Attention is drawn to the two Orders concerning Confidentiality which are attached to this Determination

Determination Number: AA 124/01
File Number: AEA 354/01

Under the Employment Relations Act 2000

BEFORE THE EMPLOYMENT RELATIONS AUTHORITY
AUCKLAND OFFICE

BETWEEN	New Zealand Office Products Ltd (Applicant)
AND	Timothy Howard (Respondent)
REPRESENTATIVES	Robert L Towner, Counsel for Applicant Don Mackinnon, Counsel for Respondent
MEMBER OF AUTHORITY	R A Monaghan
INVESTIGATION MEETING	10 July 2001 10 August 2001
SUBMISSIONS RECEIVED	10 and 13 August 2001
DATE OF DETERMINATION	3 September 2001

DETERMINATION OF THE AUTHORITY

Employment relationship problem

New Zealand Office Products Limited ("New Zealand Office Products" or "NZOP") is a former employer of Tim Howard's. On leaving his position with NZOP, Mr Howard commenced employment with Warehouse Stationery Limited ("WSL"). New Zealand Office Products has asked the Authority to determine that a restraint of trade agreement contained in Mr Howard's individual employment agreement with NZOP is enforceable, and that it precludes him from commencing employment with WSL for six months after the termination of his employment with NZOP.

I record that, during the course of the investigation into this problem, the parties produced documents which they regarded as commercially sensitive and further to that I made two orders regarding the confidential nature of those documents. The orders are attached to this determination.

Background

Mr Howard began his employment with NZOP in June 2000 in the position of new business development manager. Some two weeks after he started his employment he was given a written document embodying the terms of his employment agreement, and asked to sign it. He noted that the document contained a restraint of trade provision and that the recruitment agency through which he was engaged had not discussed the provision with him, but he signed the contract nevertheless.

In the period up to 1 October 2000 NZOP was operating an office products distribution business within the Blue Star group of companies. On 1 October the Boise Cascade Corporation ("Boise Cascade") purchased NZOP, but this had no effect on the relevant part of Mr Howard's employment agreement. Boise Cascade regarded its main competitors in the office products

distribution business as Office Products Depot, Corporate Consumables, Corporate Express, WSL, Stationery City, and Paper Plus, although it placed less emphasis on the last two of these.

In the NZOP operation Boise Cascade focuses on the corporate and government sectors of the office supplies market - with a secondary focus on small and medium sized businesses where it also has a substantial market presence. At its most basic the NZOP operation involves storing office stationery products in the company's office products warehouses, and obtaining, filling and despatching orders for these products. The detail is more complicated than that, and involves considerations such as:

(a) Building and maintaining business connections;
(b) Maintaining clear and efficient ordering processes;
(c) Offering satisfactory and reliable delivery times;
(d) Setting prices in a way that enables the company to maximise its profitability;
(e) Ensuring quality product is available and that the product meets customers' needs;
(f) Providing follow up services; and
(g) Having the infrastructure to meet the above.

As the new business development manager, Mr Howard was in the vanguard of the sales force in the sense that he was to approach and build relationships with customers with a view to ascertaining their needs and how NZOP could meet them, manage customer proposals in consultation with other sales staff, present the proposals to customers, conduct a follow up and once the business was secured hand-over to appropriate NZOP staff. In association with this he had information about NZOP's pricing, discounting and tendering processes.

Following its purchase of NZOP Boise Cascade embarked on a restructuring which saw its director of sales, John Wafer, offering Mr Howard a promotion in the form of a new national account sales manager position in March 2001. The promotion built on Mr Howard's existing position, but elevated it to an executive management position and included added responsibilities for formulating and carrying out a business plan, having input into the company's overall strategy, and having a team of national account managers reporting to him. He was also offered an increased remuneration package. Finally he was given a new written employment agreement to sign, which he did on 10 May 2001 although he had begun his new duties in April. The agreement contained the same restraint provision as in the preceding agreement.

During April 2001 Mr Howard was becoming unhappy with the direction – or lack of direction as he perceived it – which his new position was taking. When a former NZOP employee, Greg Davey, approached Mr Howard to ask if he was interested in a position of national sales manager at WSL, where Mr Davey now worked, Mr Howard was interested. The two met and discussed the matter during the weekend of 12 and 13 May 2001, culminating in Mr Davey making a formal offer. By letter dated 14 May 2001 Mr Howard gave NZOP four weeks' notice of his resignation, nominating Friday 8 June 2001 as his final day of work. However he was asked to leave the premises immediately and completed the notice period on 'garden leave'.

The relevant restraint read as follows:

> "20.3 In consideration of BCOP [NZOP] paying the employee the agreed salary hereunder, the employee covenants and agrees that for a period of six months after the termination for whatever reason of his/her employment with BCOP he/she will not:
>
> (i) be directly or indirectly interested or concerned, whether as an employee, independent contractor, shareholder, director, consultant, partner or in any other capacity, (except as the holder of not more than 5% of the issued capital of any company whose shares are listed on a recognised stock exchange) in the

office products business in New Zealand, or those states in Australia in which the employer carries out business; and

(ii) attempt to encourage or persuade any of BCOP employees or contractors to terminate or damage their employment agreements or independent contractor agreements with BCOP.

20.4 The employee acknowledges that:

(i) the value of the remuneration package and benefits contained in this contract have been assessed and are dependent upon the employee agreeing to enter into the restraints contained in this clause; and

(ii) the restraints are fair and reasonable for the preservation of the goodwill of the businesses of the employer."

Mr Howard notionally began his employment at WSL on 15 June 2001, although his activities have been affected by the nature of various undertakings he has given in the course of the parties' efforts to resolve the present problem. Warehouse Stationery Limited also operates in the office products distribution business although its market presence is most visible in its network of retail outlets. It does, however, also operate in a small office/home office market and is moving into the small to medium enterprises market. Mr Howard's new role makes him responsible for building and managing a small to medium enterprises sales team and the development of strategies in that area.

Existence of a restraint

One of Mr Howard's defences to the company's application was to say that the restraint was not part of his employment agreement at all, because no consideration ever passed between the parties in respect of the restraint. If it was necessary for the May 2001 restraint to be supported by consideration, rather than amounting to a term in an existing agreement which was not varied, then I apply the following statements of principle to whether there was consideration:

> "On orthodox principles, an effective variation of contract requires consideration as much as the original contract [authority cited] … consideration may be found in the assumption of additional obligations or the incurring of liability to an increased detriment. But where one party undertakes additional obligations and the other is required to do no more than fulfil existing obligations, or the additional obligation is for the sole benefit of the party incurring it, there is no consideration. … There are obvious difficulties with strict insistence on such a requirement …
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> …
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> The Chief Judge said in his judgment: [the one under appeal]
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> > 'Despite the fact that the variation may superficially appear to be one-sided, the Court may be able, from the surrounding circumstances, to infer consideration (and should do so if it can). An increase in remuneration may have for its consideration a more or less clearly articulated undertaking by the employee to continue working for the employer in the meantime instead of resigning immediately to take up better paid employment elsewhere. Or there may be an abandonment of threatened strike action. Similarly a reduction in remuneration may be a result of the employer agreeing in return to refrain for a time from embarking upon retrenchment which might involve job losses or, in a collective situation, to refrain from locking out workers for the sake of securing their consent to the same or a greater reduction.'
>
> We are disposed to think that the continued performance of the contract following a variation such as a voluntary pay increase, or to the practical benefit to the employer of the employee's willingness to serve in the light of the incentive, should be seen as consideration sufficient for the change to become incorporated into the contractual terms.' (**United Food & Chemical Workers Union v Talley** [1993] 2 ERNZ 360, 376 (CA))

By the time Mr Howard came to negotiate the detail of the new position of national account sales manager, he was aware that there was a restraint of trade in his existing agreement and had done nothing about it. Moreover he received a memorandum from Mr Wafer, dated 10 April 2001, to

which the new agreement was attached. The memorandum set out Mr Wafer's understanding that the new document reflected both existing terms and conditions, and the new remuneration structure. It then asked that he be contacted if that were not the case or if there were any outstanding issues. Mr Howard did not raise any concern about the restraint. This was an opportunity for him to deny having agreed to the June 2000 restraint, or to say he was not prepared to agree to being bound by a restraint, which he did not take.

Mr Howard alleged that he felt obliged to accept the restraint, or face the alternative of not being promoted or not having a job. However Mr Wafer did nothing to cause him to feel that way, and I believe Mr Howard's view was coloured by the highly negative attitude he was taking towards Boise Cascade by then. He complained vociferously about a lack of certainty in his new position, but I believe the lack of certainty was a result of the uncertainties inherent when an organisation has been sold and is in the process of restructuring. I do not accept that his feeling that he was obliged to accept the restraint can be laid at the company's door.

Overall I conclude that, if it were necessary for the May 2001 agreement to be supported by consideration in respect of the restraint of trade, then such consideration existed. By then the possibility of a restraint was not new to Mr Howard, and at the same time he had negotiated new terms and conditions of employment which conferred on him a higher status and increased remuneration. This amounts to sufficient mutuality to conclude that the restraint was supported by consideration in the sense discussed by both the Employment Court and the Court of Appeal in the above extracts from the **Talley** case. I have been able to reach this conclusion even without referring to cl 20.4(i), which records the express agreement of the parties to the same effect.

Mr Howard has also argued that his employment agreement represented an unfair bargain in terms of s 68 of the Employment Relations Act 2000. The grounds on which he relied were that: he was not given the opportunity to obtain independent advice on the agreement; the restraint and associated consideration were not discussed with him; and he was obliged to sign the agreement containing the restraint before he received the increased remuneration associated with the national account sales manager position.

The last of these grounds can be dealt with simply. Mr Howard complained that he was told he would not receive his increased remuneration until he had signed the agreement. However the person who told him that was an employee in the company's pay office, and I am satisfied that the employee raised the matter as part of an administrative process and not as a part of any standover tactics on the employer's part. The employee concerned was not acting on any instruction from Mr Wafer intended to force Mr Howard to accept the agreement as written. He or she was merely obliged by virtue of company payroll procedures to sight a written agreement before taking action on the pay increase.

The first ground can also be dealt with simply. That ground relied on an obligation said to be contained in s 64 of the Act, which sets out employers' obligations prior to entry into an individual employment agreement when no collective agreement applies. I accept that the Employment Relations Act might make it difficult for an employer to rely on a restraint of trade provision included in an agreement in the way Mr Howard says the original restraint was included in his agreement in June 2000. However the Act does not assist Mr Howard in that respect because it was not in force in June 2000, and in any event the applicable agreement is the one negotiated during April and May 2001. The Act does not assist Mr Howard in respect of that agreement because s 64 applies to 'prospective' employees, while Mr Howard was an existing employee. Further it is relevant that, regardless of which agreement is relied on, s 64(3) provides that failure to observe the obligations contained in it does not affect the validity of the agreement concerned, rather under s 64(3) the failure renders the relevant employer liable to a penalty.

As for the existence of oppressive means, undue influence or duress, that allegation rested in part on the allegation concerning withholding of payment. I have already found that the actions of the payroll office were not taken to force Mr Howard to agree to the restraint of trade. Further I do not accept that Mr Wafer's failure to discuss the restraint with Mr Howard amounted to the exercise of oppressive means, undue influence or duress. The law sets a higher threshold before such a conclusion can be reached. I reiterate that by the time Messrs Wafer and Howard came to be discussing Mr Howard's new position, Mr Howard was aware there was a restraint of trade in his existing agreement. It was open to him to raise the matter in negotiations with Mr Wafer if he wished.

Section 68 itself sets out the circumstances in which bargaining for an individual employment agreement is unfair. Section 68(3) provides that 'individual employment agreement' includes a term or condition of an individual employment agreement – here Mr Howard's restraint of trade. The section would apply to the restraint if, at the time of bargaining for or entering into it he was induced to do so by oppressive means, undue influence or duress, or s 64 applied. I have already determined that none of these was applicable.

Enforceability of restraint

With reference to the enforceability of the restraint I take as a starting point the following statements of the applicable law, as set out by the Court of Appeal in **Gallagher Group Limited v Whalley** [1999] 1 ERNZ 490:

> "20. … 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 regarded as reasonably necessary to protect proprietary interests of the former employer and in the public interest [authority cited]
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> 21. Whether a clause is in its particular circumstances reasonable and thus valid and enforceable is fundamentally a question of law but that can be answered only upon a consideration of the factual setting.
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> …
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> 23. The law is clear however that the reasonableness of a restraint clause is to be determined at the time the contract was entered into [authorities cited]. Similarly under s 8 Illegal Contracts Act the power to modify a covenant is expressly related to that which would have been reasonable at the time the contract was entered into."

The court also referred to the onus being on the appellant to show that the restraint was reasonable.

There are numerous examples of cases in which the reasonableness of a restraint have been assessed with reference to the various aspects of the restraint in question, particularly the geographical scope, the duration, and the nature of the activities to which the restraint purportedly applies. One such example, cited in submissions, was a decision of the Employment Court in **Cain v Turners and Growers Fresh Limited** [1998] 2 ERNZ 314.

I set out the following extract from the **Turners and Growers** decision because it also constitutes guidance as to what can be done when a restraint is found not to be reasonable. It addresses the powers available under the Illegal Contracts Act 1970 which are made available to the Authority under s 162 of the Employment Relations Act:

> "As is common ground, a covenant in restraint of trade is void and unenforceable unless proved to be reasonable. If it is not proved to be reasonable it renders the entire contract illegal, not just the particular provision that is objected to. This is because s 3 of the Illegal Contracts Act 1970 defines an illegal contract as including a contract which contains an illegal provision whether that provision is severable or not. Then s 6 of the Act

> provides that illegal contracts are to be of no effect and no person should become entitled to any property (defined as including money) under a disposition made by or pursuant to any such contract. This is however subject to the provisions of the Act and of any other Act. One of these is an express provision dealing with restraints of trade in s 8 giving the Court a range of options enabling it either to delete the objectionable provision, modify it so as to render it reasonable, or to decline to enforce the contract if the deletion or modification of the objectionable provision would so alter the bargain between the parties that it would be unreasonable to allow the contract to stand." (p 329 lines 8 – 22)

NZOP accepted that restraint of trade clauses in employment agreements are prima facie unlawful, but submitted that clause 20 should be upheld to the extent that Boise Cascade could show the clause was reasonably necessary for it to protect its trade secrets and trade connections. I understand these two things as identifying the nature of the proprietary interests NZOP seeks to have protected. However the evidence also suggested that NZOP claimed a proprietary interest in a broader category of confidential information and I approach the matter on that basis. I do not understand the law in New Zealand to require that confidential information, in the context of whether there is a proprietary interest capable of protection, be at the level of a trade secret before such protection can be claimed.

I begin with the restraint against working in 'the office products business' in New Zealand. On the face of the matter WSL is within that category, but that does not automatically mean it would be reasonable to restrain Mr Howard from working there. An appropriate approach is to consider the proprietary interests of NZOP's that can reasonably be protected in respect of WSL.

There was a great deal of discussion at the investigation meeting about market segmentation. That discussion was useful in highlighting the way in which the office products business operates in general, as well as for illustrating that - while some companies operate within the category of office products business - not all of them are likely to operate in such a way that a proprietary interest of NZOP's would be threatened if one of its employees went to work for one of them. Since the application in the present case is expressly concerned with WSL, then on the basis of that evidence I conclude that WSL's activities in the office products business are sufficient to amount to a threat to NZOP's proprietary interests.

Another indication I gained from the evidence overall is that NZOP's present concerns have been affected by the advent of a new owner, the perceived necessity and inevitability of organisational changes, and an associated potential for a weakening of its ability to compete fully at least in the short term. Since the validity of cl 20.3 must be determined as at the date the agreement was entered into, then the need to protect NZOP's proprietary interests with reference to the company's current circumstances was clearly in the contemplation of the parties. Mr Howard was aware of the discussions concerning the detail of those changes at a senior management level, and I accept that NZOP was entitled to protect that information.

This is not a case involving a specialised product or process – instead NZOP and its direct competitors purchase and have access to the same range of office products from the same suppliers. In general the products are made available at the same price to purchasers, although it may be that from time to time special arrangements are entered into. Thus the companies seek to distinguish themselves from each other - and maximise their profits - through the efficiency of their distribution systems and associated services, and through maintaining their trade connections. There is also scope for developing particular pricing arrangements as between NZOP and its customers.

Much of the detail which I have considered with reference to how these things are done is subject to the confidentiality orders attached to this determination. However from that information I conclude that:

(a) NZOP has a proprietary interest in information about its distribution system, for which it is entitled to seek protection. Similarly I regard as confidential information details of the business strategies underlying the system - as distinct from mere location data, ordering processes and associated material which can be obtained quite easily - as well as information identifying strengths and weaknesses as the company sees them, what can or will be done about those, and financial information about the cost of the system.

(b) NZOP has a proprietary interest in information about its pricing system, which it is also entitled to protect. Even if, in general, it purchases product at close to the same price as its competitors and is subject to the same price fluctuations, a BIS Shrapnel market report named 'the New Zealand Office Products Market 2001 – 2003' shows that consumers rated competitive pricing very highly when selecting a dealer, although accuracy, reliability and availability of product tended to be of more importance to customers with higher numbers of employees. If the ability to price in a competitive way is confined, then information about the limits on a particular company's ability to do so includes information that is confidential. Discounting forms a part of this, and the method used in setting and determining discounts must also include confidential information. Mr Wafer's evidence was that Boise Cascade uses 13 methodologies to arrive at a cost price, that such information has limited circulation within NZOP, but that Mr Howard was privy to it. Again I distinguish information of this type from mere knowledge of actual prices and discounts once these have been set and circulated, since that information, too, is easily obtainable.

(c) I accept also that NZOP has a proprietary interest in its business connections. The nature of that interest is usefully illustrated by the judgment of the Privy Council in **Stenhouse Australia Limited v Phillips** [1974] AC 391, where the Privy Council commented that in order to obtain and retain business it is necessary to cultivate and accumulate knowledge of the client's requirements so as to be able to offer attractive terms (p 401 A – B). The Privy Council commented further that to develop this might be a long term affair – that is a matter to which I return in assessing the reasonableness of the length of Mr Howards' restraint. Evidence concerning one of the ways in which senior management at NZOP went about obtaining knowledge of its clients was contained in a record of a visit to clients in the Nelson region and of the resulting. On that occasion Mr Howard was not present, but he was to receive the report. He played a key role in determining how such information was to be acted upon, as well as being expected to build up his own profiles of clients he approached himself.

Further to the right to protect business connections, on 19 July 2001 Mr Howard's solicitors filed written undertakings of Mr Howard, dated 16 July 2001. The undertakings were that, without prejudice to his right to challenge the validity of clause 20.3, for the period of six months from the date of termination of his employment Mr Howard would not solicit or seek to obtain the business of NZOP customers with whom he dealt or whose trade circumstances he had knowledge of. The point of view underlying the undertakings was that Mr Howard did not (at least in the immediate future) expect to be approaching his former customers in his new position at WSL in any event. NZOP did not find the undertakings to be adequate.

Mr Howard's view of his likely level of contact with former customers does not take into account the fact that he had access to a considerably wider range of information about NZOP's customers, not to mention other sensitive information, in addition to his personal contacts. Much of this came to his knowledge during March – May 2001, and in turn much of that information was discussed with senior managers including Mr Howard at presentations on 3, 4 and 5 April 2001. The information is summarised in a document entitled 'New Zealand Market Strategy April 2001', which is also subject to the confidentiality orders I have made. As well as market strategy itself, presentations covered aspects of restructuring, timing and financial matters. The question is not whether Mr Howard could or would disclose this information, it is whether the information by its

nature amounts to something NZOP is reasonably entitled to protect by seeking to enforce a restraint of trade. I find that it does.

Since the present employment relationship problem has arisen out of Mr Howard's employment by WSL, rather than raising a more general question about the range of Mr Howard's employment choices, I do not believe the resolution of the problem would be assisted by assessing whether the geographical restraint contained in clause 20.3 is reasonable.

It is however, necessary to assess the reasonableness of the length of the restraint. Whether a restraint period of six months is reasonable did not lend itself easily to objective measurement. NZOP took the view that, if anything, it needs a longer period of protection than that, while Mr Howard's undertaking refers to a period of six months but with a more limited restraint on the activities he can be involved in during that period.

If I grant the relief NZOP seeks, that will have serious implications for Mr Howard's employment relationship with WSL. As a matter of public policy Mr Howard has a right to choose where he works, and he has chosen to work at WSL. However in doing so he has disregarded the restraint of trade in his agreement with NZOP, and if that has adverse consequences then they are in part of his own making. In addition his career background was not one that suggested his options for suitable employment on leaving NZOP would be substantially if not completely curtailed should the restraint be enforced against him. On the contrary, he was employed at NZOP for less than a year and he had no previous background in the office supplies industry. Instead he has shown himself to be highly skilled in the area of new business development, and his CV indicates it was open to him to seek employment at an appropriate level outside the office supplies industry. In those circumstances I place less weight on the limiting effect of a restraint on his right to work than I might otherwise have done.

Looking at the period of restraint overall, I am not persuaded that a period of restraint of six months is reasonable in respect of NZOP's wish to protect its business connections in general, although it seems to be accepted that a six month period is reasonable in respect of customers with whom Mr Howard had direct dealings or had direct knowledge.

However the second main interest to be taken into account concerns confidential information, and the reasonableness of a six-month restraint in that respect must also be addressed. Counsel for Mr Howard relied on the existence in the employment agreement of a confidentiality provision, and said that provision provides all the protection that is necessary. Clause 20.1 expressly prevents Mr Howard from using, applying or otherwise exploiting the benefit of any confidential information for personal gain or the advantage of any other person, firm or corporation. It does not contain a time limit.

Counsel referred in support to a decision of the Employment Court in **Dillon v Chep Handling Systems Limited** [1995] 2 ERNZ 282, in which Judge Finnigan concluded the relevant restraint was unreasonable in its entirety, and commented that a confidentiality clause and a conflict of interest clause elsewhere in the contract were sufficient to protect the company's interests. However the court in that case considered that the relevant market was a new one, was expanding, and there was room in it for Chep Handling Systems and the company for whom Mr Dillon was proposing to work. That is not the kind of market in which NZOP and WSL are operating, so different considerations apply.

Bearing this in mind, I accept that NZOP's interest in its confidential information is entitled to the protection it seeks to enforce under cl 20.3. Following my express questioning on the matter, however, I am left unpersuaded that a six-month period is necessary. Balancing all of the

considerations I have mentioned, and taking into account that NZOP has obtained some protection from placing Mr Howard on garden leave on receipt of his resignation, I conclude that a period of restraint of four months from 8 June 2001 is reasonable. The restraint is amended accordingly.

Determination

With reference to the questions asked of me by NZOP, I determine that:

(a) clause 20.3 of the individual employment agreement between the parties is enforceable in a modified form. Because of the facts of this case I say nothing about the geographical restraint and make no finding on whether the restraint is unreasonable in that respect, but otherwise I reduce the length of time for which the restraint is enforceable from six months to four.
(b) should Mr Howard actually commence employment with WSL before the expiry of that period, he will be doing so in breach of cl 20.4

For the avoidance of doubt, I have also taken into account that Mr Howard has said he will abide by the undertaking he has given in respect of his own former customers at NZOP, or those about which he had direct knowledge, regardless of the outcome of this case. This determination rests on the assumption he will do so.

Costs

Costs are reserved.

The parties are invited to agree on the matter themselves. If they are unable to do so they shall have 14 days from the date of this determination in which to file and serve memoranda on the matter. If either wishes to respond to anything in the memorandum of the other, there shall be a further three working days from the date of receipt of the relevant memorandum in which to file and serve such reply.

R A Monaghan
Member, Employment Relations Authority