Privy Council Appeal No. 35 of 1983

Robin M. Bridge *Appellant*

v.

Deacons (a firm) *Respondent*

FROM

THE COURT OF APPEAL OF HONG KONG

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 26TH MARCH 1984

Present at the Hearing:

LORD FRASER OF TULLYBELTON
LORD WILBERFORCE
LORD SCARMAN
LORD ROSKILL
LORD TEMPLEMAN

*[Delivered by **Lord Fraser of Tullybelton**]*

The question in this appeal is whether a restrictive covenant in a partnership agreement between the partners in a firm of solicitors is enforceable against one of their number who has ceased to be a partner, or whether it is unenforceable as being in unreasonable restraint of trade.

The respondent (plaintiff) is Deacons, one of the oldest and largest firms of solicitors in Hong Kong. The appellant (defendant) Mr. Bridge was a full (capital) partner in the firm from 1st April 1974 until he retired from the firm at 31st December 1982. The partnership agreement contained a clause (clause 28(a)) whereby a partner who ceased to be a partner was restricted for a period of five years thereafter from acting as solicitor in Hong Kong, for any client of the firm, including any person who had been a client during a period of three years immediately before he ceased to be a partner. The respondent is seeking to enforce the restriction by injunctions against the appellant. The appellant contends that the restriction is not enforceable against him, as
[11] being in unreasonable restraint of trade.

The judge (Hunter J.) granted injunctions substantially in the terms sought by the respondent. Before the appeal to the Court of Appeal was heard, the appellant gave undertakings in accordance with two subsidiary injunctions ordered by the learned judge, respectively against soliciting clients and against inducing employees of the respondent to break their contracts of employment with the respondent. The appeal was limited to the central issue of the enforceability of the restriction against the appellant's acting for clients of the firm. The parties agreed that the interlocutory order by Hunter J. which was under appeal should be treated as having been in the form of a permanent injunction as if made at trial. The Court of Appeal (Leonard V-P., Cons and Fuad JJ.A.) dismissed the appeal against that order.

The clause imposing the restriction is in the following terms:-

> "28(a) Except on dissolution, no partner ceasing to be a partner for any reason whatsoever shall for a period of 5 years thereafter act as a solicitor, notary, trade mark or patent agent or in any similar capacity in the Colony of Hong Kong whether as principal, clerk or assistant for any person, firm or company who was at the time of his ceasing to be a partner or had during the period of 3 years prior thereto been a client of the partnership Provided however that this Clause shall not apply to a partner acting in any such capacity in the course of employment with Government or any public body or with any company or organisation which is not itself engaged in professional practice in any of the above fields."

It is well established law that covenants in restraint of trade are unenforceable unless they can be shown to be reasonable in the interests of the parties and in the public interest. The classic statement of the law is in the well-known passage in the speech of Lord Macnaghten in *Nordenfelt v. Maxim Nordenfelt Guns and Ammunition Co. Ltd.*, [1894] A.C. 535, 565 which is as follows:-

> "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."

In *Herbert Morris Ltd. v. Saxelby* [1916] 1 A.C. 688, 707 Lord Parker of Waddington explained that:-

> "....for a restraint to be reasonable in the interests of the parties it must afford no more than adequate protection to the party in whose favour it is imposed."

While Lord Macnaghten referred to restraints which might be justified by "the special circumstances of a particular case", it has come to be accepted that certain types of contract which impose a measure of interference with the freedom of trade are treated as not being within the field of restraint of trade, provided that the degree of interference does not exceed the accepted standard. One such type is what Lord Wilberforce in *Esso Petroleum Co. Ltd. v. Harper's Garage (Stourport) Ltd.* [1968] A.C. 269, 335 called "....the well-known type of case where a man sells his business and its goodwill and accepts a limitation on his right to compete". The justification for the limitation in that type of case is that it enhances the price which the vendor can obtain for his business - see *Mitchel v. Reynolds* [1711] 1 P. Williams 181. Even in contracts of this type it is necessary to consider whether the restrictions on the vendor of the goodwill are fairly and properly ancillary to the sale; if they exceed that limit the doctrine of restraint of trade may be applied - see *Leather Cloth Co. v. Lorsont* (1869) L.R. 9 Eq. 345. The other type of contract which has some relevance to this appeal is that in which restrictions are imposed on former employees. In cases of this type only much more limited restrictions are normally enforceable, and if their effect will merely be to protect the employer from competition from his former employee they will be invalid, unless the circumstances are unusual - as in *Fitch v. Dewes* [1921] 2 A.C. 158. The reasons for the restrictions being treated differently in the two types of case are familiar and they were explained, for example, in *Herbert Morris Ltd. supra* where Lord Shaw of Dunfermline at page 713 said this:-

> "When a business is sold, the vendor, who, it may be, has inherited it or built it up, seeks to realise this piece of property, and obtains a purchaser upon a condition without which the whole transaction would be valueless. He sells, he himself agreeing not to compete; and the law

upholds such a bargain, and declines to permit a vendor to derogate from his own grant. Public interest cannot be invoked to render such a bargain nugatory: to do so would be to use public interest for the destruction of property. Nothing could be a more sure deterrent to commercial energy and activity than a principle that its accumulated results could not be transferred save under conditions which would make its buyer insecure.

In the case of restraints upon the opportunity to a workman to earn his livelihood a different set of conditions comes into play. No actual thing is sold or handed over by a present to a future possessor. A contract is an embargo upon the energy and activities and labour of a citizen; and the public interest coincides with his own in preventing him, on the one hand, from being deprived of the opportunity of earning his living, and in preventing the public, on the other, from being deprived of the work and service of a useful member of society."

The agreement in the present case, being one between partners, does not conform exactly to either of the types to which reference has just been made, although it has some resemblance to both. Their Lordships are of opinion that a decision on whether the restrictions in this agreement are enforceable or not cannot be reached by attempting to place the agreement in any particular category, or by seeking for the category to which it is most closely analogous. The proper approach is that adopted by Lord Reid in *Esso Petroleum supra* at page 301B, where he said this:-

"I think it better to ascertain what were the legitimate interests of the appellants which they were entitled to protect and then to see whether these restraints were more than adequate for that purpose."

What were the respondent's legitimate interests will depend largely on the nature of their business, and on the position of the appellant in the firm. Their Lordships therefore turn to consider the evidence on these matters.

The respondent is a large firm established in Hong Kong in 1860, though not under its present name. At the time these proceedings began it had 27 partners and employed 49 assistant solicitors. Its main office is in Hong Kong itself, and it has a small branch in Kowloon. The appellant began his connection with the respondent firm on 1st May 1967 when he entered its employment as an assistant solicitor. He had recently completed his articles of clerkship in England but he had not actually been admitted as a solicitor in England. He had not previously practised as a solicitor in Hong Kong. He became a salaried partner in the respondent firm on 1st July 1973, and was admitted a full capital partner on 1st April 1974. He was then aged about 31. He resigned from the firm at 31st December 1982. After starting work with the firm he worked generally for several of the partners, but fairly soon he began working for one partner, a Mr. Turnbull, and he developed a growing interest in intellectual and industrial property law and in the law relating to trade marks. That was an area of the respondent's practice which had been growing during the 1960's. The growth continued and accelerated during the 1970's partly because industrial design copyright became actionable in Hong Kong in 1973. The appellant's invitation to join the firm as a salaried partner was given in the expectation, which was fulfilled, that Mr. Turnbull would, in the following year, become senior partner and that the appellant would then become the partner responsible for this part of the practice, which had by then been, or was about to be, recognised as a separate department.

An important feature of the case, which distinguishes it from any of the reported cases on partnership agreements that were brought to their Lordships' attention, and which was strongly relied on by Sir Patrick Neill on behalf of the appellant, is that the respondent's office is divided into a number of departments, largely separate from each other. This division has occurred as a result of the great expansion in the respondent's practice over approximately the last 20 years. The division is emphasised by the fact that each file in their office is specifically assigned to the partner who remains ultimately responsible for it and who reads all incoming correspondence and signs all outgoing correspondence relating to it. Consequently each partner's knowledge of the firm's business tends to be concentrated on his own department.

So far as the appellant personally was concerned, the industrial property department was moved about July 1981 to a separate suite of offices on a different floor, and served by different lifts, from the firm's other departments. He was thus physically, to some extent, cut off from the other departments. The evidence was that he had only acted for those clients of the respondent who made use of the Intellectual and Industrial Property Department.

In 1981 the total of delivered bills of the respondent was approximately HK$132,000,000 of which only about HK$6,000,000 was attributable to that department - that is about 4.5%. The number of files in the office as a whole was disputed but it seems that something of the order of 10% of the total was marked as being the responsibility of the appellant. Thus the appellant had no connection or dealings with the great majority (over 90%) of the respondent's clients, and, as he claimed, he had no advantage over any other solicitor in seeking to attract their business.

Sir Patrick maintained that, in these circumstances, the respondent was not entitled to protection against the appellant's acting for clients of the firm for whom he had never acted, while he was a partner. The respondent was only entitled to protect such part of its goodwill as would be threatened by the appellant if he were to set up practice on his own account, and that part, on the evidence which was filed, consisted only of the business which he was advantageously placed to attract because it came from clients for whom he had acted and to whom he was known.

Their Lordships do not accept that submission. In their view it is necessary to recall that the partners in the respondent firm, as constituted from time to time, are the owners of the firm's whole assets, including its most valuable asset, goodwill. The appellant had owned a share of the assets while he was a partner, but he transferred his share to the continuing partners when he ceased to be a partner. Thereafter the continuing partners owned the whole of the assets - see clause 8(a) of the agreement which provides:-

> "8(a). The assets of the partnership including goodwill and all furniture, safes, boxes, equipment, fittings, fixtures, stores and books held or used for or in connection with the practice....belong to the partners in proportion to their respective shares."

The question is whether it was reasonable, as between the parties, for the respondent to obtain protection against appropriation by the appellant of any part of the goodwill, notwithstanding the "departmentalisation" of the practice.

Their Lordships consider that it was reasonable, provided, (what is not suggested here) that the protection did not extend beyond the respondent's practice - see *British Reinforced Concrete Co. v. Schelff* [1921] 2 Ch. 563. On this question the mutuality of the contract is a most important consideration. The contract applied equally to all the partners. None of them could tell whether he might find himself in a position of being a retiring partner subject to the restriction in clause 28, or of a continuing partner with an interest to enforce the restriction. It was at least as favourable to the appellant as to the more senior partners; by clause 22 of the agreement every partner is obliged to retire on 31st December immediately following his 60th birthday, and the probability therefore was rather that the restriction would apply first against the more senior partners than the more junior ones. Moreover if any of the senior partners had retired soon after the appellant joined the firm, he might well have been able to take many more of the firm's clients with him than could the appellant. Their Lordships agree with Mason J. in the Australian case of *Geraghty v. Minter* [1979]) 142 C.L.R. 177, 198 (notwithstanding that he dissented on the facts of that case), that:-

> "The fact that the covenant is entered into by each of the partners and may become binding on any of them, depending upon the events which happen, is a factor which is to be taken into account in assessing whether it is reasonable between the parties."

It was suggested on behalf of the appellant that a restriction which would have been reasonable between the parties would have been one restricting a retiring partner from acting for clients for whom he had personally acted or for whose work he was generally responsible by, for instance, files of the respondent having been opened bearing reference to his name. But a restriction on those lines might well be difficult to apply, particularly in the case of a client who had sought advice from several partners at different times on a variety of matters. Moreover it might work very unfairly in the case of a partner who for some reason had acted only for a small number of clients - perhaps one or two very large clients, whose business took up practically his whole time - or even for no clients at all - if he were in charge of office administration - as compared with another partner with a large number of relatively small clients. And what of the partner who led an active social life and was instrumental in introducing a number of clients whose business did not fall within the scope of his department? Such possible unfairness illustrates what in their Lordships' view is the fundamental error in this part of the argument for the appellant. It overlooks the fact that the firm had one single practice in which each of the partners had an interest. Each was bound to give a just and faithful account of all transactions relating to the partnership (clause 17(c)) and each was entitled at all times to have free access to, and to inspect, books of account and all records and letters concerning the partnership (clause 11). They shared in the profits and losses of the partnership, and each stood to benefit to some extent from the success of each of the others in attracting clients. It may be possible that a partnership could exist in which the partners' interests were so separated as to make an agreement such as that in the present case unreasonable, but this is not shown to be such a case.

As regards the five year period of restriction, and the application of the restriction to persons who had been clients within three years before the particular partner retired, Sir Patrick complained that there was no evidence to justify these periods of time. Their Lordships consider that these are matters which are hardly susceptible of proof by specific evidence. The inclusion of persons who have been clients within the previous three years appears to be perfectly reasonable, having regard to the intermittent nature of a solicitor's employment by any particular client; there must be many regular clients of a solicitor's firm who do not have occasion to employ the firm even as often as once every three years. The five years' limitation also impresses their Lordships as being in no way unreasonable. They have in mind that there appears to be no reported case where a restriction which was otherwise reasonable has been held to be unreasonable solely because of its duration. They have also in mind that some weight should be given to the fact that the restriction is found in a partnership agreement which has evidently been carefully drafted and which must be taken to represent the views of experienced solicitors who would be well aware that an unduly severe restriction would be unenforceable. It must be assumed that they considered the five year period to be reasonable and their Lordships are not prepared to differ from that view.

One further argument against the reasonableness of the restriction, as between the parties, turns on the alleged inadequacy of the consideration provided for in clause 23 of the agreement. Clause 23(b) provides as follows:-

> "(b). The continuing or surviving partners shall, subject as provided in Clause 25 hereof, and if more than one in the proportions in which they are entitled on the expiry date to share in the profits of the partnership, succeed to the share of the outgoing, retiring or deceased partner in the partnership and all the assets and goodwill thereof including the partnership name and shall pay to the outgoing or retiring partner....in respect of such share in the manner hereinafter provided:-
>
> (1) The amount at which the share of the outgoing, retiring or deceased partner stands in the balance sheet...and
>
> (2) A due proportion of the sum not appearing in the balance sheet and from time to time agreed between the partners for the purposes of this Agreement as the value of the following items, namely, goodwill, library, office equipment, furniture, fixtures and

> fittings (which sum is for convenience hereinafter referred to as "the agreed value of the office assets"). Until otherwise agreed, the agreed value of the office assets shall be [HK$1,000,000 - as amended by a supplemental agreement dated 24th April 1979]."

Taking the fixed value of $1,000,000 for all the "office assets" it can be shown that only some $60,000 (say £6,000) is attributed to goodwill. That merely nominal amount is in no way related to its real value, having regard to the large profits earned by the firm. From that state of facts two conclusions were said to follow. First this is not a case like the sale of a business where protection against competition by the vendor can be justified because it will enhance the price he receives for the business. That is plainly correct and distinguishes their restriction to some extent from the vendor and purchaser type of restriction. Secondly it was said that, because the appellant's share of the goodwill had not in any real sense been sold by him to the respondent, the respondent was not entitled to protect it. Their Lordships are unable to agree with this conclusion. It may well be that the appellant's share of the goodwill was not sold for its market value in cash, but that is immaterial. It passed to the continuing partners not by a sale for a cash consideration in 1983, but as part of the contract made in 1974.

The adequacy of the consideration and the reasonableness of the contract as between the parties must be judged in 1974. At that date the appellant received a 5% share in the partnership business and all its assets, including goodwill. In return he agreed to various conditions one of which was that he would transfer his share in the business, including goodwill, to the continuing partners when he retired, and would thereafter not compete with them. The value placed upon goodwill in 1974 and in 1984 may have been only nominal but there were good reasons for treating it in that way. One reason was to avoid the need to value it on each occasion, and thus to avoid much trouble and expense. Another reason was that when a new capital partner joins a large firm, he is not normally in a position to pay the full market value of his share of the goodwill, and the only practicable system is to charge him a nominal sum. Provision was made in clause 14(b) of the contract for a new partner paying for his share in the partnership by applying his share of the profits after deducting a limited amount of drawings for his current use. It is therefore reasonable that when a partner retires, he should receive only a nominal sum for his share of the business. Their Lordships accordingly find no reason to consider that the restriction was unreasonable between the parties by reason of the consideration paid to the appellant having been inadequate.

On the question of reasonableness in the public interest, their Lordships are of opinion that there is a clear public interest in facilitating the assumption by established solicitors' firms of younger men as partners. It benefits clients by tending to secure continuity in the practice. It also tends to encourage the entry of younger men into the profession. Their Lordships accept the evidence on this matter from Mr. Wimbush in his first affidavit dated 5th February 1983 to the effect that the continuing partners in the respondent firm would only feel able to take on new capital partners if they knew that in doing so they would not run the risk that the new partners would acquire a connection with clients of the respondent and then depart with that part of the respondent's goodwill. Conversely the new capital partners in the respondent firm are required to purchase their share of its goodwill, but they could not reasonably be expected to do that if a retiring partner could freely remove part of the goodwill. Accordingly the restriction was in their Lordships' opinion reasonable in the public interest.

One recent English case must be briefly noticed because certain *obiter dicta* of Lord Denning M.R. seem to have been relied upon to some extent in argument before the Court in Hong Kong. Before this Board Sir Patrick declined (rightly in their Lordships' view) to rely on these dicta. The case is *Oswald Hickson Collier & Co. v. Peter Frederick Carter-Ruck* (unreported) decided in the (English) Court of Appeal on 20th January 1982. It was case of a solicitors' partnership. According to the transcript of the decision Lord Denning M.R., referring to a provision that a retired partner should not "act for any clients of the firm", said this:-

> "It was submitted by [Counsel for the Appellant] that - as the relationship between a solicitor and his client is a fiduciary relationship - it would be contrary to public policy that he should be precluded from acting for a client when that client wanted him to act for him: especially in pending litigation. It seems to me that that submission is right. I cannot see that it would be proper for a clause to be inserted in a partnership deed preventing one of the partners from acting for a client in the future. It is contrary to public policy because there is a fiduciary relationship between them. The client ought reasonably to be entitled to the services of such solicitor as he wishes. That solicitor no doubt has a great deal of confidential information available to him. It would be contrary to public policy if the solicitor were prevented from acting for him by a clause of this kind."

Kerr and May L.JJ. agreed with Lord Denning. If these dicta were intended to state a general rule, their Lordships must respectfully but emphatically decline to agree with it. It is unsupported by authority, and appears to have been made without any reference to the fact that it was directly contrary to a considerable volume of authority including a decision of the House of Lords in *Fitch v. Dewes (supra)*. It also seems to be unjustified in principle. For one thing a solicitor is always (except to some extent in legal aid cases) entitled to refuse to act for a particular person, and it is difficult to see any reason why he should not be entitled to bind himself by contract not to act in future for a particular group of persons. For another thing, the relationship of solicitor and client is not unique in being confidential; the relationships of medical men with their patients and of many other professional men with their clients are also confidential. If there were a general rule that they could not bind themselves not to act for former clients of the firm after they had retired from a partnership, the results would be very far reaching. It must be remembered that the clients are clients of the firm, rather than of an individual partner. These and other objections to treating the dicta in the *Carter-Ruck* case as being of general application were pointed out by Walton J. in *Edwards & Others v. Worboys* (unreported 18th March 1983). When Worboys reached the Court of Appeal Dillon L.J. and Sir John Donaldson M.R. both treated the *obiter dicta* in *Carter-Ruck* as not being of general application. Their Lordships agree with that view.

Their Lordships' attention was also drawn to the American case of *Lynch v. Bailey* (1949) 90 N.Y.S. (2nd Series) 359 where the Appellate Division of the Supreme Court, New York County held that a very severe restriction applicable to a retiring partner from an accountancy practice was against public policy and void for lack of mutuality and consideration. In the circumstances of that case their Lordships, if they may respectfully say so, have no difficulty in accepting the reasons for the decision. But, with the utmost respect, their Lordships doubt whether it justifies the proposition in the American Law Institute Restatement, (2nd) under Contracts, paragraph 188(h) that:-

> "A rule similar to that applicable to an employee or agent applies to a partner who makes a promise not to compete that is ancillary to the partnership agreement...."

In any event such is not yet the law of Hong Kong.

For these reasons their Lordships will humbly advise Her Majesty that this appeal should be dismissed with costs.