LLOYD'S LAW REPORTS

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CASES JUDICIALLY CONSIDERED

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PRIVY COUNCIL

July 9, 10, 11, 1973

STENHOUSE AUSTRALIA LTD. v. PHILLIPS

Before Lord REID,
Lord MORRIS OF BORTH-Y-GEST,
Lord WILBERFORCE,
Lord SIMON OF GLAISDALE and
Sir GARFIELD BARWICK

Master and servant — Restraint of trade — Period of restraint — Reasonableness — Restraint for five years after termination of employment — Insurance brokers — Prohibition on employee soliciting former employer's clients — "Clients" narrowly defined — Test for determining whether period reasonable — Question to be determined by Judge — Determination by Judge after informing himself of all relevant circumstances.

Trade — Restraint of trade — Master and servant— Clause not expressed to be in restraint of trade — Provision for payment of money — Duty of Court to have regard to likely effect of provision — Provision clearly operating in restraint of trade — Provision to be treated as being in restraint of trade.

A company, which had its office in Sydney, was the holding company in a group of companies ("the group"). Through its subsidiaries the company carried on the business of insurance broking in Australia. In 1964 the employee entered into an employment agreement with one of the subsidiaries. The agreement was expressed to last until the employee was 60 years old and thereafter from year to year. Under the agreement the employee covenanted for a period of five years after the determination of his services, within 25 miles of Sydney, not to engage in the business of insurance broking nor to solicit the custom of any person who during the continuation of the agreement would have been a customer of any company in the group, and (b) not, for a similar period, to be concerned in the business of an insurance broker in any town in Australia in which any company of the group, at the termination of the contract, had a recognized place of business nor in any place in Australia to solicit the custom of any person who during the continuance of the agreement should have been a customer of any company in the group.

In 1966 the agreement was novated so that the company became the employing party. The employee's main activities were concerned with reinsurance business for the group, but they also involved direct dealings or negotiations with a limited number of clients with a view to the placing of insurance business in the group. In May, 1971 the employee gave notice of his intention to resign but the company refused to accept the notice. On July 9, 1971 the employee left the company's employment and set up a company which commenced business in the first half of 1972 in competition with)the company. Meanwhile negotiations had been going on between the employee and the company with regard to the termination of his employment.

On Mar. 23, 1972 an agreement was executed which recited the earlier employment agreement and provided by cl. 1 for the termination of the eplmoyee's employment. By cl. 4 the employee covenanted that he would not for a period of five years from July 9, 1971 without the company's prior consent directly or indirectly solicit insurance business from any client as defined. Clause 5 provided that if, within the five year period, any client of the company placed insurance business, whether or not of a type currently transacted by the company for such client, through the agency of the employee or any agency other than that of one of the companies in the group, so that the employee, or any person, firm or corporation with which he was in any way connected, received or became entitled to receive directly or indirectly any financial benefit from the placing of such business then the employee was to pay or procure the payment to the company of one-half of the gross commission paid by the insurance company without any allowance for any rebate made to the client. The sums payable under cl. 5 would continue to be payable for a period of five years after such insurance business was first placed. By cl. 6 the employee covenanted that except in the circumstances provided in cl. 5 he would not for a period of three years from July 9, 1971, without the company's prior consent, act as insurance broker for any client as defined. For the purposes of cll. 4, 5 and 6, "client" was defined by cl. 8 as

any person, firm or corporation who on July 9, 1971 or in the preceding month was a client of the company or any of its associated companies with whom in the course of his employment with the company the employee had had dealings or negotiations, or prospective clients whose insurance business had, through the employee's services or agency, been the subject of negotiations within the 12 month period preceding July 9, 1971, but excluded prospective clients whose business was acquired by, or who became a subsidiary of, any person, firm or corporation which on or after July 9, 1971 was or became a client of the employee or person, corporation or firm by whom he was employed or for whom he was acting as agent, and furthermore excluded any insurance company.

The company brought proceedings seeking, *inter alia*, a declaration as to the validity of cll. 4, 5 and 6 of the agreement.

———*Held*, by P.C. (Lord REID, Lord MORRIS OF BORTH-Y-GEST, Lord WILBERFORCE, Lord SIMON OF GLAISDALE and Sir GARFIELD BARWICK), that (i) cl. 4, although in restraint of trade, was reasonable and necessary for the protection of the company's business for the following reasons—

(a) the prohibition on soliciting was narrow restraint which left open a wide field of unrestrained competitive activity by the employee (*see* p. 5, col. 2);

(b) the covenant extended only to a comparatively small number of clients with whom the respondent had dealt directly, and expressly excluded any insurance company, an exception of great importance to the respondent as the greater part of his work had been in the field of reinsurance (*see* p. 5, col. 2);

(c) the period of five years was effectively one for less than 4¼ years since it was expressed to run from July, 1971; to determine whether that period was reasonable the question to be asked was what was a reasonable time during which the employer was entitled to protection against solicitation of clients with whom the employee had had contact and influence during employment and who were not bound to the employer by contract or by stability of association; that question could not advantageously form the subject of direct evidence but was to be determined by the Judge after informing himself as fully as he could of the facts and circumstances of the employer's business, the nature of the employer's interest to be protected and the likely effect on it of solicitation; in all the circumstances the period specified in the agreement was not unreasonable (*see* p. 5, cols. 1 and 2; p. 6, col, 1);

(ii) Although on the face of it cl. 5 was not a restraint at all but a provision for the payment of money, the question whether it operated in restraint of trade was to be determined not by the form of the stipulation, but by its effect in practice. The provisions of the clause were such as to be likely to cause the employee to refuse business which he would otherwise take. The clause therefore clearly operated in restraint of trade, particularly when read in conjunction with cl. 6 since, read together, the two clauses amounted to a restriction, as stated in cl. 6, against acting as insurance broker for clients unless payment was made in accordance with cl. 5. Once it was accepted that cl. 5 operated in restraint of trade it followed from the severity, as regards the employee, of the clause, that it operated unreasonably. Furthermore the existence of the restraint in cl. 4 diminished the need for others, or at least increased the burden of proving that they were reasonably required. It followed that cll. 5 and 6, which had to be read together, were unenforceable (*see* p. 6, cols. 1 and 2).

(iii) Clause 4 was, however, in no way dependent on cll. 5 and 6 and was therefore enforceable (*see* p. 6, col. 2).

Appeal allowed in part.

The following cases were referred to in the judgment.

Attwood v. Lamont, (C.A.) [1920] 3 K.B. 571.

Esso Petroleum Co. Ltd. v. Harper's Garage (Stourport) Ltd., [1967] 1 All E.R. 699, [1968] A.C. 269.

Hudson (Howard F.) Pty. Ltd. v. Ronayne, [1972] A.L.R. 357.

Leetham (Henry) & Sons Ltd. v. Johnstone-White, (C.A.) [1907] 1 Ch. 322.

By a summons dated July 3, 1972, the appellant, Stenhouse Australia Ltd., commenced a suit in the Equity Division of the Supreme Court of New South Wales against the respondent, Marshall William Davidson Phillips, claiming, *inter alia*, injunctions restraining the respondent from acting in breach of a contract made between the parties on Mar. 23, 1972 and a declaration that the provisions of cll. 4, 5 and 6 of the contract were valid and enforceable. On Oct. 26, 1972 Mr. Justice Mahoney dismissed the suit and on Dec. 15, 1972 granted the appellant leave to appeal to the Privy Council.

James P. H. Mackay Q.C., J. A. D. Hope (both of the Scottish Bar) and J. R. T. Wood (of the New South Wales Bar) (instructed by Messrs. Wilkinson, Kimbers and Staddon) for the appellant; A. J. L. Lloyd, Q.C. and B. A. Beaumont (of the New South Wales Bar) (instructed by Messrs. Linklaters and Paines) for the respondent.

The facts are set out in the judgment of Lord Wilberforce.

Tuesday, Oct. 2, 1973

JUDGMENT

Lord WILBERFORCE: This appeal from the Supreme Court of New South Wales involves the question whether certain provisions in an agreement under seal dated Mar. 23, 1972 between the appellant and the respondent are

or are not unenforceable as being in restraint of trade. Before stating the provisions in question, it is necessary, for later discussion, to refer to some previous history concerning the relations of the appellant and the respondent.

The appellant is a company having an office in Sydney with a considerable business in the field of insurance. It carries on business itself as an insurance broker and also has a number of wholly owned subsidiaries through which it carries on the business of insurance broking in the States of Australia. It will be convenient to refer to the appellant and its subsidiaries as "the Stenhouse group".

On Dec. 11, 1964 the respondent entered into an employment agreement with one of the companies in the Stenhouse group, namely, Stenhouse Scott North Australia Ltd. The agreement was expressed to continue until the respondent should attain the age of 60 years and thereafter, subject to certain conditions, from year to year until determined by six months' notice on either side. It contained, *inter alia*, two covenants on the part of the respondent. The first was a covenant not, for five years after the determination of his services, within 25 miles from the General Post Office, Sydney, to engage in the business of insurance broking, nor to solicit the custom of any person who during the continuance of the agreement should have been a customer of any company in the Stenhouse group. The second was a covenant not, for a similar period, to be concerned in the business of an insurance broker in any town in Australia in which any company of the Stenhouse group should, at the date of termination of the agreement, have a recognized place of business, nor in any place within Australia to solicit the custom of any person who during the continuance of the agreement should have been a customer of any company in the Stenhouse group.

By an agreement dated Sept. 6, 1966 the 1964 agreement was novated so that the appellant for all purposes, was substituted as the employing party, for Stenhouse Scott North Australia Ltd. as from its date of signature, i.e., Dec. 11, 1964. The respondent continued to serve the appellant company under the terms of these agreements; he was managing director of Stenhouse Scott North Australia Ltd. and also of Stenhouse Re-Insurance Pty. Ltd., another member of the Stenhouse group. His main activities were concerned with reinsurance business for the Stenhouse group but they also involved direct dealings or negotiations with a limited number of clients with a view to the placing of insurance business with companies of the Stenhouse group. In particular he had negotiations with a substantial industrial concern called Boral Ltd. and its subsidiary and associated companies. There was evidence that between Jan. 1, 1970 and June 30, 1972 the Stenhouse group acted as insurance broker of some classes of insurance for the Boral group.

On May 12, 1971 the respondent gave the appellant eight weeks' notice of his intention to resign, but by letter of May 13, 1971 the appellant refused to accept the notice so given. On July 9, 1971 the respondent left the employment of the appellant and set about the constitution of a business in competition. He formed a company, C. E. Heath Insurance Broking (Australia) Pty. Ltd. to carry on business in association with Heath & Co. Ltd. of London. He became a director of the Australia company, which commenced business in the first half of 1972. Between July, 1971 and March, 1972 the respondent negotiated with a Mr. Hargreaves who controlled the placing of insurance for the Boral group, with a view to securing business for the Heath group of companies. This later led to the Boral group effecting certain insurance through C. E. Heath Insurance Broking (Australia) Ptd. Ltd. as brokers.

Meanwhile it would seem that negotiations had been going on between the appellant and the respondent with regard to the termination of the respondent's employment. These led to the execution on Mar. 23, 1972 of the agreement the subject of the present proceedings. This agreement, made between the appellant of the first part and the respondent, described as "Insurance Broker", of the second part, contained recitals concerning the previous agreements of Dec. 11, 1964 and Sept. 6, 1966 ending with the following:

> WHEREAS [the respondent] has tendered his resignation as an employee of Stenhouse and has requested Stenhouse to release him from his obligations under the abovementioned Agreements AND WHEREAS Stenhouse has agreed so to release [the respondent] but only on the conditions that he undertakes to be bound by the obligations hereinafter stated.

The agreement then set forth the following substantive provisions: By cl. 1 it was agreed that the respondent's employment should cease with effect from July 9, 1971, and by cl. 2 the appellant as from the same date accepted the respondent's resignation as director of specified companies in the Stenhouse group. Clause 3 contained a covenant against the disclosure of confidential information. Clauses 4, 5 and 6 were as follows:

> 4. [The respondent] covenants that he will not for a period of five years from the said 9th day of July, 1971 unless with the prior

written consent of Stenhouse directly or indirectly as principal servant or agent solicit whether by written or oral communication or otherwise insurance business from any client as hereinafter defined.

5. In the event that any client of Stenhouse shall within a period of five years from the said 9th day of July 1971 (and that whether or not such client is a client of one or more of the Stenhouse companies at the time) place insurance business whether or not business of a type presently transacted by Stenhouse for such client through the agency of [the respondent] or through any agency other than that of one of the Stenhouse companies referred to in Clause 2 of this Agreement so that [the respondent] or any person firm or corporation for whom [the respondent] is a principal or agent or by whom [the respondent] is employed and with whom he is associated or connected in any other way receives or becomes entitled to receive directly or indirectly any financial benefit from the placing of such business then [the respondent] agrees to pay or procure that there shall be paid to Stenhouse a one-half share of the commission received in respect of such transaction and such commission shall be the gross commission (including any allowances) paid by the Insurance Company in respect of such transaction without allowance for any rebate made to the client and after deduction of any procurement fee properly payable in respect of prospective clients as hereinafter defined to any third party for the introduction of such business such procurement fee not to exceed one-third of the total initial commission. The sums payable to Stenhouse pursuant to this clause shall continue to be paid for a period of five years (but only if there is a financial benefit as aforesaid for each year) from the date on which such insurance business is so first placed and shall be paid to Stenhouse concurrently with the settlement of the net premium due to the Insurance Company concerned.

6. [The respondent] covenants that except in the circumstances provided for in Clause 5 hereof he shall not for a period of three years from the said 9th day of July 1971 unless with the prior consent in writing of Stenhouse directly or indirectly as principal servant or agent act as Insurance Broker for any client as hereinafter defined.

Clause 7 was a covenant against enticement of officers or employees of the Stenhouse group. Clause 8 was as follows:

For the purposes of Clauses 4, 5 and 6 of this Agreement the word "client" shall mean any person firm or corporation who at the said 9th day of July 1971 or in the preceding month was a client of Stenhouse or any of its associated companies with whom in the course of his employment with Stenhouse [the respondent] has had dealings or negotiations and further shall mean a prospective client of Stenhouse or of its associated companies whose insurance business was the subject of negotiation with Stenhouse through the services or agency of [the respondent] either at the said 9th day of July 1971 or within the period of 12 months preceding that date but shall be construed as excluding any person firm or corporation who was a client or prospective client of Stenhouse as aforesaid and whose business is acquired by or who becomes thereafter a subsidiary of any other person firm or corporation which is at the said 9th day of July 1971 or may become during the term of this Agreement a client of [the respondent] or any person firm or corporation by whom he is employed or for whom he is acting as agent, and further shall be construed as excluding any Insurance Company.

By proceedings commenced by summons on July 3, 1972, the appellant sought declarations as to the validity of cll. 4, 5 and 6 of the agreement, and certain injunctions, an account, and damages. On Oct. 26, 1972, Mr. Justice Mahoney sitting in Equity gave judgment dismissing the proceedings for the reasons, briefly, that the clauses in question were unenforceable, or void, as being in restraint of trade.

Their Lordships consider first the provisions of cl. 4. There is no doubt that they are in restraint of trade, so the only question is whether the appellant (as covenantee) can show that they impose no greater restraint than is reasonably necessary for its protection.

The accepted proposition that an employer is not entitled to protection from mere competition by a former employee means that the employee is entitled to use to the full any personal skill or experience even if this has been acquired in the service of his employer: it is this freedom to use to the full a man's improving ability and talents which lies at the root of the policy of the law regarding this type of restraint. Leaving aside the case if misuse of trade secrets or confidential information (which is separately dealt with by cl. 3 of the agreement and which does not arise here), the employer's claim for protection must be based on the identification of some advantage or asset inherent in the business which can properly be regarded as, in a general sense, his property, and which it would be unjust to allow the employee to appropriate for his own