IN THE EMPLOYMENT RELATIONS AUTHORITY
AUCKLAND

AA294/09
5272030 and 5272806

	BETWEEN	BEN HALL Applicant in 5272030 and Respondent in 5272806
	AND	PAN PACIFIC AUTO ELECTRONICS LIMITED Respondent in 5272030 and Applicant in 5272806

Member of Authority:	Robin Arthur
Representatives:	Andrew McCormick for Ben Hall Alison Maelzer for Pan Pacific Auto Electronics Limited
Investigation Meeting:	31 July 2009 in Auckland
Determination:	21 August 2009

DETERMINATION OF THE AUTHORITY

Employment Relationship Problem

[1] Ben Hall seeks orders relieving him from parts of the restraint of trade provisions in an employment agreement with his former employer, Pan Pacific Auto Electronics Limited (PPAEL). He wants to be able to start work immediately under a new employment agreement with Exego Limited, a company employing staff to work in the business of Ashdown Ingram (AI). AI is owned by an Australian-incorporated business, newly-established in New Zealand and competing with PPAEL.

[2] PPAEL, in turn, seeks orders for the enforcement of the restraint provisions, preventing Mr Hall working for AI until the expiry of a six month restraint on 10 January 2010. It also seeks damages and penalties for what PPAEL says were breaches by Mr Hall of his employment agreement and good faith obligations, including (i) entering a new employment agreement with AI while still employed by

PPAEL; (ii) telling PPAEL that he would find a different job for the period of the restraint; and (iii) agreeing to start work for AI before the expiry of the restraint period in his PPAEL employment agreement.

The investigation

[3] The parties were directed, on an urgent basis to mediation but were not able to resolve the matter between themselves.

[4] For the investigation meeting written witness statements were provided by Mr Hall, AI's New Zealand general manager Phillip Hughes, PPAEL's founding and managing director John Cunningham and his son, David Cunningham, who acts as PPAEL's chief executive and is also a director. Each man gave additional sworn or affirmed oral evidence in response to questions during the investigation. PPAEL's chief product manager Graeme Barclay also gave affirmed oral evidence. The parties' legal representatives had the opportunity to ask additional questions and gave oral closing submissions, speaking to written synopses they provided.

The legal framework

[5] The following clauses of Mr Hall's employment agreement express limits on his activities after ending his employment with PPAEL:

> *31. Confidential Information …*
> *…*
> *31.5 Employees shall not at any time or for any reason, whether during the term of this agreement or after its termination, use or disclose to any person any confidential information relating to information, or trade secrets of the Employer except so far as may be reasonably necessary to enable the Employee to fulfil their obligations under this agreement.*
> *…*
> *31.9 During the course of employment or after termination of employment with the Employer, the Employee shall not directly or indirectly make a record of, or divulge, or communicate to any other person, any information regarding the Employer's business, or any matters associated with the Employer. When requested, the Employee hereby agrees to sign a Statutory Declaration stating they are collecting commercially sensitive and valuable information only to perform the tasks required by the Employer, that the commercially*

sensitive and valuable information will not be passed to others during and after the term of employment. …

33. Intellectual Property

33.1 Any original work, process, design or other material produced or to be published by the Employee and arising from the employment with the Employer, shall remain the property of the Employer … whether those rights are exercised in any form or not during the employment or on cessation of the employment.

42. Non Solicitation

42.1 The Employee shall not at any time during the period of employment or for a period of six months after termination of employment, for whatever reason, either on the Employee's own account or for any other person, firm, organisation or company, solicit, endeavour to entice away from for discourage from being employed by the Employer, any other employee or actual client/customer or prospective client/customer of the Employer.

43. Restraint of Trade

43.1 The Employee agrees that, in consideration of the Employer entering into this agreement, he will not at any time, without the prior written approval of the Employer:

a) During the term of this agreement or ***for a period of six months from the day he ceases to be employed by the employer****:*

> *1.* ***be*** *directly or indirectly* ***engaged****, interested or concerned whether on their own account or* ***as a*** *shareholder,* ***employee****, partner, agent, representative, consultant, lender of money, guarantor or in any other capacity* ***in any business*** *or activity* ***in competition with the business of the Employer****;*
>
> *2. directly solicit or knowingly approach and endeavour to entice away any of the employees of the employer or its customers; and*
>
> *3. disclose or use Company information, as defined in section 145 of the Companies Act 1993, at any time.* ***[emphasis added]***

b) The Employee acknowledges that:

> *1. the restrictive covenants contained in clause 43.1a are necessary in order to protect and maintain the proprietary interests of the Employer;*
>
> *2. the Employer would not have entered into this agreement and offered the Employee this position unless these restrictive covenants were included; and*
>
> *3. monetary damages will not be sufficient to repair the harm done to the Employer if these covenants are breached by the Employee.*

43.2 Should this clause be held invalid for any reason, the remainder of the agreement shall continue in force and effect as if the invalid provision had been deleted, provided however that the parties to this

> *agreement may negotiate a valid and enforceable provision in replacement of the invalid provision.*

[6] Mr Hall, in his application to the Authority, confirmed he was willing to comply with the clauses on confidential information (31); intellectual property (33); non-solicitation of employees and the current or prospective clients and customers of PPAEL (42 and 43.1(a)2); and not disclose company information (43.1(a)3).

[7] The relief he sought was solely focussed on freeing him from the clause 43.1 obligation not to be engaged as an employee in any business in competition with PPAEL for a period of six months from the day he ceased to be employed by PPAEL.

[8] A restraint of trade is *prima facie* void and unenforceable. However it may be enforceable to the extent that the former employer is able to establish that the restraint, in its particular circumstances, is reasonable between the parties and in the public interest. This inquiry includes considering whether:

- the former employer has proprietary interests, such as trade secrets and trade connections developed and invested in over time, which may properly protected by a restraint and;
- the former employee will develop or maintain, while in his former employee's service, a knowledge of those trade secrets and relationships through those trade connections which would unfairly enable him to secure business for the benefit of himself or his new employer.

[9] A restraint may reasonably be imposed only for the extent necessary for the former employer to prepare to meet the competition of its former employee. It must be no more than adequate to meet that purpose.

[10] Lord Wilberforce put the issue this way in *Stenhouse (Australia) Limited v Phillips* [1974] AC 391, 402 (PC):

> *The question is not how long the employee could be expected to enjoy a competitive edge over others seeking the client's business. It is, rather, what is a reasonable time during which the employer is entitled to protection against solicitation of clients with whom the employee had contact and influence during employment and who were not*

> *bound to the employer by contract or by the stability of association. This question their Lordships do not consider can advantageously form the subject of direct evidence. It is for the judge, after informing himself as fully as he can of the facts and circumstances relating to the employer's business, the nature of the employer's interest to be protected, and the likely effect on this of solicitation, to decide whether the contractual period is reasonable or not.* ***An opinion as to the reasonableness of the elements of it, particularly of the time during which it is to run, can seldom be precise, and can only be formed on a broad common sense viewing****. [emphasis added]*

Issues

[11] The issues for investigation and determination in the present matter are these:

(i) Does PPAEL have a proprietary interest in information and relationships capable of protection by a restraint?

(ii) Was consideration provided for the restraint in Mr Hall's employment agreement?

(iii) If the answer to (i) and (ii) are yes, is the restraint reasonable and if so, to what extent can it be enforced.

PPAEL's proprietary interests

[12] PPAEL began as a family business employing four people in 1979 and operating out of a garage in Henderson. It now employs around 50 people operating from eight branches around New Zealand. Its business is importing and distributing auto electrical products including alternators, starters, cable, lighting, air-conditioning products, and car audio systems.

[13] On the basis of the evidence of John Cunningham, David Cunningham and Graeme Barclay I find that PPAEL has sufficient proprietary interests in:

i. confidential commercial knowledge developed by staff about its suppliers, their products, the bundling and pricing of those products, customers' needs and margins on goods purchased (that amount to trade secrets); and

ii. commercial relationships developed with suppliers, and particularly suppliers' representatives, to provide products for sale, and with customers for the purchase of those products, (that amount to trade connections).

[14] These interests include some exclusive supply agreements which are not formalised contracts but are oral "gentlemen's agreements" with some suppliers developed over a number of years.

[15] Through his daily work, and regular weekly and quarterly planning meetings with the other product and senior managers, Mr Hall had access to a range of information amounting to the trade secrets of PPAEL. This included pricing decisions, developing product lines and detailed knowledge of the data and structure of a newly-developed on-line catalogue due to be released shortly.

[16] Such information and connections are capable of protection by a restraint.

Consideration for the restraint

[17] Mr Hall, now aged 27, began work for PPAEL in Christchurch in 2001, his first year out of high school. Starting as a warehouse junior he had worked his way up to a sales representative role by 2005 when he resigned to live in Melbourne. Within nine months he returned to a branch management job in Auckland from September 2005. In September 2007 he was promoted to a new role as a product manager.

[18] The new role came with a new employment agreement signed by Mr Hall on 11 September 2007. It included a salary increase, change to bonus arrangements and a six month restraint of trade rather than the three month restraint provision in his previous employment agreement.

[19] While there was some conflict in the evidence between David Cunningham and Mr Hall as to whether they discussed the longer restraint clause before Mr Hall signed the new agreement, there is no dispute that he did have the opportunity to read the agreement and seek legal advice before signing it. Mr Hall's copy of the agreement clear shows he initialled each page, including the one with the restraint provision, before returning it.

[20] I am satisfied the revised salary and benefits package comprised consideration for the longer restraint provision agreed on Mr Hall's promotion to the product manager position.

Reasonableness and enforceability of the restraint

[21] I have not found it necessary to refer to the specifics of Mr Hall's intended role at AI as the reasonableness of PPAEL's restraint must be assessed at the time it was entered into, not at the present time in which it would come into operation.

[22] Both Mr Barclay and David Cunningham accepted in their oral evidence that the importance of the restraint is to protect PPAEL's information rather than connections with its suppliers and customers. While the position vacated by Mr Hall had not yet been replaced, and John Cunningham considers it now very difficult to fill, PPAEL has Mr Barclay and two other experienced product managers already known by most if not all of those suppliers and customers with whom Mr Hall dealt. Mr Hall's relatively junior role in the product managers' team and the much longer relationships John Cunningham and Mr Barclay have in the industry mean Mr Hall would not have the necessary sway or influence with PPAEL suppliers and customers with whom he had contact to necessitate a restraint on the basis of those trade connections.

[23] The assessment is more complex in considering whether the restraint is nevertheless reasonably necessary to protect PPAEL's proprietary interest in its trade secrets and any other confidential information.

[24] Mr Hall submits such information is adequately protected by the confidentiality provisions of his employment agreement, which he accepts continue to apply to him even if he is granted relief from the restraint against employment with a competitor. If that were the case, the restraint would be unnecessary and therefore unreasonable.

[25] In recently reviewing the case law on this point the Employment Court has[1] concluded that:

> *It is not possible to say as a matter of principle that, where the key interest of the party seeking to enforce a restraint is to protect confidential information, that a restraint of trade will not be reasonable in addition to an express commitment to confidentiality. Inevitably, whether or not that is so will depend on the particular facts of the case.*

[26] Having heard the respective evidence of Mr Hall, John Cunningham, David Cunningham and Mr Barclay, I am satisfied in the particular circumstances of this case that the restraint provision entered into in September 2007 was reasonable to protect the following range of confidential information (including some trade secrets):

i. how products from different suppliers would be repackaged for retail under particular brands; and

ii. demand information from customers, including price sensitivities and brand acceptability; and

iii. prices and margins on suppliers' products; and

iv. the structure and content of its marketing catalogue (including a subsequent on-line catalogue developed and due for release shortly); and

v. sales and product development information discussed at regular weekly and quarterly meetings of product managers and senior managers.

[27] I also find that public interest factors, on balance, support some period of restraint as reasonable.

[28] One such factor is fostering competition – with perceived general benefits throughout the economy – and allowing individuals to use their skill and general trade knowledge without restriction. However there is also a public interest in enhancing the level of certainty between parties by upholding agreements on the terms on which they were made. The public interest in competition does not extend to sanctioning

[1] *Allright v Canon New Zealand Limited* (unreported, EC Auckland, AC 47/08, 3 December 2008, Couch J) at [27].

unfair competition which would allow a former employee and his or her new employer to unfairly take for their own benefit 'property' (such as trade secrets and business connections) developed on a former employer's time and money.

[29] Mr Hall has worked almost entirely in the one industry since leaving school. He should be free to fully use his personal skills and experience developed during his time working for PPAEL. However he freely signed an employment agreement containing a six month restraint. By that arrangement PPAEL sought to protect itself from the risk that has now arisen – that Mr Hall might deliberately or inadvertently give a competing new employer (as AI now is) the benefit of confidential information and trade secrets he gained on PPAEL's time and money.

[30] Although I consider PPAEL's restraint of trade on Mr Hall's future employment is reasonably necessary, I find the length of time contracted for is wider (or rather longer) than required to protect PPAEL's proprietary interest in the information. To be reasonable it must be for a shorter period.[2]

[31] No more than three months can be justified in circumstances where pricing and margin information along with intelligence from and about customers and suppliers was reviewed at weekly and quarterly meetings. After that period – at the most 12 weeks – some or all of the information to which Mr Hall was privy would be stale.

[32] I note too that Mr Hall's new employment agreement includes a three month restraint although Mr Hughes had told him such a provision would not be enforced if Mr Hall subsequently left that job. Mr Hughes told me that although he, as AI's New Zealand general manager, would not seek to enforce such a restraint, it remained in the formal employment document as a matter of "*corporate protocol*".

[33] Three months is also in line with PPAEL's restraint provisions for employees in other roles. It is also the period by which PPAEL expects to have its new catalogue released so that its contents and structure will no longer be confidential.

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[2] *Littlewoods Organisation Limited v Harris* [1978] All ER 1026, 1033 (per Lord Denning).

[34] I am conscious that a three month restraint still restricts the free movement of Mr Hall's labour. However he was aware – or must be taken to have been aware – of the prospect of such a limit both at the time that he entered into his new PPAEL employment agreement (September 2007) and at the time of signing his new his new employment agreement with Exego Limited to work for AI (May 2009). I say this because Mr Hall's evidence was that he told Mr Hughes of the PPAEL restraint before he was offered and accepted the new job. Mr Hall and Exego Limited signed the new agreement with their eyes open to the risk of a valid, enforceable limit to Mr Hall's ability to start work.

[35] For the reasons given above, and through s162 of the Employment Relations Act 2000, I exercise the Authority's power under s8 of the Illegal Contracts Act 1970 to modify the restraint of trade provision in Mr Hall's employment agreement. The modification is that the period of restraint set out in clause 43.1a) of that agreement is reduced to three months.

[36] With that modification the clauses of the employment agreement that survive the termination of the employment remain in full effect – including particularly those clauses referred to above that Mr Hall accepts remain binding on him. He will need to take steps to ensure in any subsequent work for AI that he does not breach ongoing obligations regarding PPAEL's confidential and company information.

Damages and penalties for breach of agreement or good faith

[37] PPAEL seeks penalties against Mr Hall because he:

i. entered a new employment agreement while still employed by PPAEL.

ii. agreed, in a conversation with John Cunningham, that he would find a different job for the period of the restraint; and

iii. agreed to start work for AI before the expiry of his PPAEL restraint period.

[38] Mr Hall gave notice to PPAEL on 28 May 2009 and remained employed on a six week notice period, which he served on garden leave, until 10 July 2009.

[39] On 22 May 2009 he had signed an employment agreement with Exego Limited which provided a start date of 13 July 2009.

[40] In a meeting on 29 May Mr Hall told John Cunningham that he would get a job somewhere other than AI in order to comply with the PPAEL restraint clause.

[41] Although Mr Hall arguably became an "employee" of Exego – as a person intending to work – by signing an agreement on 22 May, this is a somewhat technical point. The practical reality is that many workers will sign an agreement to take up a job elsewhere before resigning from their present job. The important point in the present case is that Mr Hall's agreement did not provide for him to do any work for AI until 13 July, after the expiry of his notice period.

[42] Mr Hall did not, I find, intend to mislead John Cunningham in his statement about finding another job for the restraint period. It was not a comment that he volunteered. Rather it was elicited as a response to John Cunningham telling Mr Hall in their meeting on 29 May that Mr Hall could not work for AI in the six months after the expiry of the notice period. Mr Hall accepted John Cunningham's statement as fact – something not unreasonable give Mr Cunningham's seniority and role as both patron and mentor of Mr Hall throughout his employment with PPAEL. I accept Mr Hall was being truthful about what he meant to do at the time. Rather than intending to mislead John Cunningham, Mr Hall subsequently received advice (whether or not it was correct) that suggested he need not do as John Cunningham suggested. That explains his subsequent different actions rather than indicating an earlier intention to mislead or deceive.

[43] While Mr Hall did agree to start work for AI before the expiry of his PPAEL restraint period, he had in fact not started work for, or received any payment from, his new employer. Within a relatively short time (and while still on garden leave) he wrote to PPAEL invoking the dispute resolution provisions and seeking relief from

the restraint on employment. He subsequently, again promptly and properly, made a formal application to the Authority for resolution of the issue.

[44] In these circumstances I do not accept that penalties need be imposed for the alleged breaches of good faith and terms of employment. For the same reasons I decline PPAEL's application for special damages, being its legal fees in defending Mr Hall's application and making its own application for an injunction and other orders.

Costs

[45] Costs are reserved. The parties are encouraged to resolve any matter of costs between themselves. If they are not able to do so, either party may lodge a memorandum requesting the Authority to determine costs. This must be done within 28 days of the date of this determination. From the date of lodgement of such a memorandum, the other party will have 14 days to lodge a memorandum in reply. No application will be considered outside this timeframe without prior leave.

[46] As a preliminary view I note that both parties have enjoyed some measure of both success and failure in their respective applications. In such a case an order that costs lie where they fall is likely unless either party persuaded the Authority otherwise.

Robin Arthur
Member of the Employment Relations Authority