

Fact Sheet – Restraints of trade: can your employer restrict what you do during and after employment?

1. What is restraint of trade?

Restraint of trade occurs when an employer attempts to prevent an employee from carrying out certain activities that are related to his or her employment. It is not uncommon for employment contracts to include “restraint of trade clauses” that may apply both during the employment and after the employment comes to an end. Even when there is no restraint set out in an employment contract, the law implies certain restraints into every employment relationship. Some of these implied restraints may continue after the employment comes to an end.

This fact sheet briefly outlines the various sources of restraints against an employee. It also provides some guidance about the scope of those restraints. The idea is to present a broad overview of when a restraint may apply and in what circumstances a court will enforce it. However, please note that the specific circumstances of your employment will determine whether a restraint of trade is enforceable or not. If you are facing a restraint of trade dispute, you should seek independent legal advice.

2. Sources of restraints

There are four main sources of restraints against past or present employees. They are:

- restraints set out in an employment contract (i.e. “restraint of trade clauses”);
- the implied duty of fidelity and good faith;
- the equitable duty of confidence; and
- fiduciary duties.

Under each of these sources, a number of specific restrictions or duties may be found. Note that there is some overlap between the restrictions and duties that may apply under each of these sources.

3. Enforcement of restraints of trade

The law prohibits unreasonable restraints on grounds of public policy. It is in the public interest for people to be reasonably free to pursue any lawful trade or employment they want. On this basis, the starting point with restraints of trade is that they are void, unless the restraint can be justified as reasonable in the circumstances. A restraint will be reasonable if it affords no more than adequate

protection to the employer's business, while at the same time not being injurious to the public.

Post-employment restraints (i.e. restraints imposed on employees after the employment relationship has ended) are generally more open to legal challenge than restraints imposed during employment. Factors which indicate whether a post-employment restraint is reasonable may include time, geographical area and the specific activities or information restrained. Where a restraint is for a long period of time, a broad geographical area or covers a broad range of activities, it is less likely to be enforceable. With respect to confidentiality, it can be difficult to protect information that is neither personal information nor a "trade secret".

Where restraints of trade are valid, breaches (or threatened breaches) by an employee could result in an injunction preventing the breach, an order for compensation to the employer or recovery of profits resulting from the breach.

4. Express contractual restraints ("restraint of trade clauses")

Employment contracts sometimes contain clauses that expressly prohibit the employee from engaging in certain activities. The effect of these clauses will depend on how they are worded. Where such clauses exist, they generally apply during the course of employment. Sometimes, they may attempt to continue applying after the employment comes to an end.

The most common restraint of trade clauses are:

- no competition clauses;
- non-solicitation clauses;
- no poaching / recruitment clauses; and
- confidentiality clauses.

Each of these types of restraint of trade clause is discussed below.

If an employer wrongfully dismisses an employee, the employer loses the benefit of an express restraint of trade clause. The employee can disregard the post-employment restraint. The exception to this is for confidentiality clauses protecting a "trade secret". In such cases, even though the contractual clause may be unenforceable, the equitable duty of confidence will still require the employee to maintain confidentiality (see [6] below).

4.1. No competition clauses

No competition clauses prevent an employee (or former employee) from competing with the employer. A clause of this type which applies during the period of employment will be valid where it is reasonably necessary and adapted to protect the employer's business interests.

As discussed above, factors which indicate whether a post-employment restraint is reasonable or not may include time, geographical area and the specific activities restrained.

4.2. Non-solicitation clauses

Non-solicitation clauses prohibit a former employee from seeking out and trying to take (or “solicit”) the employer’s clients. In determining whether “solicitation” has occurred, who makes the initial contact is not decisive. In other words, it may still be solicitation where the client makes the first contact. There is no blanket prohibition against accepting work from a former client. The line is crossed into solicitation when a former employee, in response to an approach by a client, goes beyond merely showing a willingness to be engaged and positively encourages the client to engage him or her.

Again, an unreasonably wide clause is unlikely to be enforceable.

4.3. No poaching / recruitment clauses

No poaching / recruitment clauses prohibit a former employee from persuading other employees to leave their existing employment and work for him or her. Again, such restraints are usually limited by time, area and activities, with broader restraints being harder to enforce.

4.4. Confidentiality clauses

Confidentiality clauses protect the employer’s trade secrets and other confidential information. Confidentiality clauses generally remain in force whilst the information protected remains confidential. This means that the clause may apply during employment and potentially long after the employment ends.

A confidentiality clause drafted in reasonable terms and intended to protect the “trade secrets” of the employer will be valid. This may be so even when the clause has the secondary effect of restricting the employee’s ability to work in competition with the employer.

Confidentiality agreements may also cover information other than trade secrets. This could relate to certain “confidential” information (as agreed by the employer and the employee) gained by the employee during the course of employment. Such information may be broader than information that would otherwise be protected under an implied term or in equity (both of which are explained below).

5. The implied duty of fidelity and good faith

Not every condition of your employment needs to be written down for it to be legally enforceable. In situations where there is no written contract, or the contract does not specify what is to occur in certain circumstances, a contractual term may be “implied”. An implied term is a term that the parties (in this case the employer and the employee) have not set out, but which is deemed to have been agreed to. In all employment contracts, the law implies obligations on both

employers and employees. These implied obligations form part of the employment contract. Breach of implied terms, by either the employer or the employee, may be enforceable as a breach of contract.

One such implied obligation on all employees in all employment contracts is the duty of fidelity and good faith. This duty involves a large number of specific requirements or restrictions and covers almost every aspect of an employee's duties to the employer (i.e. attending work on time, obeying lawful directions, acting honestly etc). It is difficult to provide an extensive list of all the specific obligations, as these will vary from job to job. The following discussion covers some of the obligations under the duty of fidelity and good faith that may be considered restraints of trade. These include:

- no solicitation of customers and protection of goodwill;
- no poaching of employees;
- no unauthorised use or disclosure of information;
- no unauthorised comment on the employer's business;
- restrictions on the use of the employee's spare time; and
- no bribes or secret commissions.

The duty of fidelity and good faith prescribes proper behaviour of the employee during the period of employment. The duty will end when the employment relationship ends.

5.1. No solicitation of customers and protection of goodwill

During employment, an employee cannot solicit customers (i.e. lure customers away) to a competing business, or solicit customers with the intention of establishing a competing business. Similarly, copying a list of clients for future use is also a breach. It is not a breach of duty for the employee to tell clients that he or she will be leaving. As for what amounts to "solicitation", see [4.2] above.

The employee cannot use the employer's time to establish a competing business. In his or her own time, outside of normal working hours, the employee can take steps towards setting up a competing business to begin after his or her employment ends.

5.2. No poaching of employees

The implied duty of fidelity and good faith does not prevent a former employee from approaching other employees and offering them a new job. However, the former employee should be careful that his or her approach does not expose him or her to a claim for inducing a breach of contract. This claim would potentially be available where the former employee induced another employee to breach his or her contract with the employer. It is unlikely that a claim could be made against the former employee where he or she, in offering the new job, makes it clear to the other employee that the other employee needs to fulfil his or her existing

contractual obligations, such as providing the employer with the required period of notice of resignation.

5.3. No unauthorised use or disclosure of information

Confidential information can be protected in a number of ways, including by a restraint of trade clause (see [4.4] above), under the equitable duty of confidence (see [6] below) or as a part of the implied duty of fidelity and good faith to the employer. For example, an employee would be in breach of the implied duty if during employment, and for purposes other than the employment, he or she made a list of customers, copied software, plans or designs, memorised formulas or provided details to another employer about contracts the current employer had entered into. Information does not need to be in a written document for it to be confidential.

The employee can continue to use his or her general “know-how” after the employment has ended. Know-how is the sort of information that is used every day as part of the employment and cannot reasonably be regarded as a separate and confidential part of the employee’s stock of knowledge. For example, know-how might include the name of a particular supplier or customer where there has been no deliberate attempt to copy or memorise names.

The difference between confidential information and know-how may depend on the specific facts of your situation.

5.4. No unauthorised comment on the employer’s business

In most situations, the duty of fidelity and good faith will prevent an employee from making adverse comments to outsiders about the employer’s business.

5.5. Restrictions on the use of the employee’s spare time

There is no general restriction against employees engaging in other employment in their spare time. It would be a breach of the duty of fidelity and good faith if, whilst engaging in other employment, the employee used or disclosed confidential information or the new employment adversely affected the employee’s work standards with the original employer.

There could also be express restrictions on employees taking up other work. These could be found in the employment contract, in workplace policies or, in some government and semi-government jobs, in legislation or other standards. These sorts of exclusive service clauses would need to be reasonable, having regard to factors such as time, geographic location and the range of activities restrained. The employee should consider whether or not the work done in his or her spare time seriously damages the primary employer’s business.

5.6. No bribes or secret commissions

An employee who accepts a bribe or secret commission in connection with the employer's business is likely committing a criminal offence. Apart from criminal liability, taking a bribe or secret commission would also be in breach of the duty of fidelity and good faith and is grounds for dismissal.

6. The equitable duty of confidence

An employer's confidential information can be protected by a restraint of trade clause (see [4.4] above), by the implied duty of fidelity and good faith (see [5.3] above) or by the equitable duty of confidence. Breach of the equitable duty of confidence by the employee, through wrongful use or disclosure of the employer's confidential information, may provide the employer with remedies, such as injunctions, compensation and recovery of profits resulting from the breach.

To attract the duty, the confidential information must satisfy four requirements:

- the confidential information must be specifically identifiable;
- it must have the necessary quality of confidence and not be common or public knowledge;
- it must have been imparted in circumstances giving rise to a duty of confidence; and
- there must be misuse or threatened misuse without the consent of the person entitled to be protected.

The information may have the quality of confidence if it is not freely available to competitors. It could lack this quality if no steps were taken to keep the information confidential. The equitable duty of confidence may protect a broad range of confidential information, but is most frequently cited to protect against the disclosure of personal information or "trade secrets".

The equitable duty will continue after the employment has come to an end, so long as the information remains confidential. Whilst the information is not in the public domain, the duty will continue and may even be enforced against a third party. In comparison to other means of protecting confidential information, the equitable duty may protect a more limited range of information, but the duration of protection may be longer.

6.1. Public interest disclosure

Information will not be considered confidential if it demonstrates a crime, civil wrong or serious misdeed of public importance and disclosure is made to a party with a real and direct interest in redressing the situation. The disclosure must be to an appropriate authority, such as the police or a relevant government agency. It would be rare that wider disclosure, such as to the media, would be warranted.

It is important to note that the law in Australia on this issue – whether it is a defence that disclosure is in the public interest – is unsettled. If you feel you are at risk of breaching any type of duty of confidence, you should seek independent legal advice.

7. Fiduciary duties

A fiduciary duty is an equitable duty of trust and confidence that requires one person (the fiduciary) to act in good faith for the benefit of another person. Persons subject to a fiduciary duty are not allowed to profit from their positions (other than where expressly permitted) or to put themselves in a position where the fiduciary duty and personal interest may conflict.

Ordinarily, an employee will not be subject to fiduciary duties. However, there are some employment arrangements where the employee may be in a unique situation of trust and confidence, giving rise to a fiduciary relationship. In such cases, the fiduciary duty imposes obligations in addition to the duty of fidelity and good faith.

Fiduciary duties in the employment context are usually confined to senior positions carrying high levels of discretion and trust, such as senior managers of a company or senior academics at a university.

8. Further Information

The Employment Law Centre of WA (Inc)

Advice Line 1300 130 956 or 08 9227 0111

Web www.elcwa.org.au

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