



ABETZ CURTIS  
LAWYERS

DISCUSSION PAPER

# RESTRAINT OF TRADE CLAUSES

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## 1. INTRODUCTION

- 1.1. Restraint of trade clauses in commercial contracts are very useful tools in certain circumstances, but their use needs to be considered carefully due to the predilection of the Courts to read them down or strike them out.
- 1.2. This paper is intended to give a brief overview of restraint of trade clauses and when they can be successfully used.

## 2. WHAT IS RESTRAINT OF TRADE?

- 2.1. Restraint of trade clauses seek to restrict the freedom of an individual or a company to engage in a particular form of business or commercial activity. Common examples include:
  - (a) sale of business agreements where the vendor is restrained from competing with the business being sold; and
  - (b) employment arrangements where an employee is restrained from engaging in other paid work whilst he is employed by, or ceases to work for, a particular entity.
- 2.2. The underlying purpose of a restraint of trade clause is to protect a party's business from competition. They operate by restricting or interfering with a party's liberty of action and the freedom to earn a living. It also goes against the general public interest of freedom of competition and trade.

## 3. THE LAW

- 3.1. Because of the oppressive nature of restraint of trade clauses, the common law provides that all restraint of trade clauses are presumed void and unenforceable, unless the clause:
  - (a) is reasonable in the interests of the parties; and
  - (b) is reasonable in the interests of the public.
- 3.2. The Courts will look at a wide variety of factors when determining whether a restraint of trade clause is "*reasonable*", which may vary depending on the factual setting in each case. However some key considerations are:



- (a) The period of the restraint of trade clause (i.e. one year compared to five years);
  - (b) The geographical limit of the restraint of trade clause (i.e. Hobart CBD compared to the State of Tasmania); and
  - (c) The extent of the restraint of trade clause (i.e. what breadth of activities it prevents a person from engaging in).
- 3.3. This common law position has been altered in some aspects by the introduction of the *Competition and Consumer Act 2010* (Cth) ('Act'). Section 45 of the Act generally prohibits a corporation from entering into agreements that contain provisions which have the purpose or effect of substantially lessening competition.
- 3.4. A restraint of trade clause would *prima facie* appear to breach that prohibition, however s. 4M of the Act preserves the common law doctrine where it is inconsistent with the Act, and more importantly, s. 51(2) of the Act sets out certain exceptions to the prohibition which include: employment agreements; sale of business; and partnership agreements.

#### 4. HOW TO USE RESTRAINT OF TRADE?

- 4.1. Therefore restraint of trade clauses can still be used in certain circumstances, such as sale of business agreements (which includes sale of goodwill) or particular employment arrangements, provided that the clause is sufficiently limited in scope so that it is considered "*reasonable*" with regard to the specific factual setting of the agreement.
- 4.2. In situations where there is a risk that a court may find a restraint of trade clause unreasonable and therefore void, cascading restraint of trade clauses are a useful drafting tool to avoid that risk.

For further information on how a cascading restraint of trade clause can assist your specific situation, please contact either Aaron Hindmarsh or Joe Brown.

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