

WEBBER WENTZEL
in alliance with > Linklaters

Restraints of Trade


Claire Gaul

January 2015

© Webber Wentzel 2015



GENERAL PRINCIPLES



2

WEBBER WENTZEL
in alliance with > Linklaters

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 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**? and
 - 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 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

Trade Connections of the Business

WEBBER WENTZEL
in alliance with Linklaters

CONFIDENTIAL INFORMATION

- In assessing whether the employer has a proprietary interest it is necessary to **establish** whether or not the employee, during the duration of his/her employment, had **access to the employer's confidential information (and customer connections of her/his employer)**.
- 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 the 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, and more than just trivial.

WEBBER WENTZEL
in alliance with Linklaters

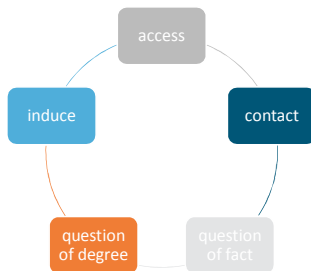
CONFIDENTIAL INFORMATION

- **Categories** of information that may, depending on the factual matrix, be regarded as confidential and therefore protectable:
 - **customer lists**;
 - information received by an employee about the **business opportunities** available to the employer;
 - information received in **confidence**;
 - information contained in **stolen** documents;
 - 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**; and
 - information relating to **tender prices**.

7
WEBBER WENTZEL
in alliance with Linklaters

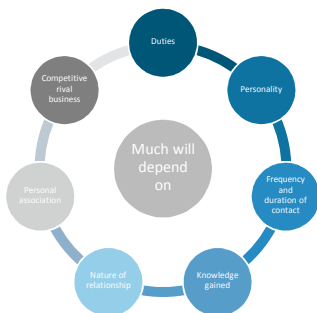
CUSTOMER CONNECTIONS

- **QUESTION OF WHETHER THE EMPLOYEE HAS BUILT UP CUSTOMER OR TRADE CONNECTIONS - HOW DO WE ASSESS THIS?**



8
WEBBER WENTZEL
in alliance with Linklaters

CUSTOMER CONNECTIONS



9
WEBBER WENTZEL
in alliance with Linklaters



DEVELOPMENTS IN RESTRAINTS OF TRADE

- **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 an employee**

11
WEBBER WENTZEL
in alliance with Linklaters

DEVELOPMENTS IN RESTRAINTS OF TRADE

- **Background**
 - FNB Insurance Brokers (FNB) conducts the business of an **insurance brokerage**, selling short term insurance policies to both commercial and private clients.
 - In August 2008, FNB acquired a business which traded as Southern Natal Insurance Brokers (Southern Natal)
 - Prithipal is 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, at the **same time joining their pension and medical aid schemes**. When FNB acquired the business of Southern Natal in 2008, 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

DEVELOPMENTS IN RESTRAINTS OF TRADE

- On **31 October 2013** Prithipal concluded a further employment contract as well as a "**Confidentiality and Restraint Agreement**"
- In terms of the further employment contract, it would be "reviewed" annually, and, contrary to the five year employment contract concluded in 2008, provided that he would be remunerated on a "**commission only**" basis.
- Upon the expiry of the one year contract on 31 October 2014, Prithipal left FNB/Southern Natal's employ and on the next day commenced employment with **Westwood Insurance Brokers** which is in competition with FNB.

13
WEBBER WENTZEL
in alliance with **Linklaters**

DEVELOPMENTS IN RESTRAINTS OF TRADE

- While the restraint of trade agreement provides that Prithipal be **prohibited** for a period of **24 months** from being employed by any competitor of FNB, FNB from the outset merely sought an order that Prithipal be so restrained for a period of **12 months** from 31 October 2014.
- It was **not disputed** by Prithipal and Westwood that Prithipal's employment with the Westwood is in contravention of the restraint of trade agreement.
- It is **common cause** between the parties that the **protectable interest** contended for by FNB is the **risk of damage to its customer connection**.

14
WEBBER WENTZEL
in alliance with **Linklaters**

DEVELOPMENTS IN RESTRAINTS OF TRADE

- Issue- whether FNB actually had a protectable interest**
 - The interest that the FNB sought to protect is the **risk of damage to its customer connection**.
 - The judge in this case quoted Nestadt JA in the case of **Rawlins and another v Caravantruck (Pty) Ltd** stated as follows with regard to 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 Judge went on further to say that 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. Further it was said that 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'"

15
WEBBER WENTZEL
in alliance with **Linklaters**

DEVELOPMENTS IN RESTRAINTS OF TRADE

- In *Rawlins*, the former employee stated that during his employment with his former employer, he largely dealt, not with its existing customers, but with his **own pre-existing following or buyers whom he later found**. Nestadt JA in this regard stated as follows:

16
WEBBER WENTZEL
in alliance with e-Linklaters

DEVELOPMENTS IN RESTRAINTS OF TRADE

"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 e-Linklaters

DEVELOPMENTS IN RESTRAINTS OF TRADE

- Application of the facts**
 - It is 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.
 - However, in the court papers, FNB stated that the amount was paid in order to retain Prithipal in FNB's employment.

18
WEBBER WENTZEL
in alliance with e-Linklaters

DEVELOPMENTS IN RESTRAINTS OF TRADE

- FNB submitted that the onus was on Prithipal to show that he never acquired any **significant influence** over the persons he dealt with as a salesman for FNB/Southern over and above that which **previously existed** prior to his employment with FNB, and that he had not discharged this onus.
- Prithipal presented a list of 18 names of persons whom he described as his customers and the dates when their relationships with him commenced (**all before he commenced employment with Southern Natal in 2004**)
- FNB placed no evidence before the court to rebut this evidence
- Accordingly the court found that Prithipal discharged the onus which rests upon him to prove that he never acquired any significant personal knowledge of or influence over the persons he dealt with as a salesman of FNB, **over and above that which previously existed**.

19
WEBBER WENTZEL
in alliance with **Linklaters**

DEVELOPMENTS IN RESTRAINTS OF TRADE

- Balancing the parties' interests**
 - The judge had to consider whether that protectable interest is threatened by Prithipal, and if that is the case, whether that interest of FNB weighs qualitatively and quantitatively against Prithipal not to be economically inactive and unproductive. Prithipal has a wife of 63 years' old who has never been employed and together they have a combined retirement some R2 100 000. A living annuity purchased with this would give him a monthly income of some R10 500 per month upon which he could barely survive. Accordingly it is imperative for him, and his wife, that he continue in employment for as long as he is able.
 - In contrast, FNB is one of the four largest banks in South Africa. The consequence to Prithipal of being unemployed is, *vis à vis* him and his wife, far more serious than the impact would be on FNB if Prithipal is able to work.
 - Thus the court found that the interest of FNB does not outweigh Prithipal's interest in not being economically active.

20
WEBBER WENTZEL
in alliance with **Linklaters**

DEVELOPMENTS IN RESTRAINTS OF TRADE

- Public Policy**
 - Is there an aspect of public policy that requires that the restraint be maintained or rejected?
 - The public interest requires that parties should comply with their contractual obligations.
 - The judge referred specifically to the personal circumstances of Prithipal and found that public policy requires that the restraint should not be enforced.
- The application was dismissed with costs.

21
WEBBER WENTZEL
in alliance with **Linklaters**

DEVELOPMENTS IN RESTRAINTS OF TRADE

- **Nautical Underwriting Managers (Pty) Ltd and Others v Diolete Maria Ferreira Dos Santos and another**
- The application was successful; however we are still awaiting the full judgement

22
WEBBER WENTZEL
in alliance with Linklaters

DEVELOPMENTS IN RESTRAINTS OF TRADE

- **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 Nautical and her new employer both provided a written undertaking that neither she nor the new employer (in this instance, 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**.
 - Dos Santos denied that she need to give any such undertaking.

23
WEBBER WENTZEL
in alliance with Linklaters

DEVELOPMENTS IN RESTRAINTS OF TRADE

- Paradigm and Dos Santos had provided an initial undertaking which was **not acceptable to Nautical**.
- Nautical's apprehension stemmed from both Paradigm's and Dos Santos' conduct in clawing back the ambit of their undertaking, particularly in respect of their understanding of the meaning of the word **"solicit"**.
- They both 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**. Nautical therefore remained vulnerable to the threat of loss against which they protected themselves by way of the restraint undertaking and its proviso.

24
WEBBER WENTZEL
in alliance with Linklaters

DEVELOPMENTS IN RESTRAINTS OF TRADE

- Dos Santos and Paradigm contended that they had furnished the required undertaking and that Dos Santos ought to be permitted to remain in Paradigm's employ. They contended further that Nautical were seeking to extract **relief in excess of what they are contractually entitled to**.

25
WEBBER WENTZEL
in alliance with Linklaters

DEVELOPMENTS IN RESTRAINTS OF TRADE

- **The main issue to be determined by the Court was whether the undertaking as provided by Dos Santos and Paradigm served to adequately protect Nautical's legitimate interests**
 - Nautical's clients are its brokers;
 - It is common cause that 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 and was gainsaid by Dos Santos herself, who admitted, *inter alia*, that –
 - the underwriting managing agents do not deal directly with the policy holders but deal through their representatives who are the brokers;
 - the broker is ultimately in a position to influence the decision as to whether or not insurance is to be placed with Nautical or one of its competitors

26
WEBBER WENTZEL
in alliance with Linklaters

DEVELOPMENTS IN RESTRAINTS OF TRADE

- Nautical has very limited contact with policyholders and relies solely on the brokers to source the business from the policyholders and thereafter, bring such business to Nautical for underwriting;
- she established relationships with Nautical's clients (i.e. its brokers) and that these relationships have been built up over a period of three and a half years during which she rendered services to Nautical; and
- 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.
- Dos Santos states that "she has worked very hard to establish relationships with the brokers" and that "the brokers were the instruments to Nautical's longevity"

27
WEBBER WENTZEL
in alliance with Linklaters

DEVELOPMENTS IN RESTRAINTS OF TRADE

- Paradigm's allegations also belie its denial that the brokers are Nautical's clients. Paradigm accepted that the underwriting managing agents do not deal directly with the policyholders but deal with the brokers who represent them. Indeed, in its explanation of its undertakings, Paradigm refers to interactions with brokers, rather than end-user consumers.

28
WEBBER WENTZEL
in alliance with Linklaters

DEVELOPMENTS IN RESTRAINTS OF TRADE

- Nautical, in order to be reasonable, sought a undertaking limited in its terms, namely that Dos Santos and Paradigm will 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 do 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. Tellingly, both Dos Santos and Paradigm acknowledged and confirmed that their undertaking was given on the basis of the above understanding.
- Notwithstanding that all parties were in agreement that the undertaking must serve to inhibit the **solicitation of these pre-existing policies** from the brokers, Dos Santos and Paradigm asserted that Nautical were somehow demanding **"additional undertakings on different terms"** to those set out above.

29
WEBBER WENTZEL
in alliance with Linklaters

DEVELOPMENTS IN RESTRAINTS OF TRADE

- The definition of "solicit"**
 - Dos Santos and Paradigm contended that the term **"solicit"** does not prevent Paradigm from accepting business of policyholders (via the brokers) provided only that Dos Santos **does not actively** solicit, canvass, persuade, or entice the broker to move the policyholder to Paradigm.
 - The contention that an approach made by an erstwhile customer to the ex-employee (and not the other way round) does not fall foul of a 'non-solicitation' clause, was given short shrift by Judge Mbha in the matter between *Experian South Africa v Haynes and another* (2011) who held that -
- "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".*

30
WEBBER WENTZEL
in alliance with Linklaters

DEVELOPMENTS IN RESTRAINTS OF TRADE

- In John Saner Agreements in Restraint of Trade in South African Law it is noted that the decision in the Experian matter (*supra*) 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”.
- Dos Santos, having acknowledged that she was privy to Nautical's confidential information, further undertook that she would not utilise the confidential information.

31
WEBBER WENTZEL
in alliance with Linklaters

DEVELOPMENTS IN RESTRAINTS OF TRADE

- 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.

32
WEBBER WENTZEL
in alliance with Linklaters

DEVELOPMENTS IN RESTRAINTS OF TRADE

- **On Customer Connections the argument put forward 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) is common cause. That a relationship has of trust has 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.

33
WEBBER WENTZEL
in alliance with Linklaters

DEVELOPMENTS IN AND RESTRAINTS OF TRADE

- **The infringement**
 - Dos Santos, upon whom the onus rests, did not provide any evidence upon which it could be concluded that her continued involvement in Paradigm would not infringe Nautical's proprietary interests.
- **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 remains 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.

WEBBER WENTZEL
in alliance with Linklaters

34

www.webberwentzel.com

JOHANNESBURG

10, 16 & 18 Fricker Road,
Illovo Boulevard,
Johannesburg, 2196, South Africa
T +27 11 530 5000

CAPE TOWN

15th Floor, Convention Tower
Heerengracht, Foreshore
Cape Town, 8001, South Africa
T +27 21 431 7000