

**IN THE EMPLOYMENT COURT
AUCKLAND**

**[2013] NZEmpC 97
ARC 96/11**

IN THE MATTER OF an application for penalties and damages

BETWEEN TRANSPACIFIC INDUSTRIES GROUP
 (NZ) LIMITED
 Plaintiff

AND KAINE HARRIS
 First Defendant

AND SMART ENVIRONMENTAL LIMITED
 Second Defendant

ARC 37/12

IN THE MATTER OF an application for declarations, penalties
 and damages

BETWEEN TRANSPACIFIC INDUSTRIES GROUP
 (NZ) LIMITED
 Plaintiff

AND STEPHEN GREEN
 First Defendant

AND SMART ENVIRONMENTAL LIMITED
 Second Defendant

Hearing: 12 and 13 September 2012
 (Heard at Auckland)

Court: Chief Judge G L Colgan
 Judge B S Travis
 Judge Christina Inglis

Appearances: Stephen Langton and Alexandra Chadwick, counsel for plaintiff
 Richard Harrison, counsel for Kaine Harris and Smart
 Environmental
 No appearance for Stephen Green

Judgment: 31 May 2013

JUDGMENT OF THE FULL COURT

[1] The issue for decision by a full Court is the lawfulness of what is known to lawyers as a covenant in restraint of trade in employment agreements. At issue in both cases (and a feature of a substantial number, perhaps as many as 1,400, restraint of trade provisions in individual Transpacific Industries Group (NZ) Limited (Transpacific) employee agreements) is a clause known as cl 7.1. It purports to prohibit a former employee of Transpacific from working as or for a competitor in the business of Transpacific for a specified period (in the case of each of the individual defendants, a period of three months) after the end of the former employee's employment.

[2] The enforceability of cl 7.1 has been isolated to be dealt with as a preliminary issue by the full Court. The remaining issues between the parties will be for trial on their merits subsequently, as will the plaintiff's claims that cl 7.1 has been breached if the clause survives this challenge to its lawfulness.

[3] Stephen Green (the first defendant in the proceedings in ARC 37/12) was not represented at this hearing and has played a limited role in the litigation. He is no longer employed by the second defendant Smart Environmental Limited (SEL) or any other competitor of the plaintiff. Mr Green filed an affidavit in the proceedings and was called for cross-examination on it.

[4] Clause 7.1 (identical in each of Messrs Green's and Harris's employment agreements) is as follows:

7. COVENANT NOT TO COMPETE

7.1 You acknowledge that the services that you are to perform for us may be of a special, unique, unusual, extraordinary and intellectual character. You appreciate that we may suffer serious injury if you took the knowledge and skills acquired during your employment with us and applied them for the benefit of a competitor of ours. Accordingly, you agree that you shall not work for a Competitor either directly or indirectly for that period of time (plus any notice period not worked out), and in that area, as set out in Schedule C after the termination of this Employment Agreement.

For the purposes of this clause:

a “*Competitor*” is an individual (including you), business, organisation or enterprise that offers services of a similar nature to the services provided by Transpacific Industries Group (NZ) Ltd, including but not limited to, those services described elsewhere in this Agreement; and

“*directly or indirectly*” means you on your own account, or as a consultant or other contractor to, or a partner, joint venturer, agent, advisor, beneficiary, shareholder or director of, or equity participant with, any other person or entity.

[5] Clause 7.1 is subject to cl 7.6 of the employment agreements which provides:

7.6 The restriction in Clause 7.1 does not prohibit you from holding up to 5% of a publicly traded company that is a Competitor.

[6] Confidential information is defined in cl 6.1 which states:

6. CONFIDENTIALITY

6.1 As a member of our staff, you may have access to confidential information.

6.1.1 Confidential information refers to all non-public information about Transpacific Industries, its parents, subsidiaries and affiliates. It includes, without limitation, information about our costs, profit margins, markets, sales, technical processes, trade secrets, business contacts, customer details, waste acceptance policies, plans and business strategies.

6.2 You understand that if such confidential information were to be disclosed it could result in serious and irreparable financial harm to the Employer. You therefore agree that you will keep secret all confidential information. You will not disclose confidential information to anyone outside the Company during or after the term of this Employment Agreement.

...

[7] In the judgment of this Court¹ on an application for an interlocutory injunction to enforce cl 7.1 against Mr Green, the Court concluded that there was no sufficiently arguable case that cl 7.1 was enforceable in law for the following reasons:

¹ [2011] NZEmpC 6.

[27] Clause 7.1 ... purports to prohibit Mr Green from engaging in competitive economic activity with Transpacific both for the period of three months following the end of his employment and within the geographic area of the North Island of New Zealand. The effect of cl 7.1 is that all that the company is required to establish is the fact of competition in business. As it stands, cl 7.1 purports to prohibit competition by Mr Green even in respect of customers or potential customers who are or were not customers of Transpacific. Whilst a restraint may be lawful to the extent that it protects reasonably a proprietary interest that the employer has, including in business with its customers, the law does not extend to prohibiting competition alone as cl 7.1 purports to do. Clause 7.1, if it were valid, would prohibit Mr Green from engaging in economic activity (including being an employee of another waste disposal enterprise) if that entity competes for business with Transpacific irrespective of whether there was an actual or had ever been a previous commercial relationship between Transpacific and the potential customer of Mr Green or his new employer. The title to cl 7 of the employment agreement (“COVENANT NOT TO COMPETE”) illustrates the misunderstanding of what the law allows and prohibits: competition per se is not able to be prohibited. The preamble to that prohibition in cl 7.1 also reinforces its flaw. It expresses Transpacific’s concern that it might suffer “serious injury” if Mr Green were to use “the knowledge and skills acquired during your employment with us and apply [them] for the benefit of a competitor of ours”. “[K]nowledge and skills acquired” are much broader than proprietary interests in recognised business assets including confidential information about business plans, pricing details, marketing strategies and the like. Knowledge and skills acquired during employment cannot generally be prohibited from being exercised by a former employee. Skills, and indeed much knowledge, are not the property of the former employer. Clause 7.1 of the agreement is very arguably void in contravention of the public policies of competition in commerce and freedom to work.

[8] The Court then found that the employer in the proceeding had an arguable case of breach of cl 7.2 of the employment agreement which will be set out later in this judgment.

[9] So, in essence, the questions for decision now are:

- The interpretation of cl 7.1 and, in particular, whether it purports to prohibit competition in business or other economic activity; and
- if so, whether this is enforceable under the New Zealand common law of employment.

[10] The validity of cl 7.1 of the employment agreements cannot be determined in isolation of other relevant provisions of those employment agreements and, in particular, other covenants in restraint of trade or other economic activity which are

not challenged as to their lawfulness in the same way as cl 7.1. These other relevant provisions include, under the same heading, “COVENANT NOT TO COMPETE”, a prohibition on what might be described broadly as dealing with Transpacific’s customers, cl 7.2. This provides:

7.2 During the term of your employment with us and for the periods and areas set out in Schedule C following the termination of employment you shall not (except on behalf of or with the prior written consent of the Employer, which will not unreasonably be withheld), either directly or indirectly on your behalf or on behalf of others:

- Solicit, divert, appropriate to or accept on behalf of any competing business; or
- Attempt to solicit, divert, appropriate to or accept on behalf of any competing business,

any business from a customer or actively sought prospective customer of the Employer with whom you have dealt, whose dealing with us you have supervised or about whom you have acquired confidential information in the course of employment.

[11] Next, the employment agreements contain a restraint on solicitation of other employees of Transpacific (cl 7.3) as follows:

7.3 During the term of your employment by us, and at any time following the termination of employment, you shall not (except with our prior written consent) either directly or indirectly, on your behalf or on behalf of others, solicit, divert or hire, or attempt to solicit, divert or hire any person employed by us.

[12] Clause 7.4 provides:

7.4 You acknowledge that the above restrictions are reasonable for the following reasons:

7.4.1 The periods, and areas, specified are appropriate to the nature and/or seniority of your position with us.

7.4.2 In respect of Clause 7.1, your knowledge and skills are easily transferable to positions with companies that do not compete with us.

[13] Clause 7.5 provides:

7.5 Since we may suffer immediate and irreparable injury if you breach the above restrictions, we reserve the right to seek injunctive relief against you, besides our other legal rights.

[14] Also relevant is cl 5.4 (under the heading “SCOPE OF EMPLOYMENT”) which provides:

5.4 You shall not within the terms of this employment establish yourself or engage in private business or undertake other employment in competition with Transpacific Industries or which in any way conflicts with Transpacific Industries’ business or restricts your ability to carry out the duties of your position without the written consent of the Managing Director, Transpacific Industries Group (NZ) Ltd.

[15] There is no argument that the general prohibition upon competitive activity in cl 5.4 is subject to the more specific provisions of cl 7 and there is no question raised in this case about the validity of the prohibition contained within cl 5.4 against competitive economic activity whilst employed by Transpacific.

Factual findings

[16] Transpacific’s individual employment agreements are generic in the sense that they apply to all relevant employees with the details relating to individual employees set out in individualised schedules to each agreement. Schedule C, which is referred to in cl 7, provided, in the case of Mr Harris, that the relevant area of the restraint was “Auckland Region” and the period was three months. In Mr Green’s employment agreement the relevant area was “New Zealand, North Island” and the period was three months. The effective period of restraint in each case may in fact have been up to four months because they applied not from the date of giving notice of termination but from the last day of that notice period.

[17] At the time of the entering into of the employment agreement with Mr Green (undated but said to have come into effect from 19 April 2010), his position was described “Business Development Manager Auckland”, his annual remuneration was \$120,000 and he reported to “Sales Manager Auckland”, Gary Richardson. Mr Green’s remuneration included the personal use of a company vehicle and his employment agreement was terminable on one month’s notice in all circumstances.

[18] Clause 2.1.2 of the agreement, which deals with the schedules attached to the agreement, refers to “*Schedule D, which contains your business description and scope of responsibilities*”. Schedule D was left blank.

[19] In the case of Mr Harris, his employment agreement was entered into mid-May 2010 and provided for a commencement date of employment of 14 June 2010. His position was “Business Development Manager – SME” (Small and Medium Enterprises) and he, too, reported to “Auckland Sales Manager”. Mr Harris’s annual remuneration was \$55,000 together with perquisites including personal use of a company car. His employment agreement was also terminable on one month’s notice in any circumstances. As in the case of Mr Green, Schedule D which should have contained the position description, was similarly blank.

[20] Mr Green was employed to manage the new business team, a new role. He had previously worked for a competitor of the plaintiff, EnviroWaste. The new team comprised three business development representatives and Mr Green was also responsible for securing new “large business” accounts.

[21] There was a large body of evidence from Mr Green and Dean Brown, the plaintiff’s Northern Regional Manager, as to the work performed by Mr Green, but we do not propose to set this out as it is not relevant to considering the reasonableness of the clause at the time it was entered into.

[22] Mr Green resigned from his employment with the plaintiff on 16 November 2010 and was placed on garden leave. He subsequently took up employment with SEL as its Northern Regional Manager. SEL is a competitor of the plaintiff but is a much smaller company that can offer a limited range of collection services. By contrast, on Mr Brown’s evidence, the plaintiff is one of the leading providers of comprehensive waste and environmental services in Australia and New Zealand and covers a wide range of services including solid waste collection, solid waste recycling, and the operation of transfer stations and landfills and recycling. The industry is extremely competitive and is particularly aggressive in the Auckland region where the majority of new entrants into the market first seek to establish themselves.

[23] Mr Harris has a work background in sales of products or services for businesses. Immediately before joining the plaintiff he worked for another company known as Remondis Metro Waste (formerly known as Metro Waste) and before that he was a sales representative for a coffee company. Mr Harris did not apply for an advertised job with Transpacific. Through an industry contact, he talked to Transpacific's sales manager and was offered a position. His base salary at Transpacific was higher than that which he had received at Remondis and the prospect of higher commission earnings with Transpacific was also held out to him. Although Mr Harris's employment agreement made no express provision for commission or other earnings above his base salary of \$55,000 per year, he did receive commission payments (albeit quite modest ones) on sales made by him. If a new customer was provided with one service by Transpacific, Mr Harris's commission was \$40 with a maximum of \$80 per new customer after the provision of two services.

[24] His employment agreement described Mr Harris's position as "Business Development Manager – SME". This was also a new role. Mr Harris reported to Mr Green. However, in reality Mr Harris was engaged to generate new customers (that is, to make sales) among small and medium sized enterprises in the Auckland area. Although sales and business development strategies were applied to his work and, to an appropriate extent, information about them was conveyed to him, Mr Harris was not involved in the development of those strategies. He compiled information about businesses on whom he "cold called", some, but not all, of which information he retained in his own records for the purpose of following up prospective leads. Mr Harris resigned from his employment on 8 March 2011.

Clause 7.1 interpreted

[25] Identifying the parties' rights and obligations under the clause is the first step in determining its lawfulness. It must be interpreted in light of the scheme of the agreement and of other relevant provisions in it.

[26] We agree with Mr Harrison that cl 7.1 is ambiguous, not only when read in isolation but, more particularly, when read in the context of other relevant provisions

in the agreement. It is not insignificant that the plaintiff's request to the Court to modify cl 7.1 addresses some of those ambiguities.

[27] Although, analysed sentence by sentence, it is possible to say, as the plaintiff would have it, that the first two sentences are non-operative, background or contextual provisions, read purposively they can more readily be interpreted and applied as operative and substantive provisions which determine when the subsequent operative provisions are engaged. The plaintiff's interpretation is strained.

[28] We interpret the first two sentences in cl 7.1 as setting out the circumstances in which the restraint will apply. Each sentence used the word "may" to take account of the possibility that the events described in them might occur although not necessarily from the outset of employment. This allowed for change of the employees' working circumstances over time. The first qualifying factor (set out in the first sentence) acknowledged that the employees might perform services of characters that were described as "special, unique, unusual, extraordinary and intellectual". We do not consider that the description of services as "intellectual" can be read literally because certainly much, if not all, of the work to be undertaken by each of the employees from the outset was intellectual in the sense that it was the application of mental effort as distinct, for example, from physical effort or manual labour. Although poorly drafted, we conclude that the reference to "intellectual" meant services that concerned the employer's intellectual property. The first sentence contemplates a change from the initial nature of the employees' work which would allow potentially for the imposition of a restraint in the future if those qualifying circumstances came about.

[29] The second qualifying factor is in the second sentence of cl 7.1. Again, by the use of "may", the sentence contemplates the possibility of serious injury to the employer by the application, for the benefit of a competitor, of "the knowledge and skills acquired during ... employment ...". It is now accepted by the plaintiff as a matter of law² that the use of the employees' "skills acquired during [their]

² See for example Lord Parker in *Herbert Morris Ltd v Saxelby* [1916] AC 688 at 709.

employment” cannot be restrained and that their “knowledge ... acquired during [their] employment” must be defined more narrowly than set out in cl 7.1.

[30] The prohibition upon competitive work in the third sentence of cl 7.1 was intended to be triggered by the accumulation of the occurrences in the first and second sentences. So, for example, the employees would be restrained from competitive work if they were engaged in services of an extraordinary nature and the knowledge of the plaintiff’s business so acquired (including knowledge of confidential information) may have caused serious injury to the plaintiff if applied for the benefit of a competitor.

[31] The plaintiff also accepted that it was arguable that on one construction of cl 7.1, the definition of a “competitor”, will prevent departing employees from working for a new employer that might provide services similar to Transpacific, when those services were not similar to, or competitive with, the services in which the employees were involved while they were working for Transpacific. Although Mr Langton would have preferred us to accept an interpretation of that clause which limited the restraint to a competitor that provided services of a similar nature to those in which the employees were involved while working for Transpacific, we consider the plain words carry the wider meaning.

Proposed modification under s 8 of the Illegal Contracts Act 1970

[32] In opening the plaintiff’s case, counsel Mr Langton proposed some changes that the Court should make to cl 7.1 pursuant to s 8 of the Illegal Contracts Act 1970, which provides:

8 Restraints of trade

- (1) Where any provision of any contract constitutes an unreasonable restraint of trade, the court may—
 - (a) delete the provision and give effect to the contract as so amended; or
 - (b) so modify the provision that at the time the contract was entered into the provision as modified would have been reasonable, and give effect to the contract as so modified; or

- (c) where the deletion or modification of the provision would so alter the bargain between the parties that it would be unreasonable to allow the contract to stand, decline to enforce the contract.
- (2) The court may modify a provision under paragraph (b) of subsection (1), notwithstanding that the modification cannot be effected by the deletion of words from the provision.

[33] We did not understand this to be a final fall-back position for the plaintiff put forward only in the event that the Court might be inclined to strike out cl 7.1 completely. Rather, we understood counsel to accept that, in some respects, the clause cannot survive reasonably and lawfully as written.³

[34] Three modifications of clause 7.1 are sought by the plaintiff:

- (a) Severance of the word “skills” from the clause. Mr Langton accepted that the plaintiff cannot restrain the employees from subsequently using such skills as they may have acquired during their employment with the plaintiff.
- (b) Limitation of the word “knowledge”, in the second sentence of cl 7.1, so as only to include knowledge of confidential information or other equivalent information covered by the confidentiality covenant in cl 6 of the agreements.
- (c) Limitation of the definition of “competitor” so that it only includes those businesses or organisations that offer services that are competitive with the services offered by the plaintiff and in which services the employees have been involved during their employment with the plaintiff. Mr Langton submitted that the parties reasonably contemplated a competitor to be one who provides waste management services to its customers, as that was the business in which Messrs Green and Harris had been involved in the past and in which they remained involved when they joined the plaintiff.

³ See para 9 of counsel’s written opening submissions and final submissions.

[35] As will be seen from our analysis and interpretation of cl 7.1, only the third proposed modification addresses the substance or operative part of the restraint by narrowing the definition of a “competitor” with whom the employee can be involved during the restraint period.

The issues in the case

[36] These are very narrow. There is no challenge to the existence of consideration for the restraints. There is no argument with their duration or with their geographic limitations. Nor, so far as we are aware, is there any indication that the more specific restraints in the contract are challenged as to their fundamental lawfulness, as is cl 7.1. So, in essence, the question is whether a clause that prohibits working for a competitor for a period of three months following the end of employment (which may, in practical circumstances, be a period of four months from the giving of notice of intention to end employment), is lawful.

[37] Despite what one might think from reviewing recent cases in this and similar jurisdictions that the presumption of voidness of restraint covenants has slipped out of favour with courts, that is still the position, at least in New Zealand employment law. The most recent and most authoritative statements on the issue are contained in cases such as *Gallagher Group Ltd v Walley*⁴ and *Fletcher Aluminium Ltd v O’Sullivan*.⁵

[38] In *Gallagher Group* the Court of Appeal re-stated this proposition⁶ as follows:

... Covenants restricting the activities of employees after termination of their employment are, as a matter of legal policy, regarded as unenforceable unless they can be justified as reasonably necessary to protect proprietary interests of the former employer and in the public interest: *Mason v Provident Clothing & Supply Co Ltd* [1913] AC 724, 733.

[39] In *Fletcher Aluminium* the Court of Appeal did not disagree with the approach used by this Court when, at [15], the Court of Appeal noted:

⁴ [1999] 1 ERNZ 490 (CA).

⁵ [2001] 2 NZLR 731, [2001] ERNZ 46 (CA). See also *Skids Programme Management Ltd v McNeill* [2012] NZCA 314, [2013] 1 NZLR 1 at [36].

⁶ At [20].

The Judge then referred to the law. He noted that it was common ground that the restraint was unenforceable unless the company established its reasonableness from the point of view of the employer, the employee, and the general public. He noted that reasonableness must be determined at the time the covenant was entered into, and referred to the recent decision of this Court in *Gallagher Group Ltd v Walley* ... He referred to the need to consider what the parties might reasonably have foreseen at the time of entering into the contract. No issue is taken with that approach.

[40] This was somewhat different from the way in which Mr Langton developed his final submissions on the law. He contended that the Court's role is to balance competing public interests between the public policy against restraining competition (and we add the freedom to work), on the one hand, with what he described as the powerful public policy interests the former employer has in protecting its proprietary interests if it wants to share its confidential information with its staff and in conducting its business affairs competitively, on the other. That approach is inconsistent with the law as confirmed by the Court of Appeal.

[41] It was common ground that the onus was on the plaintiff to establish that cl 7.1 was enforceable and reasonable at the time the parties entered into the employment agreements and it must also show that the clause was reasonable in the interests of the contracting parties and the public interest.

[42] As the law does not allow a restraint to prevent an employee from competing with a former employer or to prevent the employee using skills, experience, general knowledge and know how, the clause as presently drafted on our interpretation is unenforceable without modification. It refers to "skills" being transferred to the competitor and its use of the word "knowledge" is far too wide. Not all knowledge acquired can be capable of upholding a restraint covenant, general knowledge in particular. The definition of competitor is also wider than is reasonably necessary.

[43] As Mr Langton submitted, in determining whether to uphold the covenant, the Court must decide whether it was necessary at the time the agreements were entered into, to protect some legitimate business or proprietary interests which required protection in relation to the employees employed.

[44] Once the existence of a legitimate protectable interest has been established the restraint must be shown to be no wider than is reasonably necessary to protect that interest.

[45] Mr Langton submitted that the covenants in cl 7.1, properly construed and as should be modified, were designed to protect the plaintiff's legitimate interests in its confidential information and other equivalent proprietary information and that the covenant extended, when modified, no further than was reasonably necessary to protect those interests.⁷

[46] Mr Langton submitted that when the parties entered into the employment agreements it was reasonably contemplated by them all that Messrs Green and Harris would be exposed to the plaintiff's confidential information, as defined in cl 6, in the course of their employment. Clause 6 talks in terms of access to confidential information and does not expressly state that the employers must use that information for it to be protectable. Mr Langton submitted that not all the confidential information as defined in the employment agreements was necessarily truly confidential and in the nature of, or equivalent to, a trade secret. He relied on the distinctions drawn by the English High Court judgment in *Faccenda Chicken Ltd v Fowler and ors.*⁸ Goulding J (at first instance) there defined confidential information acquired by an employee in the course of service and not subject to any relevant express agreement⁹ as falling into three classes:¹⁰

First there is information which, because of its trivial character or its easy accessibility from public sources of information, cannot be regarded by reasonable persons or by the law as confidential at all. The servant is at liberty to impart it during his service or afterwards to anyone he pleases, even his master's competitor. ...

Second, there is information which the servant must treat as confidential, either because he is expressly told it is confidential, or because from its character it obviously is so, but which once learned necessarily remains in the servant's head and becomes part of his own skill and knowledge applied in the course of his master's business. So long as the employment continues, he cannot otherwise use or disclose such information without infidelity and

⁷ See *FSS Travel and Leisure Systems Ltd v Johnson* [1998] IRLR 382; *TFS Derivatives Ltd v Morgan* [2004] EWHC 3181 (QB); and *Dyson Technology Ltd v Strutt* [2005] EWHC 2814.

⁸ [1985] 1 All ER 724.

⁹ *Faccenda* was not a case about enforcing a restraint but was a damages claim based on an alleged breach of a contract of employment and for conspiracy to injure by abuse of confidential information.

¹⁰ At 731-732.

therefore breach of contract. But when he is no longer in the same service, the law allows him to use his full skill and knowledge for his own benefit in competition with his former master... If an employer wants to protect information of this kind, he can do so by an express stipulation restraining the servant from competing with him (within reasonable limits of time and space) after the termination of his employment. ...

Third, however, there are, to my mind, specific trade secrets so confidential that, even though they may necessarily have been learned by heart and even though the servant may have left the service, they cannot lawfully be used for anyone's benefit but the master's. ...

[47] The Court of Appeal in *Faccenda Chicken*¹¹ disagreed with the passage in Goulding J's judgment where he suggested that an employer can protect the use of information in his second category by means of a restrictive covenant even though it does not include a trade secret or its equivalent. The Court of Appeal cited the *Herbert Morris* case, which stated that a restrictive covenant will not be enforced unless the protection sought is reasonably necessary to protect a trade secret, or to protect some personal influence over customers being pursued, in order to entice them away. The Court of Appeal in *Faccenda* observed that it was impossible to provide a list of matters which would qualify as trade secrets, or their equivalent, which could be protected by way of restrictive covenants. Neill LJ, delivering the judgment, stated:¹²

... Secret processes of manufacture provide obvious examples, but innumerable other pieces of information are *capable* of being trade secrets, though the secrecy of some information may be only short-lived. In addition, the fact that the circulation of certain information is restricted to a limited number of individuals may throw light on the status of the information and its degree of confidentiality. (c) Whether the employer impressed on the employee the confidentiality of the information. Thus, though an employer cannot prevent the use or disclosure *merely* by telling the employee that certain information is confidential, the attitude of the employer towards the information provides evidence which may assist in determining whether or not the information can properly be regarded as a trade secret... (d) Whether the relevant information can be easily isolated from other information which the employee is free to use or disclose.

[48] Mr Langton argued for two legitimate interests for the plaintiff; the category three *Faccenda* confidential information and some category two *Faccenda* information, the equivalent of a trade secret. Mr Langton cited three cases of the

¹¹ [1986] 1 All ER 617, [1986] ICR 297.

¹² At 311.

Employment Court which he contended were on all fours with the approach taken by the English Courts in similar matters.

[49] The first was the judgment of Judge Colgan in *Television New Zealand v Bradley*.¹³ Interim injunctions were granted restraining Mr Bradley from being employed as a marketing executive by a competitor where it was alleged he had intimate knowledge of the confidential information pertaining to advertising, future programming schedules and volume incentive discount agreements TV3 had entered into with its customers.

[50] The second was *Allright v Canon New Zealand Ltd*¹⁴ in which Judge Couch upheld a restrictive covenant restraining Mr Allright from working for a competitor for a period of three months, where the agreement also contained an express confidentiality clause. Mr Allright had received reports on his former employer's strategy and tactics and had a detailed knowledge of its strategic and financial affairs. Judge Couch found this met the test of legitimate interest, which was conceded by the employee.

[51] The third case was that of Judge Inglis in *Warmington and O'Neill v AFFCO New Zealand Ltd*¹⁵ in which a non-competition restraint was held to be reasonably necessary to protect the employer's proprietary interests. Both former employees had been plant managers, had restrictive covenants in their employment agreements and left to take up work with a competitor. It was argued that there was a proprietary interest in confidential reports they received, which could have been used by the competitor against which to benchmark its own performance. It was accepted by Judge Inglis that *AFFCO* had a strong proprietary interest in confidential and commercially sensitive information which would not normally be available to a competitor. Judge Inglis also referred to the difficulties associated with inadvertent disclosure of confidential information,¹⁶ citing a passage from *Littlewoods Organisation Limited v Harris*¹⁷ where the English Court of Appeal stated:¹⁸

¹³ AEC 14/95, 10 March 1995.

¹⁴ [2008] 6 NZELR 367.

¹⁵ [2012] NZEmpC 19, (2012) 9 NZELR 287.

¹⁶ At [72].

¹⁷ [1978] 1 All ER 1026.

¹⁸ At 1033.

It is thus established that an employer can stipulate for protection against having his confidential information passed on to a rival in trade. But experience has shown that it is not satisfactory to have simply a covenant against disclosing confidential information. The reason is because it is so difficult to draw the line between information which is confidential and information which is not; and it is very difficult to prove a breach when the information is of such a character that a servant can carry it away in his head. The difficulties are such that the only practicable solution is to take a covenant from the servant by which he is not to go to work for a rival in trade. Such a covenant may well be held to be reasonable if limited to a short period.

[52] The plaintiff's Northern Regional Manager, Mr Brown, provided detailed evidence of what he described as its strategic business initiatives to achieve the plaintiff's aims to both grow and maintain its share of the waste industry market. He supported his evidence by producing voluminous documents, most of which were covered by consent suppression orders so that they could not be viewed by SEL.

[53] Mr Green and particularly Mr Harris, denied having being provided with much of this material which was allegedly confidential. Mr Green accepted that he had been involved in the development of some of the strategies and was aware of the others. At the level of Mr Green and above it does appear the plaintiff had an open book approach to the dissemination of its strategic initiatives. The material provided to Mr Harris, who we have found exhibited many of the characteristics of a door to door salesman, was, we find, far more limited. However, we do accept that Mr Green and, to a lesser extent, Mr Harris, had access to confidential material, which they did not choose to use. Both had new roles with Transpacific, which they developed on their own initiatives in finding prospective customers. Some of the plaintiff's strategic initiatives, including such material as pricing guides, did assist them in the discharge of their duties.

[54] We do not intend to canvass the allegedly confidential material in any detail. This could defeat the suppression orders. We will refer to the material in a way which will be understood only by the parties. The "value proposition" strategy, the "pricing strategy" and the "project broadsheet", were provided to Mr Green expressly on a confidential basis. Mr Green confirmed in cross-examination that this information was shared with him in his involvement on the strategy groups, was not

publicly available information and would have been valuable in the hands of a competitor.

[55] We accept Mr Langton's submission that information about strategy can be especially confidential when the strategy is in its developmental stages, because during that process it will be analysed and debated, as the objectives are formulated. If competitors became aware of these strategies, it could put the plaintiff at a considerable disadvantage. Whilst we have reservations as to whether these three strategies strictly fall within the *Faccenda* third category of trade secrets, we find that they were clearly meant to be confidential to the plaintiff's employees. They had limited circulation and were equivalent to trade secrets even though the secrecy may have only been short-lived. We are of the view that they were sufficiently confidential to amount to proprietary interests capable of being legitimately protected by reasonable restraints at the time the agreements were entered into.

[56] They warranted not only covenants protecting their use by a competitor but, because of the difficulties of enforcing restraints on the use of confidential information and the possibility of the inadvertent breach of such covenants, the imposition of a reasonable non-competition restraint. We have already indicated that the restraint as drafted is not reasonable and, without modification, could not be enforced. That, we note, is precisely the view reached by Chief Judge Colgan in the earlier interlocutory application affecting Mr Green.

[57] We have more reservations about the confidentiality of the plaintiff's pricing lists and its information relating to its customers. Most of that material is easily ascertained in practice by a competitor from the customers themselves and therefore we doubt that it is the equivalent of a trade secret.

[58] We also have reservations whether cl 7.1 as a whole was intended to protect the confidential information, as defined, or rather to make it difficult for competitors to solicit or gain the use of valuable employees of the plaintiff. We found a clue to the answer in Mr Harrison's cross-examination of Mr Brown. He referred Mr Brown to a third employee who left the plaintiff to go to SEL. The plaintiff had made no attempts to enforce the non-competition restraint in that person's agreement. Mr

Brown said there was an agreement on the parting of the ways as that employee, who we will not name, “was more probably a liability rather than an asset...”.

[59] Although not going so far as to say that this was the, or a, motivation of Transpacific in formulating the clause, this evidence indicates the company’s preparedness to enforce it on a case by case basis including by reference to whether it is happy to see the back of an employee and, therefore, for the employee to leave and go to a competitor. The corollary of this is that if the plaintiff sees the employee as valuable, it will endeavour to enforce the covenant. That ability for the employer to so use cl 7.1, or not, depending upon its perception of risk to it on a case by case basis, and its preparedness to do so, is relevant to the exercise of the discretion to modify the clause which we deal with next.

Is this a case for modification?

[60] Mr Langton referred to the ‘blue pencil’ test under English law for the severance of objectionable parts of unlawful restraints. We did not find that test helpful in the present case because the first criterion in the common law test is that the unenforceable provision must be capable of being removed without the necessity of modifying or adding to the wording of what remains.¹⁹ This case applied the three part test laid down in *Sadler v Imperial Life Assurance Company of Canada Ltd.*²⁰

[61] In New Zealand s 8 of the Illegal Contracts Act 1970 allows for both deletion and modification, notwithstanding that the modification cannot be effected by the deletion of the words from the provision.²¹ The discretion in s 8 may be exercised to modify the provision so that the provision modified would have been reasonable at the time the contract was entered into.²² Thus there is no question that the Court has the jurisdiction to both delete provisions such as the word “skills” and modify the meaning of “knowledge” and the definition of “competitor” as sought by the plaintiff, even if this requires considerable redrafting of the covenant.

¹⁹ See *TFS Derivatives Ltd v Morgan* [2004] EWHC 3181 (QB).

²⁰ [1988] IRLR 388 (QB).

²¹ Section 8(2).

²² Section 8(1)(b).

[62] There has been little guidance from the higher courts as to how the power contained in s 8 is to be applied. We consider it is clearly a discretionary power and that appears from the word “may” in s 8(1). This is a view endorsed by the full Court of the High Court in *C E Elley Ltd v Burgess*²³ where the High Court stated:²⁴

In *H. and R. Block Limited v. Sanott and Another* [1976] 1 NZLR 213, Somers J. treated the jurisdiction as being completely discretionary and the Judge considered the appropriateness or otherwise of modification having regard to the circumstances. In *Greenwich v. Murray and Stewart* [1977] 1 NZIPR 181, Barker J. was not prepared to accept on an interim application, that it was appropriate to express any view as to the extent to which the particular covenant could be altered by the operation of s.8 of the Illegal Contracts Act. The effect of the cases is to emphasise the discretionary nature of the jurisdiction and we think that the intervention of the Court will depend in every case on an assessment of the circumstances which are proved. We do not accept that there is a presumption that the Court will modify the covenant as distinct from the other courses open to it, rather each case must be considered in relation to the relevant circumstances and the emphasis which it is appropriate to place on each of these in considering the matter as a whole.

[63] We accept and endorse that approach.

[64] As to the meaning of “modify”, the Court of Appeal in *Welsh v Cooney*²⁵ stated:

Section 8(1)(b) has the term “modify”. This can mean moderate or limit or confine; but it can also simply mean vary or change in part. As a matter of jurisdiction we see no reason why it should not bear the latter and broader meaning, but no doubt normally the Court will be slow to alter any part of a covenant so as to make it more restrictive on the employee. Nevertheless there may be cases where that is appropriate, particularly when accompanied by other changes which make the revised covenant as a whole less onerous for the employee. That is how the Judge saw this case.

[65] Mr Langton submitted that the modifications the plaintiff sought would not alter the bargain between the parties. Mr Harrison contended that they would and that the modifications sought would change the meaning of cl 7.1. He submitted that the changes sought by the plaintiff would change it from a clause which gives as its justification for preventing the employee taking up employment with a competitor on the grounds of his knowledge and skills acquired during his employment with the

²³ AP 101/96, 9 May 1997, Gallen J presiding, Gendall J.

²⁴ At 9.

²⁵ [1993] 1 ERNZ 407 at 410.

plaintiff, to one justifying the prohibition on the grounds of maintenance of confidential information, acquired during employment, said to belong to the employer. He also relied on the earlier judgment of this Court affecting Mr Green which concluded that cl 7.1 was arguably void in contravention of the public policies of competition in commerce and freedom to work.

[66] We find Mr Harrison's submissions are supported by the views of the learned authors of *Mazengarb's Employment Law (NZ)*. They noted that it has been suggested that it would be against public policy if the Court employed its ingenuity to carve out of a void covenant, the maximum that might have been stipulated for. To similar effect Somers J stated in *H & R Block*: "I do not think the court can be used as a draftsman".²⁶ In a valuable passage the learned authors of *Mazengarb* stated:²⁷

The ability of the Authority or the Court to vary an employment agreement under s 8 of the 1970 Act is constrained also by provisions of the ER Act itself. These provisions reflect the emphasis on mediation in good faith that underpins the ER Act. Under s 164 of the ER Act, an order to vary an individual employment agreement or any term of such an agreement may only be made if four conditions are satisfied. First, the Authority must have identified the problem in relation to the agreement and directed the parties to attempt in good faith to resolve that problem. Second, the parties must have attempted to resolve the problem in good faith by using mediation. Third, despite the use of mediation, the problem must remain unresolved. Fourth, the Authority must be satisfied that any remedy other than an order varying the agreement would be inappropriate or inadequate. The same constraints apply to the Court under s 190 of the ER Act.

These provisions replace a much stricter constraint on the Employment Court under s 104(2) of the now-repealed EC Act. Under that provision, the Court was permitted to vary contracts only if satisfied beyond a reasonable doubt that such an order should be made and that any other remedy would be inappropriate or inadequate. This application of the evidentiary burden applicable to the prosecution in criminal proceedings to the Court's exercise of its discretion in civil proceedings was little short of bizarre and gave rise to significant problems in practice.

Once a modification has been effected under s 8, the Court may award damages on the basis that the modification relates back to the date of the execution of the contract.

[67] The limitations referred to in the quotation above, and which apply to the Court by virtue of s 190 of the Act, were not addressed by the parties. We note that

²⁶ At 19.

²⁷ *Mazengarb's Employment Law* (online looseleaf ed, LexisNexis) at [1038A].

the limitations on the Employment Relations Authority under s 164, and also on the Court by virtue of s 190, expressly relate to orders made under the Illegal Contracts Act 1970, because of the reference to s 162 in s 164 which provides:

164 Application to individual employment agreements of law relating to contracts

Where the Authority, has, under section 69(1)(b) or section 162, the power to make an order cancelling or varying an individual employment agreement or any term of such an agreement, the Authority may make such an order only if—

- (a) the Authority (whether or not it gave any direction under section 159(1)(b) in relation to the matter)—
 - (i) has identified the problem in relation to the agreement; and
 - (ii) has directed the parties to attempt in good faith to resolve that problem; and
- (b) the parties have attempted in good faith to resolve the problem relating to the agreement by using mediation; and
- (c) despite the use of mediation, the problem has not been resolved; and
- (d) the Authority is satisfied that any remedy other than such an order would be inappropriate or inadequate.

[68] We are not aware of any attempts to resolve the differences between the parties by the process contemplated in s 164, nor does it appear has there been a direction to mediation from either the Authority or the Court. Had we decided to modify cl 7.1 as the plaintiff sought, s 164 may have been an insurmountable hurdle.

[69] We note also that if the modifications sought by the plaintiff were granted, this would have had the retrospective effect of allowing the Court to award damages on the basis that the modifications date back to the date of execution of the contract. A court would have to exercise great caution before making a party liable for damages by modifying under s 8 in circumstances where there would have been no liability without subsequent modification.

[70] We exercise our discretion under s 8 not to modify cl 7.1 for the following reasons:

- (a) The plaintiff seeks a substantial redrafting of the clause in order to achieve the result of making the covenant binding and enforceable. That would, however, as Mr Harrison submitted, change the expressed reasons for the restraint.
- (b) We are troubled by the underlying concern we have about the true nature and consequence of the covenant in cl 7.1 referred to above. We have a real concern, based on evidence, that it may not have been solely for the purpose, now advanced, to protect confidential information but may also be used in some cases to deprive competitors of valued employees.
- (c) There is the added difficulty that although the Court may have been persuaded to modify the clause in the manner the plaintiff now seeks, by the application of s 164 at the time when its enforceability was still in issue (perhaps during the garden leave and within the three month currency), this apparently was not done. This led to the Chief Judge's decision which found that cl 7.1 was not, on its face, enforceable.
- (d) SEL acted on the Chief Judge's decision which stated:²⁸

The need for a decision of this challenge is as urgent as was the need for its hearing. I therefore intend to deal with the relevant issues relatively briefly in this judgment so that the parties, and Mr Green's new employer, know where they stand for the future.

- (e) We accept the evidence of Mr Christian of SEL that when it came to the employment of Mr Harris, he was satisfied that because of the result in the injunction case against Mr Green, the covenant not to work for a competitor for three months was not enforceable and therefore there was no legal impediment to his company employing Mr Harris.

²⁸ At [4].

- (f) If the clause is now modified, many months after the time Mr Harris was employed, it will have the effect of opening Messrs Green and Harris and SEL to claims which would not have been available at the time if the clause had remained in its unmodified form.
- (g) In determining whether to modify cl 7.1 this Court will also be guided by its equity and good conscience jurisdiction under s 189(1) of the Act. We are not persuaded, in these circumstances, that to now modify the covenant in order to render the defendants open to remedies which would not have been available if the clause had remained in its original form, would be a proper exercise of equity and good conscience.
- (h) It is most likely that had a timely application for modification been made under s 164, the plaintiff's proprietary interest in protecting its confidential information would have justified the alteration of the clause in the reasonable manner the plaintiff now seeks.

[71] For the reasons we have given, we decline to exercise our discretion under s 8 of the Illegal Contracts Act 1970 to modify cl 7.1. The clause as it stands is unenforceable.

[72] If there are any remaining issues between the parties, these may now proceed to trial before a single Judge. A directions conference should be arranged by the Registrar for this purpose.

[73] Costs are reserved. Any application may be made by memorandum within one month with the respondent thereto having a month within which to respond by memorandum.

B S Travis
Judge
for the Full Court

Judgment signed at 2.30 pm on Friday 31 May 2013