

WEBBER WENTZEL
in alliance with > Linklaters

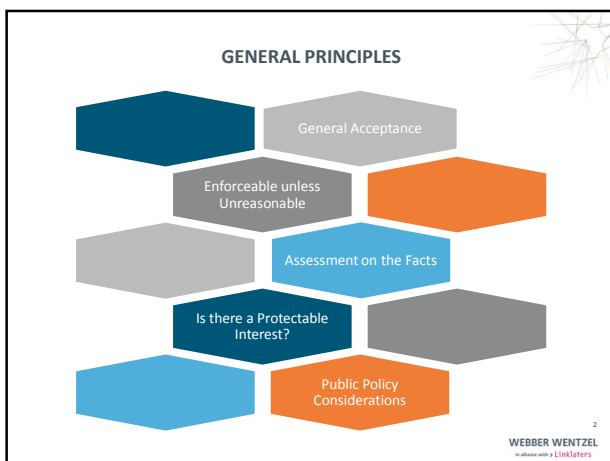
Restraints of Trade

Claire Gaul

February 2016

© Webber Wentzel 2013






HOW DO WE DETERMINE WHAT IS REASONABLE?

- We look to **case law** for guidance in **considering** the reasonableness of a restraint.
- **Four questions** have been identified that should be asked when considering the reasonableness of a restraint:
 - Does the one party have an **interest that deserves protection** after termination of the (employment) agreement?
 - If so, is that interest **threatened** by the other party?
 - In that case, does such interest weigh **qualitatively** (quality or character of something) and **quantitatively** (based on the amount or number of something) against the interest of the other party not to be **economically inactive or unproductive**?
 - Is there an **aspect of public policy** having nothing to do with the relationship between the parties that requires that the restraint be maintained or rejected?

3

WEBBER WENTZEL
in alliance with > Linklaters



HOW DO WE DETERMINE WHAT IS REASONABLE?

- In determining reasonableness, the following is also considered:

geographical application

duration of the restraint

restricted fields of activity limited by the restraint.

- If the facts show that the **restraint is reasonable** the employer must succeed. However, if the facts show that the restraint is unreasonable, the employee will **succeed**.

WEBBER WENTZEL
in alliance with Linklaters

PROTECTABLE INTEREST

2 kinds of protectable interest

Confidential Information

Customer/Trade Connections of the Business

WEBBER WENTZEL
in alliance with Linklaters

CONFIDENTIAL INFORMATION

While there is **no limit** to what constitutes 'confidential information' the information must meet, at the very least, the **following requirements**:

- it must be **useful** i.e. capable of application in trade or industry;
- it must **not** be public knowledge;
- the information must have **economic value** for the person seeking to protect it; and
- it must be something **unique and peculiar** to the employer.

WEBBER WENTZEL
in alliance with Linklaters

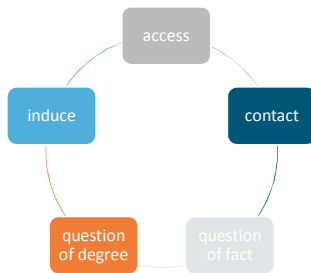
CONFIDENTIAL INFORMATION

- **Categories of information** that may, depending on the facts, be regarded as confidential (and therefore protectable):
 - **customer lists**;
 - **discounting** structures;
 - **pricing** information;
 - information received by an employee about the **business opportunities** available to the employer;
 - information received in **confidence**;
 - information gathered through **time, skill and labour**;
 - information relating to the **specifications of a product or process of manufacture** which has been kept confidential;
 - confidential information used under **license**;
 - information relating to **tender prices**.

7
WEBBER WENTZEL
in alliance with Linklaters

CUSTOMER CONNECTIONS

- **HOW DO WE ASSESS WHETHER EMPLOYEE HAS ESTABLISHED A CUSTOMER CONNECTION?**



8
WEBBER WENTZEL
in alliance with Linklaters

CUSTOMER CONNECTIONS



9
WEBBER WENTZEL
in alliance with Linklaters

GENERAL PRINCIPLES IN ENFORCING RESTRAINT

- Who bears the **onus**?
 - ✓ employer / party invoking restraint must show breach of restraint;
 - ✓ if he succeeds – onus shifts to employee to show:
 - ❖ no protectable interest;
 - ❖ restraint is unreasonable;
 - ❖ public policy dictates non-enforcement.

10
WEBBER WENTZEL
in alliance with **Linklaters**

COURT DECISIONS

- *FirstRand Bank Limited t / a FNB Insurance Brokers v Prithipal and another* [2015] JOL 32993 (KZD)
- This is a case concerning the considerations in enforcing a restraint of trade against a broker.
- Decided in favour of the broker i.e. restraint held to be unenforceable.

11
WEBBER WENTZEL
in alliance with **Linklaters**

COURT DECISIONS IN FINANCIAL SERVICES SECTOR

- **Facts:**
 - FNB Insurance Brokers (FNB) conducts the business of an insurance brokerage, selling short term insurance policies to both commercial and private clients.
 - In 2008, FNB acquired a business trading as Southern Natal Insurance Brokers (Southern Natal).
 - Prithipal was 65 years' old. When he was approximately 20 years' old, he commenced work in the short term insurance industry. He became a broker in 1987 and in 2004 joined Southern Natal.
 - When FNB acquired the business of Southern Natal, Prithipal was still employed at Southern Natal and FNB concluded a contract with him in terms of which he would be employed for a period of five years at a fixed monthly salary.

12
WEBBER WENTZEL
in alliance with **Linklaters**

COURT DECISIONS IN FINANCIAL SERVICES SECTOR

- In 2013 Prithipal concluded a further employment contract with FNB as well as a "Confidentiality and Restraint Agreement".
- In terms of the employment contract, it would be "reviewed" annually, and, contrary to the five year employment contract concluded in 2008, provided that the he would be remunerated on a "commission only" basis.
- Upon the expiry of the one year contract in 2014, Prithipal left FNB/Southern Natal's employ and on the next day commenced employment with Westwood Insurance Brokers (Westwood) in competition with FNB.

13
WEBBER WENTZEL
in alliance with Linklaters

COURT DECISIONS IN FINANCIAL SERVICES SECTOR

- While the restraint of trade agreement provided that Prithipal was **prohibited** for a period of **24 months** from being employed by any competitor of FNB, FNB merely sought an order that Prithipal be so restrained for a period of **12 months**.
- It was **not disputed** by Prithipal and Westwood that Prithipal's employment with the Westwood was in contravention of the restraint of trade agreement.
- Prithipal / Westwood therefore required to show that restraint was **unreasonable** and **contrary to public policy**.

14
WEBBER WENTZEL
in alliance with Linklaters

COURT DECISIONS IN FINANCIAL SERVICES SECTOR

• First Question? Was Prithipal in breach?

Yes – both Prithipal and Westwood did not dispute that he was in breach of the restraint agreement.

• Second Question? Did FNB have a protectable interest?

- The interest that the FNB sought to protect was the **risk of damage to its customer connection**.
- The court considered what is meant by 'customer connection'.
 - "The need of an **employer** to protect his trade connections arises where the **employee has access to customers and is in a position to build up a particular relationship with the customers so that when he leaves the employer's service he could easily induce the customers to follow him to a new business.**"
 - "The 'customer contact' doctrine depends on the notion that **'the employee, by contact with the customer, gets the customer so strongly attached to him that when the employee quits and joins a rival he automatically carries the customer with him in his pocket.'**"

15
WEBBER WENTZEL
in alliance with Linklaters

COURT DECISIONS IN FINANCIAL SERVICES SECTOR

- "A relationship must be such that the employee acquires such *personal knowledge of and influence over the customers of his employer as would enable him (the servant or apprentice), if competition were allowed, to take advantage of his employer's trade connection.*"

16
WEBBER WENTZEL
in alliance with *Linklaters*

COURT DECISIONS IN FINANCIAL SERVICES SECTOR

- Prithipal argued that he had not acquired 'his clients' by virtue of his relationship with FNB but that they pre-existed his employment.
- Court looked at decision of High Court in another case (the Rawlins' case) which considered this argument:

"Does this establish that the [former employer] did not have a proprietary interest of the kind under consideration? It is, of course, **a factor in [the former employee's] favour**; but **not conclusively** so even though the persons to whom an employee sells and whom he canvasses were **previously known to him** and in this sense '**his customers**', he may nevertheless during his employment, and **because of it**, form an attachment to and acquire an influence over them which **he never had before**. When this occurs, what I call the **customer goodwill** which is **created or enhanced** is at least in **part an asset of the employer**. As such it becomes a **trade connection of the employer** which is capable of protection by means of a restraint of trade clause. The onus being on Rawlins to prove the unreasonableness of the restraint, it was for him to show that he never acquired any **significant personal knowledge of or influence over the persons he dealt with** as a salesman of the [former employer] **over and above that which previously existed.**"

17
WEBBER WENTZEL
in alliance with *Linklaters*

COURT DECISIONS IN FINANCIAL SERVICES SECTOR

- It was common cause that FNB paid Prithipal **R200 000** in 2008 when the contract was concluded.
- FNB submitted that the amount was paid for Prithipal's **goodwill** so that Prithipal's customers as at 2008 became those of FNB.
- In support of this, the case of *Grainco (Pty) Ltd v Van der Merwe and others* 2014 (5) SA 444 (WCC) was cited, where the court reiterated the principle that the **seller of a business inclusive of its goodwill is precluded from competing by canvassing persons** who were customers of the business **at the time** of the sale.
- Prithipal contended that the amount was paid in order to retain him in FNB's employment (i.e. an incentive and not a restraint payment).
- The court accepted this. It found that Prithipal had, in fact, established his relationships with the customers prior to employment with FNB, these relationships were not advanced during employment with FNB, and the payment made to him was not in consideration for these clients. Prithipal, therefore, discharged the onus of showing that there was no threat to FNB's customer connection.

18
WEBBER WENTZEL
in alliance with *Linklaters*

COURT DECISIONS IN FINANCIAL SERVICES SECTOR

- **Balancing the parties' interests**

- The judge went on to state that even if there was a protectable interest that was threatened by Prithipal, the court would be obliged to weigh up the parties' interests before enforcing the restraint.
 - Prithipal had a wife of 63 years' old who has never been employed and together they had a combined retirement of some R2 100 000. A living annuity purchased with this would give him a monthly income of some R10 500 per month upon which they could barely survive;
 - Prithipal has been in the industry his entire adult life and would be unable to gain alternative employment (especially given his age);
 - the employment contract had expired and FNB had chosen not to retain Prithipal;
 - FNB is one of the four largest banks in South Africa. The consequence to Prithipal of being unemployed was, vis à vis him and his wife, far more serious than the impact would be on FNB if Prithipal is able to work.
- The court found that any interest of FNB would not outweigh Prithipal's interest in not being economically active.

19
WEBBER WENTZEL
in alliance with Linklaters

COURT DECISIONS IN FINANCIAL SERVICES SECTOR

- **Debate concerning pre-existing customers:**

- Prithipal managed to convince the court that his clients pre-existed his relationship with FNB and that he had not done anything since taking up employment to enhance these relationships such that they could be considered a customer connection of FNB.
- Contentious issue – as a **general proposition** it is accepted that:

"When the first respondent (employee) introduced customers and suppliers to the first applicant (employer) they became the latter's customers and suppliers. Although the first respondent may have had dealings with them before, his employment with the first applicant enabled him to re-establish any pre-existing relationships and further strengthen them..." (Nampesca v Zaderer)
- Presenter's view – this will nearly always be the case and employees must be careful before relying on argument that they had pre-existing relationships.

20
WEBBER WENTZEL
in alliance with Linklaters

COURT DECISIONS IN FINANCIAL SERVICES SECTOR

- **Nautical Underwriting Managers (Pty) Ltd and Others v Dioleta Maria Ferreira Dos Santos and another (unreported)**

- This case concerns the enforceability of a restraint of trade against the head of a department within the underwriter.
- The court found in favour of the underwriter (the employer) and enforced the restraint.

21
WEBBER WENTZEL
in alliance with Linklaters

COURT DECISIONS IN FINANCIAL SERVICES SECTOR

- **Background**
- Dos Santos undertook that for a period of **12 months** reckoned from the date upon which she ceased to be a shareholder of Nautical, she would **not be employed by a competitor** of Nautical unless she and her new employer both provided a written undertaking that neither she nor the new employer (Paradigm Risk Consultants) would "**draw away, canvas, entice or solicit**" any customer from Nautical.
- During January 2015 Dos Santos joined the employ of Paradigm, which is a **direct competitor** of Nautical. Therefore, if Dos Santos were to be permitted to remain in Paradigm's employ, both Dos Santos and Paradigm were required to provide the **necessary undertaking**.

22
WEBBER WENTZEL
in alliance with Linklaters

COURT DECISIONS IN FINANCIAL SERVICES SECTOR

- Paradigm and Dos Santos provided an initial undertaking which was **not acceptable to Nautical**.
- Dos Santos and Paradigm contended that they were free to accept **approaches from brokers** in order to place the policies held by Nautical, provided only that **they did not instigate the approach** i.e. the undertaking was only required to extend to their not actively instigating the contact.

23
WEBBER WENTZEL
in alliance with Linklaters

COURT DECISIONS IN FINANCIAL SERVICES SECTOR

- **Was the undertaking provided by Dos Santos and Paradigm sufficient to adequately protect Nautical's legitimate interests?**
- **Nautical contended:**
 - ✓ Nautical's clients are its brokers;
 - ✓ it is the brokers with whom Nautical has established its relationships and upon whom Nautical (and similarly Paradigm) depend on for the generation of business;
 - ✓ Dos Santos and Paradigm's contention that it is the policyholders who are Nautical's clients and not the brokers, it was argued, was without merit;
 - ✓ the employee established relationships with Nautical's clients (i.e. its brokers) and these relationships had been built up over a period of three and a half years during which employee rendered services to Nautical;

24
WEBBER WENTZEL
in alliance with Linklaters

COURT DECISIONS IN FINANCIAL SERVICES SECTOR

- ✓ there is a level of trust that had been built up between Dos Santos and Nautical's brokers and that the brokers specifically dealt with her as a result of having formed a relationship with her;
- ✓ Nautical had acted reasonably in seeking an undertaking limited in its terms, namely that Dos Santos and Paradigm would not draw away, entice, canvass or solicit any marine insurance business that has already been written through Nautical by its brokers. In other words, Dos Santos and Paradigm were free to deal with the brokers provided only that they did not solicit the business of policies that have already been written by Nautical. It is only in respect of these pre-existing policies that Nautical sought an undertaking from Dos Santos and Paradigm.

25
WEBBER WENTZEL
in alliance with Linklaters

COURT DECISIONS IN FINANCIAL SERVICES SECTOR

□ Dos Santos and Paradigm contended:

- ✓ Brokers are not the clients of the underwriter but the end-user policy holders are and there is, therefore, no customer connection with the brokers; and
- ✓ the term "solicit" does not prevent Paradigm from accepting business of policyholders (via the brokers) provided only that Dos Santos **does not actively** solicit, canvas, persuade, or entice the broker to move the policyholder to Paradigm.

26
WEBBER WENTZEL
in alliance with Linklaters

COURT DECISIONS IN FINANCIAL SERVICES SECTOR

□ The Court:

- ✓ Rejected the argument that brokers are not the 'clients' of the underwriter;
- ✓ considered and rejected the contention that an approach made by a former customer to the ex-employee (and not the other way round) does not fall foul of a 'non-solicitation' clause;
- ✓ quoted with approval from the decision of Judge Mbha in the matter between *Experian South Africa v Haynes and another* (2011) who held that –

27
WEBBER WENTZEL
in alliance with Linklaters

COURT DECISIONS IN FINANCIAL SERVICES SECTOR

*"This argument is devoid of merit: it has been held that it makes no difference whether or not an employee contacts the customers of his ex-employer or whether such customers contact him. **Both forms of conduct** amount to solicitation of the customers of the ex-employer which is impermissible during the restraint period"*

- ✓ the decision in the *Experian* matter is to be followed "since it is **not merely the first contact** which should be considered – even if that **first contact comes uninvited from the customer**, it will nearly always be the case that the subsequent contacts will amount to a solicitation of the customer away from the erstwhile, and in favour of the new employer". (John Saner, *the Law of Restraint of Trades in South Africa*)

28
WEBBER WENTZEL
in alliance with [Linklaters](#)

COURT DECISIONS IN FINANCIAL SERVICES SECTOR

- Dos Santos undertook not to disclose the confidential information of Nautical. The court stated in response:
 - ✓ The legal position in respect of such an undertaking is clear: Nautical is entitled to protect its interests in its confidential information. Nautical does not have to sit back and cross its fingers and hope that Dos Santos will not breach her restraint any further by using Nautical's confidential information, in circumstances where she has already breached her restraint by joining the employ of Paradigm in circumstances where they have not provided the necessary undertaking as required in terms of the shareholder's agreement.
 - ✓ The information referred to above would not ordinarily be known to a competitor and accordingly forms part of Nautical's proprietary information, in relation to which Nautical has a protectable proprietary interest and, in respect of which Nautical, by obtaining the restraint and confidentiality undertakings from Dos Santos, has sought to protect.

29
WEBBER WENTZEL
in alliance with [Linklaters](#)

COURT DECISIONS IN FINANCIAL SERVICES SECTOR

- **On Customer Connections the argument put forward by Nautical was the following:**
 - As to customer connections, it is trite that trade connections constitute a protectable proprietary interest. The simple question was whether Dos Santos was placed at an unfair advantage over Nautical by virtue of her influence over Nautical's customers (the brokers), an influence which was acquired and enhanced whilst in Nautical's employ. The answer to that question was in the affirmative.
 - Dos Santos's interaction with Nautical's clients (i.e. its brokers) was common cause. That a relationship has of trust had been forged between Dos Santos and the brokers was not denied.
 - It was also conceded by both Paradigm and Dos Santos that it is from the relationship with brokers that business flows. That makes it a protectable customer connection as contemplated in law.

30
WEBBER WENTZEL
in alliance with [Linklaters](#)

COURT DECISIONS IN FINANCIAL SERVICES SECTOR

- **Weighing of interests:**

- ✓ Dos Santos left Nautical's employ of her own accord. it was argued that Dos Santos was able to remain economically active outside of Nautical's business and she remained quite free to utilise her skills and experience in the public domain provided only that she does not do so in competition with Nautical in circumstances where she and her new employer have not provided an undertaking that they will not solicit Nautical's clients. Nautical contended that Dos Santos and Paradigm were the authors of Dos Santos's misfortune. Had they given the requisite undertaking, Dos Santos would have been able to remain in the Paradigm's employ. Instead they tried to have their cake and eat it.

The Court agreed and upheld the restraint of trade against Dos Santos.

31
WEBBER WENTZEL
in alliance with Linklaters

ENFORCEMENT OF RESTRAINT OF TRADES IN FINANCIAL SERVICES SECTOR

PRINCIPLES TO BE EXTRACTED FROM CASE LAW:

- ✓ Acceptance that clients are brokers;
- ✓ Brokers form part of customer connection and therefore constitute protectable interest;
- ✓ Cannot argue that non-solicitation leaves ex-employee free to be approached by brokers;
- ✓ Debate about brokers/customers established prior to joining new employer.

32
WEBBER WENTZEL
in alliance with Linklaters

ENFORCEMENT OF RESTRAINTS OF TRADE IN FINANCIAL SERVICES SECTOR

QUESTIONS/COMMENTS

33
WEBBER WENTZEL
in alliance with Linklaters



www.webberwentzel.com

JOHANNESBURG 10, 16 & 18 Fricker Road, Illovo Boulevard, Johannesburg, 2196, South Africa T +27 11 530 5000	CAPE TOWN 15 th Floor, Convention Tower Heerengracht, Foreshore Cape Town, 8001, South Africa T +27 21 431 7000
--	---
