It is not uncommon to see a restraint of trade clause in a franchise agreement. Generally, the restraint will act to prevent a franchisee and key staff from competing with the franchisor during and after the franchise agreement.

Breach of such a restraint may result in legal action to enforce the clause and seek compensation. The Court will be asked to make an assessment of whether the restraint of trade is reasonable and able to be upheld.

In this update we look at the principles of restraints of trade clauses in commercial use, and review a recent case which illustrates how these principles are implemented in practice.

Principles of restraints

What are the purposes of restraints?

Franchisors may include a restraint of trade clause in the franchise agreement. Their main reason for doing so is usually to protect the franchisor’s commercial interests by preventing the franchisee from using the franchise’s systems, customers and intellectual property for the advantage of a competitor.

Restraints of trade will usually specify what is prohibited, where it is prohibited and for how long.

When will a restraint be reasonable?

Restraint of trade clauses will be enforceable to the extent that the restraint is reasonably necessary to protect the legitimate business interests of the protected party. Whether a clause is reasonably necessary depends on the particular circumstances of the case. The clause must be reasonable in the interests of the parties as well as the public.

The courts will generally consider the geographical range and time period of restraint. For example, a restraint on a franchisee from selling products within 30km of the franchisor for a period of 10 years may be considered unreasonable, but a restraint of 15km for four years might be considered reasonable depending on the circumstances.

The time for assessing the reasonableness of the restraint is the date the restraint was imposed, not the time the restraint is sought to be enforced or challenged.
Recent Case

The case of *RPR Maintenance Pty Ltd v Marmax Investments Pty Ltd* [2014] FCA 409 demonstrates how a Court may apply a restraint of trade clause contained in a franchise agreement.

Facts

Spanline designed, manufacture and sold home extensions or additions to both homebuilders and professional builders through a national network of franchises and sub-franchises.

RPR Maintenance (RPR) has been a franchisee of Spanline since 2001 in the New South Wales South Coast area.

In 2003 Marmax, RPR and Spanline entered into a sub-franchise agreement granting a sub-franchise to Marmax in the Illawarra area. This agreement contained clauses titled ‘Vendor’s restraint obligations’ and ‘Purchaser restraint obligations’.

In essence, these clauses imposed restraint obligations on RPR to not promote, participate in, finance, operate or engage in business similar to or competitive with the Spanline franchise business in the Illawarra franchise area, and imposed the same obligations on Marmax in respect of the South Coast franchise area.

The restraint period was given multiple definitions, via a ‘cascading clause’, ranging from one year to 10 years.

The core of the dispute related to RPR’s claims that Marmax had sold and installed Spanline products to customers located within RPR’s franchise territory, thus breaching the restraint of trade.

RPR also complained that Spanline had breached their franchise agreement by not taking appropriate action against Marmax to protect RPR’s exclusivity.

Marmax argued that the restraint of trade was neither reasonable in the interests of the parties nor in the interests of the public, and should therefore be declared void and unenforceable. Marmax particularly argued that the length of restraint was unreasonable.

Decision

Restraint of trade

In deciding whether the restraint imposed on Marmax should be void as a restraint of trade, the Court outlined three key principles it would consider:

1. At common law, a restraint clause is void against public policy unless it is shown to be reasonable in the interests of the parties and with reference to public interest;
2. The onus of establishing reasonableness rests with the party seeking to enforce the restriction; and
3. The reasonableness of such a clause is to be determined as at the date of its creation.

When assessing reasonableness, it was noted that the Courts have generally taken a conservative approach in assessing the reasonableness of a restraint in a sale of business context as opposed to, for example, a contract of employment, due to a greater inequality, in bargaining power. However, here both parties were legally represented so no issue of inequality of bargaining power was considered to have existed.
The Court considered the reasonableness of the restraint against three criteria being:

1. the scope of trade restrained;
2. the geographical territory covered; and
3. the duration of the restraint.

The Court was of the view that the scope of the restraint clauses reasonably protected the legitimate interests of RPR, being the preservation and success of its exclusive Spanline franchise for the South Coast territory.

Marmax complained it was unreasonable that customers in RPR’s territory, but whose houses are closer to Marmax’s business, could not use Marmax. The Court did not accept this as only a minority of jobs resulted from customers visiting a Spanline showroom and inconvenience is an inevitable consequence of an exclusive franchise arrangement which impacts upon customer choice.

Finally, with respect to the duration of the restraint, the Court was of the view that multiple restraint periods were not unusual in commercial agreements and the purpose of providing multiple dates was clearly to cover the contingency of longer period(s) being declared void. The Court accepted that 10 years was unreasonable as the restraint should not extend beyond the life of the sub-franchise agreement as there was no certainty Spanline would renew any agreements.

It was concluded that any period beyond the five year term of the sub-franchise agreement would be unreasonable as being against the public interest. It would be contrary to the public interest to accept as reasonable a restraint of trade which went beyond the term of the parties’ franchise relationship.

RPR was found to have established that Marmax breached the sub-franchise agreement by doing jobs in RPR’s territory whilst subject to the restraint. The Court concluded RPR was entitled to damages and provided the parties with time to quantify damages in light of the Court’s reasons and agree to final orders.

**What about Spanline?**

It is also worth noting the conclusions the Court drew about Spanline, in their role as RPR’s franchisor.

The Court found Spanline did not fulfill its obligation to do all things necessary and reasonable on its part to enable RPR to have the benefit of the exclusivity provided by the franchise agreement.

RPR had made complaints to Spanline about another company using Spanline products in RPR’s territory. The Court concluded that Spanline’s investigations into these complaints were ‘seriously deficient’.

Spanline had the ability to discover whether Marmax was completing jobs in RPR’s territory which would have “placed Spanline in an informed position to determine what further action it, as a franchisor, should take against Marmax”. The Court was of the view that Spanline should have conducted investigations to fulfill its legal obligations as a franchisor, but instead Spanline was driven by a desire to maximise their own profit.

However, the Court did not accept that Spanline had induced Marmax to breach the agreement, so Spanline was not found to be in breach.

**Take-Away Points**

This case provides an example to franchisors and franchisees about the operation and enforceability of restraint provisions.
Restraints of trade: Effective in a franchise agreement? (cont.)

When entering an agreement, parties should identify restraint of trade clauses and assess whether they will be an issue before entering the contract. As the case discussed illustrates, courts will not necessarily agree that the restraint is unreasonable.

A carefully worded restraint of trade clause can effectively protect the legitimate business interests and include a cascading clause, in respect to geographic restraints (e.g. 10km, 5km, 3km) and/or time constraints (e.g. 10 years, 7 years, 5 years). This will mean if the Court thinks one option is unreasonable, there are other options which can still apply.

Also if, like in the case discussed, there is a sub-franchise agreement, then the main franchisor should be aware of the responsibility they have to inform their franchisee of a breach of restraint of trade if they become aware of one and potentially take action to give effect to the terms granted under the franchise agreement.

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