CASES / VONNISSE

Taut Knots Require Strong Rope: A Discussion of the Factors that Must Be Considered When Enforcing Restraint-of-Trade Agreements

Sadan v Workforce Staffing (Pty) Ltd
[2023] ZALAC 14

1 Introduction

The Labour Appeal Court (LAC) in *Sadan v Workforce Staffing (Pty) Ltd* ([2023] ZALAC 14) had to decide whether the enforcement of restraint-of-trade agreements in respect of their territorial operation and duration was unreasonable. The judgment is significant as the court emphasised and confirmed that in deciding whether to enforce a restraint-of-trade clause, issues of reasonableness, the interests of the parties and public policy will be the touchstones of the enquiry. Furthermore, employers who seek to enforce long restraint-of-trade agreements will need to provide the court with proper justification if they wish to enforce those agreements.

2 Facts

Workforce Staffing (Pty) Ltd (respondent) provided human resources, staffing solutions, staff placements and related services throughout South Africa (par 5). Furthermore, the respondent designed and developed unique computer programs for the management of staff, payroll generation and invoicing to clients (par 5).

The first and second appellants were employed, respectively, as the respondent's General Manager of Sales and National Sales Executive (par 6). As General Manager of Sales, the first appellant was required to develop and implement sales strategies for allocated regions and was responsible for revenue generation, the achievement of sales targets, recruitment and the selling of staff services and solutions to customers (par 9).

As National Sales Executive, the second appellant worked closely with the respondent's customers, as he was responsible for obtaining new business and managing existing customer relationships (par 10). In the course of his duties, he entertained customers by hosting breakfasts and also organised social events such as golf days (par 10). During the course of their

employment, the appellants had thus formed close relationships with the respondent's customers, had become aware of information relating to its pricing strategies, costing of its products and profit margins, and also had access to its client database, marketing material, business strategies and financial information (par 8).

After the appellants resigned, they took up employment with Rise Up Group (Pty) Ltd, a competitor of the respondent, which provided services relating to staffing solutions in Durban, Secunda and Johannesburg (par 11). These services were provided in competition with the respondent's services (par 11).

In the LAC, the appellants submitted two arguments. The first was that the court *a quo's* order (that clause 13.4 (the impugned clause) applied to all of the branches or offices where they had performed their duties or were assigned responsibilities) was unjustifiably harsh and unreasonable as such order prevented them from being employed anywhere in South Africa (par 13). They submitted that it would be reasonable to interpret the impugned clause to mean that they were prohibited from taking up employment with the respondent's competitors within 50 kilometres of the branch or office at which they were employed – namely, Cresta, Johannesburg (par 13).

Secondly, the appellants contended that should the court find in favour of the reasonable interpretation of the impugned clause, they would not only agree to be bound for the stipulated two-year period, but they would also not consider the two-year period to be unreasonably overbroad, as they would only be prohibited from taking up employment within a 50-kilometre radius of the respondent's Cresta office. The respondent, on the other hand, argued that the restraint applied to all branches or offices where the appellants worked, carried out duties or were allocated responsibilities (par 14).

3 Issue

The issue in the LAC was based on limited grounds. The court had to consider only whether the restraint-of-trade clauses were unreasonable and against public policy, both in respect of their territorial reach and duration (par 1).

4 Judgment

The LAC held that although the company's proprietary interest was worthy of protection throughout the whole of South Africa, the two-year operation of the restraint-of-trade agreements was unduly excessive. The court held that the respondent did not provide convincing and compelling reasons to justify the period of the restraint. The court found that two years was an inordinately long time for the appellants' replacements to meet with clients and develop relationships (which was essentially the justification the respondent provided for the duration of the restraint). The court, therefore, held that a two-year restraint of trade that prevented the appellants from taking up employment with the respondent's competitors anywhere in South Africa was unreasonable and contrary to public policy; accordingly, it reduced the restraint period to one year (par 33).

5 Discussion

5 1 The applicable legal principles

The general principles applicable to restraint agreements were well established. In *Massmart Holdings v Vieira* ([2015] ZALCJHB 451), in which the court summarised them as follows:

> "Restraint agreements are enforceable unless they are unreasonable. In general terms, a restraint will be unreasonable if it does not protect some proprietary interest of the party seeking to enforce a restraint. In other words, a restraint cannot operate only to eliminate competition. The party seeking to enforce a restraint need only invoke the restraint agreement and prove a breach of the agreement, nothing more. The party seeking to avoid the restraint bears the onus to establish, on a balance of probabilities, that the restraint agreement is unenforceable because it is unreasonable (see … *Magna Alloys and Research (SA) (Pty) Ltd* …; *Den Braven SA (Pty) Ltd v Pillay* … 2008 (6) SA 229 (D))." (par 4)

The position in our law is, therefore, that a party seeking to enforce a contract in the restraint of trade is required only to invoke the restraint agreement and prove a breach thereof.

5 2 Territorial reach of the restraint agreements

Restraint-of-trade agreements must be interpreted and construed based on the principles of statutory interpretation that have been set out in several cases including those enunciated in *Natal Joint Municipal Pension Fund v Endumeni Municipality* ([2012] ZASCA 13; 2012 (4) SA 593 (SCA); [2012] 2 All SA 262 (SCA)) (*Endumeni*), where the SCA held:

> "The present state of the law can be expressed as follows. Interpretation is the process of attributing meaning to the words used in a document, be it legislation, some other statutory instrument, or contract, having regard to the context provided by reading the particular provision or provisions in the light of the document as a whole and the circumstances attendant upon its coming into existence. Whatever the nature of the document, consideration must be given to the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production ... The process is objective not subjective. A sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results or undermines the apparent purpose of the document ... The 'inevitable point of departure is the language of the provision itself', read in context and having regard to the purpose of the provision and the background to the preparation and production of the document." (par 18; see also *Kubyana v Standard Bank of South Africa Ltd* [2014] ZACC 1; 2014 (3) SA 56 (CC); 2014 (4) BCLR 400 (CC) par 77 and 78)

According to Smith AJA, if the impugned clause in the restraint agreements is interpreted in accordance with the principles in the above-mentioned cases, then the impugned clause brooks no construction other than that contended for by the respondent (par 16). The view of the respondent (upheld by the court *a quo*) was that the prohibition extends to all other branches or offices where the appellant exercised their duties or were allocated responsibilities (par 13).

Moreover, when the impugned clause is interpreted in this manner, it makes business sense. This is so because the appellants each had national responsibilities, had formed relationships with customers throughout the country, and had access to the respondent's confidential information and national client database (par 16). It was not in dispute that the appellants were given responsibilities to procure new clients and to manage and retain existing relationships with clients throughout the country. It thus made business sense for the respondent to protect itself against the possibility of former employees, who had access to its confidential business information, being employed by a competitor in all areas where they were given responsibilities and where they would thus have had the opportunity to interact with and establish close relationships with its clients (par 16). According to Smith AJA, properly construed, the impugned clause of the agreement has the effect of prohibiting the appellants from taking up employment with the respondent's competitors anywhere in the Republic for a period of two years from their last day of employment with the respondent (par 16).

5 3 Is the enforcement of the restraint reasonable?

In our law, restraint-of-trade agreements are valid, binding and enforceable unless their enforcement would be unreasonable (par 17).

The court in *Reddy v Siemens Telecommunications (Pty) Ltd* ([2006] ZASCA 135; 2007 (2) SA 486 (SCA)) stated that *Magna Alloys and Research (SA) (Pty) Ltd v Ellis* ([1984] ZASCA 116; 1984 (4) SA 874 (A)) was

> "a landmark decision (which) introduced a significant change to the approach of the courts to agreements in restraint of trade by declining to follow earlier decisions based on English precedent that an agreement in restraint of trade is *prima facie* invalid and unenforceable." (par 10)

The court in *Magna Alloys* (*supra*) concluded that restraint-of-trade agreements are valid and enforceable unless they are unreasonable and thus contrary to public policy. As a result of the judgment in *Magna Alloys*, and because of the common-law validity of restraint-of-trade agreements, a party who challenges the enforceability of a restraint-of-trade agreement bears the burden of alleging and proving that it is unreasonable. Although the decision of the court in *Magna Alloys* has been widely criticised (see Du Plessis "Restraint of Trade and Public Policy" 1984 *SALJ* 91; Schoombee "Agreements in Restraint of Trade: The Appellate Division Confirms the New Principles" 1985 48 *THRHR* 127), the approach set out by the court in *Magna Alloys* has been consistently followed by our courts as exemplified in *Basson v Chilwan* (1993 (3) SA 742 (A)) and confirmed in *Reddy v Siemens Telecommunications (Pty) Ltd* (*supra*).

In *Basson v Chilwan* (*supra*), the court set out the test for the reasonableness of a restraint-of-trade agreement. Nienaber JA in *Basson v Chilwan* set out the following questions that should be considered:

(a) Does one party have an interest that deserves protection after termination of the agreement?

(b) Is that interest threatened or being prejudiced by the other party?
(c) If so, does that interest weigh qualitatively and quantitatively against the interest of the other party not to be economically inactive and unproductive?
(d) Is there an aspect of public policy having nothing to do with the relationship between the parties that requires that the restraint be maintained or rejected? (see 767G–H of the judgment)

A fifth consideration was raised by the court in *Reddy v Siemens Telecommunications* (*supra*) – namely, whether the restraint goes further than necessary to protect the interest. The court held that this consideration corresponds with section 36(1)(*e*) of the Constitution, which requires consideration of less restrictive measures to achieve the purpose of a limitation. The court in *Reddy v Siemens Telecommunications* held that

> "[t]he value judgment required by *Basson v Chilwan supra* necessarily requires determining whether the restraint or limitation is 'reasonable and justifiable in an open and democratic society based on human dignity, equality and freedom'." (par 17)

The judgment in *Reddy v Siemens Telecommunications* was significant because it dealt with principles and issues after the introduction of the Constitution of the Republic of South Africa, 1996. The court, in that case, had to consider the argument that the rule laid down in *Magna Alloys* (*supra*) had the effect of casting the onus upon a party (seeking to avoid the restraint) to allege and prove that the restraint was unreasonable. This included an argument that the restraint was in conflict with section 22 of the Constitution, which guarantees that every citizen has the right to choose their trade, occupation or profession freely. It was argued in *Reddy v Siemens Telecommunications* that such a restraint limited these rights, and was enforceable only if it was alleged and proved by the person seeking to enforce it that such limitation was reasonable (*Beedle v Slo-Jo Innovations Hub (Pty) Ltd* [2023] ZALAC 17 par 22).

In *Reddy v Siemens Telecommunications*, Malan AJA accepted that restraint-of-trade clauses posed a challenge and that there was a possible conflict between obligations that fall within the maxim *pacta servanda sunt* and those that are enshrined in the Constitution – specifically, the right to engage freely and choose one's profession or occupation as enshrined in section 22 of the Constitution, and the principle that parties should comply with their contractual undertakings (see generally Neethling "The Constitutional Impact on the Burden of Proof in Restraint of Trade Covenants – A Need For Exercising Restraint" 2008 20(1) *SA Merc LJ* 91; Calitz "Restraint of Trade Agreements in Employment Contracts: Time For *Pacta Servanda Sunt* to Bow Out?" 2011 22(1) *Stellenbosch LR* 63). A restraint, however, will be unenforceable if it prevents a party, after the termination of their employment, from engaging in commerce or a chosen profession (*Pilog Data (Pty) Ltd v Glencore Global Business Centre (Pty) Ltd* [2023] ZAGPPHC 464 par 59; *Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd* 1981 (2) SA 173 T). In such a case, not only is the restraint not in the public interest, but it is also contrary to public policy (par

15 of the judgment; see also *Beedle v Slo-Jo Innovations Hub supra* par 23–24).

Smith AJA stated that in the present case, in deciding whether or not it would be reasonable to enforce a restraint of trade, the court must make a value judgment. This would entail the court taking into account the following policy considerations: (a) that public interest requires that parties should comply with their contractual obligations, a notion expressed by the maxim *pacta servanda sunt*; and (b) all persons should, in the interests of society, be productive and permitted to engage in trade and commerce or their professions. Both considerations reflect not only common law but also constitutional values. In *Reddy v Siemens Telecommunications* (*supra*)*,* the court held:

> "Contractual autonomy is part of freedom informing the constitutional value of dignity, and it is by entering into contracts that an individual takes part in economic life. In this sense freedom to contract is an integral part of the fundamental right referred to in s 22." (*Reddy v Siemens Telecommunications supra* par 15)

In *Magna Alloys* (*supra* 896A–E), Rabie CJ held that a court may, in the public interest, order that either the whole or only a part of the restraint on trade be enforced (par 20).

Although section 36 of the Constitution is not applicable to public-interest considerations in that it expressly governs a law that limits an enumerated right in the Bill of Rights, Malan AJA in *Reddy v Siemens Telecommunications* (*supra*) considered that the requirement contained in section 36(1)(*e*) of the Constitution, which requires a consideration of less restrictive means to achieve the purpose of a limitation, could be equated with a value judgment confronting a court in determining the reasonableness or lack thereof of a restraint clause. Section 36 would apply where the legal basis of the case brought by a covenantee was directly sourced in the right enumerated in section 22 of the Constitution, as opposed to a case based on public policy. Regardless of whether the direct applicability of section 36 is relevant to the latter kind of case, the conclusion regarding the consideration of less restrictive means is a useful guide to a court in dealing with a public-policy challenge to a restraint clause based on unreasonableness (see *Beedle v Slo-Jo Innovations Hub supra* par 24).

Ngcobo J in *Barkhuizen v Napier* ([2007] ZACC 5, 2007 (5) SA 323 (CC)) stated that the concept of *ubuntu* is also a part of public policy and therefore should also play a role in an inquiry into the validity of a restraint-of-trade clause (par 57).

Once the party seeking to enforce a restraint-of-trade agreement has established an interest worthy of protection, and that the other party is threatening such interest, the onus is on the party resisting the enforcement of the agreement to prove that it would be unreasonable. The appellants in the present case thus bore the onus of proving that the enforcement of the restraint would be unreasonable, both in respect of its territorial operation and duration (par 19; see also *Reddy v Siemens Telecommunications supra* par 10).

The respondent argued that the appellants had failed to discharge the onus of proving that the enforcement of the restraint was unreasonable. It was argued by the respondent that the allegations made by the appellants in this regard were "bald and unsubstantiated" and that they had failed to proffer any evidence to show why the enforcement of the restraint would be unreasonable (par 21).

The appellants argued that if the restraint-of-trade agreements were to be enforced, it would, in effect, prevent them from working anywhere in the Republic, since the restraint did not stipulate a defined geographical area in which it would apply. It was argued further by the appellants that the period of two years was unreasonable in that it effectively required the appellants not to practise their chosen trade and profession for two years in what is a highly competitive, fast-paced and ever-changing industry (par 22).

Smith AJA stated that the argument that the restraint-of-trade provision was unreasonable and against public policy was tenuous and insubstantial (par 22). According to Smith AJA, the assertion that the restraint of trade does not relate to a defined geographical area was unsustainable (par 23). This was so because, reasonably construed and in terms of the principles of interpretation set out earlier, the impugned clause of the agreement prohibited the appellants from seeking employment with any of the respondent's competitors anywhere in the country. The undisputed facts in this case made it clear that neither appellant was confined to the respondent's Cresta offices but performed their duties nationally and had formed close relationships with the respondent's clients throughout the Republic. According to Smith AJA, it was thus reasonable for the respondent to expect its employees to commit to a covenant that would protect its interest wherever such employees had the opportunity to form relationships with clients. In the case of the appellants, who were both employed in capacities that required them to perform their duties nationally, only a countrywide limitation would have achieved that objective (par 22).

In *AB v Pridwin Preparatory School* (2019 (1) SA 327 (SCA)) (*Pridwin*), the SCA held that a court must declare invalid a contract that is *prima facie* inimical to a constitutional value or principle, or that is otherwise contrary to public policy. In instances where a contract is not *prima facie* invalid, but its enforcement is so in particular circumstances, a court will not enforce it. The court in that case also laid down the following principles that govern judicial control of contracts: (a) public policy demands that contracts freely and voluntarily entered into must be honoured; (b) the party who attacks the contract or its enforcement bears the onus of establishing that its enforcement will be *contra bonis mores*; and (c) a court will use its power to invalidate a contract or not enforce it, sparingly (par 24).

The Constitutional Court in *Beadicia 231 CC v Trustees for the Time Being of the Oregon Trust* (2020 (5) SA 247 (CC)) (*Beadicia*) confirmed the judgment in *Pridwin* (*supra*) and held, in addition, that abstract values such as good faith, fairness or reasonableness do not provide a free-standing basis on which courts may interfere with contractual relationships. According to the court in *Beadicia* (*supra*), they do, however, have relevance in the application of contract law when the question arises as to whether a contractual provision, or the enforcement thereof, would be against public

policy (par 25; see also Boonzaier "Contractual Fairness at the Crossroads" *Constitutional Court Review* (21 December 2021) https://doi.org/10.2989/CCR.2021.0009 (accessed 2023-02-10).

The court pointed out in *Beadicia* (*supra*) that a "careful balancing exercise" is required in instances where enforcement of a contractual term implicates constitutional rights (par 87). This is needed to determine whether the term in question has the potential to offend public policy. The court also cautioned that the power to invalidate or not enforce contractual provisions should be used sparingly, but this should not deter courts from exercising their duty to infuse public policy with constitutional values (par 25).

According to Smith AJA, application of the "careful balancing exercise" mentioned in *Beadicia* (*supra*) implies a value judgment involving the balancing of the respondent's right to hold the appellants to the agreements (on the basis of the principle of *pacta sunt servanda*) against the appellants' constitutional rights to ply their trade and engage in commerce (par 26).

Smith AJA stated that because the restraint in clause 13.4 of the agreement prohibited the appellants from plying their trade or engaging in commerce throughout the Republic, the duration of the limitation must be subjected to rigorous scrutiny. In addition, the appellants' rights in terms of section 22 of the Constitution to choose and freely practise their trade, occupation or profession required serious consideration. The fundamental question, according to the court, is whether there were any less restrictive means available to the respondent to protect its proprietary interest (par 27).

Smith AJA indicated that the justification provided by the respondent for the stipulated period of two years was based on the respondent's desire to protect its proprietary interest, namely its relationships with clients. Smith AJA was not convinced by this argument. Furthermore, the respondent did not provide any compelling evidence to justify the manifestly onerous and unreasonable limitation of the appellant's constitutional rights to ply their trade and engage in commerce. According to Smith AJA, a period of two years was inordinately long and disproportionate, particularly having regard to the fact that the territorial limitation extended to the whole of the Republic (par 27). In addition, the enforcement of the restraint would be contrary to public policy.

According to the court, it would, therefore, be appropriate to enforce the restraint partially by reducing it to a period of one year, commencing from the appellants' last day of employment. This would also be a reasonable period to ensure sufficient protection of the respondent's proprietary interest (par 31).

The LAC in *Beedle v Slo-Jo Innovations Hub* (*supra*) also had to consider whether the restraint provision entered into, and which formed part of the contract of employment concluded by the appellant and Slo-Jo on 1 April 2007, was reasonable (par 7). The court, in this case, concluded that the duration and geographical area of the restraint were reasonable. The facts in *Beedle v Slo-Jo Innovations Hub* are distinguishable from those in *Sadan v Workforce Staffing (Pty) Ltd* (*supra*). In *Beedle v Slo-Jo Innovations Hub*, the employee was appointed as head of research and development and possessed knowledge of the specific nature of the company's operations in

the beverages industry. In terms of the employee's restraint-of-trade agreement, she was prohibited from, among others, being employed by a competitor in the beverages industry in South Africa for a period of two years following the termination of her employment with the company (par 2–4 of the judgment).

Davis AJA held that "[*p*]*rima facie*, a restraint for two years without any plausible justification being offered by the party seeking to enforce the restraint cannot, on its own, pass legal muster" (par 35). According to Davis AJA, the restraint in question applied throughout the Republic as the respondent had offered a comprehensive explanation as to why two years was necessary to protect its interests. Having balanced the employee's freedom of trade against the proprietary interest sought to be protected by the company, the court found that, given the company's operations throughout South Africa, the geographical scope of the restraint of trade was reasonable (par 36). Davis AJA stated that the two-year period in which the restraint was to operate was justifiable owing to the lead-time for the conceptualisation of a product required by one of its customers until the product is brought to market, which can take between 24 and 36 months (par 36).

6 Conclusion

The enforcement of restraint-of-trade provisions must be considered in light of public policy, which must also take into account the principles of *ubuntu*. Freedom of contract is integral to a person's freedom and constitutional dignity. However, when a clause in a contract or provision in a restraint-of-trade clause is found to be unreasonable, it will not be enforced. The judgment in *Sadan v Workforce Staffing* (*supra*) illustrates that our courts have adopted a conservative approach in considering whether a restraint is unreasonable. Furthermore, the judgment makes it clear that evidence needs to be led by both employer and employee before a court would be prepared to reach a conclusion. Where there is a lack of clear, convincing and compelling justification for the duration and geographical area of a restraint, the court may reduce the duration of the restraint. The judgment indicates that the courts would be prepared to reduce the duration of a restraint in order to protect the stated interests of either of the parties, while also seeking to preserve and protect the employee's freedom to trade. In instances where employers wish to enforce a restraint for an extended period, they would need to be prepared to justify it by providing compelling evidence.

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