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AMA VICTORIA FACTSHEET

Restraint of Trade

Last reviewed May 2015

Medical practitioners are sometimes faced with the difficulty of an employee, contractor or former partner/associate seeking to set up a practice in competition nearby or keeping copies of patient lists to solicit those patients. These problems may be overcome by an understanding between professionals about their obligations when they work together.

What is a restraint of trade clause?

Restraint of trade clauses are contractual terms which expressly restrict the business activities or employment of a person following certain events, such as the termination of employment or the sale of a business. These clauses are relevant to employees, principals and potential purchasers of medical practices.

Restraint of trade clauses seek to balance competition provided by past employees or sellers of a business against the need for reasonable protection for employers and purchasers of a business.

There are three main types of restraint of trade clauses:

- (1) Restrictions on performing similar work in competition:
 - (a) within geographical restrictions;
 - (b) within time limits; and
 - (c) regarding business activity of a particular nature and scope;
- (2) Prohibitions on soliciting former co-employees.
- (3) Prohibitions on disclosure to others of confidential information and know-how.

As to the enforceability of such clauses, it is important to note that the law recognises a person's rights to carry on any chosen trade or business. As such the law is reluctant to curtail the freedom of former employees, owners, or partners.

A contract in restraint of trade will therefore be, *prima facie*, unenforceable unless it is reasonable by reference to the interests of the parties and the public.

In determining whether the scope of the restraint of trade clause is reasonable, the nature, location and duration of the practice, as well as the nature and length of the relationship are all relevant considerations.

Restraint of trade clauses are preserved under the Australian Consumer Law only insofar as they are capable of operating concurrently with that Act. Accordingly a clause that is likely to have the purpose or effect of substantially lessening competition is not allowed (section 45), nor is a clause that has the effect of amounting to exclusive dealing (section 47) or unconscionable conduct (Part IVA).



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Employees

The law does not prevent a former employee from using the skills acquired on the job from competing with the former employer.

However, employers may take steps to prevent employees from enticing patients away from the practice.

Restraint of trade clauses can therefore be included in employment contracts to protect medical practices against the loss of patients, **provided the time, distance and business activity restrictions are found to be reasonable**.

Partnerships and associateships

Restraint of trade clauses are common in partnership agreements so as to protect the interests of one party from competition from the other which would destroy any goodwill, contracts or custom purchased. In contrast to restraint of trade clauses within employment contracts, **commercial agreements with restraint of trade clauses are more likely to be enforceable** where they do not restrict an individual's freedom to use his or her professional skills.

Again the former partner or associate can only be restrained from actively competing for **a reasonable period and within a reasonable distance of the practice**. The particular characteristics of the practice and the relationship may influence what is considered reasonable.

Buying and selling a practice

One of the more important assets that a purchaser of a medical practice acquires is the goodwill attached to the practice. Having purchased a practice, the new owner can protect that goodwill by using a restraint of trade clause to restrain the former owner from setting up a new practice nearby.

The former owner can only be restrained from actively competing for *a reasonable period and within a reasonable distance of the practice*. Again, the particular characteristics of the practice and the seller may influence what is considered reasonable.

A recent example with consequences for employers

Recently the NSW Supreme Court held that a post termination restraint of trade clause against the solicitation of employees in former employees' contracts was unenforceable because the limitation period was unreasonable and the scope too broad.

The case has implications for employers, as it casts doubt on the effectiveness of restraint of trade clauses in employment agreements. It was held that such a restraint may be valid to the extent that it is necessary to prevent disclosure of trade secrets or the use of a connection built up by the employee with the employer's customers. As such, a clause will only be valid insofar that it is reasonably necessary to protect the employer's valuable confidential information. Therefore, a restraint clause will be deemed invalid if it goes further than what is reasonable to protect those interests.



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A restraining clause of this type may be valid if the employer can demonstrate a legitimate interest against this form of competition.

The restraint of trade clause in this case was found to be too wide because it applied to all employees and contractors, regardless of their position or seniority and the restraint of trade period, 12 months, was found to be too long.

The court held that the restraint clause went further than what was reasonably necessary to enforce the legitimate interests of the employer and was accordingly unenforceable.

In Victoria today, many employment contracts include standard post termination restraint clauses regarding poaching of fellow employees following the termination of employment.

An unreasonable restraint clause would be unable to be read down unless the contract provides specifically for the severance of any unenforceable clauses. To remedy a situation where a restraint clause may be held to be excessive and unenforceable, the insertion of restraint clauses which accommodate multiple restraint periods and restrain areas capable of severance would be advisable.

Other examples

In a 1996 decision, the Queensland Court of Appeal was required to rule on a case where employees of a business left to start up on their own in competition with their former employer. The former employer company alleged that the former employees had taken client lists with them.

An injunction was granted restraining the defendants from soliciting business from clients of the plaintiff however the Court recognised that certain client details could be obtained from other sources (such as the Yellow Pages) and the injunctive relief was limited to a 12 month duration.

An example of how restraint of trade clauses can operate in a health services context occurred in New Zealand. The High Court awarded \$12,500 to a physiotherapist who had purchased the business of another physiotherapist. In this particular case, the contract of sale stipulated that the seller could not open a similar business for 5 years within a 15km radius of the practice, as the purchaser had paid \$72,000 for goodwill. The fact that the seller then opened a business nearby amounted to a breach of the clause.

In a 1998 New South Wales Supreme Court case, the former managing director of the plaintiff agreed that for 3 years following the termination of his employment, that he would not 'be employed, engaged or interested, directly or indirectly, in any capacity in the business of manufacturing or selling biscuits within Australia or New Zealand'. He was later headhunted and accepted the position of managing director of a competitor company. The court in this case found the nature and scope of the restraint to be too wide and the defendant was therefore unrestrained.

Remedies

If a reasonable restraint of trade clause is found to be breached, a court may grant an injunction forcing the party in breach to comply. A court may also order a party to return property, such as patient lists, and in extreme cases order payment of damages to the aggrieved party.



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Since a restraint of trade clause which is found to be excessive will be unenforceable persons considering including a restraint of trade clause in a contract is best advised to seek advice from AMA Victoria or a qualified legal practitioner.