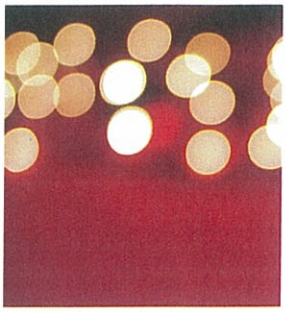

This sporting life — employer successful in retaining valuable player

By Sam Ingui ACIS, Partner, and Sarah Hedger, Solicitor, CBP Lawyers

- Court finds employment restraints in contract were reasonable but restraint period should end when risk of commercially sensitive information dissipates
- Fixed-term contract without an early termination clause carried with it mutual obligations requiring performance by both sides to an employment relationship
- Clear drafting of employment agreements is vital and it is helpful to include restraint of trade clause as part of contract rather than ancillary instrument

In *Seven Network (Operations) Limited v Warburton (No 2)* [2011] NSWSC 386 (the *Warburton case*), the employer was successful in invoking a restraint of trade clause in an employment contract and prevented a senior executive from joining a competitor before the end of his contract period.

The plaintiff, James Warburton was employed by Seven Network (Operations) Limited as a senior executive. He was highly regarded and seen as the natural successor to Seven's Chief Executive Officer, David Leckie.

Mr Warburton was initially employed by Seven in August 2003. In July 2008, he signed a contract with Seven that provided him with a further three years of employment due to expire on 14 October 2011.

In addition to this, Mr Warburton also entered into an equity participation deed with Seven's private equity investors known as the Seven Media Group (SMG). The deed provided that in return for various equity options, Mr Warburton agreed to be bound by a variety of lengthy and cascading post-employment restraint periods.

Opportunity at Network Ten

In February 2011, rival Network Ten terminated the employment of its Chief Executive Officer. By this stage, the commercial reputation of Mr Warburton was so elevated that Seven recognised that he was a natural replacement target for Ten. Seven's instincts were correct.

Ten did in fact approach Mr Warburton for the position. On 2 March 2011, Mr Warburton signed a written contract with Ten to commence employment on 14 July 2011 and informed Seven the same day that he had signed with the rival network.

Seven immediately instructed Mr Warburton to leave the premises and instructed him not to contact staff or clientele.

Seven's fury was not just related to being spurned by Mr Warburton. There were commercial concerns as well. Seven had been gearing up for negotiations with major advertising buying groups for the 2012 calendar year. Mr Warburton's timing could not have been worse. He had detailed knowledge of Seven's commercial rates, pricing models, margins and cost structures. He had also been closely involved in preparing Seven's commercial position prior to these forthcoming negotiations. If he were to start work with Ten in July, he could offer Ten insights which could be commercially disastrous for Seven.

Seven then sought to enforce the restraints to prevent Mr Warburton from commencing employment with Ten until 14 October 2012, being 12 months from the cessation date of his employment contract.

In the Supreme Court of New South Wales before Pembroke J, this case turned on two issues. First, the court had to determine whether the restraints

were reasonable. Second, if they were enforceable, for what period of time should they operate?[1]

The case brought by Seven

The wording in the restraint clauses provided that it would commence from the date Mr Warburton 'ceases to be employed or engaged' by Seven.

Seven contended that not only were they entitled to make Mr Warburton serve out his 'gardening leave' from 2 March 2011, but also that he had to continue his employment until 14 October 2011. Further, Mr Warburton should be restrained from working for a competitor for an additional period of 12 months commencing from 14 October 2011.

Mr Warburton was essentially just like a star footballer who was contracted to play for them. He could not be allowed to play for another team during the season.

Had Seven repudiated the employment contract?

Mr Warburton disputed Seven's attempts to retain his employment until October 2011. He had four principal arguments.

First, by placing him on 'gardening leave', Seven had repudiated the employment contract, thus allowing him to take up new employment with Ten. This ignored the fact that the employment contract expressly stated that Seven was 'entitled but not obliged' to give Mr Warburton any duties to perform.

The inclusion of these words was fortunate for Seven. However, they were not entirely necessary, as the court considered it likely that the case law would entitle Seven to be able to send Mr Warburton on gardening leave anyway. The court also noted that it was not uncommon for individuals in industries such as media to be required to serve out their contract term without being given any work. Pembroke J found that there had been no intention to repudiate the contract expressed by Seven.[2]

Mr Warburton's second argument was given short shrift by the court. Mr Warburton argued that comments made by Mr Leckie in a conversation with him in February 2011 led him to believe that no objection would be made to his subsequent employment with Ten. Mr Warburton submitted that Seven should be estopped or prevented from enforcing the restraint as a result of the comments made.

While Pembroke J preferred Mr Warburton's version of the conversation, he did not think Mr Warburton sufficiently demonstrated that he had acted to his detriment as a result. Instead the court thought that Mr Warburton sought to take advantage of Mr Leckie's words.

The court felt that although Mr Leckie made favourable comments that suggested that Mr Warburton was free to work for Ten, that alone was not enough. Mr Warburton had to show how the words Mr Leckie used had caused him detriment. This was going to be difficult considering his contract with Seven expressly provided that he had to work for them until October 2011. Pembroke J ultimately found that Mr Leckie's statements were not intended to have a binding effect upon Seven or to prevent Seven from enforcing the restraint clause.

In any event, courts are usually reluctant to grant relief on the grounds of estoppel for mere loose statements. The words used by Mr Leckie to Mr Warburton were not of a kind that would have allowed him to walk away from the contractual obligations he was bound to uphold with Seven.

Mr Warburton's third argument had the most merit but it required him to concede the effectiveness of his contract with Seven and most particularly the restraints. Here, Mr Warburton contended that if the restraints were effective in any way, they could only operate from the time he was placed on gardening leave. Alternatively, he argued that the period of gardening leave should reduce the time periods of the restraint.

Mr Warburton's final submission was that the restraints were void because they were uncertain. He reasoned that because of various permutations contained within the restraints, they were open to a variety of possible outcomes and so should be struck down.

The final play

The court considered that the July 2008 contract between Mr Warburton and Seven was valid. Pembroke J explicitly noted the veracity of the Latin phrase *'pacta sunt servand'* (promises must be kept). Mr Warburton had agreed to work for Seven to October 2011. That much was clear from the wording in the employment contract. Like a star footballer, he was obliged to either play for Seven or sit out the season. There was no scope for early termination of the contract. Just because he wanted to play for another team did not make Mr Warburton's desires correct.

The court confirmed the authorities upholding the obligation of employers to see out such fixed-term contracts.[3] The court held that a fixed-term contract without an early termination clause carried with it mutual obligations requiring performance by both sides to an employment relationship.

Rights of employers and employees

This is perhaps an unfair outcome. While an employee may be obliged to serve out a term under a contract, an employer has the option to terminate the contract early and face a damages action. Even then, an employee who suffers damages from early termination of a fixed-term contract may still be obliged to mitigate their loss.[4] What is good for the goose is sometimes avoided by the gander.

The court's attention then turned from the analysis of the employment contract to the analysis of the impact of the deed. Pembroke J disagreed with Mr Warburton's contention that the restraints in the deed could not be read together with the employment contract. The deed that Mr Warburton signed contained an acknowledgement clause stating that the restraints were reasonable. The restraints thus formed express obligations for Mr Warburton to honour, even though they were promised to a party that was not part of the core employment relationship.

The court also considered as irrelevant Mr Warburton's argument that the various permutations of the restraints should be void for uncertainty. While the operation of the restraints did cause some confusion, they were not so complex as to merit being set aside. The court held that it had an obligation to make genuine efforts to find a workable understanding of the restraints if they were legitimately difficult to ascertain. Ultimately, however, the court found that the restraints were not unworkable and thus should not be struck out.

Having determined that Seven had not repudiated the contract and that the restraint was valid, Pembroke J considered the correct time period for the restraint should not run until October 2012, as such a finding would be capricious or unreasonable.[5]

Analysis

The court took a holistic approach to the legal issues before it in finding that the restraint of trade was taken to be valid and enforceable from March 2011 to 1 January 2012.

In exercising its discretion the court considered that the restraint was required to protect Seven's confidential information, clientele and staff. However, any restraint past a ten-month period would exceed that which was required for the reasonable protection of the employer's legitimate interests.[6]

The court gave weight to the significant commercial imperatives that Seven faced. Seven ran a clever case, providing evidence of the commercial risk it faced if Mr Warburton were to be allowed loose into the commercial arena. The advertising revenue which was Seven's lifeblood was clearly the most important asset that it had. Mr Warburton's defection to Ten potentially threatened those revenues. The evidence supported Seven's risk exposure and this justified the restraint.

The determination of a business's legitimate interests is a moveable feast and has to be determined at the time of the court's hearing. This is because courts retain an inherent discretion to give relief if a proper basis is established.[7] A court in this regard need only apply a restraint to the extent needed at the date of enforcement to give efficacy to the parties' intention and to protect their interests. That being said, although a restraint of trade may have been reasonable when the contract was formulated, the clause may subsequently become unreasonable at the date the employer seeks to enforce it.

In Mr Warburton's case, the evidence from Seven itself suggested that the risk associated with its commercially sensitive information dissipated in January 2012 after the advertising rates for that year had been locked in during 2011. Any subsequent commercial knowledge held by Mr Warburton would only have historical value.

Seven's protection was only for the duration of its risk in 2011 and there was no need to keep the restraints going until October 2012. As a result, when the new season started in 2012, Mr Warburton could then engage in commercial endeavours with Ten.

Lessons for employers

1. To aid in ensuring a restraint will be found to be enforceable, it may assist to include an 'acknowledgement of reasonableness' clause in the employment contract, particularly for senior and executive employees.
2. Employment contracts should be unambiguously expressed. In Mr Warburton's case, the court

noted that where the language of a contract is open to two constructions, it is preferred to uphold the construction that avoids a consequence that appears to be capricious or unreasonable, even if it is 'not the most obvious or the most grammatically accurate'.[8]

3. To aid with contract certainty, employers should draft restraint of trade clauses as part of the employment contract itself, rather than an ancillary instrument. Seven got away with not doing this on this occasion; the next employer may not be so lucky. The court gave substantial weight to the fact that Mr Warburton was aware of the restraint clause. Generally speaking, the employment contract contains the entire written agreement between the parties. Incorporating the restraint of trade directly into an employee's contract will help to avoid any additional hurdles of proving that an ancillary document should also be considered as part of the employment relationship.

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Notes

1 *Warburton* case, para [4]
2 ibid para [57]
3 For example, *Curro v Beyond Productions Pty Limited* [1993] 30 NSWLR 337. Pembroke J also cited as informal authority, John Milton's poem 'On his blindness' and prophetic and profound words 'they also serve who only stand and wait'
4 *Automatic Fire Sprinklers Pty Limited v Watson* [1946] HCA 25
5 *Warburton*, para [18]
6 ibid, para [21]
7 ibid at [4] referring to *Tullett Prebon (Australia) Pty Ltd v Purcell* [2008] NSWSC 852 at paras [88] and [91]
8 ibid, para [43] ■