

# SUBMISSION TO THE PRODUCTIVITY COMMISSION REGARDING WORKPLACE RELATIONS

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## Introduction/Abstract

This submission recommends an amendment to the Fair Work Act dealing with the principle of mobility of labour and competition and the promotion of the competition and the provision of services. None of the position papers produced by the Productivity Commission deal directly with the point although it is alluded to in some references in the context of the common law discussion. In particular the Commission makes the mistake of focusing on collective arrangements in circumstances where enormous reform by the Fair Work Act could be encouraged in relation to individual employment arrangements pursuant to the common law. In particular this paper recommends that the Fair Work Act be amended or in the alternative encouragement for harmonised laws at a safe level to enact provisions identical to my recommendation in this submission.

This submission recommends enacting at a federal level a specific provision within the Fair Work Act that is intended to capture corporations operating within Australia a provision in terms identical with **s.16600 of the 2010 California Code Business and Professions Code Chapter 1 Contracts in Restraint of Trade** *“except as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void.”*

Such a change would enhance flexibility, labour mobility, entrepreneurship and stop corporations from using such restraints as an attempt to bully its employees into to not working for competitors.

## Background

The basis of this submission has been my observation as a practitioner in employment law of the increasing reliance on non-competes in Australia common law contracts in circumstances where it is simply being used as a blunt instrument to retain staff and stop what can only be described as reasonable competition.

It also has the effect of blunting efforts to encourage the free exchange of ideas and developments in what are undoubtedly 21<sup>st</sup> century growth areas involving knowledge and information technology. This is the significance of the Californian Law.

It is this Code that has encouraged and at least partly facilitated the development of knowledge hubs like Silicon Valley in the United States. In the interests of competition and in industries that are often non-unionised the abuse of non-competes by large corporations cries out for reform.

## The law in Australia

In Australia the common law operates in most states. The common law operation is modified in New South Wales by the *Restraints of Trade Act 1976*.

The current situation in Australia vests power to large corporations to enforce their common law contractual rights if an employee breaches a non-compete. Just the mere threat is enough of enforcement to stop an individual working for a competitor.

Although the underlying principle of the common law is one where a restraint is prima facie void they are enforceable or at least there are the means to enforce such restraints by going to the Supreme Court within the particular state jurisdiction and seeking interim (injunction) or final (damages) relief.

Unless the prospective employer is prepared to fund a defence most employees simply don't have the resources to be involved in such an exercise.

There is no research in Australia that has identified the effect on productivity by the utilisation of these legal handcuffs.<sup>1</sup>

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<sup>1</sup> Within the United States there has been a study co-authored by Matt Marx, Jasjit Singh and Lee Fleming entitled "*Regional disadvantage? Non-compete agreements and brain drain*". (October 13 2014) (attached).

Interestingly what the authors review in this unique study is the inventor career histories of individuals by examining US patent records from 1975 to 2005. As a result the authors have been able to demonstrate a brain drain amongst such inventors from states in the United States that enforce employee non-compete agreements to those states that do not (e.g. California, Oregon). The writers conclude that non-compete enforcement appears to drive away inventors with greater human and social capital. In developing their argument the authors observe “*Non-competes offer firms a number of advantages including employee retention (Fallick et al. 2006; Marx et al 2009), the ability to pay lower wages (Garmaise 2009) and to reduce threat of competition from new entrants (Stewart and Sorenson 2003).* They go on to further observe that “*these advantages for firms are obtained at the expense of individuals’ career flexibility.....*”

### **Restraints of trade becoming more common in Australia**

The most comprehensive review in Australian literature that I was able to identify is by Professor Christopher Arup<sup>2</sup>. Arup observes that as a result of fieldwork undertaken with colleagues, restraints of trade in Australia are “becoming more common as terms of employment contracts and in some jurisdictions they are being enforced vigorously with injunctions. The decisions to enforce have serious impacts on the parties and they also have implications for the productive use of “cognitive or non-material labour” in the new knowledge economies.”<sup>3</sup>

This has also been my professional experience in NSW.

Generally in his paper Arup observes different approaches in different states given the very discretionary nature of the interpretation of such restraints and their application by the particular judge that might be hearing it.

### **Why labour mobility is important as a contributor to a competitive economy in the 21<sup>st</sup> century**

What we know from the case studies in the United States is that the removal of non-competes for employees does encourage entrepreneurial activity including the pooling of knowledge and the pooling of labour. The Californian laws have not impacted on the bottom line of

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<sup>2</sup> Arup C. *Whose knowledge? Restraints of Trade and Concepts of Knowledge*. Volume 36, Melbourne University Law Review p.369.

<sup>3</sup> Ibid at p.370.

Apple and Google even though those corporations were alleged (subsequently settled) to have informal non-poaching agreements between them exposing both of them prosecution in the US.<sup>4</sup>

The fact is that the increasing utilisation of non-competes within Australia and their utilisation internationally is more about protecting market position, suppressing labour mobility than it is about the genuine protection of confidential information or processes (the original basis for the evolution of non-competes).

Hyde and Menegatti in reviewing the operation of non-competes in the European context<sup>5</sup>, observe that “Regions, such as Silicon Valley, California and its analogs in Singapore, India, Israel and elsewhere, experience growth as knowledge that spreads beyond the boundaries of the firm, demonstrates the endogenous growth through generation and diffusion of non-rivalrous and non-exclusive information. .... Some jurisdictions (California, Israel, India, Malaysia, Mexico) find some or all of these values so compelling that they never enforce the employee’s promise not to compete with a former employer. ... ..”<sup>6</sup>

The authors provide a global snapshot of countries that do not enforce non competes.

*The Indian Contract Act (1872)* s.27 provides “Every agreement by which anyone is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void.” The Malaysian Contracts Act 1950 s.28 is similar in terms to the Indian provision. Article 5 of the Mexican Constitution, expressly provides “*No person can legally agree to his own proscription or exile, or to the temporary or permanent renunciation of the exercise of a given profession or industrial or commercial pursuit.*” Israel as a result of recent case law, Checkpoint and Frumer v Redguard (National Labour Court 1999) and AES Systems v Sa’ar (Supreme Court 2000) forced employers wanting to enforce restrictive covenants to demonstrate a particular need for restraining employee mobility. The effect of this has meant that most Israeli employers are never successful in demonstrating an interest to be protected.

In Europe the jury is still out so to speak although it is observed that the use of restrictive covenants is incompatible with fundamental principles of EU law, specifically competition

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<sup>4</sup> Public Policy <http://knowledge-wharton.upenn.edu/topic/public/policy/siliconvalleynopoachingcase>: growing debate over employee mobility 30 April 2014.

<sup>5</sup> Alan Hyde and Emanuele Menegatti, Legal Protection for Employee Mobility June 2013 – Paper for Labour Law Research Network Inaugural Conference, Barcelona 2013.yet to be published.

<sup>6</sup> Ibid page 2.

law. Decisions in the European Court of Justice have emphasised competition law and the importance of free trade in employment. C-341/05 *Laval un Partneri* [2007] ECR I-11767 (*Laval*) and C-438/05 *The International Transport Workers' Federation and The Finnish Seamen's Union* [2007] ECR I- 10779 (*Viking*).

In France as a result of five decisions of the *Chambre Sociale de la Court de Cassation* issued on 10 July 2002 if a non-compete is to be enforced the individual for the period of time that they are not competing is to be paid.

*The China Employment Contract Law (2008)* Article 24 restricts enforcement of “competition restrictions, to senior managers, senior technicians and other personnel with a confidentiality obligation” but also requires compensation during the non-compete period of at least 30% of average salary (decision of Supreme Peoples Court, January 31 2013).

The limitation in the Chinese law to “senior managers and senior technicians” contrasts with what is now happening in Australia where relatively junior managers or junior technicians are being forced to sign non-competes when they commence employment. Such non-competes are absolutely rampant in the labour hire industry as well as in consultancy and in some legal practices let alone IT firms. This is confirmed by Arup, Dent, Howe and Van Canegen in their extensive review of non compete litigation over a 10 year period.

*“Employment restraints are becoming increasingly common. The common law principles have insisted that employment restraints are to be enforced very conservatively because they are likely to be contrary to public policy yet such conservatism is not always evident. Restraints may be seen to be over enforced, or at least overly observed where the courts do not apply the principles rigorously for example one of demanding proof of a legitimate business interest. Restraints may also be over enforced because the legal practice discourages employees from challenging the courts.”<sup>7</sup>*

This goes, in my submission, to the heart of the over utilisation of these provisions and the need to remove them.

The basis of this recommendation is mindful of the exemptions in Californian law and this is not an attempt to widen it beyond restraints of trade in relation to individual employees. That is, this recommendation is not meant to extend to partnerships, transfer of business,

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<sup>7</sup> Ibid Arup Dent Howe & Van Canegen *Restraints of Trade: The legal practice* 2013 UNSW Law Journal Volume 36, 1 page.

shareholding agreements or arrangements and the like. Equally it does not attempt to change the common law in relation to confidential information and the genuine protection of that confidential information so employees cannot simply walk off with the confidential customer lists or the secret recipe or invention.

## **G20 Communique**

At the G20 Leaders Communique at the Brisbane Summit on 15 and 16 November 2014 (Australia, India, China, the United States and EU are members) a major part of the emphasis was on the creation of jobs. As part of the Brisbane Action Plan the global infrastructure initiative was announced. In particular in paragraph 6 of the communique, the G20 agreed to establish *a global infrastructure hub with a four-year mandate. The hub will contribute to developing a knowledge sharing platform and network between governments and private sector, development banks and other international organisations. The hub will foster collaboration among these groups to improve the function and financing of infrastructure markets.* Article 8 states *“We are promoting competition, entrepreneurship and innovation, including by lowering barriers to new business entrants and investment. We reaffirm our longstanding stance to roll back commitments to resist protectionism.”*

Non-competes are a form of protectionism. They undermine entrepreneurship. They are utilised globally in some jurisdictions but in significant economies in the G20 (or in the United States example the huge regional/national economy of California and Oregon along with Mexico as a result of NAFTA) they are not enforced. The fact that there are significant regional and national economies where such restrictions are not enforced puts the lie to any argument that any attempt to weaken such large corporate protections will reduce investment and lower employment.

There is not one study that can seriously support that contention. In the economic power houses of India and west coast United States and indeed even the approach in China shows that the sort of anti-competitive common law protections which can keep alive restraints should be removed to promote competition and entrepreneurship. The evidence for the success of such an approach is out there. There is simply no evidence to support the retention of such anti-competitive provisions and the Fair Work Act 2009 should be amended to reflect such a change.

**Suggested amendment**

**Either something similar to the California Code wording or adopting the wording similar to the Indian statute would work as an amendment to the Fair Work Act.**

“Every agreement by which any employee of a constitutional corporation is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void.”

**Reliance can be placed on the Corporations Power for the constitutional basis of such a change. There would be no cost impact to companies. Indeed it would remove from the courts unnecessary litigation and enhance and promote productivity and competition particularly in the knowledge based industries.**

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