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Headnotes

Thomas v Thompson

[2019] NZCA 503

Companies Act 1993, s 284 — insolvency law — liquidation — liquidator's decision — reasonableness

Introduction

This case concerned the reasonableness of a liquidator's decision.

DD Construction Ltd (**DDC**) was in liquidation. Mr Thomas, the appellant, was the liquidator. Mr Thompson, the respondent, owned two unit-title townhouses in an eight-unit development which had weather tightness issues. DDC had been contracted to carry out the repairs.

The remedial costs exceeded the estimates that DDC had provided. Mr Thompson refused to pay four invoices totalling $20,014.69 that DDC had issued for repair works on his two units. That sum was held on trust pending resolution of the dispute over these invoices, which was still unresolved when DDC had entered liquidation.

After DDC went into liquidation, Mr Thompson asked Mr Thomas to release the funds to him. Mr Thomas declined to do so. Mr Thompson applied to the High Court under s 284 of the Companies Act 1993 for Mr Thomas' decision to be reversed. The High Court granted this application. Mr Thomas appealed.

Background

The unit title development had been defectively constructed and suffered damage from water ingress. Substantial remedial work was needed. The Body Corporate accepted DDC's tender for the work of $1,662,239. The tender included a breakdown for each unit, showing prices ranging between $177,612 to $235,086 depending on the unit.

The works did not go to plan. The $350,000 the owners had each paid into the Body Corporate account was eventually exhausted. DDC began invoicing the owners individually for the remediation costs as the excess funds required to complete works on each unit varied. There were also delays.

Mr Thompson expressed concern about the costs and delays with his units in an email to Mr Montgomery, the sole director of DDC. In late February and March 2015, DDC issued four invoices to Mr Thompson totalling $20,014.69. Mr Thompson failed to pay or dispute these four invoices within the five-working day timeframe provided for in the contract.

DDC ceased trading around 31 March 2015 and its assets were transferred to another company. Mr Thompson was not informed of this. On 13 April 2015, Mr Thompson's solicitors sent a letter to DDC's solicitors, Turner Hopkins. The letter referred to Mr Thompson's concerns over the extent to which the costs had exceeded the original estimate. The letter said that Mr Thompson was not willing to pay the latest invoices.

DDC then registered mortgages on Mr Thompson's units. The mortgages secured $175,000 for each unit and were registered without notice. Mr Thompson commenced proceedings against DDC in relation to this. The parties eventually signed a consent memorandum. DDC agreed to remove the mortgages. Pidgeon Law, Mr Thompson's lawyers, undertook to hold $20,014.82 for the benefit of Mr Thompson and DDC pending determination of the dispute between them. DDC also agreed to provide Mr Thompson with documents in order to resolve their dispute.

However, DDC ignored Mr Thompson's resulting request for these documents. Pidgeon Law advised DDC's lawyers that the court proceedings would resume in the absence of a response. No response came.

On 7 April 2016, Mr Thompson filed an amended statement of claim against DDC. The Body Corporate was added as a second plaintiff. Mr Montgomery and Turner Hopkins were added as second and third defendants. Mr Thompson's claim against DDC and Mr Montgomery was for false and misleading misrepresentations in breach of the Fair Trading Act 1986. Mr Thompson sought the difference between $350,000 (the original maximum estimated costs of the repairs) and the actual costs incurred per unit. The defendants applied for summary judgment which the High Court dismissed.

On 25 May 2017, DDC was placed into liquidation and Mr Thomas was appointed as liquidator. A memorandum was later filed on behalf of Turner Hopkins in the proceeding brought by Mr Thompson and the Body Corporate. The memorandum advised that DDC was now in liquidation and that Mr Montgomery had been made bankrupt.

On 11 December 2017, Mr Thompson and the Body Corporate filed a memorandum in response. Mr Thompson sought release of the funds paid into court because of DDC's liquidation.

The High Court directed that Mr Thompson and the Body Corporate file an application for the return of the funds. Mr Thomas contended that DDC had agreed to withdraw the mortgages in exchange for these funds being paid into escrow pending resolution of the dispute over the invoices.

Mr Thomas said that his refusal to agree to the return of the funds was reasonable because the continuance of Mr Thompson's claim was not in the best interests of DDC or its creditors. Having investigated the facts, DDC had a relatively strong claim that it owned the funds and it was in the best interests of creditors to pursue that claim. He said that the dispute should be resolved in the Disputes Tribunal or dealt with in the liquidation.

The High Court had discussed case law holding that the Court's power to intervene arose where there was fraud, a lack of bona fide exercise of the liquidator's discretion, or unreasonableness. Unreasonableness meant a decision that no reasonable liquidator could have performed.

The High Court had said that Mr Thomas' proposed alternatives for resolving the dispute were problematic. The

money in trust was above the Disputes Tribunal's jurisdictional limit and the Tribunal was not bound to give effect to strict legal rights. If Mr Thomas wished to resolve the dispute in this way, he could release the funds and pursue a claim on the invoice of up to $15,000.

Moreover, if it was determined that Mr Thompson was liable to pay the invoices and the fund was released to the liquidator in satisfaction of the debt, Mr Thompson would have no prospect of recovering any part of it because the liquidator's report made it clear that there were no funds to pay secured creditors, let alone unsecured ones.

The dispute resolution process agreed to by the parties in June 2015 had failed because DDC had not complied with it. Since becoming involved, Mr Thomas had taken no steps to have the entitlement to the disputed sum determined. With DDC in liquidation, it would be uneconomic for the dispute to be determined in the High Court.

The High Court concluded that the only reasonable solution in these circumstances was to permit the release of the funds back to Mr Thompson.

Issues

The Court had to decide whether the High Court had erred in releasing the funds on the grounds that Mr Thomas' decision had not been one that a reasonable liquidator would make.

Court's findings

Mr Thomas argued that the High Court had correctly stated the test for reversing a liquidator's decision, but said that it had misapplied that test on the facts. He submitted that the question before the liquidator was whether he should give up the security that was held for debts due to DDC. This security gave Mr Thompson an incentive to resolve the dispute and provided Mr Thomas with valuable leverage in achieving a resolution.

Mr Thomas submitted that any reasonably commercially minded person, let alone a liquidator, would not give up their security. Far from being a decision that no reasonable liquidator could make, Mr Thomas said it was in fact the only decision a reasonable liquidator could make in the circumstances.

The Court did not accept that this was a question of whether a liquidator in the position Mr Thomas found himself in should give up the security. The question was whether he should consent to the release of the funds held by Pidgeon Law. That question could only be answered by investigating the circumstances in which those funds were paid and held. The Court agreed with the High Court's view of those circumstances.

DDC in liquidation had no reasonable basis to insist on the funds being retained in trust pending a resolution of the dispute, given that DDC had failed in 2015 to adhere to the agreed process for resolving that dispute. That agreed process had effectively replaced the dispute resolution procedures under the contract and no resolution had been reached in the subsequent two years.

The Court rejected Mr Thomas' submission that the High Court should have considered that the Dispute Tribunal was a reasonable avenue for resolving the dispute. This would not have resolved Mr Thompson's claim for damages with which the dispute over the payment of the four invoices was inextricably bound.

The Court did not accept that the High Court had erred by failing to refer to the other methods of resolution the parties had allowed for in the consent memorandum. While the consent memorandum allowed for those possible methods of determining the dispute, the parties had agreed to a mediation process first. DDC had taken no steps to comply with that process.

The Court rejected Mr Thomas' submission that the High Court had erred by taking into account that the liquidator had not obtained legal advice before making his decision. While a liquidator was not required to obtain legal advice, its absence was a relevant factor in assessing whether the liquidator had given proper consideration to whether the fund should be released.

Legal advice would have assisted Mr Thomas with assessing whether DDC had breached the agreement recorded in the consent memorandum. It would also have helped him to assess the merits of Mr Thompson's claim that the invoices had been issued under a contract entered into because of DDC's misleading and deceptive conduct.

Finally, Mr Thomas suggested that Mr Thompson could still pursue his claim in the High Court because those proceedings remained on foot and a trial date had been scheduled. He suggested that the Court did not need to grant leave for the proceedings to continue, because the scope of the leave granted earlier by the High Court had covered this.

The Court did not accept this submission. First, it was clear that the leave granted was for an application to be made regarding the release of the funds and not for the continuation of the proceedings. Second, the October trial date was for the hearing of the claim against Turner Hopkins.

The Court concluded that Mr Thomas had not established that the High Court had erred. Mr Thomas' decision was not one that a reasonable liquidator would make.

Judgment

The appeal was dismissed.

Cases cited in judgment

Callis v Pardington (1996) 7 NZCLC 261, 211 (CA);
Levin v Lawrence [2012] NZHC 1452;
Re Debtor; ex parte The Debtor v Dodwell (The Trustee) [1949] Ch 236 (Ch);
Re Peters; ex parte Lloyd (1882) 47 LT 64 (CA);
Thompson v DD Construction Ltd [2015] NZHC 1458;
Thompson v DD Construction Ltd [2017] NZHC 516;
Thompson v DD Construction Ltd HC Auckland CIV-2015-404-1319, 12 December 2017;
Thompson v DD Construction Ltd HC Auckland CIV-2015-404-1319, 8 February 2018;
Thompson v DD Construction Ltd HC Auckland CIV-2015-404-1319, 22 March 2018;
Thompson v DD Construction Ltd HC Auckland CIV-2015-404-1319, 6 June 2018;

Thompson v DD Construction Ltd HC Auckland CIV-2015-404-1319, 21 November 2018;
Thompson v Hopkins [2018] NZCA 197;
Thompson v Thomas [2018] NZHC 1495.

Daniel Neighbour
Freelance Contributor

Houghton v Saunders

[2019] NZCA 506

Introduction

This case involved interlocutory matters in the "Feltex" litigation.

The High Court had made orders for discovery and security for costs. It had also ruled inadmissible parts of the evidence which Mr Houghton proposed to lead from an economist, Mr Houston.

Mr Houghton appealed against this decision.

Background

A combined investment statement and prospectus for an initial public offering (**IPO**) of shares in Feltex Carpets Ltd (**Feltex**) had contained a revenue forecast for the financial year ending 30 June 2004 (**the FY04 revenue forecast**) and a projection for the financial year ending 30 June 2005 (**the FY05 projection**).

Mr Houghton brought proceedings under the Securities Act 1978 and the Fair Trading Act 1986 which included allegations that the FY04 revenue forecast and the FY05 projection were untrue statements and misleading and deceptive conduct. The issues raised by the proceeding were dealt with in two stages.

The first stage determined Mr Houghton's own claim, together with issues that were common to the claims of all the other shareholders whom he represented. The remaining issues arising for the other shareholders were to be determined at stage two.

The first stage culminated in the Supreme Court's decision which held that the FY04 revenue forecast was untrue at the time of allotment of the shares offered for subscription. The second stage of the trial, scheduled to commence in the High Court would address whether any of the investors represented by Mr Houghton suffered loss by reason of the untrue statement concerning the FY04 revenue forecast.

Mr Houghton's challenge to the FY05 projection had been rejected by the High Court. He submitted that adverse changes must have been readily predictable in May 2004. This ought to have required the directors to adopt a more cautious approach in their projection for FY05. The High Court said that this was classic hindsight thinking and it was not convinced that the directors' approach had been unreasonable.

For the stage two hearing the claimants wished to rely on a report by Mr Houston dated 19 July 2019 (**the initial report**) and a supplementary report dated 5 August 2019 (**the supplementary report**) as evidence of the loss they had suffered.

The instructions to Mr Houston for the initial report were to provide an expert estimate as at 2 June 2004 as to whether, and if so to what extent, the Feltex IPO price would have been lower than the actual price at which shares were allotted to investors had Feltex announced that (at [9]):

> ... in relation to its FY05 revenue projection:
> - it was unrealistic to consider that Feltex could achieve the level of sales projected for FY05;
> - a 4.7 per cent increase for FY05 revenue was ambitious, and "even more so" after the results in April 2004 and May 2004; and
> - the FY05 sales revenue projection was reasonably within the range of possible outcomes.

Section 5 of the initial report addressed the price effect of the FY04 revenue information. Section 6 addressed the price effect of the FY05 revenue information. Section 7 was directed to the "total value of the FY04 and FY05 revenue information" (at [11]).

The instructions to Mr Houston to provide a supplementary report stated (at [12]): "Please provide a supplementary expert report addressing as at 2 June 2004 the following three questions in relation to the analysis that you presented in your earlier report".

The respondents sought a ruling on the admissibility of s 6 of Mr Houston's initial report, together with that part of s 7 that addressed the FY05 revenue information. They also challenged the entirety of his supplementary report.

In the High Court, the respondents had argued that the instructions to Mr Houston in respect of the FY05 revenue information were misconceived. Mr Houghton had failed to establish that the FY05 projection constituted an untrue statement. An opinion on the financial impact of the FY05 revenue information would require revisiting that stage one final determination. On grounds of issue estoppel and res judicata, the respondents submitted that it was not open to the claimants to raise those arguments.

Mr Houghton countered that Mr Houston's analysis of the FY05 revenue information had done no more than assess the impact on the Feltex share price of the knock-on effect on the FY05 projection, which had been rendered less reliable by the acknowledgment required of the directors that their FY04 revenue forecast was materially overstated.

The High Court said that the difficulty with Mr Houghton's submission was that it treated the absence of disclosure by the directors on 2 June 2004 of the FY05 revenue information as being non-compliant disclosure. This categorisation was contrary to the finding of all the courts that the FY05 projection had not contained any untrue statement.

The High Court concluded that the FY05 projection component of Mr Houston's initial report was not relevant. In terms of s 25 of the Evidence Act 2006 it was not likely to be substantially helpful in determining the loss that the claimants could establish as arising from the untrue statement in the prospectus.

The High Court had also accepted the respondents' objection that the supplementary instruction to Mr Houston depended on a factual premise for which there was no

relevant basis. It followed that his opinions on the additional propositions could not be substantially helpful in resolving the stage two issues.

The High Court had also dealt with two other issues. First, was a discovery order. The High Court had recorded that all the stage two claimants would contend that, had they known of the untrue statement in the prospectus at the time they committed to purchase their shares, they would have reversed their investment decision.

Consequently, the individual circumstances in which they proceeded with the purchases and then retained the shares would be relevant. The respondents had complained that the number of documents disclosed was improbably small with inadequate details of the extent of searches undertaken to locate the documents.

The High Court had directed each stage two claimant to file a supplementary discovery affidavit, including particulars of the steps taken to search for relevant documents, and identification of the categories of documents searched for.

The other issue was security for costs. The High Court had directed that security for costs for the stage two hearing of $1.65 million was to be provided by 12 July 2019 in the form of either cash lodged in Court or a solicitor's trust account, or a bond or bank guarantee by agreement between the parties.

This security was not provided, so the respondents proposed the provision of alternative forms of security, either by the larger of the stage two claimants or by means of an order attributing personal liability to Mr Gavigan as the alter-ego of the litigation funder, Joint Action Funding Ltd.

The High Court had said that if the original security order was not followed, then an alternative would be required. Three to six of the largest claimants were to provide security severally for the respective portion that each represented of the total of the claims of those contributing, for a total of $1.65 million. The defendants were also to have the benefit of a guarantee in their favour from Mr Gavigan, payable on the default by any of the claimants of their several liabilities of the total of $1.65 million.

Issues

The Court had to decide whether:

a. sections 6 and 7 of Mr Houston's initial report addressing the FY05 projection and the entirety of his supplementary report were admissible;
b. the High Court had erred in deciding that the discovery provided by the claimants had been insufficient; and
c. The High Court could make the orders for security for costs to be provided in the proposed alternative methods.

Court's findings

The Court started by considering the admissibility of Mr Houston's reports.

Mr Houghton had disavowed any attempt to rely on the FY05 projection as being an untrue statement. It was the appellant's case that the untrue statement in respect of the FY04 forecast had a repercussion or "knock-on" effect on the other financial information in the prospectus and in the marketplace as at 2 June 2004, particularly the FY05 projection and broker commentary on the expectations for future cash flows of Feltex from 2 June 2004 onwards.

Mr Houghton said that the untrue statement in relation to the FY04 revenue information caused a direct loss as valued by Mr Houston. The FY04 revenue information had caused the reasonableness of the FY05 projections to change. This change was negative and had established a further source of loss to Feltex shareholders.

The respondents argued that ss 6 and 7 of Mr Houston's initial report were based on a mistaken interpretation of the Supreme Court's observations. The words relied on by the appellant were not findings or even steps in the Supreme Court's reasoning, but simply an articulation of Mr Houghton's arguments.

They said that the supplementary report was inadmissible because it responded to three additional questions, each of which assumed the disclosure at 2 June 2004 of additional corrective disclosure for which there was no evidential foundation and no relevant finding of an untrue statement. Opinion evidence as to loss said to arise from undisclosed information about the FY05 projection was therefore irrelevant to the issue of loss to be determined at stage two.

The respondents said that this meant the High Court had correctly concluded that it could not obtain "substantial help" from the opinion evidence prepared in reliance on the assumptions in Mr Houston's instructions.

At stage one, the Supreme Court had held that, judged at the time of the due diligence committee meeting on 2 June 2004, the extent of the likely revenue shortfall for FY04 meant that the FY04 revenue forecast was no longer the probable outcome and the assumptions on which the forecast was based were no longer reasonable. In order to avoid the FY04 revenue forecast in the prospectus being untrue, the directors would have had to disclose that information. Mr Houghton had argued that had that been disclosed, it would have changed the investors' assessment of the FY05 projection.

The respondents did not challenge the proposition that there may have been a repercussion or knock-on effect from the disclosure of the FY04 revenue shortfall. They accepted that the knock-on effect on the market's view of the reliability of the FY05 projection may have been a component of the market's reaction to disclosure of the untruth of the FY04 revenue forecast.

However, the respondents submitted that in s 6 Mr Houston had assessed not the knock-on effect of the FY04 revenue information but rather an additional "loss" arising from additional "corrective disclosure" for FY05 for which there was no foundation. They said that his instruction to do this had been misconceived.

The High Court had accepted this argument, which Mr Houghton claimed was a mischaracterisation of Mr Houston's analysis. He submitted that no part of that analysis turned on an

implied obligation to disclose the FY05 revenue information. Mr Houghton said that while the Supreme Court had ruled that the FY05 projection did not qualify as an untrue statement, it had upheld criticisms of the projection.

The Court disagreed, saying that the Supreme Court's comments were not "findings". They were observations made in the course of a discussion which had led to the rejection of Mr Houghton's claim that the FY05 projection had contained an untrue statement.

This was most clearly demonstrated by reference to the first of the three assumed FY05 disclosures in Mr Houston's initial instructions, namely that it was unrealistic to consider that Feltex could achieve the level of sales projected for FY05. While recognising Mr Houghton's contention, it was plain that the Supreme Court did not conclude that the FY05 sales revenue projection was unrealistic as at 2 June 2004. Had it done so it could not also have found that the FY05 sales revenue projection was reasonably within the range of possible outcomes.

The Court therefore accepted the respondents' submission that it followed from the principles of issue estoppel and res judicata that the appellant could not advance a claim for loss at the stage two trial that relied on facts which were inconsistent with the findings made at stage one.

The Court affirmed that ss 6 and 7 of Mr Houston's initial report were inadmissible and did not satisfy the requirement of substantial helpfulness in s 25 of the Evidence Act. The supplementary report was also inadmissible.

The Court then considered the discovery orders. Given the context of the challenged discovery orders, having been crafted in the interval between the two trial phases and by a Judge who had been involved throughout the litigation, the Court treated it with the traditional restraint applicable to the trial court's case management function.

The Court did not perceive any error in the nature and scope of the discovery orders. They appeared to have been designed to facilitate the resolution of the stage two issues. At least to some extent the discovery task appeared to have a connection with the further particulars of the claims which the Judge had directed, the provision of which was no longer resisted. If it transpired that there were no documents of the nature specified in the order, then there would be nothing to discover.

The final issue was security for costs. Mr Houghton contended that the security for costs orders were inappropriate to the extent that they required the stage two claimants and Mr Gavigan to provide security for costs. Security for costs may not be ordered against a non-party, even though costs orders could be made.

The respondents argued that the terms of an order for security for costs was a trial management issue. The order had given the appellant an opportunity to satisfy the security obligation in an alternative way and was moot as the appellant had chosen not to take up the option available. No sanction had followed from the appellant's choice and there was no longer a live issue between the parties.

The Court also viewed this issue as one of trial management. It agreed with the respondents' submissions and upheld the order.

Judgment

The appeal was dismissed.

Cases cited in judgment

Ashmore v Corp of Lloyd's [1992] 1 WLR 446 (HL);
Houghton v Saunders (2011) 20 PRNZ 509 (HC);
Houghton v Saunders [2012] NZHC 1828, [2012] NZCCLR 31;
Houghton v Saunders [2014] NZHC 2229, [2015] 2 NZLR 74;
Houghton v Saunders [2016] NZCA 493, [2017] 2 NZLR 189;
Houghton v Saunders [2018] NZSC 74, [2019] 1 NZLR 1;
Houghton v Saunders [2019] NZHC 1362;
Houghton v Corbett [2019] NZHC 2007;
Houghton v Saunders [2019] NZCA 491;
Houghton v Saunders HC Wellington CIV-2008-409-0348, 9 August 2019;
Imperial Chemical Industries Ltd v Merit Merrell Technology Ltd [2018] EWHC 1577;
Jupiter Air Ltd v Australian Aviation Underwriting Pool Pty Ltd (2002) 16 PRNZ 702 (HC);
Knauf Insulation Ltd v Tasman Insulation New Zealand Ltd [2013] NZCA 427, (2013) 21 PRNZ 535;
Oxygen Air Ltd v LG Electronics Australia Pty Ltd [2018] NZHC 2504, [2018] NZAR 1699.

Daniel Neighbour
Freelance Contributor

Mainland Digital Marketing Ltd v Willetts

[2019] NZHC 2542

Restraint of trade — franchise agreement — breach of contract — contract law

Introduction

This case involved a restraint of trade clause in a franchise agreement.

The defendants, Mr Willetts and Ms Von Nordeck Myers, were photographers. They had both entered photographer franchise agreements with the plaintiff, Mainland Digital Marketing Ltd (**MDM**). The defendants supplied real estate photography services to real estate agents.

When the five year term of the franchise came to an end, the defendants did not renew it. Instead, they went to work for Whalan and Partners Ltd, which operated a real estate business in Canterbury and Wanaka under the Bayleys Real Estate brand name (**Bayleys**).

MDM sought an interim injunction to restrain the defendants from providing real estate photography to anyone in a defined area of the South Island, including Bayleys, until 31 March 2021. The application was made on the grounds that there were binding restraints of trade in the photographer franchise agreement which prohibited such activities.

Background

MDM was an area franchisee of the Open2View real estate marketing system. It operated in a defined area of the South Island.

The defendants were already experienced photographers when they entered the photographer franchise agreement, although they had no particular experience as real estate photographers. MDM provided extensive training to the defendants and introduced them to its customers. The defendants did not pay for goodwill in the franchise as they were not taking over an existing business.

The defendants were encouraged to develop a base of up to 100 real estate agent contacts. Those real estate agents would contact the defendants and arrange for a vendor's property to be photographed. MDM would invoice the real estate agency for those services and MDM would then account to the defendants for their share of the fee, being 55 per cent.

As photographer franchisees, the defendants enjoyed the support of Open2View's business systems, IT, marketing and process support. While their commissions were initially low, by their third year they were both earning approximately $100,000 a year.

Bayleys became MDM's biggest client. By 2018, Bayleys was invoiced $247,029 for real estate marketing services. While Bayleys was serviced by a number of MDM photographer franchisees, the defendants did the majority of the work.

The photographer franchise agreement provides for a fixed term, being five years from the commencement date of the agreement. For both defendants, the commencement date of the agreement was 1 April 2014, and it terminated on 30 March 2019. On 22 March 2019, both defendants advised Mr Perry, one of MDM's directors, that they would not be renewing the franchise agreements.

During March 2019, discussions occurred between the defendants and one of the Bayleys owners, Mr Jones, about the possibility of the defendants working for Bayleys exclusively. On 26 March 2019, the defendants signed employment agreements with Bayleys. Their appointment as employees was announced at a Bayleys staff meeting on the same day.

The photographer franchise agreements were comprehensive documents comprising 60 pages of definitions, terms, schedules and appendices. There were two restraint clauses, referred to as cl 38.2 and Appendix I.

Clause 38.2 provided:

> The Photographer Franchisee and the Guarantor agree that on Termination Date they jointly and severally will not from Termination Date conduct on their own or other account or be concerned or interested either directly or indirectly as owners, partners, directors, officers, consultants, representatives, agents, licensees, investors with or as part of any business firm or corporation which could be regarded as a market competitor or an imitation of the Franchise System including without limiting the generality of this clause any business identical with or similar to the Franchised Business or the Restraint Business and the Photographer Franchisee and the Guarantor shall contemporaneously with completion of this Agreement, complete the Restraint Agreement and be bound by the terms of that Restraint Agreement.

MDM argued that the courts were willing to enforce restraints in the context of franchising, because a franchisor may "have a legitimate interest in protecting the goodwill developed through use of its business model" (at [19]). The courts had also accepted that a franchisor may legitimately demand a reasonable time for a new franchise holder to enter an area and develop a fledgling business to a viable stage before facing competition from a previous franchise holder. The ordinary principles for contractual interpretation applied in the context of restraints in franchising agreements.

MDM submitted that cl 38.2 placed an obligation on the defendants to "not be interested indirectly or directly in a business that could be regarded as a market competitor" (at [21]). The defendants, as employees, now had an interest in a market competitor, as agents or representatives, and were engaging in business transactions with ex-clients. It did not matter that the clause did not include the term "employees".

MDM said that "agent" was an expansive term which was used to describe the relationship where a person acted as the representative of a principal when dealing with third parties. Accordingly, when the defendants were carrying out real estate photography for their employer, they were doing so in the name of their employer and, to the reasonable person, this would suggest that they are acting as "representatives" or "agents" of Bayleys.

Appendix I of the franchise agreement prohibited the defendants from soliciting any business dealings in real estate photography through "associates (sic) with any personal company" (at [55]). The evidence showed that the defendants had been soliciting business dealings with vendors listed with Bayleys to provide them with real estate photography services.

The defendants submitted that restraint of trade provisions should be interpreted strictly because they limited a person's economic freedom. Clear language or necessary implication was required. The contra proferentem rule should apply in the event that there was ambiguity in the words used.

The defendants said that they were not, through Bayleys, soliciting a business relationship with sales agents or their vendor clients. Those business relationships were the same as they had been before 1 April 2019 and were for the provision and delivery of real estate marketing services. In any event, the relationship with Bayleys was not a business relationship but an employment one.

The defendants rejected MDM's suggestion that they were actually operating a competing business model but "disguising it through their employment relationship" (at [41]). The defendants said that their roles at Bayleys were traditional employment relationships governed by individual employment agreements. The fact that they were paid an incentive rate for some of their work did not alter the nature of the relationship or give the defendants a financial interest in Bayleys' business.

Furthermore, the defendants' role as in-house photographers was not confined to photographing and videoing real estate listings. They also provided other photography

services to Bayleys. Thus, they were not illegitimately taking advantage of something the plaintiff had expended its effort to develop. They were therefore not in breach of Appendix I.

Issues

The Court simply had to identify whether the restraint of trade provisions captured the defendants' activities. It did not have to determine whether those provisions were enforceable. Those were considerations for a subsequent hearing.

Court's findings

The two clauses were not co-extensive so the Court considered each independently, starting with cl 38.2.

Clause 38.2 was limited to a restraint in relation to leading a business venture that was a market competitor to MDM. The wording in the restraint provision contrasted with comparable provisions discussed in other franchise cases, where it was clear that what was restrained was any connection with a market competitor, including as an employee.

The Court did not consider that the use of the words "agents" or "representatives" was sufficient to cover a connection as an "employee" when that term appeared to have been deliberately omitted from the list of prohibited roles, and where the evidence did not establish that the defendants were agents or representatives. This was sufficient to preclude the clause from applying to the defendants.

However, the Court did consider that Bayleys could be said to be carrying on a business which was "identical with or similar to the Franchised Business" or the "Restraint Business". "Restraint Business" included "each separate business or activity specified in the Schedule" and so could mean just the provision of real estate photography as the defendants were doing (at [51]).

Bayleys could also be regarded as a "market competitor" to the Franchised Business in the sense that Bayleys was offering identical services to its agents to those which were offered to its agents by photographer franchisees for Open2View.

However, cl 38.2 had not been breached by the defendants' employment with Bayleys, because the clause did not exclude them from working in that capacity.

The Court then considered Appendix I. The Court disagreed with MDM's submission that the clause simply meant that the defendants were prohibited from offering real estate photography services. The clause was worded more specifically than that. The key relevant terms were the prohibition on soliciting any business dealings in the same type of business (defined to include real estate photography), either directly or indirectly through association with any person, company or other organisation.

The defendants said that "solicit" meant to "ask repeatedly or earnestly for or seek or invite (business etc)" (at [57]). However, the Court said that proof of "earnest entreaty" was not required. It was sufficient to indicate a willingness to do business.

The first issue here was whether the defendants had been soliciting business as real estate photographers, directly or indirectly. MDM relied on four pieces of evidence to prove this.

One, was an emailed letter to Bayleys agents that promoted the photography services and encouraged the agents to engage with them. Two, that same information had been provided to Bayleys agents at a staff meeting.

Three, the Bayleys price guide had been amended to show the prices for real estate photography services provided in-house by the defendants. In the Court's view, this was captured by the broad definition of solicit, which required a presence and a willingness to do business. The defendants' willingness to do business had been promoted directly to Bayleys agents, along with details about the quality and price of their services. The defendants were therefore indirectly soliciting business from Bayleys agents.

The fourth piece of evidence was that Mr Willetts had solicited vendors directly through his LinkedIn profile page. The Court said that this was a form of solicitation in the broadest sense.

Appendix I also required that what was being solicited was a "business dealing". The Court said view that the term "business dealings" was broad and implied transactions where there would be monetary gain or potential monetary gain. Each time the defendants were asked to provide real estate photography services for a vendor of a Bayleys agent, there was a "dealing" or "transaction" in the business of real estate photography. Bayleys would receive a payment as a result of that business dealing, and the defendants would receive a commission payment based on the value of the transaction. Each time the defendants engaged in real estate photography for a Bayleys agent, they were indirectly facilitating a business dealing.

The third requirement of Appendix I was that the soliciting be in the "same type of business". The defendants argued that for the clause to apply, Bayleys would have to be transformed to a business like the plaintiff's, and not merely be a different business, but offer a similar service.

The Court accepted that Bayleys was not the same type of business as Open2View, nor was it providing photography services to the market generally. The issue was whether it was enough to focus on any one service provided by Open2View. If the defendants were soliciting business dealings in that service alone, were they in breach of contract?

The Court said that looking at the agreement as a whole, it was intended that the restraints would apply not just to engaging in an imitation or similar business to Open2View, but also to engaging in the individual components of that business. Because the photographer franchise had been engaged in real estate photography only, it was covered by the term "Restraint Business" and was captured by the provision.

Therefore directly or indirectly through another entity, the defendants had been soliciting business dealings in real estate photography. They were technically in breach of Appendix I.

Judgment

The defendants' employment with Bayleys breached Appendix I, but not cl 38.2.

Cases cited in judgment

Dorchester Finance Ltd v Deloitte [2012] NZCA 226, [2012] NZCCLR 15;

Health Club Brands Ltd v Colven Botany Ltd [2013] NZHC 428;

Investors Compensation Scheme Ltd v West Bromwich Building Society [1998] 1 WLR 896 (HL);

Mad Butcher Holdings Ltd v Standard 730 Ltd [2019] NZHC 589;

Mainland Digital Marketing Ltd v Willetts [2019] NZHC 1201;

Mike Pero (New Zealand) Ltd v Exact Solutions Ltd HC Wellington CIV-2007-442-0066, 17 April 2007;

Mike Pero (New Zealand) Ltd v Krishna [2016] NZHC 1255, (2016) 14 NZELR 244;

Skids Programme Management Ltd v McNeill [2012] NZCA 314, [2013] 1 NZLR 1;

Washworld Corp (Leases) Ltd v Reid (1998) 8 TCLR 372 (HC).

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Legislative Update

Acts

Partnership Law Act 2019 No 53

The Partnership Law Act 2019 (the Act) received Royal assent on 21 October 2019.

The Act is a revision Act that re-enacts the Partnership Act 1908 in an up-to-date and accessible form, but does not change the effect of the law, except as expressly provided. In the Act:

- Part 1 contains the purpose and overview of the Act;
- Part 2 provides for the nature of partnership, including rules for determining whether a partnership exists;
- subpart 1 of Part 3 provides for the relationship between partners and third persons;
- subpart 2 of Part 3 provides for the relationship of partners to each other; and
- Part 4 provides for financial reporting and the end of a partnership.

The Act comes into force on 21 April 2020 (immediately after the expiry of the six-month period that starts on the date of Royal assent).

Regulations

Telecommunications Operators (Commerce Commission Costs) Levy Regulations 2019 (LI 2019/233)

The Telecommunications Operators (Commerce Commission Costs) Levy Regulations 2019 revoke and replace the Telecommunications Operators (Commerce Commission Costs) Levy Regulations 2011 (SR 2011/325) (the 2011 Regulations).

The main difference between the Regulations and the 2011 Regulations is that, for the financial years beginning 1 July 2018, 1 July 2019, 1 July 2020, and 1 July 2021, two additional sub-levies are payable.

The Regulations came into force on 31 October 2019.

Financial Services Legislation Amendment Act Commencement Order 2019 (LI 2019/252)

The Financial Services Legislation Amendment Act Commencement Order 2019 brings into force, on 29 June 2020, the provisions of the Financial Services Legislation Amendment Act 2019 that are not already in force.

The Order was made on 21 October 2019.

Financial Markets Conduct (Fees) Amendment Regulations (No 2) 2019 (LI 2019/253)

The Financial Markets Conduct (Fees) Amendment Regulations (No 2) 2019 amends the Financial Markets Conduct (Fees) Regulations 2014 (LI 2014/110) by making changes in connection with the new regime for financial advice services under the Financial Markets Conduct Act 2013. This regime is being introduced by the Financial Services Legislation Amendment Act 2019.

Regulations 4 and 5(2) came into force on 25 November 2019. The rest of the Regulations come into force on 29 June 2020.

Financial Markets Authority (Levies) Amendment Regulations 2019 (LI 2019/254)

The Financial Markets Authority (Levies) Amendment Regulations 2019 amends the Financial Markets Authority (Levies) Regulations 2012 (SR 2012/121) by making changes in connection with the new regime for financial advice services under the Financial Markets Conduct Act 2013. This regime is being introduced by the Financial Services Legislation Amendment Act 2019.

Regulation 11 came into force on 25 November 2019. The rest of the Regulations come into force on 29 June 2020.

Financial Service Providers (Registration) Amendment Regulations (No 2) 2019 (2019/255)

The Financial Service Providers (Registration) Amendment Regulations (No 2) 2019 amends the Financial Service Providers (Registration) Regulations 2010 (SR 2010/235) by making changes in connection with the new regime for financial advice services under the Financial Markets Conduct Act 2013. This regime is being introduced by the Financial Services Legislation Amendment Act 2019.

The Regulations came into force on 25 November 2019.

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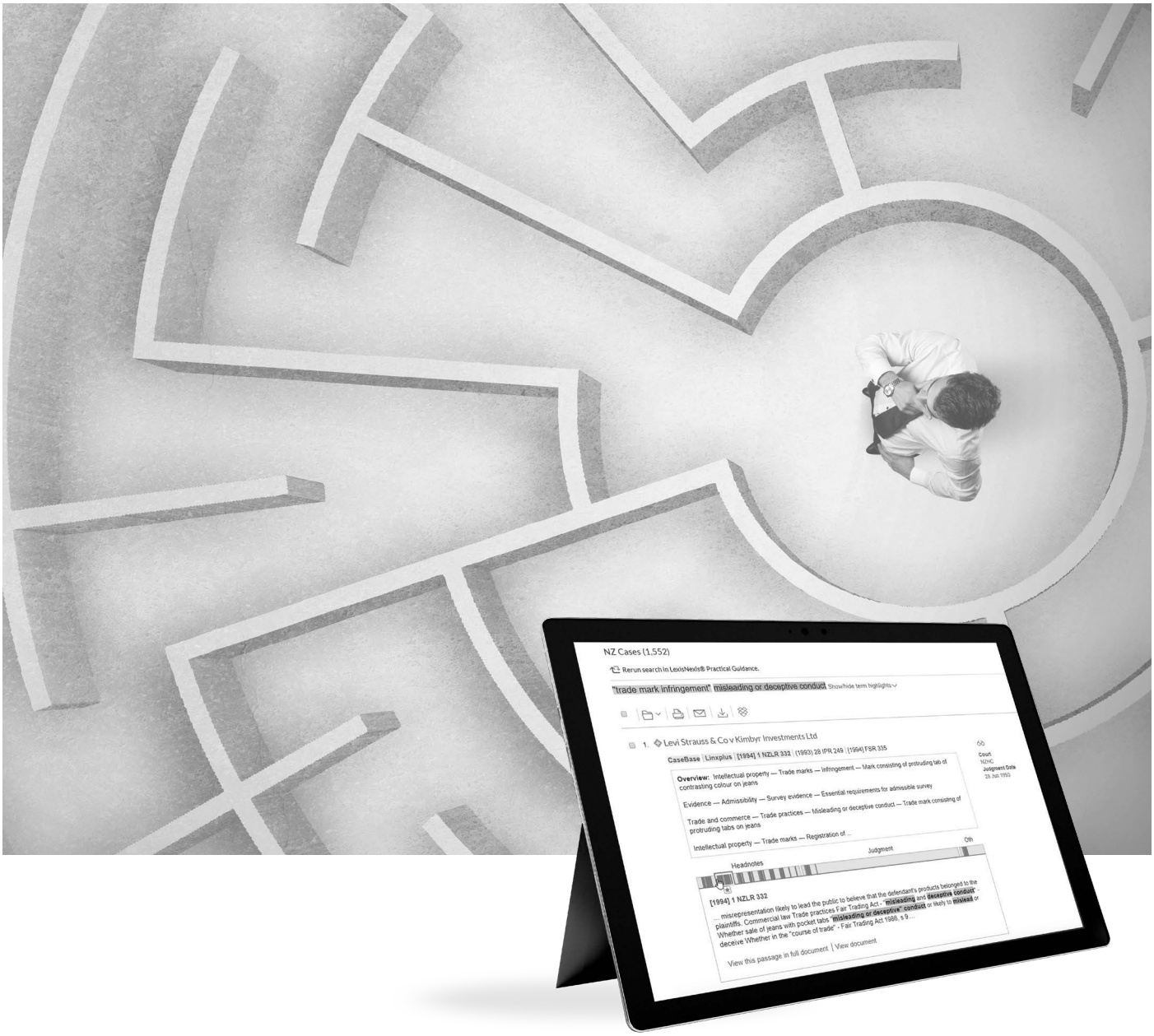

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