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Court of Appeal Changes Law on Restraint of Trade

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In March 2007, the Court of Appeal kicked for touch the prevalent idea that extra contractual consideration (that is, something of value) is a prerequisite for an enforceable restraint of trade.

Restraint of trade clauses are a feature in many agreements with employees, contractors and businesses (such as on the sale of a business). However the party relying on a clause must be able to show that the protection is reasonable in all the circumstances (e.g. that someone should not trade in the same area for three months).[1]

Since a 1993 case, many have taken the view that, for a restraint of trade clause to be effective, extra consideration (that is, something of value) must be given.

That conclusion flies in the face of normal contract law. The general rule is that, where there is in fact consideration, the Courts will not enquire into the adequacy of that consideration (for example it won't be concerned whether a car is sold for $1 or $10,000, whatever the car's value).

In March 2007, the Court of Appeal has said that the same point applies to restraint of trade provisions. At the level of contract law, those provisions do not require an extra "*premium*" in the contract. It's not the job of the courts to enquire into the adequacy of consideration, including in these situations.[2]

The Court of Appeal noted that the error arose from a wrong interpretation of a 1993 case. That case was dealing with a subsequent variation of an employment agreement. Extra consideration was required to support the variation (the variation itself needed consideration as though it is a new contract)[3]. But generally, a restraint of trade arises when there is only one contract and no variation (that is, it is sorted when the relationship starts).

So, in the judgment under appeal, the Court wrongly looked for:

- specific consideration (e.g. an additional payment expressly stated in the agreement) for the restraint of trade; or
- some other "*premium*" which could be inferred from the circumstances.

That is the wrong approach.

That doesn't mean, as the Court of Appeal said, that the issue of adequacy of consideration (e.g. whether the dollar payment is enough) is irrelevant. There is a separate question as to whether the restraint of trade is reasonable. The adequacy of consideration can be relevant to that issue. To take an extreme example, if all journalists at a newspaper are paid $30,000 and only one journalist has a restraint of trade provision, that's a strong indicator that the

[1] For further background, see our article, *Confidential Information and Restraint of Trade: Practical Issues* http://www.wigleylaw.com/Articles/ArticleArchive/HeresyConsiderationNotNeededInContracts/.
Note that this is a 2002 paper, and so there have been other developments since.

[2] The decision is *Fuel Espresso v. Hsieh* [2007] NZCA 58.

[3] The Court of Appeal decided, in another case, that sometimes consideration is not required. See our article, *Heresy: Consideration not needed in Contracts* http://www.wigleylaw.com/Articles/ArticleArchive/HeresyConsiderationNotNeededInContracts/

restraint would be unreasonable. Generally however, circumstances are not as clear as that.

The Courts will delve more deeply into the amount of the payment with, for example, lower paid employees. At the other extreme (such as on the sale of a business), the Courts are much less likely to topple a restraint of trade provision.

We welcome your feedback on this article and any enquiries in relation to its contents. This article is intended to provide a summary of the material covered and does not constitute legal advice. We can provide specialist legal advice on the full range of matters contained in this article.

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