



# Restraint of trade: What to consider if you're purchasing a business

A party purchasing a business typically includes a restraint of trade provision in the contract. In consideration of the price, the purchaser requires comfort that the vendor cannot undermine the business by competing in such a way that compromises its value or goodwill. Penalties for breaching a restraint should also be considered at the time of contracting.

The following case was recently before the High Court and demonstrates the issues at play.

## Background

The directors of the vendor company owned two businesses, an earthworks business (Company A) and a gravel quarry business (Company B). They sold Company A to Company C. The name of the company did not change save for amending the incorporation date in the title.

The restraint of trade clause provided that Company A would not, within a defined area, during the 2 year restraint period, in their own right or on behalf of any person or entity, be directly or indirectly involved or engaged with any business or enterprise that was similar to or competed with the business being purchased by Company C. Nor could it solicit or entice away from the business, or attempt to do so, any persons or entity who were a customer or employee of the business at settlement date.

They agreed that if the restraint was breached, damages may not be adequate, and Company C could seek equitable relief including an injunction.

Post settlement, several instances occurred which resulted in Company C applying to the High Court for an injunction.

Company A mistakenly invoiced some of Company C's clients. This was resolved. Its directors, on behalf of Company B, contacted Company C's customers attempting to set up a landscaping business in the "restricted" area. Its directors met with one of Company C's clients to discuss potential work. At this time the restraint still had another 13 months to run. About the same time, Company C learned that Company B had carried out work in the "restricted" area on at least three occasions.

Company C complained to Company A, which countered alleging Company C had breached an essential but unwritten term of the agreement by failing to employ Company A's directors for a period of two years post settlement, rendering the restraint clause manifestly unjust and therefore unenforceable.

The relationship unravelled.

## The Case

Two issues arose. Had there been a fundamental breach of the contract regarding that "employment" provision? If not, had Company A breached the restraint?

On the first issue, Company A suggested that Company B's written agreement to provide vendor assistance to Company C for one year (which it said was onerous) indicated Company C had also agreed to provide

Company A's directors with work for a two year period.

The Court noted there was no reference to this "employment" agreement in the contract and that the agreement required Company A to provide assistance for a specific period of just one year. No breach.

On the second issue, Company A suggested it had never solicited any work at the expense of Company B and the problem had arisen because the relationship between the parties had broken down.

The Court found that there was a prima facie case that Company A had sought business on their own account, in breach of the restraint, and that they intended to continue doing so, claiming that they were legally free to because of the breach of that "employment" provision.

The Court concluded this was not a situation where Company C could obtain an adequate remedy through an award of damages. Firstly, Company A still had the original name available to them so there was the potential for confusion in trade. Secondly, the parties were operating in a relatively confined area with a small market. If Company A was competing for business, there was the potential for it to cause a loss of goodwill, not just through work it obtained at the expense of Company C, but also through damage it might do to the standing of Company C and its key personnel in ways that would not be readily measurable. Company B would be losing the advantage of the freedom from competition it had bargained for.



The Court was satisfied that the situation entitled Company B to an injunction prohibiting Company A in the restricted area from being involved or engaged with any business similar to or competing with Company B's business, or from soliciting or enticing away, or attempting to do so, any personal entity that was a client or employee of Company C.

### Summary

Restraints of trade are typically limited to a specific geographical area and only last for a specific period of time. Generally, a restraint of trade clause will not be enforceable where it acts to prevent fair competition.

In deciding whether a restraint is enforceable, the Courts will assess whether the period of the restraint is reasonable, whether the geographical restriction is reasonable, what consideration was paid for the restraint, whether there is a legitimate interest to be protected and how wide the restraint is.

As between commercial parties, the Courts will be reluctant to hold such an agreement unreasonable and therefore void, preferring to make the necessary orders to ensure that what was bargained for between the parties is upheld.

In this respect, breaches of contract of restraint are prime candidates for injunctive relief.



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