

# SUPREME COURT OF SOUTH AUSTRALIA

(Full Court: Civil)

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## POSITIVE ENDEAVOUR PTY LTD v MADIGAN & ORS

[2009] SASC 281

### Judgment of The Full Court

(The Honourable Justice Bleby, The Honourable Justice Gray and The Honourable Justice Layton)

9 September 2009

**TRADE AND COMMERCE - OTHER REGULATION OF TRADE OR  
COMMERCE - RESTRAINTS OF TRADE - VALIDITY AND  
REASONABLENESS - PARTICULAR CASES - VENDOR OF BUSINESS**

**TRADE AND COMMERCE - OTHER REGULATION OF TRADE OR  
COMMERCE - RESTRAINTS OF TRADE - SEVERANCE**

**CONTRACTS - GENERAL CONTRACTUAL PRINCIPLES -  
CONSTRUCTION AND INTERPRETATION OF CONTRACTS**

Appeal from order of District Court Judge dismissing appellant's claim for damages for breach of contract – appellant and its controller were partners in finance broking business together with the respondents and companies controlled by them – partnership was dissolved and appellant bought part of business from other partners – contract for sale of business included clause by which vendors agreed not to “solicit, canvass or secure the custom of a person who is at completion, or was within twelve months before completion, a customer” of any of the partnership entities – appellant claims damages for breach of restraint of trade clause.

Whether restraint of trade clause imposes unreasonable restraint on trade – whether clause too broad in the activities it prohibits, the customers with whom it prohibits trading and the duration for which the restraint is to continue – consideration of intended purpose of restraint – whether severance is appropriate – whether relief available against the third respondent, a company controlled by the first and second respondents.

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**On Appeal from DISTRICT COURT OF SOUTH AUSTRALIA (HER HONOUR JUDGE SHAW) [2008] SADC 33**

**Appellant: POSITIVE ENDEAVOUR PTY LTD      Counsel: MR J WHITE - Solicitor: PETER SCRAGG & ASSOCIATES**

**First Respondent: TREVOR JOHN MADIGAN      Counsel: MR P J GEYER - Solicitor: MR P GEYER**

**Second Respondent: KYLIE JAYNE LEHMANN      Counsel: MR P J GEYER - Solicitor: MR P GEYER**

**Third Respondent: FIRST PACIFIC MORTGAGES PTY LTD      Counsel: MR P J GEYER - Solicitor: MR P GEYER**

**Hearing Date/s: 04/05/2009**

**File No/s: SCCIV-08-1452**

**A**

Appeal allowed - (per Bleby and Layton JJ) clause unreasonably broad but severance of part of the clause is possible - (per Gray J) clause is reasonable restraint.

*Supreme Court Act 1935* (SA) s 30; *District Court Act 1991* (SA) s 36, referred to.  
*Brew v Whitlock (No 2)* [1967] VR 803; *Attwood v Lamont* [1920] 3 KB 571, distinguished.  
*Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896;  
*Bank of Credit and Commerce International SA v Ali* [2002] 1 AC 251; *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd* (2004) 219 CLR 165; *Lake v Simmons* [1927] AC 487; *McCann v Switzerland Insurance Australia Ltd* (2000) 203 CLR 579; *Pacific Couriers Ltd v BNP Paribas* (2004) 218 CLR 451; *Watson v Phipps* (1985) 63 ALR 321; *Kirin-Amgen Inc v Hoechst Marion Roussel Ltd* [2005] RPC 9; *Nordenfelt v Maxim Nordenfelt Guns & Ammunition Co Ltd* [1894] AC 535; *Hitchcock v Coker* (1837) 6 AD & E 436; *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269; *Amoco Australia Pty Ltd v Rocca Bros Motor Engineering Company Pty Ltd* (1973) 133 CLR 288; *Ronbar Enterprises v Green* [1954] 2 All ER 266; *Eastwood Co-operative Society Ltd v Williams* (1932) 34 SR(NSW) 403; *Pemberton v Vaughan* (1847) 10 QB 87; *Avery v Langford* (1854) 23 LJ Ch 837; *Fitch v Dewes* [1921] 2 AC 158; *Connors Brothers Ltd v Connors* [1940] 4 All ER 179; *Escott v Thomas* [1934] NZLR 1046; *Humphries v The Proprietors "Surfers Palms North" Group Titles Plan 1955* (1994) 179 CLR 597; *SST Consulting Services Pty Ltd v Rieson* (2006) 225 CLR 516; *Barlow v Neville Jeffress Advertising Pty Ltd* (1994) 4 Tas R 391; *Gilford Motor Co Ltd v Horne* [1933] Ch 935; *Wentworth v Woollahra Municipal Council* (1982) 149 CLR 672, discussed.  
*Maggbury Pty Ltd v Hafele Australia Pty Ltd* (2001) 210 CLR 181; *Codelfa Construction Pty Ltd v State Rail Authority (NSW)* (1982) 149 CLR 337; *Reardon Smith Line Ltd v Hansen-Tangen* [1976] 1 WLR 989; *Bowler v Hilda Pty Ltd (in liq)* (2001) 112 FCR 59; *Mitchel v Reynolds* (1711) 42 ER 347; *Elsley v JG Collins Insurance Agencies Ltd* (1978) 83 DLR(3d) 1; *McFarlane v Daniell* (1938) 38 SR NSW 337; *Thomas Brown & Sons Ltd v Fazal Deen* (1962) 108 CLR 391; *Carney v Herbert* [1985] AC 301; *Brooks v Burns Philp Trustee Co Ltd* (1969) 121 CLR 432; *Lindner v Murdock's Garage* (1950) 83 CLR 628; *H & R Block Ltd v Sanott* [1976] 1 NZLR 213; *Hawker de Havilland Ltd v Fernandes* [1996] ATPR 41-479; *Artemus (Aust) Pty Ltd v Del Casale* [2006] NSWSC 146; *Smith v Hancock* [1894] 2 Ch 377; *Ferguson v Wilson* (1866) LR 2 Ch ; *Mills v Ruthol Pty Ltd* (2004) 61 NSWLR 1; *The Millstream Pty Ltd v Schultz* [1980] 1 NSWLR 547; *ASA Constructions Pty Ltd v Iwanof* [1975] 1 NSWLR 512; *JC Williamson Ltd v Lukey and Mulholland* (1931) 45 CLR 283, considered.

**POSITIVE ENDEAVOUR PTY LTD v MADIGAN & ORS**  
**[2009] SASC 281**

**Full Court:     Bleby, Gray and Layton JJ**

1     **BLEBY J.**           The facts giving rise to this litigation are adequately set out in the judgment of Gray J at paragraphs [55]-[70]. I will not repeat them.

**The restraint provisions and principles of interrelation**

2           The contract for the sale and purchase of the shares in the Fairway companies was between the respondents Mr Madigan and Ms Lehmann and their respective companies Kopala Pty Ltd and Erimus Pty Ltd, as vendors on the one hand and Mr Smoker and the appellant Positive Endeavour Pty Ltd (“Positive Endeavour”), as purchasers on the other hand. For the purpose of these reasons it is convenient to set out in full the terms of the restraint provisions of the contract. Clause 8 provided:

**Restraint**

8.     (1)   *Non-interference*

On and from completion, each vendor must not, and must procure that each of its associated persons does not:

- (a)   solicit, canvass or secure the custom of a person who is at completion, or was within twelve months before completion, a customer of a body corporate or the vendors or purchasers in connection with a body corporate, except as set out in schedule 1;
- (b)   represent itself as being in any way connected with, interested in or associated with a body corporate (except as the prior owner of the shares) or any business conducted by the purchasers, or a body corporate;
- (c)   itself or by any of its agents or servants, disclose or use to advantage or to the disadvantage of the purchasers:
  - (i)   the name of any person who is at completion, or was within twelve months before completion, a customer of a body corporate, or of the vendors in relation to a body corporate;
  - or
  - (ii)  any of the trade secrets, or secret or confidential operations, processes or dealings of, or any confidential information relating to, a body corporate or its organisation, finances, transactions, customers or affairs; or

- (d) solicit, employ or engage the services of any person (other than Ms. Jackie Aylesbury) who is at completion, or was within twelve months before completion, an employee of a body corporate.

(2) *Permitted involvement*

Clause 8(1) does not prevent a vendor, together with any of its associated persons, being the holders in aggregate of less than two per cent of the issued shares or units of a company or unit trust listed on the stock market conducted by the Australian Stock Exchange Limited.

(3) *Independence of Restraint*

Each of the restraint obligations imposed on the vendors by clause 8(1) is a separate and independent obligation from the other restraint obligations imposed (although they are cumulative in effect).

(4) *Reasonableness of restraint*

The vendors agree that each of the restraint obligations imposed by clause 8(1):

- (a) is reasonable in its extent having regard to the interests of each party to this agreement;
- (b) extends no further than is reasonably necessary;
- (c) is solely to protect the purchasers as purchasers of the shares in respect of the goodwill of the bodies corporate and the businesses;
- (d) has been taken into consideration by the vendors in fixing the purchase price; and
- (e) that a breach of the same cannot be adequately compensated by payment of damages and warrants injunctive relief.

(5) *Definition of customer*

In this clause 8, 'customer' means a person who has entered into an agreement with any body corporate to arrange a loan on behalf of that person.

3 For the purpose of that clause "associated person" was defined in the contract as meaning:

'Associated person' means:

- (a) in relation to a corporation, any related corporation, director or substantial shareholder (as the term is defined in the *Corporations Act 2001*) of the corporation; and
- (b) in relation to a natural person, any spouse, or blood or adoptive relative of that person or that person's spouse;

The reference to “body corporate” was a reference to the companies the shares in which were the subject of the contract of sale and purchase.

4 Clause 8(1)(a) refers to an exception contained in Schedule 1. Schedule 1 was in the following terms:

**SCHEDULE 1** (*clause 8(1)(a)*)

**Restraint**

The vendors are permitted to undertake further business with the customers listed below, including re-financing loans already in existence at the time of this agreement, provided however that any lending services provided to these customers relate solely to commercial or business lending. Under no circumstances are the vendors or any of them to provide lending services to any customer included in the terms of clause 8(1)(a) in relation to personal lending or home loans (including loans for the purpose of purchasing investment property) and whether new loans or re-financing of existing loans,

O’Neill RJ, RJ & CA  
Clift PJ (Epic Peat Pty Ltd)  
Willson, A & G  
Allen RH (ABTEC Services Pty Ltd)  
Heusler J  
Nolan J  
Pipikos S

5 The principles of interpretation of contracts and in particular of restraint of trade clauses stated by Gray J are well-known. They were not in dispute in this case. Of particular significance in this case is the need to construe the terms of the contract against its primary purpose and the conventions of the industry in which the parties are engaged.<sup>1</sup>

**The trial Judge’s findings**

6 I agree that the trial Judge made the four errors identified by Gray J in his reasons at paragraphs [97]-[101]. However, it does not follow that the trial Judge was necessarily wrong in her conclusion that the restraint provisions were invalid as being in restraint of trade.

7 The crucial provisions in the contract are cl 8(1)(a) and, as will be seen, part of Schedule 1. For the purpose of those provisions, “customer” was defined in cl 8(5) as meaning “a person who has entered into an agreement with any body corporate to arrange a loan on behalf of that person”.

8 In order to understand how that definition was understood and applied in the finance broking industry, the Judge found, and it was not in dispute, that it was “common knowledge” in the industry that a person became a customer upon

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<sup>1</sup> *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd* [2004] HCA 52, [40], (2004) 219 CLR 165, 179; *McCann v Switzerland Insurance Australia Ltd* [2008] HCA 65, [22], (2000) 203 CLR 579, 589; *Pacific Carriers Ltd v BNP Paribas* [2004] HCA 35, [22], (2004) 218 CLR 451, 461-462.

settlement of the loan and remained a customer until the loan was discharged either by repayment, renegotiation or default. This meant that, for the broker, there was an ongoing entitlement to “trail” commissions from the lender for the duration of the loan, in accordance with commission arrangements between the broker and the lender.

### **The effect of the restraint provisions**

9 Some other observations need to be made about cl 8 and Schedule 1. First, by cl 8(1)(a) the restraint was to operate “on and from completion” of the contract. Completion occurred on 22 March 2004. What was embargoed by reason of the restraint clause was that from that date the vendors must not “solicit, canvass or secure” the custom of a relevant person. The use of the word “secure” enlarges substantially the scope of the restraint beyond mere soliciting or canvassing. It would include actions which may not have been stimulated by the vendor but which resulted from the initiative of the customer. That breadth of the restraint is also reflected in Schedule 1 which provided that “under no circumstances are the vendors or any of them to **provide** lending services ...”. The use of the words “secure” and “provide” make quite clear that what was prevented was the actual arranging of a loan by a vendor, even where the customer might, of his or her own volition, seek out the vendor and request the vendor to arrange the loan.

10 Secondly, the breadth of the restraint is also indicated by the definition of “customer” in cl 8(5). It means a person who has entered into an agreement with a body corporate to arrange “a loan” on behalf of that person. There is no restriction on the type of loan, whether it be for housing, investment, commercial or personal purposes. That such breadth was intended is also apparent from the terms of Schedule 1 which excluded certain customers from the restraint but which exclusions were limited “solely to commercial or business lending”. It was therefore a limited exclusion in respect of the named customers, with loans for any other purpose not falling within the exclusion.

11 The third observation concerns cl 8(1)(a). There are two classes of customer described in that paragraph. The first class is a person who “is at completion” a customer of a body corporate. The second class is a person who “was within 12 months before [22 March 2004] a customer”. Mr Smoker, in evidence, gave an explanation for the inclusion of this latter class. According to him that class was included because the effective operation of the partnership had ceased some 12 months previously, but the accreditation of Fairway Securities Pty Ltd had continued to be used during that time, even though the loans may have been negotiated separately by the vendors. The class was included to avoid any dispute as to who might have been a customer during that period. While that may be an explanation for the inclusion of this class, the actual provision does nothing to achieve that object and seems to have included more people than were intended, at least by Mr Smoker. I consider that the addition was not necessary to achieve

Mr Smoker's intention, and that that intention is achieved without the addition of those words.

12 Nevertheless, it is the words of the contract that must be given effect, rather than the intention of Mr Smoker. This class would include any customer who, within the 12 month period from 22 March 2003 to 22 March 2004 had become a customer but, as at 22 March 2004 had ceased to be a customer by virtue of termination of the loan. It would also include a customer who had been a customer for many years with an existing loan which had been discharged prior to 22 March 2004 and not renewed. These two classes of customer must therefore be included in the group of persons in respect of whom the restraint applies.

13 The fourth point to note is that there are no words of limitation contained within the clause or anywhere else in the contract which suggest that the restraint is not to continue in perpetuity, at least so far as the personal respondents to the appeal are concerned, for the rest of their lives.

14 The fifth point to be made about the provision is the effect of Schedule 1. I have already drawn attention to its effect on the breadth of the restraint both as to the services and as to the type of loan to which the restraint extends. Schedule 1 also has a significant effect on the interpretation of cl 8(1)(a).

15 The first sentence relates solely to the exception. The second sentence, however, applies to "any customer included in cl 8(1)(a)". It does not apply only to the parties listed in Schedule 1. Indeed, it has no effect on the exception at all. If it has any work to do, it must be read in conjunction with cl 8(1)(a) as explaining or qualifying the operation of that paragraph.

16 The sixth point to be made about the provision is its intended purpose. That is seen in cl 8(4)(c) and (d) as being "solely to protect the purchasers as purchasers of the shares in respect of the goodwill of the bodies corporate and the businesses". The only component of goodwill in the business was the right to trail and other commissions. It was the value of that right only which determined the price paid by the purchaser. It was the extent of the restraint obligations which was said to have been "taken into consideration by the vendors in fixing in the purchase price".

17 The final point to be made about the provision is that, besides cl 8(1)(a) fixing two classes of customer,<sup>2</sup> the second sentence of Schedule 1, as well as recognising loans for a variety of purposes, recognises two classes of loan included in the restraint, namely new loans and refinancing of existing loans. This will be of some significance in considering the question of severance.

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<sup>2</sup> See para [11] above.

**The purpose of the provisions and the protection required**

18 I have already referred to the intended purpose of the restraint as reflected in cl 8(4). Put another way, its purpose was to preserve the asset represented by the purchase of the shares by Positive Endeavour. It was apparent from the evidence that that asset was the right to receive income by way of commissions paid to the bodies corporate by various lenders in respect of loans arranged by or on behalf of the bodies corporate by any of the former partners. According to the evidence the right to receive those commissions had two components.

19 First, Positive Endeavour was effectively purchasing shares in a business which included a right to ongoing income by way of trail commissions from lenders for as long as the loans negotiated by the broker and current at the date of the sale of the business continued. If one of the vendors was to solicit such a customer to refinance their loan, or merely “secure” that customer without any solicitation, the existing loan would be discharged and trail commissions would cease. The existing business, shares in which Positive Endeavour had purchased, would thereby be diminished. It was that right to existing trail commissions which, in part, Positive Endeavour was seeking and was entitled to protect by way of a restraint clause against the vendors. If a borrower merely wished to raise an additional loan without discharging the existing loan, the broker who negotiated the new loan would be entitled to commissions on the new loan, but the trail commissions on the existing loan would continue. In that situation the purchaser in this case would suffer no less.

20 The second component of commissions to be protected concerned the refinancing of existing borrowings. As already noted, the right to trail commissions will cease where a loan is repaid or is discharged by default. That is a risk which attends the broker upon the negotiation of any loan. However, the evidence showed that a substantial part of a finance broker’s business and entitlement to commissions relates to borrowers returning to the agent to refinance their borrowings in order to consolidate or extend their borrowings. This involves renegotiating the loan with the same or a different lender. It results in the cancellation of the existing trail commissions but also in the payment of an additional up front commission on the negotiation of a fresh loan and the payment of new, or what might be described as replacement, trail commissions on the replacement loan. If the refinancing is done through the same broker, although the existing right to trail commissions ceases, the right to ongoing commissions is effectively protected and possibly enhanced by the renegotiation of the loan. The right to those commissions will not be protected if, while the existing loan continues, another broker is able to negotiate the refinancing of the loan and hence obtain the right to ongoing commissions in respect of the renegotiated loan.

21 Thus, what Positive Endeavour bought was the right to trail commissions previously earned by the vendors. Those commissions included both trail commissions on existing loans and the right to earn further commissions upon a

customer seeking to refinance the current loan. It would therefore not be unreasonable to protect the asset purchased by a restraint clause which prevented the vendors from securing loans for persons who were customers in the sense described above as at 22 March 2004 for so long as those existing loans continued. The vendors would then be prevented from negotiating the refinancing of loans for those persons because that would be during the period that they remained customers of the bodies corporate.

### **The validity of the provisions**

22 The validity of the restraint provisions must therefore be measured against what was required to be protected compared with what the clause actually provides.

23 Counsel for the appellants argued that the class of persons the subject of the restraint provision was limited to those persons who were customers as at 22 March 2004 and that the restraint would only apply “during the term of the loan which was in existence” as at 22 March 2004. He submitted that the restraint would come to an end at such time as the loan came to an end by reason of default or by reason of being refinanced elsewhere. In that way, the entitlement of the appellants to the commissions that they had purchased would be preserved.

24 However, so to hold would be to read words into cl 8(1)(a) which are not there. The clause applies to customers of both classes discussed above. It applies in perpetuity. It prevents the vendors from negotiating, on behalf of such customers, any loan for any purpose at any time in the future, including any new or additional loan that a customer may wish to arrange. It goes beyond the refinancing of a loan existing at “completion”, which it appears was the limit of the intended purpose of the restraint clause.

25 It was common ground that the only asset of the vendor companies was the value of future commissions in the trail book. Mr Smoker and his company were purchasing the right to those future commissions. A calculation of \$120,000 was made by the vendor for the purchase price. This calculation centred around estimated future commissions from the trail book with certain deductions and adjustments including application of a multiplier to arrive at a present day value. The evidence was both confused and confusing. It does not matter, for present purposes, how it was arrived at. It is evident, however, that it was based on an expectation of the payment of future commissions for a finite period in respect of those persons who were “customers” as at 22 March 2004. Adequate protection could have been achieved by imposing an appropriate time limitation on the operation of the restraint clause or by limiting the class of person and the class of loan to which the provision related. No such limitation was included. To apply restraint in respect of all persons who were customers at the relevant time for ever for any class of loan went beyond what was reasonable for the protection of the value of the asset which Positive Endeavour purchased. That is enough to invalidate the clause.

26 I consider that it would also be against public policy and should not be enforced for that reason. While it does not prevent “customers” of the bodies corporate from instructing a finance broker of their choice other than the respondents, it does prevent them forever from engaging the respondents or any of them for that purpose. It restricts their freedom to contract for an unreasonable period. While some restriction on customers’ rights to engage finance brokers is necessary in the public interest to preserve the value of an asset being purchased, it cannot be in the public interest to impose that restriction effectively for the life of the customer, and in respect of any class of loan at any time.

27 I do not consider it possible to construe the existing provisions to limit their meaning in order to arrive at a reasonable restriction. This is not a case where the words can be construed to exclude something improbable or unlikely to occur, and therefore not within the contemplation of the parties, such as was the approach able to be taken by the majority in *Rentokil Pty Ltd v Lee*.<sup>3</sup> That principle was referred to by Doyle CJ in the following terms:<sup>4</sup>

I also accept that in construing such restraints a court will not treat them as providing a protection which is more than reasonable, and so hold them void, because there are circumstances, falling within the restraint but either unlikely to occur or not within the contemplation of the parties, in which the protection provided by the restraint would be more than reasonable. The judgment of Lindley MR in *Haynes v Doman*<sup>5</sup> which is set out in the judgments of Matheson J and Debelle J adequately expresses this principle. To my mind the principle is concisely summarised in *Home Counties Dairies Ltd v Skilton*:<sup>6</sup>

"If a clause is valid in all ordinary circumstances which can have been contemplated by the parties, it is equally valid notwithstanding that it might cover circumstances which are so "extravagant", "fantastic", "unlikely or improbable" that they must have been entirely outside the contemplation of the parties."

28 Such a construction is more likely to be available in respect of the description of the activities proscribed, as was the case in *Rentokil* itself. However, the invalidity in this case does not turn on the breadth of the activities referred to in clause 8(1)(a). It relates to the description of the classes of person who might not be solicited, canvassed or secured, and the class of loans which may not be negotiated. Those classes are clearly defined and cannot easily be read down.

29 The plain meaning of the words takes the provisions well beyond that which was necessary to protect the asset purchased by the appellants. The only way the provision could be made reasonable is by inserting words which are not there or by severing words which are. There was no claim for nor any evidence directed to possible rectification of the contract by inserting words of limitation

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<sup>3</sup> (1995) 66 SASR 301.

<sup>4</sup> *Ibid* 304.

<sup>5</sup> [1899] 2 Ch 13, 24-26.

<sup>6</sup> [1970] 1 WLR 526, [1970] 1 All ER 1227, Salmon LJ 536; 1233.

into the provision. Without such a remedy the Court will not rewrite the contract for the parties.<sup>7</sup> It is necessary, therefore, to consider whether severance of some part of the provision is appropriate and practicable.

### Severance

30 The general principle relating to severance of promises within a contract was summarised by McHugh J in *Humphries v The Proprietors "Surfers Palms North" Group Titles Plan 1955*:<sup>8</sup>

#### *Severance*

In the case of promises that are invalid, the general test for determining whether they are severable from the agreement of which they form part was laid down by Jordan C.J. in *McFarlane v. Daniell*<sup>9</sup> in a passage approved by this Court in *Thomas Brown & Sons Ltd. v. Fazal Deen*<sup>10</sup> and by the Privy Council in *Carney v. Herbert*.<sup>11</sup> Jordan C.J. said:<sup>12</sup>

"When valid promises supported by legal consideration are associated with, but separate in form from, invalid promises, the test of whether they are severable is whether they are in substance so connected with the others as to form an indivisible whole which cannot be taken to pieces without altering its nature ... If the elimination of the invalid promises changes the extent only but not the kind of the contract, the valid promises are severable."

However, this is not an exclusive test. The test of severability is a flexible one. "There are not set rules which will decide all cases".<sup>13</sup>

31 In their joint judgment in *SST Consulting Services Pty Ltd v Rieson*,<sup>14</sup> Gleeson CJ, Gummow, Hayne, Heydon and Crennan JJ identified a number of questions affecting the law of severance in relation to covenants in unreasonable restraint of trade. Of the first question they said:<sup>15</sup>

The first question is whether the covenantee can enforce the restraining covenant to the extent to which it would have been valid had it been narrowly drafted. The answer is that the covenantee can do so if the parts which are too wide can be removed without altering the nature of the contract and without having to add to, or modify, the wording in any way other than by excision.

32 This is not a case where the invalidity of the restraint provision taints the whole of the contract. Nor is it the type of the situation referred to by the Full

<sup>7</sup> *SA Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269, 295 Lord Reid; *Lindner v Murdock's Garage* (1950) 83 CLR 628, 648 Webb J.

<sup>8</sup> (1994) 179 CLR 597, 618-619.

<sup>9</sup> (1938) 38 SR (NSW) 337.

<sup>10</sup> (1962) 108 CLR 391, 411.

<sup>11</sup> [1985] AC 301, 310-311.

<sup>12</sup> (1938) 38 SR (NSW) 337, 345.

<sup>13</sup> *Carney v Herbert* [1985] AC 301, 309.

<sup>14</sup> [2006] HCA 31, (2006) 225 CLR 516.

<sup>15</sup> *Ibid* [46], 531.

Court of the Supreme Court of Victoria in *Brew v Whitlock (No 2)*,<sup>16</sup> where the Full Court said:<sup>17</sup>

It seems to us that once the conclusion is reached that the invalid promise is so material and important a provision in the whole bargain that there should be inferred an intention not to make a contract which would operate without it, but to make a contract which is conditional upon the operation of that promise, then it must be treated as forming with the other valid promises an indivisible whole which cannot be taken to pieces without altering its nature, and as not being capable of elimination without changing the kind of the contract. ...

On the contrary, the inference to be drawn from cl 8 is that the parties did desire that there should be an operative restraint clause designed to protect the asset being purchased. They expressed the view in cl 8(4)(a) that each of the restraint obligations was reasonable in its extent having regard to the interests of each party to the agreement. If those parts of the restraint provision which render it unreasonable can be severed to make it a valid provision, it seems that that would be consistent with the desire of the parties in entering into the contract.

33 Assuming that the severance of invalid provisions will not vitiate the whole of the contract, the question whether such provisions should be severed is a matter of intention to be gleaned from the terms of the contract itself. In *Rentokil Pty Ltd v Lee*<sup>18</sup> the restraint of trade clause, properly interpreted, was held by Matheson and Debelle JJ to be reasonable and not invalid. Doyle CJ considered that it was unreasonable, and then addressed the question of severance. He said:<sup>19</sup>

The court in considering severance is concerned with the question of whether, properly construed, the relevant agreement should be permitted to operate as between the parties with some part of its apparent or intended operation not being given effect. But while the courts have said on many occasions that they will not rewrite the contract for the parties, in order to create a valid restraint from an invalid restraint, the question is again ultimately one of intention. The question is whether, construing the contract as a whole, it may be concluded on an objective basis that the parties intended the relevant provision to have the reduced operation if it could not have its full operation.

34 In this case such an intention is manifested by the terms of the agreement. Clause 8(3) provides that each of the restraint obligations “is a separate and independent obligation from the other restraint obligations imposed (although they are cumulative in effect)”. Clause 12(5) is also relevant. It provides:

If any provision of this agreement is invalid and not enforceable in accordance with its terms, other provisions which are self-sustaining and capable of separate enforcement with regard to the invalid provision, are and continue to be valid and enforceable in accordance with their terms.

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<sup>16</sup> [1967] VR 803.

<sup>17</sup> *Ibid* 813.

<sup>18</sup> (1995) 66 SASR 301.

<sup>19</sup> *Ibid* 306.

It follows that where there is an identifiably separate and independent obligation which is unreasonable, it can and should be severed.

35 The case is therefore to be distinguished from cases like the well-known case of *Attwood v Lamont*.<sup>20</sup> That case involved a restraint against a former employee, and among other things the Court of Appeal decided that an employer was not entitled by covenant to protect himself after the employment had ceased against the former employee's competition, although the purchaser of goodwill of a business was entitled to protect himself against such competition on the part of the vendor. The plaintiff carried on business at Kidderminster as draper, tailor and general outfitter. The defendant had worked in the tailoring department. The relevant covenant provided that he would not any time after the employment ceased "either on his own account or on that of any wife of his or in partnership with or as assistant, servant, or agent to any other person, persons or company carry on or be in any way directly or indirectly concerned in any of the following trades or businesses; that is to say, the trade or business of a tailor, dressmaker, general draper, milliner, hatter, haberdasher, gentlemen's, ladies' or children's outfitter at any place within the radius of 10 miles of" Kidderminster. Those activities described the extent of the business activities of the plaintiff. Any one or more was capable of being severed by deleting relevant words. However, the Court of Appeal refused to sever all the activities except that of tailor. This was based on the Court's interpretation of the effect of the clause.

36 Lord Sterndale MR considered that a contract could be severed if the severed parts were independent of one another and if the severance did not affect the meaning of the part remaining. The Master of the Rolls said, of the agreement in question:<sup>21</sup>

This was a common form agreement which was required from the head of every department, and each such head was required to agree not to engage in the business of any department however distinct from that of his own, for instance, children's outfitting and tailoring, and however unlikely or even impossible it might be for such head to be brought into contact with the customers of the other departments. If it be admissible to look at the plaintiff's evidence it becomes evident that this was his intention, for he referred in justification of the extent of the restriction to the fact that customers would have to pass through one department in order to get to another. Apart, however, from the evidence, I think it is quite clear that this agreement was part of a scheme by which every head of a department was to be restrained from competition with the plaintiff even in the business of departments with which he had no connection and with the customers of which he was never brought into contact. If this be the true meaning of the agreement, it was, as it is described, an agreement not to trade in opposition and not an agreement to restrain the unfair use of secrets or knowledge of customers acquired by the servant in the employer's service. To effect this object the retention of the restraint to the business of all the departments is necessary, and I think that to strike out all but the tailoring department is not merely to remove one of several covenants, each directed to the legitimate object of preventing unfair competition, but to alter entirely the scope and intention of the agreement. It is thereby sought to be converted from an agreement to restrain general

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<sup>20</sup> [1920] 3 KB 571.

<sup>21</sup> *Ibid* 579-580.

competition into an agreement which will conform to the requirements of the cases to which I have referred.

37 The agreement in this case is not of that type. The separate restraints are intended to be treated as such and as separate covenants. Severance in that situation comes within the exception recognised by Younger LJ, with whom Atkin LJ agreed:<sup>22</sup>

Now I agree with the Master of the Rolls that this was not a case in which upon any principle this severance was permissible. The learned judges of the Divisional Court, I think, took the view that such severance always was permissible when it could be effectively accomplished by the action of a blue pencil. I do not agree. The doctrine of severance has not, I think, gone further than to make it permissible in a case where the covenant is not really a single covenant but is in effect a combination of several distinct covenants. In that case and where the severance can be carried out without the addition or alteration of a word, it is permissible. But in that case only.

Now, here, I think, there is in truth but one covenant for the protection of the respondent's entire business, and not several covenants for the protection of his several businesses. The respondent is, on the evidence, not carrying on several businesses but one business, and, in my opinion, this covenant must stand or fall in its unaltered form.

It follows that, if as a matter of construction of the restraint provision, separate restraints can be identified which make the provision unreasonable, then they can and should be severed.

38 In that regard the case of *Barlow v Neville Jeffress Advertising Pty Ltd*<sup>23</sup> is instructive. The appellant had been the managing director of an advertising business in competition with the respondent's business. The parties entered into an agreement under which the respondent purchased the appellant's business and engaged the appellant to work in the business. The agreement included the following clause:

In consideration for the Purchaser [respondent] agreeing to employ the Covenantor [appellant] upon the terms and conditions hereinbefore appearing the Vendor and the Covenantor jointly and severally covenant and agree that the Covenantor will not during the term of his employment with the Purchaser or for a period of three (3) years from the date of termination of that employment either directly or indirectly or as principal agent employee or otherwise conduct or be associated with the conduct of any advertising business with the Clients *or with any other clients of the Purchaser or with any persons or Corporations who during that period of the Covenantor's employment with the Purchaser become clients of the Purchaser* PROVIDED THAT the provisions of this clause shall not apply to the Covenantor when he is conducting advertising business as an employee of and for the benefit of the Purchaser.

[Emphasis added].

39 The reference in the clause to "the Clients" was a reference to 24 clients identified in a schedule to the agreement.

<sup>22</sup> Ibid 593.

<sup>23</sup> (1994) 4 Tas R 391.

40 The trial Judge found (and the Full Court of the Supreme Court of Tasmania agreed) that the clause was reasonable insofar as it prohibited the appellant from conducting business with “the Clients” but unreasonable to the extent that it applied to other clients. The Court then considered whether the words which are italicised above could be severed. Cox J (with whom Green CJ and Slicer J agreed) said:<sup>24</sup>

The covenant itself is expressed in a series of undertakings to refrain from the prohibited conduct "during the term of his employment or for a period of three years from the date of termination of that employment" with "the clients or with any other clients of the purchaser or with any persons or corporations who during the covenantor's employment with the purchaser become clients of the purchaser". In effect, the undertaking was to refrain from dealing with three classes of persons in two distinct periods of time. The undertaking to refrain from dealing within three years after the termination of his employment with listed clients was a separate and distinct undertaking to any of the other five undertakings. The covenant in question was, in my view, of the kind referred to by Sargant J in *S V Nevanas and Co v Walker and Foreman* [1914] 1 Ch 413 at 423 namely "cases where the two parts of the covenant are expressed in such a way as to amount to a clear severance by the parties themselves, and as to be substantially equivalent to two separate covenants." (See also *Attwood v Lamont* [1920] 3 KB 571 at 578).

Counsel for the appellant did not dispute the three tests stated in Halsbury, 4th edn, vol47, para62 referred to by the learned trial judge as being:

"(1) the severed parts are independent of one another and are substantially equivalent to a number of separate covenants; (2) the severance can be effected without affecting the meaning of the part remaining; and (3) the excess to be severed is not a part of the main purport and substance of the agreement".

He submitted that in substance it was one and not six separate covenants, the original proposal relating only to Clients but being extended by the respondent to other classes; that the severance effects a major reworking of the agreement and ignores the employment component as distinct from the vendor's sale of goodwill; and that the excess severed is part of the main purport and substance of the covenant in that it was contemplated that the appellant would be conducting business with all clients of the business not just with the listed clients. Counsel for the respondent argues however that the negotiations leading to the final wording of the covenant are irrelevant to the question of severance and that it is the effect of the words used in the covenant in its final form which governs the situation. I think this is correct. The parties ultimately included promises not to conduct business with additional classes of client. It was not a case of rewording the covenants so as to restrict dealings with a whole species of persons, namely clients generally, of which listed clients were a subspecies. I agree also with his contention that the evidence shows that the main subject of the agreement in question was to procure the benefit of the patronage of the existing clients of The Ball Agency and to protect that investment. The employment of the appellant was incidental to that. To sever covenants which were designed to protect the respondent from competition from the business of clients to whom the appellant's employment with the respondent might expose him did not effect a major reworking of the agreement as claimed. The main purpose of the appellant's employment was to preserve the connection with the listed clients, an added inducement being that the return of minimum revenue for the first two years from that source would result in the bonus payments to the appellant. In my opinion the

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<sup>24</sup> Ibid 399-400.

covenant can properly be severed, as it was by the learned trial judge, without infringing the tests above set forth.

41 In this case the trial Judge only considered, and it appears was only asked to consider, the possible severance of cl 8(5) of the contract comprising the definition of “customer”. She held that if sub-s (5) was severed the restraint would still be unreasonable and void. I agree. It does no more than identify the bodies corporate in respect of whose customers the restraint was to apply. It does nothing to extend the definition of “customer” to include a class of person which renders the restraint unreasonable. The Judge did not consider, and apparently was not asked to consider, possible severance of cl 8(1)(a) and Schedule 1 of the contract.

42 I return to a consideration of cl 8(1)(a) of the contract affected, as it is, by the second sentence of Schedule 1. I have already identified the two classes of person to whom the clause relates, namely a person who is at completion a customer, and a person who was within 12 months before completion a customer. I have also identified two classes of loans affected, namely new loans and refinancing of existing loans. There are therefore four discrete promises which can be identified which the vendors have undertaken not to breach by soliciting, canvassing or securing custom from:

- 1 In respect of new loans, a person who is at completion a customer;
- 2 In respect of the refinancing of existing loans, a person who is at completion a customer;
- 3 In respect of new loans, a person who was within 12 months of completion a customer; and
- 4 In respect of the refinancing of existing loans, a person who was within 12 months of completion a customer.

Those are each separate covenants identifiable from cl 8(1)(a) and the second sentence of Schedule 1.

43 For reasons which I have explained, promises numbered 1, 3 and 4 are those which make the restraint unreasonable. Promise number 2 is the one that was necessary and reasonable to protect the asset purchased by the appellants. In my opinion the offending covenants can be severed by deleting or ignoring the words struck-out in the following reproduction of cl 8(1)(a) and Schedule 1:

**Restraint**

8. (1) *Non-interference*

On and from completion, each vendor must not, and must procure that each of its associated persons does not:

- (a) solicit, canvass or secure the custom of a person who is at completion, ~~or was within twelve months before completion,~~ a customer of a body corporate or the vendors or purchasers in connection with a body corporate, except as set out in schedule 1;

#### **SCHEDULE 1** (*clause 8(1)(a)*)

##### **Restraint**

The vendors are permitted to undertake further business with the customers listed below, including re-financing loans already in existence at the time of this agreement, provided however that any lending services provided to these customers relate solely to commercial or business lending. Under no circumstances are the vendors or any of them to provide lending services to any customer included in the terms of clause 8(1)(a) in relation to ~~personal lending or home loans (including loans for the purpose of purchasing investment property) and whether new loans or re-financing of existing loans,~~

44 Deletion of the words in cl 8(1)(a) has the effect of removing from the provision the class of person who had been, within 12 months of completion, a customer, but who was not a customer at completion. Such persons could not properly be the subject of the restraint, as there were no trail commissions which required protection in respect of such persons. It leaves unaffected those who were customers at completion.

45 By deleting the reference to new loans and limiting the class of loans to the refinancing of existing loans by deleting the relevant words in Schedule 1, it means that the restraint is also limited in time to the duration of loans existing at completion. By that means the right to existing trail commission is preserved for the duration of the loan, as is the right to fresh commissions on any refinancing of an existing loan, as the negotiation for or arranging of the refinancing cannot be undertaken by the vendors during the currency of the existing loan without breaching the clause. The severance of those words does not prevent vendors from negotiating and arranging new i.e. additional loans for existing customers. However, that would not prejudice the appellants' right to continuing trail commissions on the existing loans, which is what the clause was designed to protect.

##### **Conclusion – Restraint of trade**

46 In my opinion the trial Judge was correct, but for the wrong reasons, in holding that the restraint provisions of the contract as drawn are unreasonable. However, the trial Judge was wrong in failing to sever those identifiable covenants which rendered the provisions void. With appropriate severance I consider that the contract is enforceable.

##### **The position of First Pacific Mortgages Pty Ltd**

47 As to the position of the respondent First Pacific Mortgages Pty Ltd, the trial Judge considered that it was not bound by the restraint because it was not a party to the contract. I agree that it is not liable in damages for any breach of

contract. It was not a party to the contract. However, I agree with Gray J that there may be equitable remedies available against it which have not yet been properly pleaded and which do not rely on contractual liability. It does not matter that the company was already in existence before the date of the contract. What matters is how it was used by the personal defendants in breach of the covenant if indeed there was a breach.

48 As the matter must be remitted to the District Court for further hearing, those are matters which can be pursued in the District Court if the plaintiff is so advised.

### **Proposed orders**

49 For all the foregoing reasons I would order that the appeal be allowed; that the orders made by the District Court on 11 September 2008 be set aside; that there be substituted for those orders an order by way of declaration that:

- (a) Clause 8(1)(a) and Schedule 1 of the agreement dated 22 March 2004 referred to in the Fourth Amended Statement of Claim should be applied as if the expression “, or was within 12 months before completion,” in clause 8(1)(a) and the expression “personal lending or home loans (including loans for the purpose of purchasing investment property) and whether new loans or” in Schedule 1 were deleted therefrom, and
- (b) clause 8(1)(a) and Schedule 1 of the said agreement as so amended are valid and enforceable;

that the plaintiff’s claim be remitted to the District Court for further hearing and determination; and that the respondents pay the appellant’s costs of the appeal to be adjudicated.

**GRAY J.**

50 This is an appeal from an order of a Judge of the District Court dismissing a claim for damages for breach of contract.

51 At issue is the interpretation of a commercial contract and of the enforceability of a restraint of trade clause. A subsidiary issue arises as to whether another entity related to the vendors should be the subject of relief.

52 In relation to a written contract, interpretation is the ascertainment of the meaning which the document would express to a reasonable person, possessed of all the background knowledge which would reasonably have been available to the parties in the situation they were in at the time of the contract.<sup>25</sup> There exists also the principle of objectivity by which the rights and liabilities of the parties to a contract are determined.<sup>26</sup> It is not the subjective beliefs of the parties that govern their contractual relations. Of importance is what each party, by words and conduct, would have led a reasonable person in the position of the other party to believe. The common intention of the parties to a contract, and the meaning of the terms of a contractual document are to be understood as referring to what a reasonable person would understand by the language in which the parties have expressed their agreement. This may require consideration not only of the text, but also of the surrounding circumstances known to the parties, and the purpose and object of a transaction.<sup>27</sup> A commercial contract should be construed having regard to its purpose. This requires an understanding of the genesis of the transaction, its background, its documentary context, and the market in which the parties are operating.<sup>28</sup>

53 The approach to assessment of the validity of a restraint of trade clause is also well established.<sup>29</sup> A restraint of trade must be reasonable. Whether such restraint is reasonable is assessed by considering whether the restraint is such that it affords no more than adequate protection to the interests of the party in favour of whom it is given, whilst at the same time not interfering with the interests of

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<sup>25</sup> *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896, at 912 per Lord Hoffman; see also *Maggbury Pty Ltd v Hafele Aust Pty Ltd* (2001) 210 CLR 181 at [11]

<sup>26</sup> Confirmed in *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd* (2004) 219 CLR 165 at 179 [40], citing *Pacific Carriers Ltd v BNP Paribas* (2004) 218 CLR 451 at 461-462.

<sup>27</sup> *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd* (2004) 219 CLR 165 at 179 [40] citing *Pacific Carriers Ltd v BNP Paribas* (2004) 218 CLR 451 at 461-462.

<sup>28</sup> *Codelfa Construction Pty Ltd v State Rail Authority (NSW)* (1982) 149 CLR 337, 350 applying *Reardon Smith Line Ltd v Hansen-Tangen* [1976] 1 WLR 989, 995-996. See also *Pacific Carriers Ltd v BNP Paribas* (2004) 218 CLR 451.

<sup>29</sup> see eg *Nordenfelt v Maxim Nordenfelt Guns & Ammunition Co Ltd* [1894] AC 535; see also the formulation of the High Court in *Amoco Australia Pty Ltd v Rocca Bros Motor Engineering Co Pty Ltd* (1973) 133 CLR 288.

the public.<sup>30</sup> It is for the party in whose favour the restraint operates to demonstrate that the restraint is reasonable.<sup>31</sup>

54 The Judge concluded that it was reasonable for the purchasers to be commercially protected by a restraint of trade clause with respect to the consideration it paid for the purchase of ongoing commissions and goodwill. However, the Judge concluded that the restraint of trade clause was too wide, could not be read down and could not be severed and as a consequence found the restraint clause to be wholly unenforceable. This led to a non-commercial consequence. The purchasers, having paid substantial consideration, were left totally unprotected from the ability of the vendors to erode the value of the business the subject of the consideration.

55 Positive Endeavour Pty Ltd, (Positive Endeavour) the plaintiff and appellant, claimed damages for breach of a contract entered into on 22 March 2004. Positive Endeavour was the purchaser of a finance broking business from the defendants, Trevor John Madigan and Kylie Jane Lehmann, the respondents to the appeal. Michael Smoker, the controller of Positive Endeavour, was also a party to the contract as a purchaser.

56 The contract included a restraint of trade clause. Positive Endeavour alleged that the defendants and a related entity, First Pacific Mortgages Pty Ltd (First Pacific Mortgages), also a defendant and respondent, acted in breach of the restraint clause. Positive Endeavour claimed damages as a consequence.

57 As earlier noted, the Judge concluded that the restraint of trade clause would operate more widely than was necessary to protect the legitimate interest of Positive Endeavour, and further that it was uncertain and unreasonable. The Judge concluded that the restraint was unenforceable and dismissed Positive Endeavour's claim.

58 Before coming to discuss the Judge's reasons for reaching the above conclusions, I propose to outline the background facts. In doing so I have drawn in part on the Judge's findings, none of which were contested on the appeal. The parties had a developing and complex relationship. A full discussion of that relationship is unnecessary. The outline that follows is abridged to set out those facts necessary for the determination of the appeal.

59 Mr Smoker, at the time of the contract, had been involved in the finance industry for more than 20 years. He operated as a finance broker through the corporate entity, Positive Endeavour. Mr Madigan also conducted the business of a finance broker and had done so in that industry for more than 30 years. He conducted his business through the corporate entity, Kopala Pty Ltd (Kopala).

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<sup>30</sup> See the summary given by Lord Denman CJ in *Hitchcock v Coker* (1837) 6 AD & E 436 at 444 – 445; see also the High Court of Australia in *Amoco Australia Pty Ltd v Rocca Bros Motor Engineering Co Pty Ltd* (1973) 133 CLR 288 at 307.

<sup>31</sup> See *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269 at 319.

60 In or about 2001, Mr Smoker through Positive Endeavour and Mr Madigan through Kopala, entered into a partnership agreement. Positive Endeavour and Kopala traded as finance brokers in the commercial and domestic market. On 1 July 2001, Fairway Securities Pty Ltd (Fairway Securities) was appointed as the agent of the partnership. Sometime thereafter, Kopala sold one half of its partnership share to Erimus Pty Ltd (Erimus). Erimus was the corporate entity through which Ms Lehmann conducted her finance broking business.

61 On 5 March 2002, Mr Madigan and Ms Lehmann incorporated First Pacific Mortgages. They were the shareholders and directors of that entity.

62 On 30 July 2002, Positive Endeavour, Kopala and Erimus entered into a partnership, trading through Fairway Securities. By this time Mr Smoker, Mr Madigan and Ms Lehmann were directors of Fairway Securities. That entity held the finance broking accreditation. The partnership undertook finance broking activities in Adelaide, Victor Harbor and the Northern Territory.

63 The partnership arrangement was such that the commissions earned were divided between the partners having regard to the particular partner who wrote the business. The balance of partnership profit was shared proportionately according to the partners' contributions.

64 As and from 31 March 2003, First Pacific Mortgages began to operate as a finance broker under the control of Mr Madigan and Ms Lehmann. First Pacific Mortgages used the finance broking accreditation held by Fairway Securities to enable First Pacific Mortgages to carry on its business.

65 In April 2003, the partners decided to separate. It was agreed that each partner would seek its own finance broking accreditation.

66 During the latter part of 2003, relations between Mr Smoker, Mr Madigan and Ms Lehmann deteriorated, as did the business arrangements between their corporate entities. By July 2003 their disputes had become deadlocked.

67 On 5 December 2003, Positive Endeavour issued proceedings for pre-action discovery against the defendants. By January 2004, the parties were in negotiation and Mr Madigan and Ms Lehmann, through their corporate entities, offered to sell to Positive Endeavour their interest in the home finance business of the partnership Fairway Securities.

68 On 10 February 2004, consideration of \$120,000.00 was agreed. On 26 February 2004, the solicitors for Positive Endeavour prepared the first draft of the proposed contract between the parties. On 15 March 2004 the final draft contract was prepared. It contained amendments to the restraint, and a schedule which contained the exceptions to the restraint. The contract was signed on 22 March 2004.

69 On 4 August 2005, Positive Endeavour wrote to the defendants complaining about alleged breaches of the restraint of trade clause of the contract.

70 On 9 October 2006, Mr and Mrs Smoker entered into a contract to sell their shares in Positive Endeavour. However, they retained the right to pursue the within proceedings on behalf of Positive Endeavour for their benefit.

71 Against this background I turn now to the terms of the contract. The vendors were described as Mr Madigan, Ms Lehmann, Kopala and Erimus, and the purchasers as Mr Smoker and Positive Endeavour. Recitals in the contract were as follows:

Kopala, Erimus and Positive Endeavour operate a partnership business under a Partnership Agreement dated 30 July 2002.

By a Deed dated 30 July 2002 Fairway Securities Pty Ltd (ACN 079 342 697) ('Fairway Securities') was appointed as agent and nominee for the aforementioned partnership.

Madigan, Lehmann and Smoker are directors of Fairway Securities.

Kopala and Erimus each own 17.5% of the issued shares in Fairway Home Loans (North) Pty Ltd (ACN 096275142) ('Fairway North'). Positive Endeavour owns a further 35% of the issued shares in Fairway North. Madigan and Smoker are directors of Fairway North.

Madigan and Smoker each own 50% of the issued shares in The Fairway Group Pty Ltd (ACN 070 290 827) ('Fairway Group') and are directors of Fairway Group.

The vendors now desire to sell their interests in Fairway Securities and Fairway North to the purchasers who wish to purchase the same.

As a consequence of that sale, the aforementioned partnership will be dissolved.

The parties additionally wish to deregister Fairway Group.

It is the intention of the parties that on completion of the above acts all outstanding and ongoing claims and obligations between the vendors and the purchasers will be completely extinguished and finalised except as provided by the terms of this agreement.

The parties have executed this document to record the terms of their agreement.

72 Pursuant to the terms of the contract the vendors agreed to sell to the purchasers the shares held by Kopala and Erimus in Fairway Securities and Fairway Home Loans (North) (Fairway North), free from any security or third party interest. It was further agreed that between the signing of the contract and settlement, the vendors would procure that each of Fairway Securities and Fairway North would manage and conduct its business as a going concern with all due care and in accordance with normal and prudent practice, and that each body corporate would use its best endeavours to maintain the profitability and

value of its business. It was further agreed that Fairway Securities and Fairway North would not terminate or alter any term of any material contract or commitment.

73 The contract further provided that at completion, the vendors were to confer on the purchasers title to the shares, and to place the purchasers in effective position and control of Fairway Securities and Fairway North and the businesses that those entities conducted. To give effect to this obligation, the vendors agreed to carry out a number of steps designed to effect the transfer. The above provisions were designed to ensure that in exchange for the payment of \$120,000.00, the assets and goodwill of Fairway Securities and Fairway North would come under the entire control of the plaintiffs.

74 To further protect the purchasers, the vendors agreed to a restraint of trade in the following terms:

(1) *Non-interference*

On and from completion, each vendor must not, and must procure that each of its associated persons does not:

- (a) solicit, canvass or secure the custom of a person who is at completion, or was within twelve months before completion, a customer of a body corporate or the vendors or purchasers in connection with a body corporate, except as set out in schedule 1;
- (b) represent itself as being in any way connected with, interested in or associated with a body corporate (except as the prior owner of the shares) or any business conducted by the purchasers, or a body corporate;
- (c) itself or by any of its agents or servants, disclose or use to advantage or to the disadvantage of the purchasers:
  - (i) the name of any person who is at completion, or was within twelve months before completion, a customer of a body corporate, or of the vendors in relation to a body corporate;or
  - (ii) any of the trade secrets, or secret or confidential operations, processes or dealings of, or any confidential information relating to a body corporate or its organisation, finances, transactions, customers or affairs; or
- (d) solicit, employ or engage the services of any person (other than Ms. Jackie Aylesbury) who is at completion, or was within twelve months before completion, an employee of a body corporate.

(2) *Permitted involvement*

Clause 8(1) does not prevent a vendor, together with any of its associated persons, being the holders in aggregate of less than two per cent of the issued shares or units

of a company or unit trust listed on the stock market conducted by the Australian Stock Exchange Limited.

(3) *Independence of Restraint*

Each of the restraint obligations imposed on the vendors by clause 8(1) is a separate and independent obligation from the other restraint obligations imposed (although they are cumulative in effect).

(4) *Reasonableness of restraint*

The vendors agree that each of the restraint obligations imposed by clause 8(1):

- (a) is reasonable in its extent having regard to the interests of each party to this agreement;
- (b) extends no further than is reasonably necessary;
- (c) is solely to protect the purchasers as purchasers of the shares in respect of the goodwill of the bodies corporate and the businesses;
- (d) has been taken into consideration by the vendors in fixing the purchase price; and
- (e) that a breach of the same cannot be adequately compensated by payment of damages and warrants injunctive relief.

(5) *Definition of customer*

In this clause 8, 'customer' means a person who has entered into an agreement with any body corporate to arrange a loan on behalf of that person.

Clause 9(4) of the contract provided that the parties were to release each other absolutely from all or any claims. However, subparagraph 9(4)(e) provided that the release of the vendors was subject to the vendors not being in breach of clause 8(1).

75 To understand the full import of clause 8 it is necessary to refer to the following definitions set out in the contract:

'Associated person' means:

- (a) in relation to a corporation, any related corporation, director or substantial shareholder (as the term is defined in the *Corporations Act 2001*) of the corporation; and
- (b) in relation to a natural person, any spouse or blood or adoptive relative of that person or that person's spouse.

'Body corporate' means each of Fairway Securities, Fairway North and Fairway Group, and 'bodies corporate' has a corresponding meaning.

Schedule 1 to the contract is also of relevance:

Restraint

The vendors are permitted to undertake further business with the customers listed below, including re-financing loans already in existence at the time of this agreement, provided however that any lending services provided to these customers relate solely to commercial or business lending. Under no circumstances are the vendors or any of them to provide lending services to any customer included in the terms of clause 8(1)(a) in relation to personal lending or home loans (including loans for the purpose of purchasing investment property) and whether new loans or re-financing of existing loans.

76 Evidence was led by Positive Endeavour from Mr Smoker and by the defendants from Mr Madigan and Ms Lehmann. The Judge, where there were differences, accepted and acted on the evidence of Mr Smoker.

77 The Judge summarised aspects of Mr Smoker's evidence in the following terms:

Mr Smoker gave evidence that the consideration of \$120,000.00 was paid in order to obtain the benefit of the customer connection of the Fairway Group whereby the plaintiff would secure the business of the partnership in its entirety. According to Mr Smoker, the plaintiff remained liable for an outstanding tax liability, intercompany loans, staff entitlements and the sum of \$20,000 in respect of outstanding creditors.

Mr Smoker said that the plaintiff would not have entered into the agreement unless the defendants had agreed that they would not deal with the customers in the trail book, other than those expressly excluded from the restraint. As a result of discussion between the parties, it was agreed that there would be no restraint period. Mr Smoker said that the intended effect of the restraint clause was that the defendants were not to deal with the customers in the trail book at any time in the future. This included the customers of the parties who were the subject of business during the preceding twelve months. He said that the restraint meant that the defendants were entitled to continue to deal with their commercial clients solely for commercial purposes.

However, as the Judge correctly concluded:

I found Mr Smoker to be an impressive witness. He had a clear memory of important events. His account was consistent with other objective evidence. On the other hand, I found the evidence of Mr Madigan and Ms Lehmann unreliable in a number of areas. Where there was a conflict between Mr Smoker and either or both of the first and second defendants, I preferred the evidence of Mr Smoker. **However, it is the construction of the terms of the contract which is critical to the resolution of the issues between the parties.**

(emphasis added)

78 With respect to the finance broking industry, the Judge made the following findings:

The finance industry is extremely competitive. The personal relationship between the finance broker or his business and the client is extremely important. A customer wishing to re-finance would usually return to the person who arranged the loan.

It was common knowledge in this industry, and it was the understanding of the parties to the contract, that “the customer” became a customer at the settlement of the loan, and remained a customer until the loan was discharged.

and then noted:

The parties to the contract entered into the contract upon the basis that the value of the trail book would be diminished if a loan in the trail book was discharged and not re-financed by the purchaser of the trail book.

Therefore, it was necessary to protect the purchaser by restraining the vendors from diminishing the value of the trail book by dealing with the persons named in it.

### ***Principles of Construction***

79 The legal principles that guide a court when construing a commercial contract may be summarised as follows.

80 The fundamental objective of contractual construction is to ascertain the intention of the parties. The means of ascertaining that intention have transformed over time from a legalistic black letter or linguistic approach to construing the meaning of words in the document, to a holistic approach where the entirety of the document is relevant in the interpretation of each clause, as are the surrounding circumstances and the context of the contract.

81 The position in the modern day was authoritatively outlined by Lord Hoffmann in *Investors Compensation Scheme v West Bromwich Building Society*:<sup>32</sup>

I do not think that the fundamental change which has overtaken this branch of the law, particularly as a result of the speeches of Lord Wilberforce in *Prenn v Simmonds* [1971] 3 All ER 237 at 240–242, [1971] 1 WLR 1381 at 1384–1386 and *Reardon Smith Line Ltd v Hansen-Tangen, Hansen-Tangen v Sanko Steamship Co* [1976] 3 All ER 570, [1976] 1 WLR 989, is always sufficiently appreciated. The result has been, subject to one important exception, to assimilate the way in which such documents are interpreted by judges to the common sense principles by which any serious utterance would be interpreted in ordinary life. Almost all the old intellectual baggage of 'legal' interpretation has been discarded. The principles may be summarised as follows.

- (1) Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.

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<sup>32</sup> *Investors Compensation Scheme v West Bromwich Building Society* [1998] 1 WLR 896 at 912-914.

- (2) The background was famously referred to by Lord Wilberforce as the 'matrix of fact', but this phrase is, if anything, an understated description of what the background may include. Subject to the requirement that it should have been reasonably available to the parties and to the exception to be mentioned next, it includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man.
- (3) The law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent. They are admissible only in an action for rectification. The law makes this distinction for reasons of practical policy and, in this respect only, legal interpretation differs from the way we would interpret utterances in ordinary life. The boundaries of this exception are in some respects unclear. But this is not the occasion on which to explore them.
- (4) The meaning which a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of its words. The meaning of words is a matter of dictionaries and grammars; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean. The background may not merely enable the reasonable man to choose between the possible meanings of words which are ambiguous but even (as occasionally happens in ordinary life) to conclude that the parties must, for whatever reason, have used the wrong words or syntax (see *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] 3 All ER 352, [1997] 2 WLR 945.
- (5) The 'rule' that words should be given their 'natural and ordinary meaning' reflects the commonsense proposition that we do not easily accept that people have made linguistic mistakes, particularly in formal documents. On the other hand, if one would nevertheless conclude from the background that something must have gone wrong with the language, the law does not require judges to attribute to the parties an intention which they plainly could not have had. Lord Diplock made this point more vigorously when he said in *Antaios Cia Naviera SA v Salen Rederierna AB, The Antaios* [1984] 3 All ER 229 at 233, [1985] AC 191 at 201:

'... if detailed semantic and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business common sense, it must be made to yield to business common sense.'

The principles outlined by Lord Hoffmann were succinctly summarised in *BCCI v Ali*<sup>33</sup> by Lord Bingham of Cornhill:

To ascertain the intention of the parties the court reads the terms of the contract as a whole, giving the words used their natural and ordinary meaning in the context of the agreement, the parties' relationship and all the relevant facts surrounding the transaction so far as known to the parties. To ascertain the parties' intentions the court does not of course inquire into the parties' subjective states of mind but makes an objective judgment based on the materials already identified.

82 In *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd*<sup>34</sup> the High Court of Australia accepted Lord Hoffmann's description of the nature of interpretation:<sup>35</sup>

<sup>33</sup> *Bank of Credit and Commerce International SA v Ali* [2002] 1 AC 251 at 259.

<sup>34</sup> *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd* (2004) 219 CLR 165.

References to the common intention of the parties to a contract are to be understood as referring to what a reasonable person would understand by the language in which the parties have expressed their agreement. The meaning of the terms of a contractual document is to be determined by what a reasonable person would have understood them to mean. That, normally, requires consideration not only of the text, but also of the surrounding circumstances known to the parties, and the purpose and object of the transaction.

83 These observations have been restated extensively in relation to the construction of commercial contracts. In *Lake v Simmons*<sup>36</sup> Viscount Sumner observed:<sup>37</sup>

Every one must agree that commercial contracts are to be interpreted with regard to the circumstances of commerce with which they deal, the language used by those who are parties to them, and the objects which they are intended to secure.

These words were drawn on in *McCann v Switzerland Insurance Australia Ltd*,<sup>38</sup> where Gleeson CJ observed:<sup>39</sup>

A policy of insurance, even one required by statute, is a commercial contract and should be given a businesslike interpretation. Interpreting a commercial document requires attention to the language used by the parties, the commercial circumstances which the document addresses, and the objects which it is intended to secure.

84 In *Pacific Carriers Ltd v BNP Paribas*,<sup>40</sup> the High Court restated the general principles in regard to the construction of commercial contracts:<sup>41</sup>

The case provides a good example of the reason why the meaning of commercial documents is determined objectively: it was only the documents that spoke to Pacific. The construction of the letters of indemnity is to be determined by what a reasonable person in the position of Pacific would have understood them to mean. That requires consideration, not only of the text of the documents, but also the surrounding circumstances known to Pacific and BNP, and the purpose and object of the transaction. In *Codelfa Construction Pty Ltd v State Rail Authority of NSW*, Mason J set out with evident approval the statement by Lord Wilberforce in *Reardon Smith Line Ltd v Hansen-Tangen*:

In a commercial contract it is certainly right that the court should know the commercial purpose of the contract and this in turn presupposes knowledge of the genesis of the transaction, the background, the context, the market in which the parties are operating.

85 Despite the modern emphasis on the “factual matrix” and surrounding circumstances, the importance of the language actually used to the ascertainment

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<sup>35</sup> *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd* (2004) 219 CLR 165 at 177.

<sup>36</sup> *Lake v Simmons* [1927] AC 487.

<sup>37</sup> *Lake v Simmons* [1927] AC 487 at 509.

<sup>38</sup> *McCann v Switzerland Insurance Australia Ltd* (2000) 203 CLR 579.

<sup>39</sup> *McCann v Switzerland Insurance Australia Ltd* (2000) 203 CLR 579 at 589. (footnotes omitted)

<sup>40</sup> *Pacific Carriers Ltd v BNP Paribas* (2004) 218 CLR 451.

<sup>41</sup> *Pacific Carriers Ltd v BNP Paribas* (2004) 218 CLR 451 at 461-462. (footnotes omitted)

of the intention of the parties has not diminished. In *Watson v Phipps*,<sup>42</sup> in the process of identifying the true construction of a contract, the Privy Council stated the principle as follows:<sup>43</sup>

The function of a court of construction is to ascertain what the parties meant by the words which they have used. For this purpose the grammatical and ordinary sense of the words is to be adhered to, unless they lead to some absurdity or to some repugnance or inconsistency with the rest of the instrument, in which case the grammatical and ordinary sense of the words may be modified so as to avoid that absurdity or inconsistency, but no further: see the speech of Lord Wensleydale in *Grey v Pearson* (1857) 6 HLC 61 at 106, repeated by Lord Blackburn in *Caledonian Railway Co v North British Railway Co* (1881) 6 App Cas 114 at 131.

This formulation of the approach to contractual construction was recently applied by the Australian Federal Court in *Bowler v Hilda Pty Ltd (in liq)*.<sup>44</sup> The assessment of construction in this manner is not in conflict with the principles of commercial construction as outlined above.

86 The grammatical and ordinary sense of the words is to be assessed in the context of the commercial purpose of the contract and the market in which the parties are operating, and these surrounding circumstances maintain relevance. As was stated by Lord Hoffmann in *Investors Compensation Scheme v West Bromwich Building Society*<sup>45</sup> and restated by the High Court in *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd*:<sup>46</sup>

Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.

Lord Hoffmann explained this statement in *Kirin-Amgen Inc v Hoechst Marion Roussel Ltd*:<sup>47</sup>

Construction, whether of a patent or any other document, is of course not directly concerned with what the author meant to say. There is no window into the mind of the patentee or the author of any other document. Construction is objective in the sense that it is concerned with what a reasonable person to whom the utterance was addressed would have understood the author to be using the words to mean. Notice, however, that it is not, as is sometimes said, 'the meaning of the words the author used', but rather what the notional addressee would have understood the author to mean by using those words. The meaning of words is a matter of convention, governed by rules, which can be found in dictionaries and grammars. What the author would have been understood to mean by using those words is not simply a matter of rules. It is highly sensitive to the context of and background to the particular utterance. It depends not only upon the words the author has chosen but also upon the identity of the audience he is taken to have been addressing and the knowledge and assumptions which one attributes to that audience.

<sup>42</sup> *Watson v Phipps* (1985) 63 ALR 321.

<sup>43</sup> *Watson v Phipps* (1985) 63 ALR 321 at 324.

<sup>44</sup> *Bowler v Hilda Pty Ltd (in liq)* (2001) 112 FCR 59.

<sup>45</sup> *Investors Compensation Scheme v West Bromwich Building Society* [1998] 1 WLR 896.

<sup>46</sup> *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd* (2004) 219 CLR 165 at 177.

<sup>47</sup> *Kirin-Amgen Inc v Hoechst Marion Roussel Ltd* [2005] 1 All ER 667 at [32].

87 In the circumstances of these proceedings it is appropriate to assess the terms of the contract in the commercial context which informed the drafting of the contract.

88 Assessing the contract the subject of this action objectively, its meaning is clear. The terms of the contract outline without ambiguity that the parties would acquire the trail commissions and the customer base/goodwill for the consideration of \$120,000.00. The contract included the following clauses:

*Agreement to sell and buy the shares*

*Sale and purchase*

Subject to clause 3, the vendors agree to sell to the purchasers and the purchasers agree to buy from the vendors, the shares (together with all benefits, rights and entitlements accrued or attaching to the shares) free from any security or third party interest for the purchase price and otherwise on the terms and conditions of this agreement.

...

‘Purchase price’ means one hundred and twenty thousand dollars only (\$120,000.00) which amount is exclusive of GST in accordance with clause 7 hereof;

‘Shares’ mean the shares in the bodies corporate owned by the vendors or any of them;

...

The vendors agree that each of the restraint obligations imposed by clause 8(1):

- (c) is solely to protect the purchasers as purchasers of the shares in respect of the goodwill of the bodies corporate and the businesses;
- (d) has been taken into consideration by the vendors in fixing the purchase price;

The natural language and grammar of the contract and the purpose of the contract and its surrounding commercial context together support a conclusion that the consideration was exchanged for the assets of the corporate entities including goodwill and the trail commissions.

89 The terms of the restraint clause are clearly drafted without ambiguity. The restraint is to operate to prevent the vendors from in any way interfering with individuals or entities that were customers of the vendors or their related entities within the 12 months prior to the signing of the contract. The restraint contains no limitation as to time, but the clause includes an agreement by the vendors that the restraint is reasonable, and is solely to protect the purchasers as purchasers of the shares in respect of the goodwill of the bodies corporate and the businesses. The intended breadth of the restraint clause was not in issue – rather, whether that breadth was valid.

90 The tests to be applied when determining the validity of a restraint of trade clause find their more recent genesis in the remarks of Lord Macnaghten in *Nordenfelt v Maxim Nordenfelt Guns & Ammunition Co Ltd*.<sup>48</sup>

All interference with individual liberty of action in trading, and all restraints of trade of themselves, if there is nothing more, are contrary to public policy, and therefore void. That is the general rule. But there are exceptions: restraints of trade and interference with individual liberty of action may be justified by the special circumstances of a particular case. It is a sufficient justification, and indeed it is the only justification, if the restriction is reasonable - reasonable, that is, in reference to the interests of the parties concerned and reasonable in reference to the interests of the public, so framed and so guarded as to afford adequate protection to the party in whose favour it is imposed, while at the same time it is in no way injurious to the public.

The issue of reasonableness was discussed in the early 19<sup>th</sup> century in *Hitchcock v Coker*<sup>49</sup> where Lord Denman CJ summarised:

The law upon this subject has been settled by a series of decisions, from *Mitchel v Reynolds* (1 P.W.181), to *Horner v. Graves* (7 Bing. 735); viz. that an agreement for a partial and reasonable restraint of trade upon an adequate consideration is binding, but that an agreement for general restraint is illegal. What shall be considered as a reasonable restraint was much discussed in the case of *Horner v. Graves* (7 Bing 735); where the Chief Justice of the Common Pleas observed (p. 743), “We do not see how a better test can be applied to the question whether reasonable or not, than by considering whether the restraint is such only as to afford a fair protection to the interests of the party in favour of whom it is given, and not so large as to interfere with the interests of the public. Whatever restraint is larger than the necessary protection of the party, can be of no benefit to either, it can only be oppressive; and if oppressive, it is, in the eye of the law, unreasonable. Whatever is injurious to the interests of the public is void, on the grounds of public policy.

This approach to restraint of trade clauses was discussed by Hodson LJ in *Esso Petroleum Co Ltd v Harper’s Garage (Stourport) Ltd*:<sup>50</sup>

It has been authoritatively said that the onus of establishing that an agreement is reasonable as between the parties is upon the person who puts forward the agreement, while the onus of establishing that it is contrary to the public interest, being reasonable between the parties, is on the person so alleging: see *Herbert Morris Ltd. v. Saxelby*, per Lord Atkinson and Lord Parker. The reason for the distinction may be obscure, but it will seldom arise since once the agreement is before the court it is open to the scrutiny of the court in all its surrounding circumstances as a question of law.

This proposition was accepted in Australia by Walsh J in *Amoco Australia Pty Ltd v Rocca Bros Motor Engineering Co Pty Ltd*:<sup>51</sup>

I acknowledge that the consequence of what I have just stated is that there is to some extent a merging of the second branch of the *Nordenfelt* formulation of the applicable principle with its first branch. But this does not mean that the distinction between them is

<sup>48</sup> *Nordenfelt v Maxim Nordenfelt Guns & Ammunition Co Ltd* [1894] AC 535 at 565.

<sup>49</sup> *Hitchcock v Coker* (1837) 6 AD & E 436 at 444–445.

<sup>50</sup> *Esso Petroleum Co Ltd v Harper’s Garage (Stourport) Ltd* [1968] AC 269 at 319.

<sup>51</sup> *Amoco Australia Pty Ltd v Rocca Bros Motor Engineering Co Pty Ltd* (1973) 133 CLR 288 at 307.

wholly obliterated. In order to justify a restraint of trade both tests must be satisfied. The restraint must be reasonable in the interests of the parties in that it affords no more than adequate protection to the covenantee “while at the same time it is in no way injurious to the public” (see the *Nordenfelt Case* [1894] AC, at 565).

91 The Judge correctly directed herself with respect to the onus of proof. It was for Positive Endeavour to prove that the restraint clause was reasonable having regard to the interests of the parties to the contract and the need for Positive Endeavour to demonstrate that the restraint was to protect the legitimate interest of itself and that the extent of the restraint went no further than necessary to protect that interest. The legitimate interests which may be protected included those interests which are in the nature of proprietary interests such as goodwill and the customer connection of a business. If Positive Endeavour met the onus with respect to the reasonableness of the restraint, the onus then moved to the defendants to show that the restraint clause was contrary to public policy.

92 The Judge made a finding that the protection of the customer connection identified in the trail book was a legitimate purpose for restraint:

In the finance broking business, the personal relationship between the broker and his customer is important. That is, the customers of the first and second defendants would likely follow them if not restrained. From the plaintiff’s perspective, the restraint was necessary in order to ensure a continuing relationship between the customers in the trail book and the purchaser. It provided protection to the plaintiff in order to secure the benefit of the trails which were the subject of the consideration provided in the contract. In my view, the protection of the customer connection identified in the trail book was a legitimate purpose for the restraint.

93 The Judge considered whether the restraint applied to First Pacific Mortgages and in that respect concluded:

In my view, upon a proper construction of the contract, the definition of “associated person” does not include the third defendant. It is not reasonable to imply or infer such a term where the third defendant is a separate legal entity that was in existence at the time the parties entered into the contract. I find that the third defendant was not a party to the contract and that the third defendant is not bound by the restraint.

This finding was challenged on appeal.

94 The Judge made the following findings with respect to the construction of the restraint clause:

In my view, the definition of customer in clause 8(5) of the contract means that the restraint applies indefinitely to any customer of the partnership prior to the date of the contract. The wide operation of the restraint is fatal to the enforceability of the restraint. I am not satisfied that clause 8(5) ought to be severed from the contract. Further, I am not satisfied that the contract ought to be rectified by the addition of the words suggested by the plaintiff in order to limit the operation of the restraint.

I am reinforced in this view by the fact that even if clause 8(5) of the contract is severed, I consider that the restraint is void in any event.

I am not satisfied that the identification of the particular customer in the trail book and the inbuilt period of the loan of the particular customer, is a sufficient limitation upon the operation of the restraint.

Although the parties gave evidence based upon their respective experience, as to the average length of loans in the industry, there is no specific evidence as to the length of each of the loans in the trail book.

I am not satisfied that the court ought to imply any terms in the contract in order to give effective operation to the restraint. I am not satisfied that the terms of the restraint ought to be “read down”, or that it is possible to otherwise interpret the restraint in order to achieve its enforceability.

The Judge then considered severance:

I am not satisfied that the court ought to sever clause 8(5) of the contract in order to support the enforceability of the restraint. In my view, even if the court was to sever this clause, the restraint is unreasonable and void. I am not satisfied that the court ought to resolve ambiguities, imply terms or rectify the restraint in the manner contended for by the plaintiff, for the purpose of enforcing the restraint.

Further, in my view, the plaintiff’s contention in relation to the meaning of ‘secure’, in clause 8 of the contract, upon which its claim depends, means that the restraint is unreasonable. That is, the protection afforded to the plaintiff is greater than is reasonably necessary to protect the interests of the plaintiff. In addition, in my view, it unduly and unreasonably restricts the liberty of the defendants in the carrying out of their business activities in the same field as the plaintiff.

I am not satisfied that the court ought to imply a term into the contract so that it applies to the third defendant, a corporate entity not otherwise caught by the contract.

...

However, it is my view that the restraint exceeds what is necessary to protect the plaintiff’s legitimate interests.

...

In the present case, I am not persuaded that any of the matters relied upon by the plaintiff, override the presumption that the restraint is unenforceable.

95 The Judge’s ultimate conclusion was in the following terms:

I have considered the reasonableness of the restraint having regard to an overall assessment of the restraint clause, the contract within which it is found and all of the surrounding circumstances. In my view, the customer connection detailed in the trail book is a legitimate interest which may be protected by a restraint clause. However, having regard to the interests of each of the parties to the contract, I am of the view that the restraint is uncertain. In any event, it operates wider than is necessary to protect the legitimate interests of the plaintiff. Having due regard to the legitimate interests of the parties to the contract as at the date of the contract, I find that the restraint is unenforceable. Therefore, the plaintiff’s claim is dismissed.

(footnotes omitted)

## The Appeal

96 The Judge's conclusions in regard to the restraint of trade clause being unenforceable and unsustainable were challenged on the appeal. It was also contended that Mr Madigan and Ms Lehmann were responsible for the actions of First Pacific Mortgages, whose actions were said to have breached the restraint clause.

97 Positive Endeavour submitted that the Judge made errors in her reasoning with respect to the construction of the restraint clause. Counsel for the defendants accepted that four errors had been made by the Judge. The defendants first accepted that the following finding could not be sustained:

... the definition of customer in clause 8(5) of the contract means that the restraint applies indefinitely to any customer of the partnership prior to the date of the contract.

The defendants acknowledged that the definition of customer was limited temporarily and that the conclusion that the restraint applied to any customer prior to the date of the contract was incorrect. It can be seen that this finding was critical to the conclusion about the width of the restraint clause and the consequences that followed in the Judge's view in respect of enforceability.

98 It was accepted that the Judge's ultimate conclusion that the restraint could not be enforced because it was "uncertain" could not be supported. The Judge did not identify any uncertainty. The defendants accepted that there was no uncertainty.

99 It was next accepted that the Judge had misunderstood the question of severance when she observed:

I am not satisfied that the court ought to sever clause 8(5) of the contract in order to support the enforceability of the restraint. In my view, even if the court was to sever this clause, the restraint is unreasonable and void. I am not satisfied that the court ought to resolve ambiguities, imply terms or rectify the restraint in the manner contended for by the plaintiff, for the purpose of enforcing the restraint.

The defendants accepted that if there was to be severance it would operate on clause 8(1)(a) and not clause 8(5). The Judge failed to address severance by reference to the appropriate subparagraph of clause 8.

100 Positive Endeavour finally drew attention to the Judge's observation:

Further, in my view, the plaintiff's contention in relation to the meaning of 'secure', in clause 8 of the contract, upon which its claim depends, means that the restraint is unreasonable.

The Judge did not provide any explanation for this conclusion and counsel appearing for the defendants on the appeal could not offer any explanation for such a conclusion.

101 The Judge's conclusions were flawed and materially so by reason of each of the above errors. The defendants were correct to make the above concessions. It follows that it is necessary for this Court to address the issues arising on appeal afresh.

### **Reconsideration on Appeal**

102 The courts have recognised that the purchaser of a business is entitled to the protection by covenant of the customer connections of the business. This is typically attended to by restraining the vendor from subsequently engaging in activities competitive with those of the business acquired. The earlier referred to observations of Lord Macnaghten in *Nordenfelt* require the protective interests of the party seeking to enforce the restraint to be identified.

103 In the present case it was accepted that Positive Endeavour had a legitimate proprietary interest that was protectable. The trial judge so found. The question that then arises is whether the restraint clause is of a reasonable scope.

104 It is to be immediately observed that the restraint clause fell far short of a general clause not to compete. The clause related directly to customers of the business during a closed period of 12 months and a non-dealing with those customers. The restraint only relates to a discrete number of identifiable customers. It is also relevant to note that Schedule 1 to the contract limits the restraint even further with respect to commercial transactions for named customers. There is no attempt to preclude competition from the vendors in any geographic area. Considerations of the breadth of a geographic market – the space – do not arise.

105 Viewed objectively, it is clear that the parties intended the restraint to be unlimited in time. Clause 8(1)(a) is expressly linked to Schedule 1 and both make reference to customers as defined. Any ambiguity as to the term of the restraint as within Clause 8(1)(a) is resolved by the terms of the Schedule and reference to “whether new loans or refinancing of existing loans”. It is clear that the parties contemplated new loans to customers as defined in addition to the refinancing of existing loans. The reference to persons who were “within twelve months before completion, a customer”, also confirms that the restraint was unlimited in time. A person who had been a customer, but ceased to be a customer within the 12-month period was to be the subject of restraint. In other words, the restraint of such a customer related to future dealings.

106 The consideration of \$120,000.00 was not simply a payment for the present day calculation of the value of the trail commissions attaching to existing loans. If this is all that had been intended, there would be no reason to refer to persons who had been customers in the preceding twelve months, who were no longer customers at the date of the contract.

107 The question that arises is whether the restraint in the agreed terms was unreasonable, and if so, whether severance can be effected.

### *Restraint Clauses*

108 When considering the enforceability of a restraint clause, it is important to consider the purpose of the restraint, the parties intention as to the extent of the restraint as assessed objectively, the parties understanding as to the reasonableness of that restraint and whether the restraint includes the protection of goodwill or whether it operates to restrict employment. In assessing the overall reasonableness of the restraint, regard must be had of any restrictions as to space and time.

109 Courts draw a clear distinction between employment restraints and sale of business restraints. As Trebilcock in his work, *The Common Law of Restraint of Trade*, observes:<sup>52</sup>

From an early date the courts have recognized that restrictive covenants in the sale of a business as a going concern might advance the interests of both contracting parties and the public and hence justify enforcement. The two celebrated cases in the mercantilist era in which partial restraints were recognized as exceptions to the general prohibition on restrictive covenants, *Rogers v. Parrey* and *Mitchel v. Reynolds*, both involved sales of businesses or business premises. The distinction, first articulated authoritatively in the modern era by Lord Macnaghten in *Nordenfelt*, between employment restraints and sale of business restraints, a distinction vigorously taken up in the judicial trilogy shortly thereafter and affirmed in numerous modern cases, generally implies a much more permissive judicial attitude to restrictive covenants in the sale of businesses. In the modern era, such covenants, while commonplace, are much less frequently litigated than post-employment contracts and much less frequently overturned.

(footnotes omitted)

Reference is made by the author to the following observation of Jenkins LJ in *Ronbar Enterprises Ltd v Green*:<sup>53</sup>

I think it can be regarded as settled that the court takes a far stricter and less favourable view of covenants in restraint of trade entered into between master and servant than it does of similar covenants between vendor and purchaser. In the case of a covenant between vendor and purchaser, the court recognizes that it is perfectly proper for the parties, in order to give efficacy to the transaction, to enter into such restrictive provisions as regards competition as are reasonably necessary to enable the purchaser to reap the benefit of that which he has bought; and restrictions of that kind are regarded as necessary, not only in the interests of the purchaser, but in the interest of the vendor also, for they not only preserve the value to the purchaser of that which he buys, but also enable the vendor to realize a satisfactory price. It is obvious that in many types of

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<sup>52</sup> Michael Trebilcock, *The Common Law of Restraint of Trade: A Legal and Economic Analysis* (1986) 231-232.

<sup>53</sup> *Ronbar Enterprises Ltd v Green* [1954] 2 All ER 266 at 270 (CA). See also *Elsley v JG Collins Ins. Agencies Ltd.* (1978), 83 DLR (3d) 1 at 6 (SCC) (Dickson J.).

business the goodwill would be well-nigh unsaleable if it was unlawful for the vendor to enter into an adequate covenant against competition.<sup>54</sup>

110 In the present case the restraint relates to the sale of part of a business and concerns the protection of the receipt of trail commissions to be paid over many years as well as goodwill. The restraint is unusual in that it is a partial restraint in respect of dealings with a discrete and closed group of customers without limitation as to time. There is no restraint against the vendors competing in respect of finance brokerage generally. Against this background, it is convenient to turn to the guidance to be obtained from earlier authorities.

111 There are a number of authorities from the 19<sup>th</sup> century which dealt with restrictive covenants extending for the life of the covenantor. These authorities were succinctly summarised in the following terms by Harvey CJ in *Eastwood Co-operative Society Ltd v Williams*:<sup>55</sup>

So far as I am aware no restrictive covenant entered into between vendor and purchaser on the sale of a business has ever been held to be unreasonable because it extended to the whole life of the covenantor. On the contrary there are a great number of cases in which such covenant has been enforced. In *Tallis v. Tallis* (1 E. & B. 391 at 411) Lord Campbell, C.J., delivering the judgment of the Court says that the time may be unlimited provided there is a reasonable limit as to space. In *Nordenfelt v. Maxim Nordenfelt* ([1894] A.C. 535) a time limit of 25 years on the part of a man of 46 was upheld by the House of Lords. Other cases in which the covenant lasted for the covenantor's life in the case of the sale of a business are *Williams v. Williams* (2 Swan. 253); *Archer v. Marsh* (6 Ad. & El. 959), both cases of a carrier's business; *Elves v. Crofts* (10 C.B. 241), the case of a butcher; *Brampton v. Beddoes* (13 C.B. (N.S.) 538), the case of a draper; *Marshalls (Limited) v. Leek* (17 T.L.R. 26), the case of a manufacturing chemist; *Pemberton v. Vaughan* (10 Q.B. 87), the case of a ginger beer maker; *Bird v. Lake* (1 Hem. & M. 338), an eating house keeper; *Price v. Green* (16 M. & W. 346), a perfumer and hair merchant; *Stride v. Martin* (77 L.T. 600), a dairyman; *Dales v. Weaber* (18 W.R. 993), an optician; *Castelli v. Middleton* (17 T.L.R. 373).

112 In *Pemberton v Vaughan*,<sup>56</sup> Lord Denman CJ held that an agreement not to carry on the business was valid, notwithstanding the lack of limitation as to the time for which the restraint was to operate:<sup>57</sup>

As to the other point, there is no case which decides that an agreement in restraint of trade is illegal because it is for life. It does not follow that the plaintiff will not require the protection of the agreement because he may not himself continue the business: he may sell the business, and sell it on better terms on account of the protection secured to it by such an agreement.

Patteson J agreed with Lord Denman's findings:<sup>58</sup>

<sup>54</sup> *Nordenfelt v Maxim Nordenfelt Guns & Ammunition Co.*, [1894] A.C. 535 (H.L.).

<sup>55</sup> *Eastwood Co-operative Society Ltd v Williams* (1932) 32 SR (NSW) 403 at 405.

<sup>56</sup> *Pemberton v Vaughan* (1847) 10 QB 87.

<sup>57</sup> *Pemberton v Vaughan* (1847) 10 QB 87 at 90.

<sup>58</sup> *Pemberton v Vaughan* (1847) 10 QB 87 at 90.

With respect to the other point, the agreement is perfectly legal; the restraint of trade is limited as to distance, although it is not as to time.

113 Similarly, in *Avery v Langford*<sup>59</sup> Wood VC considered that a restriction for the term of a life was not an unreasonable restriction:<sup>60</sup>

The question there was as to the space within which such a restriction would be good, and the time of its duration. With respect to the latter it has been held that a trade is a thing saleable; and that the restriction for the term of a life, though not the life of the original vendor, is not an unreasonable condition.

114 During the 20<sup>th</sup> century, the courts followed these earlier authorities. In *Fitch v Dewes*<sup>61</sup> the members of the House of Lords agreed that a covenant, which was unlimited in time, did not in the circumstances exceed what was reasonably required for the protection of the covenantee and was not against the public interest. As Cave LJ said in that case:<sup>62</sup>

That the contract in this case is reasonably restricted as regards space is not in dispute. ... No one would say that that is an unreasonable restriction. As regards time there is no limit other than the life of the person entering into the contract, and the question is whether the clause is on that ground unreasonable from either point of view. But in considering that question we must not entirely put out of sight the limit of space, which may have a bearing upon the question arising as to the limit of time.

...

It is impossible to say that there must in every case be some specified limit of time defined by a figure. Nor can we say that the contract ought to be confined to the life of the covenantee, for he might die in the next year or so and the goodwill might then be lost to his successors. It was no doubt thought necessary to continue the protection throughout the period during which the covenantee and his successors in interest might carry on the practice, and for that purpose to bind the appellant (so far as the limited area was concerned) for the remainder of his life. I cannot think that in the circumstances of this case the restriction imposed was unreasonable from any point of view...

115 In *Connors Brothers Ltd v Connors*,<sup>63</sup> Maugham VC adopted the reasoning of Cave LJ:

If the restriction as to space is considered to be reasonable, it is seldom in a case where the sale of a goodwill is concerned that the restriction can be held to be unreasonable because there is no limit as to time. Their Lordships accept as correct the statement by Lord Cave in *Fitch v Dewes*, at p 168:

‘... it has been settled (I think) since *Hitchcock v. Coker*, that where there is a goodwill to be protected, a covenant in restraint of trade, even when imposed as a condition of employment, may be so framed as to give adequate protection not only to the covenantee himself but also to his successors in the business, and this

<sup>59</sup> *Avery v Langford* (1854) 23 LJ Ch 837.

<sup>60</sup> *Avery v Langford* (1854) 23 LJ Ch 837 at 838.

<sup>61</sup> *Fitch v Dewes* [1921] 2 AC 158.

<sup>62</sup> *Fitch v Dewes* [1921] 2 AC 158 at 168.

<sup>63</sup> *Connors Brothers Ltd v Connors* [1940] 4 All ER 179 at 195.

although it may be necessary for that purpose to impose a restriction upon the covenantor for the remainder of his life.’

116 In *Escott v Thomas*<sup>64</sup> Reed J of the New Zealand Supreme Court considered that a restraint of 20 years was reasonable in the circumstances:

As to the time – twenty years – I am not aware that in the case of the sale of a business the question of the time of the restraint has ever been held a vital factor going to the reasonableness of the covenant. If a business is to be built up, time is necessary; and the time mentioned having been considered by the parties as reasonable when the sale took place, there does not appear to be any good reason why the Court should hold it otherwise; it is not a case of employer and employee where a question of public policy might arise. However, a limit of time is not essential to make a contract in restraint of trade reasonable: *Fitch v Dewes*. Together with the area prescribed it is an element that must be taken into consideration in judging as to the reasonableness of the restriction as a whole.

117 In the present proceeding, I consider that the following factors lead to the conclusion that the restraint is a reasonable restraint to protect the covenantee’s interests. As earlier discussed, as a matter of interpretation, the restraint was intended to extend beyond contracts with customers in existence at the date of the contract. Further, the parties explicitly agreed that the restraint was reasonable in that it extended no further than was reasonably necessary and that the restraint, and in particular its terms, were taken into consideration by the vendors in fixing the purchase price.

118 It is helpful at this point to repeat the terms of clause 8(4) of the contract:

(4) *Reasonableness of restraint*

The vendors agree that each of the restraint obligations imposed by clause 8(1):

- (a) is reasonable in its extent having regard to the interests of each party to this agreement;
- (b) extends no further than is reasonably necessary;
- (c) is solely to protect the purchasers as purchasers of the shares in respect of the goodwill of the bodies corporate and the businesses;
- (d) has been taken into consideration by the vendors in fixing the purchase price; and
- (e) that a breach of the same cannot be adequately compensated by payment of damages and warrants injunctive relief.

119 It was expressly agreed that the purpose of the restraint was solely to protect the purchasers as purchasers of the shares in respect of the goodwill of the bodies corporate and the business. As the Judge noted, customer connections were an important part of the business and assets of Fairway Securities and

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<sup>64</sup> *Escott v Thomas* [1934] NZLR 1046 at 1054.

Fairway North. Having regard to the limited scope of the restraint, both as to customers and as to the nature of the business involved, in my view, it cannot be said that the restraint was not a reasonable restraint to protect the purchasers. The contract would be of no commercial utility without the restraint of trade clause. Without the restraint of trade, the vendors could undermine the value of the customer base and goodwill for which the purchaser has parted with considerable consideration. As such, the restraint of trade is a reasonable protection afforded to the purchaser in the circumstances.

120 In my view, Positive Endeavour has established on the balance of probabilities that the restraint is reasonable.

121 The question that then arises is whether the restraint is against public policy and should not be enforced for that reason. In this respect several public interests may be identified. There is an interest in unrestricted access by the public to mortgage brokers. Their freedom of choice is a matter to have regard to. On the other hand, in the present proceeding, it was not in dispute that the finance broking industry was highly competitive with many brokers available to service the public. The observations of Lord Macnaghton in *Nordenfelt* are apposite, when he noted that when brokerage services are readily available, it is not easy to appreciate the injury to the public resulting from the withdrawal of one particular broker:<sup>65</sup>

[w]hen all trades and businesses are open to everybody alike, it is not very easy to appreciate the injury to the public resulting from the withdrawal of one individual... ... how can the public be injured by the transfer of a business from one hand to another? ... this particular case the purchasers brought in fresh capital, and had at least the opportunity of retaining Mr. Nordenfelt's services ...

(footnotes omitted)

122 Other public interest considerations have been encapsulated in the phrase "vendibility of assets". As summarised by Trebilcock:<sup>66</sup>

These considerations are encapsulated by Handler and Lazaroff<sup>67</sup> in the phrase, the "vendibility of assets", the facilitation of which has generally been viewed by the courts in the present context as promoting both the mutual interests of the contracting parties and the public interest.

123 I respectfully agree with these observations and consider that they remain valid with respect to commercial transactions occurring today. I do not consider that the vendors have established that there is a public interest in declaring the restraint unenforceable.

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<sup>65</sup> *Nordenfelt v Maxim Nordenfelt Guns & Ammunition Co Ltd* [1894] AC 535.

<sup>66</sup> Michael Trebilcock, *The Common Law of Restraint of Trade: A Legal and Economic Analysis* (1986) 233.

<sup>67</sup> M Handler & DE Lazaroff, "Restraint of Trade & The Restatement (Second) of Contracts" (1982) 57 *New York University Law Review* 669.

124 Even if there were such public interest, it would not be appropriate to reach the conclusion that the entire restraint is unenforceable. If necessary, it may be possible to sever words from the restraint clause to have the restraint only relate to customers with existing contracts. Such a severance in my view, would however fail to provide full protection to Positive Endeavour with respect to the purchased goodwill.

### *Severance*

125 Since preparing these reasons, I have had the opportunity to peruse the draft reasons of Bleby and Layton JJ. If, contrary to my view the restraint clause is considered to be too wide, then the question arises whether it is possible to sever parts of the clause or to read the clause down. In my view, those parts of the clause that are said to render it too wide, may be severed. If severance is not possible, then it is my view that the contract can be read down, as a matter of construction, so as to leave an unobjectionable restraint. It is instructive to note that a more liberal approach to severance is generally found in business sales cases, whilst a more limited or strict approach applies predominantly in employment cases.<sup>68</sup>

126 Regardless of any distinction between business sales cases and employment cases, the application of a strict “blue pencil test” permits the restraint clause in the present proceeding to be read so that the vendors are restrained from diminishing the value of the trail book by dealing with persons who, at the date of the settlement of the agreement, had an existing loan arrangement.

127 The provisions of the restraint clause under attack in the present proceedings are to be found in Clause 8(1)(a) and Schedule 1. Those clauses can be “blue pencilled” as follows:

On and from completion, each vendor must not, and must procure that each of its associated persons does not:

- (a) solicit, canvass or secure the custom of a person who is at completion, ~~or was within twelve months before completion,~~ a customer of a body corporate or the vendors or purchasers in connection with a body corporate, except as set out in schedule 1;

(strikethrough represents blue-pencilling)

#### Restraint

The vendors are permitted to undertake further business with the customers listed below, including re-financing loans already in existence at the time of this agreement, provided however that any lending services provided to these customers relate solely to commercial or business lending. Under no circumstances are the vendors or any of them to provide lending services to any customer

<sup>68</sup> See eg *Ronbar Enterprises Ltd v Green* [1954] 1 WLR 815 (Jenkins LJ).

included in the terms of clause 8(1)(a) in relation to ~~personal lending or home loans (including loans for the purpose of purchasing investment property) and whether new loans or re-financing of existing loans.~~

(strikethrough represents blue-pencilling)

128 Turning to the alternative approach of reading down the relevant provisions, it is to be noted that the primary concern of the parties was to protect Positive Endeavour from the vendors diminishing the value of the trail book of customers with contracts in existence at the time of the completion of the agreement. To repeat the earlier unchallenged finding of the trial Judge:

The parties to the contract entered into the contract upon the basis that the value of the trail book would be diminished if a loan in the trail book was discharged and not re-financed by the purchaser of the trail book.

Therefore, it was necessary to protect the purchaser by restraining the vendors from diminishing the value of the trail book by dealing with the persons named in it.

129 In *Rentokil Pty Ltd v Lee*,<sup>69</sup> when dealing with a restraint of trade clause in an employment contract, Doyle CJ discussed the question of severance and construction and in the course of his reasons observed:<sup>70</sup>

...The court in considering severance is concerned with the question of whether, properly construed, the relevant agreement should be permitted to operate as between the parties with some part of its apparent or intended operation not being given effect. But while the courts have said on many occasions that they will not rewrite the contract for the parties, in order to create a valid restraint from an invalid restraint, the question is again ultimately one of intention. The question is whether, construing the contract as a whole, it may be concluded on an objective basis that the parties intended the relevant provision to have the reduced operation if it could not have its full operation.

Accordingly, the exercise is not one in which the court endeavours to create a valid restraint. It is one in which the court should be mindful of the interests of employers and of employees, and it is clear that the courts have shown some restraint in applying the principle of severance to save the validity of a restraint imposed on an employee which restraint would be unenforceable if it were given its apparent effect. But in dealing with these considerations the court must give appropriate attention to the intentions of the parties.

Doyle CJ also drew on the following words of Taylor J in *Brooks v Burns Philp Trustee Co Ltd*:<sup>71</sup>

But the problem of severability is the same in either case; fundamentally the question is one of intention to be gathered from the instrument itself: *Fitzgerald v Masters* (1956) 95 CLR 420 and *Whitlock v Brew* (1968) 118 CLR 445.

<sup>69</sup> *Rentokil Pty Ltd v Lee* (1995) 66 SASR 301.

<sup>70</sup> *Rentokil Pty Ltd v Lee* (1995) 66 SASR 301 at 306.

<sup>71</sup> *Brooks v Burns Philp Trustee Co Ltd* (1969) 121 CLR 432 at 442 as cited in *Rentokil Pty Ltd v Lee* (1995) 66 SASR 301 at 307.

130 Adopting the approach outlined in *Rentokil*, the question is whether  
construing the contract as a whole, it may be concluded that the parties intended  
the relevant provision to have its reduced operation if it did not have its full  
operation.

131 In the present case, the evidence referred to in the reasons of Bleby and  
Layton JJ demonstrate that considerable attention was given to the correlation of  
trail commissions and the consideration paid. The evidence went so far as to  
suggest that the consideration was arrived at by utilising a particular software  
program that developed a spreadsheet allowing for precise calculations.

132 It cannot be doubted that the parties intended a level of restraint to operate,  
even if the restraint clause did not have wider operation. It accords with the  
intentions of the parties to prevent, by restraint, the vendors from diminishing the  
value of the trail commissions of existing customers at the date of completion of  
the agreement. I would, if my primary view were incorrect, so construe the  
restraint clause.

133 It is to be appreciated that the severance suggested or the reading down as a  
matter of construction would lead to the same ultimate conclusion. However, I  
repeat that in my view there is no good reason to adopt either course, and that the  
restraint as agreed was a reasonable restraint.

### *One further matter*

134 As earlier noted, one further issue was raised on the appeal. Positive  
Endeavour contended that the purchasers, Mr Madigan and Ms Lehmann  
breached the agreement through “the medium of their ‘creature’”, First Pacific  
Mortgages Pty Ltd trading as Allcapital, the third defendant. It was argued that  
First Pacific Mortgages contracted with customers for the benefit of the  
purchasers, thereby undermining the basis of the sale agreement. It was said that  
it was immaterial that the purchasers cloaked their activities by the use of a non-  
contracting company. Although Positive Endeavour acknowledged that First  
Pacific Mortgages would not be susceptible to an order for damages for breach of  
a contract to which it was not a party, it was contended that First Pacific  
Mortgages might be made the subject of equitable relief such as an account or  
equitable or tortious damages.

135 The Judge noted the submissions with respect to the liability of First Pacific  
Mortgages:

Further, the plaintiff alleged that the third defendant had breached the contract as agent of  
the first and second defendants, and as an “associated person” to the first and second  
defendants.

With respect to these issues the Judge made the following findings:

The plaintiff submitted that clause 8(1) of the contract prohibited the first or second defendants, either directly or indirectly from securing the custom of those persons identified in the trail book.

The plaintiff submitted that the first and second defendants were directors, shareholders and controllers of that company. It was contended that the first and second defendants breached the contract through the agency and control of the third defendant, by securing customers from the trail book.

Alternatively, it was submitted that the restraint was framed and intended to apply to associated persons of the vendors. The first and second defendants were co-directors and joint shareholders of the third defendant at the time of completion of the contract. It was submitted that although the third defendant fell outside the general definition of “associated person”, it was specifically referred to in schedule 2 of the contract as an “associated person”. It was submitted that the contract expressly contemplated that the third defendant was an “associated person” under the contract. The plaintiff asked the court to imply that the definition of “associated person” specifically included the third defendant. The plaintiff submitted that the recognition elsewhere in the contract of the third defendant as an “associated person” of the vendor, constituted objective evidence of a common intention that the third defendant was included in the contract as an “associated person” of the first and second defendants.

The plaintiff submitted that it ought to be inferred that clause 8 applied to a corporate entity of the vendors.

Therefore, it was submitted, the court ought to find that the definition of “associated person”, by necessary implication, included the corporate entity of which the first two defendants were co-directors and joint shareholders and which entity was in operation at the time of the completion of the contract.

It was submitted that in all the circumstances and for business efficacy, it ought to be inferred that the securing of the custom of a customer in the trail book by a vendor which was prohibited under clause 8 of the contract, included securing the custom by the third defendant.

The Judge concluded with respect to First Pacific Mortgages that in her view:

...upon a proper construction of the contract, the definition of “associated person” does not include the third defendant. It is not reasonable to imply or infer such a term where the third defendant is a separate legal entity that was in existence at the time the parties entered into the contract. I find that the third defendant was not a party to the contract and that the third defendant is not bound by the restraint.

136 It is instructive to note that the Judge made no express finding as to whether  
the restraint applied to First Pacific Mortgages as a company controlled by and  
an agent for Mr Madigan and Ms Lehmann.

137 The evidence established that Mr Madigan and Ms Lehmann were the  
directors and shareholders of First Pacific Mortgages.

138 Insofar as the evidence may establish that First Pacific Mortgages acted as  
the agent for the vendors in breach of the restraint provisions, the vendors are

liable for that breach. As the proceeding is to be remitted to the trial Judge to consider the question of breach, this will be an issue addressed at the rehearing.

139 The agreement, when dealing with the restraint of trade, defined “Associated Person” in the following terms:

- (a) in relation to a corporation, any related corporation, director or substantial shareholder (as the term is defined in the *Corporations Act 2001*) of the corporation; and
- (b) in relation to a natural person, any spouse, or blood or adoptive relative of that person or that person’s spouse;

140 It is clear that the parties intended the restraint to apply to associated persons of the vendors; however, the definition of associated person does not expressly pick up First Pacific Mortgages. The definition of associated person only refers to a related corporation of a corporation. In my view, there is an insufficient basis to justify an implied term that would make First Pacific Mortgages an associated person within the meaning of the definition.

141 The question remains as to whether equity would enable relief to be obtained directly against First Pacific Mortgages. In *Heydon on The Restraint of Trade Doctrine*,<sup>72</sup> the learned author states:

But the covenantor cannot evade the covenant by carrying on a business under a title, or by forming a limited company which is a mere veil for the covenantor’s own activities, or by using a nominee for this purpose.

142 In a footnote, reference is made to the decision of *Gilford Motor Co Ltd v Horne*.<sup>73</sup> In that case, the Court considered the use of a company by a defendant to circumvent the terms of the relevant covenant of restraint. The Court took the view that the persons behind the company were liable for the company’s conduct either through principles of agency or the doctrine of *alter ego*. However, the company was held not liable in contract as it was not a party to the contract.

143 There is authority to support the proposition that equitable relief may be granted in similar circumstances.<sup>74</sup> Generally that relief has been injunctive relief or specific performance, but in principle, there seems no reason why equitable damages might not be available.

144 As earlier mentioned, Mr Madigan and Ms Lehmann were the directors and shareholders of First Pacific Mortgages at the time of completion of the contract. It would be open on any remittal of the proceedings for the trial Judge to

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<sup>72</sup> J D Heydon, *The Restraint of Trade Doctrine* (3<sup>rd</sup> ed, 2008) at 311.

<sup>73</sup> *Gilford Motor Co Ltd v Horne* [1933] Ch 935.

<sup>74</sup> See eg *H & R Bolck Ltd v Sanott* [1976] 1 NZLR 213; *Hawker de Havilland Ltd v Fernandes* [1996] ATPR 41-479; *Artedomus (Aust) Pty Ltd v Del Casale* [2006] NSWSC 146 (Burchett AJ).

conclude that First Pacific Mortgages was a cloak<sup>75</sup> for the activities of the vendors and that First Pacific Mortgages was their *alter ego*.

145 Having regard to the foregoing and to the terms of section 30 of the *Supreme Court Act 1935* (SA), it appears that this Court can award damages in lieu of, or together with, injunctive relief.<sup>76</sup> Section 30 relevantly provides:

In any action arising out of the breach of any covenant, contract, or agreement, or instituted to prevent the commission or continuance of any wrongful act or for the specific performance of any covenant, contract, or agreement, the court shall have power to award damages to the party injured either in addition to or substitution for the injunction or specific performance, and those damages may be assessed by the court or in such manner as it directs.

146 Section 30 is based on section 2 of the Imperial Act, *The Chancery Amendment Act 1858*, known as ‘*Lord Cairns’ Act*’. This Act gave the Court of Chancery the power to award damages as an alternative remedy.

147 In *Wentworth v Woollahra Municipal Council*,<sup>77</sup> Gibbs CJ, Mason, Murphy and Brennan JJ discussed the history and scope of the *Lord Cairns’ Act* and observed:<sup>78</sup>

Cairns L.J. (later Lord Cairns L.C.) seems to have thought that the power to award damages conferred by the 1858 Act could be exercised if the plaintiff made out as at the commencement of the suit the ingredients of a case for equitable relief, notwithstanding that ultimately he failed to obtain that relief on discretionary grounds. In *Ferguson v. Wilson*,<sup>79</sup> after quoting the words of the section, he said:

That, of course, means where there are, at least at the time of bill filed, all those ingredients which would enable the Court, *if it thought fit*, to exercise its power and decree specific performance -- among other things where there is the subject matter whereon the decree of the Court can act -- in a case of that kind, the Court has a discretionary power to award, under certain circumstances, damages in substitution for, or in addition to, the decree for specific performance. The object obviously was to enable the Court of Chancery to do ‘complete justice,’ as it was called, a phrase which assumed that there was the power in the Court of Chancery to make a decree to some extent, but not to make a decree to the whole extent which the case required. (Emphasis supplied.)

148 In order for the power under section 30 to be invoked, a plaintiff must demonstrate that at the time of commencement of proceedings, “the circumstances were such that the Court could, not necessarily would, have granted a final injunction or specific performance.”<sup>80</sup> If after the commencement

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<sup>75</sup> *Smith v Hancock* [1894] 2 Ch 377; *Gilford Motor Co Ltd v Horne* [1933] Ch 935.

<sup>76</sup> See discussion in Meagher, Heydon and Leeming, *Equity: Doctrines and Remedies* (4 ed, 2002), 842-855.

<sup>77</sup> *Wentworth v Woollahra Municipal Council* (1982) 149 CLR 672.

<sup>78</sup> *Wentworth v Woollahra Municipal Council* (1982) 149 CLR 672 at 678.

<sup>79</sup> *Ferguson v Wilson* (1866) LR 2 CH at 91-92.

<sup>80</sup> *Mills v Ruthol Pty Ltd* (2004) 61 NSWLR 1 at 13 (Palmer J) following *The Millstream Pty Ltd v Schultz* [1980] 1 NSWLR 547 (McLelland J); *ASA Constructions Pty Ltd v Iwanof* [1975] 1 NSWLR

of proceedings, the circumstances change, rendering an injunction or specific performance unavailable, or if for discretionary reasons the Court would not grant that relief, the power to award damages under section 30 is not thereby lost.<sup>81</sup>

149 The District Court of South Australia has an equivalent jurisdiction provided by section 36 of the *District Court Act 1991* (SA), which provides:

- (1) Although a particular form of relief is sought by a party to an action, the Court may grant any other form of relief that it considers more appropriate to the circumstances of the case.
- (2) In particular—
  - (a) where a party seeks relief by way of injunction or specific performance, the Court may award damages in addition to or in substitution for such relief;

...

150 Ultimately on any remittal of the present proceeding to the District Court, it would be open to the trial Judge to give consideration to any claim for equitable relief, and in particular, any claim for equitable damages against First Pacific Mortgages. However it is to be noted that amendments to the pleadings may be required before any such claim could be pursued.

## Conclusion

151 I would allow the appeal. I would set aside the orders of the trial Judge. I would remit Positive Endeavour's claim to the District Court for further hearing and determination in accordance with these reasons.

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512 (Needham J); see also *JC Williamson Ltd v Lukey* (1931) 45 CLR 282 where it was held that damages were only available where equity could have granted other relief.

<sup>81</sup> *Mills v Ruthol Pty Ltd* (2004) 61 NSWLR 1 at 13 (Palmer J).

152 **LAYTON J:** I consider that the appeal should be allowed and the decision made by the District Court on 11 September 2008 should be set aside. I further agree with the orders proposed by Bleby J. I also agree that the respondent should pay the appellant's costs of appeal.

153 My reasons for so concluding, in general terms, are those articulated by Bleby J. I consider that the restraint clause was invalid, as it stood, because it was unlimited in time and went beyond what was reasonable between the parties. There was no dispute that the sum of \$120,000 was paid by the appellant to the respondents for goodwill and that the only assets of the Fairway companies were future commissions from the trail book. I am also mindful of the evidence of Ms Lehmann as to how she calculated the consideration of \$120,000, which was accepted by Mr Smoker without his mathematical calculation. Although Ms Lehman's evidence lacked precision, it was an attempt to put a value on the future commissions from customers in the trail book. It was arrived at, in a general sense, by ascertaining the likely future commissions stream from the current loans in the trail book, applying a multiplier to reflect the present value and also making allowance for future contingencies. It was a rough methodology, and imperfect as the process was, it was indicative that the consideration was for future commissions for a finite period. Although this factor of itself is not determinative, it is one of the factors that is relevant to whether the restraint of trade clause was reasonable between the parties.

154 I also consider that the restraint clause as it stood should not be enforced by reason of it being contrary to public policy. I agree with the reasons given by Bleby J.

155 In relation to whether the otherwise invalid restraint clause may be saved by partial severance, I am persuaded by the reasoning of Bleby J that a partial severance of particular clauses as named by him is appropriate. This partial severance would result in the remainder being unaffected, it would mean that it is appropriately limited in time and would no longer be an unreasonable restraint of trade between the parties. I also consider it would no longer offend public policy.

156 Finally, I agree with both Bleby and Gray JJ that it is open for the trial Judge to consider an appropriate application, if made, for equitable remedies in respect of the respondent, First Pacific Mortgages Pty Ltd.

157 For these reasons, I therefore agree to the orders set out above.