

Law Reform Commission

REPORT 9 (1970) - COVENANTS IN RESTRAINT OF TRADE

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Preface

The Law Reform Commission is constituted by the Law Reform Commission Act, 1967. The Commissioners are-

The Honourable Mr Justice Reynolds, Chairman.
Mr R. D. Conacher, Deputy Chairman.
Mr C. R. Allen.
Professor D. G. Benjafield.

The Honourable Mr Justice Manning, Professor W. L. Morison and Mr J. O. Stevenson were Commissioners during part of the period of the Commission's work on the subject-matter of this Report. Mr Justice Manning retired as Chairman of the Commission upon his appointment as a Judge of Appeal on the 7th October 1969. Mr Stevenson died on the 16th February, 1970. Professor Morison's term as Commissioner expired on the 28th February, 1970.

The Executive Member of the Commission is Mr R. E Walker. The offices of the Commission are at Park House, 187 Macquarie Street, Sydney.

This is the ninth report of the commission on a reference from the Attorney-General. Its short citation is L.R.C. 9.

REPORT 9 (1970) - COVENANTS IN RESTRAINT OF TRADE

Report

REPORT ON COVENANTS IN RESTRAINT OF TRADE

**To the Honourable K M McCaw, M.L.A.,
Attorney-General for New South Wales.**

1. On the 27th of February 1969, you made a reference to this Commission in the following terms-

“To review the law relating to the validity and enforcement of covenants in restraint of trade.”

2. We gave the subject some consideration and then published a working paper. The working paper produced a response which has been helpful to us in pointing out possible problems arising out of our proposals. We are grateful to all who gave us their views. In particular, we mention with gratitude the thoughtful comments which we received from the Department of the Federal Attorney-General, from the Registrar General, and from some barristers and solicitors who looked at the problems at the request of the Council of the Bar Association and the Council of the Law Society.

3. It is better not to attempt to define what we understand by the words “covenants in restraint of trade” in our terms of reference. The words refer to a well-known legal category which will be sufficiently identified by a few examples. A common example occurs where a shopkeeper sells his business and agrees that he will not engage in that business within specified limits of time and place. Another example occurs where a servant agrees that he will, after his service has ended, restrict his activities in some way beneficial to his master. Again, the producers of some article of commerce may make an agreement regulating the distribution and sale of their products. These are but examples: the occasions on which in a person may give a promise in restraint of trade, and the kinds of restraint of trades for which such a promise may provide, are of unlimited variety.

4. The restraint which arises under the promise is usually a restraint on the promisor. Sometimes, however, a promise is offensive to public policy because of the restraint which puts on the trade of other persons. A promise of this latter kind was considered in *Eastham v Newcastle United Football Club Ltd* (1964) Ch. 413. Sometimes promises of this latter kind are lost sight of when a definition is attempted. Consider, for example, the definition by Diplock L.J. in *Petrolina (Great Britain) Ltd v. Martin* ([1966] Ch. 146, at p. 180) “A covenant in restraint of trade is one in which a party (the covenantor) agrees with any other (the covenantee) to restrict his liberty in the future to carry on the trade with other persons not parties to the contract in such manner as he chooses.”

5. In this context “covenant” extends to promises not under seal. In this report we shall speak of promises in restraint of trade rather than of covenants in restraint of trades; but the meanings is the same. In this context “trade” includes any calling or profession.

6. The law recognises a public policy against interference with liberty of action in trading, and withholds its remedies of damages and injunction in case of an actual or apprehended breach of contract where the promise in question conflicts with public policy in this respect. The classic formulation of the tests to be applied is that of Lord Macnaghten in *Nordenfelt v. Maxim Nordenfelt Guns & Ammunition Co. Ltd* ([1894] A.C. 535, p. 565). Under this formulation, the general rule is that a promise in restraint of trade, if there is nothing more, is against public policy and is void. But a restraint is justified, and thus effective, if it is reasonable, that is reasonable in reference to the interests of the parties concerned and reasonable in the interests of the public. The ambit of public policy, however, is not static: it is a concept which develops and changes with the passage of time. Thus, the test was authoritatively re-defined (*Vancouver Malt and Sake Brewing Co. Ltd v. Vancouver Breweries Ltd* [1934] A. C. 181, at pp. 189, 190) by Lord Birkenhead in *McEllistrim v. Ballymacelligott Co-operative Agricultural and Dairy Society Ltd* ([1919] A. C. 548, at p. 562) in these words: “A contract which is in restraint of trade cannot be

enforced unless (a) it is reasonable as between the parties; (b) it is consistent with the interests of the public". This approach was expressed in different words in the judgements in *Linder v. Murdoch's Garage* ((1950) 83 C.L.R. 628). A new formulation was recently propounded by *Lord Pearce in Esso Petroleum Co. Ltd v. Harper's Garage (Stourport) Ltd* ([1968] A.C. 269 at p. 234). He said "There is one broad question: is it in the interests of the community that this restraint should as between the parties, be held to the reasonable and enforceable?"

7. The limits on grounds of public policy on the validity of promises in restraint of trade have given rise to dissatisfaction in some special cases and these cases have been dealt with by Parliament. See, for example, the Trade Union Act 1881, s. 3. and the Co-operation Act, 1923, s. 77 (1). More general provision is made in the Monopolies Act, 1923. This legislation was passed and no doubt has been retained because of policy matters upon which our views are not entitled to any special weight and we do not consider them further in this report.

8. Apart from cases which are covered by the legislation we have mentioned, and apart from the problem of severance with which we deal at length in this report, we are not aware that the general rules of public policy in relation to promises in restraint of trade have given rise to dissatisfaction. In particular we see no call for an attempt to state by legislation the tests by which invalidity on grounds of public policy should be determined. As Lord Wilberforce said in *Esso Petroleum Co. Ltd v. Harper's Garage (Stourport) Ltd* ([1968] A.C. 269, at p. 331), "it would be mistaken, even if it were possible, to try to crystallize the rules of this, or any, aspect of public policy into neat proposition".

9. The dissatisfaction which has arisen concerns the extent to which a promise in restraint of trade may be held invalid. Suppose a man has a business in Sydney with a local goodwill extending throughout, but not appreciably beyond, the City of Sydney. On a sale of the business he may, without offence to public policy, promise not to engage in a competing business within the City of Sydney. But the parties may settle on a restraint with a wider local operation. The seller may promise not to engage in a competing business within the City of Sydney nor within other specified local government areas: these areas may comprise the whole of the Country of Cumberland. Alternatively, the seller may simply promise not to engage in a competing business within the Country of Cumberland. The first promise does not offend public policy and is wholly valid. The second promise is wider than necessary for the protection of the buyers and thus does offend public policy, but by a peculiar rule of construction it will be treated as being made up of separate promises for each local government area, and it will be valid in its relation to the City of Sydney: it is said to be severable. The third promise, however, does not admit of verbal dissection in this way and it is altogether invalid. If the promise is in the third form, the Court will not stop the seller from engaging in a competing business within a few yards of the business which he has sold.

10. The way in which this result is reached is no less curious than the result itself. Suppose these facts. A owns a bakery business in Windsor. He sells the business, including the goodwill, to B and B pays the sale price. In the contract for sale A promises that he will not afterwards carry on a bakery business within fifteen miles of Windsor. Soon afterwards carry on a baker business at Richmond, four miles from Windsor. By this means A takes advantage of the goodwill which he had in connection with his former business at Windsor and does corresponding harm to the business which he has sold to B. B sues for an injunction to restrain A from carrying on business in Richmond in breach of his promise.

11. A man not versed in this part of the law might think that the proper matters for inquiry by the court would be whether there was a breach or threatened breach of the contract and whether the harm suffered by B was harm to an interest which, consistently with public policy, B was entitled to protect by contract.

12. But the law is otherwise. The court does not consider the actual breach, it considers imaginary breaches. Penrith and Blacktown are both within fifteen miles of Windsor. The court takes the imaginary cases if A starting a bakery business in the one or the other of those towns and sees whether that would harm the legitimate interests of B. If the answer is no, the next steps is to see whether the contract can be appropriately confined by crossing out words. If not, A is at liberty to do this best to take back the goodwill which he has sold to B. This, let it be emphasised, is done in the name of public policy by a court of equity, that is, a court of conscience.

13. The facts supposed in the last example are partly hypothetical and are partly the facts in *Hawkesbury Bakery Pty Ltd v. Moses* [1965] N.S.W.R. 1242. There is a striking example in a master and servant cases of a similar judicial approach in *Commercial Plastic Ltd v. Vincent* [1965] 1 Q.B. 623.

14. It is only in comparatively recent times that the law has been settled in this way in England and in New South Wales and other common law countries following English judicial precedent. See the difference approach of North J. in *Baines v. Geary* ((1887) 35 Ch.D 154) and the approval of Kay L.J. in the Court of Appeal in *Pearls v. Soalfeld* 9[1892] 2 Ch. 149, at pp. 156, 157). See also *Urmston v. Whitelegg Bros* ((1890) 63 L.T.N.S. 455, at p. 456) per Day J. The rules about crossing out words, "severance" as it is called, are quite artificial and it was not long before the artificiality was remarked upon (*Attwood v. Lamont* [1920] 2 K.B. 146, at p. 155).

15. The effect of these rules as to severance is to allow an enforcement in part of a promise in restraint of trade notwithstanding that, as a whole, the promise offends public policy. The rules evince a consciousness amongst the judges that in this field the principles of public policy can lead to injustice. The rules are, as far as they go, a confinement of the operation of public policy so as not to avoid a promise to the extent to which it protects a legitimate interest. The defect of the rules is in their mechanical nature, decisive effect being given to the form of the words in which the promise is expressed.

16. The results of the rules as to severance include the following. A man who is not a lawyer will usually fail, however honest and fair and reasonable he may be, to word a promise in restraint of trade in such a way that the promise is to any extent binding. It is easy even for a lawyer to fall into the trap of using general words which are in some respect too wide. It is in practice impossible, even for the best of lawyers, to draw a promise in restraint of trade which gives full protection to a legitimate interest within the limits of public policy: it is impossible because the only way to approach the task is to break the promise into a multitude of severable parts; in this way one can, so to speak, sprinkle the permissible field, but one cannot cover it. This leads to another point. A promise in restraint of trade professionally drawn with the rules of severance in mind tends to be no less artificial than the rules of severance themselves and to have a prolixity can the justified by any matter of substance. Only by such prolixity can the lawyer afford to his client protection which is as complete as the patience of the lawyer and other demands upon his time permit.

17. The examples we have given or referred to of the operation of rules as to severance are cases between buyer and seller of a business and between master and servant. But the rules apply in whatever circumstances a promise in restraint of trade is made. Thus a garage company borrowed money from an oil company, the loan being secured by a mortgage for twenty-one years. As part of the loan transaction the borrower promised that during the twenty-one year period it would use the mortgaged premises as a garage selling only the lender's fuel. Twenty-one years was too long but five years would have been proper. The promise was altogether void (*Esso Petroleum Co. Ltd v. Harper's Garage (Stourport) Ltd* [1968] A.C. +. Jones 1969 1 W.L.R. 1293), promises between retailers and manufacturers of goods (*Peters Ice Cream (Vic.) Ltd v. Todd* [1961] V.R. 485), and promises by the owner of a formula with a manufacturer (*Bonda v. Wagenmaker* (1960) 77 W.N. 363). Agreements between business competitors of the type which are examinable agreements under the Trade Practices Act 1965 (Commonwealth) have been the subject of a number of reported cases but the reported cases do not, so far as our researches have gone, include an instance of the severance of promises in such an agreement. There is however, no reason in principle why the rules as to severance should not be applied to such an agreement, and the possibility was adverted to by Esher M.R. in *Urmston v. Whitelegg* ((1891) 55 J.P. 453 at p. 454). The possibility of severance of promises in restraint of trade in an agreement between business competitors was again adverted to in *Kores Manufacturing Co. Ltd v. Kolok Manufacturing Co. Ltd* ([1959] Ch. 108, at p. 124), though the agreement there was not an examinable agreement within the meaning of the Trade Practices Act.

18. The result that a promise in restraint of trade too widely expressed is invalid, so as to leave a person free to disappoint the reasonable and legitimate expectations of the promisee, has been criticized in the courts. See, for example, *Mertel v. Rigney* ((1939) 56 W.N. 122, at p. 123) : *Commercial Plastic Ltd v. Vincent* ([1965] 1 Q.B. 623, at p. 647) ; *S.W. Strange Ltd v. Mann* ([1965] 1 W.L.R. 629, at p. 642) ;

Papastravou v. Gavan ([1968] 2 N.S.W.R. 286, at p. 288) : *Lyne-Pirkis v. Jones* ([1969] 1 W.I.R. 1293, at p. 1299).

19. Where the relationship is that of master and servant there may be qualifications to the rule as to severance that we have mentioned: *Mason v. Provident Clothing and Supply Co. Ltd* ([1913] A.C. 724, at p. 745) ; cf. *Marquett v. Walsh* ((1929) 29 S.R. 298, at pp. 309 - 314) : *Ronbar Enterprises Ltd. v. Green* ([1954] 1 W.L.R. 815 at pp. 820, 821). However, the qualifications are ill-defined, of doubtful validity and, in the last forty years at least, appear not to have affected the result of any reported case in Australia or England. See especially *Scorer v. Seymour Jones* ([1966] 1 W.L.R. 1419).

20. The law we have discussed so far is the law of England and of those common law countries which follow English judicial precedent. In the United States of America there is a different doctrine, accepted in many of the States and preferred by text-writers of authority. We quote a passage from Corbin on Contracts, Vol. 6a (1962), paragraph 1390, pages 66-74.

“An agreement restricting competition may be perfectly reasonable as to a part of the territory included within the restriction but unreasonable as to the rest. Will the courts enforce such an agreement in part while holding the remainder invalid? It renders no service to say that the answer depends upon whether or not the contract is ‘divisible’. ‘Divisibility’ is a term that has no general and invariable definition; instead the term varies so much with the subject-matter involved and the purposes in view that its use either as an aid to decision or in the statement of results tends to befog the real issue.

“With respect to partial illegality, the real issue is whether partial enforcement is possible without injury to the public and without injustice to the parties themselves. It is believed that such enforcement is quite possible in the great majority of cases. If a seller whose business and good will do not extend beyond the city limits of Trenton promises not to open a competing business anywhere within the state of New Jersey, the restriction is much greater than is reasonable. This is a good reason for refusing to enjoin the seller from doing business in Newark; but it is not a good reason for permitting him to open up a competing store within the same block in Trenton

“In a good many cases, it was held that if the contract itself indicated no geographical line between the reasonable and the unreasonable, it was ‘indivisible’ and illegal as a whole. Thus, if a seller promised not to compete anywhere in England the whole was void, but if he had promised not to compete in London or elsewhere in England, partial enforcement was possible in case the business had extended throughout London. [A footnote here refers to *Mallan v. May* ((1843) 11 M. & W. 653; 152 E.R. 967), *Price v. Green* ((1847) 16 M. & W. 346; 153 E.R. 1222). *Putsman v. Taylor* ([1927] 1 K.B. 637), *Chestman v. Nainby* ((1727) 2 Ld.Raym. 1456, 93 E.R. 819; 1 Bro. Parl. Cas. 234).]

“The rule that is applied in the line of cases following *Mallan v. May*, supra, has been colourfully described as the ‘blue pencil rule,’ sometimes with approval and sometimes to discredit it. By this rule, the divisibility of a promise in excessive restraint of trade is determined by purely mechanical means: if the promise is so worded that the excessive restraint can be eliminated by crossing out a few of the words with a ‘blue pencil,’ while at the same time the remaining words constitute a complete and valid contract, the contract as thus ‘blue pencilled’ will be enforced. By some occult process, the courts adopting this rule convinced themselves that partial enforcement without the aid of a ‘blue pencil’ would be ‘making a new contract for the parties’ while partial enforcement in the wake of a ‘blue pencil’ is not.

“In very many cases the courts have held the whole contract to be illegal and void where the restraint imposed was in excess of what was reasonable and the terms of the agreement indicated no line of division that could be marked with a ‘blue pencil.’ In the best considered modern cases, however, the court has decreed enforcement as against a defendant whose breach has occurred within an area in which restriction would clearly be reasonable, even though the terms of the agreement imposed a large and unreasonable restraint. Thus, the

seller of a purely local business who promised not to open a competing store anywhere in America has been prevented by injunction from running such a store within the same block as the one that he sold. In some cases it may be difficult to determine what is the exact limiting boundary of reasonable restriction; but often such a determination is not necessary. The question usually is whether a restriction against what the defendant has in fact done or is threatening would be a reasonable and valid restriction. The plaintiff should always be permitted to show the actual extent of the good will that is involved and that the defendant has committed a breach within that extent. If a restriction otherwise reasonable has no time limit, it is quite possible for the court to grant injunctive relief for a specific and reasonable time...

“What has been said above with respect to ‘divisibility’ of territory included within the restriction is equally applicable where the restriction is excessive in matters other than extent of time or space. Thus, when a baker sells his business and goodwill to a large department store and promises not to compete in any way with the business carried on by the buyer, the restraint is excessive and illegal. But the fact that in the restraining promise no division is suggested between the bakery business and the many other departments run by the buyer, such as furniture, dress goods, or hardware, does not prevent a court from making such a division. The living facts make as clean a division between bread and furniture as do the two words themselves: and the court should enforce the baker’s promise not to compete in the bakery line so far as the business sold by him had established customers and good will, while refusing to enforce his promise not to compete in furniture and hardware. The contract would be enforceable in part if it had named all the departments separately or had said ‘bakery and other departments’ although it is clear that this in no way affects the character of the illegality or the extent of harm to the public.”

21. We regard as unsatisfactory the present law of New South Wales concerning the enforcement of a promise in restraint of trade which is in part offensive to public policy. We propose that legislation should be enacted to the effect that a promise in restraint of trade should be valid to the extent, in point of time, place, nature of restraint and otherwise, to which it is not against public policy, but only to that extent, whether the promise is in severable terms or not. Our proposal is that the Conveyancing Act, 1919, be amended by inserting a new Division 5 in Part VI of that Act. The new Division to contain a single section 89a, in the terms appearing in the appendix to this report.

22. Subsection (1) of the proposed new section 89a embodies the principle of our recommendation. Where a question arises as to the validity of a promise in restraint of trade, it will be held valid so far as it is not against public policy, but so far only. Just as public policy is concerned with substance and not with form, the extent of the validity of the promise will depend on the substance of the promise and not on its form. This is emphasised by the closing words “whether the promise is in severable terms or not”.

23. The proposed new section will not result in the parties to a promise in restraint of trade being freed from the need to work out for themselves the restraint which they intend. The court will not enforce a promise in restraint of trade if the promise is so indefinite that the parties would be “asking the law to do for them what they have not made up their minds about themselves.” (*Davies v. Davies* (1887) 36 Ch. D. 359, Bowen L.J. at p.392). In such a case the promise is unenforceable, not because it contravenes public policy, but because that the language used is so obscure “that the court is unable to attribute to the parties any particular contractual intention.” (Lord Wright in *Scammell and Nephew Ltd. v. Ouston* [1941] A.C. 251 at p. 268). There is nothing special in this regard about promises in restraint of trade. Any promise may be void for uncertainty. An illustration of a promise in restraint of trade which is void for uncertainty is the covenant considered in *Davies v. Davies*. The covenant was that the promisor would not engage in a specified business “as far as the law allows”. Of this covenant Bowen L.J. said “You cannot get a measure out of it at all, and whatever reason says about it you remain still in want of the definition which is necessary to make the covenant a restricted one. The most obvious proof of the truth of that proposition is to recall to one’s mind this, that, supposing the law will allow certain restrictions, there may be twenty different restrictions, all of which may serve the purpose of the parties; all of which the law would allow. How are we to know which of those particular restrictions the parties intended to impose? They leave it absolutely uncertain and for the best of reasons, because they have not made up their own minds.” (at pp.392, 393). There is another illustration in *Peters Ice Cream (Vic) Ltd. v. Todd* ([1961] V.R. 485).

24. The proposed new section expressly provides that it “does not affect any question concerning the validity of a promise in restraint of trade, other than questions arising on grounds of public policy.” This provision should make it clear that the section would not validate, in whole or in part, a promise which is void for uncertainty.

25. As our proposals do not involve any validation of a promise which is void for uncertainty, it follows that, in applying the proposed new section 89a, a court would know the limits of restraint as to duration, area, and activity which the parties contemplated. Where, the relevant limits to the restraint as promised: it would know what the promisor has done or intends to do is in breach of his promise: and it would know the interest which the promisee is entitled to protect within the limits of public policy. The remaining question would be whether the act of the promisor interferes with this interest of the plaintiff. A determination by the court of this question would not involve any speculation by the court as to what parties intended. We are fortified in this view by the development of the common law in the United States, to which we have referred in paragraph 20 of this report.

26. Our proposal would not require the court to re-write a promise in restraint of trade. Although we are not aware of any directly comparable legislation, there is an analogy in section 37d of the Conveyancing Act, 1919. That section is concerned with trusts for purposes not entirely charitable. It confines the purposes of such a trust to charitable purposes and makes the trust valid with its purposes so confined. It operates as well where there is a single compendious statement of purposes, eg., “benevolent purposes”, as where the statement of purposes makes it own division, eg., “charitable or benevolent purposes”. See generally *Leahy v. Attorney-General* ([1959] A.C. 457).

27. Our proposal has no analogy in section 89 of the Conveyancing Act, 1919, which enables the Supreme Court to modify an easement or a restriction arising under a covenant. Section 89 is concerned with re-writing easements and restrictions; the proposed section 89a is not concerned with re-writing promises in restraint of trade.

28. Under the proposed section 89a, the remedy for breach of a promise in restraint of trade will still be damages and the remedy for a threatened breach will still be an injunction. The Supreme Court has, of course, a discretionary power to give relief by way of declaration under section 10 of the Equity Act, 1901, and it will retain this power it would be open to the Court to define by declaration the extent to which a promise in restraint of trade is enforceable. That power exists today but we are not aware of any instance of its exercise in this sort of case. We see no reason to fear that the power, together with the proposed new section 89a, would cause any difficulty,

29. Our proposal applies to any promise in restraint of trade, made in any circumstances. Thus it applies not only to a promise given on the sale of a business but also (to mention two cases which have evoked comment on our working paper) to a promise given in circumstances of oppression, as has been feared in the case of service agreements (that is, agreements between masters and servants relating to terms of services), and to a promise given as part of an examinable agreement within the meaning of the Trade Practices Act 1965. We shall say more below about each of these cases, but we shall first advert (in paragraphs 30, 31, 32) to some general matters affecting the ambit of our proposals.

30. The first general matter is that wherever a promise in restraint of trade goes to some extent beyond what is permissible within the principles of public policy, a question must arise as to whether, and to what extent, the promise is valid. If we exclude some specified categories, the result would be that, to that extent, the old rules of severance would continue. We regard those rules as productive of injustice in whatever circumstances the promise is made. It may appear to some that there are grounds for saying that a promise in restraint of trade by a servant to his master should always be invalid. Again, it may appear to some that the validity of a promise in restraint of trade which is part of an examinable agreement within the Trade Practices Act should depend on that Act alone. But such views would be concerned with the limits of permissible restraint, not with the invalidity of a promise which partly transgresses those limits. Our concern is with the latter question.

31. The second general matter is that if our proposals are subject to exclusions, or are limited, as mentioned in paragraph 30, difficult questions of characterisation are likely to occur. Thus if promises in

service agreements are excluded, borderline cases will arise where it will be difficult to say whether the agreement in question is a service agreement or not. The court would have to decide the question one way or the other, but such a decision on a point of statutory construction would be necessarily unrelated to the substantial questions of justice and public policy. This is a matter which, though not in itself conclusive, carries weight with us.

32. The third general matter is that if our proposals are thus subjected to exclusions, or are thus limited, encouragement will be given to the distortion of the true nature of relationships and to attempts so to contrive the agreement that it will fall on one side to the other of whatever line may be drawn. The well known effects in this respect of the revenue legislation and the landlord and tenant legislation lead us to avoid proposing fresh encouragement of this kind.

33. We turn to the more particular question whether our proposals should extend to a promise in restraint of trade given in circumstances of oppression, as has been feared in the case of service agreements. There is a problem here. It was adverted to by Lord Moulton in *Mason v. Provident Clothing & Supply Co. Ltd.* ([1913] A.C. 724, at pp. 745, 746). He said that it would in his opinion be the worst of examples if, when a master had exacted a covenant deliberately framed in unreasonably wide terms, the court were to come to his assistance and, by applying their ingenuity and knowledge of the law, carve out of his void covenant the maximum of what he might validly have required. He went on

“It must be remembered that the real sanction at the back of these covenants is the terror and expense of litigation, in which the servant is usually at a great disadvantage, in view of the longer purse of his master. It is sad to think that in this present case this appellant, whose employment is a comparatively humble one, should have had to go through four Courts before he could free himself from such unreasonable restraints as this covenant imposes, and the hardship imposed by the exaction of unreasonable covenants by employers would be greatly increased if they could continue the practice with the expectation that, having exposed the servant to the anxiety and expense of litigation, the Court would in the end enable them to obtain everything which they could have obtained by acting reasonably. It is evident that those who drafted this covenant aimed at making it a penal rather than a protective covenant, and that they hoped by means of it to paralyse the earning capabilities of the man if and when he left their services, and were not thinking of what would be a reasonable protection to their business, and having so acted they must take the consequences.”

34. Similar thoughts have promoted comments made to us that this is increasingly the day of the big corporation much more able to take advantage of the law than its employee” and that “it might not be unreasonable to expect a corporation to accept the discipline of being right the first time in any restriction it imposed on its employee, instead of encouraging restrictions widely case with the expectation that the courts would write them back to whatever was a permissible maximum”.

35. It is as well to deal with some points arising on the above comments.

36. First, whatever may be said of “a covenant deliberately framed in unreasonably wide terms” what of the cases where the master has acted with all that could be asked in the way of honesty, fairness and reasonableness? There are pitfalls for the draftsman of a promise in restraint of trade no matter how honest, fair and reasonable he be. It would not be a defensible mode of reasoning to take the proposition that some masters behave badly to their servants and to conclude from that proposition that any master who makes a slip in the wording of a service agreement should be at risk of disclosure of his trade secrets, his lists of customers and so on. We shall come later (paragraph 41 to 45 below) to the question whether the law should give some special significance to the conduct and intentions of the promisee at and before the time when a promise in restraint of trade is given. It is enough to say here that we do not favour a special provision for, and confined to, a promise by a servant to his master.

37. Secondly, it is not part of our proposals that a court should, to echo some of Lord Moulton’s words in *Mason’s* case, be required to carve out of an over-extensive promise in restraint of trade the maximum of what might validly have been required. See paragraphs 25, 26, 27, and 28 above.

38. Thirdly, there is the point that a corporate employer ought to accept the discipline of being right the first time in any restriction it imposed on its employee. But the master, corporate or unincorporate, whose goes to the trouble, and can afford the expenses, of having his services agreements settled by a competent lawyer need fear little difficulty with the rules about severability. Our proposals will extend only marginally (see paragraph 16 above) what can now be achieved by detailed prolixity of expression.

39. Fourthly, the advantage in litigation which is enjoyed by a master because of his longer purse is no longer as real as it was in 1913 when Mason's case was decided. The relatively poorly paid servant, with a short purse, will qualify for legal assistance under the Legal Assistance Act, 1943 or under the more liberal provisions of the Legal Practitioners (Legal Aid) Act, 1970.

40. Fifthly, notwithstanding the forceful language of Lord Moulton, we find it difficult to envisage the motives which would induce a master to hope that he could paralyse the earning capabilities of his former servant. Each of us has come across a fair number of restraint of trade cases in the course of his professional work, and we have considered a large number of reports of such cases in our work on this reference. We have found that commonly enough a promise is so wide as to offend public policy, but it has always, in our experience, been calculated to give some business advantage to the promisee, never to inflict gratuitous harm on the promisor.

41. But, when all this has been said, there is still a problem. The public policy with which we are concerned confines the extent to which a man's liberty to trade may be restricted by contract. It is possible that, for the reasons mentioned by Lord Moulton, a promise in restraint of trade will in fact lead the promisor to restrict his trade to an extent greater than that to which the promise is enforceable in law. It may be thought that where the promisee intends the promise to operate in this way, intends, that is to say, to flout the rules of public policy, the law should refuse to lend him its aid. This idea is one which requires careful consideration. There are substantial arguments against implementation of it.

42. One argument is that the purpose of such a provision would be merely punitive. Its effect would be to deny to the promisee a protection otherwise inoffensive to public policy. The consequences to the promisee of this denial may be trifling or disastrous or anything in between. The gravity of these consequences would be unrelated to the seriousness of the conduct of the promisee. The infliction of punishment in this way has no place in a civilised system of law. Indeed, it is a well established principle that the basis for imposing limits upon what is permissible in restraint of trade is that such limits are required by public policy: it is not that there is anything criminal in exceeding the limits. Public policy, it may be argued, must be satisfied if the validity of a promise in restraint of trade is confined to the extent to which it does not exceed any limit which public policy requires. Finally, it may be argued that adoption of the idea would produce difficult questions in border-line cases and thus aggravate the troubles of litigation in a field which is already troublesome enough.

43. We have come to the conclusion that these arguments should yield to the concept that if the promisee violates the rules of public policy a court should not find itself in the position that, no matter how flagrant the violation, it is compelled by statute to come to his aid. The court should have, we think a discretion to withhold its aid. Such a discretion would not be by any means unique. Courts of equity, for example, do not aid a plaintiff who does not have "clean hands", even though he has not committed any crime. Public policy does require, in our view, that a promise in restraint of trade be at least a real attempt by the parties to provide a restraint which is reasonable as between the promisor and the promisee. Unless it is such an attempt, the promise affords neither guidance to the promisor as to what restraint the parties intended. However, in the formulation of any sanction for public policy in this regard all the matters referred to in paragraph 42, and not merely public policy, must be taken into consideration.

44. We do not consider that a flagrant violation of public policy should necessarily disentitle the promisee to any relief. The gravity of the harm which the promisee would suffer by a refusal of relief may be out of proportion to the gravity of the violation of public policy. Again, although the promisee has violated public policy, the promisor may be behaving outrageously. Consider these supposed facts. The promisor willingly gives a promise in restraint of trade which manifestly is absurdly wide. He does so knowing that the promise cannot be enforced according to its terms. Forthwith after completion of the sale the promisor opens a rival business next door and solicits his old customers. Should he not be

restraint, even though the promise was not a real attempt to provide a restraint which was reasonable as between the promisor and the promisee? Our proposal, therefore, is not that the court be required to withhold relief: it is merely that it be empowered to withhold relief or to restrict the relief which it grants. Indeed, we envisage that a case in which relief is refused will be quite exceptional, just as it is rare for relief in equity to be refused because the plaintiff's hands are not "clean". But the power to refuse or restrict relief should be given. If this is done, we consider that as a matter of prudence the draftsman of a promise in restraint of trade will appreciate that it would be dangerous not to apply his mind to what would be a restraint within the bounds of reason and will attempt, therefore, to provide a restraint which is within these bounds. If this is the result, the sanction will fulfil its purpose. The sanction is expressed to be applicable only where there is a manifest failure to attempt to make a promise which is reasonable as between the parties (s. 89a (3)) We do not consider that it is desirable to impose upon the promisee the burden of attempting to assess the reasonableness of a restraint from the point of view of public interest. It is easy enough, we think, to determine whether a promise disregards anything that could be considered reasonable as between the parties. It is not so easy to determine a like question as to public interest, at least in so far as public interest requires more than reasonableness between the parties. We do not consider that where an attempt has been made to provide by the promise a restraint which is reasonable between the parties, there should be any possibility of the promisee being at risk of having a court refuse its aid because some wider aspect of public policy has been infringed. The concept of reasonableness between the parties is central to the purpose of the sanction. It is well settled that where persons of comparable bargaining power and at arms length have negotiated a promise in restraint of trade, a court will not readily conclude that the promise was unreasonable as between them. The promisor is usually in better position than the court to know what is his own interests. But the attitude of a court is quite different where there has been a marked inequality of bargaining power, or a relatively small consideration for the promise, or the imposition by the promisee of his standard form of promise and hence no room for negotiation in respect of it. The approach of the court is a realistic one. The court is far more ready to conclude, in such circumstances, that the promise was not reasonable. We think that the judicial approach ought not be altered in this regard by our proposals, with the result that, in practice, the sanction will bite only in cases where there is a real risk of oppression.

45. We must deal with the relationship, as we see it, between our proposals and the Trade Practices Act. The first thing is to summarise the relevant provisions of the Act. The summary does not set out to be exhaustive. The provisions which we need to consider are those concerning "examinable agreement", that is, restrictive agreements (enforceable or unenforceable: s. 91 (5)) amongst competitors in a business of the supply of goods or services (s. 35). In determining whether an agreement for the sale of a business is an examinable agreement, regard is not to be had to any provision solely for the protection of the purchaser in respect of the goodwill of the business (s. 38 (e)). Where the Commissioner is of opinion that a relevant restriction under an examinable agreement is contrary to the public interest he may institute proceedings in the Tribunal in respect of the restriction (s. 47 (1)). The Tribunal must determine whether the restriction is contrary to the Public interest (s. 49 (1) (b)). Section 50 deals with the concept of public interest: these are the relevant terms of s. 50 (1) , (2)-

"50. -(1.) In considering whether any restriction... is contrary to the public interest, the Tribunal shall take as the basis of its consideration the principle that the preservation and encouragement of competition are desirable in the public interest, but shall weigh against the detriment constituted by any proved restriction of, or tendency to restrict, competition any effect of the restriction.... as regards any of the matters referred to in the next succeeding subsection if that effect tends to established that, on balance, the restriction..... is not contrary to the public interest.

(2.) The matters that are to be taken into account in accordance with the last preceding subsection are-

- (a) the need and interests of consumers, employees, producers, distributors, importers, exporters, proprietors and investors;
- (b) the need and interests of small businesses;
- (c) the promotion of new enterprises;
- (d) the need to achieve the full and efficient use and distribution of labour, capital, materials, industrial capacity, industrial know-how and other resources;

- (e) the need to achieve the production, provision, treatment and distribution, by efficient and economical means, of goods and services of such quality, quantity and price as will best meet the requirements of domestic and overseas market; and
- (f) the ability of Australia producers and exporters to compete in overseas markets.”

Where the Tribunal determines that a restriction under an examinable agreement is contrary to the public interest, the agreement (if in force) becomes unenforceable as regards observance of the restriction on and after the date of the determination (s. 51 (1)) and the Tribunal is empowered to make order restraining the parties from giving effect to the restriction and other consequential orders (s. 52).

46. It has been put to us that legislation along the lines proposed in the working paper could encourage a climate favourable to restriction rather than competition, particularly if “public policy” were to be considered in common law terms, with the emphasis of the common law on reasonableness as between the parties and the lack of emphasis, as it is put, on wider public interest issues. Our proposals are said to involve that the courts would be able to make restrictive agreements as enforceable as possible. The prospect is seen that businessmen who became aware of the amendment might well think it ran in a direction opposite to that of the Trade Practices Act and encouraged the type of restriction which that Act calls in question.

47. Our proposals, however, do not involve that any conduct will be open to restraint by agreement which is not open to such restraint under the law as it is today. We are concerned with a different purpose, namely, to see that, so far as consistent with the public policy against undue restraint of trade, the law should give effect to the reasonable expectations of the parties to a contract rather than let legitimate interests be imperilled by inartificialities of expression.

48. Nor do we see that our proposals run in a direction opposite to that of the Trade Practices Act. That Act embraces unenforceable restrictive agreements as well as enforceable ones and, it need hardly be said, attaches no significance to the tests under the ordinary law by which a promise in restraint of trade may be enforceable in part. It is no doubt true that there are differences between the common law rules of public policy in the case of restraints of trade and the statutory concept of the public interest in the Trade Practices Act, but those differences are differences between the Act and the law as developed in the courts and would not be affected in any way by our proposals.

49. Further, we do not think that it would be a right inference that the legislation which we propose would encourage the type of restriction which the Trade Practices Act calls in question. We say that the lawful interests of contracting parties should not be imperilled by inartificiality of expression: we say nothing about what those lawful interests ought to be. Of course, our proposals are not designed to produce the result that a restriction unenforceable by reason of the Trade Practices Act could yet be enforceable in the courts of New South Wales.

50. It has been put to us also that difficulties might arise in the situation where a person sues successfully in one of the ordinary courts to enforce a promise in restraint of trade, and the agreement containing the promise subsequently becomes the subject of action under the Trade Practices Act. This situation is one which may be encountered under the law as it is today. We refer again to the fact that the enforceability or unenforceability under the general law of a restriction in an examinable agreement is expressly made irrelevant for the purposes of the Trade Practices Act. If a business man or other person thought that a decision on public policy under the general law concluded the question of public interest under the Trade Practices Act, he would simply be mistaken. Again, we do not see that our proposal has any bearing on these apprehended difficulties.

51. The appendix to this report embodies our proposal in the form of an amendment to the Conveyancing Act, 1919, by the insertion of a new Division 5 of Part VI of that Act, in the terms appearing in the Appendix to this report. We think that the Conveyancing Act is an appropriate Act because, by its long title, it is, amongst other things, an Act “to simplify and improve the practice of conveyancing” and because the drafting of promises in restraint of trade is part of the practice of conveyancing. We think that Part VI of that is the appropriate place in the Act because that Part is headed “Covenants and Power”, and “covenants” is used in a sense which includes promises by simple contract (see for example section 72).

52. The view has been put to us that restrictive covenants of the kind which may run with land are not subject to the limitations of public policy applied to promises in restraint of trade and that to place our proposed legislation immediately after section 89 of the Conveyancing Act may be to create an embarrassing juxtaposition, that, in particular, it may lead to our proposed section 89a being given a restricted interpretation. As to the first proposition, while it seems to us that ordinary restrictive covenants given on the occasion of a sale or other disposition of land are unlikely to be affected by these limitations of public policy, we do not think that the authorities establish the proposition, at least as to restrictive covenants which are not ordinary or are not given on such an occasion. The question is discussed with divergent result in *Esso Petroleum Co. Ltd v. Harper's Garage (Stourport) Ltd* ([1968] A.C. 269). We do not see that the juxtaposition is likely to lead to difficulty, and we think that any possibility will be disposed of by putting our proposed section 89a in a separate Division of Part VI of the Act.

53. We conclude by noting some points relating to the effect which we intend that our proposals would have.

54. First, subsection (1) of the proposed section 89a speaks simply of "public policy", without express mention of matters of reasonableness in the interests of the public. Some of those who have given us their comments have felt that the effect of using the bare words "public policy" may be that there will be but one test—is the restraint reasonable in the interests of the public? They fear that the section as drawn should be so construed. The customary inquiry into two aspects of reasonableness, reasonableness in reference to the interest of the parties and reasonableness in the interests of the public, is the inquiry appropriate to the doctrine of public policy as formulated by Lord MacNaghten in the *Nordenfelt case*. In this field of the law, for those who follow that formula, a determination of the effect of public policy calls for an inquiry into those two aspects of reasonableness. But there have been other formulations of the doctrine since Lord MacNaghten's day (see paragraph 6 above) and no doubt there will be new formulations in the future. We think it would be mischievous to elaborate by statute what is involved in the doctrine of public policy. For one thing, so far as the statutory formulation might turn out to be narrower than the case-law formulation, the present rules of severance would have room to operate: that would be an unfortunate result. It is true that, as has been pointed out to us, the reasons for judgement in some cases refer to questions of reasonableness in one way or another but do not expressly speak of public policy: *Papastravou v. Gavan* ([1968] 2 N.S.W.R. 286) is an example. But that is only because the occasion for applying these tests of reasonableness is so well understood as being based on grounds of public policy that it is unnecessary to say so expressly. We think that the only safe course is to speak in general terms of "public policy": that will enable, and require, the application of whatever tests are appropriate to the formulations from time to time of the rules of public policy in this field of the law.

55. Subsection (2) of the proposed section 89 a is intended to leave room for the invalidity effect of other circumstances, such as uncertainty, mistake, fraud and absence of consideration.

56. Subsection (4) calls for explanation. Public policy has many manifestations in the law of contract. In the absence of subsection (4) it might be argued that a promise in restraint of trade which is not against public policy as far as concerns restraint of trade is valid notwithstanding that it is against public policy in some other respect. The point may be illustrated by reference to *Neville v. Dominion of Canada News Co. Ltd* ([1915] 3 K.B. 556).

There was an agreement by a newspaper company to abstain from comment on a land selling company. The newspaper company held itself out as giving honest advice to intending buyers of land. The agreement was held to be in restraint of trade and to be against policy in that respect, but it was also against public policy inasmuch as it was not consistent with the proper conduct of the newspaper in the public interest. Suppose a somewhat similar case in which the agreement was not wholly against public policy as regards restraint of trade, but was wholly against public policy on the second ground. We would not wish the proposed section to validate the agreement. Hence subsection (4).

29th June, 1970.

R. D. CONACHER, Deputy Chairman.

R.G. REYNOLDS, Chairman.

REPORT 9 (1970) - COVENANTS IN RESTRAINT OF TRADE

Appendix

Division 5A - *Restraint of trade.*

89a. **(1)** A promise in restraint of trade shall be valid to the extent, in point of time, place, nature of restraint and otherwise, to which it is not against public policy, but only to that extent, whether the promise is in severable terms or not.

(2) Subsection one of this section does not affect any question concerning that validity of a promise in restraint of trade, other than questions arising on grounds of public policy.

(3) Where-

- (a) a promise in restraint of trade is made to any person;
- (b) he or a person through whom he claim brings proceedings in any court for relief in respect of the promise, whether the relief is-
 - (i) by way of damages for breach of the promise;
 - (ii) by way of injunction to restrain breach of the promise;
 - (iii) by way of declaration concerning the validity of the promise to any extent; or
 - (iv) otherwise;
- (c) the promise is to any extent against public policy; and
- (d) it appears to the court that the promise is thus against public policy by reason of, or partly by reasons of, a manifest failure to attempt to make a promise which is reasonable as between the parties, the court may, on such terms if any as it thinks fit-
- (e) refuse to grant that relief: or
- (f) grant that relief as if this subsection had not been enacted, but with such limitations and restrictions if any as the court thinks fit.

(4) References in this section to public policy references to public policy in respect of restraint of trade.

(5) This section applies only to a promise in restraint of trade made after the commencement of the Conveyancing (Amendment) Act, 1970.

(6) This section applies notwithstanding any stipulation to the contrary.

(7) This section does not affect the operation of-

- (a) section three of the Trade Union Act 1881 ;
- (b) Part Two of the Monopolies Act, 1923 ;
- (c) section seventy-seven of the Co-operation, Community Settlement, and Credit Act, 1923; or
- (d) any other enactment concerning the validity of a promise in restraint of trade.