

Restraint of Trade in a commercial context

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Restraints are commonplace in shareholders agreements, business sale contracts, and

investment documentation of all types as they are an important tool in protecting legitimate protectable business interests from current and former stakeholders.

Enforceability

The starting point for a Restraint at law is that it is unlawful but may be upheld if the protected interest is reasonable. Courts have given a clear message that a person cannot be restrained from earning a livelihood. The party wishing to enforce the Restraint, will have the onus of demonstrating the interest that requires protection.

Below we have set out some pointers to follow when drafting a Restraint to ensure it works as intended:

Factors to consider

- Identify the legitimate protectable interest. This could be proprietary right or interest, or a commercial right or interest such as the goodwill of the business, confidential information, trade secrets and/or intellectual property.
- Ensure that the Restraint balances the interests of a restrained person's ability to earn a livelihood with the interests of those protected to not have that person compete with them.
- Ensure there is equal bargaining power for both parties at the time the agreement was entered into. It is more likely that the restraint will be found to be reasonable.
- What is the type of business protected by the restraint? How will you then define "competing business"? Make sure the definition of competing is broad enough to ensure the interest is protected within the particular industry but not broad enough that it could be found to be unreasonable.
- Who will this restraint apply to? This is relevant as you will need to decide how wide the restraint will be. For example, will it only apply to the vendor or departing shareholder or will it apply to the vendor or departing shareholder, their associates and business partners?
- Consider the time restriction and geographical restriction. The Courts have confirmed that the longer the restriction (time) or the larger the restricted area (location), the more difficult it is to establish the reasonableness of the restriction. If there is no time limit or the area is too large, the restraint is likely to be deemed unreasonable. The Courts have discretion to intervene and modify or remove a Restraint clause, if the

Restraint clause in the contract is deemed unreasonable. However, the Courts are reluctant to intervene when the two parties have equal bargaining power and access to advice.

- If the Restraint is included in a business sale and purchase agreement, consider the amount and allocation of the price paid for the business. If the vendor is compensated fairly at the time of the transaction, the Restraint is more likely to be found reasonable.

Conclusion

If they are drafted correctly, Restraints can provide parties with a reliable assurance that their legitimate business interests are protected whilst also ensuring the restrained party is compensated appropriately for agreeing to be reasonably restrained. If this is not achieved, they do little more than facilitate parties making hollow threats of litigation.

If you would like to talk through Restraints you are considering putting in place, reach out to your usual CLM contact Campbell Izzard or Georgia Thomson.