Privy Council Appeal No. 4 of 1973

Stenhouse Australia Limited – – – – – *Appellant*

v.

Marshall William Davidson Phillips – – – – *Respondent*

FROM

THE SUPREME COURT OF NEW SOUTH WALES

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 2ND OCTOBER, 1973

Present at the Hearing:

LORD REID
LORD MORRIS OF BORTH-Y-GEST
LORD WILBERFORCE
LORD SIMON OF GLAISDALE
SIR GARFIELD BARWICK

[*Delivered by* LORD WILBERFORCE]

This appeal from the Supreme Court of New South Wales involves the question whether certain provisions in an agreement under seal dated 23rd March 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 11th December 1964 the respondent entered into an employment agreement with one of the companies in the Stenhouse Group, namely, Stenhouse Scott North Australia Limited. 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 5 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 recognised 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 6th September 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.* 11th December 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 Limited, and its subsidiary and associated companies. There was evidence that between 1st January 1970 and 30th June 1972 the Stenhouse Group acted as insurance broker of some classes of insurance for the Boral Group.

On 12th May 1971 the respondent gave the appellant eight weeks' notice of his intention to resign, but by letter of 13th May 1971 the appellant refused to accept the notice so given. On 9th July 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 & Company 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) Pty. 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 23rd March 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 11th December 1964 and 6th September 1966 ending with the following:

> " Whereas Mr. Phillips [the respondent] has tendered his resignation as an employee of Stenhouse and has requested Stenhouse to release him from his obligations under the above-mentioned Agreements;
>
> And whereas Stenhouse has agreed so to release Mr. Phillips 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 Clause 1 it was agreed that the respondent's employment should cease with effect from 9th July 1971, and by Clause 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. Mr. Phillips 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 Mr. Phillips or through any agency other than

that of one of the Stenhouse companies referred to in Clause 2 of this Agreement so that Mr. Phillips or any person firm or corporation for whom Mr. Phillips is a principal or agent or by whom Mr. Phillips 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 Mr. Phillips 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. Mr. Phillips 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:

"8. 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 Mr. Phillips 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 Mr. Phillips 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 Mr. Phillips 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 3rd July 1972, the appellant sought declarations as to the validity of Clauses 4, 5 and 6 of the agreement, and certain injunctions, an account, and damages. On 26th October 1972, Mahoney J. 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 Clause 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 of misuse of trade secrets or confidential information (which is separately dealt with by Clause 3 of the Agreement and which does not arise here), the employer's claim for protection must be based upon 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 purposes, even though he, the employee, may have contributed to its creation. For while it may be true that an employee is entitled—and is to be encouraged—to build up his own qualities of skill and experience, it is equally his duty to develop and improve his employer's business for the benefit of his employer. These two obligations interlock during his employment: after its termination they diverge and mark the boundary between what the employee may take with him and what he may legitimately be asked to leave behind to his employers.

In the business of insurance and insurance broking, as the evidence in this case shows, a successful enterprise depends upon a number of factors which vary according to the nature of the customer, or client, with whom business is done. The more varied or diversified the business of the client, and the larger the amount of insurance to be placed, the more likely is it that he will look around the market for himself in order to obtain the best terms. With a less diversified business, the likelihood grows that, while he is satisfied with the service he gets, he will keep his business, at least for a period, with the same insurer, and place it through the same broker. The advice and guidance, based on collation of information, by the broker, will be more valuable in such a case, to both broker and customer. In either case, in order to obtain and to retain business it is necessary to cultivate and accumulate knowledge of the client's requirements and of his record, so as to be able to offer him attractive terms. To develop this may be a fairly long term affair: even if it has been developed there is always the risk that the client may decide to go elsewhere if better prospects offer. It is clear from this that the connection between an insurer or insurance broker and his client is not nearly so firm as, for example, that between a solicitor and his client. On the other hand its comparative fragility makes the risk of solicitation of clients by a former employee the more serious. A client is not easily detached from a solicitor who has been handling his affairs over a period of years: but a comparatively mild solicitation may deprive an insurance broker of valuable business which otherwise, assuming attention to and knowledge of his clients' affairs, might safely be reckoned on for a period.

These considerations make it appear that, in principle, a covenant against solicitation of clients may be entirely reasonable and necessary for the protection of the employer. It remains necessary to look carefully at the scope of the particular covenant in question. The significant points, in their Lordships' opinion, are the following:

1. Its expressed duration is for 5 years, but effectively is for less than $4\frac{1}{2}$ years since the period runs from July 1971.

2. The prohibited activity is soliciting, a narrow prohibition, which leaves open (apart from other clauses in the agreement) a wide field in which competitive action by the employee is unrestrained, and one which has often, if suitably confined, been accepted by the Courts.

3. The clients, whom the respondent may not solicit, though widely defined in Clause 8 and including prospective clients, are limited to clients of the Stenhouse Group with whom the respondent has had dealings or negotiations. Even more importantly the definition expressly excludes any Insurance Company. This exclusion was certainly obtained by the respondent and was of great importance to him since the greater part of the work he did was, as already stated, re-insurance. There was nothing corresponding to this exclusion in the earlier agreement. This means that the covenant against solicitation in practice only extends to the comparatively small number of clients with whom the respondent has dealt directly.

In these circumstances the only matter which calls for consideration, in their Lordships' judgment, is the period of its operation: is 5 years too long? While not regarding this as decisive, their Lordships cannot be uninfluenced by the fact that this period was accepted by the respondent in March 1972, at a time and in circumstances when he, as much as anyone in the employment of the Stenhouse Group, would be able to appraise the nature and quality of the interest which the appellant would wish to protect. A period of five years had been stipulated in the previous agreement of 1964: at that time it could only be a pre-estimate of what might, in circumstances which could not be precisely foreseen, be required. But in 1972 the parties were faced with an actual situation, and unless the period fixed was clearly excessive, they may be thought to have agreed upon a realistic limitation.

The learned judge, holding that the period was excessive, took into account some evidence, elicited by the Court itself, from Mr. Hargreaves, the General Manager of a company in the Boral Group which handled much of the Group's insurance. This was directed towards the question how long after termination of his employment a person in the position and with the experience of the respondent might be expected to enjoy an advantage over others in the obtaining of the Boral Group's insurance business. Mr. Hargreaves' opinion was that, in relation to a diversified group such as Boral, a period of 2½ years was the maximum: in relation to an ordinary manufacturing company possibly 3–4 years. His Honour appears to have placed some reliance on this evidence in deciding that 5 years was too long. On this approach their Lordships would make two observations. First, the evidence was, in their opinion, directed to the wrong point. The question is not how long the employee could be expected to enjoy, by virtue of his employment, a competitive edge over others seeking the clients' business. It is, rather, what is a reasonable time during which the employer is entitled to protection against solicitation of clients with whom the employee had contact and influence during employment and who were not bound to the employer by contract or by stability of association. This question, secondly, their Lordships do not consider can advantageously form the subject of direct evidence. It is for the judge, after informing himself as fully as he can of the facts and circumstances relating to the employer's business, the nature of the employer's interest to be protected, and the likely effect on this of solicitation, to decide whether the contractural period is reasonable or not. An opinion as to the reasonableness of elements of it, particularly of the time during which it is to run, can seldom be precise, and can only be formed on a broad and commonsense view. On this matter, while accepting much of the learned judge's reasoning, their Lordships come to the conclusion that the restraint, regard being had to the field in which it was designed to operate, was reasonable and should be upheld.

Clause 5 is a stipulation of a different character. It is not on the face of it a restraint at all, but a provision for the payment of money: it was described by counsel for the appellant as a profit-sharing agreement. And it was submitted that, as such, the court should not enquire whether it was burdensome, or onesided. The learned judge took a different view, holding that it operated in restraint of trade and that it was not shown to be reasonable.

Their Lordships on the whole agree with this view. Whether a particular provision operates in restraint of trade is to be determined not by the form the stipulation wears, but, as the statement of the question itself shows, by its effect in practice. Such approach to provisions of this kind has been endorsed by the High Court in the recent decision of *Howard F. Hudson Pty. Ltd. v. Ronayne* (1972) 46 A.J.L.R. 173, which in turn is in line with English decisions (*cf. Esso Petroleum Co. Ltd. v. Harper's Garage (Stourport) Ltd.* [1968] A.C. 269). The clause in question here contains no direct covenant to abstain from any kind of competition or business, but the question to be answered is whether, in effect, it is likely to cause the employee to refuse business which otherwise he would take: or, looking at it in another way, whether the existence of this

provision would diminish his prospects of employment. Judged by this test, their Lordships have no doubt that the clause operates in restraint of trade. First, it is to be noticed that the employee comes under obligation to pay or procure payment even if business is obtained without his knowledge. Secondly, the proportion which he is committed to pay or procure is 50% of the gross commission regardless of the size of the financial benefit obtained by him. Thirdly, the clause may operate for a period of five years and thereafter the obligation to pay may continue for a further five years. All of these provisions are far more than " profit-sharing " provisions, and contain in aggregate a substantial element of restraint of trade. Finally, it must be appreciated that Clause 5 is closely linked with Clause 6. Indeed if one reads them together the two clauses amount to a restriction, as stated in Clause 6, against acting as insurance broker for clients, unless payment is made according to Clause 5. This too shows that essentially Clause 5 forms part of provisions operating and intended to operate in restraint of trade. Once it is accepted that Clause 5 operates in restraint of trade, the conclusion follows inevitably that it does so unreasonably. This follows from the severity, as regards the employee, of the clause as already explained. Furthermore it is relevant that some protection has already been provided for the employer by the non-solicitation clause (Clause 4, as above). The presence of one restraint diminishes the need for others, or at least increases the burden of those who must justify those others. It cannot be said that provisions such as those in Clauses 5 and 6 are no more than is necessary for the employer's protection when he is already protected against solicitation. As regards Clause 6 itself, their Lordships need say no more than that it is so closely intertwined with Clause 5 that once the latter is held to be unenforceable, Clause 6 must fall at the same time. It has no independent life of its own.

It remains necessary to deal with some subsidiary points.

1. Severance. The only context in which a question of severance can arise, on the opinion previously expressed by their Lordships, is whether Clause 4 can remain effective if Clauses 5 and 6 do not. Cases as to severance were duly cited in argument (*Attwood v. Lamont* [1920] 3 K.B. 571 *et al.*) but there is no need to refer to them. Clause 4 is in no way dependent upon other clauses declared to be unenforceable and since the effect of a holding that a contractual provision is in unreasonable restraint of trade is merely to render that provision unenforceable, without destroying the rest of the contract, there is no reason against enforcement of Clause 4 alone.

2. It was submitted that, since the agreement of 23rd March 1972 was entered into after the termination of the employment, it was an agreement " *in gross* " and so for that reason unenforceable. But this argument fails to take account of the circumstances in which the agreement was made. As already stated, there were, in 1971–72, questions in dispute and unsettled between the appellant and the respondent: first, the question whether the employment had been validly determined by the notice given by the respondent: secondly, there were questions concerning the effect of the restrictions contained in the agreement of 11th December 1964—particularly the restriction against insurance broking within 25 miles of the General Post Office at Sydney. The agreement of 23rd March 1972 recited the previous agreements, the respondent's tendered resignation, and his request to be released from his obligations under the earlier agreements, and recited the appellant's willingness to release him " only on the conditions that he undertakes to be bound by the obligations hereinafter stated ". In the face of these facts it is impossible to agree that the new contract, of March 1972, was unrelated to a subsisting contract of employment, and was merely an agreement *in gross*. It was not contended that there was no consideration for the respondent's covenants therein contained.

3. It was submitted that whereas the agreement of 23rd March 1972 was made with the appellant company, the interests to be protected were the interests of its subsidiaries—independent legal entities—and reference

was made to the case of *Henry Leetham & Sons Ltd. v. Johnstone-White* [1907] 1 Ch. 189, 322. That was a case where the agreement, as interpreted by the Court of Appeal, was with one company of a group, that one company having a limited business, whereas the restraint was expressed in far wider terms, extending to the area covered by the operations of the group as a whole. The facts of this case are different and do not support the respondent's argument, technically attractive though it may appear. The evidence is clear that the business of the Stenhouse Group was controlled and co-ordinated by the appellant company, and all funds generated by each of the companies were received by the appellant. The subsidiary companies were merely agencies or instrumentalities through which the appellant company directed its integrated business. Not only did the appellant company have a real interest in protecting the businesses of the subsidiaries, but the real interest of so doing was that of the appellant company. It is not necessary to resort to a conception of " group enterprise " to support these proceedings. The case is, more simply, that of the appellant's business being to some extent handled for it by subsidiary companies. Their Lordships therefore agree with the Judge in rejecting this argument.

In the view which their Lordships take of this matter as a whole, the appellant succeeds as to the validity of Clause 4 of the agreement of 23rd March 1972, but not as regards the provisions contained in Clauses 5 and 6. They will humbly advise Her Majesty that, to that extent, the appeal be allowed, that a declaration be made that the provisions of Clause 4 of the Deed made between the appellant of the one part and the respondent of the other part on 23rd March 1972 are valid and enforceable. The appellant is to be at liberty to apply to the Supreme Court for the granting of an injunction in accordance with such declaration. The respondent must pay one half of the appellant's costs before this Board and in the Supreme Court.

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In the Privy Council

STENHOUSE AUSTRALIA LIMITED

v.

MARSHALL WILLIAM DAVIDSON PHILLIPS

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