IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV-2015-404-001361
[2015] NZHC 2040

BETWEEN	MIKE PERO (NEW ZEALAND) LTD Applicant
AND	JAMES ROBERT HEATH First Respondent
	J & S HEATH LTD Second Respondent
	JAMES HEATH MORTGAGES LTD Third Respondent
	GINA MAREE SMITH Fourth Respondent

Hearing: 5 August 2015

Appearances: Bruce Stewart QC and Anna Bloomfield for the Applicant
Paul Sills for the Respondents

Judgment: 27 August 2015

JUDGMENT OF MOORE J

This judgment was delivered by me on 27 August 2015 at 3:00pm
pursuant to Rule 11.5 of the High Court Rules.

Registrar/ Deputy Registrar

Date:

Contents

Paragraph Number

Introduction .... **[1]**

These proceedings .... **[19]**

Legal principles .... **[23]**

Is there a serious question to be tried?

General principles .... [29]

Legal principles/restraint of trade .... [32]

(a) Is there a proprietary interest which could sustain a restraint of trade clause? .... [36]

(b) Do the parties appear to be in competition? .... [55]

Where does the balance of convenience lie? .... **[60]**

Adequacy of damages for Mike Pero if this application is not allowed but Mike Pero succeeds in its claim .... [61]

Adequacy of damages for Mr Heath in the event interim orders were made but Mike Pero was unsuccessful at trial .... [67]

Comparable case law .... **[78]**

P5 Holdings Ltd v Elisha's Well Ltd .... [79]

Safety Step (New Zealand) Ltd v Safety Step Auckland Ltd & Ors .... [82]

Health Club Brands Ltd v Colven Botany Ltd .... [90]

Overall justice .... **[94]**

Position of Ms Smith .... **[96]**

Preservation and inspection orders

Preservation orders .... [101]

Inspection orders .... [104]

Result .... **[109]**

Costs .... **[115]**

Introduction

[1] Mike Pero (New Zealand) Ltd ("Mike Pero") is an Auckland-based company which carries on business as a mortgage broking franchisor. Mike Pero's trading name is "Mike Pero Mortgages".

[2] In May 2000, the first respondent, James Robert Heath ("Mr Heath") entered into a franchise agreement with Mike Pero.

[3] The agreement recorded that Mike Pero had expended time, effort and money in developing and acquiring knowledge about and expertise in the business of mortgage broking. It noted that the franchise had established a substantial demand and goodwill for that business and an exclusive reputation and goodwill in the name of "Mike Pero Mortgages". It also stated that the franchisee desired to obtain the benefits of Mike Pero's knowledge, skill and experience and the right to act as an independent franchise operator in the business of mortgage broking using the name, "Mike Pero Mortgages".

[4] In signing the agreement, Mr Heath agreed he would, amongst other things:

(a) use and operate the franchisor's "System" which was Mike Pero's method and system for operating the business set out in its "Manual";

(b) not refer clients to any third party without the prior approval of Mike Pero;

(c) devote the whole of his time and attention to the business and not, without Mike Pero's prior written consent, be directly or indirectly engaged or concerned in any other business; and

(d) comply with the provisions of the Deed of Restraint of Competition.[1]

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1 The Deed of Restraint on Competition was a separate document which was required to be executed contemporaneously with the Agreement.

[5] The agreement also contained confidentiality provisions which remained in force beyond the expiry or termination of the agreement. This included an obligation of confidentiality in relation to the "System"[2] and customer database, both of which remained the sole property of Mike Pero.

[6] Additionally, the agreement separately required Mr Heath to severally covenant that he would not:

(a) directly or indirectly canvas, solicit or attempt to solicit, serve or act for any customer of Mike Pero's business; or

(b) personally, or by circulars, letters or advertisements interfere with Mike Pero's business or divulge to any person any information concerning the business.

[7] This restraint had application within all of New Zealand for six months and within the Christchurch and Canterbury region for two years.

[8] Three years later, following the incorporation of the second respondent, J & S Heath Ltd ("JSHL"), a replacement Franchise Agreement and Deed of Restraint on Competition were executed on 21 July 2003. JSHL assumed Mr Heath's position as franchisee and Mr Heath signed as convenantor. The terms of the Deed of Restraint were expressed identically to the earlier restraint.

[9] On 14 June 2010 the franchise agreement was renewed for the third time when Mr Heath and JSHL entered into a Lite Franchise Agreement.[3] Mr Heath and

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2 The "System" was defined in the agreement as the Franchisor's method and system for the development and operation of the mortgage broking business as set out in the Manual including the intellectual property and the database and the franchisee's database.

3 Known as the Lite Franchise Agreement, this agreement commenced operation from 1 April 2010 shortly before the second agreement expired on 30 June 2010. According to Mr Heath, the Lite Franchise Agreement were offered only to experienced franchise holders who were able to self-generate business. The model was designed to help Mike Pero grow its business but also gave the franchisee the opportunity for a higher guaranteed commission split and the potential to grow their own business. Mr Heath said he decided to change to this new form of agreement in 2010 after he had analysed JSHL's trading history for 2009 and found that only 21 per cent of his business came from Mike Pero referrals. The new agreement allowed a higher commission split and the ability to employ extra staff. The restraint provisions remained identical to the earlier iterations.

JSHL signed the agreement and the Deed of Restraint which included the protected restraints which, again, mirrored the obligations which Mr Heath and the company had accepted in the previous deeds. It is this agreement and deed which are at issue in the present application.

[10] On 30 March 2015 Mr Heath advised Mike Pero that JSHL would not be renewing the agreement when it expired on 30 June 2015.

[11] Three weeks later, on 20 April 2015, Mr Heath, JSHL and a number of other Mike Pero franchisees unconnected to the present proceedings, commenced proceedings in this Court seeking declarations that the restraint covenants in the various deeds which they had executed were unenforceable. Mike Pero filed an appearance objecting to jurisdiction. Both the jurisdictional point and substantive dispute are yet to be determined (whether by this Court, or through mediation or arbitration pursuant to the terms of the agreement).

[12] The following day,[4] the fourth respondent, Ms Smith, incorporated the third respondent, James Heath Mortgages Ltd ("the new company"). She was recorded as the sole director and shareholder.

[13] Ms Smith is Mr Heath's de facto partner. She was first employed by Mr Heath in 2008 to provide secretarial support services. At that time she signed a document described as an employee's covenant. Under this agreement she undertook that while employed by Mr Heath she would maintain confidentiality of the business systems of her employer and would not undertake any activities in competition to James Heath, Mike Pero or any other franchise of Mike Pero Mortgages.[5] For reasons which are unexplained, the covenant signed by Ms Smith differed from the standard form used for the employees of Mike Pero franchisees in that it omitted to include the two year restraint following termination of employment which the standard form in the agreement contained. In other words the restraint applied only for the duration of her employment with Mr Heath.

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4 21 April 2015.

5 The form of this document was attached to the agreement as a schedule. Under the agreement the franchisee was required to obtain from all staff employed a confidentiality undertaking in the form specified in the schedule.

[14] Ms Smith left Mr Heath's employment in 2008 to start work as a real estate agent. She was employed in this role for approximately two years before moving to Mike Pero Real Estate where she worked as an agent for another three years.

[15] In February 2014 she returned to Mr Heath's business working for JSHL as a business development manager with the intention of becoming a loan writer for Mr Heath. On her re-employment she did not execute a fresh employee restraint undertaking.

[16] On 2 June 2015, Mr Heath returned Ms Smith's iPad to Mike Pero and appeared to vacate his business premises in Riccarton, Christchurch. In fact, the company moved to smaller space in the same building, apparently for financial reasons, but the business continued to operate from that office.

[17] On 17 June 2015, three months after Mr Heath gave notice of termination, despite advice from Mr Heath that the franchisee was continuing to operate in accordance with the agreement, Mike Pero became aware that Ms Smith had applied to the New Zealand Financial Services Group for accreditation as a mortgage broker.[6] Her application recorded she would be trading as James Heath Mortgages Ltd. It included a business plan which stated that the work of the company would be carried out in the Christchurch/Canterbury region. Reference was made to a 90 day plan which included references to contacting "existing clients". The core business was described as "mortgage broking and advisory services", with the "key people" listed as James Heath and Gina Smith. The plan also recorded under the heading, "Weaknesses":

> "Starting from scratch due to leaving existing clients with Mike Pero Mortgages. Restrain (sic) of trade limitations."

Under the heading, "Opportunities" the business plan stated:

> "Very well known in the industry and a large amount of clients from previous franchise will possibly transfer over."

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6 The application was dated 23 April 2015, just two days after the new company, James Heath Mortgages Ltd had been formed.

Under "Threats" it was recorded:

> "Losing past clients due to change in brand."

In relation to marketing, reference was made to:

> "Mail out to existing clients, friends, professionals."

[18] It was also at this time that Mike Pero discovered the new company had a publicly available website through which it was soliciting enquiries from the public for mortgage broking services. The website included a statement attributed to Mr Heath that he had "taken the plunge and set up [his] own company". This could only be a reference to the new company, James Heath Mortgages Ltd. Ms Smith in her affidavit explained that the presence of the website in the public domain was as a result of an error on the part of the designer. She said that in anticipation of the new company beginning to trade in the future she had commissioned a consultant to design a website. She said the content was still in draft and she had no intention of the website going live or trading under the name of the new company until after the expiration of the Lite Franchise Agreement. Both she and the website designer said Ms Smith did not authorise the website going live and when Ms Smith learned this had happened she instructed the designer to remove it. That was done on 19 June 2015.

These proceedings

[19] On 18 June 2015, the day after Mike Pero became aware of the various steps apparently being undertaken by Mr Heath and Ms Smith to set up a mortgage broking business in Christchurch, Mike Pero made an urgent without notice application for interlocutory restraining orders.

[20] The application sought the following orders:

(a) the respondents comply with the franchise agreement and the restraints of trade;

(b) the respondents preserve various documents as evidence;

(c) for inspection of those documents;

(d) for making forensic copies of the documents; and

(e) costs.

[21] On 19 June 2015 Keane J made interim orders in terms of (a) and (b) above. He declined to make the inspection orders (c) and (d) applied for on a without notice basis. He also refused to order costs.

[22] At the hearing, I raised with counsel my concern that Ms Smith was not bound by any restraint of trade as her period of employment with Mike Pero had now ceased. By way of a memorandum filed after the hearing, Mike Pero also intimated a request that I order an injunction against Ms Smith, restraining her from:

(a) Carrying on business under the name of James Heath Mortgages Ltd;

(b) Otherwise using or referring to Mr Heath in any business conducted in competition with Mike Pero; and

(c) Having any involvement with, reference to, or consultation with Mr Heath while engaging in the business of mortgage brokering or the provision of domestic financial advice.

Legal principles

[23] I consider first the application for an injunction enforcing the restraint of trade against Mr Heath and JSHL.

[24] Both counsel accepted that the principles to be applied in considering applications for interim injunctions are those as set out by the Court of Appeal in *Klissers Farmhouse Bakeries v Harvest Bakeries Ltd.*[7] These are:

(a) whether there is a serious question to be tried;

(b) whether the balance of convenience favours the granting of an injunction;

(c) whether the overall justice of the case favours the granting of an injunction.

[25] Thus, the Court must first consider whether there is a serious question to be tried and, if it determines there is, whether damages would provide an adequate remedy and against that, where the balance of convenience properly lies. In assessing the balance of convenience, regard may be had to the adequacy of damages should relief not be granted, the relative strength of each party's case and the impact of the decision on the rights of third parties.[8]

[26] Finally, the Court is required to step back and consider what overall justice requires having regard to these considerations.

[27] I note that after identifying those issues, Cooke J (as he then was) in *Klissers Farmhouse Bakeries* emphasised that:[9]

> "... an interlocutory decision of this kind is essentially discretionary and its solution cannot be governed and is not much simplified by generality."

[28] The Court is not concerned with attempting to resolve conflicts of evidence in respect of facts which may determine the case, nor is it concerned with deciding difficult questions of law which "call for detailed argument and mature considerations".[10]

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7 *Klissers Farmhouse Bakeries v Harvest Bakeries Ltd* [1985] 2 NZLR 129 (CA).

8 *Wellington International Airport v Air New Zealand Ltd* HC Wellington CIV-2007-485-1756, 30 July 2008 at [6] and [13].

9 *Klissers Farmhouse Bakers* above n 7 at [142].

10 *American Cyanamid Co v Ethicon Ltd* [1975] AC 396 (HL) at 407.

Is there a serious question to be tried?

General principles

[29] As to whether there is a serious question to be tried, it has been said this consideration should not be lightly brushed over.[11]

[30] A serious question to be tried was explained by the Court in *Henry Roach (Petroleum) Pty Ltd v Credit House (Vic) Pty Ltd*[12] and has been affirmed by New Zealand Courts[13] where it was said:

> "In order to determine whether there is a serious question to be tried, it is necessary to consider what is the applicable law and whether there are arguable differences concerning it, what the facts are said to be on the opposing sides and where the issues lie, and whether there is a tenable combination of resolutions of the issues of law and fact on which the plaintiffs could succeed."

[31] In *Re Lord Cable (Dec'd)* the Court said that it is:[14]

> "[N]ecessary for any plaintiff who is seeking interlocutory relief to adduce sufficiently precise factual evidence to satisfy the Court that he has a real prospect of succeeding in his claim for a permanent injunction at the trial."

Legal principles/restraint of trade

[32] In this case, the serious question to be tried is the enforceability of the express covenants which Mr Heath and JSHL provided when executing the deed.

[33] When considering injunctive relief in a restraint of trade context, whether there is a serious question to be tried requires the applicant to show:

(a) it has a proprietary interest which could sustain a restraint of trade clause;

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11 *Ansell v New Zealand Insurance Finance Ltd* HC Wellington A434/83, 3 November 1983, cited in *McGeechan on Procedure* (online ed) at [HR7.53.05].

12 *Henry Roach (Petroleum) Pty Ltd v Credit House (Vic) Pty Ltd* [1976] VR 309 at 311.

13 *Eco Maintenance Ltd v Leighton Contractors Pty Ltd* [2014] NZHC 2340.

14 *Re Lord Cable (Dec'd)* [1977] 1 WLR 7 (Ch) at 19, cited in *McGeechan on Procedure* (online ed) at [HR7.53.05(1)].

(b) the parties appear to be in competition.[15]

[34] The public policy interest which underpins this principle is that the market for goods and services should not be distorted by the unreasonable diminution of consumer choice arising from private restrictions on those willing to offer their goods and services in the market. This is likely to lead to monopolies and other negative economic consequences.

[35] Mr Sills, for the respondents, submits that Mike Pero has not adduced a sufficiently precise factual basis to justify interim orders being made:

(a) to identify the proprietary interest or interests it says requires protection;

(b) to show the restraint provisions it seeks to enforce are reasonably necessary to protect the proprietary interest or interests;

(c) as to how Mr Heath would damage the proprietary interests sought to be protected if he was permitted to work as an independent adviser in Christchurch.

(a) Is there a proprietary interest which could sustain a restraint of trade clause?

[36] It is well settled a franchisor may have a legitimate interest in protecting the goodwill created by its business model by means of a restraint of trade. As William Young J stated in *Washworld Corporation (Leases) Ltd v Reid*:[16]

> "In terms of the public interest, I see no particular difficulty with a restraint, at least if it is properly limited. In my view, a franchisor who has gone to the difficulty and expense of developing a successful business model is entitled to protect its investment in that business model by prohibiting franchisees by exploiting it for their own advantage and in competition with the franchisor and other franchisees."

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15 *Propeller Property Investments Ltd v Moore* [2015] NZHC 863 at [20]-[21].

16 *Washworld Corporation (Leases) Ltd v Reid* (1998) 8 TCLR 372 (HC) at 385.

[37] Mr Stewart QC, for Mike Pero, submits that this Court has previously accepted Mike Pero has a proprietary interest in its successful business model which it is entitled to protect by means of restraints of trade[17] where Miller J said:

> "I accept that a franchisor such as Mike Pero that has established a successful business model is entitled to protect its investment by means of restraint of trade.[18] In that case William Young J held that the validity of the restraint is to be determined as at the time it was entered into, and that it is appropriate to consider what is reasonable both between the parties and by reference to protection of interests that the law regards as legitimate. Restraints of similar duration and scope have been held to be reasonable.[19] "

[38] Mr Sills submits this case can be distinguished on its facts. This is because the Lite agreement was entered into in June 2010 and expired in June 2015. He points to Mr Heath's evidence that Mike Pero's business model and the value of its systems, intellectual property and brand had deteriorated significantly. He submits the value of the Mike Pero franchise in 2007, when *Exact Solutions* was decided, was substantially greater than during the term of the third agreement in this case. He submits the value of the Mike Pero brand and franchise has since greatly eroded.

[39] However, the difficulty with that submission is that it is common ground that the validity of the restraint is to be determined as at the time it was entered into.[20] Even if Mr Heath's claim is correct, a determination which is not possible to make on the present state of the evidential record, Mr Heath and JSHL have enjoyed the benefits of Mike Pero's business model, goodwill, reputation and brand for over 15 years. In 2010 they renewed their decade long contractual relationship for a further five years.

[40] The Court of Appeal in *Skids Programme Management v McNeill*[21] has since endorsed *Exact Solutions*[22] in the context of a different franchise dispute, stating:

> "This is a restraint of trade provision in the sense that it restrains a franchisee and persons associated with it from carrying out their trade. We have no doubt that in New Zealand a franchisor may, depending on the circumstances

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17 *Mike Pero (New Zealand) Ltd v Exact Solutions Ltd* HC Wellington CIV-2007-442-66, 17 April 2007 at [22].
18 *Washworld Corporation (Leases) Ltd v Reid* above n 16.
19 *Dymocks Franchise Systems (NSW) Pty Ltd v Bilgola Enterprise Ltd* (1999) 8 TCLR 612 (HC).
20 *Washworld Corporation (Leases) Ltd v Reid* above n 16 at 385.
21 *Skids Programme Management Ltd v McNeill* [2012] NZCA 314 at [47]-[49].
22 *Mike Pero (New Zealand) Ltd v Exact Solutions Ltd* above n 17.

of the case, have an interest in a franchise that is properly protected by a restraint of trade provision [citing *Mike Pero (New Zealand) Ltd v Exact Solutions Ltd*]."

[41] The Court went onto say with specific reference to mortgage broking as a type of franchise warranting protection:[23]

> "By making available to franchisees, methods to groom the business offered, to display particular attractive features and characteristics, the franchisor enables the franchisee to achieve sales that would not otherwise be possible.
>
> [...] While an assiduous competitor might be able to accumulate a body of material itself over a period, to do so would take considerable time and effort. We do not think the issue is only whether the know-how and the material is widely available. It is about the opportunity and immediate knowledge given by the franchisor to the franchisee, which equips the departing franchisee who intends to compete within immediate significant advantage over any other start up competitor. It is our conclusion that the provision of the franchise benefits that we have outlined give rise to a reasonable interest on the part of the franchisor to protect its investment and its name, its business model and the systems and written materials from exploitation by franchisees following termination of the franchise agreement."

[42] The franchise agreement at the centre of the present case specifically recorded in its first section under the heading, "Background" Mike Pero's expenditure of time, effort and money in developing and acquiring its knowledge and expertise in the business of mortgage broking. It also invested in developing systems and manuals for franchisees to use.

[43] However, Mr Sills submits the evidence reveals that by June 2010, when the Lite agreement was entered into, only a relatively small proportion of JSHL's business was through Mike Pero referrals. From April 2010 Mr Heath claimed the business was entirely self-generated from personal referrals and networking initiatives. Furthermore, he said Mike Pero's customer management systems were unreliable and embarrassingly unprofessional. Mr Heath's evidence is that in its 2013 review, the results of which were not shared with franchisees, Mike Pero learned it was no longer a competitive brand within the mortgage broking market (a claim which Mike Pero challenges). In other words, Mr Sills submits that there was no valuable proprietary interest for Mike Pero to protect as at June 2010 when the Lite agreement was entered into.

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23 *Skids Programme Management Ltd v McNeill* above n 21.

[44] While Mr Sills accepts the principles as stated in *Skids Programme Management*, he submits that on the present facts there are no sufficient franchise benefits for Mike Pero to protect.

[45] Apart from the difficulty of resolving such complex and contentious issues of fact on an application for injunctive relief, I agree with Mr Stewart it is no defence for Mr Heath to say that he now considers the terms of restraint to be too wide because he finds it inconvenient or uneconomic to comply with those terms now the agreement has expired. As at the time he entered the Lite agreement in 2010 and on the two previous occasions in 2000 and 2003, Mr Heath and JSHL acknowledged, after taking legal advice, that the restraints they were accepting were no more than what was necessary to protect Mike Pero's legitimate interests.

[46] Mr Heath agreed to these terms on three separate occasions. It was not until November 2014, just four months before he gave notice of his intention not to renew, through his lawyer, that he first raised concerns about the quality of Mike Pero's services as franchisor or questioned the fairness of the terms of the restraint. When Mr Heath advised Mike Pero he did not intend to renew his agreement, he made no reference to the restraint of trade provisions being unreasonable.

[47] Mr Sills also raised the question over whether the terms of the restraints were reasonable. I am not persuaded that this question needs to be determined on the present application, although I am satisfied, for the reasons which follow, that there is at least a seriously arguable case that the restraints are reasonable.

[48] The general principle is that all contractual provisions in restraint of trade are prima facie void and thus unenforceable.[24] As discussed above, this is necessary to avoid monopolies, unreasonable diminution of consumer choice and other negative consequences.[25] However, where the party seeking to enforce a restrictive provision is able to establish that the restriction is reasonable, it may be enforced. The onus is

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24 John Burrows Jeremy Finn and Stephen Todd *Law of Contract in New Zealand* (4th ed, LexisNexis, Wellington, 2012) at [13.9.1].

25 See above at [34]

upon the party seeking to enforce a restrictive provision to show that the restriction is no wider than the circumstances reasonably require.[26]

[49] Mr Sills submits that Mike Pero has not adduced a sufficiently precise factual basis to meet that onus.

[50] However, a table was produced showing the annual totals for the net commissions received by Mr Heath and/or JSHL since June 2001. In his first year of trading (i.e. from May 2000 until June 2001) Mr Heath earned $50,249 in net commissions. In his second year of trading this sum more than doubled to $106,625. In the third year the net commissions received totalled $180,490 and for the next five years (i.e. from June 2003 to June 2008) the net commissions ranged between $187,000 and $244,000. Following this, trading declined, apparently as a result of the Christchurch earthquake, but by 2012 revenue had increased again to $339,289 and to over $350,000 in 2013 and 2014.

[51] These figures demonstrate that after the first two years of trading, Mr Heath and/or JSHL received incremental increases in the net commissions received. However, the first two years of trading reflected the relatively modest earnings as the business was established and built up. It was not until the third year that the revenue from net commissions began to stabilise. In other words, on these figures, even with Mike Pero's assistance as franchisor it took Mr Heath at least two years to establish his business to a point where the revenue levels began to approach something of an equilibrium. For that reason a two year restraint does not appear to be unreasonable.

[52] Furthermore, comparable cases involving temporal restraints on franchisees have determined that a two year restraint in these circumstances is not unreasonable.[27]

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[26] John Burrows. Jeremy Finn and Stephen Todd *Law of Contract in New Zealand* (4th ed, LexisNexis, Wellington, 2012) at [13.9.1]; *Blackler v New Zealand Rugby Football League* [1968] NZLR 547 (CA).

[27] See for example *Ryan v Mason* [2012] NZHC 3105, (2012) 10 NZELR 174 (Five year restraint on employee reduced to two years); *Air8tors Ltd v Umbers* ERA Auckland AA257/05, 11 July 2005.

[53] Even if a Court or an arbitrator ultimately determines that the restraints extend beyond what is reasonable the remedies for an adjustment may be made under s 8 of the Illegal Contracts Act 1970. That is a question to be addressed at the substantive phase of the dispute when there is a more comprehensive body of evidence; not at an interlocutory stage.

[54] Therefore I am satisfied that it is at least seriously arguable that the restraints are not unreasonable.

(b) Do the parties appear to be in competition?

[55] This issue can be dealt with relatively briefly. The incorporation of the new company, although undertaken by Ms Smith, is strong evidence that Mr Heath, with Ms Smith, intends to commence a mortgage broking business in the Christchurch area. Indeed, Mr Heath in his evidence has not attempted to suggest otherwise. He said that he needed to be able to work once the franchise agreement expired and he wished to do that with Ms Smith as part of the new company. He said the new company was called James Heath Mortgages Ltd because he had built up personal goodwill as a mortgage advisor which he claimed was not attributable to or owned by Mike Pero. He said he wanted to make use of that and did not believe it would erode Mike Pero's ability to leverage off its own goodwill, noting it had other franchises in the area which would continue to operate under the Mike Pero banner.

[56] The timing of the incorporation of the new company also supports the conclusion that Mr Heath intends to operate in competition with Mike Pero. The new company was incorporated the day after Mr Heath and other franchisees commenced the proceedings seeking declarations from the Court that the restraint covenants were unenforceable. The new company will operate from the same premises, albeit with a reduced footprint, as JSHL did under the Mike Pero banner.

[57] Ms Smith's application for accreditation as a mortgage broker plainly conveys her intention to set up business as a mortgage broking and advisory service with Mr Heath. She expressed the view that it was possible a large number of clients from Mike Pero would transfer over to the new business.

[58] Finally, the website, even if its public manifestation was premature and unintended, clearly conveys that Mr Heath was setting up his own company to provide mortgage broking services.

[59] I have no doubt that Mr Heath, Ms Smith and the new company are in competition or intend to compete with Mike Pero.

Where does the balance of convenience lie?

[60] There are a number of factors which I am required to consider when weighing where the balance of convenience lies.

Adequacy of damages for Mike Pero if this application is not allowed but Mike Pero succeeds in its claim

[61] As Wild J observed in *Wellington International Airport Ltd v Air New Zealand Ltd* a key consideration in the assessment of the balance of convenience is whether either party will suffer unquantifiable loss in the event they are successful at trial but not on the interim application.[28]

[62] Mr Sills submits that it is difficult to see how Mike Pero might suffer damage to any goodwill that it may establish in relation to the Mike Pero brand as a result of Mr Heath working as a mortgage broker in Christchurch. He points out that Mike Pero has eight other franchises in the area and approximately 30 throughout New Zealand. All other franchisees have been in a position to contact Mr Heath's clients and maintain Mike Pero's goodwill after 30 June 2015 when the Lite agreement terminated. Mr Sills submits that any damage is likely to be minor.

[63] On the state of the present evidence it is not possible to make a sensible assessment of damages. Mr Heath has said that he has no interest in using any of Mike Pero's systems or intellectual property which are protected by confidentiality. He also says that since 1 April 2010 JSHL's business has been entirely self-generated from personal referrals, Mr Heath's own marketing programme and networking initiatives although I note he also said that after analysing JSHL's core history for

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28 *Wellington International Airport Ltd v Air New Zealand Ltd* HC Wellington CIV-2007-485-1756, 30 July 2008 at [4]-[14].

2009 he found that 21 per cent of the company's business came from Mike Pero referrals. This, apparently, was the reason he decided to change to the Lite franchise agreement in early 2010.

[64] Mr Stewart submits that damages will not be an adequate remedy if Mike Pero ultimately succeeds. The damage to Mike Pero's goodwill would be substantial and Mike Pero would suffer harm which is not adequately able to be compensated by damages if the injunctions are not granted.

[65] He also submits that the interests of innocent third parties would be adversely affected in the event of a refusal to grant the relief sought. In particular, he submits that the franchisees of Mike Pero in the Canterbury region would find themselves in direct competition with Mr Heath and the new company. He submits that franchisees who are complying with their obligations to Mike Pero deserve to be protected from competition by departing franchisees who have made the decision to resile from their contractual obligations.

[66] It is also evident from the evidence filed by Mr Heath that while his financial circumstances are not dire, they are not substantial. His ability to meet an award of damages is limited.

Adequacy of damages for Mr Heath in the event interim orders were made but Mike Pero was unsuccessful at trial

[67] Mr Sills submits that Mr Heath must work in order to maintain his personal goodwill. He submits it would be very difficult to assess the damage to his personal goodwill if he was not allowed to continue mortgage broking while the present issues remained unresolved.

[68] Furthermore, he submits that Mr Heath and Ms Smith will be unable to meet their expenses if they are unable to work and it would be necessary to sell their home after four to five months. Between them they have five children. At the age of 46, Mr Heath's evidence is that he does not believe he will be able to obtain another job in another industry where he has no skills in comparison to what he might, potentially, earn as a financial advisor and mortgage broker in Christchurch.

[69] However, the restraint is not a blanket ban on Mr Heath ever working in the finance industry. The protective restrictions are limited to the provision of mortgage broking and related services; they do not cover all areas of work within the entire industry. Furthermore, the deed provides that Mike Pero may agree to grant a dispensation to the franchisee to provide non-related services to customers of the business where the services are conducted under contract to Mike Pero and are not conducted in competition with the business of Mike Pero.

[70] Additionally, the prohibition is limited to six months in New Zealand and two years in the Canterbury region. It is not indefinite.

[71] It is plain that Mr Heath is an astute businessman with a range of skills, including management in the customer services field. Ms Smith has skills as a personal assistant and has worked for approximately five years as a real estate agent although it appears her registration has lapsed and she would be required to re-qualify if she was to return to that industry.

[72] While I accept that an inevitable consequence of granting interim relief will result in hardship to Mr Heath and Ms Smith I am far from satisfied it would be of the catastrophic levels which are frequently encountered in applications of this sort.

[73] Furthermore, Mr Heath said the decision not to renew the franchise agreement was a decision he did not make lightly. Mr Heath must have known that Mike Pero would respond in the way it has when confronted with the prospect of a former franchisee setting up business in direct competition contrary to its contractual obligations. It is inconceivable he did not contemplate the consequences and the need for him to take steps to secure alternative employment which would not breach the terms of the restraint. I am satisfied that any harm to the respondents is capable of being adequately protected by damages and note that in this regard Mike Pero has provided an undertaking as to damages.

[74] The interim relief sought in this case is to prevent a breach of contract and to maintain the status quo. In this context the observations of the Court of Appeal in *Shell (Petroleum Mining) Company Ltd v Todd Petroleum* deserve repetition:[29]

> "Cases to restrain breaches of contract are prime candidates for injunctive relief. As Dr Spry QC observes, it is going too far to say that, 'where it is sought to restrain a breach of contract or breach of covenant, the Court has no discretion to refuse an injunction.' But injunctions to restrain breaches of contract are nonetheless common because 'ordinarily … considerations of hardship on the part of the defendant do not prevent the grant of an injunction, not because they are irrelevant, but because they are of diminished weight in view of the fact that he has by his conduct or covenant deliberately undertaken not to perform the acts that are in question.'"

[75] As already discussed, the evidence amply demonstrates Mr Heath's intention to set up business as a mortgage broker in the Christchurch area in direct competition with Mike Pero. This is the very conduct which Mr Heath and JSHL expressly undertook they would not do following termination of the agreement.

[76] In this context the observations of Cooke J (as he then was) in *Thomas Borthwick & Sons (Australia) Ltd v South Otago Freezing Co Ltd* are pertinent:[30]

> "As we see it, the main significance of an express negative covenant … is twofold. It enables the Court to readily define what the defendant may be enjoined from doing; and it emphasises that the defendant has unequivocally accepted this obligation, thus tending to make it more difficult for him to set up hardship. As Dickson J said in *J C Williamson Ltd v Lukey & Mulholland*:[31]
>
> > 'If … a clear legal duty is imposed by contract to refrain from some act, then prima facie, an injunction should go to restrain the doing of that act.'"

[77] While I do not minimise the adverse effects on Mr Heath and his family and the threat that it will be necessary to sell the family home after four to five months if an injunction is granted, sight should not be lost of the fact Mr Heath was aware of the restraint provisions and made the decision to terminate his relationship with Mike Pero without apparently putting in place any plan for protecting his income

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29 *Shell (Petroleum Mining) Company Ltd v Todd Petroleum* [2007] NZCA 586 at [124].

30 *Thomas Borthwick & Sons (Australia) Ltd v South Otago Freezing Co Ltd* [1978] 1 NZLR 538 (CA) at 547, line 48.

31 *J C Wilkinson Ltd v Lukey* (1931) 45 CLR 282.

without breaching his agreement with Mike Pero. In this sense I am satisfied Mr Heath has brought these consequences upon himself through his own actions.

Comparable case law

[78] The Courts have consistently granted injunctions to uphold a restraint of trade where a departing transferee seeks to simply rebrand their services and continue business by competing with the franchisor with little or no material change to the business. Examples are discussed below.

P5 Holdings Ltd v Elisha's Well Ltd[32]

[79] *P5 Holdings* developed and franchised a system for the operation of weight loss clinics trading under the brand "Keto Clinic". Three franchisees, shortly after commencing business, purported to cancel their franchise agreements, arguing that their actions were justified on the grounds that serious misrepresentations on the part of the franchisor had induced them to enter the agreements which contained a two year restraint provision. Having cancelled, the defendants continued to operate their businesses under a new name, "Figurz".

[80] Despite claims of dire financial consequences for the defendants the Court granted the injunction observing: [33]

> "... without it, the Court would have been sanctioning the effective appropriation by the defendants, operating from their customer sites, of a weight loss system, products and machinery clearly very similar to *P5* and derived from it, with no more than a name change, the surrender of confidential information and, ultimately, termination of telephone links. That unattractive possibility was exacerbated by the efforts clearly taken by the defendants to maintain their existing customer base derived when they were operating Keto Clinics and enhance it by the use of a system virtually indistinguishable, other than in name, from the plaintiff's system, the one they had been operating before issuing their notices of termination."

[81] Mr Sills submits that this case is distinguishable on its facts from the present. He points to the Court's observation that the franchisee's position would have been

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32 *P5 Holdings Ltd v Elisha's Well Ltd* HC Auckland CIV-2006-404-4067, 27 September 2006.

33 At [79]. Two years' restraint being the same period upheld in *Dymocks* above n 19, *Safety Step (New Zealand) Ltd v Safety Step Auckland Ltd* HC Auckland CP 466/01, 14 September 201 and *Fletcher Aluminium v Sullivan* [2001] 2 NZLR 731 (CA)..

much stronger had the identity between their operation system and the franchisor's system had not been so marked or had they shifted premises. [34] All they did was merely change the name of their clinics.

Safety Step (New Zealand) Ltd v Safety Step Auckland Ltd & Ors[35]

[82] In this case a group of franchisees purported to cancel franchise agreements for non-performance and then set up in competition with the franchisor. The franchisor sought an injunction to restrain the defendants from operating businesses in competition with it, relying upon the restraint of trade clauses in the agreements. The restraint clause was for two years over the whole of New Zealand. The defendants argued that because the franchise agreements had been cancelled, neither side was obliged to perform the contract further, and it followed the defendants were not bound by the restraint.

[83] Randerson J rejected this argument on several grounds, noting that compliance with a restraint of trade obligation does not involve performance of an obligation under the contract, but rather amounts to the observance of a negative obligation.[36]

[84] Mr Sills refers me to [62] of the judgment where Randerson J, having determined that the franchisor had established an arguable case for the protection of its goodwill and franchise business, also recognised that the franchisees would also have established goodwill of their own in developing their customer base during the period of their operations under the franchise agreement. His Honour observed it might be the franchisor had contributed to that goodwill through the provision of products, systems and manuals but the precise extent, nature and ownership of the goodwill in the franchisees' customer base will ultimately be an issue for trial. That must be the position in the present case. Mr Sills' primary submission is that Mr Heath and JSHL had developed a business which was largely independent on

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34 At [80].

35 *Safety Step (New Zealand) Ltd* above n 33.

36 This observation was rejected by Winkelmann J in *Health Club Brands Ltd v Colven Botany* [2013] NZHC 428 at [32] who noted that although ultimately an issue for trial, it seemed "difficult to contend that compliance with a restraint of trade clause is not undertaken in performance of the contract. If it is not what compels compliance?"

Mike Pero both in terms of the business systems and intellectual property used as well as client referrals.

[85] However, the precise extent, nature and ownership of that goodwill is incapable of being assessed in any sensible or comprehensive way on this application. It is properly a matter for trial when the evidence can be fully explored.

[86] Mr Sills also emphasises Randerson J's conclusion that an injunction in the wide terms sought by the franchisor was not necessary to protect the franchisor's interests pending trial. In coming to the conclusion that a six month, rather than a two year limit, would enable the franchisor to be "up and running" in the franchise areas to enable it to compete with the franchisees, an injunction to restrain the franchisees for a period of six months was considered sufficient to meet the franchisor's concerns.

[87] However, the evidence before Randerson J was that the franchisor would take a minimum of six months to be "up and running" in the franchise areas to enable it to compete with the defendants. It was against that evidential background that his Honour ordered an injunction to restrain the defendants for a period of six months on the basis that that period would be sufficient to meet the franchisor's concerns. There is no such evidence in the present case. His Honour also imposed tight timetabling orders for the purposes of setting the matter down for trial within the six month period.

[88] Mr Stewart relies on the judgment for the recognition Randerson J gave to the circumstances in which the franchisee terminated the agreement. In that context his Honour said:[37]

> "I am also satisfied that the overall justice of the case favours the grant of an interim injunction. The defendants were well aware of the restraint covenants from the beginning of their business relationship with the plaintiff. They took the step of purporting to cancel the agreements with the benefit of legal advice and with the intention of establishing businesses competitive with that of the plaintiff in full knowledge of the risk they would be restrained from competing. In doing so, they would be utilising the confidential information to which they had been privy as part of their

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37 *Safety Step (New Zealand) Ltd* above n 33 at [74].

> franchise arrangements with the plaintiff. They will inevitably be taking advantage of the plaintiff's goodwill for their own profit. That is evident, for example, from the letter [the franchisee] sent to all its customers at the time of termination and its approach to one of the plaintiff's suppliers."

[89] A similar situation exists in the present case. As noted earlier, Mr Heath was well aware of the restraint covenants from the beginning of his business relationship with Mike Pero. He took the step of electing not to renew the agreement with the intention of establishing a business which would compete with Mike Pero's with the benefit of legal advice. He did so in the full knowledge of the risk they would be restrained from competing. It is also evident that despite Mr Sills' submission that there is now no residue of goodwill for Mr Heath to take with him it is difficult to reconcile that claim with Ms Smith's statement in her business plan, referring to Mr Heath and herself as:

> "Very well known in the industry and a large amount of clients from previous franchise will possibly transfer over."

Health Club Brands Ltd v Colven Botany Ltd[38]

[90] In this case, the franchisor, *Health Club Brands*, operated a franchise of gymnasiums across Auckland trading under the name "Club Physical". The three defendants were franchisees operating gymnasiums in different suburbs around Auckland. The fourth defendant was the owner and sole director of the three franchisees and a guarantor of their obligations. The fourth defendant terminated the three franchise agreements alleging he had been induced to enter into the agreements by misrepresentations and that *Health Club Brands* had breached its ongoing assistance obligations under the agreements.

[91] Following termination, the three gymnasiums were immediately rebranded as "Jolt Fitness" and continued to trade under that new name. *Health Club Brands* applied for an interim injunction restraining the defendants from conducting or having any interest in any health and fitness business within a distance of five kilometres from the premises formerly operated by them as a Club Physical gymnasium. *Health Club Brands* relied on the restraint of trade clause.

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38 *Health Club Brands Ltd v Colven Botany Ltd* [2013] NZHC 428.

[92] Following termination *Health Club Brands Ltd* contacted members of the three Jolt Fitness gymnasiums in an attempt to persuade them to revert to Club Physical memberships. The franchisees applied for interim injunctions restraining *Health Club Brands* from accessing its membership lists and from contacting those members. Winkelmann J determined that although the franchisees were no longer using the Club Physical brand, there was a respectable argument that by operating from the existing premises they continued to trade on the goodwill built up through access to the Club Physical business model.[39] *Health Club Brands* had a legitimate interest in ensuring the transfer of that goodwill to an incoming franchisee. That could only be achieved if the defendants were prevented from exploiting the goodwill in competition with the new franchisees. Her Honour concluded that there was a serious question to be tried and the retraints were reasonable in scope.

[93] On the question of hardship it was accepted that the grant of an injunction would terminate the defendants' businesses with catastrophic effect. The fourth defendant would lose more than $2 million in his capital investment and the businesses of the three gymnasiums would be rendered insolvent. Furthermore, rent would continue to accrue, 40 permanent staff and 20 contracting staff would lose their jobs, members would lose access to the gymnasium and the defendants would have to refund about $90,000 in pre-paid gymnasium fees. The defendants would have no income to meet outstanding debts to suppliers.

Overall justice

[94] I accept that granting the injunctions sought may have the adverse consequence that Mr Heath and Ms Smith will be required to sell their house. There may well be other adverse consequences which also follow. However, I am easily satisfied that the overall justice of this case favours the grant of an injunction restraining the defendants from commencing or continuing any business in the name of the new company or otherwise in competition with Mike Pero contrary to the terms of the restraint of trade provision, until further order of the Court. In reaching that conclusion I have taken the following factors into consideration:

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[39] At [28].

(a) Mike Pero has a strongly arguable claim. It has enforceable contractual provisions which restrain the defendants from commencing or continuing any business in competition with Mike Pero.

(b) Damages will not be inadequate to remedy if Mike Pero ultimately succeeds. The damage to Mike Pero's goodwill is likely to be substantial and the harm is not adequately able to be compensated by damages if the injunctions are not granted.

(c) Mr Heath and the other respondents have only limited means by which to meet an award of damages.

(d) Mr Heath was well aware of the restraint covenants from the beginning of his business relationship with Mike Pero. He took the step of electing not to renew the agreement with the intention of establishing a business which would compete with Mike Pero's with the benefit of legal advice. He did so in the full knowledge of the risk he would be restraint from competing.

(e) The respondents expect a large number of clients from Mike Pero would possibly transfer to the new business.

(f) The only means to assess the extent, nature and ownership of the goodwill can only be assessed when evidence is adduced, including expert evidence, and tested by cross-examination at trial.

[95] I therefore make an order preventing Mr Heath or JSHL from breaching the restraints of trade which they have agreed. In particular, I note that Mr Heath is restrained from engaging or being involved in the mortgage brokering business in New Zealand for a period of six months, beginning on the date of the termination of the franchise agreement and in the Canterbury region for a further eighteen months after the conclusion of that period.

Position of Ms Smith

[96] Mike Pero also seeks an injunction against Ms Smith, restraining her from:

(a) Carrying on business under the name of James Heath Mortgages Ltd;

(b) Otherwise using or referring to Mr Heath in any business conducted in competition with Mike Pero; and

(c) Having any involvement with, reference to, or consultation with Mr Heath while engaging in the business of mortgage brokering or the provision of domestic financial advice.

[97] These claims were not raised at the hearing and while I have now received written submissions from Ms Smith on the application, I am hesitant to impose such an order without the opportunity for Ms Smith to respond in detail. However, for reasons which will become clear, I do not consider it is necessary to determine this issue.

[98] Given the injunction I have ordered against Mr Heath, I consider that many of the issues that this injunction is directed to address simply cannot arise. Mike Pero has obtained an injunction to prevent Mr Heath from carrying on or being involved in a mortgage brokering business. I consider that this would extend to allowing his name to be used in relation to that business, or providing advice to a person engaged in such a business. In short, the injunction against Mr Heath necessarily prevents the activity set out in (a) and (b) above. It also severely limits the interactions between Mr Heath and Ms Smith, in partial fulfilment of (c) above. The only question then is whether a further injunction is required to additionally restrict the contact between Mr Heath and Ms Smith. I consider that it is not.

[99] The injunction already granted prevents Mr Heath from being involved in a mortgage brokering business in any way whatsoever. He cannot assist Ms Smith if she elects to start such a business. Any restriction that goes beyond this would be both punitive and unwarranted. Indeed, I cannot see any reasonable basis on which such an order could be sought.

[100] I therefore decline to grant any injunction against Ms Smith or James Heath Mortgages Ltd on the basis that the orders in relation to the other parties make such orders unnecessary.

Preservation and inspection orders

Preservation orders

[101] The respondents did not oppose the making of the preservation orders before Keane J. They do not oppose the continuation of the orders.

[102] Mr Sills advises that Mike Pero is now in possession of all its confidential information and property which was previously in Mr Heath's possession. He points out that Mike Pero is now at liberty to inspect that information without the need for further orders.

[103] Accordingly, the preservation orders made by Keane J on 19 June 2015 are to continue until further order of the Court.

Inspection orders

[104] Mike Pero also seeks orders permitting the inspection of the property which is subject to the preservation orders and the taking of forensic copies, where relevant, of the hard drives of this property. Furthermore, Mike Pero seeks orders permitting the inspection of the forensic copies taken of the hard drives of the property referred to above.

[105] Mr Stewart submits that the orders for inspection are necessary to enable the proper determination of the substantive dispute between the parties, satisfying the threshold for jurisdiction under r 9.34 of the High Court Rules.

[106] Mr Stewart further submits the inspection of the preserved property will be important for establishing the extent and consequences of the respondents' deliberate misconduct and for determining whether there had been any improper use of confidential information belonging to Mike Pero that has caused or may cause damage to Mike Pero. He submits these will be central issues in the substantive

proceedings and the probable evidential benefit of the inspection orders outweighs any possible detriment or expense which might ensue for the respondents.

[107] Mr Sills submits that now Mike Pero is in possession of all its confidential information and property which was previously in Mr Heath's possession, obtaining further orders would amount to a fishing expedition. He also submits that an order for inspection under r 9.34 cannot be made until the matters in question in the proceeding are apparent which will not occur until a statement of defence has been filed. Because there is no proceeding and no pleadings at present, such a course is premature.

[108] In the present case, particularly given that the information contained on the hard drives of the property will inevitably include personal and private communications involving the respondents and third parties as well as privileged communications, I am not prepared to order a disclosure regime in substitution of the orthodox discovery process which would follow the filing of substantive proceedings.

Result

[109] Pending resolution of all disputes between the parties or further order of the Court, the first, second and third respondents (including their officers, employees and agents) are restrained from taking any steps in breach of obligations which the first and second respondents owe Mike Pero under or in connection with the franchise agreement between Mike Pero as franchisor and JSHL as franchisee dated 14 June 2010.

[110] The respondents (including their officers, employees and agents) shall preserve, until further order of the Court:

(a) all computer hardware in the respondents' possession or control including any Smartphones, iPads, computer tablets, laptops, desktop computers, and email servers whether kept at office premises or at the first and fourth respondents' home or elsewhere; and

(b) any external hard drives, disks, USB devices, or any other data storage devices in the respondents' possession, wherever located; and

(c) all data stored on the items in paragraphs [110](a) and [110](b); and

(d) the contents of all email accounts used by the respondents to the extent covered by paragraphs [110](a) to [110](c); and

(e) all telephone call records including text messages, diary notes and appointment calendars relating to any contacts whether accessed electronically or in non-electronic format; and

(f) all hard copies of documents relating to the mortgage broking business of any of the respondents.

[111] The application for inspection of the property in [110](a) and the taking of forensic copies, where relevant, of the hard drives of the property in paragraph [110](b) is refused.

[112] The application for inspection of the forensic copies taken in accordance with [110](c) is refused.

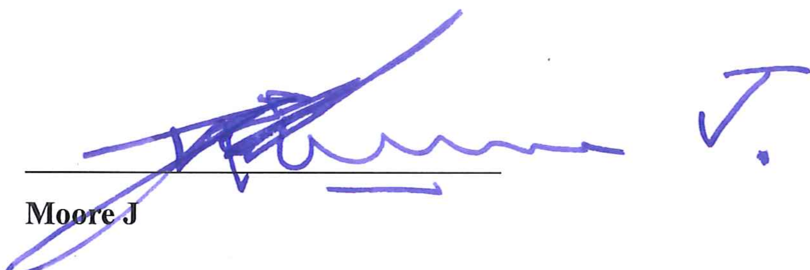
[113] I direct that counsel are to confer with a view to obtaining agreement on directions to deal with all procedural matters to expedite the matters proceeding to a hearing on an urgent basis. If counsel are unable to agree, memoranda are to be filed and referred to me within 20 days of the date of this judgment.

[114] Leave is reserved for any party to apply for such further directions or orders as may be necessary to give effect to this judgment.

Costs

[115] Mike Pero, having succeeded on the substantive application is entitled to costs. I direct the parties to file a joint memorandum as to costs within 20 working

days of the date of this judgment. In the event the parties are unable to agree I direct the parties to file memoranda within 25 days of the date of this judgment.



Moore J

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