cullings

LATEST ISSUE

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Restraint of trade – protecting your business

Protecting your valuable business secrets, intellectual property, and clients as an employer may be one of the most important steps you can take in ensuring the commercial success of your business.

At the outset employers do not have any protection after the employment relationship ends, as restraint of trade clauses are, in principle, illegal in New Zealand. However, if the employer has a legitimate **proprietary interest** and the restraint is **reasonable** then they are enforceable.

Whether or not a restraint of trade clause is enforceable is a question that a court may ultimately have to decide. This is why it is so important for an employer to turn its "mind" to what it may need to protect and what may be reasonable in the circumstances before the employment relationship even starts. It is also something that should be reviewed as the employment relationship evolves (for example, when an employee gets promoted and gets more responsibility).

A recent case in the Employment Relations Authority canvasses some of these issues.

Design Engineering v Kearins

Design Engineering is an engineering specialist consulting firm based in Timaru. As part of its design services it provides structural steel detailing. Steel detailing is a specialist skill. It involves preparing detailed working drawings of prefabricated building components. Before 2009, Design Engineering was the only employer of steel detailers in the Timaru region.

Warwick Kearins was employed by Design Engineering as a steel detailer from 2001 until 2009. His work initially consisted of a range of tasks but from July 2003 until December 2009, he worked in steel detailing exclusively.

On 14 December 2009 Mr Kearins applied for annual leave from 24 December 2009 until 11 January 2010.

On 15 December 2009 Mr Kearins incorporated his own company — Aoraki Detailing Service Limited. Its registered office was in Timaru. The purpose of the new company is to provide structural steel detailing and services in direct competition with Design Engineering.

On 23 December 2009, the day before Design Engineering closed for its Christmas break, Mr Kearins sent an email saying that "I am resigning, effective today."

Following Mr Kearins resignation Design Engineering drew Mr Kearins attention to his employment agreement signed in 2001 and the restraint of trade and non-solicitations provisions it contained. Early in the new year Design Engineering became aware that a significant client had engaged Mr Kearins through Aoraki Detailing for detailing services in Timaru. A majority of the work Mr Kearins had done for Design Engineering was for this client.

Design Engineering also became aware that confidential information about its prices was possibly being used to its disadvantage by Mr Kearins. He had contracted with the significant client to provide services to them after their Design Engineering contract had expired, for approximately half the rate charged by Design Engineering.

Design Engineering wrote to Mr Kearins following a previous discussion and asked that he cease trading due to the restraint of trade provisions and non-solicitation provisions of his employment agreement. Mr Kearins response

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was that he had resigned from Design Engineering in 2002 and when he returned in 2003 he did not have a written employment agreement. He argued that there were no restrictive covenants that were enforceable.

The decision

The Employment Relations Authority first looked at whether there had been a resignation and re-employment in 2002–2003. On that point it found that there was no written notice of resignation and the company's payroll records did not show a termination report. The 2001 agreement was also referred to in performance reviews in following years. There was a range of other evidence to show that there had been no period of resignation. There had simply been an extended period of leave under the flexible work arrangement that existed. The Authority determined that employment agreement entered into in 2001 still applied in 2009.

The second point was whether the restraint of trade clause was reasonable. The Authority said that the reasonableness of the restraint will usually be judged at the time of its making. However, things that the employee did and learned throughout the course of the whole employment may be considered.

When Mr Kearins had started work he was doing a range of things - not just detailing. At the time of signing the employment agreement the parties had not discussed the restraint of trade clause.

The Authority said a restraint covenant may be reasonable if the nature of the (Mr Kearin's) employment was such that customers would learn to rely on his skill and judgement, or if the client dealt with him to the virtual exclusion of the employer, giving him influence over the client.

In this case Mr Kearin did conduct a significant amount of work with the client and did become known by it as a good detailer. He worked fairly autonomously. It was not Mr Kearins role to bring in work or sell his skills, rather it was to do the work he was asked to do. There was no evidence Mr Kearin had significant training from Design Engineering. The Authority considered that a **proprietary interest** did not arise just because Mr Kearins was good at his job and that even though he did have some influence over the client it was not to the extent that it was to the virtual exclusion of the employer.

The Authority did conclude that the only proprietary interest Design Engineering had in Mr Kearins that it could have protected was that of unfair competition arising from influence he may have had over their clients. That was his ability or head start in establishing a future customer base, by virtue of having been introduced to and performing work for Design Engineering clients.

The Authority found that based on previous decisions the length of 18 months of restraint in the agreement was too long. 12 months was at the upper end of the reasonableness scale. 18 was unreasonable. This was especially so in view of the two week termination period.

The geographical restriction in the clause attempted to prevent Mr Kearins from "carrying on, being connected, engaged or interested, either directly or indirectly, alone or with any other person in any capacity in any business that competes or may compete with Design Engineering within a radius of 50km from the business premises of Design Engineering".

The Authority found Mr Kearins would have to leave Timaru entirely if he were to carry on the same type of steel detailing he had undertaken since 2001. This too was unreasonable.

The Authority found that the non-solicitation clause in the agreement covered the relevant proprietary interest Design Engineering had over Mr Kearins. The restraint covenant was unreasonable, unenforceable, and not necessary. There had also been no breach of confidentiality that could be evidenced. The Authority declined to make a determination about damages and found that the restraint of trade clause should not be modified.

What this means

Employers may include restraint of trade clauses in employment agreements. The key however is to ensure that such clauses are appropriate to the employee's role and reasonable in the circumstances. There are several factors that contribute to the reasonableness test. From a legal perspective these should be taken into account in the drafting of a restraint of trade clause.