

High Court voids restrictive covenant imposed on ex-employee: *Lek Gwee Noi v Humming Flowers & Gifts Pte Ltd* [2014] SGHC 64

Background

1. The Plaintiff, Lek Gwee Noi, had been in the flowers, gifts, hampers and wreaths business for virtually her entire life.
2. The Defendant, Humming Flowers and Gifts Ltd, a wholly owned subsidiary of Noel Gifts International, had purchased the Plaintiff's former company in 2008 and the Plaintiff continued in her position as sales manager with the Defendant.
3. Her employment agreement with the Defendant contained a restrictive covenant, Clause 13, which the High Court restated as follows (shorn of all excess words):

*Upon the termination of the Employee's employment ... the employee **shall not** for a period of 2 years ... undertake ... nor be employed ... in the same or similar business as the relevant Company ..., or in any other business carried on by the relevant Company, in Singapore, and Malaysia and any other countries the relevant Company has offices at the date of such termination ... and **shall not** during the like period and within the same areas ... canvass or solicit orders from or ... interfere with any person ... who shall ... during ... the Employee's employment ... have been a customer ... of the relevant Company & ... the Employee **shall not** ... endeavour to take away from the relevant Company ... any customer[s] ... who have been customers ... of the relevant company.*

The relevant company shall refer to ... the Company and any ... related companies which the Employee shall have performed duties ... in relation to and for the benefit of ... during the ... nine ... months prior to the date of termination of employment

(emphasis added by the Court)

4. The Plaintiff resigned in late 2011 and subsequently informed the Defendant of her intention to set up her own business selling flowers and gifts. But the Defendant objected and threatened to

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sue the Plaintiff for breaching Clause 13.

5. The Plaintiff sought a pre-emptive declaration that Clause 13 was an unreasonable restraint of trade and, hence, void.

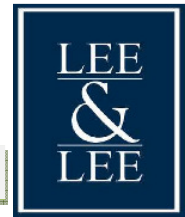
Decision of the District Judge

6. The District Judge held that:
 - a. Clause 13 consists of two separate and distinct restraints: (i) a geographical restraint; and (ii) a non-solicitation restraint.
 - b. The geographical restraint is unreasonably wide and therefore void and unenforceable because it operates to bar the Plaintiff from employment even in a country in which the Plaintiff has never had dealings.
 - c. The non-solicitation restraint was reasonable because it is restricted to the customers of the Defendant and the customers of those other companies for which the Plaintiff may have worked.
7. Accordingly, the District Judge deleted the portion of Clause 13 relating to the geographical restraint (which he had found was unreasonable), whilst retaining the non-solicitation restraint (which he held to be reasonable). Both parties appealed to the High Court.

Law on Restrictive Covenants

8. The High Court took the opportunity to review the law on restrictive covenants in the employer-employee context. The law stipulates that a restrictive covenant is *prima facie* void unless the employer can establish the following conditions:
 - a. The restrictive covenant is necessary to protect his legitimate interests;
 - b. If so, the restrictive covenant will be valid and enforceable if in addition it is reasonable in the interests of the parties as well as in the interest of the public.
9. Further, if the restrictive covenant or part thereof is unreasonable,

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the court can consider if the doctrine of severance can be invoked to “save” the covenant or the remaining part thereof.

10. In general, the law takes a stricter approach to construing restrictive covenants in employment contracts than those in contracts for the sale of a business.
11. The Defendant argued that Clause 13 ought to be considered in the context of a sale of a business because the Plaintiff came to be employed by the Defendant only as a result of sale and purchase of the business of the Plaintiff’s former employer.
12. The Court disagreed and held that Clause 13 was a restrictive covenant in an employment context because the Plaintiff was not a shareholder in the former employer and did not have a say in the sale of the business to the Defendant. Further, the sale was independent of the Plaintiff’s continued employment because she was free to choose not to work for the Defendant.
13. In addition, the Plaintiff did not reap any direct financial rewards associated with the sale of the business. Although the Defendant argued that the Plaintiff derived an indirect benefit from the sale of business in that her siblings were the shareholders of the business, the Court was of the view that the indirect benefit was not referable to the acquisition of the business by the Defendant.

Legitimate Interest

14. There are commonly three legitimate interests which an employer can seek to protect through a restrictive covenant: (a) its interest in protecting trade secrets or confidential information akin to trade secrets, (b) its interest in protecting trade connection and (c) its interest in maintaining a stable, trained workforce.
15. In the present case, the Defendant claimed that the restrictive covenant serves to protect both the Defendant’s trade secrets and trade connection.
16. The Court accepted that the Plaintiff had access to the Defendant’s confidential information which was of commercial significance. Even if this information did not amount to trade secrets in the strict sense of the term, it amounted to confidential information “of such

a highly confidential nature as to require the same protection as a trade secret”.

17. However, the protection of confidential information is not a sufficient legitimate interest to justify a non-competition covenant in Singapore law if there is already another clause in the employment agreement protecting the information. In this regard, the Court followed the Court of Appeal decision of *Stratech Systems Ltd v Nyam Chiu Shin (alias Yan Qiuxin) and others* [2005] 2 SLR(R) 579 which was binding on the Court.
18. The second legitimate interest relied by the Defendant was the protection of trade connection. In order to establish such an interest, it must be shown that the employee has personal knowledge of, and influence over, the customers of the employer.
19. The Court agreed that the Defendant has a legitimate interest in protecting its trade connection because the Plaintiff was a senior salesperson and had acknowledged that she has established personal relationships and rapport with the customers.

Reasonableness of Restraint: The Non-competition Covenant

20. The Court then considered whether Clause 13 was reasonable. It considered the non-competition aspect of the clause on 2 key aspects: (1) the geographical restriction and (2) the activity restriction.
21. The time at which the reasonableness of a restrictive covenant is tested is the time at which it is entered into. In the present case, both the activity restriction and the geographical restriction depended on the definition of “relevant company” used in Clause 13.
22. The core concept of “relevant company” is that of a “related company”. This meant that Noel Gifts (the parent company of the Defendant) and every one of its subsidiaries is a “related company” of the Defendant within the meaning of clause 13. This had wide-ranging implications, and was a clear indication that the definition of “relevant company” may be far too wide.

23. The Plaintiff played no role in Noel Gifts or in the Noel group of companies and there was no evidence that she had access to confidential information of Noel Gifts or of the Noel group. Likewise, there was no evidence that Noel Gifts or the Noel group had any trade connection with customers through the Plaintiff.
24. Therefore, the definition of “relevant company” makes the activity restriction unreasonably wide because it would prevent the Plaintiff from engaging in activities which have nothing to do with her employment simply because the Defendant’s related companies engage in those activities
25. As regards geographical restriction, the non-competition covenant extends to “Singapore, and Malaysia and any other countries the relevant Company has offices at the date of such termination”.
26. The Court held that including Malaysia in the geographical restriction was intended to protect Noel Gifts’ interests rather than the Defendant’s interests, because the Defendant had no business presence or ongoing business in Malaysia, and had at best only plans to expand into Malaysia. Therefore the geographical scope of Clause 13 was too wide and was also unreasonable.

Reasonableness of Restraint: The Non-solicitation Covenant

27. The non-solicitation covenant restrains the plaintiff for two years in Singapore and Malaysia from: (i) canvassing or soliciting orders from any person who was a customer of a relevant company; and (ii) endeavouring to take away from a relevant company the business of *any* of its customers.
28. The Court held that the activity restriction in the non-solicitation covenant is unreasonably wide as between the parties because the scope of the definition of “relevant company” was too wide. Its effect is to extend the non-solicitation covenant to prevent the Plaintiff from soliciting orders from customers of other Noel group companies even if her connection with that company was purely incidental and even though she may have no trade connection with those customers.
29. The Court’s observations on the definition of “relevant company”

and its effect on the geographical restriction in the context of the non-competition covenant apply equally to the non-solicitation covenant. That definition operates to extend the geographical reach of the non-solicitation covenant beyond that which is reasonably necessary to protect the Defendant's trade connection.

30. As regards the temporal scope of the non-solicitation of customers, the High Court was of the view that two years was an unreasonably long time given the legitimate interest to be protected.

31. The Court expressed its views in strong terms, at [114]:

"...No restrictive covenant can have as its purpose the naked stifling of competition by the departing employee. Where the legitimate interest in question is trade connection, the purpose of the protection allowed by the law is to prevent the departing employee from relying on his trade connection to draw custom away for a reasonable period of time. The restraint ought not, therefore, to last longer than reasonably necessary to allow the employer the breathing space it needs, free of active interference with its trade connection from the departing employee, to transfer that trade connection to its other employees..."

32. The Defendant did not explain why it needed two years for its remaining sales staff to build their own trade connection with those customers. The Court was of the view that it should not have taken the Defendant more than one year to rebuild such trade connections. Accordingly, it held that the 2-year period of restraint was unreasonably long.

Severance

33. Having decided that the scope Clause 13 was too wide, the Court then considered if the objectionable parts of the clause could be severed so as to "save" the remainder of the clause.

34. The modern legal test for severance is to be found in the English case of *Sadler v Imperial Life Assurance Co of Canada Ltd* [1988] IRLR 388 ("Sadler"). A contract which contains an unenforceable provision nevertheless remains effective after the removal or severance of that provision if the following conditions are satisfied:

- (1) The unenforceable provision is capable of being removed without the necessity of adding to or modifying the wording of what remains.
- (2) The remaining terms continue to be supported by adequate consideration.
- (3) The removal of the unenforceable provision does not so change the character of the contract that it becomes "not the sort of contract that the parties entered into at all".

35. To these three *Sadler* propositions, the Court added a 4th requirement, namely, the severance must be consistent with the public policy underlying the avoidance of the offending part, following *Marshall v NM Financial Management Ltd* [1995] 4 All ER 785.
36. Applied to the present case, the Court was of the view that Clause 13 cannot be saved through the doctrine of severance because the clause contained fundamental defects which go beyond the manner in which the geographical restriction, activity restriction or temporal scope are expressed. Therefore, the clause could not be severed under the *Sadler* principles.
37. The High Court also added that even if Clause 13 could be severed under the *Sadler* principles, the clause contained "cascading covenants" which appear to be calculated to accommodate — or invite — blue pencil severance.
38. The Court was of the view that such a "cascading covenant" would not pass muster under the 4th requirement and added that "*To that extent [of having a cascading covenant], it appears to me that the non-solicitation covenant would have an in terrorem effect on a reasonable employee in the plaintiff's position*".

Concluding Remarks

39. The case is a timely reminder to employers that any restrictive covenant imposed on employees should be carefully tailored and calibrated according to the role of the employee and the scope of

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the employees' work. A standard template clause or a clause that does not clearly delineate a reasonable geographical and temporal scope of restriction is vulnerable to challenge.

40. In addition, where the employment contract already contains provisions dealing with the protection of confidential information, it is possible that the employer may not be able to rely on such protection as a legitimate interest to justify a restrictive covenant.

Lee & Lee's Tan Tee Jim S.C. & Freddy Lim acted for the successful Plaintiff in the above case.