**IN THE EMPLOYMENT RELATIONS AUTHORITY**
**AUCKLAND**

AA 469/09
5286090

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| | BETWEEN | INTERCAD (NZ) LIMITED<br>Applicant |
| | AND | KERRY RICE<br>Respondent |

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| Member of Authority: | Robin Arthur |
| Representatives: | Susan-Jane Davies for Applicant<br>Tim Clarke and Anna Clark for Respondent |
| Investigation Meeting: | 30 November 2009 |
| Submissions received: | 3 and 10 December 2009 from Applicant<br>9 December 2009 from Respondent |
| Determination: | 23 December 2009 |

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**DETERMINATION OF THE AUTHORITY**

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**Employment Relationship Problem**

[1] The matter presently before the Authority is, in reality, part of a commercial dispute between the two main resellers in the Australian and New Zealand markets of a 3D computer-aided design software product named SolidWorks.

[2] Intercad (NZ) Limited is the subsidiary of an Australian business group selling that software, training and other support for its use. It seeks an order requiring its former New Zealand manager, Kerry Rice, to comply with a 12-month long non-competition clause in his previous employment agreement with Intercad.

[3] The effect of the order would be to restrain Mr Rice until 13 September 2010 from working in a job he began three days after the expiry of his one-month notice period at Intercad (which he had served on garden leave). From 17 September 2009

Mr Rice became the New Zealand manager of Solidtec Solutions Limited (SSL), a subsidiary of a similarly-named Australian company.

[4] The founders of SSL's Australian parent company include former senior managers of Intercad. SSL's main business activity is reselling the same software product and similar training options as form the core of Intercad's business.

[5] Both Intercad and SSL have reselling agreements with the French-owned international company that produces SolidWorks.

[6] Following Mr Rice's resignation nine of the 11 staff reporting to or managed by him in New Zealand also left Intercad and started working for SSL. Intercad says Mr Rice has "*ripped the heart out*" of its business with software subscription renewals dropping 20 per cent in October. It projects a loss of more than $1 million in its business turnover between 2009 and 2010 as a result of competition from SSL.

[7] Intercad says enforcement of a restraint of trade on Mr Rice is necessary to rebuild its business without interference from SSL. It says SSL – through Mr Rice's role – has the unfair advantage of knowing Intercad's business inside out.

[8] This is the term in Mr Rice's former employment agreement that Intercad seeks to enforce:

> *During your employment, and for the period of twelve (12) months, commencing from your leaving Intercad, you shall not, alone nor in partnership with, or as director, servant, agent or representative of any person whether directly or indirectly carry on or be involved, engaged or interested or assist any other person to carry on or be involved, engaged or interested in, any business in competition with Intercad within Australia and New Zealand.*

[9] Mr Rice opposes Intercad's application on the grounds that the business interest meriting protection has not been sufficiently defined and that the restraint is unreasonably long and onerous.

**The issues and the investigation**

[10] The Authority's investigation was conducted under urgency to minimise uncertainty – commercially for Intercad and personally for Mr Rice. The parties had

been directed to mediation but not resolved the matter between themselves.

[11] Written witness statements were provided by Intercad chief executive Max Piper, Intercad sales and marketing director Evan Palmer, Intercad business development manager Richard Dyson and Mr Rice. Each witness answered questions, under oath, from the Authority member and the parties' representatives. The representatives also lodged written closing submissions.

[12] Prior to the investigation meeting I made an order for non-publication of financial and sales data in an Intercad operational plan which was one of the documents lodged in evidence. That order is confirmed by this determination and remains in place.

[13] In accordance with s174 of the Act, I have not needed to set out all the evidence and submissions. Before preparing this determination I have closely reviewed all the written and oral evidence given and the representatives' submissions about that evidence and the applicable legal principles.

[14] During a preliminary conference with counsel on this matter I directed that the Authority's investigation would initially be limited to the application for a compliance order, penalties and costs. If the restraint clause was determined to be enforceable, whether fully or partially, the issue of damages would be referred for further mediation between the parties. An investigation as to damages would be scheduled only if the parties then failed to resolve the matter between themselves. On reflection I also consider any issue of penalties should be deferred to a subsequent investigation, if one proves necessary.

[15] The issues for determination by the Authority now are:

(i) Whether Intercad has a proprietary interest that may legitimately be protected by the purported restraint on Mr Rice; and

(ii) If so, what period and extent of restraint may be reasonable and necessary to protect that interest; and

(iii) To the extent there is a reasonable and enforceable restraint, whether Mr Rice has breached that obligation.

**Proprietary interest**

[16] Mr Rice submits Intercad has failed to define or precisely identify any proprietary interest capable of protection by the restraint.

[17] I do not agree. I find that Intercad does have proprietary interests capable of protection in:

(i) knowledge of its margins; and

(ii) relationships with customers, and decision-makers within those customer entities, which are developed to the extent that the staff member has significant 'sway' or influence with particular customers; and

(iii) knowledge of customers' needs and pricing for products and services; and

(iv) the stability of its workforce

[18] The 'knowledge' items identified at (i) and (iii) in the previous paragraph are forms of confidential information. They are the sort of information clearly contemplated by the enduring confidentiality clause also found in Mr Rice's former employment agreement:

> *As a member of the Intercad team you will have access to some sensitive technical and commercial information. You must not during your employment or any time thereafter, without the prior written consent of Intercad or as otherwise required by law, disclose directly or indirectly to any person for any reason other than the conduct of Intercad's business, any secrets, information, process, methods, products, customer information, prices or data belonging to Intercad; nor shall you divulge any time to any parties information that could damage or harm Intercad's business interests.*

[19] As the Employment Court noted in *Allright v Canon New Zealand Limited*:[1]

> *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 its confidential information, that a restraint of trade will not be reasonable in addition to an express commitment to confidentiality.*

[20] There are however limits to the extent which Mr Rice possessed or had developed the 'property' in those identified interests of Intercad.

[21] He had access to information on Intercad's Australian customer base but I accept his evidence that he did not refer to it and had no significant in-depth

[1] (unreported, 3 December 2008) at [27] per Couch J.

knowledge of it. However he must, as New Zealand manager, have had considerable knowledge of commercially important information on margins, pricings and customer preferences in this country. All that knowledge – on the specifics of selling the SolidWorks software to those particular customers – was developed solely within the service of Intercad as he had no prior experience with that product and limited experience in that particular part of the wider technology industry.

[22] Mr Rice worked for Intercad for a relatively short period of 15 months from May 2008 to August 2009. For most of that period he was managing sales and training teams rather than having direct contact with customers. From April 2009 a revision of roles implemented by Mr Palmer resulted in Mr Rice working more directly in supervising sales and having direct contact with some key clients.

[23] However there is, I find, insufficient evidence to support the proposition that Mr Rice had developed – by factors such as lengthy and repeated contact or strength of personal relationships with decision-makers – such influential connections with any customers that would amount to a proprietary interest of Intercad. Simple contact or familiarity with customers and their decision-makers is not enough.[2] What is required is real 'sway' with them – and Intercad provided no sufficient proof of Mr Rice having that.

[24] Mr Rice was responsible for managing Intercad's New Zealand team. In doing so he was also responsible for maintaining Intercad's interest in retaining the skill and experience of staff recruited. However it is notable that Intercad had no restraint of trade clauses in its former employment agreements with the other staff who later left to work for SSL. Neither did Mr Rice's restraint include a non-solicitation clause in relation to those former employees once he had left Intercad's employment. The proprietary interests to be protected by the actual wording of his restraint clause are not to be 'stretched' to cover those omissions.

[25] Accordingly I accept Intercad had a definable proprietary interest, in respect of Mr Rice, in the knowledge of business and customer information he had developed in its service. That interest is capable of protection by a restraint. The issue now turns to the extent and duration of restraint reasonable and necessary to protect that interest.

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[2] *Broadcasting Corporation of New Zealand Limited v Neilsen* (1988) 2 NZELC 96,040 at 96,049.

**What restraint is reasonable and necessary?**

[26] Although the parties' submissions start at the extremes – Intercad wanting the full extent of its written term and Mr Rice wanting its application dismissed entirely – neither limited themselves to such stark positions.

[27] Intercad's submissions in the alternative proposed a nine-month restraint period with a New Zealand only geographical limitation if the Authority were to modify the restraint under s8 of the Illegal Contracts Act 1970.

[28] And Mr Rice accepted during the Authority's investigation that he should be subject to some form of restraint, as he usually has been in the various management positions he has held through his career. Most recently the employment agreement he signed with SSL contained a three-month non-competition restraint clause.

[29] He also gave evidence that on joining Intercad he had questioned the 12-month non-competition term and suggested to his manager at that time that a three-month restraint would be acceptable to him. In that light he cannot say a restraint of any kind is unreasonable.

[30] What is really at issue between the parties is not whether a restraint *per se* is reasonable but rather what extent and duration of the restraint is reasonable and necessary in the particular circumstances.

[31] The reasonableness of the restraint is to be assessed at the time and in the circumstances when it was entered, not the time at which it is said to later come into effect. The following factors are considered in the present case.

*Public interest considerations*

[32] Mr Rice says the former Intercad manager with whom he discussed his employment agreement told him "*not to worry*" about the restraint. However Mr Rice is an experienced manager with a working life, largely in sales, reaching back 30 years. He is well aware that the terms of employment agreements are meant to be binding. Neither is there any doubt that Mr Rice received consideration for the

restraint, in the form of a remuneration package at a market level for a role of that type. There is a public interest expressed in the principle that "*[a]greements are made to be kept*".[3] A restraint – to the extent it is reasonable – should be upheld to give effect to that interest.

[33] There is also a recognised public interest in fostering competition and allowing individuals to use their knowledge and skills without restriction. Accordingly the restraint is not reasonable to the extent that Intercad seeks protection from mere competition. What may be permissible is a period necessary to prepare for the prospect – not necessarily the certainty – of meeting the competition, and then only in respect of matters in which there is an established proprietary interest. Here that concerns the utility of the information to which Mr Rice was privy in his national role.

*Geographical reach*

[34] Mr Rice's work at Intercad was to manage sales and support services to New Zealand customers. There was no reasonable or necessary foundation for a restraint extending to Australia.

*Time needed to get replacements 'up to speed'*

[35] There was detailed evidence from Intercad about the time needed to recruit the software sales and training staff, replacing those who had left to work for SSL. However the proper measure of the reasonable duration of restraint on Mr Rice is the time needed to recruit and induct a manager like him, not the staff reporting to the person in that position.

[36] Unsurprisingly Mr Rice's evidence minimised that time. He suggested his experience was that this work could be done from day one as the skills needed to manage the sales and training staff were relatively generic and did not require acquisition of much specialised knowledge of the products and customers.

[37] What is necessary is, I accept, considerably less than the 12 month period suggested by Intercad – which it linked to an annual sales cycle. It is also not

[3] *Fuel Espresso v Hsieh* [2007] ERNZ 60 at [21] (CA).

necessary to wait until the former employer has a replacement manager recruited and familiarised with the company's systems, products and customers. Intercad was able to have Mr Palmer and three other staff travel regularly from Australia, as Mr Piper's evidence showed. In that respect it had already been able to take preparatory steps to meet its competition.

[38] However if the time to recruit and train sales and support staff were relevant, Mr Palmer's evidence was that a recently-qualified trainer could be effective in as few as 30 days while the necessary minimum period for a sales representative would be three months.

*Changes to Mr Rice's terms of employment*

[39] Mr Rice's witness statement laid the foundation of an argument that because terms of his employment – relating to his title and structure of his remuneration package – were changed without his prior consent, Intercad had breached its obligations to him and he consequentially should not be bound by the restraint term. It was a foundation understandably not built upon in his closing submissions.

[40] While the circumstances of the termination of the employment may be a factor in assessing the enforceability of a restraint,[4] it is not a relevant factor here. Mr Rice's departure appears to have been related to unhappiness with changes in senior management and his relationship with the recently-appointed Mr Palmer. However title and remuneration changes would not entitle Mr Rice to unilaterally deem the restraint term ineffective. His proper remedy would have been by way of personal grievance application regarding the changes – if there were a real issue – and seeking a declaration on the reasonableness and enforceability of the restraint. Any argument that Intercad had repudiated its agreement with him by those changes is negated because, rather than cancelling it, he affirmed the agreement by continuing to work.

[41] In those circumstances the actions of Intercad do not make the restraint any less reasonable or enforceable.

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[4] *Grey Advertising (New Zealand) Limited v Marinkovich* [1999] 2 ERNZ 844, 859-860 discussing the application of *General Billposting Co Limited v Atkinson* [1909] AC 118 (HL) .

*The software supplier's system for governing issues between resellers*

[42] The existence of a system run by the software supplier to mediate some competition issues between its licensed resellers is a factor relevant to assessing the restraint's reasonableness. It is relevant to the question of the minimum necessary extent of restraint.

[43] SolidWorks operates a system enabling its resellers to register leads in a central database. This provides a period where a particular reseller is regarded as having priority in contact with a particular customer or potential customer.

[44] In circumstances where a reseller breaches the protocols in that agreed system and achieves sales, that reseller may be required to transfer the funds generated to another reseller whose priority rights were not respected.

[45] While Intercad does not accept that system always works properly or satisfactorily, it is pursuing some disputes about sales generated by SSL through that procedure. Intercad has known throughout that it does not have an exclusive licence in the New Zealand market for the SolidWorks product and could face direct competition with another authorised reseller, as it now does from SSL. It must also be taken to accept that the benefit of some internal regulation by its supplier lessens the degree to which external control by operation of the law is necessary, and that it is not reasonable to achieve by that operation of law, what its supplier has not licensed – that is greater protection from competition between resellers.

*Effect on Mr Rice if held to restraint*

[46] The effect on Mr Rice of being held to a 12-month restraint may be taken into account in assessing the reasonableness of the duration of the restraint. He is concerned about potential financial consequences for him, his family and his mortgage obligations as he fears SSL would "*dump*" him if he was subject to such a long restraint. However he accepted he had no "*definitive*" conversation with his SSL managers about that prospect. He also "*can't recall*" if he told SSL about his non-compete clause with Intercad before accepting his new job but believes he would have. I consider it more likely than not that both Mr Rice and SSL were aware of his

restraint and were prepared to take the commercial risk that it could be enforceable. For that reason I do not give any weight to the potential effect on Mr Rice in assessing the reasonableness of the duration of the restraint.

*Nature of the confidential information known by Mr Rice*

[47] The period necessary to protect Intercad's proprietary interest in its confidential information is relatively short.

[48] While Mr Rice had access to Intercad's operational plan for 2010, that document contained little of competitive advantage, although its sales figures and targets remain confidential information.

[49] Rather, what is important is the pricing, margin and customer base information of which Mr Rice was aware. However the evidence of Mr Palmer and Mr Piper confirmed Intercad has already adjusted elements of its pricing and margins so that what Mr Rice knows, or knew, was already stale to a certain degree. What he knows about customer preferences and the structure of their software licences and support services cannot reasonably be protected for the full 12-month term. Rather what is protected is the opportunity for Intercad managers and new sales representatives to establish contact with those customers – a task requiring a considerably shorter period.

*Modification of the restraint*

[50] Having considered the factors discussed, and the circumstances disclosed by the evidence, I consider it necessary to modify the restraint clause of Mr Rice's former employment agreement in two ways. The first is deletion of its reference to Australia. The second is by modifying its effective term to three months. The changes are made in exercise of the Authority's powers, through s162 of the Employment Relations Act 2000, under s8 of the Illegal Contracts Act 1970. Such an order was sought at paragraph 3.3 of Intercad's statement of problem.

**What has Intercad lost by Mr Rice breaching of the restraint?**

[51] Having determined the reasonable and necessary extent of the restraint is for three months in the New Zealand market, the question of Mr Rice's breach is now historical. He was working for SSL from 17 September up to the date of the Authority investigation and, presumably, continued to do so until 17 December – the end of the restraint's duration as modified by this determination. He was consequently, in that period and in the words of the clause, a "*servant*" of a "*business in competition with Intercad within … New Zealand*" and in breach of the restraint term.

[52] On the basis of this finding, it is now appropriate to allow an opportunity for the parties to meet in mediation on any issue as to damages.

[53] In doing so, some preliminary points on the issue of loss may assist.

[54] Much of Intercad's evidence about alleged breaches and resulting losses concerned the activities of its former sales representatives now working for SSL.

[55] Mr Rice denied he was responsible for all the actions of his sales team. While there is an element of disingenuousness to that evidence, the important point made is that those employees were not subject to a restraint of trade. Intercad cannot seek to impose collaterally or by proxy through action against Mr Rice what it did not bargain for and agree with those former employees.

[56] Similarly allegations that Mr Rice "poached" Intercad staff for SSL is not directly relevant to the question of loss. Mr Palmer and Mr Piper both accepted there was no evidence of Mr Rice encouraging or approaching staff to leave Intercad. Mr Dyson, an Intercad staff member who stayed, gave evidence of being approached by someone else in SSL and not Mr Rice. In any event Mr Rice was not bound by a non-solicitation clause and neither were the other former Intercad staff restrained from joining SSL.

[57] If Mr Rice is responsible for loss to Intercad, a clear chain of causation must be established in the evidence. Much of what is already before the Authority is

supposition. If he is said to be responsible for the loss of orders from former Intercad customers, the causal link would need to be established directly to him and not through SSL staff formerly at Intercad where they did not have restraints of trade.

[58] I accept the principle identified in a relatively recent English chancery case and cited in Mr Rice's submissions is relevant:[5]

> *It is critical that, in order to establish a claim for damages, the loss allegedly suffered by [the former employer] is linked to the Individual Defendants' unlawful acts rather than the mere fact of loss of senior management personnel and sales people. The Individual Defendants were entitled to resign. In general, there is no legal impediment to a number of employees deciding in concert to leave their employer and set themselves up in competition.*

[59] The general point is correct, but subject to the specific details of the former employees' obligations to the former employer – such as observing the duty of fidelity prior to leaving, the duty of confidentiality before and after, and, any express restraining terms which are reasonable and enforceable.

**Costs**

[60] Costs are reserved.

**Further directions**

[61] If Intercad wishes to pursue the question of damages, initially in mediation, it is to advise the Authority within the next 42 days so a direction may be issued.

Robin Arthur
Member of the Employment Relations Authority

[5] *Shepherd Investment Limited v Walters* [2006] EWHC 836 (Ch) at [150]