

RESTRAINTS

Can your employer stop you
starting your own business?



Thinking of starting your own business?

It has never been easier to throw off the shackles of employment and try your hand at business ownership.

In fact, so many people have taken the plunge recently that it has become known as “The Great Resignation” – a global trend that does not appear to be slowing.

New technologies, the rise of alternative work arrangements (such as co-working and work from home), as well as a greater emphasis on the work life balance post pandemic has inspired an entrepreneurial generation.

If you are considering business ownership as the next stage in your career, the prospect of telling your boss can be daunting.

If your new business is substantially the same or similar to that of your employer, this comes with added uncertainty:

“will your employer try to stop you from living your dreams, and will they be successful if they tried?”

This short guide will help you navigate the uncertainty, so that you can devote your time to what is really important: building your new business and seeing it thrive.



The Employment Contract



The primary source of your obligations to an employer is your employment contract – that document you signed all those years ago but can barely remember reading.

Other than setting out your salary and leave entitlements, employment contracts often contain a wide range of clauses that may govern what you can and cannot do after your employment ends. These provisions may relate to your use of company

property, treatment of confidential information and how intellectual property rights are dealt with. A subset of such post-employment obligations are “restraint of trade” clauses – or simply **restraints**.

Restraint of Trade

Restraints are a set of terms and conditions which aim to restrict you from competing with your employer in some way, shape or form.

There are different types of restraints, often used separately or in combination with one another, and these include restrictions on:

- (a) working or being involved in a competing business;
- (b) taking customers/clients away from your employer; and
- (c) poaching staff away from your employer.

If your employment contract includes such a restraint (and there is a good chance that it does), there is no need to panic – it does not mean that your dream of starting a business is automatically dashed.

Are restraint clauses enforceable?

The first thing to keep in mind when considering restraints is that the law starts off with the presumption that they are unenforceable as a matter of policy. This long-standing presumption is based on the premise that every person has the right to work and earn a living. Restraints, by their very nature, impose a restriction on that right and should therefore not be enforced.

However, the rights of employees need to be balanced against the rights of an employer. The law recognises that serious harm can be done to a business if an employee walks away and takes customers, employees and trade secrets with them.

The courts have been balancing these competing interests for many years, and the end result is the following general proposition:

Restraint clauses are unenforceable, except to the extent that they:

- (a) protect a legitimate business interest; and*
- (b) are reasonable and go no further than is necessary to protect that interest.*

As far as legal principles go, the general position on restraints is not overly complex. Put simply, a court will consider each restraint on a case-by-case basis and determine whether it is reasonable in the specific circumstances before it. The more reasonable the restraint, the greater the likelihood that it would be upheld.

Applying the law to practice

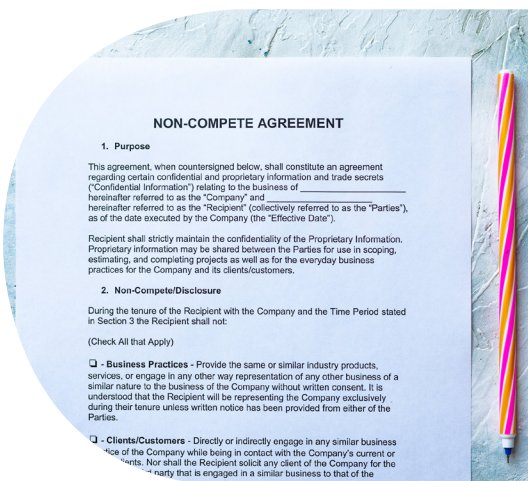
In analysing your own restraint, the first step is to identify what conduct is your employer seeking to prevent. A restraint that involves a blanket ban on working in a competing business will be interpreted very differently to a ban on poaching staff and customers.

Non-compete restraints

These types of restraints are intended to prevent you from starting up (or working in) a competing business to that of your employer. Due to the blanket restriction on working within a specific field or industry, they can be hard to enforce.

The first step in considering whether a non-compete restraint will be enforceable is to determine whether the employer has a legitimate business interest to protect.

- Senior employees and executives are likely to have detailed knowledge of the financial position and strategic goals of an organisation, so an employer would have legitimate grounds to try and stop them from taking that knowledge elsewhere.
- Non-executive employees on the other hand may not have access to this level of knowledge within an organisation, and it can be argued that an employer's rights against such employees are adequately protected by the confidentiality provisions of an employment contract without requiring the added protection of a non-compete restraint.



Even when there is a genuine business interest to protect, the non-compete restraint still needs to be reasonable before it is enforced. What is reasonable will depend on the circumstances, and a restriction will only be enforced if the employer can establish it goes no further than is necessary to protect the employer.

Example: In 2016 the CFO of the Just Jeans Group was able to commence work at a competitor despite her senior role in the business because the non-compete restraint in her contract was found to be too broad to be enforceable. In this case, the employer had tried to enforce a non-compete restraint anywhere in Australia and for a period of two years after employment. Even a lower level restraint of 12 months and within Victoria was found to be too broad in this situation.



Restrictions on dealings with customers and staff

Where the restraint only seeks to prevent you from soliciting or enticing away your former employer's customers and staff, it is much more likely to be enforced because the restriction does not interfere with your ability to work. Further, employers have a clear and legitimate business interest to protect – the relationship that they have with their customers and staff.

It is safe to say that in most instances, if a former employer catches you soliciting their customers, they would be entitled to enforce a restraint clause against you.

However, what happens if their customers approach you? Is this still considered soliciting your former employer's customers? The answer may well depend on the specific wording of your contract and how you and the customer have interacted.

In one example, a gym instructor was found not to have breached her restraint when customers of her former employer terminated their gym memberships and approached her for personal training services. This was because the customer had clearly and definitively ended their relationship with the former employer at the time that the approach was made.

This can be contrasted with another example ...

where a customer approached the former employee while still a customer of their former employer. Even though the customer had made the first approach, the former employee's subsequent attempts to win over the business of the customer was found to be a breach of the restraint, because the relationship between the customer and the former employer had not come to an end.

A similar approach will be adopted when it comes to hiring staff of your former employer – much will depend on their status at the time and what role you may have played in causing them to leave their employment.

Confidentiality and Intellectual Property



No article on the question of restraints is complete without also touching on confidentiality and intellectual property.

As an employee, you owe a duty of confidentiality to your employer and these rights do not end on termination of your employment. These duties persist even if your restraint clause is unenforceable, as they are separate obligations.

When ceasing employment, you should destroy any client lists, price lists, databases and contact numbers that were in your possession. Aim to build your new business without having to rely on any confidential information of your former employer so as to not expose yourself to a claim for breach of confidentiality.

You should also avoid using your former employer's intellectual property, as that may also give rise to a claim. Even relatively simple documents – such as your former employer's standard terms and conditions or customer intake forms – constitute their intellectual property and cannot be used without their consent. Importantly, the intellectual property rights in any item of work that you have created during the course of your employment (e.g. templates that you created) are owned by your former employer and you cannot assume that you will be allowed to use them in your new business venture.

Final thoughts

With careful consideration and planning, a restraint of trade clause in your employment contract shouldn't prevent you from fulfilling your dream of business ownership. The key is to understand exactly what rights your former employer is seeking to protect, and whether they have been reasonable in protecting those rights.

While reasonableness will be determined on a case-by-case basis, the broader the restriction that your former employer is seeking to enforce, the harder it will be for them to obtain the protection they are seeking.

Sami Sara, Partner

Lawcrest

This article is general advice only, and does not take into account your specific circumstances and requirements. A lot of nuance and detail is lost when summarising legal principles in a manner which is accessible and easy to understand. As such, this article is no substitute for carefully considered independent legal advice. You should obtain such advice before taking any steps which may expose you to the prospect of legal proceedings.

We trust you found the article on restraints “Can your employer stop you from starting your own business” by Sami Sara, Lawcrest, insightful.

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Divyesh Nathoo
CEO

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Each have built their own businesses and held C Suite and/or Board level positions in some of Australia's most successful companies.

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