

SUPREME COURT OF QUEENSLAND

CITATION: *EzyDVD P/L v Lahrs Investments Qld P/L & Ors* [2009] QCA 389

PARTIES: **EZYDVD PTY LTD** ABN 65 123 658 702
(applicant/appellant)
v
LAHRS INVESTMENTS QLD PTY LTD
ABN 62 125 595 468
(first respondent)
JAMIE THOMAS LAHRS
(second respondent)
ANNETTE MARIE LAHRS
(third respondent)
VIEW DVD PTY LTD ACN 137 533 450
(fourth respondent)

FILE NO/S: Appeal No 9956 of 2009
SC No 7730 of 2009

DIVISION: Court of Appeal

PROCEEDING: General Civil Appeal

ORIGINATING COURT: Supreme Court at Brisbane

DELIVERED ON: 15 December 2009

DELIVERED AT: Brisbane

HEARING DATE: 11 November 2009

JUDGES: Fraser JA and Fryberg and McMeekin JJ
Separate reasons for judgment of each member of the Court, each concurring as to the orders made

ORDERS: **1. Leave granted to the appellant to amend the notice of appeal in accordance with paragraph 3 of these reasons.**
2. Appeal dismissed.
3. Appellant to pay the respondents' costs of the appeal to be assessed.

CATCHWORDS: TRADE AND COMMERCE – OTHER REGULATION OF TRADE OR COMMERCE – RESTRAINTS OF TRADE – VALIDITY AND REASONABLENESS – PARTICULAR CASES – OTHER CASES – where appellant and respondents entered into a franchise agreement for an 'EzyDVD' store – where agreement contained a restraint of trade clause – where respondents opened a different DVD store at the same location as the EzyDVD store upon expiry

of the franchise agreement – where appellant franchisor sought injunction to enforce the restraint of trade clause – where appellant argued interest sought to be protected by clause was its intellectual property – whether restraint of trade clause unreasonable and therefore invalid – whether trial judge erred in refusing to grant the injunction

Amoco Australia Pty Ltd v Rocca Bros Motor Engineering Co Pty Ltd (1973) 133 CLR 288; [1973] HCA 40, cited
Bridge v Deacons [1984] 2 WLR 837, cited
Esso Petroleum Co Pty Ltd v Harper's Garage (Stourport) Ltd [1968] AC 269; [1967] UKHL 1, cited
EzyDVD Pty Ltd v Lahrs Investments Qld Pty Ltd & Ors [2009] QSC 227, affirmed
Geraghty v Minter (1979) 142 CLR 177; [1979] HCA 42, cited
KA & C Smith Pty Ltd v Ward (1998) 45 NSWLR 702, cited
Kone Elevators Pty Ltd v McNay (1997) ATPR 41-564, cited
Lindner v Murdock's Garage (1950) 83 CLR 628; [1950] HCA 48, cited
Littlewoods Organisation Ltd v Harris [1977] 1 WLR 1472, considered
Masterclass Enterprises Pty Ltd v Bedshed Franchisors (WA) Pty Ltd [2008] WASC 67, cited
Miles v Genesys Wealth Advisers Ltd [2009] NSWCA 25, considered
Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co Ltd [1894] AC 535, cited
Printers and Finishers Ltd v Holloway (No 2) [1965] 1 WLR 1, considered
Raine & Horne Pty Ltd v Adacol Pty Limited [2006] NSWSC 36, cited
Rentokil Pty Ltd v Lee (1995) 66 SASR 301; [1995] SASR 538, cited
Woolworths Ltd v Olson [2004] NSWCA 372, considered
Wright v Gasweld Pty Ltd (1991) 22 NSWLR 317, distinguished

COUNSEL: K E Downes, with S B Hooper for the appellant
 I R Pike for the respondents

SOLICITORS: DLA Phillips Fox for the appellant
 Marque Lawyers for the respondents

- [1] **FRASER JA:** On 13 August 2009 the Chief Justice found that cl 5.6.3 of the franchise agreement between the appellant as franchisor, the first respondent as franchisee, and the second and third respondents (the first respondent's directors and guarantors) as "Control Persons" identified in the clause was invalid as an unreasonable restraint of trade. The Chief Justice therefore dismissed the appellant's claim for an injunction to enforce the clause.¹

¹ *EzyDVD Pty Ltd v Lahrs Investments Qld Pty Ltd & Ors* [2009] QSC 227.

[2] Clause 5.6.3 of the franchise agreement provides:

"5.6.3 Protection of the EzyDVD Intellectual Property

The Franchisee acknowledges that as the Franchisee will have regular and continuing access to and knowledge of the EzyDVD Intellectual Property the Franchisor may reasonably protect itself against competition from the Franchisee for a period of time after the expiration termination assignment or transfer of this Agreement and accordingly for a period of six (6) months following the expiration termination assignment or transfer of this Agreement the Franchisee and its Control Persons will not directly or indirectly in any capacity whatsoever (including without limitation either individually or as a trustee, principal, beneficiary, member, franchisor, franchisee, lender, joint venturer, agent, officer or employee of any business) engage in a or have a Financial Interest in or render consulting or other services to any, Competitive Business:

- (i) within a radius of one kilometre (1km) of any 'EzyDVD Store' located in Australia; and
- (ii) within a radius of five kilometres (5km) of the Store."

[3] At the hearing of the appeal, the appellant applied for leave to amend its originating application and its notice of appeal by substituting for the claims for injunctive relief against the respondents a claim for a declaration against the first respondent that cl 5.6.3 of the franchise agreement is not invalid on the ground that it is an unreasonable restraint of trade. That application was not opposed by the respondents. I would grant leave to make the amendment. That makes it unnecessary to consider whether, as the Chief Justice tentatively concluded, cl 5.6.3 imposed a contractual obligation on the second and third respondents as "Control Persons".

[4] As will appear, I consider that the issue in the appeal is whether the Chief Justice erred in failing to find that it was reasonable to impose the restraint to protect against the use by the franchisee in competition with the franchisor of such of the franchisor's intellectual property as may have remained in the franchisee's memory, notwithstanding the contractual regime which obliged the franchisee to return or destroy all records of that information.

[5] I will address the arguments in the appeal after I have first summarised the factual background to the litigation, the general principles concerning the validity of contractual restraints of trade, and the Chief Justice's reasons for dismissing the claim.

The factual background

[6] The appellant and first respondent became franchisor and franchisee respectively by separate assignments under a franchise agreement made in November 2007 between the original franchisor and franchisee. The franchise agreement granted the first respondent as franchisee the right to operate an "EzyDVD" store within the

Westfield Garden City Shopping Centre at Mount Gravatt and a licence to use the franchisor's system, know-how and trade secrets in the operation of that store. The franchise fee was \$20,000. Clause 3.3 provides that the rights granted to the franchisee are exclusive to "the Territory" (the area within the shopping centre) and that the franchisor must not appoint another EzyDVD franchisee to use the EzyDVD system and the Trade Marks in the Territory during the Term. That is subject to an exception allowing the franchisor itself or through an agent or similar appointee to offer the DVDs and associated products, or any other products, for sale in the Territory by the internet and the "EzyDVD website".

- [7] The business of the first respondent's EzyDVD store and other franchisees' similar stores in various parts of Australia was the retail sale of DVD recordings ("DVDs"). The franchisor earned its profits from franchise fees which were paid upon entry into new franchise agreements and from commissions it earned when franchisees bought DVDs from distributors with whom the franchisor had negotiated pricing arrangements.
- [8] At about the time of expiry of the franchise agreement on 17 June 2009 the first respondent ceased to carry on business and it set about the destruction or return of the records of the appellant's intellectual information in its possession as required by provisions in the franchise agreement. The fourth respondent, of which the second respondent is the sole director and shareholder, thereupon commenced a business of a similar character under the name "View DVD Garden City". The fourth respondent conducts that business as a member of the "Network Video buying group", which provides the fourth respondent with DVD titles, pricing, purchasing and stock information.
- [9] When the appellant's application for an interlocutory injunction came before the Court on 28 July 2009 a judge of the Trial Division set the matter down for a trial for final relief commencing on 5 August 2009. The speed of the trial was motivated by the shortness of the period of the restraint.

The general principles

- [10] The general principles concerning the validity of restraints of trade of the general character in cl 5.6.3 of the franchise agreement were not in issue at the trial or in this appeal. Such a provision interferes with the restrained party's liberty of action in trading and is therefore contrary to public policy and void unless it is justified by the special circumstances of the particular case, for which purpose it is sufficient justification that the restriction is reasonable having regard to the interests of the parties and the public.² (No question about the public interest arises in this case.) A restraint of trade is not enforceable unless the party benefited demonstrates that it affords no more than adequate protection to the interests of that party in respect of which it is entitled to be protected.³ It is therefore appropriate first to ascertain the legitimate interest which the party benefited was entitled to protect and then to determine whether the restraint was no more than adequate for that protection.⁴ The reasonableness of the restraint is to be determined at the time the restraint was

² *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co Ltd* [1894] AC 535 at 565; *Lindner v Murdock's Garage* (1950) 83 CLR 628.

³ *Amoco Australia Pty Ltd v Rocca Bros Motor Engineering Co Pty Ltd* (1973) 133 CLR 288 at 306; *Geraghty v Minter* (1979) 142 CLR 177 at 184.

⁴ *Bridge v Deacons* [1984] 2 WLR 837, approving Lord Reid's statement to that effect in *Esso Petroleum Co Pty Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269 at 301.

agreed upon.⁵ The courts take a stricter (less favourable) view of covenants in restraint of trade entered into between employer and employee than of similar covenants bargained at arm's length and on an equal footing, such as between vendor and purchaser and at least some cases of partnership.⁶

The trial judge's reasons

[11] The Chief Justice took into account the significance of the fact that the parties had bargained for the restraint on apparently equal terms at arms' length and that another clause of the franchise agreement acknowledged that the franchisee had obtained or had decided not to seek independent legal and financial advice,⁷ but concluded that the restraint was nevertheless unreasonable in the circumstances.

[12] There were essentially two limbs to the Chief Justice's reasoning.

[13] **First**, the Chief Justice analysed the extensive contractual scheme designed to protect the franchisor's intellectual property upon expiry of the franchise agreement. The Chief Justice referred to the following relevant definitions in a schedule to the franchise agreement:

"[7] By Schedule D, the term 'EzyDVD Intellectual Property' is defined to mean:

'all Intellectual Property in connection with the EzyDVD System including the Trade Marks; the Confidential Information; and all other Intellectual Property disclosed or provided by the Franchisor to the Franchisee and includes but is not limited to any database of customer details created by the Franchisee or used by the Franchisee in the operation of the Store.'

and the term 'Intellectual Property' is defined to mean:

'all intellectual property rights; including without limitation: patents, copyright, rights in circuit layouts, registered designs, trade marks and the right to have confidential information kept confidential; and any application or right to apply for registration of any of those rights.'

The term 'Confidential Information' is defined as follows:

'Confidential Information' means the following information, regardless of its form and whether the Franchisee becomes aware of it before or after the date of this Agreement:

(a) all information treated by Franchisor as confidential including without limitation the

⁵ *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co Ltd* at 574; *Artcraft Pty Ltd v Chandler* [2003] QSC 102 per Muir J at [24].

⁶ *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* per Lord Reid at 300; *Geraghty v Minter* (1979) 142 CLR 177 at 185.

⁷ [2009] QSC 227 at [13]. The Chief Justice cited *Masterclass Enterprises Pty Ltd v Bedshed Franchisors (WA) Pty Ltd* [2008] WASC 67 at [94], *Esso Petroleum Co Pty Ltd v Harper's Garage (Stourport) Ltd* at 300, and *Miles v Genesys Wealth Advisers Ltd* [2009] NSWCA 25 at [66].

provisions of this Agreement, all information in connection with Franchisor, the Approved Products, and the Manual; and

- (b) disclosed by Franchisor to the Franchisee or of which the Franchisee becomes aware, except information;
- (c) the Franchisee creates independently of Franchisor; or
- (d) that is public knowledge (otherwise than as a result of a breach of confidentiality by the Franchisee or any of the Franchisee's permitted disclosees);"

[14] The Chief Justice also set out the provisions of the franchise agreement which set up the contractual scheme designed to protect the franchisor's intellectual property:

"[16] The provisions in the franchise agreement to which I have referred are as follows, and I am afraid they must be set out notwithstanding their length:

5.4 Intellectual Property

5.4.1 Ownership

The Franchisee acknowledges that:

- (a) the Franchisor owns all the EzyDVD Intellectual Property and has the right to retain the business telephone and facsimile numbers used in or in relation to the Store after the termination or expiration of this Agreement;
- (b) the Franchisee must provide the Franchisor with such written authorities and must take all other action or steps, as required or requested by the Franchisor, to better effect the Franchisor's rights and entitlements under this Clause 5.4; and
- (c) the EzyDVD Goodwill vests absolutely in the Franchisor and all such rights will at all times and for all purposes remain vested in the Franchisor.

5.4.2 Use of the Trade Marks

The Franchisor grants the Franchisee the right to use the Trade Marks and the EzyDVD Intellectual Property but only:

- (a) in the Territory in connection with the Store during the Term;
- (b) in the manner specified in the Manual;

- (c) as required and prescribed in writing from time to time by the Franchisor; and
- (d) subject to the condition that the Franchisee may not modify the Trade Marks and the EzyDVD Intellectual Property without the Franchisor's prior written consent.

5.4.3 **Prohibited Use**

The Franchisee must not use any of the EzyDVD Intellectual Property in connection with the sale of any product or service not authorised by the Franchisor or in any other manner not explicitly authorised by the Franchisor in writing.

5.4.4 **Ownership of Inventions and Improvements**

The Franchisee:

- (a) assigns to the Franchisor all existing and future Intellectual Property in any improvement of the Manual, the EzyDVD System or any original works created by the Franchisee which modify, improve, further develop or add to the Manual, the EzyDVD System or the Store (whether created alone or jointly with the Franchisor); and
- (b) acknowledges that by virtue of this Clause 5.4.4 the Intellectual Property described in Clause 5.4.4(a) is deemed to be EzyDVD Intellectual Property immediately upon its creation.

5.4.5 **Infringement by other than the Franchisee**

The Franchisee must immediately notify the Franchisor in writing and provide full details of any actual, potential or suspected infringement of the EzyDVD Intellectual Property by any third party of which the Franchisee becomes aware.

5.4.6 **No Action**

- (a) The Franchisee must not take any action or steps of whatever nature against any third party infringing the EzyDVD Intellectual Property.
- (b) The Franchisee must not contest the Franchisor's exclusive rights to use any of the EzyDVD Intellectual Property.

5.4.7 **Acknowledgement**

The Franchisee acknowledges that the Franchisor is not obliged to take any action against any

infringement by a third party of EzyDVD Intellectual Property but has the exclusive right to control any such action or related litigation.

...

5.5.2 Documents

The Franchisor must execute and deliver to the Franchisee all documents necessary or as prescribed by the Franchisor, to enable the Franchisee to register the Approved Business Name as a business name.

5.5.3 Ceasing to Carry on Business

On execution of this Agreement, the Franchisee must provide the Franchisor with a signed transfer of the Approved Business Name and/or a notice of cessation in blank which may be lodged by the Franchisor on the termination or expiration of this Agreement for whatever reason.

5.5.4 No Transfer of Approved Business Name

The Franchisee must not transfer, deal with or transfer the Approved Business Name to any person except by a transfer in accordance with Clause 10.

5.6 Protective Covenants

5.6.1 Acknowledgement

The Franchisee acknowledges that the EzyDVD System is distinct and unique and has been developed by the Franchisor at great effort and expense.

5.6.2 Protection of EzyDVD Goodwill

The Franchisee further acknowledges that one of the reasons the Franchisor has signed this Agreement with the Franchisee is the Franchisor's reasonable expectation that the EzyDVD Goodwill will increase in value by virtue of the Franchisee diligently marketing and selling the Approved Products from the Store and accordingly the Franchisee will devote the Franchisee's whole time and efforts to the operation of the Store and accordingly:

- (a) during the Term, the Franchisee will not and will ensure that its Control Persons do not:
 - (i) directly or indirectly in any capacity whatsoever (including without limitation either individually or as a trustee, principal, beneficiary,

- member, franchisor, franchisee, lender, joint venturer, agent, officer or employee of any business) engage in or render consultancy or other services to any Competitive Business;
- (ii) be a lender to or have a Financial Interest in any Competitive Business;
 - (iii) let or permit any part of any premises owned or controlled by the Franchisee to be used for the operation of a Competitive Business;
 - (iv) by any direct or indirect inducement divert or attempt to divert to any Competitive Business any customer or business of the Store; and/or
 - (v) commit any other act or suffer any omission which could lessen the value of the EzyDVD Goodwill.
- (b) The Franchisee represents to the Franchisor that as at the date of execution of this Agreement:
- (i) the Franchisee and its Control Persons are neither a party to nor otherwise bound by any one or more other agreements which are inconsistent with or would interfere with the Franchisee's performance of this Agreement; and
 - (ii) the Franchisee and its Control Persons do not directly or indirectly in any capacity whatsoever (including without limitation either individually or as a trustee, principal, beneficiary, member, franchisor, franchisee, lender, joint venturer, agent, officer or employee of any business) engage in or have a Financial Interest in any Competitive Business.

...

6.1.6

- (e) ensure that the Franchisee complies with the terms and conditions of any licences for software it uses in connection with the Store. Where the Franchisor has licensed the Franchisee to use software, those terms and

conditions include (without limitation) that the Franchisee must not (and must not permit any of its officers, employees or representatives to, or procure any third party to), without the Franchisor's prior written permission:

- (i) copy or reproduce the software;
- (ii) reverse engineer or decompile the software;
- (iii) modify the software;
- (iv) sell or otherwise transfer ownership of the software to a third party, or purport to do so;
- (v) create derivative works based on, or translations of, the software; or
- (vi) remove, obscure, or fail to include any copyright, trade mark or confidentiality notices, or any other proprietary marking, on the software;
- (f) In a prominent location in the Store, make available for customer use, no less than one (1) computer, upon which the EzyDVD Website must be continuously available to customers; and
- (g) not directly or indirectly operate any website relating to the Store;

...

6.4.4 Access

The Franchisee acknowledged and agrees that the Manual is confidential and accordingly the Franchisee:

- (a) may print a copy of the Manual from the EzyDVD Website provided that it only retains one copy of the Manual at all times; and
- (b) must cease accessing the Manual and return its copy of the Manual to the Franchisor immediately upon the expiration or termination of this Agreement or upon any reasonable request by the Franchisor.

...

9.6.3 Return of Materials

- (a) Immediately upon the expiration or termination of this Agreement, the Franchisee will (at the Franchisee's expense) either return or if so instructed

by the Franchisor destroy and in writing confirm to the Franchisor the destruction of any and all materials which are comprised of convey bear display incorporate or refer to the EzyDVD Intellectual Property or the Confidential Information.

- (b) If the Franchisee does not comply with Clause 9.6.3(a), the Franchisee authorises the Franchisor or its employees, representatives or agents to (at the Franchisee's expense):
 - (i) enter the Store and remove or obliterate all copies of the Manual, EzyDVD Intellectual Property and Confidential Information; or
 - (ii) carry out other work necessary to ensure the Franchisee's compliance with this Clause 9.6.3."

[15] The Chief Justice found that these contractual provisions provided a comprehensive level of protection for the franchisor, qualified only by the possibility that the franchisee might retain parts of the intellectual property in memory, available to the franchisee for subsequent use. In that context the Chief Justice acknowledged the appellant's reliance upon the passage from paragraph [63] of Handley JA's judgment in *Miles v Genesys Wealth Advisers Ltd*⁸ in the following submission for the appellant:

"When considering restraints for the protection of confidential information, it must be borne in mind that the recipient of the confidential information does not divest himself or herself of the knowledge of that information simply by returning or destroying the documents or other medium which recorded that information. At least to some extent, information, once imparted to a person, is inevitably retained by them, whether consciously or subconsciously."

[16] **Secondly**, the Chief Justice posed the question whether it was reasonable in order to protect the appellant's rights in respect of such of the information as may have remained in the second and third respondents' heads, notwithstanding the return or destruction of the relevant records, to impose the restraint on competitive trade in cl 5.6.3. The Chief Justice analysed the evidence concerning the nature of the franchisor's intellectual property imparted to the franchisee under the franchise agreement, concluded that it was generally of short term applicability, and was not satisfied that it was reasonable to supplement the contractual regime for protection of the appellant's intellectual property with the particular restraint of trade found in cl 5.6.3 of the franchise agreement.

[17] In this part of the reasons, the Chief Justice referred to the nature of the appellant's intellectual property imparted to franchisees:

"[8] The principal source of the franchisor's intellectual property is computer software provided to the franchisee and regularly updated. There is also a handbook, which was

⁸ [2009] NSWCA 25 at [63].

admitted before me as a confidential exhibit, but the focus in the affidavit material and at the hearing rested on that software. It is convenient to adopt, here, the following summary in relation to the software taken from the applicant's counsels' outline:

- '(a) The franchisor provides each franchisee with a software package called 'MYOB Retail Manager'. This is standard, 'off-the-shelf' software which the franchisee can use for general account-keeping, ordering and invoice purposes.
- (b) Over a period of 8-9 years, the former franchisor developed specific software systems to enable it to provide information to and receive information from a franchisee's 'MYOB Retail Manager' software. Pursuant to the asset sale agreement, the Applicant now owns those systems. At its head office the Applicant runs software called 'EzyDVD Advances Business Manager' ('ABM'). This software contains information which the franchisor can communicate electronically to the franchisee. This is done through software called 'EzyDVD Store Toolbox' (the 'Toolbox'), which acts a portal between the ABM software and the franchisee's 'MYOB Retail Manager' software. The Toolbox populates the franchisee's software with information contained in ABM. Thus, the interaction between the software allows the franchisor to transfer data to the franchisee's individual software; and to receive data from each franchisee.'

Relevantly, this process means that the franchisee is provided with access to what is known as the 'EzyDVD Titles Database'. This database contains information that is confidential to the franchisor and which gives it and its franchisees commercial advantage. The information includes:

- (a) a listing of all the DVD titles and promotional products sold by the EzyDVD online and retail network;
- (b) records of customers of particular franchisees who have placed orders or requested to be put on the store's mailing list (including details of their names, phone numbers, addresses and email addresses);
- (c) all promotional and merchandise items manufactured by EzyDVD for franchisees, such as premium metal DVD cases and movie posters;
- (d) information about the prices at which franchisees can place orders through the franchisor for the purchase of DVDs from distributors, including the next scheduled price increases and decreases;

- (e) details of historic prices and exclusive deals negotiated between the franchisor and the distributors; and
- (f) details and prices of exclusive promotional items manufactured by the franchisor for exclusive distribution through the EzyDVD retail network."

[18] The Chief Justice's analysis, so far as it is relevant to the issues of this appeal, was as follows:⁹

"[21] Focusing on the question of the reasonableness of supplementing a contractual regime specifically designed to protect the intellectual property, with a restraint of trade provision, it is necessary to consider the nature of the information in issue. It substantially concerns customers, titles, prices and promotional matters. Mr Ingrey offered the following somewhat more comprehensive summary in his affidavit:

- '17.1 A listing of all the DVD titles and promotional products sold throughout the EzyDVD online and retail network;
- 17.2 Records of customers of that particular EzyDVD franchisee who have placed individual orders or asked to be put on that store's mailing list, including those customers' names, telephone numbers, addresses and email addresses;
- 17.3 All promotional and merchandise items manufactured by EzyDVD for franchisees, such as premium metal DVD cases and movie posters.
- 17.4 All information about the prices at which franchisees can place orders through EzyDVD for the purchase of DVDs from DVD distributors, including the next scheduled price increases and decreases, as determined by confidential agreements negotiated between the Applicant and the various DVD distributors containing advantageous terms not available to DVD retailers generally;
- 17.5 Details of historical prices and exclusive deals negotiated between the Applicant and the various DVD distributors; and
- 17.6 Details and prices of exclusive promotional items manufactured by the Applicant for exclusive distribution through the EzyDVD retail network.

[22] Was it reasonable, in order to protect the applicant's rights in respect of such of that information as may have remained in the second and third respondents' heads notwithstanding

⁹ [2009] QSC 227 at [17] – [18], [21] – [24].

the return or destruction of the relevant records, to impose this restraint on competitive trade?

[23] To answer that, I have had regard to some particular parts of the evidence especially – that most of the customers of the store could have been expected (as at the execution of the franchise agreement) to be 'passing traffic', and mostly 'one-off', (para 63 Lahrs); that every month, there would be great variation in the content of the software, with hundreds of changes to titles and prices (para 11 Lahrs); that use for marketing campaigns was minimal (para 10 Lahrs); and from the oral evidence of Mr Ingrey, that DVD prices change regularly, because of regular negotiations between retailers, wholesalers, and distributors, with regular updating of the 'EzyDVD Toolbox' to reflect price changes and the addition of a 'constant stream' of new products (transcript p 1-43).

[24] Notwithstanding Mr Lahrs' confirmation that he drew upon his memory in the manner described in para 51(e) of his affidavit set out above, I am not satisfied that it was reasonable to supplement the contractual regime set up to protect the applicant's intellectual property by this general restraint of trade provision, effectively to guard against the risk of a former franchisee's retaining and subsequently using confidential information notwithstanding its having returned or destroyed the relevant records in accordance with its contractual obligation. I reach that conclusion having regard to the nature of the confidential information. With rapidly changing titles and prices, the information in the database was generally of short term applicability, even if the description 'evanescent' might be going somewhat too far. But adding in the circumstance that most of the customers were passers by, and there being no substantial use of the software for broader marketing purposes (as to which I accepted the evidence of Mr Lahrs), it was, I conclude, unreasonable to add this particular restraint."

[19] Were it not for that conclusion the Chief Justice would have found that the six month time limitation in the restraint was reasonable, measured against the time the franchisor would probably take to find a replacement franchisee and for it to establish contact with former customers, that the five kilometre limitation beyond the Mount Gravatt store was prima facie reasonable, and that the geographical limitation in relation to other stores around Australia could as necessary be deleted by using the "blue pencil" rule.¹⁰

The interest protected by the restraint of trade clause

[20] The Chief Justice decided the case on the basis that the interest which was sought to be protected by the restraint of trade clause was derived from the appellant's intellectual property. The Chief Justice thought that this emerged clearly from the opening acknowledgement in cl 5.6.3 and also observed that the appellant's counsel

¹⁰ [2009] QSC 227 at [11] – [12].

made it clear at the trial that it was by reference to the protection of intellectual property that the appellant sought to justify the reasonableness of the restraint: the case “was argued on that basis, and not by reference to other considerations, such as the protection of goodwill.”¹¹

- [21] The appellant contended in its written outline of submissions in this appeal that the Chief Justice erred by confining attention to the protection of intellectual property as the justification for the restraint of trade even though the appellant had relied also upon three further matters, namely, its interest in protecting itself from competition from a former franchisee, its interest in protecting itself from competition with its own "on-line store" in which it dealt with customers located within the geographical area of the restraint,¹² and its interest in protecting its other franchisees who operated in and around Brisbane.
- [22] However the appellant confined its case at trial with reference to the franchisor's interest in preventing the franchisee from using the franchisor's intellectual property to compete with the franchisor after termination of the franchise agreement. The appellant's outline of argument in reply contended that:

"[13] The applicant's case is that, as a franchisor which had provided confidential information to its franchisee, it had a legitimate interest in protecting itself against the possibility of use of that information after the franchise agreement expired, which interest was capable of protection by a restraint clause reasonable in scope ..."

and that:

"[16] ...the applicant does not rely upon the protection of patronage as being the legitimate interest which it was entitled to protect via the restraint clause. Rather the applicant relies upon its legitimate interest in protecting itself from the possibility of the use by a former franchisee of its intellectual property and confidential information". In final submissions at trial the appellant's senior counsel submitted that, "we are not talking about the legitimate interest being to protect customers or customer connections but in fact being a case about the protection of confidential information imparted to a franchisee and there is a possibility that he may use that in competition with us."

- [23] Although the appellant's original outline of submissions lodged before the trial had cited more general propositions about the legitimacy of protecting goodwill, the appellant's senior counsel made it plain at the trial that the appellant's case that the restraint was valid was based only upon the franchisor's interest in protecting itself from the franchisee's use of the franchisor's intellectual property to compete with the franchisor after termination of the franchise agreement. The Chief Justice decided that case and did not err by not deciding some other case which was not litigated.
- [24] The appellant also developed an argument that the appellant's interest as franchisor in preventing the first respondent from using the appellant's intellectual property in competition with the appellant was necessarily a sufficient justification for the restraint of trade and that was so regardless of the extent to which the franchisee

¹¹ [2009] QSC 227 at [14].

¹² There was evidence that the appellant's website business, operated by a franchisee, was used by customers in the territory of the first respondent's store and that it had generated nearly \$800,000 from DVD sales since 1999.

might recall that information and despite the contractual provisions for destruction or return of the records of the information.

- [25] The appellant's senior counsel referred to the following passages in Doyle CJ's reasons in *Rentokil Pty Ltd v Lee*:¹³

"In particular, an employer who has a relevant protectable interest should be able to obtain effective protection against an employee engaging in a competitive business when the employee's engagement in that business would enable the employee to make use of the knowledge of and influence over customers of the employer which the employee might have acquired and to make use of protectable information in the possession of the employer: cf *Lindner v Murdock's Garage* (1950) 83 CLR 628 at 653-654, per Kitto J and at 636, per Latham CJ (dissenting).

It is well established by the cases that an employer who has a protectable interest is not limited to a restraint which prevents the specific conduct which would infringe that protectable interest. In other words, the employer is not restricted to a restraint which prohibits solicitation of former customers or making use of confidential information. It is well established that an employer may restrain a former employee from engaging in a business when to do so is likely to present an opportunity to behave in a manner which would infringe upon or damage the employer's protectable interest. That is what the employer has done here, and in principle that is permissible."

- [26] In *Woolworths Ltd v Olson*¹⁴ Mason P (with whose reasons McColl JA and Bryson JA agreed) observed that a recognised method of protection against misuse of confidential information by an employee is the procurement of the restraint upon the employee given access to such information taking up employment with a competitor to whom he might be willing to provide such information. Mason P said that such a restraint was easier to enforce than a breach of confidence or breach of copyright claim; it removed the temptation for the former employee to offer and for the new employer to solicit confidential information; and it provided certainty of definition as regards the area of confidential information to be protected: those interests were recognised in *Littlewoods Organisation Ltd v Harris*,¹⁵ *Wright v Gasweld Pty Ltd*¹⁶ and *Kone Elevators Pty Ltd v McNay*.¹⁷

- [27] *Wright v Gasweld Pty Ltd* may be put to one side because the passage to which Mason P referred concerned the effect of New South Wales legislation which has no counterpart in Queensland. In *Littlewoods Organisation Ltd v Harris*, which was applied in *Kone Elevators Pty Ltd v McNay*, it was found that the protection of an employer's confidential information might provide sufficient justification for the restraint of the employee's trade after termination of employment. One matter relied upon in *Littlewoods* for that conclusion was the difficulty of proving a breach of a covenant against disclosing confidential information "where the information is of such a character that a servant can carry it away in his head."¹⁸ In that respect

¹³ (1995) 66 SASR 301 at 303-304.

¹⁴ [2004] NSWCA 372 at [67].

¹⁵ [1977] 1 WLR 1472 at 1479, 1485.

¹⁶ (1991) 22 NSWLR 317 at 337 – 338 (per Kirby P).

¹⁷ [1997] ATPR 41-564 at p 43,834.

¹⁸ [1977] 1 WLR 1472 per Lord Denning at 1479.

Lord Denning MR¹⁹ and Megaw LJ²⁰ referred to the following passage in Cross J's judgment in *Printers and Finishers Ltd v Holloway (No 2)*:²¹

"If the managing director is right in thinking that there are features in the plaintiffs' process which can fairly be regarded as trade secrets **and which their employees will inevitably carry away with them in their heads**, then the proper way for the plaintiffs to protect themselves would be by exacting covenants from their employees restricting their field of activity after they have left their employment, not by asking the court to extend the general equitable doctrine to prevent breaking confidence beyond all reasonable bounds."

- [28] Similarly, in *Miles v Genesys Wealth Advisers Ltd*²² Handley JA (with whose reasons Basten JA agreed) observed that the restrained employee in that case "could not help remembering" certain confidential information²³ and that there was no evidence that the confidential information was likely to become obsolete or public knowledge before the end of the relevant restraint period.²⁴ It was in that factual context that Handley JA concluded that the principles applied in *Littlewoods Organisation Ltd v Harris* and *Kone Elevators Pty Ltd v McNay* established the prima facie justification for the restraint on the defendant's employment with a trade rival of his former employer.
- [29] In those cases, the information the protection of which was found to justify the restraint was not merely characterised as confidential by the contract between the parties. The information was of such a character that it might have been anticipated that the employee's use of the information after termination of the employment might give the employee an advantage in competing with the employer for the period of the restraint. *Printers and Finishers Ltd v Holloway (No 2)*, *Littlewoods Organisation Ltd v Harris*, and *Miles v Genesys Wealth Advisers Ltd* also support the view that the question whether such information is of a character which might be retained in the employee's memory, so that conventional remedies for breach of confidence might provide an ineffective or impractical protection, is a relevant consideration in assessing whether the restraint is reasonable.
- [30] The Chief Justice addressed analogous issues in the context of this franchise agreement. The decisions cited for the appellant do not support the much broader proposition that a franchisor's interest in preventing misuse of its confidential information of itself necessarily justifies a general restraint of the franchisee's trade. Those decisions do not deny the necessity of assessing the reasonableness of the restraint and taking into account the character of the anticipated confidential information and the likely practical efficacy of contractual or other remedies for preventing misuse of confidential information.
- [31] It is, however, unnecessary to reach any concluded view upon this topic or to discuss the decisions about franchise agreements cited for the appellant.²⁵ I

¹⁹ [1977] 1 WLR 1472 at 1479.

²⁰ [1977] 1 WLR 1472 at 1485.

²¹ [1965] 1 WLR 1 at 6. I have added the emphasis.

²² [2009] NSWCA 25 at [63].

²³ [2009] NSWCA 25 at [63].

²⁴ [2009] NSWCA 25 at [65].

²⁵ *Raine & Horne Pty Ltd v Adacol Pty Limited* [2006] NSWSC 36; *KA & C Smith Pty Ltd v Ward* (1998) 45 NSWLR 702.

understood the appellant's senior counsel ultimately to accept in the course of oral argument that, as was submitted for the respondent, the trial judge correctly framed the question for determination at the trial as being whether it was reasonable to impose the particular restraint on competitive trade in order to protect the applicant's rights in respect of such of its information as may have remained in the second and third respondents' heads notwithstanding the contractual regime in the franchise agreement which provided for the return or destruction of the relevant records. As I mentioned at the outset, the question which falls for decision in this appeal is whether the Chief Justice erred by failing to give an affirmative answer to that question.

Relevance of the first respondent's conduct during the franchise agreement

- [32] The appellant submitted that the Chief Justice erred by relying upon evidence of the actual conduct of the first respondent during the term of the franchise agreement. That submission is not easy to reconcile with the appellant's submission at the trial that the court was entitled to consider what had happened subsequently to the extent that it threw light upon the circumstances existing at the time of contract.²⁶ That this was the purpose of the Chief Justice's reference to the post-contractual conduct was made clear by the statement in paragraph [23] of the reasons that the evidence showed what could have been expected "as at the execution of the franchise agreement". It was not necessary for the same basic point to be expressed every time his Honour referred to such conduct.

Did the first respondent return all of the confidential information?

- [33] The appellant argued that the Chief Justice wrongly placed significant weight on the second respondent's evidence to the effect that the first respondent had complied with the contractual provisions in the franchise agreement requiring the return to the appellant of its confidential information and intellectual property and that no such material had been used in the new database established for the fourth respondent. Evidence was given by a forensic expert engaged by the appellant to the effect that the first respondent "may" not have returned or deleted all of the appellant's software and databases from the computer system subsequently operated by the fourth respondent. The second respondent also gave evidence that, for tax purposes only, he had given his accountants a CD containing a copy of an accounting database: he said that he was then unaware of any means by which he could extract only the first respondent's information required for tax purposes. The second respondent also gave evidence that the first respondent had inadvertently retained (in a computer system it had previously used) some backup files of data from 2006 and 2007 (before the first respondent was running the store) which referred to the franchisor and its website.
- [34] The issue to which this evidence directly related was resolved at the trial by the parties' agreement upon a regime under which the appellant would be permitted to inspect the respondents' computer systems, but the appellant relied upon the evidence for a submission that the trial judge was wrong in placing critical significance upon the existence of a contractual regime for the delivery or destruction of the appellant's confidential information at the end of the franchise agreement. The appellant contended that this evidence demonstrated that the contractual regime was inadequate to protect it from misuse of its confidential information following expiry of the franchise agreement.

²⁶ *Amoco Australia Pty Ltd v Rocca Bros Motor Engineering Co Pty Ltd* (1973) 133 CLR 288 at 318.

- [35] In my view the evidence instead tended to exemplify the general proposition that under the extensive contractual provisions the franchisor would likely be able readily to discover and obtain an effective remedy if the franchisee retained records of the franchisor's intellectual property. In any event, the findings which I discuss in the next section of these reasons suggest that it would not have been anticipated when the franchise agreement was made that such records might provide the franchisee with a material advantage in competing with the appellant for a period nearly as lengthy as the six month duration of the restraint.

Evidence of the second respondent's memory

- [36] The second respondent gave evidence that after the fourth respondent commenced business the second respondent entered DVD titles into the fourth respondent's database, including titles which were not included in the Network Video database. The appellant relied upon the second respondent's evidence that when entering this information he used terminology with which he had become familiar when operating his Garden City store under the franchise agreement. The appellant argued that it was "telling" that the second respondent was able to recall, in relation to two particular DVD titles out of many thousands, that the appellant's database had used the term "super buy", which the appellant had used to denote a form of confidential pricing agreement it had reached with distributors.
- [37] This was the evidence in paragraph 51(e) of the second respondent's affidavit referred to in paragraph [24] of the trial judge's reasons (set out in paragraph 18 of these reasons). It is unsurprising that the second respondent would recall descriptive terms which he had regularly used, but the appellant's submissions did not explain how the mere terminology could constitute confidential information or give the franchisee any competitive advantage after expiry of the franchise agreement.
- [38] It is a different question whether the particular prices for and arrangements under which the franchisee acquired the titles might be of that character. The appellant's managing director, Mr Uniacke, gave evidence that by operating an EzyDVD store, a franchisee would become familiar with the types of DVDs that sold well at that particular store and the "price-points" at which average sales would increase, and the relative effectiveness of special promotions and other price changes; that franchisees also had the opportunity to become familiar with the examples of merchandise exclusive to EzyDVD stores and their price points. He expressed the opinion that a competent franchisee would remember such knowledge.
- [39] There was, however, competing evidence. The appellant's parent company employee, Mr Ingrey, agreed in cross-examination that the prices of DVDs changed regularly, that there were regular negotiations about prices of DVDs as between retailers and wholesalers and wholesalers and distributors; that the "EzyDVD toolbox" (computer software) which recorded the pricing information was changed regularly; that there was a "constant stream of new products coming on line"; and in response to the suggestion that the deals offered by the distributors were only for a short period of time he said that it depended upon the deal (as to which there was no further elucidation). The employee of the appellant who was responsible for managing its intellectual property, Mr Iovino, gave evidence that the pricing and titles in the EzyDVD titles database were updated every day by use of the "Ezy DVD toolbox". The appellant's head office would send information electronically each night and software in the franchisees' store would read that information when

the “toolbox” was opened each morning. The second respondent agreed with that evidence during his cross-examination.

- [40] This evidence supported the finding that with rapidly changing titles and prices the information in the database was generally of short term applicability. The titles and prices were also so numerous and varied as to render it very improbable that the franchisee would recall them. And the accepted evidence also cast doubt on the appellant’s case that the information was of such a character as would materially advantage the first respondent in competing with the appellant for any period approaching the period of the restraint. The second respondent’s evidence was to the effect that most of the customers of the franchisee’s store were “passing traffic” and mostly “one-off” (who, I would interpolate, were not shown to be likely also to buy significant numbers of videos from the appellant’s online store), his knowledge of prices and other details of arrangements between the franchisor and distributors would quickly become obsolescent, and the nature of the industry was such that an individual franchisee could not negotiate competitive prices with distributors but instead depended upon the buying power of organisations such as the appellant or buying groups such as Network Video. In the absence of more compelling evidence about the market at the time when the franchise agreement was made, the trial judge was right to infer that those conditions represented what might have been anticipated at that time.
- [41] In my opinion the Chief Justice did not err in the findings to the effect that the information likely to be transmitted to the franchisee under the franchise agreement was of such a character as would not likely be retained in memory and would in any event quickly become obsolescent.

Other evidence said to support reasonableness of the restraint

- [42] The appellant contended that the finding that the information in the database was generally of short term applicability did not apply to all categories of the appellant’s confidential information. The appellant argued that the long term nature of other categories of its intellectual property, and other evidence, falsified the conclusion that it was not shown to be reasonable for the franchisor to supplement the contractual regime with the general restraint of trade provision to guard against the risk of a former franchisee retaining and subsequently using confidential information.

Information about marketing and promotions

- [43] The appellant argued that confidential information supplied under the franchise agreement in relation to marketing and promotional initiatives would remain commercially useful to the franchisee for some time after the franchise agreement came to an end. In that respect, Mr Ingrey deposed that franchisees were informed of “upcoming promotional and marketing initiatives”; those initiatives were “usually devised and notified three months in advance of the implementation of the initiative at the retail level”; and those initiatives would often contain details of the terms of agreement which had been negotiated by the appellant with suppliers. Mr Iovino deposed that promotional data was updated fortnightly or monthly.
- [44] However, the second respondent’s evidence that the customer database did not contain customer addresses and was not used by the first respondent or the appellant to carry out any promotions or direct mail-outs or marketing campaigns was capable of shedding light about what was anticipated when the franchise agreement was

made. The appellant argued that this evidence referred only to one aspect of the confidential information provided by the appellant, namely the customer database of the Mount Gravatt store, but the Chief Justice was right to place weight upon it in so far as it demonstrated that, in that respect, the anticipated marketing and promotions information was not likely to be of such a nature as would assist the first respondent in competing with the appellant after termination of the franchise agreement. There was also no evidence that when the franchise agreement was made any promotion or marketing initiative might have been expected to persist for any particular period of time. In light of the second respondent's evidence summarised earlier, the Chief Justice was not bound to accept Mr Ingrey's opinion that information about marketing and promotions could be used by an individual franchisee after termination of the franchise agreement to compete with the appellant, much less that this might have been anticipated when the franchise agreement was made.

- [45] Accordingly I would affirm the Chief Justice's conclusion that the appellant did not prove that the protection of the franchisor's confidential information about marketing and promotions justified the restraint of trade.

Pricing arrangements negotiated between the appellant and DVD distributors

- [46] The appellant referred to the evidence of Mr Ingrey to this effect: the EzyDVD titles database contained confidential information about the prices at which franchisees could place orders through the EzyDVD system to buy DVDs from distributors, including the next scheduled price increases and decreases specified in confidential agreements between the appellant and DVD distributors; in Mr Ingrey's opinion, information about pricing arrangements (such as "mark downs", "scans", and "super buys" (both current and historical))" conferred upon the first respondent the ability to attempt to negotiate for similar concessions from distributors, or to provide that information to a wholesaler for that purpose; and it would not be necessary for the respondents to retain a copy of the EzyDVD titles database in order to utilise the information in it for the purposes of competing with the appellant following the termination of the franchise agreement. The appellant described this evidence as "unchallenged", but the facts underlying Mr Ingrey's opinions were challenged in his cross-examination and in the second respondent's evidence discussed earlier in these reasons. The court was not obliged to accept Mr Ingrey's opinion evidence.

The appellant's manual

- [47] The appellant argued that confidential information in its manual provided to franchisees formed part of the justification for the restraint of trade clause.
- [48] This case was barely litigated at trial. The appellant's first set of written submissions at trial did not rely upon the manual as constituting confidential information which would justify the restraint. The appellant's reply submissions asserted that the manual "contained a variety of confidential information about the EzyDVD system and the conduct of an EzyDVD franchise", and that it was a "confidential document", but in the oral submissions for the appellant at trial the manual was referred to only in passing. There was no specification in the oral or written submissions of any particular confidential information in the manual which might be of such a character as to confer any advantage upon the franchisee in competition with the franchisor after expiry of the agreement. It is unsurprising that the Chief Justice referred to the manual in the following terms:

"The principal source of the franchisor's intellectual property is computer software provided to the franchisee and regularly updated.

There is also a handbook, which was admitted before me as a confidential exhibit, but the focus in the affidavit material and at the hearing rested on that software."²⁷

- [49] Mr Ingrey expressed his opinion that the manual was "a confidential document", but the only evidence to which this Court was referred which directly concerned any alleged confidential information in the manual were Mr Ingrey's statements in paragraphs 11 and 12 of his affidavit that he was "aware" that franchisees "receive or are given access to" the manual at the commencement of the franchise agreement, and that the manual "contains a variety of detailed information about the EzyDVD system and conduct of an EzyDVD franchise".
- [50] The Chief Justice was plainly right to focus on the significance of the computer software, upon which particular emphasis was placed. In light of the sparse evidence and submissions about the manual I am not persuaded that, when the franchise agreement was made, it might have been anticipated that the manual might contain confidential information the protection of which justified the restraint of trade clause.

Restraint of trade clause on first respondent's purchase of the franchise business

- [51] The appellant argued that the Chief Justice erred in failing to attribute weight to the evidence that the contract by which the first respondent purchased the franchise business from the original franchisee included a clause which restrained the seller from competing with the first respondent for three years within an area within five kilometres of the business. The interest which might have justified such a restraint was the first respondent's interest in preserving the goodwill of the business in circumstances in which the first respondent bought it for \$435,000 plus \$150,000 for stock in trade. That transaction had no bearing upon the reasonableness of the restraint of trade under consideration in this appeal, which was said to be justified by the franchisor's very different interest.

Conclusion

- [52] I am not persuaded that the Chief Justice erred in any of the respects contended for by the appellant. In light of the issues litigated, on the evidence adduced at trial the appellant did not prove that the particular restraint of trade was reasonable having regard to the interests of the parties to the franchise agreement.

Proposed orders

- [53] I would grant the appellant leave to amend the notice of appeal in accordance with paragraph 3 of these reasons, dismiss the appeal, and order the appellant to pay the respondents' costs of the appeal to be assessed.
- [54] **FRYBERG J:** I agree with the orders proposed by Fraser JA and with his Honour's reasons for those orders.
- [55] I would add only one thing. The appellant's Standard Operating Procedures Manual was tendered as a confidential exhibit. It is a lengthy document. Section 1 states that it is confidential and "should not, without written consent from EzyDVD, be disclosed, published or made known to any person other than sales associates of the Franchisee whose duties and functions require a knowledge of, or access to, this

²⁷

[2009] QSC 227 at [8].

manual and its contents.” It deals with customer service, instructions on the use of the MYOB off-the-shelf software, induction of new employees, stock and cash handling, employee relations and visual merchandising.

[56] I have browsed through it. It is conceivable that it contains something which might be described as confidential information in the relevant sense, but if it does, I have been unable to find it. I have found nothing which would make the restraint sought to be enforced in these proceedings reasonable.

[57] **McMEEKIN J:** I agree with the orders proposed by Fraser JA and with his Honour's reasons for those orders.