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Navigating Scylla and Charybdis

A Review of Restraint of Trade, Implied Duties and Concurrent Jurisdiction in New Zealand Employment Law

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Contents

Abstract

Restraint of trade and implied duties in the employment relationship can impose a heavy burden on employees. For many people, their only real asset is the ability to work. This should only be prevented with good reason. Over the centuries the courts have evolved a complex system for analysing the validity of employment restraints. In 1946, Lord Moulton commented:

> As I see it, the court stands in a sense between Scylla and Charybdis, because it would be most unfortunate if anything we said, or any other court said, should place an undue restriction on the right of a workman [...], to make use of his leisure for his profit.

Hivac Ltd v Park Royal Ltd [1946] 2 All ER 350, at 356.

Unfortunately it cannot be said that the approach to restraint of trade taken by the New Zealand courts reflects this admonition of caution. The courts, particularly the Court of Appeal, are steering the restraint of trade doctrine onto the rocks rather than skilfully navigating Lord Moulton's Scylla and Charybdis.

This paper surveys the development and current state of the law relating to restraint of trade, implied duties, and jurisdictional issues that affect the application of the doctrine. The current United States trends discussed help to clarify the outlines of our analysis of restrictive covenants, and to warn of pitfalls.

The text of this paper (excluding contents page, footnotes and bibliography) comprises approximately 15,284 words.

I Introduction

A What is Restraint of Trade?

Scicom is a nationwide scientific instrumentation wholesaler. John Timms has worked for his employer Scicom for several years. John has moved up through the ranks of the company and is now employed as the North Island senior manager. He is responsible for strategic planning and sales and routinely deals with information of a sensitive nature. John is, so to speak the public face of Scicom. The company is aware of the importance of John's role within the company and of the influence he has over clients. When the company promoted John it drafted a restrictive covenant, preventing John from dealing with current clients of Scicom for a period of six months, in the North Island. The restriction does not prevent John dealing with former clients of Scicom. As consideration for John entering into the restraint the company agreed to pay him the equivalent of six months pay. This sum could be uplifted after the restraint period had ended.

Pete Symonds is a helicopter pilot. He has been trained by his employer, has completed post training bonded period and now seeks employment elsewhere. Pete is held to the terms of a restrictive covenant on the grounds that the employer trained him and the replacement pilot is not as skilled as he was.[1] Furthermore, he is prevented from doing business with a company which has specifically indicated to the employer that they operate on a preferred pilot policy as opposed to a preferred company policy [2]

Cate is dismissed from her position because she is having a relationship with an employee of a rival firm. The judge holds that her dismissal was justified for good business reasons.[3]

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[1] *Marine Helicopters Ltd v Stevenson and Farm Helicopters Ltd* Unreported, Employment Court, Auckland Registry, 25 June 1996, AEC 30/96, A 168/95 at 15.

[2] Above n 1, at p 5.

[3] *Northern Clerical Workers Union v Printpac UEB Carton* [1989] 1 NZILR 644.

The courts' interpretation and application of the restraint of trade doctrine and implied duties is more likely to resemble the latter examples. The doctrine of restraint of trade typically applies to the situation where a former employee uses confidential information gained during the employment relationship to compete in a subsequent employment relationship. The alleged risk posed or breach may encompass using confidential information, poaching clients or soliciting former staff. The threat posed has been intensified by the development of information technology.[4] Restrictive covenants take the form of a standard form contract with little or no option of negotiation. The terms are usually dictated by the party with greater bargaining power. The doctrine requires a careful balancing of factors from a wide variety of areas. Considerations as varying as commercial contracts, public policy, economics and equity are involved.[5] Restraint of trade in relation to goods and the sale of goodwill in businesses is extensively dealt with by antitrust law and common law. For the purposes of this paper the main focus will be on the effect of restrictive covenants in the employment market.

B Objectives

This paper provides a comprehensive survey of the doctrine of restraint of trade, and related issues such as implied duties in the employment relationship. This is to determine the extent to which an employer may restrict its employees' right to concurrent or future work. The paper will look at the way in which these doctrines have been interpreted by the New Zealand courts and the extent to which the approach differs from the traditional analysis of restraint of trade.

The interface between injunctive relief and the operation of the doctrine of restraint of trade will be covered. Restrictive covenants fall within the jurisdictions of the

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[4] For a further discussion see: Ian Smith "Dealing with the Disloyal Employee" 142 New Law Journal, 1992, at 164.

[5] See M. J Trebilcock *The Common Law of Restraint of Trade* Sweet & Maxwell Ltd, London, 1986.

Employment Court, Employment Tribunal, High Court and the Court of Appeal.[6] This can give rise to some differences in the interpretation and application of restrictive covenants. Perhaps the most fundamental difference between the two courts is the approach to modification of restrictive covenants. The High Court and Court of Appeal proceed on the basis that restrictive covenants should be allowed to stand, with the most unreasonable provisions severed so as to allow the covenant to be enforced. The Employment Court approaches the problem from the point of view that restrictive covenants are prima facie void and that a covenant with no attempt at reasonableness should not be allowed to stand. The Employment Court has the power to rewrite a contract. Such power is used sparingly. The Employment Court prefers to look at the overall reasonableness of the covenant, not just the effect of an isolated provision.

Approaches taken in selected states from the United States will be considered. The states mentioned are selected to indicate different ways in which restrictive covenants can be dealt with. This facilitates an inquiry into whether correct and desirable considerations are being taken into account when assessing the reasonableness of the restraint. There is an advantage to be gained from evaluating overseas structures in that American states have developed specific solutions for dealing with restrictive covenants. Some of these could be usefully implemented in New Zealand. United States law charts potential developments that may affect our interpretation and application of law relating to restraint of trade.

It is unlikely in the short term that the use of restrictive covenants will decrease. New Zealand must assess whether it is desirable to continue to apply the same tests that we have thus far. It is time to rethink our approach to restrictive covenants. Specific types of covenant could be developed that more specifically target that which the employer is entitled to protect. This would dispense with some of the uncertainties in the present system of analysis of restrictive covenants.

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[6] Unless otherwise indicated a reference to the High Court includes the Court of Appeal and a reference to the Employment Court includes the Employment Tribunal.

II Freedom of Occupation

Restraint of trade affects freedom to choose an occupation and an employer. Implied duties and restraint of trade hinder employees' present and future employment opportunities. Freedom of occupation was hard won and is regarded by many as a fundamental right. These doctrines are not the only hindrances to freedom of occupation. Sexual discrimination and disability discrimination can restrict entry or hinder retention in the labour market. The lack of creche facilities and the toothlessness of maternity legislation act as a very real restriction on freedom of occupation. The right to strike can be argued as a right fundamental to the expression of freedom of occupation. In New Zealand the right to strike exists in name alone as one cannot take positive legal steps to exercise the right. Each of these points in worthy of further exploration, which is impossible within the confines of this paper.

III Theories and Legal Background to Restraint of Trade

A Theory

The doctrine of restraint of trade has always reflected the political and economic situation of the time. The doctrine has adapted over the years to reflect the prevailing economic theories. Thus there has been a movement from a mercantilist emphasis on freedom of trade to one of freedom of contract. There has been a trend in favour of upholding restrictive covenants, despite a general trend towards increasing economic liberalisation and labour market deregulation. More latterly there has been a swing in favour of an economic theory that takes account of externalities. This recognises that freedom of contract is not always in the public interest.[7]

[7] For a discussion of the economic theories underlying restraint of trade see above n 5, at 29 ff.

Restrictive covenants are used by employers for a variety of reasons. Trade secrets are an obvious example of where the employer may seek to enforce a restraint. In many cases the employer is seeking to protect something more. The employer may seek to enforce a restrictive covenant so that it can realise the outlay made investing in training an employee. The covenant returns the initial investment and increases the employer's profits. It operates as a double edged sword, acting as a disincentive to the employee leaving and maximising the employer's recoup on initial training investment. This is not a legitimate use of a restrictive covenant, the employer has no right to attempt to monopolise the employee's skills.

1 Sale of Goodwill v Pre-Employment Restrictive Covenants

There is a fundamental difference between a non competition agreement that is tied to the sale of a business and a general restrictive covenant in the employment context. Parity of bargaining power is more likely to exist between the vendor and purchaser, than between an employer and employee. When the business is sold the purchase price is consideration for the physical property, the goodwill, the transfer of the business and a covenant not to compete.[8] The transaction is carried out at arm's length and it is usual that legal advice is sought prior to entering into the transaction. The seller gets financial benefit from the transaction and negotiates the terms, so there is more likelihood that the benefit will be proportionate to what is being ceded.

2 Pre-Employment Restrictive Covenants

This is in contrast to the situation where there is an existing employment relationship. The prospective employee is generally presented with a standard package. There is often little opportunity to object to or negotiate the terms presented. The employee is faced

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[8] GP Kohn "A Fresh Look: Lowering the Mortality Rate of Covenants Not To Compete Ancillary To Employment Contracts And To Sale Of Business Contracts In Georgia" 31 Emory Law Journal, 635, at 639.

with accepting or refusing the offer. The employee will sign the non competition agreement because it is a precondition for employment with the firm. When a restraint is entered into prior to employment the employer does not have to provide any consideration. Yet, due to the imbalance of bargaining power, this is a time at which the employee is vulnerable. A prospective employee is less likely to seek legal advice about the provisions of a restrictive covenant. It is not yet the norm in New Zealand to seek legal advice prior to entering into an employment relationship. In a sale and purchase transaction it is usual that the vendor has recourse to legal advice. The employer does not purchase goodwill when it hires an employee. The employer purchases the employee's skills and knowledge. A post employment restrictive covenant is not necessary for the employer to get the full value of what is being acquired ie the employee's services.[9] A restraint that applies beyond the life of the employment relationship is something extra for which consideration should be given. It is relatively uncommon for the employee to be compensated for agreeing to be bound by a restrictive covenant.

3 Partnerships

Restraints involved with partnerships differ from restraints in the employment context. The differences are perhaps best illustrated by a case from Georgia. In *Rash v Toccoa Clinic Medical Associates* the former partner of a medical practice was bound by the provisions of a restrictive covenant from which he sought relief.[10] The court surveyed the existing state of law. Generally, restrictive covenants were deemed to fall into the category of an unreasonable restraint of trade. The Court concluded that a twenty-five mile restriction was acceptable because the partner had contractually agreed that the covenant was reasonable. He had agreed that to breach the covenant would result in

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[9] For a further discussion see H.M. Blake "Postemployment Restraints" 73 Harvard Law Review 625, at 647.

[10] 320 SE 2d 170 (Ga 1984).

harm to the partnership.[11] At the same time the partner obtained the benefit of the other partners agreeing to be bound by the same restriction.

Inequality of bargaining power is a relevant consideration in the assessment of the validity of a restrictive covenant. However partnership structures militate against a presumption that there is an inequality of bargaining power.[12] There is an obvious mutual benefit.

B Case Law

1 Common Law

Restrictive covenants restrict a former employee's ability to work in an industry or a particular geographical area for a specified period of time. They may also restrict the persons or businesses with whom the employee may deal. Non competition covenants originated in the fifteenth century.[13] Courts were initially reluctant to enforce the provisions, as they were regarded as an unreasonable restriction on an employee's freedom to work

The developments of the seventeenth century heralded an assumption of more equal bargaining power between the worker and employer. During this period the test for reasonableness was introduced. Restraint clauses were acceptable if they were related to the sale of a business and were limited in scope. In the eighteenth century the test was extended to apply to the employment relationship. *Mitchell v Reynolds* drew a distinction between particular and general restraints and weighed the social utility of them against the undesirable effects on the public and the covenantor.[14] Gradually the courts adapted

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[11] Above n 10, at 174

[12] Above n 10, at 173.

[13] For a further discussion of the historical basis of restraint of trade see J.D. Heydon *The Restraint of Trade Doctrine* 1971, London, Butterworths

[14] 24 Eng.Rep 347, QB (1711).

the *Mitchell v Reynolds* test.[15] In *Horner v Graves* the Court held that it was not bound to look only at the terms of the restraint, but could also look at any other relevant facts.[16] The question was thus framed:

> whether the restraint is such only as to afford a fair protection to the interests of the party in favour of whom it is given, and not so large as to interfere with the interests of the public.[17]

The Court analysed the restraint in terms of what was reasonable, on the facts of the case before the Court. This remained the legal approach until 1853 when the Queen's Bench held that the burden fell on the covenantor to show that the restraint was unreasonable.[18] This was no doubt largely due to the laissez-faire approach to trade and commerce that prevailed at the time. In 1913 *Mason v Provident Clothing & Supply Co*[19] and in 1916 *Herbert Morris Ltd v Saxelby*[20] established many of the tests that we now consider central to assessment of the validity of restrictive covenants. The cases established that restrictive covenants in the employment context are different from more general restraints of trade. The employer must show that the restraints are no broader than necessary for the employer's reasonable protection and that the restraint is reasonable, for both the employer and employee. Restraints that simply aim to protect against future competition were held to be unjustified. The more modern definition of restraint of trade is fairly broad. Lord Reid in *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* defined it as an employee giving up a freedom that they would otherwise have had.[21] The common law regards restrictive covenants as prima facie invalid because they are contrary to public policy. To an extent this incorporates a certain amount of welfarist policy. Public policy can be defined at two levels, freedom to earn a living and the

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[15] Above n 14.

[16] 131 Eng. Rep. 232 (1839).

[17] Above n 16, at 287.

[18] *Tallis v Tallis* 118 Eng.Rep 482 (1853).

[19] [1913] AC 724.

[20] [1916] 1 AC 688.

[21] *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269.

public's interest in freedom to choose with whom to do business. A covenant would only be enforced if the employer could show that it was necessary to protect a proprietary interest and that it did so in a reasonable way. Competition per se cannot be guarded against, only unfair competition.

2 American State Approaches

The United States law regarding restraints largely evolved from the English approach to the area.[22] In restraint cases the courts are less reluctant than those in the United Kingdom to base decisions on public policy.[23] By 1898 the United States Supreme Court affirmed a formulation of circumstances in which a restraint of trade would be valid as being consonant with public interest.[24] In contrast, Michigan prohibited restrictive covenants until 1985, when the State passed the Michigan Antitrust Reform Act. [25] Promises by former employees not to compete are classed as restraints ancillary to a lawful contract. Such restraints were enforceable if they were reasonably necessary to protect the employer's business from danger or to protect against loss caused by an employee's unjust use of confidential knowledge acquired in the course of the employment. In determining reasonableness the duration and geographical scope of the restraint was not to be any larger than was necessary to protect the employer in its established trade. The Supreme Court case of *Briggs v Butler* stated that covenants could be enforced where they:

> do not impose a restraint beyond that reasonably required for the protection of the employer in his business are not unreasonably restrictive upon the rights of the employee and do not contravene public policy[26]

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[22] Above n 14.

[23] See Heydon above n 13, at 34.

[24] *United States v Addyston Pipe and Steel Co* 85 F.271 (6th Circuit 1898) affirmed 175 US 211 (1899) as set out in T.J. Collin "Antitrust Law: Restrictive Covenants and Reasonableness" 24 Akron Law Review 479, 485.

[25] From 1905 until 1985 restrictive covenants were prohibited by ss 445.771-778 of the Michigan Competition Laws Annotated.

[26] 140 Ohio St. 499, 45 NE 2d 757 (1942), at 763.

The Supreme Court applied the "blue pencil" test.[27] In *Extine v Williamson Midwest Inc* the Court upheld the reasonable parts of a restraint clause that could be severed from the unreasonable provisions without having to rewrite the contract.[28]

Washington focuses attention on the public interest element of restraint of trade. The public interest in maintaining the goodwill of the business, in receiving services from a chosen professional, and the individual's right to work are balanced. The harm that an employee would suffer by being deprived of livelihood and public interest in encouraging competition are important considerations. In spite of this theoretically equitable approach the Court largely favours the employer. In the landmark decision of *Perry v Moran* an accountant directed not to serve any of the employer's clients, was ordered to pay liquidated damages for accepting business from the employer's former clients.[29] The restriction was arguably unreasonable as there had been no significant personal contact between the client and the accountant. There was no legitimate interest to protect.

C Legislative Protection

New Zealand has no constitutional guarantee of freedom of occupation. Such safeguards as exist are to be found in international conventions, common law and legislation. Some American states have chosen to adopt a legislative approach to restraint of trade. The approach varies from Florida where the legislature has sought to codify the factors that the Court must assess, and Georgia, which stringently limits the application of restrictive covenants. Further legislative protection may be an option that New Zealand should consider.

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[27] Ie the common law doctrine of severance.

[28] 76 Ohio St 403, 200 NE 2d 297 (1964).

[29] 748 P.2d 224 (1987).

1 Employment Contracts Act 1991

The long title of the Employment Contracts Act 1991 states that the Act is designed to promote freedom of association. The provisions of the Act provide limited protection against the more excessive restraints on freedom of occupation. No reference is made to the role of employee associations (unions) in this new industrial regime. Ostensibly, it is for the employer to choose whether to recognise a union bargaining representative. No framework for the settlement of disputes is provided, as the underlying presumption is that workers can negotiate their employment conditions directly with the employer. Union power has been significantly weakened by the advent of the Act. The personal grievances provisions of the Act recognise other forms of restraints on freedom of occupation.[30] Personal grievances cover sexual harassment, duress in relation to union activity and any other activity which affects access and the reasonable enjoyment of employment. Section 29 provides additional protection on the basis of sexual harassment. Elements of social protection are contained in legislation such as the Minimum Wages Act, Holidays Act and the Human Rights Act. These bottom line protections have come under fire from the New Right who argue that they inhibit the development of a free market economy. The New Right advocate that an employment contract should be treated on the same basis as any other commercial contract. On this analysis it would be thought that restrictive covenants would be opposed on the grounds that they inhibit the operation of a free labour market. The New Right philosophy as expressed by the Chicago school aims for an unregulated labour market, freedom of contract and employment at will.[31] Restrictive covenants are designed to limit an employee's freedom of association. A balance therefore has to be struck between the public interest and the legitimate protection of goodwill and customer contacts in business. The concept of reasonableness is to be judged from the viewpoint of both parties, and measured against the public interest.[32]

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[30] s 31 Employment Contracts Act 1991.

[31] For a discussion of Chicago School of Economic theories see I.L O. Schmidt; J.B. Rittaler *A Critical Evaluation of the Chicago School of Antitrust Analysis* Kluwer, Dordrecht, 1989.

[32] *Debtor Management (NZ) Ltd v Quail* [1993] 2 ERNZ 498.

2 Commerce Act 1986

The Commerce Act 1986 will only check restraint of trade if it has the effect of substantially lessening competition in a market.[33] Restraints occur on a case by case basis, not industry wide, so this precondition is unlikely to be satisfied.

3 New Zealand Bill of Rights Act 1990

Section 17 of the Bill of Rights Act 1990 provides for freedom of association. Reasonable limits may be imposed on the freedoms by virtue of s 5. The difficulty in relying on the Bill of Rights is that restrictive covenants are contracts and not laws enacted by Parliament, and so the scope of application of the Bill of Rights is questionable. However, if the employee performed a public function it could be argued that the Bill of Rights would apply. The New Zealand Bill of Rights was raised in the *Medic Corp* case but was not fully discussed.[34]

4 International Obligations

The operation of restrictive covenants may also conflict with the principles enunciated in international conventions which New Zealand has ratified.[35] Such clauses arguably impact on the objectives set out in the Declaration of Philidelphia.[36] One of the most obvious effects of restrictive covenants is that they prevent an individual from providing for their economic well-being for a period of time, within a given occupation. This

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[33] See ss 7(1) and 28 Commerce Act 1986.

[34] *Medic Corp v Barrett* [1992] 3 ERNZ 523.

[35] ILO Convention 122; Article 1 provides:

> There is freedom of choice of employment and the fullest possible opportunity for each worker to qualify for, and to use his skills and endowments, in a job for which he is well suited, irrespective of race, colour, religion, political opinion, national extraction and social origin Article 1 Universal Declaration of Human Rights.

[36] A founding documents of the ILO, which outlines the organisation's philosophy.

adversely affects the right to work and right to free choice of employment contained in Article I of the Universal Declaration of Human Rights.

5 American State Legislative Approaches to Restraint of Trade

Some federal jurisdictions have adopted a legislative approach to restraint of trade. This has the advantage of concretising the factors relevant to an analysis of restrictive covenants. Section 542.33 of Florida's Regulation of Trade, Commerce, Investments and Solicitations Act 1990 specifies that a court may not grant an injunction if a non competition agreement is contrary to the public health, safety or welfare, if in all the circumstances it is unreasonable, or if no irreparable injury to the employer is shown.[37] Prior to 1953, no Florida court had enforced a non competition covenant against an employee. The 1990's saw a reversal of fortune. In *Atlas Travel Service Inc v Morelly* the validity of a two year period of restraint was upheld as the Court held that there was no public interest in the availability of the employee's services.[38] Irreparable harm is now only presumed where the employee uses trade secrets or customer lists, or directly solicits the employer's clients.

Georgia's statute dealing with restraint of trade has a narrow application. [39] The definition of employee includes only executives, officers, managers, research and development personnel and people possessing significant confidential information or abilities. The definition specifically excludes any employee "who lacks selective or specialised skills, learning, customer contacts or abilities."[40] Furthermore a restraint must be limited to the area in which the employee was working at the time of termination. The activities prohibited must bear a reasonable resemblance to those that the employee

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[37] This was a reaction to the judgment in *Capraro v Lanier Business Products Inc* 466 SO 2d 212. where it was said that there would be a presumption of irreparable harm where there was a breach of a restrictive covenant. Judge Overton's dissenting judgment sparked the impetus for reform.

[38] 98 So 2d 816 (1987).

[39] GA Laws 1676, GA Code Ann. ss 13-8-2 -2.1.

[40] GA Code Ann. ss 13-8-2.1(c)(i)(B).

previously performed for the employer. The solicitation and acceptance of prior clients of the former employer are permitted. The restraint can only prohibit the solicitation of customers with whom the employee had material prior contact.[41] Material contact is defined as direct business dealings, confidential information, sales negotiations etc.
Legislation may help to cement and clarify the law relating to restraint of trade. The notion of restricting the application of restraints to certain types of employee is an innovative way of limiting the scope of restraints.

American and New Zealand courts have similar problems scoping the terms of a restraint. In Michigan a court assessed a restraint of trade clause and decided that a one year restraint over a fifty mile radius was reasonable. No reasons were given justifying the conclusion.[42] The American experience shows how even when the policy considerations of restraint of trade have been worked out, there can still be practical difficulties in how the theory is to be applied.

IV Restrictive Covenants in New Zealand

A Criteria

A restrictive covenant can apply to the goodwill attached to a business that is being sold. It also applies to an employee covenanting not to compete with a former employer by working for a rival firm or by starting their own business. The restraint typically involves a covenant not to work but can also require that compensation be paid to the former employee. A restrictive covenant is usually unilaterally imposed as opposed to being the outcome of mutual bargaining.[43]

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[41] s 13-8-2.1(c)(3).

[42] *Robert Half International Inc v Van Steenis* 784 Fed Supp 1263 (1991).

[43] *Kemp v NZRFL* (1989) 2 NZELC 96. The problem with this approach is that it can take considerable time to gain a Court fixture.

Restrictive covenants affect subsequent employers. This effect should be monitored to ensure that it does not have an unhealthy effect on labour market mobility and efficiency. The effect is more stark in a specialised area, where skilled workers are in high demand and training takes a considerable period of time. Restrictive covenants are prima facie void once the employment relationship has ended. A valid clause may only seek to prevent unfair competition. A blanket ban on competition is not a valid form of restriction. The former employer must show that there is an actual or realistically potential misuse of trade secrets or customer connections. It is insufficient that the employee is using skills or knowledge obtained while on the former employer's payroll.[44] A third party may not be immune to liability if they induce someone to breach an unreasonable restrictive covenant. An application to the Court to consider the validity of the clause is a preferable course of conduct. [45]

1 Proprietary Interest

A fundamental requirement of a restrictive covenant is that there is an identified proprietary interest that the employer seeks to protect. The problem is that this requirement has been loosely interpreted by the courts. There is a blurring of the distinction between what constitutes an identifiable proprietary asset and more general restraint on the employee's future use of skills. A restrictive covenant can only be used to protect an employer's proprietary interest, not the personal following of the employee. [46] There must be an identifiable asset, a trade secret, trade connections or confidential information. There is a common law duty not to reveal confidential information during the course of the employment relationship and for some time afterwards. A restrictive covenant operates beyond this. Such covenants are used to protect the goodwill of a business.[47] In *Business Associates Ltd v Telecom* Telecom recruited the plaintiff's

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[44] *Herbert Morris v Saxelby* [1916] AC 688, 709.

[45] *DB Breweries v Marshall* [1994] 1 ERNZ 98.

[46] *Radio Horowhenua Ltd v Bradley* [1993] 2 ERNZ 1085. This point appears to have been overlooked by Finnigan J in his analysis in *Marine Helicopters v Stevenson*. See above n 1.

[47] *Cooney v Welsh* [1993] 1 ERNZ 1.

employee after contractual disputes resulted in Business Associates not being given any further work.[48] Telecom was aware of the restrictive covenants. Business Associates established that there was a proprietary interest to protect, in respect of the trade connection with Telecom. The plaintiff had a reasonable expectation of doing business with Telecom in the future, even though there was no present contractual arrangement between the parties. The Court awarded the plaintiff damages inducement to breach of contract. This case is problematic in that the Court is prepared to grant protection to the plaintiff's hope of future business contacts with Telecom. It could not be said that there was an existing trade connection requiring protection.

2 Springboard Concept

The springboard concept means that an employee is not allowed to take unfair advantage of information gained in their previous employment relationship. In *Rank Xerox NZ Ltd v U-Bix Copiers NZ Ltd and Adamson* the defendant was bound by a three month restraint. Judge Sinclair determined that if a plaintiff had accepted the terms of the contract he could not later seek to repudiate them unless the provision was unreasonable.[49] The defendant had access to information regarding the marketing strategies of the plaintiff company and the employer was properly entitled to keep this information to itself. The employee was not entitled to use information obtained during his employment as a "springboard" into a new employment relationship. The area that the restraint applied to was not excessive and the duration was considered reasonable.[50] The balance of convenience favoured upholding the restraint. Mr Adamson would suffer little financial harm as a result of the order, Ubix would probably suffer some inconvenience but this was balanced against the company's imputed knowledge of the covenant. The judge commented:

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[48] [1992] 4 TCLR 685.

[49] Unreported, , High Court, Auckland Registry, 29 October 1985, A.1276/ 85.

[50] Limited to 3 months.

> By employing him in the manner in which it did, it sought to obtain a commercial advantage, and the commercial advantage must have been for its own benefit at the expense of competitors including Xerox. It now ill behoves, in my view, Ubix to complain that it may and will suffer some loss and inconvenience if it is prevented from acting as it otherwise would have had Mr Adamson's employment with its company not been subject to any restrictions at all. [51]

In *Broadcasting Corporation of New Zealand v Inglis*[52] the covenant prohibited the defendant from working for a competitor for six months.[53] The clause purported to apply regardless of the duration of the defendant's employment with the plaintiff. The plaintiff had to establish that it sought to protect its property, as opposed to the personal aptitudes of the employee. The plaintiff argued that if the defendant left the corporation he would take advertisers with him. The company sought to protect the recurring business relationship with its clients. This was properly within the scope of protection. These cases are now over a decade old. The restraint was relatively short, three to six months. Since then the length of restraints has increased substantially. Fact situations that justified a three month period of restraint should not be used to support a longer restriction.

3 Reasonableness

The concept of reasonableness by nature lends itself to indeterminacy. Reasonableness is assessed at the time that the contract is entered into and both parties' perspectives are taken into account.[54] If the restraint was entered into at the time of employment, courts are more favourably disposed towards upholding its validity.[55] There are problems associated with the assessment of reasonableness. Theoretically there is greater freedom of choice at the outset of the employment relationship. This ignores the reality that many

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[51] Above n 49, at 20.

[52] Unreported, , 21 June 1984, A.141/ 84.

[53] Hardie Boys J held that 6 months was a reasonable period of restraint, both from the plaintiff and defendant's viewpoint, at p 15.

[54] *M A Watson Electrical Ltd v Kelling* [1993] 1 ERNZ 9.

[55] *BCNZ v Nielsen* (1988) 2 NZELC 96,040.

employees possess little bargaining power and must accept employment on the terms offered. The employer might be said to use the opportunity of an offer of employment to gain a competitive advantage that will extend beyond the term of the employment relationship. The time that the clause was incorporated into the contract is relevant. If a restrictive covenant is entered into during the course of the employment relationship some form of valuable consideration must be given in return.[56] If a clause is inserted in the course of the employment relationship additional consideration would be required.[57] The logic behind this may lie in interpreting it as meaning that the original contractual terms have been varied. This writer suggests that consideration should also be given in cases where there is a pre-employment negotiation of a restrictive covenant

Whether or not the employee actually had access to confidential information is a relevant inquiry. The employee must have been of such seniority that they had access to confidential material.[58] Restraints applying to non managerial staff are less likely to be upheld. The relative bargaining position of the parties is assessed in the Court's balancing test.[59] Covenants have been subject to special scrutiny where the defendant was young, inexperienced, or had not sought independent advice.

The proportional effects on the parties are a relevant criterion guiding the Court's assessment of the merits of the case.[60] In some cases it may be more acceptable and expedient to insert a "garden leave provision".[61] A restrictive covenant that purports to apply irrespective of termination is more likely to be found unreasonable by the Court.[62]

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[56] This is because of the assumption that employees are free to choose to accept the position in knowledge of the restriction, and because it is at least theoretically part of the negotiating process. This represents a quantum leap in assumptions, ignores the imbalance of bargaining power and does not address the issue of consideration. See also *Radio Horowhenua v Bradley* above n 46, at 1085.

[57] See *Force Four NZ Ltd v Curtling* [1994] 1 ERNZ 542.

[58] Above n 14.

[59] Above n 52.

[60] Above n 46.

[61] Garden leave is a period of protracted leave during which time the employee is paid but cannot work or seek employment elsewhere.

[62] Above n 46.

The clause will not be effective if it is later found that the employee was wrongfully dismissed.[63]

The points are well illustrated in *Royal v Axon Computer Systems Ltd.*[64] The employment contract contained a restrictive covenant. The plaintiff left the company, commenced work with a new employer and sought a declaration that he was not bound by the restrictive covenant. The defendant company sought an injunction enforcing the restraint. The Court held that Axon's restraint was aimed at preventing competition, no substantive proprietary interest was identified by the company. A strict observance of the restraint would have precluded the defendant seeking any meaningful employment in the computer retailing or servicing industry. The onus lay on Axon to prove that the restraint was reasonable and in the interests of both parties and the public. In this respect the restraint was unreasonable and substantially altered the bargain between the parties. No order could be made to vary the contract under the Illegal Contracts Act 1970 as the Court was not satisfied that such modification was appropriate.

4 Ability to Earn a Living

New Zealand courts are reluctant to enforce a clause if it will render an employee idle or unable to earn a living.[65] To this limited extent courts are prepared to recognise the public interest in freedom to work. In *LEP International v Hass* the defendant could not seek employment in the New Zealand shipping forwarding industry for a year after he left LEP. [66] A confidentiality clause in the contract prohibited him using LEP information for twelve months after the expiration of the contract. The defendant left the country, but returned and commenced employment with a trade competitor. The Court held that only

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[63] *General Billposting v Atkinson* [1909] AC 118.

[64] [1994] 1 ERNZ 312.

[65] *Ogilvy & Mather v Darroch* [1993] 2 ERNZ 58.

[66] [1987] 2 TCLR 615.

in an obvious case would it deprive a person of their means of support, particularly where the person is an immigrant on a conditional work permit.

5 Duration, Area, Scope

The duration, area and scope of the restraint are also relevant considerations for the Court. These three factors are traditional concerns and derive from the historical origins of the doctrine. During times when there was a shortage of labour it was of prime importance that labour mobility was retained. These factors must not be any wider than is necessary to protect the employer's interests. This requires a fact specific inquiry in each case. The length of the employment relationship is relevant. The duration of the restraint in relation to the time remaining until the contract expires is also an important factor.[67] Some jurisdictions have specified what constitutes a valid temporal restriction. In Georgia there is a rebuttable presumption that a two year period of restraint is valid.[68]

A restraint was reduced by the Employment Court in *MA Watson Electrical Ltd v Kelling*, because it was deemed unreasonable to exclude the defendant from Auckland central which is the largest market in New Zealand.[69] The restrictive covenant provided that the defendant could not operate in opposition to the plaintiff within a 15 kilometre radius, for two years after the termination of employment. The clause prohibited the defendant soliciting the plaintiff's past or existing clients. The defendant did this and as a result the plaintiff issued injunction proceedings. The Court found the covenant provisions unreasonable and unenforceable. The temporal restriction was too long and the geographical area too broad. The existence of a provision in the covenant allowing the defendant to apply for a release from the terms did not make the restraint reasonable. The Court was not persuaded to exercise discretion under section 8 Illegal Contracts Act. No consideration had been given for the deed of covenant, which was created

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[67] Above n 57.

[68] See GA Code Ann. Ss 13-8-2.1 ff.

[69] Above n 54.

during the employment relationship. Equity will not enforce a restrictive covenant unless good consideration is given. In *Medic Corp Ltd v Barrett* it was considered unlikely that a restriction applicable to "New Zealand" would be reasonable.[70] The scope of the restraint must not be any broader than the employer can justify.

DB Breweries v Marshall concerned issues relating to restrictive covenants, the implied duty of fidelity, confidentiality, garden leave and issues relating to freedom of occupation.[71] The defendant was a sales representative for DB Breweries. His employment contract stipulated that one month's notice be given and expressly prohibited the disclosure of confidential information during and after the period of employment. A restrictive covenant restrained the defendant from seeking employment in the New Zealand liquor industry for three months. The scope of the restraint clause in *DB v Marshall* was wide.[72] The term "engagement in the liquor industry in New Zealand" encompassed a wide range of commercial activities that may have no connection with the activities carried out by DB. The restraint applied to an indefinite range of people. DB sought an injunction preventing the defendant from commencing employment with Lion and alleged the tort of inducement to breach of contract. The Employment Court suggested that the restraint be modified to prevent the defendant from dealing with DB's actual customers. Such a restriction is a sensible one. DB cannot legitimately claim to protect non existent client contacts (notional future competition).

Dillon v Chep Handling Systems is a recent example of the way in which the Employment Court is approaching restrictive covenants. Justice Finnigan stated that restraints are acceptable if they are reasonable in their own context. [73] This involves weighing the value of protecting the propriety interest, against the interest of the employee in protecting their freedom to contract. The Court objectively surveys what is

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[70] [1992] 2 ERNZ 1048.

[71] Above n 45.

[72] Above n 45.

[73] [1995] 2 ERNZ 282.

reasonable in all the circumstances of the case and asks what is actually required. Chep Holdings sought to enforce a covenant that would prevent the divulgation of specialised and individual knowledge of market expansion strategy and the knowledge of customer needs. The judge partially rejected the employer's argument on the basis that contractual terms relating to the implied duty of confidentiality and the conflict of interest clauses were sufficient to deal with the perceived problem.[74] The plaintiff and the company that sought to employ him provided a specific guarantee that they would not use any of the confidential information gained during Mr Dillon's employment with Chep. The restraint clause was wider than was necessary to protect the employer's legitimate interests. The restraint purported to last for twelve months and had a potential worldwide application in respect of any potential employer who had operations in Auckland. The Court was not convinced that it would be an appropriate or adequate solution to vary the clause pursuant to the Illegal Contracts Act 1970. The Court did not consider that the employer had provided sufficient consideration for the restraint clause. No real attempt at reasonableness had been made.

6 Other Means of Protecting Business

New Zealand analysis of restrictive covenants underrates the merit of an inquiry into whether the employer has other means of protecting its business interest. The Employment Court in the *DB* case made the obiter observation that the restraint was intended to prevent unfair competition, which is a legitimate aim of such covenants.[75] However, the Court gave little credit to the fact that there was an independent clause in the contract restricting the use of confidential information beyond the termination of employment. If an interest is already protected, it should not be further entrenched by a restrictive covenant. In the *DB* case no evidence was adduced to indicate that the defendant would breach the duty of confidentiality. Lion had testified that the company

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[74] Above n 73, at 301 and 303.

[75] Unfair competition meaning the employee making unfair use of information or contacts gained in the course of employment.

would ensure that there was no breach of the covenant. Courts should pay more attention to analysing whether the restraint is necessary. The writer suggests that if there are less disruptive means of protecting an interest they should be used.

B Anatomy of an Analysis

In *Broadcasting Corporation of New Zealand v Nielsen* the Court undertakes a comprehensive analysis of the relevant considerations in restraint of trade. In some areas the approach is forward thinking, particularly the requirement that there be significant client contact.[76] BCNZ sought an injunction restraining Nielsen from entering into employment with a trade competitor, Radio Avon.[77] For six months Nielsen could not engage in broadcasting for any other organisation in a 100 km radius of the Christchurch Central Post Office. This condition could be discharged with written consent and would not apply if BCNZ terminated the defendant's contract of employment for any reason not provided for in the employment contract. Courts are more likely to uphold the validity of a restraint of trade clause if the clause does not apply in the event of the covenantor terminating the employment contract. There was a covenant to maintain confidentiality during and after employment.

BCNZ had to establish that the clause was necessary to protect an identifiable proprietary interest. The covenant could not be unreasonable from the point of view of the employee and should not conflict with the interests of the public. The defendant was an intelligent businessman who understood the effect of the covenant. The Court assessed the reasonableness of the clause and the degree of contact the defendant had with the plaintiff's customers.[78] The whole course of the employment relationship was taken into account.[79] This required an analysis of the nature of the employer's business

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[76] See section on potential developments.

[77] Unreported,, 26 February 1988, CP 484/87.

[78] See above n 49 and discussion below at p 56 for a discussion of client contact.

[79] *H&R Block Ltd v Sannot* [1976] 1 NZLR 213,219

and the employee's role in the business. The responsibilities undertaken by the employee and the opportunities afforded to the employee were considered.

> Thus I consider that the issue of reasonableness is to be judged in light of all the circumstances, both at the time the contract was entered into, and during the course of the employment.[80]

The broadcasting industry is highly competitive and depends on the results of its audience surveys for advertising revenue. Radio stations try to protect their relationships with regular advertisers. This was the business interest that BCNZ wanted to protect. Nielsen was the programme director of the station and was responsible for the quality control of the advertising. He was involved with promotional campaigns initiated by advertisers, although on the evidence before the Court, it appears that this was a small percentage of the total advertising business. Justice Hardie Boys observed:

> The employer's interest in maintaining his trade connection does not entitle him to obtain protection against every employee who deals with his customers, but only against those who because of the nature of their employment are likely to have personal knowledge of or influence over the customers and hence over where they place their custom to such an extent that it is within their power to entice them away.[81]

In requiring that the employee must have had personal knowledge or influence over clients the judge verged on applying a test that requires significant client contact before a restraint is deemed reasonable. This is a sensible distinction which safeguards the public interest. The judge concluded that the covenant was not justified on the grounds of the position that the defendant held. The degree of personal contact with company customers was not such as to enable him to entice customers to transfer their business elsewhere.

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[80] Above n77, at 17.

[81] Above n 77, at 19.

BCNZ's claim based on trade secrets fared better. Whether information could be classed as confidential, depends on all the circumstances and the nature of the employment. The nature of the information and whether or not the employer has impressed on the employee the confidentiality of the information is an important factor.[82] The plaintiff alleged four categories of confidential information; information concerning staff details, station budgets, planned promotions and attitudinal surveys. Confidential information was regularly handled by Nielsen and this imposed on him a high obligation of confidentiality. The latter three categories of information were deemed confidential. The judge was concerned about the possible effect that disclosure would have on the market research and attitudinal surveys and directed that the restraint should apply well past the completion of the surveys.

The geographical extent of the restraint was not challenged but objection to the duration was noted. Justice Hardie Boys directed that the defendant should be restrained from commencing employment with Radio Avon for six months after his resignation. Nielsen gave an express undertaking that he would not breach the duty of confidentiality. This was accepted by the plaintiff

The *Nielsen* case is an example of a comprehensive approach of the Court of Appeal to restrictive covenants. The Court makes an effort to weigh each relevant element in the case in order to effect a balance for the purposes of deciding whether or not to grant an injunction. The main fault with the analysis is that the Court did not consider other ways of protecting the information. Nielsen had already given the Court an express undertaking that he would not use the confidential information. The approach taken proceeds on the basis that the employee will misuse the information. The role of undertakings should be expanded.

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[82] *Allco Agencies Auckland Ltd v Naidoo & Anor* Unreported, Auckland, 12 October 1987, A 1214/85.

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In *Marine Helicopters Ltd v Stevenson* the Employment Court lost direction in its approach to restraint of trade.[83] This judgment emphasises irrelevant considerations. Justice Finnigan seems more concerned with protecting the plaintiff's investment in the defendant's training than with the traditional analysis of the restraint of trade doctrine. The company was less concerned with identifying an asset that it wanted to protect than it was with restraining competition in an area in which they previously had dominance.

The defendant and his father were employed as pilots for Marine Helicopters Ltd. Stevenson and enjoyed considerable personal following as a result of their longstanding association with the area and exemplary work record.[84] Affidavit evidence indicated that the majority of Marine Helicopters former clients preferred the services of Mr Stevenson. He was the sole reason why they had done business with Marine Helicopters. After resigning, the defendant gained employment with another helicopter line. Two months later he was offered contract work piloting for Carter Holt, a firm with which Marine Helicopters considered it had an established business arrangement. Marine Helicopters was concerned that the plaintiff was poaching its clients and sought to enforce a restrictive covenant contained in the original written contract of employment. The issue was complicated by the fact that the written employment contract was never signed by the defendant and the employment relationship proceeded on the basis of established practice. The judge determined that the contract was oral but the terms were evidenced by the original, unsigned contract in the defendant's possession. The restrictive covenant purported to restrain the defendant from being employed as a helicopter pilot for any company or organisation in the area, or for the former customers of Marine Helicopters. The defendant was bonded to Marine Helicopters for five years to enable the firm to recoup the cost of training the defendant. Justice Finnigan rejected counsel for the

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[83] Above n 1.

[84] Above n 46, in *Radio Horowhenua* the plaintiff could not seek to monopolise the personal following of the employee.

defendant's submission that one of the aims of the covenant was to protect the company's investment in training the pilots.[85] The judge correctly stated that this was more appropriately protected by the five year bond that binds trainee pilots. The judge agreed that prevention of competition is not a legitimate aim of restrictive covenants. However in spite of Justice Finnigan's earlier protestations, he confused the distinction between the role of the bond and the restrictive covenant. He stated:

> Having trained Mr Stevenson from the commencement of his helicopter pilot training to the point where he was a superbly trained and very skilful helicopter operator, and having done so for the sole purpose of building up its own business in his local area, it acted reasonably in requiring Mr Stevenson, from the outset and before their relationship commenced, to agree that he would not work for persons who had hitherto been its (ie. his) customers for a period of two years after ceasing to work as its employee.[86]

This paragraph indicates an intention to protect the former employer so as to enable him to recoup the investment in the defendant's training. This is reinforced by Justice Finnigan's justification for allowing two year restraint period. The pilot who replaced Mr Stevenson did not have the personal reputation that the defendant possessed. The new pilot did not have the same level of experience and flying skill.[87] The judge reasoned that this meant that:

> To have Mr Stevenson available and flying with any available operator during that time negates the plaintiff's right to reasonable protection.[88]

Even assuming that Marine Helicopters was legitimately trying to protect the goodwill in the company there are still problems with the judge's assessment of the merits of the case. This writer submits that the judge is aiming to guard against legitimate competition.

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[85] Above n 1, at p 11.

[86] Above n1, at p 14.

[87] Above n1, at p 15.

[88] Above n 1, at p 15.

The fact that Marine Helicopters hired a less able and less popular pilot is not reason to extend the period of a restrictive covenant. There are very good policy reasons why this should not be the case. If skilled helicopter pilots are hard to come by this is an even better reason why there should be a limited period of restraint, if there is to be one at all.

The one redeeming feature of the case is that Justice Finnigan did not grant an injunction. A declaration was issued to the effect that the clause was valid and time was left for submissions to be made to the Court and the quantum of damages to be assessed. The former employer was not seeking to enforce the restraint in respect of the majority of clients who had followed the defendant. He only sought to enforce it in respect of the contract work being done for Carter Holt Harvey.

Marine Helicopters represents a dangerous development in the Employment Court's approach to restrictive covenants. The result in the case was not too harsh, but it sets a dangerous precedent. The fundamentals of the doctrine of restraint of trade have been studiously ignored. Judicial willingness to grant the employer a monopoly on the employees skills should be severely scrutinised.

V Other Developments

A Garden Leave

Garden leave is increasingly common in managerial positions in industries where the rate of technological advance means that information is rapidly outdated. Garden leave provides the employee with a protracted period of leave during which they are paid as usual, but not required to work. At the same time, the employee may not seek employment in a related area.[89] Garden leave will become more common because both the Employment Court and the High Court are lenient in their approach towards it.

[89] See above n 54.

Employers worried about the uncertainties associated with the courts' approaches to restrictive covenants may consider garden leave an acceptable compromise. On the face of it garden leave may seem to be an agreeable option. However, where the duration exceeds six months it can operate as an insidious form of restraint. Skills and marketability are quickly lost in many industries today.

The employee in *Rank Xerox New Zealand Ltd v U-Bix Copiers (NZ) Ltd and Morton* had given notice and was paid but not required to work.[90] Morton claimed that the employer had breached an implied term of the employment contract that the employer shall provide work. The employee repudiated his contract on this basis. The High Court's view was that

> [i]t was reasonable for the plaintiff to withhold work from him provided it was prepared to keep on paying him.[91]

Factors such as the duration and area of the restraint in the case favoured the plaintiff. An injunction was not granted against the first defendant as there was no evidence that Ubix had sought confidential information from the second defendant. From this it followed that there was no evidence of a serious question to be tried. However an injunction was granted against the second defendant preventing him from working until the end of the period of restraint.

The restrictive covenant in *McHerron v Ceramco Corporation* [92] prevented the former employee from working in a range of capacities, for the duration of the garden leave, and for one year afterwards. [93] The plaintiff sought declaratory relief against the provisions. The Court approved of the plaintiff's course of conduct in seeking the relief.[94] Implicit in

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[90] Unreported, High Court, Auckland Registry, 20 December 1985, A 1407/85.

[91] Above n 49, at 11.

[92] [1994] 2 ERNZ 586.

[93] From 29 April 1994 until 31 March 1995 at which time the restrictive covenant would become operative.

[94] Above n 92, at 590.

the Court's approval is a condemnation of the practice of ignoring restrictive covenants and commencing employment elsewhere.

Chief Justice Goddard in *Radio Horowhenua* suggested that payment may negate a finding that a restrictive covenant is unreasonable, since the hardship to the employee is alleviated.[95] Hardship, however is only one of the factors to be considered by the Court in assessing the reasonableness of a restrictive covenant. Paying employees for not working restricts their freedom to work but operates so as to mitigate the harshness of the effect. Garden leave is viewed by employers as an effective means of sanitising former employees. In practice garden leave has an effect very similar to a restrictive covenant, the payment of consideration is the only real difference. Garden leave provisions can hinder career continuity and development. Long periods of absence from a quickly changing industry can result in the employee being a less marketable proposition for potential employers. This impacts on their future employment prospects. Because there is consideration given for the arrangement, both the High Court and Employment Court are more reluctant to intervene than in the case of a simple restrictive covenant. It is important that this trend should be carefully scrutinised lest the duration of the restriction should last so long that it unduly interferes with the career development of employees.

B Employer Agreements Not to Hire

A potentially dangerous extension of the implied duty is employer collusion, whereby employers agree not to employ each other's staff. This operates as a de facto ceiling on the level of wages payable. Workers would not be denied the right to earn a living, and future courts might be more willing to uphold the validity of such restraints, especially if under pressure from the business community. This occurs regularly in the sports world where the transfer system operates as a restraint on players' freedom to choose whom

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[95] Above n 46 , at 1096.

they will play for.[96] The rules operate on several levels. They prevent the player negotiating and contracting to play for a team of their choice. Restrictions on player transfers bind the player to a club for an indefinite period during which they may not be remunerated. In *Blackler v New Zealand Rugby Football League (Inc)* the New Zealand court refused to allow the NZRFU to refuse to grant Blackler clearance to play in Australia.[97] Salary caps instigated by clubs create a ceiling for payment of players. Where there exists an involuntary restraint the courts should be more hesitant to assume that the restraint is reasonable. The Court should consider the inequality of bargaining positions between the players and the clubs. Lord Diplock in *A Schroeder Music Publishing Co Ltd v Macaulay* stated that restraint of trade is about:

> the protection of those whose bargaining power is weak against being forced by those whose bargaining power is stronger to enter into bargains that are unconscionable. [98]

With the increase in popularity of Rugby League and the high prices being negotiated by players it may be that there will be a move away from an automatic presumption of inequality of bargaining power. Additionally, if the practise had the effect of substantially lessening competition in a market, it would fall within s 28 of the Commerce Act.

VI Restraints on Non-Work Activities

A Implied Duties

In recent years employers have tried to monopolise employees' skills by claiming that the use of the employee's skills to the benefit of anyone but the employer, constitutes a breach of the implied terms of fidelity or confidentiality. This enables the employer to do

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[96] For a discussion of the operation of restraint of trade in sport see A. Humphreys "Sport, Restraint of Trade and the Australian Courts" 15 Sydney Law Review 92.

[97] [1968] NZLR 547.

[98] [1974] 1 WLR 1308, at 1315.

that which it would not otherwise be able to do within the traditional rubric of restraint of trade. The implied duties are used in a number of ways, to prevent secondary employment, and as justification for dismissal on the basis of personal relationships, and to act as a ceiling on wages.

Implied duties represent a quagmire of legal uncertainty for the employee. The implied duties operate during the employment relationship, while restraint of trade operates when the employment relationship has ended. The duty comprises a duty of fidelity, confidentiality and an obligation not to do anything that might undermine the trust and confidence in the employment relationship. The duties are sketchily defined and expand incrementally. The lack of certainty leads to the employer defining the duty as widely as possible. In construing the terms so widely the Court can sometimes ignore the basic legal principles relating to restraint of trade. The requirement that there be an identifiable asset to protect and the fact that there are other means of protection available to the employer often go unnoticed.

An employee may not do anything that betrays the duty of fidelity that he or she owes the employer. The American Restatement (First) of Contracts defines such a duty as a vertical restraint of trade. According to *Petrofina,* a restraint of trade consists of an employee agreeing any time *after* the formation of the contract, to restrict their liberty to trade in the future.[99] The duties become more confused where an employee gains secondary employment. There is no absolute rule preventing an employee from working for someone else during their spare time. To prevent this the employer has to show the existence of harmful competition inconsistent with the duty of good faith.[100] Courts will not imply a restrictive covenant, it must be specifically stated. Secondary employment is not subject to the doctrine of restraint of trade. The clause does not take away a liberty that the employee would otherwise have had. An employee cannot contract out of the duty of fidelity. The duty is breached if your spare time activities adversely affect the

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[99] *Petrofina (GB) Ltd v Martin* [1966] Ch 146.

[100] *Hivac Ltd v Park Royal Scientific Instruments Ltd* [1946] Ch 169.

employer's interests. According to the traditional analysis if your secondary employment is similar in nature to your full time employment this could constitute a breach of fidelity.[101] An employee must serve their employer with the utmost faith and fidelity.[102] Conduct that the ordinary person would regard as dishonest is prohibited. The implied duty of confidentiality exists independently of a restrictive covenant and survives the employment relationship.

1 Confidential Information

Many contracts contain provisions relating to issues of confidentiality. *Target Recruitment Services v Lewin* involved both restraint of trade and confidentiality issues. Target consultancy agency requested staff to sign an agreement not to disclose or use information in such a way that would cause loss or injury to Target.[103] The prohibition operated during employment and for twelve months afterwards. It was limited to competition in a specific area. The defendant's employment was terminated and within two months he began working with a competitor in defiance of the restrictive covenant. Confidential information had been acquired in the course of employment. This was within the scope of the restraint. The duration of the restraint was considered excessive and was reduced. The Court commented that a person should not be denied the subsequent use of skills acquired during the course of employment, even if those skills may assist a competitor.[104] An employer could however impose a restraint to protect an identified proprietary interest.[105]

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[101] Above n 63.

[102] *Schilling v Kidd-Garrett Ltd* [1977] 1 NZLR 243.

[103] [1987] 2 TCLR 391.

[104] Compare this with Judge Finnigan's analysis in *Marine Helicopters* above n 1.

[105] *Stenhouse Australia Ltd v Phillips* [1974] AC 391

2 Undermining the Employer's Authority

The employee has a duty not to do anything that would undermine the trust and confidence in the employment relationship. Great emphasis has been placed on this concept by employers, as it can be interpreted to mean almost anything. In *Bridge v Big Save Furniture Ltd* [106] the plaintiff obtained a lease to commence his own business and approached potential suppliers, but did not attempt to persuade the supplier to discontinue supplying the defendant. The Tribunal held that the plaintiff's actions in approaching the suppliers had the potential for creating a rumour about the employer. Bridge owed a duty of good faith and loyalty to the employer which was being undermined by the plaintiff's actions. The defendant was held to be justified in summarily dismissing the plaintiff for undermining the employment relationship. The Employment Court reversed the Tribunal's decision and held that the employee had not engaged in dishonest conduct. Goddard CJ referred to *Schilling v Kidd Garrett Ltd* and stated that the test for "fraudulently undermining" the employment relationship was too narrow a test of the employee's intentions.[107] He stated what he believed an employee may not do:

> What the employee may not do is act against the interests of the employer by devoting himself in time paid for by the employer - otherwise than incidentally - to the pursuit of his own interests, or, while still employed by the employer, pursuing commercial advantage at the expense (usually meaning to the exclusion) of the employer.

The Court of Appeal said that dishonesty was not a precondition for finding that the duty of fidelity had been breached. The breach occurred when the employee's intention to leave was made known to the suppliers and staff, but not to the employer. This test is lower than that of the Employment Court and encompasses a wide range of conduct. It is unimaginable that an employer planning to retrench employees would be under a similar duty to let staff know before other people such as the solicitor or accountant.

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[106] [1993] 2 ERNZ 201.

[107] [1977] 1 NZLR 243.

If an employee induces customers to leave the employer for the employee's advantage this amounts to misconduct. In *Compass Union of New Zealand Ltd v Foodstuffs Auckland Ltd* the employee undertook private accounting work for customers of his employer.[108] The employee claimed that he was unjustifiably dismissed. The dismissal was procedurally unfair but the Court refused to award damages because of the misconduct. In *Davis Trading Co Ltd v Lewis* the nature of the work was of importance in deciding whether the conduct involves a breach of duty. [109]

> The traditional approach to an employee's spare time activities is that employees are free to use their spare time as they see fit, unless there is a conflict of interest. The cases usually involve a clear threat of damage to the employer, hostile competition or bad faith. Actual conflict is usually caused by the employee's activities not just a mere apprehension of conflict.

Conduct that is likely to undermine the employment relationship is now defined widely, and dishonest intent is not a prerequisite. The Court of Appeal *Bridge* test is moving towards an attempt to restrict an employee on the basis of apprehension of conflict, rather than actual damage. This does not bode well for employees seeking to establish a business before they leave employment. Would listing the company or seeking a bank loan be sufficient to undermine an employer's authority?

B Pillow Talk Cases

An undesirable trend in New Zealand employment law is the "pillow talk" case. This consists of a real or imagined threat that an employee may pass on confidential information to an employee of a rival company because of the personal relationship between them. Employers have reacted to the perceived threat by sacking the (invariably female) employee. Discrimination on the basis of marital status is prohibited by the Human Rights Act 1993. Employees who are married enjoy a better level of protection.

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[108] [1992] 3 ERNZ 16.

[109] [1993] 2 ERNZ 272.

In the other cases the women dismissed were not married to their partners. No argument was made by counsel in the case on the basis of sex discrimination. This is an option that the writer hopes will be utilised should similar cases arise in the future.

In *Northern Clerical Workers Union v Printpac UEB Carton* an employer was concerned that a female employee might pass on confidential information to her partner who worked for a rival firm.[110] The employee's dismissal was held to be justified because of the possibility that she might pass on confidential information. Justice Travis considered that dismissal could be justified for good business reasons, totally unrelated to the employee's conduct. The judge applied a United Kingdom case which established that close relationships may justify dismissal.[111] Justice Travis concluded from his survey of the authorities that, if the employer had reasonable grounds for suspecting that there was potential for information to be passed, dismissal could be justified. Mere access to information was sufficient. It is unclear from the case law what type of evidence the employer would have to present as justification.

Meeuwsen v New Zealand Railway Co Ltd and *Eggleston v Firestone Tyre & Rubber Co Ltd*[112] both involve women being dismissed from their employment. The female employees were dismissed because of their relationship with a person employed by a competing business. The employers alleged potential for confidential information to be disclosed, even if inadvertently. In *Meeuwsen* the Court accepted the employer's assessment of risk and held that the dismissal was justified. It is arguable that the Court did not exercise procedural fairness.[113] In *Eggleston* the dismissal was found to be unjustified because the dismissal was founded on the marital status of the employee. An evidential basis for the perceived risk was required. The issue of sexual discrimination was never raised in relation to these cases The *Eggleston* approach is preferable but should be extended to provide protection for de facto couples. Otherwise the law would

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[110] [1989]2 NZILR 644.

[111] *Skyrail Oceanic Ltd v Coleman* [1980] IRLR 226.

[112] Unreported judgments, AT 212/93, and CT 119/ 93 respectively.

[113] The Court did not test the validity of the employer's allegation, but just accepted it as true.

operate so as to put unmarried couples at a palpable disadvantage. The substantiality of the risk should be assessed and principles of procedural fairness applied.

C Secondary Employment

An area which is cause for concern is the development of restraints on secondary employment. An increasing number of people are relying on a combination of part time jobs. Women tend to be over represented in this category of work. Difficulties arise because the employer frequently fails to identify the interest they seek to protect. *Communications & Energy Workers Union v Tisco* is perhaps the best known of the cases involving implied duties of confidentiality and fidelity.[114] Tisco's employment contract provided that the pursuit of electronic trade practises for monetary reward without the knowledge and consent of the company was strictly forbidden. An employee of Tisco's repaired and sold old televisions in his spare time. Tisco objected to this on the grounds that the employee used spare parts bought at a staff discount and other retailers had complained to Tisco that it might lead to a drop in new television sales. The plaintiff could not claim that there was any direct competition. The employer was claiming an exclusive right to the employee's skills. The Court of Appeal judgement defined this by saying that it comprised the mutual trust and confidence in the employment relationship.

> [a]ny conduct by an employee which is likely to damage the employer's business, for example by impairing its goodwill, or to undermine significantly the trust which the employer is entitled to place in the employee, could constitute a breach of duty.[115]

The Court of Appeal determination of *Tisco Ltd v Communications & Energy Workers Union* departed from the Employment Court approach.[116] The Employment Court had

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[114] [1992] 2 ERNZ 1087.

[115] [1993] 2 ERNZ 779, at 782.

[116] Above n 115.

analysed the issues according to the restraint of trade doctrine, which theoretically requires a balancing of interests.[117] The Employment Court held that there was no attempt to injure the employer's interests so the duty of fidelity was not breached. The Court of Appeal considered that any conduct likely to damage the employer's business by impairing the goodwill or undermining the implied duty of trust would constitute a breach. Such conduct is unspecified and is left for the Court to define on a case by case basis. This results in a substantial extension to the duties and obligations in the employer employee relationship. A more equitable result would be reached if public policy considerations were taken into account.

1 The Tisco Aftermath

If a checkout employee at Kmart works fifteen hours a week, and ten hours a week as a shop assistant at a retail store, would it be reasonable to prevent her from working one of the jobs because of a possible breach of the duty of fidelity? If so, then which job would take priority, the job she was first employed in or the job that she works more hours in? Would the duty still apply if the jobs although both in the retail sector were substantially different? Many of these questions remain unanswered by the Tisco decision.

The defendant in *Tisco* was not acting in direct competition with the plaintiff company. The Court had found four factors constituting a breach of the implied duty of fidelity and confidentiality.[118] If an express term in the contract had prohibited secondary employment the employee would benefit because the Court would have analysed it in accordance with the restraint of trade doctrine. The clause would be prima facie void,

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[117] Above n 114.

[118] The abuse of staff purchasing concessions

Profiting from the repair work

The risk that potential customers may purchase from the defendant and not Tisco

The damage to Tisco's relations with other businesses.

subject to an assessment for reasonableness. If the clause prevented an employee from earning a living the courts would be more reluctant to enforce the clause. Implied terms prevent the employee from taking on other employment if it in any way jeopardises the implied duty of fidelity. This duty includes third party interests.

The Court of Appeal *Tisco* decision has a potentially serious impact on the work conditions of part time workers, independent contractors and people who rely on a combination of jobs. Employees are substantially disadvantaged by the fluid scope of implied duties. A system of analysis should be devised that takes account of the employee's role in the organisation and the type of work that they are carrying out in their secondary employment. Employers should have to point to an interest that is being damaged by the employee's conduct, not to abstract or theoretical damage. The duty should only apply where the employee has real and substantial client contact and is in a position to influence the decision making process within the organisation. The duty should in some way be proportional to the hours worked by the employee.

2 A Return to a More Conservative Approach?

More recently *McKay Electrical (Whangarei) Ltd v Hinton* dealt with the implied terms of fidelity in the employment relationship.[119] The fact situation is clearer than the *Tisco* decision. McKay Electrical, one of the leading electrical firms in the Whangarei area was invited to submit a tender for work at Northland Health. Northland Health was not satisfied with the tender and invited McKay Electrical's employee to tender. Hinton's tender was accepted and he resigned. Counsel for the plaintiff argued that it was not necessary to show dishonest intent in order to establish a case against the defendant. There could be a breach of fidelity without dishonesty.[120] The employer was seeking to protect his legitimate existing business interests. The employee was not undertaking secondary employment, but sought to supplant his employer's services in a limited

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[119] Unreported, Court of Appeal, 25 June 1996, CA 123/96.

[120] See *Bridge v Big Save Furniture* [1994] 2 ERNZ 507, at 517.

market. The plaintiff did not attempt to restrict the future employment prospects of the defendant. The defendant was not restrained from submitting tenders for any future work at the hospital. The writer can perceive less harm in the approach of the Court of Appeal than in the *Tisco* case. There was a clear conflict of interest and undermining of the employment relationship. The defendant remained free to pursue other contracts with Northland Health and so the damage suffered by him was mitigated.

In *Tisco* a strong obligation was placed on employees where there is potential for conflict of interest.[121] Competition per se is not what should be objected to, but the abuse of the employment relationship. *Tisco* lacks a sense of proportionality and a method of analysis that enables employees to undertake secondary employment without fear that they will be breaching the vaguely defined implied duties.

VII Procedural Issues

A Employment Court Jurisdiction

Jurisdictional issues have haunted the Employment Court since its creation. The Employment Court has both concurrent and exclusive jurisdiction. Sections 104(1) (f), (g) and (h) set out the Court's jurisdiction. Section 104(1)(f) grants jurisdiction to determine any matter connected with an employment contract. Section 104(1)(g) grants the Court exclusive jurisdiction to hear and determine any action based on an employment contract. Section 104(1)(h) provides jurisdiction to grant any order that the High Court or District Court may make, in any proceedings that are founded on, or related to an employment contract. In *Medic Corp Ltd v Barrett* counsel for the plaintiff suggested that the Employment Court did not have jurisdiction to grant injunctions.[122] *X v Y Ltd & NZ Stock Exchange* reaffirmed that the Employment Court has all the tools

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[121] Above n 115.

[122] [1992] 2 ERNZ 1048, (HC).

that were possessed by previous jurisdictions.[123] All cases founded on an employment contract should, however be heard in the Employment Court.[124] *Cooney v Welsh*, a High Court decision should rightfully have been heard in the Employment Court.[125] In *Cooney* a separate deed of restraint of trade was appended to the employment contract. The plaintiff sought relief from the terms of the deed. The Court held that provided the deed was sufficiently isolated from the employment contract, the Court could deal with the matters therein contained. The fundamental question is whether or not the deed and the employment contract are intimately connected. *Medic Corp v Barrett* dealt with the issues of confidentiality and Employment Court jurisdiction.[126] The question was thus framed:

> But is the breach of duty so closely interwoven with a breach of an employment contract that it can be said that there is an action relating to an employment contract? It is certainly referable to an employment contract.[127]

B Modification

1 New Zealand

The modification provisions of the Employment Contracts Act are a major reason why employers seek to avoid the jurisdiction of the Employment Court. It is difficult to obtain an order for modification if no attempt at reasonableness has been made. If this procedural hurdle is jumped the plaintiff the contract can be modified by the Employment Court. Modification is more extensive than the approach of the High Court which is simply to strike out the elements of the contract that seem most unreasonable.

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[123] [1992] 1 ERNZ 863.

[124] S 3(1) Employment Contracts Act.

[125] Above n 47.

[126] Above n 34.

[127] Above n 34, at 530.

The enforcement of restrictive covenants is governed by the Employment Contracts Act 1991 and the Illegal Contracts Act 1970. Section 104(1)(h) Employment Contracts Act 1991 grants the Employment Court the jurisdiction to make any order that the High Court of District Court may make. This means that the provisions of the Illegal Contracts Act apply. Section 104 (2) sets a double requirement before the Court can modify a restrictive covenant. The Court must be satisfied beyond reasonable doubt that:

a) The order should be made

b) That any other remedy would be inadequate or inappropriate.

The employer must prove these elements to the criminal standard of proof. In *Radio Horowhenua* Goddard CJ remarked that the requisite standard to justify modification is higher than the requirement prior to 15 May 1991.[128]

The Illegal Contracts Act provides:

> s 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 so amended; or
>
> (b) So modify the provision that at the time the contract was entered into the provision so 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 provision

The powers of modification contained in section 8(1)(b) are wider than those of the common law doctrine of severance.[129] Section 8(1)(c) implies that a clause can be modified unless it would substantially alter the bargain between the parties.

Section 104 is only relevant if the court exercising jurisdiction is the Employment Court. It is not applicable if either the High Court or District Court exercises jurisdiction. The

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[128] The date that the Employment Contracts Act was introduced.

[129] The clause need not consist of separate covenants and there are few limits on the type of modification that may be made.

High Court approach proceeds on the basis that a restraint may be modified unless there is a cogent reason not to do so.[130] This approach however may be based on an impressionistic reading of the *Mason* case.[131] The appellant, notably titled Mason (Pauper), sought relief from a broadly drafted contract that prohibited vaguely similar for a three year period, within twenty five miles of London. *Mason* did say that a court may enforce a covenant even when taken as a whole it exceeds what is reasonable.[132] However, Lord Moulton qualified this by saying:

> It would in my opinion be pessimi exempli if, when an employer had extracted a covenant deliberately framed in unreasonably wide terms, the Courts were to come to his assistance and, by applying their ingenuity and knowledge of the law, carve out of this void covenant the maximum of what he might validly have required.[133]

Employers prefer the approach of the High Court as it is easier to satisfy the Court that a modification should be made. It is unlikely that many employers would persuade the Employment Court to exercise jurisdiction to modify. *H & R Block v Sannot* and *Cooney v Welsh* affirmed that the High Court has a wide discretion to modify clauses.[134] In *MA Watson v Kelling* Justice Smellie noted that a balanced, careful judicial approach is needed to reach a fair and reasonable result.[135] The overall justice of the case should be considered in deciding whether to exercise the power to modify. "Modify" means to vary or change the provisions of the contract. Therefore it is possible that a clause could be made stricter.[136] The power to modify should only arise where the restraint is unreasonable. If a clause is unreasonable it seems hard to justify increasing the restraint. In this writer's opinion, clauses that make no attempt to be reasonable should not be

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[130] See above n 79.

[131] See above n 19.

[132] See above n 19, at 745, where Lord Moulton stated that severance should only be done where the part was severable and only where the excess was of trivial importance or was merely technical.

[133] Above n 19, at 745.

[134] Above n 79, and above n 47.

[135] Above n 54.

[136] Above n 47.

modified.[137] This is also borne out by the dicta in the *Mason* case. If the overall effect of the clause is unreasonable it should not be modified. *Dillon v Chep* is a step in the right direction for the High Court. The judge commented that a reason why the clause should not be modified was because the employer had made no attempt at reasonableness in drafting the terms of the covenant. The Employment Court standard of proof required to enable modification is high. If a clause is not modified it will be struck out. For this reason many employers seek to have their cases brought before the District Court or High Court. The plaintiff in the *DB* case barely managed to establish an arguable case that the Court would be satisfied beyond reasonable doubt that modification should be made. If the contract could be modified and allowed to stand, there would be an arguable case that Lion was party to the breach of contract. Lion took a commercial risk by employing the defendant in full knowledge of the restrictive covenant. This factor was balanced against the potential hardship to the defendant. The balance of convenience and justice favoured DB. The defendant had proceeded in spite of the restraint of trade clause, hoping that DB would not seek to enforce it. The Court disapproved of this course of action.

> [I]t can hardly be said that equity should favour such an approach when there exists a viable, lawful, and measured means of challenging an agreed contractual term that now appears inconvenient or unreasonable.[138]

If the Court cannot be persuaded to modify the clause it will be struck out. The fact that there are still jurisdictional debates means that as the law stands with regard to modification of provisions, the employer will always favour the High Court.

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[137] Above n 19 at 745-746.

[138] Above n 45, p 11.

2 *American State Approaches to Modification*

Problems relating to modification are not unknown in other jurisdictions. The State of Ohio used to operate a bright line test for the assessment of restrictive covenants. Since then Ohio law has refined the principles of law in *Briggs v Butler*.[139] Covenants must be reasonable, protect a legitimate business interest of the employer, not be unduly harsh on the employee and be in the public interest. Clauses were interpreted by the Court in such a way that they were either valid, or unreasonable and consequently invalid. This approach was refined in *Arthur Murray Dance Studios of Cleveland Inc v Witter*.[140] The main point was that there was no longer to be a bright line test applied to analysis of restrictive covenants. The *Arthur Murray* test has been accepted by over fourteen states as the correct test to adopt for the analysis of the reasonableness of covenants.[141]

The Court in *Extine* severed the covenant into four parts.[142] Severability allowed some elements of the covenant to be retained whilst striking out the more unreasonable ones. The doctrine of severance led the State of Ohio towards a regime that favours the employer. An extreme example of this was the Court upholding the validity of an eighteen month restriction encompassing forty-five states.[143] By 1977 the Court was able to rewrite portions of the contract that it felt were unreasonable. The Court expressed its view that:

> a covenant not to compete which imposes unreasonable restriction on an employee will be enforced to the extent necessary to protect an employer's legitimate interests.[144]

This indicates a presumption in favour of the employer and presumes nefarious intent on the part of the employee. This gives scope for employers to draft wide clauses as there is

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[139] Above n 26.

[140] 105 NE 2d 685 (1952).

[141] See B.D. Pynnonen "Post Employment Covenants" 55(1) Ohio State Journal 215, at 220.

[142] See above n 28.

[143] *Patterson International Corp v Herrin* 264 NE 2d 361 (1970).

[144] Above n 28, at 547.

no longer the fear that the covenant will be struck down for unreasonableness. The Court refuses to enforce the most unreasonable clauses and allows the remaining clauses to stand. In *Raimonde v Van Vlerah* the court decided that injunctive relief should run from the time of the judgment not from the end of the employment relationship.[145]This was a reaction to the delay in fixing a court hearing. In many cases, the period of restraint had already run out by the time a fixture was gained.[146] The law relating to restrictive covenants in Ohio uncertain geographical restraints vary greatly, and the assessment of the validity of duration is also variable. It can be argued that this is the very approach that the Court desired to achieve when it departed from the bright line test.

The development of the law in Ohio is pertinent to New Zealand. There is increasing uncertainty as to how the courts will assess covenants. Compounding this is the problem of concurrent jurisdiction. The High Court and Court of Appeal in effect apply the doctrine of severance. The Employment Court can undertake to modify the contract. The New Zealand Employment Court has an advantage in that it requires a high threshold to be satisfied before a covenant can be modified. This may act as a buffer against potential excesses. It is probably fair to say that it is true that if employers feel that they can draft what they will and then rely on the Court to sever or modify the covenant, there is less incentive to draft fair clauses.

C Injunctive Relief

Injunctive relief reinforces the problems in the courts' assessment of restrictive covenants. Where a decision to uphold the validity of covenant or to modify the restraint has been made, an injunction will cement the provisions of the covenant. The High Court, and now it seems the Employment Court also take a varied approach to the assessment of the reasonableness of restrictive covenants. These uncertainties are reflected in the limb of assessment that requires the Court to look at the overall justice of

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[145] 325 NE 2d 544 (1975).

[146] In New Zealand, delays in the Court system are endemic.

the case in determining whether to grant the injunction or not. Courts should always bear in mind that granting the injunction may act as a de facto determination of the case. Injunctive relief requires a four pronged analysis:

1. Determining where the threshold in the case is.[147]
2. Ascertaining where the balance of convenience lies.
3. Calculating damages.
4. Determining the overall justice of the case.

1 Threshold

The *American Cyanamid* approach asks if there is a serious question to be tried. This was modified in *Armourguard Security* where it was said that a prima facie case had to be made out. In *DB Breweries* the requirement was that an "arguable or serious case" be shown.[148] The prima facie test is on the whole preferable to the "arguable or serious case" test. As the latter test would effectively decide the case at the interim injunction stage.[149]

2 Balance of Convenience

In assessing the balance of convenience, the Court considers the damage that the business will suffer if the injunction is not granted. This is balanced against the injury the employee will suffer if the injunction is granted. Given the length of time before most hearings, a case is frequently decided at the interim injunction stage anyway. This de facto determination should be borne in mind when effecting the balancing process. An employee is placed at a disadvantage, because an employer can enforce a restraint of trade clause without having to prove any facts. It has been argued that *American*

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[147] Ie is there really a case to bring?

[148] Above n 45.

[149] Although to a large extent this is the case already due to the delays inherent in gaining a fixture. It is hoped that the case flow management system being introduced may speed this up.

Cyanamid does not apply in cases where there are exceptional circumstances, where granting or refusing the interlocutory injunction would dispose of the major issue of contention.[150] In many cases a substantive trial may not take place until the restraint clause period has elapsed. The High Court in *LEP International v Hass* found that there was a serious issue to be tried but the balance of convenience indicated that damages would be an adequate remedy.[151] The plaintiff could not show that irreparable damage would result if the defendant was allowed to continue in his employment. Conversely, the effect on the plaintiff upon granting of the injunction would be great. Caution is to be advocated where an interim injunction would achieve the plaintiff's desired result ahead of a substantive hearing. There is some force to the proposition that the overall strength of the plaintiff's case against the defendant should be assessed. Another alternative would be to apply the balance of convenience test and have regard to the strength of the employer's case within that heading.

3 Overall Justice

Court has considered whether s 8 Illegal Contracts Act should come in to play at the interim injunction stage. In *Castle Parcels v Dale* the Court suggested that s 8 should not be invoked at the interim injunction stage of proceedings. [152] Once a clause is varied it is binding. However, to refuse to apply s 8 could effectively put an end to the proceedings. Most restraint of trade proceedings do not reach the substantive hearing stage. *Key Graphics (Auckland) Ltd v Verhoeyen* indicated that a clause could be modified if it were unreasonable.[153] However if the restraint is unreasonable it is harder for the employer to satisfy the requirements of s 104(2) Employment Contracts Act that allows the Court to effect a modification, and no modification would occur. In *Dominion Breweries v Marshall* the existence of the section 8 power to modify was deemed not to

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[150] P.L. Davies, *"Post Employment Restraints: Some Recent Developments"* Journal of Business Law 1992.

[151] Above n 66.

[152] (1989) 2 NZELC 96,774.

[153] (1989) 2 NZELC 96,566.

be the sole reason for upholding the validity of a restraint.[154] The Employment Court had to consider the potential application of s 8. To gain an injunction DB had to establish that they had an arguable case. The Court had to be satisfied beyond reasonable doubt that modification should be made and other remedies would be inadequate or inappropriate. The time lapse before a substantive hearing should be considered. In the *Greenwich* case there was no substantive hearing scheduled in the foreseeable future. The *DB* case lies between *Castle Parcels* and *Key Graphics* in the judicial spectrum. An arguable case must be established that the Court can exercise its discretion to modify. If the employer can establish an arguable case that the clause can be modified an injunction will be granted. This leaves open the possibility of potentially unreasonable terms being enforced.

One of the main difficulties with injunctions is that it takes so long to gain a fixture that the interim injunction in effect determines the case substantively. If, as in Ohio the restraint were to operate from the time that the judgment were handed down, this might not be the case. If we accept that in the majority of cases the interim injunction will determine the matter, it is vital that the Court should very carefully balance all the factors which are traditional considerations in the restraint of trade doctrine.

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[154] Above n 45.

VIII Potential Developments/ Alternative Approaches

The United States has formulated alternative approaches to restrictive covenants. There is merit in some of the approaches, especially where they serve to clarify the type of assessment the Court should be making. Not all of the proposals are as benign. The trend in targeting employee benefits may well be something that New Zealand is yet to face.

A Requirement of significant personal contact

An employee should be able to demonstrate that they had no significant personal contact with the client whilst employed. The employer's records could be used to establish the degree of contact that existed. An employer should not be able to prevent an employee from working for former clients. There is no legitimate interest to protect. This test would not presuppose the employee's dishonesty.

B Solicitation Tests

Washington considered a rule requiring solicitation in order that a restraint be upheld. This test mitigates the hardship to the employee. If the burden of proof lay on the employer it may be an undue burden to discharge and offend the employer's clients. A solicitation test causes detriment to all parties. The advantage that an employee receives can harm the employer whether there is solicitation or mere acceptance of the client's business. Obtaining proof may be difficult where the client prefers the employee's services and does not wish to harm its relationship with the employee by testifying. Expensive litigation would be necessary to decide whether or not the employee had solicited. The employee and employer could be harmed by gaining a reputation for dragging clients into Court. The client's testimony could have an adverse effect on the employer by revealing the reasons why the employee is preferred over the employer. The

solicitation test is of little benefit to the public as it does not effectively improve the public's freedom to choose the services of a professional.

C Liquidated Damages

Liquidated damages can be awarded where the employee had an unfair competitive advantage. This allows the market to determine the value of the employee's skills. Expert testimony could establish an amount that would reasonably compensate the employer for loss of clients. The harm to the public and the employee would be mitigated. This approach may be more acceptable to the business community.

D Loss of Accrual Benefits: the "Bad Boy" Provision

In the last twenty years in the United States there has been a substantial amount of litigation obliquely involving restrictive covenants. Instead of the employer enforcing the covenant, the employee is forced to take action to obtain their accrual benefits. For various operational reasons, an injunction may be insufficient to protect the employer's interests. Instead of relying on the covenant, the employer withholds a benefit that would otherwise have accrued to the employee upon termination of the employment relationship. The nature of the benefit withheld changes from industry to industry. It may concern company initiated pension top ups or performance linked payments.

Employers have withheld employees' pensions as punishment for a breach of the restrictive covenant. The Employee Retirement Income Security Act 1974 prevents the contractual forfeiture of interest under a deferred compensation plan.[155] The arrangement may involve more than one type of pension payable. In such cases the courts are prepared to divide the agreement and grant the employee such funds as are protected by ERISA, while withholding monies that do not constitute a pension plan under ERISA. In

[155] ERISA ss 3(2)(A), (7), 203(a), (a)(2)(A-C), 502(a), 29 USCA ss 1002(2)(A), (7), 1053(a), (a)(2)(A-C), 1132(a).

Darden v Nationwide Mutual Insurance Company the court held that the fund at issue had two functions which could be separated.[156] The employer's deferred compensation plan was protected by ERISA. The extended earnings plan which gave the employee sums equal to their earnings in renewal fees over the last twelve months was held to not be a pension plan within the meaning of the Act.[157] In *Hauck v Eschbacher* employees entitled to benefit from an employee benefit scheme faced forfeiture of their entitlement for breach of a restrictive covenant. The former employees were not given notice of the alleged breach until 27 months after the employment relationship had ended. They had no real chance to cure the defect. The court held that a restrictive covenant in a profit sharing plan could not be retroactively applied.[158]

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[156] 922 F2d 203.

[157] Above n 156, at 208.

[158] 665 F 2d 843, at 847.

IX Whither?

The New Zealand approach to restraint of trade is not innovative. The common law has been modified on a case by case basis, without any re-evaluation of the doctrine. Restraints appear to be more common than they were twenty years ago. The duration of restraints has increased over the last ten years. Perhaps this is a result of society's ever increasing awareness of the value of information.

New Zealand has been tardy in its approach to issues of competition law. The Commerce Act does not have a real impact on restraint of trade in the employment context. The United States has had such conduct firmly in its legislative eye for a considerable time. Individual states have legislated to create a check on employer practices. The approach has been to attack the problem in two ways, by modifying the common law and by legislation. The requirement of solicitation and similar occupational requirements is an interesting approach to the problem. The Georgia approach which strictly limits the types of employees to whom restrictive covenants may apply seems to be eminently sensible and in the public interest.

An obvious problem is the concurrent jurisdiction of the High Court and Employment Court. The writer perceives substantial problems with lack of clarity as to the boundaries of the courts. This inevitably leads to forum shopping as employers move for a determination in the High Court which is perceived to be more employer user friendly. Employees favour a determination in the Employment Court. The jurisdictional debate is highly topical and will continue for some time.

The High Court is more likely to modify the provisions of a covenant to allow it to stand. This creates little incentive for the employer to make a genuine attempt to draft a reasonable restrictive covenant. The Employment Court requires that the employer prove to the criminal standard that a restraint should be modified. In practise this is very rarely

achieved. Instead of a harsh covenant being altered and substantially enforced, it is struck out.

New Zealand case law diverges from the traditional analysis of restraint of trade. The recent *Marine Helicopters* decision is disturbing if it represents a new trend in the approach of the Employment Court. It can only be hoped that it is a temporary aberration.

The extension of the scope of implied duties leaves employees extremely vulnerable to pressure from employers. These factors combined with the absence of any specific legislative guarantee of freedom of occupation, means that employees have few options when faced with a restrictive covenant.

The confusion caused by the variable standard of analysis in both courts is counterproductive. Giving parties the option of haggling over jurisdictional issues is similarly a waste of time and resources. During all of this the employee is unable to work and faces losing future opportunities as a result of the period of inactivity.

If New Zealand wants to aim for a labour market that is vertically and horizontally mobile, we should consider legislating to enable this. Legislation could resolve some of the difficulties by specifying the types of employee that a restrictive covenant may apply to. It could also help to clarify the factors that must be considered when assessing the validity of covenants. Jurisdictional issues should be resolved by giving one Court jurisdiction over restrictive covenants. Developments in the United States give us some indication of the face of developments in restraint of trade. Whatever reform process may be decided on, New Zealand should be mindful of Scylla and Charybdis and should steer a course that balances the interests of both parties. It is undesirable to create a shadow labour market, where motility is illusory.

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