

**Attention is drawn to the order
prohibiting publication of
certain information**

**IN THE EMPLOYMENT RELATIONS AUTHORITY
CHRISTCHURCH**

[2012] NZERA Christchurch 260
5295883

BETWEEN DESIGN ENGINEERING (SI)
LIMITED
Applicant

A N D WARWICK JOHN KEARINS
Respondent

Member of Authority: Helen Doyle

Representatives: Craig O'Connor, Counsel for Applicant
Tony Shaw, Counsel for Respondent

Investigation meeting 9 December 2011

Submissions: On the day
Supplementary submission from the respondent
22 November 2012.

Affidavit of Peter Grant Sworn at Timaru on 14 September 2012
McPherson

Date of Determination: 28 November 2012

DETERMINATION OF THE AUTHORITY AS TO DAMAGES

- A. I have modified a non-solicitation covenant to a three month period from 23 December 2010 to 23 March 2010.**
- B. I have found that the restrictive covenant as modified has been breached by the respondent.**
- C. I have found the breach to have been causative of loss to the applicant of work from one of its clients.**

- D. I have ordered payment of damages by the respondent to the applicant in the sum of \$13,169.23 together with interest on that sum at the rate of 5% from 1 January 2011 until the date of payment.**
- E. I have reserved the issue of costs and failing agreement being met have timetabled for an exchange.**

Prohibition from publication

[1] I prohibit from publication details of the financial information provided by Design Engineering (SI) Limited (Design Engineering) and its accountant as part of this claim except to the limited extent that such information appears in this determination.

[2] I express my regret to the parties for the delay in this determination. This was largely as the result of the compounding effect of the need to complete work from files that had been trapped in the Authority offices following the February 22nd earthquake which impacted on current workload issues. When the Authority came to determine the matter in June 2012 it realised that further information was required from the applicant before damages could be properly assessed. This information was provided by way of affidavit from Mr McPherson, chartered accountant in the firm of Footes Limited Timaru who have been the accountants for Design Engineering for approximately ten years. Mr Shaw then provided a further submission in response to that affidavit.

Modification of non-solicitation covenant

[3] In my determination dated 17 September 2010, CA183/10, I made findings as to whether the restraint of trade and non solicitation covenants in Mr Kearins' employment agreement with Design Engineering were enforceable.

[4] In paragraphs 57 and 58 of the determination I found that:

[57] The restrictive covenants should also be no wider than necessary. It was clear from the evidence that the interest Design Engineering most wanted to protect was its relationship with its customers and unfair competition from Mr Kearins having influence over those customers and enticing them away. I am not satisfied that there is any other proprietary interest that is capable of protection that is not simply to prevent competition.

There is adequate protection for the proprietary interest that I have found in the non solicitation covenant in clause 12(b). Clause 12(a), the restraint in trade covenant is unreasonable, and unenforceable and not necessary.

[58] *The scope of the non solicitation covenant is restrictive being clients, customers or suppliers of the employer for the period of 18 months immediately preceding termination of the contract which includes Chapman Engineering. Nevertheless if the length of the non solicitation covenant is limited to not more than three months I am satisfied that the scope is reasonable.*

[5] The Authority in its determination of that date considered modification of clause 12(b) under the Illegal Contracts Act 1970 of the restrictive covenant but as required to do so it directed the parties attend mediation under section 164 of the Employment Relations Act. No orders modifying the non solicitation clause have been made.

[6] The parties attended mediation and I am satisfied that they attempted in good faith to resolve the issue. The Authority is satisfied under s164 of the Act that any remedy other than modification of clause 12(b) of the individual employment agreement would be inappropriate or inadequate. Mr O'Connor at the resumed hearing asked the Authority to consider modification for a longer period than three months. I have considered his submissions in this regard but I am not minded to extend the restrictive covenant beyond a three month period.

[7] The Authority has jurisdiction under s162 of the Act to make any order that the High or District Court may make under the Illegal Contracts Act 1970. I modify clause 12(b) in the individual employment agreement between Mr Kearins and Design Engineering as follows:

The employee shall not, at any time during the term of this agreement, or for a period of three months after termination of this agreement, for any reason:

- (b) *directly or indirectly canvas, solicit or attempt to solicit, or act for, in respect of work undertaken by the employer's business, any person, firm or corporation which has been a client, customer or supplier of the employer during the period of 18 months immediately preceding termination of this contract.*

Was there a breach of the restrictive covenant as modified?

[8] Mr Kearins incorporated a company, Aoraki Detailing Services Limited (Aoraki Detailing), on 15 December 2009 of which he is the sole director and shareholder when he was still an employee of Design Engineering. Mr Kearins approached Chapman Engineering on 1 or 2 January 2010 after resigning with immediate effect from his employment with Design Engineering on 23 December 2009 and thereafter undertook its steel detailing work. Chapman Engineering had been a customer of Design Engineering during the period of 18 months immediately preceding termination of Mr Kearins' employment relationship on 23 December 2009.

[9] I find that Warwick Kearins breached the restrictive covenant in clause 12(b) as modified when he solicited work from Chapman Engineering between the period 23 December 2009 and 23 March 2010. The breach was only with respect to Chapman Engineering and it is with respect to the loss of work from Chapman Engineering that Design Engineering seeks damages from Mr Kearins.

The issues

[10] The Authority is required to determine the following issues:

- Is the breach by Mr Kearins of his non solicitation covenant in his employment agreement causative of the loss to Design Engineering of Chapman Engineering's work?
- If the Authority is satisfied that the breach did cause loss to Design Engineering, what is the amount of the loss to Design Engineering?

[11] This involves an assessment of:

- i. What loss of profit flowed from Mr Kearins' breach to Design Engineering in respect of Chapman Engineering work?
- ii. Are damages able to be recovered beyond the conclusion of the restraint period?

- iii. What, if any account, should the Authority take of a possibility that Design Engineering may not have continued to receive Chapman Engineering's work after the resignation of Mr Kearins?

Is the breach by Mr Kearins of his non solicitation covenant in his employment agreement causative of the loss to Design Engineering of Chapman Engineering's work?

[12] Design Engineering was the only employer of steel detailers within Timaru before Mr Kearins formed his own company in late 2009. Design Engineering have not undertaken any steel detailing work for Chapman Engineering since Mr Kearins' departure notwithstanding that Design Engineering had been doing detailing service for Chapman Engineering for a period of about six years.

[13] For the year 1 April 2007 to 31 March 2008 Design Engineering undertook work for which it charged Chapman Engineering in excess of \$250,000. For the year ending 31 March 2009 it charged Chapman Engineering in excess of \$220,000. For work for the year ending 31 March 2010 it charged Chapman Engineering \$155,951.50. There was no steel detailing work performed for Chapman Engineering between January and March 2010. That coincided with Mr Kearins' departure from the firm and his undertaking work for Chapman Engineering. Mr Kearins undertook work that Design Engineering said it anticipated it would have carried out for Chapman Engineering for a project involving fabrication of steel for the Timaru Mitre 10 Megastore.

[14] Mr Kearins in his evidence acknowledges that he did detailing work for Chapman Engineering from 1 January 2010. He also confirmed that within the three months to 23 March 2010 he undertook some work for Chapman Engineering in relation to the Mitre 10 mega store in Timaru for which he invoiced \$15,957.50. He says that he was told by Mr Chapman the owner of the firm that he was the only person they would use to do detailing work. Mr Kearins said that it was his belief that Design Engineering would have lost the work in any event after he resigned even with the observing of the restraint period. He says his evidence that he was the preferred detailer for Chapman Engineering is supported by the fact that Chapman Engineering continued to use Design Engineering to undertake some other work that was not steel detailing work.

[15] Mr Kearins within a week or so of his without notice resignation approached Chapman Engineering to undertake its work. He had earlier set up his own company. Mr Kearins says in his evidence that Design Engineering would have lost the business anyway as Chapman Engineering only wanted him to do their detailing work. I did not hear evidence from anyone from Chapman Engineering.

[16] The evidence did not satisfy me that there was no-one at Design Engineering who could have undertaken the steel detailing work for Chapman Engineering after Mr Kearins resigned. I am not satisfied by the evidence of Mr Kearins that the loss of Chapman Engineering work was certain to occur or probable, at least for the period of restraint, if he had not breached his restrictive covenant after his resignation.

[17] I find that Design Engineering lost an opportunity to retain Chapman Engineering as the result of Mr Kearins breach and the opportunity to retain ongoing steel detailing work. It is that lost opportunity to retain Chapman Engineering as a client for which Mr Shaw submits damages are to be assessed or measured – *Schilling v Kidd Garrett Limited* [1977] 1 NZLR 243.

[18] I find that Design Engineering has proved to the required standard that the breach of the restrictive covenant by Mr Kearins was a substantial reason or cause that it lost Chapman Engineering and fees from that client from January 2010. Beyond the restraint period ending 23 March 2010 as modified I accept Mr Shaw's submission that there was a possibility from the evidence Design Engineering would have lost its work to Mr Kearins. Mr Kearins overheads were considerably lower than Design Engineering which in turn reflected in a lower charge rate by him per tonne of steel. He had undertaken the work whilst at Design Engineering for Chapman Engineering. That possibility will have to be assessed in terms of any loss that could be proven beyond the conclusion of the restraint period.

The claim for damages

[19] Mr Shaw referred the Authority to the Employment Court judgment of *BFS Marketing v Field (No 1)* [1993] 2 ERNZ 101. It was held at p.105 in that case that the loss or impairment of an opportunity to obtain or retain some profitable connection where the plaintiff is entitled to that opportunity by contract is a proper head of damages for breach of that contract.

[20] In *BFS* at p.110 it was found in addition to the plaintiff's entitlement to damages for the period of restraint representing the loss of income arising out of the breach it should have further damages for a period of three months following the expiry of the restraint. Although Judge Colgan, as Chief Judge Colgan was at the time of the judgment, concluded on the balance of probabilities that even if Mr Field had honoured the terms of his restraint and had not sought to do business with the client in that case until the end of the restraint period there was insufficient probability that the plaintiff would thereafter have retained the client business. He recognised however that this would not be an immediate loss to the plaintiff although over-generous to find that it would have retained the business for more than a period of 3 months following the expiry of the restraint. His assessment took account of the reality of the ordered conclusion of a long-standing business relationship.

[21] Mr O'Connor in his submissions sets out the approach taken by Design Engineering to assessing damage as the loss of profit from the loss of the Chapman Engineering work.

[22] Mr van Buuren is the managing director of Design Engineering. His evidence is that the loss of profit for an average year to Design Engineering from the loss of Chapman Engineering's work is \$83,265.15.

[23] In arriving at that figure Mr van Buuren firstly calculated anticipated fees for the period 1 January to 31 March 2010 if the work from Chapman Engineering remained with his firm. As set out earlier there was no work from Chapman Engineering over this period. On the basis that the average monthly fee charged to Chapman Engineering from 1 April 2009 to 1 January 2010 was \$17,327 Mr van Buuren multiplied that figure by three to arrive at anticipated fees for the three months in question of \$51,981. He then added that sum to the known detailing fees charged to Chapman Engineering for the year 1 April 2009 to 31 March 2010 of \$155,951.50 to arrive at a figure of \$207,932.50. I should record here that the figures referred to in Mr van Buuren's statement of evidence, para.3, were incorrect and by agreement they are replaced by the above.

[24] Mr Kearins takes issue with the methodology presented by Mr van Buuren about the calculation of anticipated fees for the three months in question. He does not accept that even if Chapman Engineering work had been given to Design Engineering the fees would have continued to be generated to the average rate they had been for

the first nine months of the year. He says that the detailing work which Design Engineering was undertaking for Chapman Engineering was declining over the years. I accept that is supported by a comparison of the detailing fees for 2008, 2009 and 2010. Further he says that the work undertaken for Chapman Engineering for the months in November and December 2009 was only \$6,640 and \$1,235 respectively.

[25] Mr van Buuren said that he knew in late 2009 that Chapman Engineering had secured a contract to fabricate the steel for the Mitre 10 Megastore in Timaru which involved about 160 tonnes of steel to be detailed. He said that if approximate costs of tonnage are used which I will not set out here for confidentiality reasons then he would have expected a further \$45,000 GST inclusive to have been generated. Mr van Buuren added that amount of \$45,000 to the figure of \$207,932.50 to arrive at the overall anticipated annual fees generated for 1 April 2009 to 31 March 2010 to be \$252,932. Mr Kearins does not accept this methodology. He does not accept that the charge out rate for that tonnage would have been as high as Mr van Buuren said it was and that not all the work was undertaken in the three months to 31 March 2010. Mr Kearins accepts that in the three months to 23 March 2010 he did undertake some work for Chapman Engineering in relation to the Mitre 10 Mega Store in Timaru. He says that he invoiced Chapman Engineering for this work \$15,957.50. Even at a higher charge out rate fees for the three month period he says would only have been \$24,000.

[26] Mr Shaw takes issue with what he says is a double up of anticipated fees plus the Mitre 10 job and submits the latter is effectively absorbed within the fees. I agree that there could be for some of the period I am being asked to consider a double up on that basis.

[27] Mr van Buuren has then averaged the three years annual fees charged to Chapman Engineering and applied a profitability margin of 33% to arrive at the amount claimed for one year. Mr Shaw takes issue with averaging in circumstances where the fees generated have been declining. I agree that that is not a reasonable calculation where the fees have been declining over the respective years. The focus should be on 2010.

[28] Finally there was a dispute about what should be used for the profitability margin. On the day of the Authority investigation meeting the Authority was provided with a survey undertaken by the University of Waikato Engineering Design

and Engineering Consulting Services showing the net profit of total income for the industry as 35.88%. Design Engineering had selected a general industry calculation of 33% in terms of ratio of net profit to income. That was described in the Consulting Services' analysis as being a medium net profit as a percentage of total income.

[29] Mr Shaw submits that the correct approach would have been for actual figures to be produced of Design Engineering's net profit from Chapman Engineering's work and that any calculation should be based on the firm's actual ratio of net profit to turnover.

[30] Whilst I do not disregard the industry standard completely in that it does provide a guideline the Authority considered that it needed for its purposes the actual ratio of net profit from Chapman Engineering's work to turnover. This was provided with the affidavit of Peter McPherson. With all due respect to Mr McPherson I could not understand why in the later part of his table he had excluded overheads. I have relied on the first four lines of the table for 2010 where at least fixed overheads have been taken into account. I find the ratio of net profit to turnover for the 2010 year is 15.2% on the basis of the affidavit evidence and that is what should be applied.

Determination

[31] The Authority had rather unsatisfactory evidence to determine the difficult issue of damages. It will however use its best judgment to determine a fair award of damages in the circumstances. For completeness I do not accept Mr Shaw's submission that given Design Engineering would have had a loss anyway in the 2010 year then the loss of Chapman Engineering's work caused no financial loss to it. The loss overall to Design Engineering would have been reduced if there had not been the loss of Chapman Engineering's work. There was a loss in that regard.

[32] The anticipated averaged monthly fees of \$17,327.94 from the first nine months of the financial year I find on the balance of probabilities include/overlap with the fees anticipated from the Mitre 10 job. I accept that the evidence supported a decline in fees over the years and for the last two months of Mr Kearins employment. On the horizon though as at November/December 2009 was the Mitre 10 job. I was not satisfied from the evidence that there would not be other work on top of that as well from Chapman Engineering, but for the breach by Mr Kierans. I have also taken into account that the Mitre 10 work continued on after the three month period.

[33] I take the figure then of \$17,327.94 per month anticipated fees as a starting point for assessment of damages. $\$17,327.94 \times 12$ is \$207,935.28. The loss for a year taking the net profit to turnover as 15.2% is \$31,606.16. The restraint period was three months. I accept that on the balance of probabilities Design Engineering would in all likelihood have lost its work to Mr Kearins and his company after the three month period. I have found it would in all probability but for the breach have retained it for the three month restraint period. Had there been no breach by Mr Kearins and the Mitre 10 work had been secured by Design Engineering the evidence supported that work ran beyond the three month period. For practical purposes that work may have been left with Design Engineering and other work that required completion would have had to be finalised beyond the three month period. I take that into account and find the recoverable loss is for the restraint period of three months and two further months. That is the sum of \$13,169.23.

[34] I have also considered the issue of interest. The Authority may under schedule 2 of the Employment Relations Act 2000 order the payment of interest on an award made. I intend to exercise my discretion and order interest be payable on the sum of \$13,169.23 at the rate of 5% prescribed under section 87(3) of the Judicature Act 1908 until payment is made from 1 January 2011.

[35] I order Warwick Kearins to pay to Design Engineering (SI) Limited the sum of \$13,169.23 together with interest at the rate of 5% from 1 January 2011 until the date of payment.

Costs

[36] I reserve the issue of costs. If agreement cannot be reached then Mr O'Connor has until 20 December 2012 to lodge and serve submissions as to costs and Mr Shaw, bearing in mind the Christmas break, has until 23 January 2012 to lodge and serve submission in reply.

Helen Doyle
Member of the Employment Relations Authority