UNFAIR TRADE RESTRAINS IN ENGLISH LAW AND ITS RECEPTION BY SRI LANKAN LEGAL SYSTEM

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Introduction

The Author got fascinated from a recent research that he conducted on the area of Trade Restraints Law in Sri Lanka. The said area of law has not been developed or argued in court of law in the Sri Lankan jurisdiction except in handful of cases, of which, 2-cases have already mentioned in the caption. The law pertaining to unfair trade restraints in Sri Lanka, is construed, more often from English and/or American law which have also shown lot of changes and developments over the years. Hence, in addition to the findings in the Bible of Sri Lankan Contract law – the Law of Contracts by C. G. Weeramantry, it is hard to find any other good writings in this area. In this backdrop, a discussion on 'Unfair Trade Restraints' in Sri Lanka is not completed unless the ilk of Common Law and English Law are taken into contemplation. In addition to some texts penned by late Justice C. G. Weeramantry, we must oblige to the Honurable Judges in our Superior Courts who have also ventured to write some excellent peace of writings in this area of law in their respective Judgments. Those authorities have helped a lot to cater the needs of Lawyers and Academics who are desperate to find wisdom in the stream of Law of Unfair Trade Restraints in Sri Lanka.

Law of Restraints of Trade

Restraints of trade is defined as a legal contract between a buyer and a seller of a business, or between an employer and employee, that prevents the seller or employee from engaging in a similar business within a specified geographical area and within a specified period. Rather than a question of relationship between one buyer and one seller, covenants of trade restraints are more disputed between the Employers and Employees. In this side of law, a trifling attempt has been carried out by the lawmakers in Sri Lanka by implementing *Unfair Contract Terms Act, No. 26 of 1997*. However, the said Act has been postulated only to impose limits on the extent to which civil liability for breach of contract, or for negligence or other breach of duty by <u>the Sellers towards the Customers</u>. Except the protection given to customers in various instances by ensuring *'the contract terms which purports to exclude or restrict or has the effect of excluding or restricting, a person's liability for death or personal injury*

resulting from negligence shall be of no effect' [1], there is no protection for Employees who enter into Contracts of Employment under this instant Act. Thus, the law regarding trade restraints in Sri Lanka is not statutory law; but an exclusive artifact of case law.

Evolution of the Legal Position with regard to the Restrictive Clauses in English Law (Road from "Restraint Clauses considered to be Unlawful" to "Lawful")

Before we move on to handful of Sri Lankan cases decided in this subject area, it is pertinent to review on English law. Until 18th century, English Common Law recognized any restriction clause preventing an employee being employed at a competitor business entity for a certain period of time as unlawful. The said legal position varied with the pronouncement of *Mitchel vs. Reynolds*[2]. In the said judgment, it was stated that "*…although a general restraint is necessarily void yet a partial restraint is prima facie valid and enforceable, if reasonable…"* This is the beginning of a change of perception in law of trade restraints in English Jurisdiction. In the said ***Mitchel*'s** case, it was further decided that, *"To conclude: in all restraints of trade, where nothing more appears, the law presumes them bad; but if the circumstances are set forth, that presumption is excluded, and the Court is to judge of those circumstances, and determine accordingly and if upon them it appears to be a just and honest contract, it ought to be maintained. For these reasons we are of opinion, that the plaintiff ought to have judgment."*[3]

The said changing approach of the English law has been phrased by *Judge C. G. Weeramantry* as follows: *"…the English law concerning restraint of trade has fluctuated with changing social concepts and conditions. In Elizabethan days all restraints of trade whether general or partial were regarded as totally void in view of their tendency to create monopolies. Early in the 18th century however the courts deviated from this view…"*[4]

In support of the above said paradigm shift, successive cases given further impetus. The judgment of one celebrated English case, named, *Maxim Nordenfelt Gun Company Vs. Nordenfelt* [5] was pronounced at the dawn of the 20th Century which had also emphasized the following salient points which highlight the transformation of perception of trade restraint law, *viz: "……..the old rule that general restraints were bad always and that partial restraints were if unreasonable has been modified and that the true test of the validity of a condition in restraint of trade is whether the restraint in the particular case, be it general or particular, is or not reasonable…"* The aforesaid judgment

[1] Section 5, 6, and 7 of Unfair Contract Terms Act, No. 26 of 1997.
[2] (1711) 1 P Wms 181.
[3] p. 352 of Mitchel v. Reynolds 1P.WMS.195.
[4] p. 382 of Volume I of Law of Contracts by C. G. Weeramantry, 2nd ed. 2012.
[5] (1894) A.C 535

paved a fresh avenue in relation to the restrictive clauses of Contract of Employment and provided the basis for the modern law of restriction clauses. As a result of the said case, it was established that validity of a trade restraint is based **not on generality of the trade restraint; but by its reasonableness**.

In *Mason Provident Clothing & Supply Co. Ltd*[6], the standpoint taken up by *Lord Machnaghten* in the said *Nordenfelt case* was affirmed and further held that, *"…all covenants in restraint of trade, whether partial or general, are deemed to be prima facie void and unenforceable unless the test of reasonableness propounded by Lord Macnaghten in the Nordenfelt case was satisfied…"* In *Mason Provident Clothing* case, *Lord Moulton* advanced ahead and made an opinion that court will come to rescue a poor employee who had been framed to sign for a contract which has unreasonably wide terms that could prevent him from working at some other place when he leaves the incumbent Master. *Lord Moulton* further conferred that, *'It would in my opinion be pessimi exempli if, when an employer had exacted a covenant deliberately framed in unreasonably wide terms, the Courts were to come to his assistance and, by applying their ingenuity and knowledge of the law, carve out of this void covenant the maximum of what he might validly have required. It must be remembered that the real sanction at the back of these covenants is the terror and expense of litigation, in which the servant is usually at a great disadvantage, in view of the longer purse of his master.'*[7]

Paradigm Shift Further Continues…

As an extension to the said new-found nuance, in *Herbert Morris Ltd Vs. Saxelby*[8] it was further held that though a general restriction clause preventing an employee being employed in a competitor establishment is void, if an employee is well aware of trade secrets of a business, it is reasonable to restrict him from being employed at a competitor business establishment by way of imposing a restrictive covenant. It was emphasisly added in the said case that, *"…a covenant which restraints a servant from competition is always void as being unreasonable, **unless there is some exceptional proprietary interest owned by the master**, whether in the nature of a trade connection or in the nature of trade secrets, which requires protection…."*[9]

In this line of cases, the aforesaid novel principle was born and brought up in the garden of English jurisdiction. That is to say, as and when a protection is needed for the previous employer from an outgoing worker who has possessed some knowledge which is worthy of protecting, inasmuch as such protection is justifiable, such an outgoing worker be restricted by contract terms which they have signed

[6] 1913 A.C 724

[7] p. 725 of Mason Provident Clothing & Supply Co Ltd. 1913 A.C. 274

[8] 1916-1917 AER 305 at 314; (1916) 1 AC 88

[9] As per Lord Parker of Waddington in Herbert Morris Ltd Vs. Saxelby

for. In these circumstances, there was a necessity for the Court to consider, whether the restraints secured no more than adequate protection to the party in whose favour it was imposed. The yardstick of deciding the adequacy of the protection was compared with the nature of the employment and how strong the privy of the employer to the trade secrets and insider information of the previous Company (or the Employer). In deciding the adequacy of the protection, the formulae was, if the employment is engulfed with full of trade secrets, the necessity of trade restraints were high; if the employment lacks the trade secrets, then the necessity of trade restraints were low.

In this novel thinking, the right of an employer to impose restrictive covenants to protect trade secrets not became a taboo anymore. As such the said principle considered to be a legitimate exercise and it was discussed in the following judgments too. In Foster & Sons Ltd Vs. V Suggett[10], it was held that, *"…A restraint against competition by a servant has been held to be justifiable if its object is* ***to prevent the exploitation of trade secrets learned by the servant in the course of his employment****…."* **In** Commercial Plastics Ltd Vs. Vincent[11], it was opined that *"…in such a case the employer would have to prove definitely that the servant has acquired substantial knowledge of some secret process or mode of manufacture used in the course of his business. Even the general knowledge derived from secret information which has taught an employee how best to solve particular problems as they arise may be a proper subject matter of protection…"* In a recent case, Esso Petroleum Co. Ltd Vs. Harper's Garage (Stourport) Ltd[12] it has been held that in the modern era, restraints of trade have become a part of the accepted structure of trade and such restraints are tools for encouraging trade relations rather than limiting them. This style of law was manifested in the said Esso Petroleum Co. Ltd case as follows: *"…restrictions which in an earlier age were classified as restraints of trade may, in the difference circumstances of today have become "part of the accepted pattern or structure of trade" as encouraging rather than limiting trade…."*[13] *And "…that certain restrictive agreements have now "passed into the accepted and normal currency of commercial or contractual or conveyancing relations" and are therefore no longer suspect…"*[14]

Having articulated the above synopsis of evolution of English Law during the last 2-3-centuries, it is not wrong to determine that the present English Common Law has modified the legal position to admit the restrictive clauses as a *sine qua non* in the dialect of contract of employments. The prominent underlying principle for legitimizing such restrictive clauses was the consistent and swift flow of trade relations of the modern-day Contracts of Employment.

[10] (1918) 35 TLR 87
[11] (1964) 3 AER 546
[12] (1967) 1 AER 699
[13] Per Wilberforce at page 731
[14] Per Wilberforce at page 731

Thus, the yokes of all contracts in restraints of trade are *prima facie void ab intio* was branded as archaic and a liberal approach to such cases became trite law in English Legal world. As per this new *Grundnorm*, each case must be examined having regard to its special circumstances to consider whether or not the restraint is justified. According to *Cheshre & Fifoot*, "*…The only ground of justification is that the restraint is reasonable having regard to the interests of both contracting parties as well as to the interests of the public…*"[15].

Reception of English Law in Sri Lanka

The aforesaid legal principles in regard to restrictive clauses evolved in English Common Law, have been adopted by the Courts in Sri Lanka and have now become a part of Sri Lankan Law too. In the Sri Lankan legal system, *Hentley Garments Ltd vs. J. S. A. Fernando* [16], was one highlighted case among others. In the aforesaid *Hentley Garments Ltd case*, the Petitioner Company carrying on the business of manufacturing and exporting of garments, who instituted an action in the District Court against the Respondent who was at one time employed by the Petitioner Company as a shift supervisor, for breach of a written contract of employment resulting from his resignation. The Petitioner Company sought an interim injunction against the Respondent restraining him from engaging himself in employment in any garment manufacturing or exporting business in terms of the contract. After inquiry, the learned District Judge refused to issue an interim injunction and vacated the enjoining order initially issued. The Petitioner Company appealed from that order. In the Appeal Court, it was decided in favour of the Plaintiff-Petitioner Company by granting the interim injunction against the Defendant-Respondent worker.

The *Ratio Decidendi* of *Hentley Garments Ltd vs. J. S. A. Fernando* is as follows; *"All contracts in restraint of trade are prima facie void, and each case must be examined having regard to its special circumstances to consider whether or not the restraint is justified. The only ground of justification is that the restraint is reasonable having regard to interests of both contracting parties as well as to the interests of the public".* [17] The aforesaid contention has been morefully elaborated by *His Lordship Justice Ranasinghe* as follows; *"…on a consideration of the principles set out in the case dealing with contracts in restraint of trade referred to above, it would appear that, although a restrictive covenant of service would be considered to be prima facie void, yet, it is open to the employer to show that, having regard to the particular facts and circumstances in which the said agreement has been entered into, the said agreement is reasonable. The employer would therefore have to place before court all the evidence upon which he relies to*

[15] Cheshire & Fifoot, 6th ed., p. 320.
[16] 1980 (2) SLR 145

[17] P. 145 of Hentley Garments Ltd vs. J. S. A. Fernando

establish the reasonableness of the covenants complained against…"[18]

In the aforesaid observations, it is reasonable for the Plaintiff-Employer to prevent the Defendant-Employee from disclosing confidential information which the latter learnt in the course of employment.

Protection of Confidential Information as a Justification for Trade Restraints

In addition to the said point of protection of confidential information as a justification for trade restraints, *Justice C.G Weeramantry* gave emphasis to another ground for justification of 'restrictive clauses' in his finest legal literature – Law of Contracts as follows: *"…therefore all contracts in restraint of trade are prima facie void, and each case must be examined having regard to its special circumstances to consider whether or not the restraint is justified. The only ground of justification is that the restraint is reasonable having regard to the interests of both contracting parties as well as to the interests of the public…"* [19] *Justice C.G Weeramantry* has specifically stressed on the ***interest of public*** in justifying whether a restraint of trade is reasonable.

If the employee has got access to bulk of confidential and sensitive information of the business of the employer, in terms of *Justice C.G Weeramantry*, those are needed to be protected. In the event of such an access to confidential information and the experiences gained during the course of work are to be disclosed to a 3rd party through an ex-employee of the former, it is the employee's obligation to preserve such information without unduly disclosing the same to 3rd parties in the course of employment. It is further submitted that such obligation would extend and bear on an employee even after the resignation from his previous employer. This position has been morefully elaborated by *Megarry J* in the case of *Coco Vs. Clerk*[20] as follows: *"…it seems to me that if the circumstances are such that any reasonable man standing in the shoes of the recipient of the information would have realized that upon reasonable grounds the information was given to him in confidence, then this should suffice to impose upon him the equitable obligation of confidence…"* The aforesaid position was re-affirmed in the case of *Attorney General Vs. Blake*[21] and it was further held that employees have an implied obligation to safe guard the secrecy of confidential information which they became aware of in the course of employment even after the termination of such employment. In the said case, it was pronounced that, *"….The present case is exceptional. The context is employment as a member of the security and intelligence services.* ***Secret information is the lifeblood of these services.*** *In the 1950s Blake deliberately committed repeated breaches of his*

[18] p. 155 of Hentley Garments Ltd vs. J. S. A. Fernando

[19] p. 384 of 384 of Volume I of Law of Contracts by C. G. Weeramantry, 2nd ed. 2012.

[20] (1969) RPC 41

[21] (1998) 1 All ER 833 or [2000] UKHL 45; [2000] 4 All ER 385; [2000] 3 WLR 625 (27th July, 2000)

undertaking not to divulge official information gained as a result of his employment. He caused untold and immeasurable damage to the public interest he had committed himself to serve...."[22] In this backdrop, it is correct to say that the power of the restrictive clauses in contract of employment could extend even after the resignation given by en employee to his previous employer.

In a land mark case *Faccenda Chicken Vs. Fowler*[23] the Court of Appeal of England recognized several yardsticks in order to distinguish general information from confidential information which has to be safe guarded by the employees in the course of their employment and even after their termination of employment. Several of such guidelines *inter alia* are as follows:

- The nature of the employment and the status of the employee;
- The nature of the information;
- Whether the employer has stressed the confidentiality of the information to the employee;
- Whether the information could be isolated from other non-confidential information;

In addition to the aforesaid authorities, the following authorities show different types of trade secrets which have to be protected by the ex-employees.

- chemical formulae - *Amber Size & chemical Co. Vs. Menzel*[24]
- secret manufacturing process - *Herbert Morris vs. Sexelby*[25]
- designs and special methods of construction - *Reid and Sigrist vs. Moss and Mchanism*[26]
- other information of a sufficiently high degree of confidentiality which amounts to a trade secret - *Printers and Finishers vs. Holloway*[27]

Liberty of the Employee Must Supersedes Trade Restraints

Apart from the aforementioned English Law cases and its evolutionary approach to the law of trade restraints over the years, one, recent Sri Lankan case, named, *Finlay Rentokil (Ceylon) Ltd vs. A. Vivekanandhan*[28] has given a new colour and glamour to the ilk of approach of area of trade restraints. In the aforesaid *Finlay Rentokil* case, it was highlighted that if the employee has no any other option but to go back to the ex-employer or starve himself, in the event of an injunction prevents him from going for a new work place, in such cases, the liberty of the employee must supersede the justification of the trade restraints. *Finlay Rentokil (Ceylon) Ltd Case*, could consider as a ground-breaking and progressive decision in law of unfair trade restraints,

22 As per *Lord Nicholls* of Birkenhed in *Attorney General Vs. Blake*
23 (1987) ch 177

24 (1913) 2 Ch 239
25 (1916) AC 688,701
26 (1932) 49 RPC 461
27 (1965) RPC 239,253.
28 1995 (2) SLR 346

where if the circumstances are such that if the consequences of that injunction would be to put the employee in a position that he could have to go on working for his former employer or starve, hence, the Court has the power to dismiss an injunction be given against a worker. In the said case, *Hon. Justice Ranaraja*, in his fascinating judgment, quoting few landmark English cases and went on to said that *"…Herbert Morris v. Saxelby Public policy requires that every man shall be at liberty to work for himself and shall not be at liberty to deprive himself or the state of his labour, skill or talent by any contract that he enters into… ….Besides, in contracts of service the parties are not in an equally strong position and the employee will find it difficult to resist the imposition of terms favourable to the employer.* ***Thus if an employee agree that after leaving his employment, he will not work for a competitor, the courts will rarely enforce such an agreement, Herbert Morris (supra), because the employee will be forced either to work for his former employer or to starve****."[sic]*[29]

The instant position taken up by *Hon. Justice Ranaraja,* is much more favourable to the non-influential, poor worker who might have to enter into some covenants of trade restraints in his Contract of Employment with great displeasure; but do not possess any power over strong Employer who has got more bargaining power. In that context, the ***Finlay Rentokil (Ceylon) Ltd Case*** is more progressive decision towards the welfare of employees. *A fortiori*, this case has upheld the constitutional right that has been enshrined under Article 14(1)(g) of the Constitution of the Democratic Socialist Republic of Sri Lanka too.

Yet, the Employees have been pushed in to the Receiving End According to the Facts of Each Case

Having said that the *Finlay Rentokil (Ceylon) Ltd Case* has, presently, widened the liberty of the employee against the trade restraints to certain extent, yet, the employees have been pushed in to the receiving end according to the facts of the each case. In *Finlay Rentokil (Ceylon) Ltd Case,* the Respondent-employee engaged in the marketing, sale or supply of products or services. According to the description of the said employment, the worker has no chance of access to the production process of the Company except dealing with the outside customers. Nevertheless, if a job opportunity is replaced by an employment which has the access and powers to confidential information *inter alia* the blends, taste and formulaes of an employer, then the aforesaid liberal approach shall not as apply as *per se*.

To explain the said reasoning, it would do no harm if the Author cites a case named, *International Distilleries Ltd. vs. Meedeniya*[30] filed at DC Kaduwela (in this case, there was an interim injunction

[29] p. 349 of Finlay Rentokil (Ceylon) Ltd Case

[30] DC Kaduwela Case No. 368/Spl/2017

given against the employee and the said Order of interim injunction had been challenged in the High Court of Civil Appeal holden in Homagama by way of a Leave to Appeal by the employee and, presently, the said Leave to Appeal has been dismissed), in which the learned District Judge had given his order of Interim Injunction against the Defendant-worker based on the violation of trade restraints. The rationale behind of giving such an Order by the learned District Judge was that the employee who had knowledge and experience with regard to the blends, taste, formulaes, etc. of arrack products during the work of the Plaintiff Company, deemed to be secret and confidential information which need to be protected from divulging to a 3rd party. Hence, by issuing an interim injunction the learned District Judge prevented the said worker from divulging the secret information of the previous Company to the new Company that the said employee subsequently joined with [31]. In this background, when we read back the *Finlay Rentokil* case, it must be noted that in the *Finlay Rentokil* case where the Respondent-employee engaged in the marketing, sale or supply of products is quite different from an employee who worked at a place where who has the access to secret and confidential information. Especially, prevention of an employee from leaking confidential information out will be essential if the said entire business of the Plaintiff-company based on the said 'confidential information' which needs to be protected. In the *Attorney General Vs. Blake* case, this was called as "the lifeblood of that previous Company" [32]. In the said *International Distilleries Ltd. vs. Meedeniya Case,* it was decided that damage could cause to the Plaintiff-Company due to the joining to a competitor by the Defendant-Worker who had access to confidential information of the Plaintiff Company. I was further held that such damage is much greater than the damage could be caused by an employee who had engaged in the business of sale or supply of product or services, like in *Finlay Rentokil (Ceylon) Ltd.*

Conclusion

Having enunciated a wide spectrum of law pertaining to trade restraints, the Author would like to conclude his writing by leaving a pragmatic answer to the tug of war between 2-antogonists who take sides for whether the trade restraints must be honoured or not.

i.e.: each trade restraint case must be carefully measured by its own merits keep in the mind to provide the cushion to the existence of the market system in today's world. Any punitive attitude towards big Companies, would pave the way to

[31] In the said DC Kaduwela Case no. 368/Spl/2017 an Interim Injunction was given against the Defendant-Worker who had alleged to have been joined with another competitor in the industry of Arrack Products subsequent to a period of work during which having privy to the confidential information of the company *inter alia* the blends, taste and formulaes of the previous Employer.

[32] Supra, p. 7

collapse those companies and ultimately the entire economy of that particular country would be adversely affected unless a painstaking approach is not followed. If the employer is not well-protected, the thousands of other employees who work under the said employer may also loose their jobs and that would create more economic and social harm rather than protecting rights of an individual. Therefore, due to an action of an ex-employee violates the trade restraints of a Contract of Employment, thereby, which would put the entire business of the employer at a stake, in such an event, safeguarding the employer, notwithstanding protecting the liberty of an individual, is much more valuable for general good.