AMAVIC AUSTRALIAN MEDICAL ASSOCIATION VICTORIA

FACTSHEET

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Restraint of Trade

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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 four 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 soliciting or interfering with customers or patients of the practice
4. 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. This will be the case even where the restriction has been freely accepted.

A restraint of trade clause will therefore be treated as and presumed to be invalid, unless the employer or person seeking to have the restraint enforced can establish that the restraint is 'reasonable'; as judged at the time the restraint was agreed.

To show that the restraint is reasonable, the person relying on it must show that they have a legitimate interest, and that the scope of the restraint is no wider than is reasonably necessary to protect that interest. In determining whether the scope of the restraint of trade clause is reasonable, the nature, area in which the clause is to have effect, and duration of the restraint, as well as the nature and length of the relationship are all relevant considerations.

Restraint of trade clauses are not subject to the general controls on restrictive trade practices imposed by Part IV of the *Competition and Consumer Act 2010* (Cth) but 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).

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.

Restraints in exchange for valuable consideration which are incidental to the sale of the business are generally permitted to have a much broader scope than ordinary post-employment restraints due to the money paid in exchange for the goodwill of the practice.

A RECENT EXAMPLE WITH CONSEQUENCES FOR EMPLOYERS

In the recent case of *Breedon v Oosthuizen* [2023] NSWSC 859 the NSW Supreme Court held that a post termination restraint of trade clause which sought to both prevent a former partner from soliciting, canvassing, or seeking the custom of clients of the partnership was valid and reasonable. This was the case even where the restraint sought to prohibit the former partner from providing any goods or services to those who may have been previous clients of the partnership [130][134].

This case usefully summarised the principles to be applied in cases for interlocutory injunctions and restraint of trade at [66]. Notably, it was reaffirmed and held at [67] that 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.

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

Despite the fact that the restraint of trade clause in this case was too broad in certain respects and did not adequately specify a restraint period, it was able to be read down and in conjunction with the covenant against non-solicitation and competition to constitute a valid restraint.

The court held that an interlocutory injunction restraining Mr Oosthuizen was warranted, as there was a legitimate interest to be protected and a that an injunction was needed to enforce the legitimate interest of the employer. It was held that there was both a prima facie case, and that the balance of convenience favoured the granting of an injunction.

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 Ladder or Cascading restraint clauses which accommodate multiple restraint periods and restrain areas capable of severance would be advisable.

However, there is a risk that the use of Ladder or Cascading Clauses may be viewed by the courts as the parties not making a genuine attempt to define the protection, or that the clauses will be found to be invalid for lack of certainty.

OTHER EXAMPLES

In the recent case of *KPW Law v Patel* [2023] NSWSC 617 an application by a rural law firm for an interlocutory injunction to prevent one of its former lawyers from practicing law in the same town was dismissed, as there was a significant dispute as to the validity and drafting of the clause and significant countervailing public policy factors which required protection.

In this case it was able to be shown at [47] that due to the lack of resources in the regional area where the lawyer practices, the community would suffer if he were to be restrained, as it would be denied the service of the only criminal lawyer in the area. In this case the poor drafting of the clauses gave rise to uncertainty and whether the clause was reasonably necessary to protect the legitimate interests of the employer (that being their goodwill) [49]. This combined with the fact that his clients would otherwise be unable to access a lawyer and would be left without access to justice, resulted in the application for an injunction being dismissed.

This case potentially has impacts for doctors and specialists working in rural and remote areas, where to restrain them from providing care to patients in their area of expertise would result in the patients not being able to access healthcare, and suffering as a result of not having access to a doctor if they were restrained.

This followed from an earlier decision concerning the restraint of trade in a health services context in the case of *Specialist Diagnostic Services Pty Ltd v Healthscope Ltd & Ors* [2012] VSCA 175. In this case the full court of appeal acknowledged at [76] that questions of public interest may arise in respect of restraints of trade which affect the supply of essential medical services. Further, the court acknowledged at [77] that there was no evidence to support the limitation of restraints of trade where they are given by hospitals and grant exclusivity to health service providers.

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.

In order to obtain an injunction, the employer must show they have a legitimate prospect of establishing that the restraint is valid, that there is evidence of a breach or imminent breach by the employee, and that those actions have caused or are likely to cause harm.

Where an employer can establish that it has suffered loss as a result of a breach or that they are owed liquidated damages, they may also sue the ex-employee for damages.

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 a qualified legal practitioner.