

# Submission to the Competition Taskforce on Post-Termination Worker Restraints

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## About the submission

This submission is made in response to the Treasury's April 2024 Issues Paper on *Non-Competes and Other Restraints: Understanding the Impacts on Jobs, Business and Productivity (Issues Paper)*. It draws on the extensive research recently conducted by Dr Ross on this issue,<sup>1</sup> together with the expertise gained by Professor Stewart from over three decades of academic research and writing,<sup>2</sup> along with his longstanding work in helping to advise employers on the enforceability of post-employment restraints. Its purpose is to outline reforms that we believe are desirable, in order to address the policy challenges framed in the Issues Paper. In doing so, we either restate or add detail to some of the propositions recently advanced by Dr Ross.

The views expressed are ours alone, and not those of any of the organisations with which we are associated.

## The need for reform

We take as our starting point three propositions about the need for government intervention to limit the use of non-compete clauses – that is, agreed restrictions on the

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<sup>1</sup> See Iain Ross, *Non-Compete Clauses in Employment Contracts: The Case for Regulatory Response*, TTPI Working Paper 4/2024, Tax and Transfer Policy Institute, Crawford School of Public Policy, ANU, Canberra, March 2024.

<sup>2</sup> See eg Andrew Stewart, 'Confidentiality and the Employment Relationship' (1988) 1 *Australian Journal of Labour Law* 1; Andrew Stewart, 'Confidential Information and Departing Employees: The Employer's Options' [1989] *European Intellectual Property Review* 88; Andrew Stewart, 'Drafting and Enforcing Post-Employment Restraints' (1997) 10 *Australian Journal of Labour Law* 181; Andrew Stewart et al, *Creighton & Stewart's Labour Law*, 6th ed, Federation Press, Sydney, 2016, pp 515–21; Andrew Stewart, *Stewart's Guide to Employment Law*, 7th edition, Federation Press, Sydney, 2021, pp 318–23.

freedom of a worker to establish, work for or otherwise be involved in another business, once their engagement ends.

The first is that '[t]he use of non-competes by Australian business has increased over the past 5 years and, absent a policy response, this trend is likely to continue'.<sup>3</sup>

The second is that 'the research literature suggests that non-competes are associated with ... reduced employee mobility, with consequential negative impacts on wages and productivity'.<sup>4</sup>

The third is that:

The existing law and practice in respect of the use of non-competes in Australia is manifestly unfair and contrary to the public interest. In most cases the parties to a non-compete cannot be certain of enforceability without a judicial determination and such uncertainty weighs more heavily on employees than employers. For many employees the mere threat of litigation is enough to secure compliance, irrespective of the enforceability of the non-compete.<sup>5</sup>

We acknowledge that the first of those propositions is based on limited data, although the available figures accord with observations from other developed economies,<sup>6</sup> as well as anecdotal experience. We also accept that reasonable minds might differ on the second proposition, or at least on the extent to which it is true. But we do not believe that a serious argument can be made against the third. The uncertainty of the current law is a product of the open-ended and context-specific nature of the reasonableness test that underpins the common law doctrine of restraint of trade,<sup>7</sup> exacerbated by a combination of the *Restraints of Trade Act 1976* (NSW) (**RoT Act**) and the willingness of courts applying the law of other Australian jurisdictions to tolerate the use of 'cascading' restraints.<sup>8</sup> That uncertainty can only work in favour of a party with greater resources and access to expert advice – which in the great majority of cases will be the employer<sup>9</sup> seeking to enforce the restraint.

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<sup>3</sup> Ross, above n 1, p 1.

<sup>4</sup> Ibid.

<sup>5</sup> Ibid.

<sup>6</sup> See Issues Paper, p 8.

<sup>7</sup> Ross, above n 1, pp 3–4.

<sup>8</sup> See *Stewart's Guide to Employment*, above n 2, pp 322–3; Issues Paper, pp 12–14.

<sup>9</sup> We generally use the term 'employer' in this submission in a broad sense, to include both employers in the common law sense and those who engage certain types of independent contractor to perform work. More is said about the latter type of worker later in the submission.

## Proposed reforms

In the sections that follow we briefly outline some key points about the content, form and scope of the statutory reforms we believe are necessary. In summary:

1. The use of non-competes should be prohibited for workers earning below an income threshold. Such provisions should not merely be declared void, but attract penalties for inclusion in relevant contracts.
2. For lower-paid workers, restraints on the solicitation of former clients with whom the worker has had personal contact should be permitted for a period of no more than three months after termination.
3. For higher-paid workers, if non-competes are not to be prohibited altogether, a limit of six months should be imposed, and the employer should be required to provide compensation for the duration of the restraint.
4. Limitations on the duration of a restraint should take account of any period of 'garden leave' imposed by the employer on a departing worker.
5. Restraints on the solicitation of former co-workers should be prohibited in all cases.
6. Employers and their advisers should be encouraged to draft simpler and more moderate restraints, by providing that an employer may not seek to enforce a post-termination restraint if *any* invalid restraint is imposed on the same worker.
7. The threshold for obtaining an interlocutory injunction to require a worker to comply a post-termination restraint should be lifted, by requiring the employer to show a likelihood of success at trial.
8. These rules and limitations should be included in the *Fair Work Act 2009* (Cth) (**FW Act**) and apply for the benefit of both national system employees and workers performing work under a services contract for which an unfair contract term remedy may be sought under s 536ND.
9. The FW Act should also be amended to prohibit enterprise agreements, workplace determinations and collective agreements from including provisions imposing any type of post-termination restraint on workers.
10. The enforceability of restraints on the use or disclosure of confidential information should continue to be governed by the common law. The same should apply to non-competes associated with the sale of a business or the dissolution of a partnership.

In settling on these proposals we have had regard to the importance of introducing rules that as far as possible avoid complexity, while also minimising the potential for evasion.

## Prohibit non-competes for lower-paid workers

The revelation that post-termination restraints are being widely applied to the likes of childcare workers provides a clear reason to intervene. In summary:

There is a strong case for prohibiting the use of non-competes in respect of low-paid workers. It is difficult to conceive of the 'legitimate interest' that would justify a non-compete in respect of a strawberry picker, or for that matter a hairdresser ... The use of a non-compete in such circumstances is akin to using a sledgehammer to crack a walnut.<sup>10</sup>

The prohibition should be framed by reference to agreements, arrangements or understandings that seek, whether directly or indirectly, to limit the freedom of a worker after the end of their engagement to establish, undertake for, or otherwise be involved in, another business.

Given evidence that employers routinely require workers to agree to post-termination restraints that are clearly or likely to be unenforceable,<sup>11</sup> it is important that any reform not just restrict the enforceability of non-competes, but increase the 'cost' of using them. This could be done through provisions similar to ss 333C and 333D of the FW Act concerning pay secrecy clauses, which both declare offending provisions unenforceable *and* prohibit their use. The latter type of provision would expose employers to a penalty merely for including a prohibited restraint in a relevant contract.

As to the income threshold for this prohibition, we can see merit in two options. One would be to use the high income threshold prescribed under s 333 of the FW Act, which is used (among other things) to limit the capacity of award/agreement free employees to bring unfair dismissal claims under Part 3-2 of that Act. At the time of writing, that threshold is an annual rate of earnings of \$167,500. If that were considered too high, an alternative would be to set a threshold at, or something close to, average weekly ordinary time earnings for a full-time adult. Given that the most recent data from the ABS puts this at \$1886.50 per week,<sup>12</sup> an annual earnings threshold of \$100,000 might be chosen.

## Limit client solicitation restraints on lower-paid workers

The objections to non-compete provisions do not apply anywhere near as strongly to provisions restricting workers from seeking to 'solicit' clients of their former employer to switch to a new business. Such a restraint may reduce the value of a worker to a new employer, but it does not directly prevent them from switching jobs or pursuing new

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<sup>10</sup> Ross, above n 1, pp 32–3.

<sup>11</sup> Ibid, p 34.

<sup>12</sup> ABS, *Average Weekly Earnings, Australia, November 2023*, ABS, Canberra, 2024.

opportunities. The common law also limits the enforceability of such restraints by requiring that the clients in question be ones with which the worker had had personal contact.<sup>13</sup>

However, our concern is that if nothing is done to expressly limit their use, an employer might seek to impose overly broad or onerous solicitation restraints whose effect is to dissuade a worker from seeking alternative work.<sup>14</sup> That being the case, we see value in limiting their duration to a period of three months, again with prohibitions on the inclusion of longer restraints in relevant contracts.

To be clear as well, under our proposal a client solicitation restraint of three months or less would not necessarily be valid: it would still be for the employer to establish a legitimate interest for the restraint, and to demonstrate that the restraint imposed was no wider than reasonably necessary to protect that interest. This would be determined in accordance with the common law principles that presently apply. While that would mean some uncertainty, it would avoid the need to have to draft rules codifying those principles. The simpler alternative would be to allow three month restraints as a matter of course. But that would effectively invite the inclusion of such provisions in work contracts even in situations where there would be no legitimate basis for them under the common law.

### Limit restraints on higher-paid workers

A case can be made for introducing a total ban on non-competes, similar to that already imposed by Californian law<sup>15</sup> and recently proposed by the US Federal Trade Commission.<sup>16</sup> However, if the government chooses not to take this step, we would propose a term limit of six months, which in most instances is the maximum duration that Australian courts tend to

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<sup>13</sup> See eg *Woodmason's Melrose Dairy Pty Ltd v Kimpton* [1924] VLR 475; *Wallis Nominees (Computing) Pty Ltd v Pickett* [2013] VSCA 24.

<sup>14</sup> For a recent example, see the *two-year* restraints on solicitation successfully challenged by a hairdresser in *Lochdyl Pty Ltd v Lind* [2024] SAMC 43.

<sup>15</sup> California Business and Professions Code, §16600(a) ('every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void'). For other examples, see Alan Hyde and Emanuele Menegatti, 'Legal Protection for Employee Mobility' in Matthew Finkin and Guy Mundlak (eds), *Comparative Labor Law*, Edward Elgar, 2015, p 195 at pp 200–3.

<sup>16</sup> Federal Trade Commission, 'FTC Announces Rule Banning Noncompetes', press release, 23 April 2024.

regard as reasonable.<sup>17</sup> Drawing on European regulatory models,<sup>18</sup> we also propose that for higher-paid workers, non-compete restraints should be valid only if the worker receives adequate compensation from the employer proposing the restraint, measured by reference to a percentage of their previous earnings. The German requirement of at least 50% would seem a reasonable standard to adopt in this regard.

As with our proposal above in relation to client solicitation restraints on lower paid employees, non-compete restraints of six months or less would not automatically be valid. For such a restraint to be enforceable, it would still be necessary for the restraint to be shown to be reasonably necessary to protect a legitimate interest of the employer, under the existing common law principles. Contracts would simply be prohibited from stipulating a duration of longer than six months.

As for client solicitation restraints on higher-paid employees, we do not propose any formal limit. Once again, however, to be enforceable these would need to satisfy the existing common law test.

### **Take account of garden leave in limiting restraint duration**

To the extent that any limits are placed on the duration of post-termination restraints, it will be important to take account of any period of ‘garden (or gardening) leave’ imposed by the employer prior to the termination of the relevant engagement: that is, a period during which the contract under which the worker has been engaged remains in operation, but the employer instructs the worker not to attend or perform work.<sup>19</sup> Suppose, for example, that a rule were adopted limiting non-compete durations to six months. If that restriction applied only to periods after the termination of the relevant contract, an employer could avoid the restriction and achieve a longer period of protection against competition by also putting the worker on garden leave. As a matter of common law, some judges have accepted the need to apply the doctrine of restraint of trade to periods of garden leave.<sup>20</sup> However, to avoid any doubt on this issue it should be expressly stipulated that any period

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<sup>17</sup> Ian Neil and Nicholas Saady, ‘The Reasonableness of Restraints: An Analysis of the Enforcement of Post-Employment Restraints’ (2018) 46 *Australian Business Law Review* 99 at 101. While longer restraints are sometimes upheld, these tend to be exceptional cases, often involving employees who have sold their businesses but agreed to keep working for the new owner: see *Stewart’s Guide to Employment Law*, above n 2, p 321. We return to restraints involving a sale of business in a later section.

<sup>18</sup> See Hyde and Menegatti, above n #, pp 208–11; Issues Paper, p 25.

<sup>19</sup> See Amanda Coulthard, ‘Garden Leave, the Right to Work and Restraints on Trade’ (2009) 22 *Australian Journal of Labour Law* 87.

<sup>20</sup> See eg *Tullett Prebon (Australia) Pty Ltd v Purcell* (2008) 175 IR 414 at [52]–[65].

of garden leave should be taken into account, and deducted from, the maximum permissible duration of a post-termination restraint.

## **Prohibit restraints on solicitation of co-workers**

Historically, the only interests that an employer could legitimately use as a basis for imposing a post-termination restraint were the protection of trade secrets or other confidential information, and the protection of the employer's trade connections with customers.<sup>21</sup> But in recent years, courts (mostly in New South Wales) have come to assert that there is a third such interest: the protection of the employer from key staff being recruited or 'poached' by former colleagues.<sup>22</sup> For reasons cogently advanced by Professor Joellen Riley Munton (as she now is),<sup>23</sup> such provisions should be prohibited outright, not least because they may limit the mobility and job opportunities of workers without their direct agreement and with no requirement for compensation.

## **Limit severance and reading down of invalid restraints**

For any contract governed by New South Wales law, the effect of the RoT Act is that an employer can draft a restraint in the broadest possible terms, but then seek to enforce it only to the extent that it covers what the defendant worker has done or is proposing to do.<sup>24</sup> In theory, a worker may seek an order under s 4(3) that a restraint be invalidated because of 'a manifest failure ... to attempt to make the restraint a reasonable restraint'. But it is difficult to find an example of this ever being done. The effect of the RoT Act is to confer on employers the great advantage of partial enforcement, without any risk of invalidity. Hence there is little incentive for moderate drafting.

The same effect can be achieved for other contracts by drafting multiple and overlapping restraints, then seeking only to rely on those that are capable of being adjudged reasonable. Restraints in this cascading form have, with only very few exceptions, been upheld by the courts.<sup>25</sup> Their effect is to leave workers with little way of knowing what they can or cannot do:

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<sup>21</sup> See eg *Herbert Morris Ltd v Saxelby* [1916] 1 AC 688 at 702, 709; *Lindner v Murdock's Garage* (1950) 83 CLR 628 at 640.

<sup>22</sup> See eg *Cactus Imaging Pty Ltd v Peters* (2006) 71 NSWLR 9 at [55]; *Agha v Devine Real Estate Concord Pty Ltd* [2021] NSWCA 29.

<sup>23</sup> See Joellen Riley, 'No "Poaching"? Why Not? A Reflection on the Legitimacy of Postemployment Restrictive Covenants' (2005) 19 *Commercial Law Quarterly* 3; and see also Issues Paper, pp 27–8.

<sup>24</sup> See eg *Woolworths Ltd v Olson* [2004] NSWCA 372.

<sup>25</sup> See eg *Hanna v OAMPS Insurance Brokers Ltd* (2010) 202 IR 420; *Bulk Frozen Foods Pty Ltd v Excell* [2014] TASSC 58.

It is one thing to be unsure whether a single restraint is valid or invalid: usually it is possible for a lawyer to make an educated assessment of its scope and have some confidence as to whether or not it will be upheld. It is quite another to be faced with tens or even hundreds of restraints covering a wide spectrum of activities, locations and time periods, some of which will catch a proposed course of conduct and others of which will not. The cost of seeking advice as to which if any of the combinations is valid is likely to be considerable, and ultimately there may be little option but to either fight the matter in court or submit to even the broadest of the combinations. From a policy perspective, this surely stacks the deck too much in favour of employers.<sup>26</sup>

While a ban on non-competes might lessen the impact of partial enforcement, it would still be a concern in relation to solicitation restraints. Our proposal is to create an incentive for more moderate drafting by providing that an employer may not seek to enforce a post-termination restraint if *any* invalid restraint is imposed on the same worker, whether in the same contract or a different one.

### Lift the threshold for interlocutory relief

As the law stands, it is relatively easy for an employer to obtain an injunction compelling a worker to comply with a post-termination restraint, pending a full trial at which in theory its validity can be assessed, but which in practice often does not go ahead. All the employer need show is that the employer has a *prima facie* case for relief (which requires a legitimate prospect of being able to establish that the restraint is valid), and that the balance of convenience favours making an order.<sup>27</sup> In practice, this is not a high bar to clear:

If the court considers that an arguable case is made out, it is rare to see a decision in which the hardship to the employee tips the balance of convenience against granting the employer the injunction. Generally, the balance of convenience is weighed in the employer's favour. The court is more concerned about the threat of an immediate injury to the employer's interest.<sup>28</sup>

In order to ensure that greater account is taken of worker interests in this situation, we propose that employers be required to show a *likelihood* of being able at trial to establish a case for relief, and that the court be obliged to take into account the public interest in the promotion of competition and the interests of affected employees in deciding whether the balance of convenience favours the grant of injunctive relief.

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<sup>26</sup> Stewart, 'Drafting and Enforcing Post-Employment Restraints', above n 2 at 218.

<sup>27</sup> See eg *IceTV Pty Ltd v Ross* [2007] NSWSC 635.

<sup>28</sup> Chris Arup et al, 'Restraints of Trade: The Legal Practice' (2013) 36 *University of New South Wales Law Journal* 1 at 10. See also Joellen Riley, 'Sterilising Talent: A Critical Assessment of Injunctions Enforcing Negative Covenants' (2012) 34 *Sydney Law Review* 617.



## Include restrictions in the Fair Work Act and not just for employees

The simplest method of imposing the restrictions we have proposed would be to include them in the FW Act, so as to apply for the benefit of the national system employees who make up around 85% of employed workers in Australia.<sup>29</sup> The recent inclusion of limitations on pay secrecy provisions<sup>30</sup> provides a useful and relevant precedent.

However, we also believe there is a case for extending the restrictions to cover at least some types of independent contractor. It is clear that post-termination restraints can be included in contracts for services, and that as a matter of common law they are subject to similar principles as those applicable to post-employment restraints.<sup>31</sup> The extension of rights and protections to ‘employee-like’ contractors was a significant feature of the federal government’s recent ‘Closing Loopholes’ reforms.<sup>32</sup> As part of those changes, persons performing work under a ‘services contract’ (as defined in a new s 15H of the FW Act) will be able to apply to the Fair Work Commission (**FWC**) under s 536ND for review of unfair contract terms, provided they have annual earnings that do not exceed the ‘contractor high income threshold’ prescribed under s 15C.<sup>33</sup> What we propose is that workers who are eligible to bring such claims also be protected by any new restrictions introduced for the benefit of employees.

## Prohibit restraints in enterprise/collective agreements

It is rare, but not unknown, for enterprise agreements made under the FW Act to contain provisions imposing post-employment restraints.<sup>34</sup> There must be doubt as to the validity of such provisions, given the general need for such agreements to deal with (existing) employment relationships, not those that have come to an end.<sup>35</sup> Nevertheless, even if such provisions are not technically enforceable,<sup>36</sup> the FWC is not empowered to call for their

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<sup>29</sup> As to that estimate, see Productivity Commission, *Workplace Relations Framework*, Inquiry Report No 76, Productivity Commission, Canberra, 2015, pp 69–70.

<sup>30</sup> FW Act Pt 2-9 Div 4, inserted by the *Fair Work Legislation Amendment (Secure Jobs, Better Pay) Act 2022* (Cth) Sch 1 Pt 7.

<sup>31</sup> See eg *NE Perry Pty Ltd v Judge* (2002) 84 SASR 86.

<sup>32</sup> *Fair Work Legislation Amendment (Closing Loopholes No 2) Act 2024* (Cth) Sch 1 Pt 16.

<sup>33</sup> These provisions are not yet in effect, but will take effect on 26 August 2024 unless proclaimed to commence on an earlier date.

<sup>34</sup> For exceptions, see the examples given in Ross, above n 1, pp 11-12.

<sup>35</sup> See FW Act s 172(1)(a); and see eg *Re Glen Eden Thoroughbreds Pty Ltd* [2010] FWA 7217.

<sup>36</sup> By virtue of s 253(1)(a) of the FW Act.

removal from an agreement submitted for its approval.<sup>37</sup> This has the unsatisfactory result that:

a non-compete may be included in an enterprise agreement despite the fact that the term will likely have no legal effect. The potential for such a term to have an in terrorem effect on the employees covered by the agreement is obvious. There is nothing on the face of the agreement to indicate that the non-compete term has no legal effect. In all likelihood, the employees covered by such an agreement would assume that the non-compete term is valid. This is an entirely unsatisfactory state of affairs.

As a matter of principle, it is not clear to us in any event why an employer should be able to impose a post-employment restraint on individual employees who may not have voted to support the enterprise agreement in which it is contained, or even have been employed at the time. It should certainly not be impossible to use an enterprise agreement to circumvent any statutory restrictions on the inclusion of non-competes in individual employment contracts. Accordingly, we propose that post-employment restraints, whether in the form of non-competes, anti-solicitation provisions or limits on the post-termination use or disclosure of confidential information, should be added to the list of unlawful terms in s 194 of the FW Act.

Such a reform would also, by virtue of s 279, restrict the content of workplace determinations made by the FWC under Part 2-5 of the FW Act to resolve bargaining disputes.

For the reasons given in the previous section, we also believe that a similar limitation should be placed on the permissible content of a collective agreement entered into under Part 3A-4 of the FW Act between a trade union and either a road transport contractor or a digital platform operator.<sup>38</sup> As with enterprise agreements, it is unclear whether collective agreements can validly include post-termination restraints, given that are generally required to regulate the terms and conditions on which 'regulated work' is performed by road transport contractors or 'employee-like' digital platform workers.<sup>39</sup> But once again, it would be better to put the matter beyond doubt.

## **Confidentiality and sale of business/partnership restraints**

For clarification, and with only one exception, the reforms we have put forward in this submission are not intended to affect the operation of contractual promises not to disclose

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<sup>37</sup> This was not the view taken in *Re Glen Eden Thoroughbreds Pty Ltd* [2010] FWA 7217. But cf Ross, above n 1, pp 14–16.

<sup>38</sup> Part 3A-4 is not yet in effect, but again is expected to be proclaimed to take effect in August 2024.

<sup>39</sup> FW Act, s 536MK(2)(a), (3)(a). Note also s 536MX(2), prohibiting the inclusion of terms dealing with 'matters that are primarily of a commercial nature that do not affect the terms and conditions of engagement of regulated workers'.

or make subsequent use of trade secrets or other confidential information acquired by a worker during the course of their engagement.<sup>40</sup> It is possible for a worker to comply with such commitments without losing the freedom to establish or work for another business. As such, we do not see a need for statutory intervention to limit their use. The only exception to this would be our proposal to prevent enterprise agreements, workplace determinations or collective agreements for regulated workers dealing with the issue of post-termination obligations.

In a similar vein, nothing that we have proposed is intended to affect the validity or enforceability of non-competes that are incidental to the sale of a business. A purchaser has a legitimate interest in protecting their investment in the goodwill of the business by ensuring that the vendor does not compete with the business and draw off their former clients. The same applies to post-termination restraints in partnership agreements. In both of these contexts, it has been accepted that restraints should be judged according to standards that are not as strict or limiting as those applicable to post-employment restraints.<sup>41</sup>

Should the vendor of a business or a departing partner agree to perform work for the new owner or the remaining partners, any restraint in their employment contract or contract for services might be subject to the limitations outlined above. But those limitations should be stated not to affect the validity of any restraints in the relevant sale or partnership agreement.

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<sup>40</sup> As to the principles applicable to such commitments, and the separate equitable and statutory duties that may impose requirements of confidentiality even in the absence of any express promises of secrecy, see *Stewart's Guide to Employment Law*, above n 2, pp 316–18.

<sup>41</sup> *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co Ltd* [1894] AC 535 at 566; *Geraghty v Minter* (1979) 142 CLR 177 at 185.