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Goodwill Hunting: Protecting the Purchaser

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Introduction

My topic addresses what one has to do to ensure purchasers of a business obtain what they have bargained for. There are three areas to this paper, first restraints on the purchaser, secondly identifying key sources of goodwill such as location and lease, key employees, franchisers, supply agreements and the like, and thirdly key warranties a purchaser should seek including tax, environmental, IP, employee and litigation warranties.

Being at the litigious end of legal services, my paper will focus on covenants in restraint of trade and the cognate topic of identified and protecting confidential information as these are the areas which crop up in a barrister's practice more frequently than the remaining areas.

I have quoted fairly extensively from chapter 16 of *Injunctions Law & Practice*, Jacobs, McCarthy, Negro (Thomson, looseleaf service), as regards the substantive law on when such covenants will be enforced, and what constitutes confidential information. I have left out paragraphs 16,300 to 16,900 which traverse the following: defence of public interest, defence of inequity, defence of public domain, what serious questions can arise when seeking an injunction, balance of convenience in restraint of trade cases, balance of convenience in confidential information cases and forms and precedents.

Everything in paragraphs 1-58 come from paras [17.105] to [17.245.2] of

Injunctions.

Covenants in restraint of trade and to restrain solicitation

1. The prima facie common law position with a covenant in restraint of trade is that it is invalid for offending public policy and the onus of demonstrating validity is on the party who seeks to rely on it. The seminal statement on the topic is that of Lord Macnaghten in *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co Ltd* [1894] AC 535, 565:

“The public have an interest in every person’s carrying on his trade freely: so has the individual. All interference with individual liberty of action in trading, and all restraints of trade of themselves, if there is nothing more, are contrary to public policy, and therefore void. That is the general rule. But there are exceptions: restraints of trade and interference with individual liberty of action may be justified by the special circumstances of a particular case. It is a sufficient justification, and indeed it is the only justification, if the restriction is reasonable – reasonable, that is, in reference to the interests of the parties concerned and reasonable in reference to the interests of the public, so framed and so guarded as to afford adequate protection to the party in whose favour it is imposed, while at the same time it is in no way injurious to the public. That, I think, is the fair result of all the authorities.”

2. This passage represents the law in Australia: *Lindner v Murdock’s Garage* (1950) 83 CLR 628, 642-643; *Buckley v Tutty* (1971) 125 CLR 353, 376; *Amoco Australia Pty Ltd v Rocca Bros Motor Engineering Co Pty Ltd* (1973) 133 CLR 288, 305-306.
3. To like effect is *Herbert Morris Ltd v Saxelby* [1916] 1 AC 688, 715, which is also oft cited in Australia eg in the *Lindner* cases (ibid).
4. This principle relates both to restraints against competition and also restraints on solicitation of customers.
5. However, such restraints “...may be valid where they are reasonably necessary to prevent disclosure of confidential information garnered by the former employee in the course of his or her former employment, or the exploitation of a connection built up by that employee with the former employer’s customers in the course of that employment”: *Kearney v Crepaldi* [2006] NSWSC 23, McDougall J.
6. “[A] covenant given by an employee to an employer, prohibiting the employee, after termination, from soliciting former fellow employees to join a new business venture, may not be justified simply by the employer’s interests in maintaining a stable trained workforce, but may be justified

where the solicitation is based on confidential information which the former employee has concerning the relationship between the other employees and the employer. In other words, it may be justified where the former employee uses (or may use) confidential knowledge gained in the course of the contract of employment to target particular employees and to pitch the terms of offers of employment to them. I do not intend this to be a comprehensive statement of the circumstances in which such a covenant may be upheld...”: per McDougall J in the *Kearney* case above at para [53].

7. In New South Wales s4(1) of the *Restraints of Trade Act (1976)* provides that “a restraint of trade is valid to the extent to which it is not against public policy, whether it is in severable terms or not.”¹
8. The section only applies where the sole reason why the clause is void is because it is so unreasonable that it is against public policy. The section does not apply where a clause is attacked as being void for uncertainty : *Corporate Express Australia v Swift McNair* Unreptd NSWSC Young J 2 October 1998.
9. In *Woolworths Limited v Mark Konrad Olson* [2004] NSWCA 372 (*Olson*) Mason P (with whom McColl and Bryson JJA agreed) summarised the New South Wales position as follows:
 - 1 The restraint operates for a fixed period after termination of employment and is justifiable only if the restriction is reasonable in reference to the interests of the parties and of the public. If it is not, the restraint will be contrary to public policy and invalid.
 - 2 The courts in general take a stricter and less favourable view of covenants in restraint of trade entered into between employer and employee than of similar covenants in commercial agreements. Nevertheless an employer may have interests capable of protection by a restraint covenant. These interests go beyond protection of goodwill and retention of customers and extend to trade secrets.
 - 3 The court gives considerable weight to what parties have negotiated and embodied in their contracts, but a contractual consensus cannot be regarded as conclusive, even where there is a contractual admission as to reasonableness.
 - 4 The validity of the restraint is to be tested at the time of entering into the contract and by reference to what the restraint entitled or required the parties to do rather than

¹ Until the decision in *Woolworths* in 2004, the main decision on the correct approach to s4(1) of the *Restraints of Trade Act (NSW) 1976* was *Orton v Melman* (1981) 1 NSWLR 587.

what they intend to do or have actually done.

- 5 The court may not re-write the covenant in restraint of trade whilst exercising power under s4(1) but may “amputate” such parts as are unreasonable.
10. The general position with negative covenants which operate only during the period of employment and which eg prevent the employee working for another person, is that they will be unreasonable only in “very unusual” circumstances: *Buckenara v Hawthorn Football Club Ltd* [1988] VR 39.
11. The more special the services, the more fair and lacking in oppression will be such a negative covenant; however, to the extent they are unreasonable, they are invalid by reason of the doctrine of restraint of trade: *Curro v Beyond Productions Pty Ltd* (1993) 30 NSWLR 337 (CA).
12. A negative covenant will not be upheld if its effect is that the employee will be idle or starve: *Evening Standard v Henderson* [1987] ICR 588, where an injunction issued to restrain an employee working for a competitor in his two month’s notice period.
13. A cascading restraint is one which contains alternative restraints as to temporal and geographic compass. As the analysis below shows, where there is an internal contractual mechanism whereby the court can excise such sections as are unreasonable, the clause is more likely to be upheld; and vice versa.
14. The leading case on this topic (as observed by Finkelstein J in *Run Corp Limited v McGrath Limited* [2007] FCA 1669 at para [27] ff) is the Court of Appeal decision in *Davies v Davies* (1887) 36 Ch D 359. There a retiring partner covenanted to “retire wholly and absolutely from the partnership, and so far as the law allows from the trade or business thereof in all its branches ...” The court held these words were too vague to enforce.
15. Cotton LJ held at 387-388 “A covenant in this form, indefinite as it is in my opinion, is one which neither a Court of Equity nor a Court of Law ought to enforce. The parties must make up their minds to say what they agree to as regards the limits of time or space within which there is to be no trading.”. Bowen LJ and Fry LJ emphasised that it is only the duty of the courts to interpret contracts which the parties themselves have made; not the duty to make the contract for the parties.
16. See also *Peters Ice Cream Vic Ltd v Todd* [1961] VR 485, 490-491; *Austra Tanks Pty Ltd v Running* [1982] 2 NSWLR 840, 845-846.
17. In *HiTech Contracting Limited v Jane Lynn*, Unreptd NWS SC Austin J, 1 May 2001 there were cascading restraints with an internal mechanism which allowed the court to read them down as required. This was regarded as enforceable.

18. In *Tyser Reinsurance Brokers Pty Ltd v Cooper* [1998] NSWSC 689 , Young J considered , obiter, that the absence of an internal mechanism to read down the cascading restraints was not a reasonable way of letting employees know of the requirements that bind them. In the result, the contract was held void for uncertainty on a separate basis.
19. In *Run Corp* (ibid), Finkelstein J, without reference to the *Hi Tech* and *Tyser* cases , came to the same decision, viz the clause was valid as there was a contractual mechanism whereby the court could sever any part of the clause found to be invalid.
20. Two main categories of confidential information: contractual and under general equitable principles.
21. There are two broad classes of actions for breach of confidence – first, where there is an express or implied contractual obligation not to use specified information; and second, where the equitable jurisdiction is invoked to enjoin the use of confidential information: *Seven Network Ltd v News Ltd* [2007] FCA 1062 para [2949]. Moreover, some statutes clothe certain information with the character of being confidential: eg *Southern Adelaide Health Services Inc v C* [2007] SASC 181.
22. As regards the second class, the initial question which arises is whether the plaintiff can show that the information sought to be protected has “the necessary quality of confidence” about it: see *Coco v A N Clark (Engineers)* 1969 RPC 41; (1968) 1A IPR 587.
23. As was said in *Seven Network Ltd v News Ltd*:

“2951 In *Coco v Clark*, Megarry J considered (1A IPR, at 590) that three elements are normally required if, independently of contract, a case of breach of confidence is to succeed:

‘First, the information itself ... must "have the necessary quality of confidence about it". Secondly, that information must have been imparted in circumstances importing an obligation of confidence. Thirdly, there must be an unauthorised use of that information to the detriment of the party communicating it’.

24. Although there is doubt as to whether detriment is always essential, Megarry J’s formulation has been cited with approval in Australia: *Commonwealth v John Fairfax & Sons Ltd* (1980) **147 CLR 39**, at 51, per Mason J; *Australian Broadcasting Corporation v Lenah Game Meats Pty Ltd* (2001) **208 CLR 199**, at 222 [30], per Gleeson CJ.
25. In *Corrs Pavey Whiting & Byrne v Collector of Customs (Vic)* (1987) 14

FCR 434, at 443, Gummow J regarded it as settled that a plaintiff or applicant must satisfy four criteria to make out a case in equity for the protection of allegedly confidential information:

'The plaintiff: (i) must be able to identify with specificity, and not merely in global terms, that which is said to be the information in question; and must also be able to show that (ii) the information has the necessary quality of confidentiality (and is not, for example, common or public knowledge); (iii) the information was received by the defendant in such circumstances as to import an obligation of confidence; and (iv) there is actual or threatened misuse of that information'.

26. Although his Honour dissented as to the result, the majority did not disagree with this formulation.
27. There is a somewhat imprecise quality to the elements of a claim based on breach of confidentiality articulated in these statements. This is perhaps not surprising, given the infinite range of circumstances in which the principles might be invoked. As Gleeson CJ observed in *ABC v Lenah Game* 208 CLR, at 227 [45], the difficulty in any given case is to determine what a *'properly formed and instructed conscience'* has to say about the particular circumstances. The circumstances include the nature of the allegedly confidential information and the manner in which it was communicated to the defendant."

General principles

28. Employers sometimes seek to enjoin ex employees or consultants from using allegedly confidential information obtained in the course of employment/ consultancy, eg pricing lists and customer names. However, courts are reluctant, at an interlocutory stage, to restrain a person from carrying on his or her chosen career or profession, especially if they have been engaged in it for any length of time. Not only would there have to be a serious question to be tried regarding the underlying right to restrain such person (for example under a non-competition clause or restraint of trade agreement) but in addition "Clear evidence of substantial prejudice which may be irreparable to the Plaintiff should be before the Court before the Court will take that step" and in addition, there would have to be evidence of a real risk of misuse of confidential information: *Webster Signs Pty Ltd v Nicolaou (No 2)* [2007] NSWSC 705, Palmer J. The extent and reach of a non-competition covenant is "debatable": *Webster Signs Pty Ltd v Nicolaou* (particularly at para [12]), and hence as the commentary below demonstrates, courts will be very reluctant to grant interlocutory relief merely on the basis of a serious question that there has been a breach of such a clause.

29. Naturally, injunctions can issue to restrain the unlawful use of information which, for example, a contract of employment has stipulated is confidential although when considering whether to seek urgent relief in that regard, it should be carefully remembered that “in the absence of a valid restrictive covenant an employee is entitled to use retained knowledge of his former employer’s customers – their identity, requirements, contact details and so on – when the employee leaves the employment of his employer and sets up in competition. What the employee is not able to use is any property of the former employer, such as customer lists, which would enable the employee more readily to identify customers of the former employer or contact details of the customer”: per Young CJ in Eq in *Pathfinder Systems Australia Pty Ltd v Austact Pty Ltd* [2006] NSWSC 892, which demonstrated the difficulty of obtaining an injunction to prevent an employee from canvassing the clients of the ex-employer, in the absence of a restraint of trade. This was despite the fact that there was a clause in the employment contract whereby the employee undertook to keep confidential a range of information concerning the ex-employer’s business.
30. In *Malone v Metropolitan Police Commissioner (No 2)* [1979] Ch 344 at 361, Megarry VC said (emphasis added):
- “If A makes a confidential communication to B, then A may not only restrain B from divulging *or using* the confidence, but also may restrain C from divulging *or using* it if C has acquired it from B, even if he acquired it without any notice of impropriety ... In such cases, what will be restrained is the *use* or disclosure of it after notice of the impropriety...”
31. In *Director of Public Prosecutions v Kane* (1997) 140 FLR 468, where defendants had inadvertently been provided by the DPP with a copy of a privileged advice, Hunt CJ at CL restrained them “from *using* or otherwise dealing” with the document.
32. “In *Sullivan v Sclanders & Goldwell International Pty Ltd* (2000) 77 SASR 419, the Full Court of the Supreme Court of South Australia restrained the plaintiffs/respondents – who had brought proceedings using the defendant/ appellant’s confidential information which they had obtained by a subterfuge – from “disseminating or *making use* of the contents of the confidential documents”. The statement of claim, which had been filed making use of those documents, was struck out. The plaintiff was granted liberty to file a fresh statement of claim “*making no use either directly or indirectly* of the confidential documents or their contents”. In other words, no use – not even an intellectual use – of the confidential documents or their contents could inform the preparation of the fresh statement of claim.”

33. In *AG Australia Holdings Limited v Burton* [2002] NSWSC 170 at [222], Campbell J (as his Honour then was) said:²

“The decision of the English Court of Appeal in *Lord Ashburton v Pape*, which had the effect that surreptitiously obtained material could not be used at all in the bankruptcy court, illustrates how it is within the scope of the way in which an equity court will enforce an obligation of confidence, to ensure that no advantage is obtained in litigation from the breach of confidence.”

34. The aforesaid authorities were cited with approval in *British American Tobacco Australia Ltd v Peter Gordon* [2007] NSWSC 230, para [21]ff.

Information received in course of employment

35. Information received by an employee in the course of employment often can be considered confidential and thus imposes a duty of confidence towards the employer in relation to it: *Ashworth Hospital Authority v M G N Limited* [2001] 1 WLR 515, 527-528, paras [51]-[53]. However, this may well only be the position if the employer has taken steps – perhaps considerable – to ensure such information is protected and not widely disseminated: *Maggbury Pty Ltd v Hafele Australia Pty Ltd* (2001) 210 CLR 181; *Wright v Gasweld Pty Ltd* (1991) 22 NSWLR 317.

Customer lists and contact details

36. It is well established that customer lists may be confidential: *Mid City Skin Cancer & Laser Centre v Zahedi-Anarak* [2006] NSWSC 844 at [140], [144]-[149].
37. Naturally, injunctions can issue to restrain the unlawful use of information which, for example, a contract of employment has stipulated is confidential although when considering whether to seek urgent relief in that regard, it should be carefully remembered that “in the absence of a valid restrictive covenant an employee is entitled to use retained knowledge of his former employer’s customers – their identity, requirements, contact details and so on – when the employee leaves the employment of his employer and sets up in competition. What the employee is not able to use is any property of the former employer, such as customer lists, which would enable the employee more readily to identify customers of the former employer or contact details of the customer”: per Young CJ in Eq in *Pathfinder Systems Australia Pty Ltd v Austact Pty Ltd* [2006] NSWSC 892, which demonstrated the difficulty of obtaining an injunction to prevent an

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employee from canvassing the clients of the ex-employer, in the absence of a restraint of trade. This was despite the fact that there was a clause in the employment contract whereby the employee undertook to keep confidential a range of information concerning the ex-employer's business.

The head-start principle and the hypothetical uninformed competitor

38. In *Terrapin Ltd v Builders Supply Co (Hayes) Ltd* [1967] RPC 375, Roxburg J clarified the "head start" principle (at [391]) by stating that the essence of this branch of the law is that a person who has obtained information in confidence is not allowed to use it as a springboard for activities detrimental to the person who made the confidential communication. Further, that the possessor of such information must be placed under a special disability in the field of competition in order to ensure that he does not get an unfair start. There is numerous authority to the same effect.³
39. Megarry J in *Coco v AN Clark (Engineers) Ltd* [1969] RPC 41 at 49, stresses that the person who obtains confidential information should "not get a start without paying for it".
40. As the cases below show, after the expiration of the head start period, the competitor is free to bring its goods to market. However, competition within the period is sanctioned by an injunction or damages, at the election of the plaintiff, with the plaintiff being entitled by way of compensation to the profit it was deprived of by reason of such competition. That is, the profits it would have made in the springboard period or such other measure as may be appropriate, for example, depreciation of the value of its rights: *Titan Group v Steriline Manufacturing* [1991] AIPC 37, 514; 19 IPR 353. The determination of the duration of the springboard is "a question of degree depending on the particular case": *Franchi v Franchi* [1967] RPC 149 at 153 per Cross J. However, in every case, the period of the springboard will always be "one of limited duration": *Harrison v Project & Design Co (Redcar) Ltd* [1978] FSR 81 at 87 per Graham J.
41. In *British Franco Electric Pty Ltd v Dowling Plastics Pty Ltd* [1981] 1 NSWLR 448, a design for twin-wheel furniture castors had been registered by the first plaintiff. The first defendant was the first plaintiff's joint venturer and was to manufacture and market the castors. Twelve months after the termination of the agreement the first defendant began manufacturing the castors for itself. Wooten J held that the castors had been available on the market for twelve months and thus the springboard period commenced at

³For example, Lord Denning MR in the Court of Appeal in *Seager v Copydex Ltd* [1967] 2 All ER 415 at 417 specifically approved these dicta; *Harrison v Project & Design Co (Redcar) Ltd* [1978] FSR 81 at 86. McLelland J, the primary judge in *Hospital Products v United States Surgical Corp* (1984) 156 CLR 41 - see the observations of Dawson J in the High Court.

- the time the product was commercially available. His Honour said that if the defendants “had a springboard, it would no longer have projected them ahead of competitors” (at [453]).
42. A further Australian example ⁴ is *Deta Nominees Pty Ltd v Viscount Plastic Products Pty Ltd* [1979] VR 167 at 191 per Fullagar J, where Fullagar J said that the period of the springboard could be determined as follows:
- The time it takes the plaintiff to get its product onto the market in substantial quantities; and in addition
 - The time it would reasonably take some uninformed competitor (that is, one without the current know how of the defendants obtained from their breach of confidence) to reverse engineer and get into production a tool for the manufacture of a similar product.
43. In that case, his Honour had to consider the proper time for an injunction to eliminate the defendant’s head start.
44. In *Titan Group v Steriline Manufacturers* (1991) 19 IPR 353 per Loughlin J, the defendant manufactured specialised hydraulic gym equipment for the plaintiff (Titan) and used the plaintiff’s technology in introducing a competing range. However, it was held that their unlawful use did not give them a “head start” in the market, and accordingly it was held that Titan did not suffer any damage by reason of the unauthorised use. His Honour spent some time considering when precisely the public became aware of the product and noted that ⁵ the defendant cannot, “exploit any advantage he may have gained over other members of the public by reason of having had advance knowledge of the former ‘secret’”.
45. His Honour looked at the factors relevant to an objective assessment of the steps that a member of the public who wished to copy Titan’s idea and noted that when introduced onto the market, such member had merely achieved awareness or an appreciation of an idea:
- “He would have known nothing about internal designs or patents. He would, as a prudent businessman, need to investigate costing, the type of manufacturing equipment and machinery that would be needed, the availability and suitability of factory premises and the need for a workforce, including, perhaps, skilled tradesmen. A prudent businessman would not even then embark upon a manufacturing exercise without investigating his likely market. This

⁴See also the pre-*Terrapin* case of *Ackroyds (London) v Islington Plastics Ltd* [1962] RPC 9 and its treatment by Loughlin J in *Titan’s* case highlighting the very important aspect of when the public generally became aware of the product.

⁵Citing Pritchard J in *Aquaculture Corp v New Zealand Green Mussel Co Ltd* (1985) 5 IPR 353 at 383.

exercise would lead to cash flow projections, budgets and forecasts. The list is very long and I would not suggest that what I have so far identified is, by any means, exhaustive.” ((1985) 19 IPR 353 at 382).

46. In other words, his Honour, in considering the head start period, was looking at matters from the perspective of the hypothetical uninformed competitor. His Honour concluded⁶ that as the head start period had elapsed by the time Steriline introduced its competitive product, there could be no damages. In the event he was wrong as regards the springboard period, his Honour went on to consider damages and after expressing his difficulties with the various mathematical approaches propounded, he rejecting a strict statistical approach, and considered himself “forced back to the role of the jurymen”.
47. Titan submitted that Steriline’s presence in the market had forced it to sell at a discount and claimed almost \$100,000 on account of accumulated discounts. This claim failed for want of evidence, however, the important aspect to note was that his Honour made no adverse comment about its theoretical application.⁷
48. Wielding a jury’s broadaxe, the court recognised that that Titan’s sales did drop off in the period under consideration and that the entry of Steriline into such a small market for hydraulic gym equipment would have had a material effect. However, it would not be fair to lay all Titan’s misfortunes at the door of Steriline.

Pricing information

49. Pricing information, including the basis on which prices are calculated, may be confidential: *Brinks v Kane* [2007] NSWSC 62 at [45]-[47].

Third party who comes into possession of confidential information

50. A third party who comes into possession of such information on notice of its confidential character owes similar duties: *Jockey Club v Buffham* [2003] 2 WLR 178 at 189, adopting the general principle enunciated by Lord Goff in *Attorney-General v Guardian Newspapers Limited (No 2)* [1990] 1 AC 109, 281.
51. In *Malone v Metropolitan Police Commissioner (No 2)* [1979] Ch 344,

⁶*Titan Group v Steriline Manufacturing* [1991] AIPC 37,514; 19 IPR 353.

⁷However, note the discussion on depreciation being the correct measure.

Megarry VC said (at 361) (emphasis added):

“If A makes a confidential communication to B, then A may not only restrain B from divulging *or using* the confidence, but also may restrain C from divulging *or using* it if C has acquired it from B, even if he acquired it without any notice of impropriety ... In such cases, what will be restrained is the *use* or disclosure of it after notice of the impropriety...”

Restraint can extend to making no direct or indirect use of the information, not even intellectual use

52. In *Director of Public Prosecutions v Kane* (1997) 140 FLR 468, where defendants had inadvertently been provided by the DPP with a copy of a privileged advice, Hunt CJ at CL restrained them “from *using* or otherwise dealing” with the document.
53. “In *Sullivan v Sclanders & Goldwell International Pty Ltd* (2000) 77 SASR 419, the Full Court of the Supreme Court of South Australia restrained the plaintiffs/respondents – who had brought proceedings using the defendant/appellant’s confidential information which they had obtained by a subterfuge – from “disseminating or *making use* of the contents of the confidential documents”. The statement of claim, which had been filed making use of those documents, was struck out. The plaintiff was granted liberty to file a fresh statement of claim “*making no use either directly or indirectly* of the confidential documents or their contents”. In other words, no use – not even an intellectual use – of the confidential documents or their contents could inform the preparation of the fresh statement of claim.”
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“The decision of the English Court of Appeal in *Lord Ashburton v Pape*, which had the effect that surreptitiously obtained material could not be used at all in the bankruptcy court, illustrates how it is within the scope of the way in which an equity court will enforce an obligation of confidence, to ensure that no advantage is obtained in litigation from the breach of confidence.”
55. The aforesaid authorities were cited with approval at para [21]ff of *British*

American Tobacco Australia Ltd v Peter Gordon [2007] NSWSC 230.

Information in the public domain

56. There can be no breach of an equitable obligation of confidence if information is in the public domain: *Seven Network Ltd* [2007] FCA 1062 at [2954], and likewise as regards a contractual obligation of confidence; *EPP v Levy* [2001] NSWSC 482 (6 June, 2001), Barrett J, para [21].
57. In *Seager v Copydex Ltd* [1967] 1 WLR 923, Lord Denning MR (at 931) cited the following passage from the judgment of Roxburgh J in *Terrapin Ltd v Builders Supply Company (Hayes) Ltd* [1960] RPC 128, 130:
- "As I understand it, the essence of this branch of the law, whatever the origin of it may be, is that a person who has obtained information in confidence is not allowed *to use it as a springboard* for activities detrimental to the person who made the confidential communication, and springboard it remains even when all the features have been published or can be ascertained by actual inspection by any member of the public.
58. The law on this subject does not depend on any implied contract. It depends on the broad principle of equity that *he who has received information in confidence shall not take unfair advantage of it*. He must *not make use of it* to the prejudice of him who gave it without obtaining his consent. The principle is clear enough when the whole of the information is private. The difficulty arises when the information is in part public and in part private. As, for instance, in this case. A good deal of the information which Mr Seagar gave to Copydex was available to the public, such as the patent specification in the patent office, or the "Klent" grip, which he sold to anyone who asked. If that was the only information he gave them, he could not complain. It was public knowledge. But there was a good deal of other information he gave them which was private, such as the difficulties which had to be overcome in making a satisfactory grip; the necessity for a strong, sharp tooth; the alternative forms of tooth; and the like. When the information is mixed, being partly public and partly private, then the recipient must take special care to use only the material which is in the public domain. He should go to the public source and get it: or, at any rate, not be in a better position than if he had gone to the public source. He should not get a start over others by using the information which he received in confidence. ..."

Recognise and protect key sources of goodwill such as location and lease,

key employees, franchises, supply agreements

Goodwill associated with premises – location

59. As the following extract from my book *Damages in a Commercial Context* (Law Book Co, 2000) show, courts are willing to recognize that certain trading premises have an established goodwill associated with them.
60. Whilst the analysis is through the prism of damages for damage to such premises, nevertheless, the discussion will illustrate the types of premises that can legitimately be said to have a goodwill associated with them and thus guide the practitioner in assessing whether to protect such goodwill by way of a lease, appropriately executed and registered, and with sufficient option to renewal and the like.
61. (Everything in paragraphs 000-000 come from paras [6.130] to [6.140] of *Damages in a Commercial Context*) (updated version to be published later this year by Thomson.)
62. A fundamental way of protecting local goodwill is to ensure that the lease for the premises has sufficient periods of renewal which permit the purchaser to not only recoup their investment but also to obtain a sufficient return on capital, both financial and human. The task of the advisor ought not stop at simply providing a bullet proof option to renew clause, but ought extend to advising the clients on how to exercise the option. Time and again in practice one sees lessees who send their notice of exercise of option to the wrong address, being the address they are accustomed to sending correspondence for convenience, but not necessarily conforming to the address stipulated in the lease.
63. A whole jurisprudence has built up regarding the manner in which notices of renewal of options can be exercised, but of course, it is less adventurous not to test the boundaries of this jurisprudence and to simply play it safe by conforming to the precise contractual mechanism.

Key employees

64. Sometimes even in national and international corporations a key part of the business may be associated with one or a few key players. This is especially the circumstance where the business involves “branding” where it is common to see one person in charge of rolling out the new stores in accordance with the “look” of the brand and having just the sufficient inventory to meet expected demands; and with the knowledge to integrate point of sales equipment with centralized data base etc.

65. Of course, smaller businesses are even more prone to having goodwill associated with key individuals, for example a security business where it is common to find one person who knows exactly which security guards are willing to do particular shifts and which institutions would respond best to the personality of individual guards.
66. There is no one magic formula for retaining such individuals in the business but some of the tried and tested measures include:
- (1) the first basic and essential step of checking that key personnel have written contracts of employment covering the most important matters from the perspective of the employer, namely the period of notice they must give if they wish to leave and of course the restraints they are subject to, to disincline them to leave;
 - (2) the promise of early salary reviews and bonuses for achieving specific targets;
 - (3) a soft taxation delivery of the salary package;
 - (4) a happy and supportive work environment that is sufficiently flexible to reasonably meet the needs of both employer and employee.

Franchises and supply agreements

67. There is an endless list of criteria to have regard to when considering how to protect goodwill referable to a franchise or a supply agreement. Examples include:
- (i) ensuring, prior to sale, that the franchisor/supplier is economically stable ;
 - (ii) checking that there is sufficient time to run in the franchise and supply agreements, including any periods of renewal;
 - (iii) calculating with reasonable precision whether royalties/ licence fees payable to a franchisor or supplier are likely to be met;
 - (iv) checking whether any critical supply agreement confers exclusivity in a particular market and if it does not, then evaluate the risks of the same supplier supplying goods and/or services to a competitor. A subordinate enquiry would be to check that the relationship between key personnel of the supplier and key personnel of the business being purchased, is on an even keel.
 - (v) Ensuring that the benefit of any franchise or supply

agreement are capable of being validly assigned. Authorities to have regard to include section 199 of the *Property Law Act 1974* (Q) and the cognate new South Wales section, being section 12 of the *Conveyancing Act 1919*; *Boston Commercial Services Pty Ltd v GE Capital Finance Australasia Pty Ltd* [2006] FCA 1352 (damages claimed under section 82 TPA not capable of assignment *Ivan Charles Price v HP Mercantile* [2007] NSWSC 1538 (difference between an assignment of a debt under a contract and an assignment of the benefit of a contract); and the article by Justine Kirby, *Assignments and Transfers of Contractual Duties: Integrating Theory and Practice*, [2000] VUWLRev 21; *Norman v Federal Commissioner of Taxation*; [1963] HCA 21 equitable assignment in relation to future/after acquired property.

68. The mere reference to a smattering of some of the judicial and extra curial references illustrate that taking an assignment is a tricky area requiring the practitioner to proceed with all caution to ensure the purchaser of the business gets the benefit it expects.

Are commercial premises merely an “address” or a “catchment area”?

69. In *Dominion Mosaics & Tile Co Ltd v Trafalgar Trucking Co Ltd*,⁸ the plaintiff's factory was damaged due to the defendant's negligence which caused a fire that damaged machinery and the building. The plaintiff's options were to:
- (a) rectify the building at a cost of £570,000 (and this course would have led to lost profits of £300,000 per year during the period of rebuilding);
 - (b) purchase the lease on new premises for £390,000.
70. The defendants contended that the measure be diminution in value.
71. The court held⁹ that cases awarding diminution in value referred to by the defendant all involved damage to property which did not consist of income producing premises.
72. It was suggested that where the plaintiff has no option but to rebuild so as to carry on its business, the proper measure of damages is the cost of replacement.

⁸[1990] 2 All ER 246 (CA), referred to with approval by Ormiston JA in *VACC Insurance Co Ltd v Lekkas* [1999] 2 VR 529; [1999] VSCA 31 at [3].

⁹[1990] 2 All ER 246 at 249f-g per Taylor LJ (*Stocker and Fox LJJ agreeing*).

73. As the discussion in that case shows:
- (a) the cost of rectification is displaced by the diminution in value measure where the plaintiff intends to sell the damaged property;
 - (b) where diminution in value would be wholly inadequate to replace the premises so as to carry on the business, then rectification costs are reasonable.
74. Stocker LJ added at 255-256 that the measure of damages would depend, in most cases:
- “[O]n whether or not the building destroyed is a profit-making asset. Since in almost any other case if the plaintiff recovers as damages the diminution in value he will have been restored to his original position, reinstatement, or its equivalent, is only appropriate where such is the only reasonable method of compensating a plaintiff for future loss of profits derived from the asset destroyed.”
75. To a similar effect is *Williamson v Commissioner for Railways*,¹⁰ a tort case of damage to a farm by fire, where it was held that, where the premises were being used for a *business*, this militated in favour of rectification costs as the proper measure.
76. A plaintiff can also recover losses sustained by reason of loss of use in the period taken up by repairing the property. However, Sugerman J in *Williamson's* case said that the costs of rectification together with damages for loss of use may well amount to evidence of diminution in value, in any event.¹¹
77. In *Munnelly v Calcon Ltd*,¹² the plaintiff ran his auctioneers' business from the ground floor of a house in Dublin. He rented eight flats on the first floor to tenants. The house was destroyed by the defendant's tortious conduct. The plaintiff wished to rebuild at a cost of £65,000. With consequential loss, this amounted to over £80,000. However, the diminution in value was only £35,000, for which price he could have obtained similar premises for conducting his business and letting flats in another part of Dublin. The move would not significantly affect his business, since he drew his clients from all over Dublin and thus the premises provided “an address rather than a catchment area”.

¹⁰(1959) 60 SR (NSW) 252; 76 WN (NSW) 648 (FC).

¹¹These observations of Sugerman J were approved by the Full Federal Court in *WA Green Centre Pty Ltd v White* [1996] ATPR 41-532 at 42,800.

¹²[1978] IR 387 (Supreme Court of Ireland).

78. It was noted that the destroyed premises, whether as auctioneers' premises or rental premises, had no special feature or unique advantages, which would justify the costs of reinstatement.
79. Indeed, the alternative premises would have the same income potential from letting.
80. It might be different "if the plaintiff had a well-established business in Aungier Street, such as that of a publican, a grocer or a bookmaker, which depended on the immediate locality for its custom."
81. In the circumstances, it was held that the plaintiff was entitled to diminution in value plus consequential loss, amounting to some £43,000 (the lower measure).
82. In *WA Green Centre Pty Ltd v White*,¹³ it was held in respect of a residence purchased for rental that:

"[E]ven if the cost of restoration of the property was significantly greater than the amount by which the value of the property has been diminished so that there was a disproportion between them, there was evidence upon which it was open to be found that the cost of restoration was reasonable. There was evidence the appellant intended to retain the property and rent it out when it bought the property. It was not a case where there was evidence that the appellant intended to demolish the building on the land."

The key warranties the purchaser will need, including tax, environmental, IP, employee and litigation warranties

83. The nature of the warranties that a purchaser ought obtain should be driven by the nature of the business purchased. Hence, the danger I pause to highlight is the danger of using a boilerplate form which is a guarantee that the particular business is not receiving the intellectual focus that it should. So for example:
- (i) where one is purchasing a restaurant, a nightclub, coffee shop and the like, the key warranty must surely be in relation to turnover, over a given period, so as to arrive at a net present value;
 - (ii) the endless string of cases, which I deal with in my *Damages* text, where upset purchasers sue for misleading and deceptive conduct in relation to representation about turnover, are illustrative of the intellectual focus this aspect

¹³[1996] ATPR 41-532 at 42,800 (FCAFC).

deserves;

- (iii) other warranties which can be sought, depending on the nature of the business, relate to tax, environmental, IP, employee and litigation.

84. The warranty will of course not be worth the paper it is written on unless backed either by a company which is properly capitalised or a personal guarantee which in my view is the preferable course.

Post script:

Whilst I have taken every care in preparing this paper I naturally take responsibility for any errors and welcome comments and positive critique:
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