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Restraint of Trade or Restrain of Freedom to Trade?

An analysis of the concept of restraint of trade clauses and unequal bargaining power in employment contracts.

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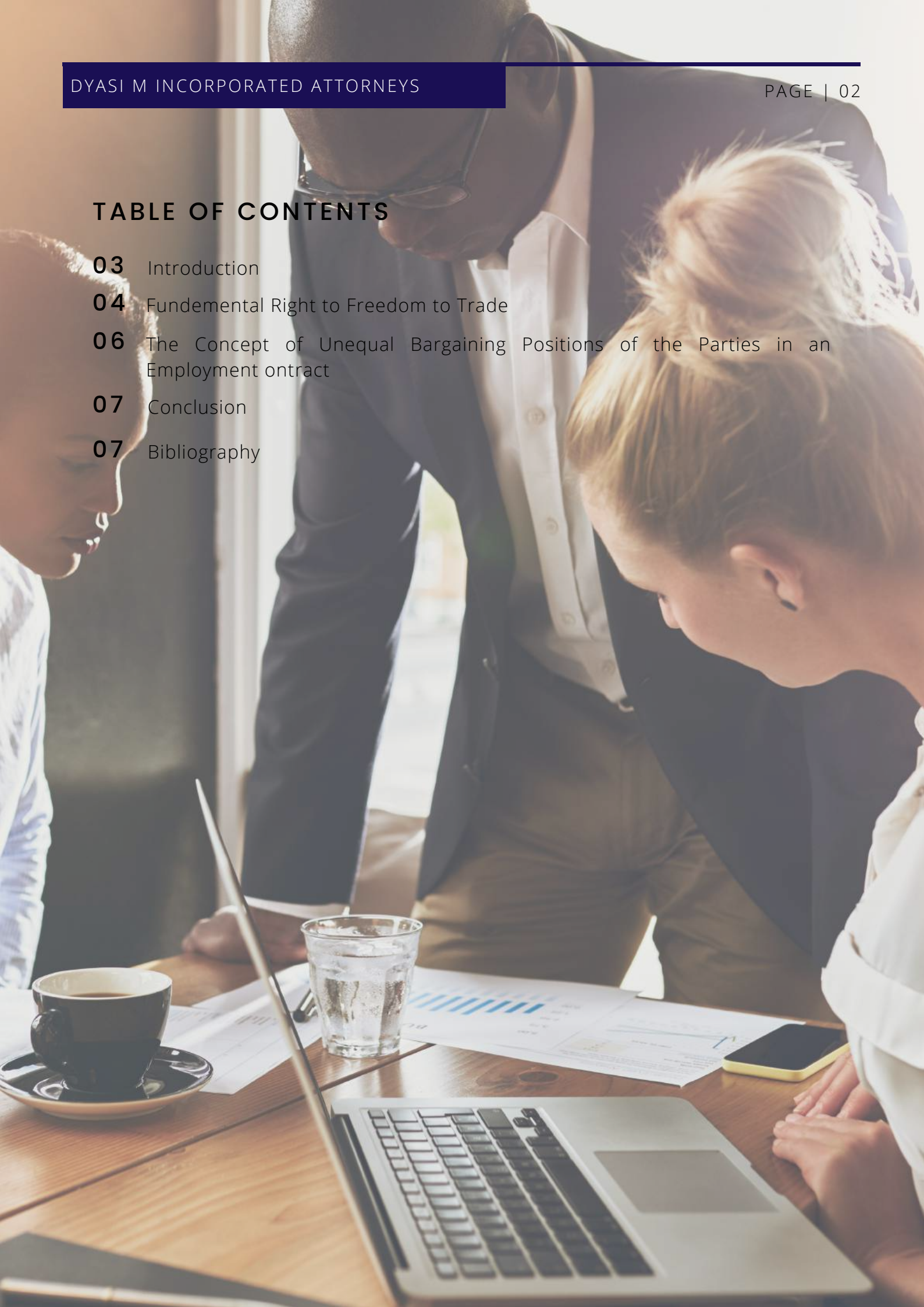

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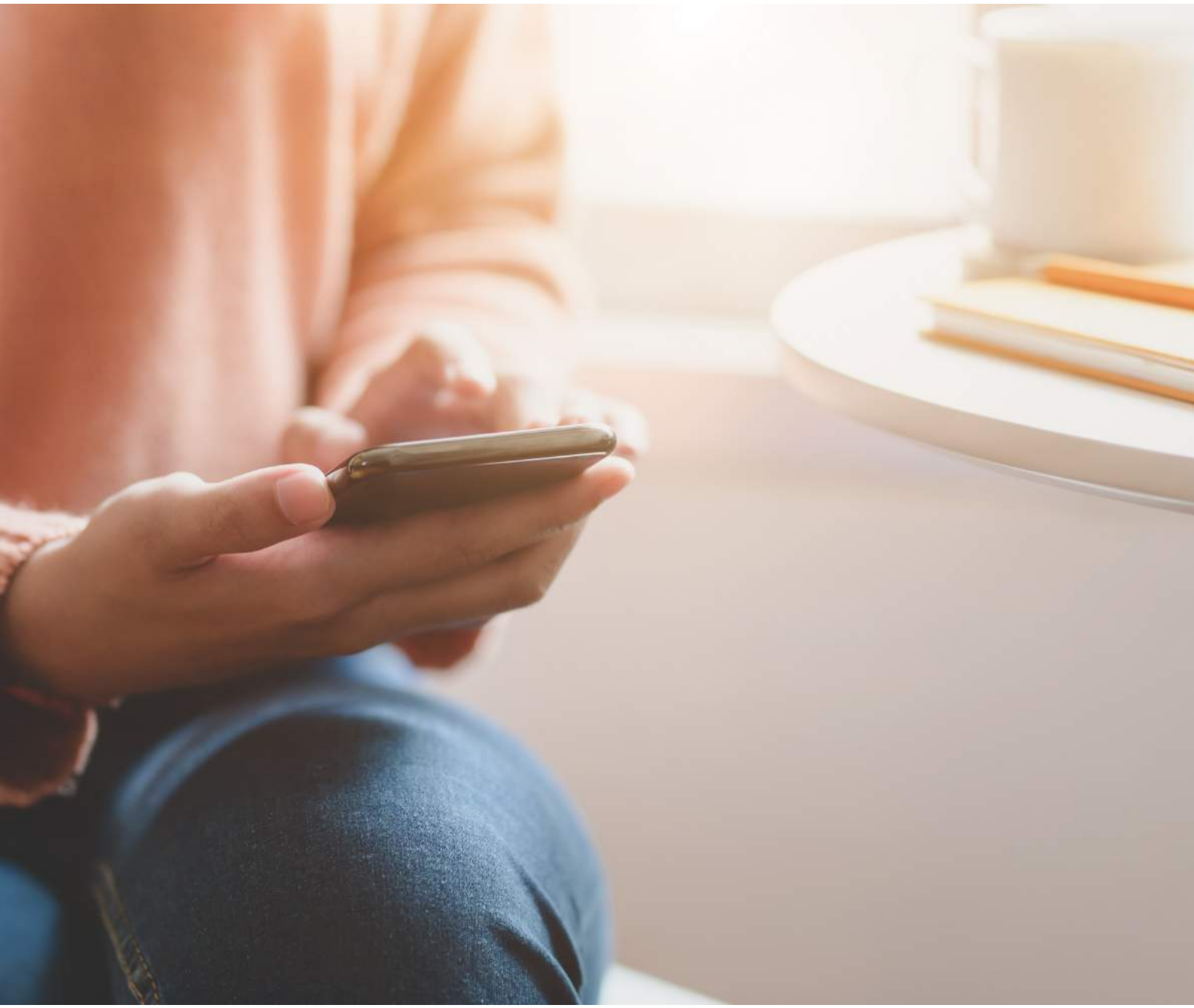
INTRODUCTION

A restraint of trade is a provision that is usually contained in an employment contract which restricts the employee from working, practicing, performing work or trading in the same and / or similar field as their former employer for a prescribed period of time and within a specified geographical area. [1]

The purpose of a restraint of trade is to protect the employer's proprietary interests, which include but are not limited to, client and customer database, trade secrets and confidential information. Although there is no legislation or regulation that directly provides an employer the protection offered in terms of the restraint of trade, the employee is bound to the provision where they elect to agree to the terms of the contract. [2] The impact of a restraint of trade could be prejudicial to a former employee and potentially restrict them from exercising their constitutional right to trade.



[1] B Workman-Davies and M Livingstone 'Restraints of Trade' at https://www.werksmans.com/legal-updates-and-opinions/restraints-of-trade/.
[2] K Calitz 'Restraint of trade agreements in employment contracts: time for pacta sunt servanda to bow out?' 2011 Stell LR 50.

FUNDEMENTAL RIGHT TO FREEDOM OF TRADE

Section 22 of the Constitution of the Republic of South Africa, 1996 provides for the freedom to trade. Every citizen is afforded the right to choose their occupation and profession. An individual has the freedom to earn a livelihood by working in a field of their choice. In *Home Affairs v Watchenuka* [3] the Supreme Court of Appeal (SCA) held that the freedom to work formed a component of human dignity. This means that a person's self-esteem and sense of self-worth is affected by their ability or inability to work and contributes to them feeling socially useful as their means of making a livelihood, in most instances, provides for their family's survival and well-being.

From the aforementioned, we can deduce that the freedom to work is an important right as it maintains an individual's dignity and self-respect by providing for one's own and family's upkeep in order to avoid being dependent on anyone or the state. [4] Conversely, the inability of exercising ones right to trade could possibly lead to social exclusion due to poverty, lack of interaction inherent to a workplace, depression and dependency on the state or community. [5] The right to freedom to trade should be read together with section 10, the right to dignity, section 21, the freedom of movement, section 13, the right to not be subjected to forced labour, section 18, freedom of association and section 23, the right to fair labour practices. [6]

Although we find that the Constitution provides for the freedom to trade, there are common law maxims in contract law such as *pacta sunt servanda* which are regarded as being more important than the value of freedom to trade. The *Magna Alloys v Ellis* [7] case is evidence of the fact that common law principles will be considered as more important than the right to trade. Although the case was decided in 1984, pre-constitution, many court decisions have applied its principle post the enactment of the constitution. The Appellate Division held that a contract in restraint of trade is enforceable like any other contract which is freely entered into and that an unreasonable restraint will usually be against the public interest. [8] Furthermore, parties are obliged to honour their agreements, the fact that an agreement is unreasonable or unfair will not constitute a ground to challenge the validity of the agreement. [9]

[3] [2004] 1 All SA 21 (SCA)
[4] Calitz op cit note 2 above at 64.
[5] Ibid.
[6] Ibid, 65.
[7] Magna Alloys & Research (S.A.) (Pty) Ltd. v Ellis 1984 (4) SA 874 (A).
[8] Calitz op cit note 2 above at 54.;
[9] Ibid; Magna Alloys v Ellis 1984 (4) SA 874 (A) 893..

Following the Magna Alloys case, the current position in our Courts is that unless the employee is able to prove that the terms of the restraint were unreasonable and against public policy, the restraint will be enforceable. The onus to prove this lies on the employee. [10] Every case will be assessed on an individual basis. In *Basson v Chilwan* [11] the Appellate Division established four requirements that must be taken into consideration in determining the validity of the restraint of trade:

1. The Employer must have a legitimate interest that they are protecting by enforcing the restraint of trade.
2. The protected interest will be prejudiced should the restraint of trade clause be contravened.
3. Consideration should be afforded to whether the prejudiced interest of the employer is greater than the right of the employee to be economically active after the termination.
4. Current public policy should be considered.

The *Reddy v Siemens Telecommunications (Pty) Ltd* [12] established one more requirement to consider in addition to the above-mentioned factors. This additional factor assesses whether the restraint of trade goes further than just protecting the interests of the employer, is there an ulterior motive for the restraint other than the protection of the employer's interests?

[10] Workman-Davies op cit note 1 above.
[11] Basson v Chilwan and Others 1993 (3) SA 742 (AD).
[12] 2007 (2) SA 486 (SCA).

THE CONCEPT OF UNEQUAL BARGAINING POSITIONS OF THE PARTIES IN AN EMPLOYMENT CONTRACT

The English Courts have held that regardless of whether a contract was entered into freely by the parties, there will always be a difference between a restraint of trade clause in an employment contract and one in a contract of sale. This is partially due to the fact that there is more freedom of contract between a buyer and seller rather than an employer and a person seeking employment.

Conversely, South African Courts have discussed the issue of the inequality of bargaining power in contracts in numerous cases. [13] This factor is taken into consideration when determining public interest in terms of whether the unequal bargaining positions of the parties have an influence on the unenforceability of a contract. Professor Calitz [14] suggests that if the superior Courts continue to neglect developing the common law to include the notion of unequal bargaining power, we will be faced with a series of problems as employees would be left unprotected. She makes a suggestion that we should look to the factors that were established in Germany by their Courts in considering whether a restraint of trade is enforceable. The following must be complied with in order for a restraint of trade to be enforceable in Germany:

1. The employer must have a protectable interest.
2. The clause must be expressly written.
3. The duration of all restraints is limited to two years after the termination of the employment contract.
4. The employer has to pay half of the employee's salary for each year that the restraint of trade is operative.
5. Courts will not enforce a restraint of trade that causes unreasonable disadvantage for the employee in terms of the geographical area and subject of competition. [15]

13Afrox Healthcare Bpk v Strydom 2002 (6) SA 21 (SCA); Barkhuizen v Napier 2007 (5) SA 323 (CC).
14 Calitz op cit note 2 at 62.
15 Calitz op cit note 2 above at 65.

South African Courts have already established a list of factors to help determine whether a restraint of trade is enforceable or whether it is contrary to public policy. However, it is my observation that the German Courts have been successful at being direct in their principles. South African Courts need to be as direct and possibly set a standard on which we can look for authority and a duration of time with regards to what constitutes 'reasonable'.

Where a restraint of trade is breached, the employer can insist on compliance of the contract by enforcing the restraint clause by applying for an interdict to prohibit the employee from breaching it. Where an employer suffers a financial loss or any form of prejudice resulting from a breach of a restraint, the employer may have a claim for damages, however, it is very difficult to prove that the financial loss was a direct result of the restraint.

CONCLUSION

A restraint of trade is inserted into a contract of employment solely for the purposes of protecting an employers' proprietary interest. What has become apparent through the analysis of this article is that the employee is not offered any protection. The issue of unequal bargaining power between the parties in a contract of employment is very prominent, in most instances, the employee has no bargaining power to decide on the clauses that are inserted in an employment contract. Although the employee has the option of electing not to enter into the contract with the employer due to freedom to contract, in a country such as South Africa where the unemployment is on the raise and in order to maintain their self-esteem and provide for their family, an employee mostly finds themselves in a position where they have no other choice but to enter into a contract of employment regardless of how prejudicial a restraint of trade is to their freedom to trade. Personally, I wonder whether it would be possible for our Courts to insist on constitutional values such as good faith and ubuntu being applied to employment contracts in order to ensure that the employee is protected since they do not have equal bargaining power and have to agree with the terms suggested by the employer.

Both the SCA and the Constitutional Court have failed on several occasions to develop the definition of public policy and what is 'acceptable' in terms of 'public interest'. It is acknowledged that public policy is not a static concept and differs in each community but, we need a standard to refer to as to what is acceptable and what is contrary to the norms of society. The restraint of trade principles should be developed to be more specific as to what is 'reasonable'. Finally, in developing the restraint of trade, although the employer's aim is to protect their own interests, they should be mindful of the fact that the employee has a right of freedom to trade thus, they should not be too restrictive in their approach.

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