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Going Beyond Accounting, Taking Business Forward

Restraints of Trade – from a Business Perspective

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Restraint or trade and non-solicitation clauses are most commonly found in employment contracts, business partnership and franchise agreements and will contain restraints of trade where the employer, partners or franchisor sets out certain work restrictions which will come into effect in the event of the employee, business partner or franchisee leaving its employment or the business.

When Should a Business Require a Restraint of Trade to be Signed?

A business or employer will normally require a restraint of trade to be signed in instances where it's likely that an employee or franchisee will gain first-hand knowledge of a range of key information such as trade secrets, confidential company information, client connections, supplier connections, pricing, marketing strategy and more, collectively known as "protectable interests", and where the employer or franchisor seeks to protect these interests that are not in the public domain and which is commercially useful, in other words, capable of application in other or similar trade or industry, has economic value to the person seeking to protect it, and or be known only to a restricted number of people.

Often an employee, business partner or franchisee may also have built up relationships with clients or customers and this could understandably prove disastrous to the company and its current employees if that employee leaves, taking these clients or customers with him or her.

Therefore, a business who has an interest deserving of protection should consider a non-solicitation or restraint of trade agreement where employees or franchisees have close working relationships with customers or clients to such an extent that there is a danger of them taking them with when they leave the business with the potential of harming the business's interests.

Protectable Interests

If you can demonstrate that your business has "confidential company information" or a "protectable interest" that could be threatened or prejudiced if an employee or franchisee leaves the business, it is highly advisable that you engage a commercial attorney expert to draw up a well-considered, well-constructed and precise restraint of trade or non-solicitation clause for those particular employees. Surprisingly, some employers try to apply generic restraints of trade to their entire workforce in the hope that the courts will hold employees to their contracts.

A protectable interest is "an advantage possessed by an employer or franchisor, the use of which by the employee or franchisee after the end of the employment or business relationship, would make it unfair to allow the employee or franchisee to compete with the former employer or franchisor."

Examples of "protectable interests" are intellectual property, trade secrets, goodwill and client, customer and supplier connections acquired by an employee through employment or a franchisee in a franchised business. Identifying protectable interest in a business is entirely dependent on the type of industry or business model of the employer or franchisor.

What is a Non-Solicitation Agreement?

A non-solicitation agreement is a narrower form of a restraint of trade agreement which precludes an employee or franchisee from soliciting business from company customers or clients for a certain period of time after the employee or franchisee goes to work for himself or another company.

Can restraint of trade and non-solicitation agreements be enforced?

Despite the common belief to the contrary, case law in South Africa shows that restraints of trade are most definitely legally enforceable. It is held that, in the public interest, parties should comply with their contractual obligations, the common-law principle that "agreements must be honoured", together with the constitutional value that all persons should be productive and permitted to engage in trade and commerce. No hard and fast rules apply, and provided that the limitations that the restraints impose are reasonable, the answer needs to be considered on a case-to-case basis.

What law governs restraint of trade and non-solicitation agreements?

It is important from the outset to note that restraint of trade agreements are not regulated by Labour Law. They are regulated by the Law of Contract. This means that should a dispute arise, it cannot be referred to the CCMA, but has to follow the civil court process which can be lengthy and very expensive for both parties concerned.

Interests of the Individual versus the Interests of the Company

Is it reasonable for businesses to present a restraint of trade clause in their employee, partnership or franchise contracts and have it signed before the business is willing to place the person? In certain cases, it has been established that the courts do not require a restraint of trade to be signed for it to be enforceable.

In assessing the nature of a restraint to determine whether it is reasonable and enforceable or not, one must weigh up what the restraint of trade seeks to protect against and what it seeks to prevent. A restraint of trade will be void and unenforceable if its sole purpose is to prevent competition. An employee is entitled to take his skill away with him even if he acquired it through Company training. He is also free to earn a living in his chosen occupation.

On the other hand the company or party seeking to enforce a restraint must have a protectable interest. The Supreme Court cases provide the courts with precedents to follow. In this regard four questions that should be asked when considering the reasonableness of a restraint:

1. Does one party have an interest that deserves to be protected after the employment contract or franchise agreement has ended? If so, is that interest threatened by the other party?
2. In that case, does such an interest weigh against the interests of the other party?
3. Is there an aspect of public policy (principles embodied in the constitution, the law and judicial decisions) apart from the relationship between the parties that requires that the restraint be maintained or rejected?
4. In light of section 36(1) of the constitution, does the restraint go further than necessary to protect the interest?

Recent Judgement Where a Former Employee Starts a Business in Competition with the Employer

ENSAfrica, South Africa's largest law firm, and Personal Finance published yet another recent case handed down by the Northern Cape High Court which illustrates how a restraint-of-trade could prevent an employee or franchisee from exploiting a business opportunity that would threaten the legally recognised interest of the employer or franchise.

"Pierre Jean and Margaret Duraan managed the Kimberley branch of Freepak, which sells packaging material to wholesale and retail customers in the Northern Cape, Free State and Gauteng. The Duraans were "the face of the business" for 16 and 15 years respectively.

Mr and Mrs Duraan were subject to restraint of trade obligations, in terms of their respective contracts of employment with Freepak. The terms of the restraint of trade inter alia provided that for a period of five years after the termination of employment for whatever reason, he/she could not be involved in any other business which sells similar products as Freepak. The terms of the restraint were silent in respect of a specific geographical area within which the restraint would operate.

During February 2013, Mr Duraan was subjected to a disciplinary enquiry and summarily dismissed. Mrs Duraan thereafter tendered her immediate resignation. The Duraans then set out to open a business which sells packaging material in competition with Freepak, their previous employer. Freepak, accordingly, brought an application to the High Court to enforce the restraint-of-trade clause.

Freepak sought to protect its customer connections on the basis that the Duraans had virtually exclusive and personal contact with its clients in the Northern Cape, were in possession of its clients' cellphone numbers, and their relationship with clients was such that clients would regularly call one of the Duraans directly to place orders, discuss their business needs and negotiate pricing. It was common cause that they were both instrumental in building the business of Freepak from a struggling concern to a huge enterprise.

The Duraans argued that the restraint was invalid and unenforceable, because it was too broad and would prevent them from participating in the only economic activity in which they had any experience. They also said it would be unreasonable to enforce the restraint in circumstances where Freepak had dismissed Mr Duraan, which led to the resignation of Mrs Duraan.

The Duraan's did not dispute that they had client contact details, but argued that this was not indicative of a customer connection, and that a distinction should be drawn between possession of the list of clients and customer connections.

The Duraans argued that they largely acquired knowledge of the business as a result of their own drive, personality and initiative, which, they contended, constituted skills, general knowledge and experience that they could not be restrained from utilising.

Turning to the possibility of a protectable proprietary interest in the form of customer connections, the court found that the Duraans did have a customer connection with Freepak's clients. The court accordingly found that the risk of harm to Freepak's customer connections could not be discounted in circumstances where the Duraans had been the "face" of Freepak's Kimberley branch for more than a decade and had almost exclusive dealings with its clients throughout the Northern Cape.

The court dismissed the contention that it would be unreasonable to enforce the restraint, because Mr Duraan had been dismissed by Freepak. It was clear from the terms of the restraint that it would be triggered after any form of termination of employment.

The court therefore enforced the restraint against the Duraans, restraining each of them for two years from the date of termination of their employment from being involved in any other business selling similar products as Freepak in the Northern Cape".

Unfortunately, it is often the clients who lose out by not being able to pursue a relationship which they were happy with. The reality is that business relationships are never permanent and can be terminated for many other reasons. Nevertheless, one must not lose sight of the fact that restraint of trade agreements remain a valuable mechanism utilised by employers, business partners and franchisors to protect genuine business interests and the stability of jobs.

Next time in the BAN Bulletin, our alliance partners Robyn Hey Attorneys Inc. will share the legal perspective of restraints of trade.

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