 2<sup>nd</sup> ed, 2012).

<sup>76</sup> Either with, or without, the assistance of the new employer: Arup et al, above n 12, 19.

<sup>77</sup> This has the effect that the complexity of the decisions, and the pressures on the employee's life, at the time of the breach are irrelevant to the reasonableness of the restraint.

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may have impacts on the first party.<sup>78</sup> In other words, an employer's decision to enforce a restraint will, in most cases, force a reaction from the former employee — either to defend the claim or to fold — and the employer could not be sure, ahead of time, which is the option that will be taken.<sup>79</sup> The parties, therefore, have to make an educated guess about the motivators of the other side in order that they best assess the risks associated with any course of action.

Of course, interaction may also be seen as being constructive. The settlement of the dispute, through negotiation, may allow both parties to benefit.<sup>80</sup> It was also interaction (though, perhaps not full, and equal, negotiation) that produced the employment contract in the first place (and, of course, the possibility of the breach of the clause). The point is that the fact that any outcome depends on more than just the decision of one party means that there is always going to be a degree of uncertainty that attaches to any course of action. In other words, the interaction, as well as the other confounding factors, means that either party cannot simply consider her or his own motivators when deciding whether to breach, or enforce, a restraint of trade.

### IV DISCUSSION – HOW IMPORTANT IS THE LAW?

The question then becomes: Does the inclusion of the confounding factors render the motivators-based analysis misguided? It would be tempting to suggest that the complexity of the circumstances means that the consideration of what drives the parties themselves is not important enough to think about. However, the implicit approach of this area of law is that the choice of the ex-employee is of fundamental importance. The law facilitates restrictions on the work, and movement, of the employee in order to impact on her or his decision to change jobs. If the role of the doctrine of restraints is to discourage the leakage of employees and knowledge from one firm to another (where a clause purports to restrict the movement), then the choices, and the motivators behind those choices, have to be of great relevance. So, if the motivators are of significance, then the question may be posted: How important is the law?

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<sup>78</sup> It may be noted that there is another form of interaction beyond the employer-employee dynamic and that is the interaction between the employer (as organisation) and employer (as individual making the decision on behalf of the organisation). There may be a mismatch between the interests of the organisation and the perception of those interests by the individual (as evidenced by the claims that 'personal animosities ... cloud judgments': Arup et al, above n 12, 23). It is, however, not feasible to dwell on this form of interaction.

<sup>79</sup> Save for the issue of the taking of evidence, it is not clear how the issue of interaction impacts on the decisions of the judges.

<sup>80</sup> See, generally, Arup et al, above n 12, 10–12.

To begin, a crude summary of what happens now: Despite, or perhaps because of, the fact that restraints of trade have been around for centuries, the law in the area does not accommodate the complexities of the interpersonal dynamics of the employment relationship.<sup>81</sup> The key concern is that the system is aimed at adjudicating claims as to the reasonableness of a clause at a time many months, or years, in the past. Judges, therefore, are not assessing the behaviour of the employee — such as examining whether it was reasonable, at the time of the breach, for the employee to take up the new position — in terms of what their conduct should be. Further, the legal method is to apply past, decontextualized, statements of the law to the facts in the dispute.<sup>82</sup> That is, the proper conduct of judges is to apply the ratio of a case, decided by an appellate court, which is understood to be in the same area of law to those facts.<sup>83</sup> This cannot reflect an assessment of the decisions of the parties at the time of the breach—an important consideration if it is accepted that one of the roles of law in society is to improve the behaviour of its citizens.

### *A Law as Threat vs Law as Norm*

A key issue around the failure of the law in this area is how it may be characterised. Two options are to (a) see the litigation as a threat that keeps the employee in line; or (b) to see the law underlying the possibility of litigation as a norm that is aimed at guiding the behaviour of the parties. To understand the law in terms of the former option is to see it as essentially punitive; to see it in terms of the latter option offers a more positive take on the system, but it is far from certain that the law operates effectively as it could in this mode.

It is clear that the law, or at least the prospect of litigation, may be used as a threat in the interaction between the employee and the employer. Most obviously, it is the employer who will threaten the employee in order to prevent her or him taking the

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<sup>81</sup> There is one aspect of disputes around restraint clauses that has not been discussed in depth here—the one that relates to the fact that, in practice, most disputes are decided at the interlocutory stage. At that stage, judges use the ‘balance of convenience’ test to assess whether an injunction should be granted to prevent the employee working for a new employer (see, for example, *Complete Field Maintenance v Coulson* [2013] WASC 374). Given that many interlocutory decisions are not reported, it is not clear that extent to which the decisions can possibly be used by the parties to guide their behaviour. As a result, the interlocutory procedures have to be set aside for the ensuing discussion.

<sup>82</sup> As has been noted, the ‘neglect’ of the history of decisions ‘depoliticises law by robbing it of context. At the same time it deifies law by making it immortal’: J Conaghan and W Mansell, *The Wrongs of Tort* (Pluto Press, 1993) 63.

<sup>83</sup> See further, C Dent and I Cook, ‘Stare Decisis, Repetition and Understanding Common Law’ (2007) 16 *Griffith Law Review* 131.

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new job. There are at least four aspects of the threat: the financial cost; the time cost; the reputational impact it may have for the new employer; and the stress that comes from being a novice in the court system. Of course, a threat is most likely to be effective if it is offered before the offending action is taken. This is less likely to be the case where an employee takes a new position after leaving the first employer but within the restraint period.<sup>84</sup> It may, however, be more likely if the employee is still employed by the first employer who hears about the new offer before the employee resigns. As a form of behaviour guidance, it is not clear that a process that only works in certain situations will be the most effective tool.

If the goal of the regulation of employees and their employers is to improve their behaviour, the key issue around the use of reasonableness as a test is that it is difficult to see it as a norm that either party can judge their own behaviour by. The outcomes of the disputes relate to the status of the clause at the time of their signing; and, until the clause is held to be reasonable, the employee does not, and cannot, know whether she or he breached the clause. If a clearer norm was established, then employees would have a better idea of the standard against which their decisions to breach a restraint could be judged. Further, according to the empirical research already referred to, many employees and employers see the clauses as unenforceable,<sup>85</sup> meaning that those purportedly bound by a restraint may assume that the clause is invalid.

Put differently, the current process of assessing whether a clause is reasonable or not does not guide the behaviour of the employee. For a norm to operate effectively it has to set a clear standard that may be understood, and internalised, by those who are supposed to live up to it. The judicial decision on the clause focuses on the interests of the employer that are intended to be protected,<sup>86</sup> often with these interests not being listed in the clauses and, therefore, not even offering the employee a reason for the restraint (in case she or he referred back to the contract when considering her or his actions). A court ruling on whether it was reasonable, in the circumstances faced by the employee, could be used by others as measure for their own actions. Finally, a settlement between the employee and the employer — in particular, if it is based on their uncertainty around the validity of the restraint as signed — may not offer significant normative guidance either as it will be based more on the assessment of

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<sup>84</sup> This assessment is made on the basis that the employee has little contact with her or his former employer after the contract is over.

<sup>85</sup> Arup et al, above n 12, 24.

<sup>86</sup> It can hardly be otherwise as, in most cases, the employee will not have started work for the company yet.

the risks the parties are facing rather than an accurate idea of what is (or what the law thinks is) reasonable.

It is, of course, possible to see the current system as a norm for employers rather than for employees.<sup>87</sup> The problem with this is that the central decision in a dispute is the one of the employee to take up the new position. The formal sanction for the breach is against the employee and not the employer. The only sanction for an employer for getting the clause wrong (that is, drafting an invalid restraint) is the cost associated with enforcing it, and that is only significant if the firm decides to sue.<sup>88</sup> In fact, the greater impact of an invalid clause may be on all the other employees who refuse positions in other firms because they wish to 'do the right thing' and abide by the restraint. If the courts were to rule on the reasonableness of the employee's actions, there would likely still be sufficient engagement with the quality of the restraint in question for employers, and their lawyers, to use the judge's decision to formulate future clauses.

### **B Law as Policy**

If the law, currently, does not work well as either a threat or a norm, then it may be worth considering the policy that it may, or may not, be supporting. What may be drawn from the history of the use of the word 'reasonable' is the fact that the purpose of this area of law has not remained constant. This is, in part, the result of the fact that the underlying policy of the law has changed. In the early modern period, it was general restraints that were held invalid, with these restraints tending to be grants from the Crown. As a result, the law was an additional tool to counter the reach of the monarch.<sup>89</sup> As noted above, in the nineteenth century, the restraint doctrine

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<sup>87</sup> Perhaps this is how the unique legislation, in the Australian context at least, of NSW may be understood. Unlike with a simple yes/no response to the reasonableness of a standard clause, the judges, under the *Restraints of Trade Act 1976*, get to say what a reasonable clause would be in the circumstances of the signing of the contract (and not what a clause that a reasonable person in the circumstances at the time would sign). The judges may be seen, here, to be giving guidance to the employers as to what a reasonable clause looks like. This is not a case of the law operating as a norm, however; it is a case of the judge using the law as a standard which s/he applies to the facts, it is not a norm in that it does not guide the behaviour of the person applying it.

<sup>88</sup> The employer may be up for the cost of a lawyer's advice as to the enforceability of the clause before any litigation is commenced, but this would be a relatively low amount. Of course, there are also the costs of getting the invalid clause drafted, but they are there whether the clause is invalid or not.

<sup>89</sup> Dent, above n 50.

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seems to have been aimed at protecting the investments of business owners — perhaps necessary for the economic expansion of the time.

These days, there is a tension in the underlying purpose of the system between protecting the interests of employers and the mobility of employees. This tension is, on paper at least, managed through the ‘balancing’ of these interests. The interests of the employer are restricted to those that were in place at the time of the signing of the clause (it is not clear that the interests of the employee — such as the interest to earn a living — changes significantly between the time of signing and that of the breach.)<sup>90</sup> The decisions of the judges, therefore, apply the law to the facts around the interests of the employer.<sup>91</sup>

Considering those factors that impact on the decisions of employees to breach a clause it may be better, instead, to have the system regulate the interaction of the parties at the time of the breach. This would include, for example, the law taking into account the circumstances of the breach when adjudicating the dispute — relevant circumstances being those both before and after the employee left the first firm.<sup>92</sup> This would allow for a more precise account of the interests to be protected by the clause; it would also allow an investigation of what other practices the employer undertook to maintain those interests,<sup>93</sup> and the ‘quality’ of the decision made by the employee. Of course, enabling the investigation of the reasonableness (if that test is retained) of the employee’s behaviour does not preclude the possibility of challenging the validity of the clause.<sup>94</sup> The approach suggested here, however, allows the possibility that the employee acknowledges the validity of the restraint but asserts that the employee’s decision was, nonetheless, reasonable.

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<sup>90</sup> Almost all the discussion in the cases is focussed on the interests of the covenantee, rather than the covenantor; therefore, it is almost an unfounded assertion that the interests of the covenantor do not change in the period between the signing of the clause and the breach.

<sup>91</sup> It has been held that the ‘question of validity of a covenant in restraint of trade (including, in this, a covenant against solicitation of the covenantee’s customers or clients) is not really a question of law’: *Stacks Taree v Marshall [No.2]* [2010] NSWSC 77, [54].

<sup>92</sup> Another effect of the change may be a resurgence in the use of liquidated damages clauses (not that they are totally unknown today; see *BDO Group Investments (NSW-Vic) Pty Ltd v Ngo* [2010] VSC 206. There is not the space, here, to consider the likelihood, or the impact, of such a change.

<sup>93</sup> For example, was it made clear to the employee that a particular interest of the employer needed protecting and, perhaps, whether the reasons for the protection were also made clear.

<sup>94</sup> The value of challenging the clause is, of course, to excuse the behaviour, no matter how egregious, of the employee (where the clause is held to be invalid).

It is not possible here, for reasons of space as much as anything else, to provide a complete formulation of a test that could be applied at the time of the breach of a restraint. One possibility would be to use an 'ordinary person in the circumstances of the employee' test. Such a test could take account of what knowledge/information the employer has told the employee is valuable to the firm; it could take account of what the employee knows about the transferability, and relevance to competitors, of that knowledge or information; and it could take account of the treatment of the employee by the first employer and the inducements offered by the second employer. A test like this would be less focussed on assessing the validity of the restraint but would assess the actual behaviour of the employee in light of a clearer norm of behaviour (a norm perpetuated, and clarified, by decisions of the courts — although it may have to be instituted via statute).

Another way of stating this is to say that, in some circumstances, the decision of an employee to breach a restrictive covenant may be protected from sanction, should the decision to breach the clause be seen to accord with the norm. The clauses may be ignored on the basis of the actions, and interests, of both parties. If the law does have an interest in protecting the employee's capacity to look after her or his own career, then if the employer failed to do what it said it would do<sup>95</sup> — for example, with respect to any training, the provision of further opportunities or even simply certainty of employment — the employee may be entitled to disregard any restraint of trade clause in the contract of employment. The law already imposes obligations on the employer in terms of the contract,<sup>96</sup> and may also examine the conduct of the employer when considering the enforcement of a restraint.<sup>97</sup> This proposal simply extends these obligations to more specifically engage with the career of the employee.<sup>98</sup>

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<sup>95</sup> This may occur either explicitly or implicitly through the psychological contract between the employer and employee. For a discussion of the psychological contract, see K Stone, 'Knowledge at Work: Disputes over the Ownership of Human Capital in the Changing Workplace' (2002) 34 *Connecticut Law Review* 721; and N Anderson and R Schalk, 'The Psychological Contract in Retrospect and Prospect' (1998) 19 *Journal of Organisational Behaviour* 637.

<sup>96</sup> Such as the duty of care underlying the occupational health and safety legislation and the possible duty to act fairly and reasonably. The Full Court of the Federal Court has, more recently, has confirmed the existence of an implied duty, on the part of the employer, of mutual trust and confidence: *Commonwealth Bank v Barker* [2013] FCAFC 83. At the time of writing, the High Court had reserved its decision on the appeal to the decision of the Full Court of the Federal Court.

<sup>97</sup> See, for example, *Northern Tablelands Insurance Brokers v Howell* (2009) IR 307.

<sup>98</sup> If the employee should care about the long-term health of the firm, why should the firm not care about the long-term health of the employee's career?

## UNPACKING POST-EMPLOYMENT RESTRAINT OF TRADE DECISIONS: THE MOTIVATORS OF THE KEY PLAYERS

Admittedly, to claim that this is a ‘simple extension’ is an understatement. The approach suggested here pays significantly more attention to the interaction between the employee and the employer than does the current system; further, it engages with the extent to which incomplete knowledge on both sides may contribute to the decision of the employee to breach the clause. Unsurprisingly, this approach would impose obligations on the firm to make clear the limits, and purposes, of the clause, and it would impose obligations on the employee to ensure that the firm was clear about the employee’s career needs and aspirations.<sup>99</sup> In other words, such an approach would engage with the different motivators that guide the actions of both sides of a dispute.

It may be that, as a result, these expanded concerns would not be suited to a court setting. One other possibility, raised before,<sup>100</sup> may be suggested. That possibility is to have post-employment restraint disputes heard in a tribunal rather than a court. Tribunals may allow a more informal procedure that would suit an examination of the interaction between the employee and employer. Another result of a shift to a tribunal, potentially at least, would be to reduce the expense associated with the disputes and, therefore, the ‘threat’ aspect would be reduced. A key way of reducing the financial cost of disputes is to reduce the emphasis on legal representation, and many tribunals operate without lawyers. This, in particular, could remedy the situation where a well-funded employer, with experienced counsel, ‘bullies’ an unequally represented employee in a courtroom. Lawyers, of course, could still be used to provide advice (both at the time of the breach and for drafting clauses), but a shift to a tribunal may reduce the need for silks and their juniors. It is also possible that a less formalistic setting would change the nature of the decisions given that at the moment that the system is currently constrained, in part, by the manner in which judges, in accordance with the constraints of their proper conduct, have to make their decisions. This may reduce the precedential effect of the decisions; however, as many of the judgments, these days, are of an interlocutory nature, their value for future cases are also limited.

### V CONCLUSION

The purpose of this article was both to provide a more expansive discussion of the dynamic involved in decisions to breach restraints of trade and also to suggest ways in which this understanding can assist in drafting changes to the law. Given the slow

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<sup>99</sup> Experimental work has been done recently into how parties relate to contractual obligations generally, see Y Feldman and D Teichman, ‘Are All Contractual Obligations Created Equal?’ (2011) 100 *Georgetown Law Journal* 5.

<sup>100</sup> Arup et al, above n 12, 28.

pace of common law reform, it is likely that any such change would be in the form of legislation. Of course, it is arguable that the system does not need radical change. The number of disputes, relative to the number of employment contracts, is very small, so it may be that it is not broken. Even if this understanding is adopted, there is value in comparing the current law with a more realistic perspective of the processes involved in the breach of a restraint of trade clause.

The focus of the proposal here is to shift the emphasis from the reasonableness of years-old clause to the behaviour of both parties at the time of the alleged breach. This change would facilitate the law's function as a guide to the behaviour of those bound by it. As a result it may assist in more directly supporting the 'obligation to be free' of both parties. That is, closer attention to the point of breach may encourage employers to do what they can to protect their interests throughout the life of the employment contract—instead of simply including a clause in the contract, (this support's the firm's self-interest in profiting from any innovation). Further, to allow an employee to ignore a clause, when it is reasonable to do so, facilitates her or his capacity to advance her or his career. This mobility of employees has been understood to spur innovation itself. In short, given the state's interest in innovation generally, this more nuanced approach to restrictive covenants may be seen to support that goal through reliance on the self-interest of all parties concerned.