

SMR BULLETIN

TOPIC: KEY EMPLOYEES AND THE THREAT TO YOUR GOODWILL

An important and frequently overlooked weapon in a business proprietor's armoury for the protection and preservation of goodwill is the "restraint of trade clause". A recent decision of the NSW Court of Appeal in *Woolworths Limited v Olson* supports what we believe is an increasing willingness on the part of the Courts to enforce properly drafted restraint of trade clauses for key personnel in employment agreements. In that case, both the Court of Appeal and the High Court affirmed the right of Woolworths to obtain an injunction preventing a key employee (Olson) who had worked on a sophisticated stock control project developing software, from working for a competitor (Franklins) for a period of 6 months.

In a decision in 2004, the Supreme Court of NSW¹ upheld a clause effectively preventing a real estate salesperson from being employed by a rival business and using the confidential information that he had obtained or may have obtained during the course of his employment with his old employer. The Court in that case found that a restraint of 6 months within a radius of 45 kilometres from the employer was not unreasonable.

For some time it has been mostly assumed by lawyers that restraint of trade clauses in employment agreements were considered by the Courts to be anti-competitive and unenforceable. We believe that there is a growing awareness of the importance of key employees and a willingness to enforce a properly drafted restraint of trade clause. It is now appropriate for small business to review their situation regarding key employees with a view to updating employment contracts generally and in this area in particular. There is real scope now for professional employers and other small business proprietors to gain some protection against the loss of key personnel with access to customers and confidential information to competitors. For those employers with employment agreements, there is real value in reviewing those contracts at a cost in most cases of less than \$1,000 and updating the general agreement for future use with a relatively small one

off cost. Whilst recent decisions have demonstrated a willingness to enforce, they have made it clear that the restraints must be properly and precisely drafted. Some general principles have emerged as follows:

1. The acts to be prohibited should not be drafted (as is commonly the case) in one continuous sentence or paragraph. The acts to be prohibited should be drafted as separate covenants in a cascading order, i.e.:
 - (a) the employee shall not conduct as a property manager in a certain radius and for a certain period of time;
 - (b) the employee shall not solicit custom from any person or corporation identified as a client of the employer's business as at the date of termination;
 - (c) the employee shall not utilise any confidential information for the gain of the employee or some other thirdparty, which information was obtained during the course of his employment with the employer.

2. Similarly, the area of restraint must be specifically considered and again drafted in cascading terms so that if any part of the restraint clause is considered to be too wide, then the remainder will continue to operate for the benefit of the employer.

In the case of a sale of a business, the Courts are even more likely to uphold a restraint of trade covenant where consideration has been paid for the goodwill of the business, as opposed to the employment agreement where no such consideration passes. The need for precision in drafting is equally important, however, in ensuring that the restraints are no wider in either geographical restraint or duration, than is reasonably necessary to protect the interest of the purchaser.

In our view, the standard REIQ contract which is largely adopted for the purchase and sale of businesses in this area can be improved upon and ought to be the subject

of a special condition even if it is only otherwise incorporated in the standard terms and conditions.

There are always opportunities to review and improve internal documentation, however we do see this as a real opportunity to add some value in a fluid employment environment where attracting employees for regional employers is difficult enough let alone the prospect of losing a well-trained key employee to a competitor.

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