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IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

366

A.No. 1337/83

No Special
Consideration

BETWEEN

MANCHESTER DYE CO. (N.Z.)
LIMITED a duly
incorporated company
having its registered
office at Auckland, and
carrying on business as
Ceiling Cleaners

PLAINTIFF

A N D

RUSSELL SMITH of Rocky
Bay Store, Waiheke,
Storekeeper

DEFENDANT

Hearing : 3rd April 1984
Counsel : R.J. Beech for Plaintiff
P.Dymond and J.M.W. Ralston for Defendant
Judgment : 3rd April 1984

ORAL JUDGMENT OF CHILWELL J.

The plaintiff has a business which it has been conducting for the last three years. That business is described in the statement of claim as one which sells dealerships in ceiling cleaning, sells ceiling cleaning products, cleans ceilings and re-sells dealerships on commission. The trade name of the business is "Ceiling Clean". That description of the business is admitted

in the statement of defence. The plaintiff company appears to have been established in 1980 by Mr. John Russell Chandler, the present managing director, Mr. Russell Smith, the present defendant, and some other person. In particular, Messrs. Chandler and Smith were original shareholders. That short statement of the establishment of the plaintiff is not contested. Nor is it contested that the defendant, Mr. Smith, left the company in March 1982. He resigned his directorship, sold his shares, terminated such employment as there may have been and settled some accounting matters.

On the 17th December 1983 Mr. Chandler noticed an advertisement in a newspaper which appeared to him to be similar in many respects to advertisements of his company. The advertisement in question indicates the establishment of a new business in the field of ceiling cleaning systems. It speaks about the use of chemicals and it is designed to attract persons prepared to purchase some interest in the system for \$1995. Included in that price is equipment, chemicals, software and full training in the cleaning system. At that particular stage the plaintiff had entered into franchise agreements with 19 franchise holders who covered certain areas not specifically referred to in the affidavits. It is apparent to anyone reading that advertisement that there is a correspondence between the supposed trade name "Ceiling Cleaning Systems" and the plaintiff's trade name "Ceiling Clean". It is probably not surprising that when Mr. Chandler saw this advertisement he procured his company to commence an action against Mr. Smith. This action was

commenced by statement of claim without a writ on the 19th December 1983.

The statement of claim raises two causes of action against Mr. Smith. The first is based on breach of confidence; the second is based on the tort of passing off. The prayers for relief are essentially injunctive. Under the first cause of action a permanent injunction is sought restraining the defendant and others from disclosing to any other person the process, formulas and/or methods used by the plaintiff in its ceiling cleaning business. Under the second cause of action it is sought to restrain the defendant and others from advertising and/or using in any manner whatsoever the name of "Ceiling Cleaning Systems" or any like or similar name.

When the action was commenced a notice of motion, in ex parte form, for an interim injunction was filed. It was dealt with on that day by Sinclair J. who ordered Mr. Smith and others, by way of restraint :-

- "(a) From disclosing to any other person the processes formulas and methods used by the plaintiff company in its ceiling cleaning business;
- (b) From advertising and/or using in any manner whatsoever the name of Ceiling Cleaning Systems or any like or similar name."

Being an interim injunction those orders apply until further order of the Court.

The present notice of motion to set aside those orders was filed on the 26th March 1984. I observe that the affidavit of Mr. Smith in support was sworn on the 22nd February 1984. The delay of one month is not explained by affidavit but I was informed from the Bar that there had been some mistake or mix up concerning the process of getting it filed.

There are two matters of a preliminary nature to be discussed. The first relates to an informal undertaking given by Mr. Smith to adopt the trade name "Above All Ceiling Cleaning Systems". Mr. Beech has fairly conceded that he could not argue that name to be sufficiently similar to the plaintiff's present trade name to be any cause for concern. Hence, this Court is now more concerned with the cause of action based on breach of confidence. Secondly, in view of the fact that when the matter was called yesterday I allowed Mr. Smith an adjournment for the purpose of filing an affidavit, the haste required to prepare file and serve the affidavit did not permit counsel to explain the method by which it is proposed Mr. Smith will conduct his proposed new business venture. As I understand the position, as explained by counsel from the Bar, the proposal is to sell to the public what is colloquially called a "package" comprising containers of the appropriate chemicals in a way in which it is not revealed what they are, a piece of spraying equipment and a training course in the use of the equipment and the system. It is not to be a franchise style of operation but one in which the purchaser acquires his "package" and goes into business whenever and wherever he pleases without any form of

trade restriction.

This being an application to review an ex parte order the Court treats it, in nearly all respects, as if it were an application de novo for an injunction. The exception affects procedure in that the defendant, seeking to set aside the order, presents his argument first. On behalf of Mr. Smith there were two broad submissions. The first that the evidence does not disclose any serious question to be tried; the second that in any event the balance of convenience favours Mr. Smith and justice requires that the orders made by Sinclair J. be set aside.

With regard to the serious question to be tried issue, five submissions were made by counsel for Mr. Smith. The first (and possibly most important submission) was that the evidence did not establish that the plaintiff had any property in the system. On the contrary, the submission was that the evidence indicated that at all times the property in the system was owned by Mr. Smith. The submission was that it was acquired by him initially from an American owner, that he merely used the plaintiff as a vehicle for marketing the system while he was a member of the company and that there is no evidence whatever of his having transferred ownership to the plaintiff. On this issue of ownership there is a direct conflict between Mr. Chandler and Mr. Smith. In these circumstances the Court usually restrains itself from endeavouring to resolve the conflict. There have been, and will in the future be, cases where the Court is able to say that the affidavits point in one direction only. That

cannot, however, be said of the evidence in this case. The pointers to the acceptance of a triable issue on the question of ownership are that the issue was not positively raised until a very late stage. It was highlighted in the affidavit of Mr. Smith sworn and filed yesterday. By contrast it was by no means so clearly highlighted in his first affidavit sworn on the 22nd February 1984. Another pointer is to be found in the notes made by Mr. Smith of a meeting of shareholders and/or directors at the time Mr. Smith left the company. In particular the first paragraph of what he recorded is significant :-

"That Russell Smith be allocated the rights to use the Ceiling Clean System in the Western Suburbs of Auckland as a part payment of monies due to him by the Company: That he may assign, sell and dispose of those rights if he so wishes to Richard Simon Wiseman without any further reference (sic) to the Company."

The document goes on to deal with questions of accounting between the interested personalities and to refer to the transfer of shares, in particular, by Mr. Smith. As a matter of inference from those two pointers I find, as a question of probability, that the plaintiff can certainly argue that something was purchased and sold and that the cleaning system was part of what was purchased and sold because part of it was retained by Mr. Smith in the passage to which I have referred. I have not been informed on the affidavits as to whether that supposed arrangement was carried into effect. Its relevance goes to the state of mind of the person who wrote it.

Secondly, it was argued by counsel for Mr. Smith that there was no evidence of any express or implied agreement between the plaintiff and Mr. Smith concerning trade restrictions or the use of confidential information. Indeed, the omission of such topics from the notes made of the company meeting, to which I have referred, has been advanced as a pointer to support Mr. Smith's contention. The law with regard to confidential information is, I think, particularly clear. It does not depend on contract. It is a branch of the law of equity. I analysed most of the relevant cases in Whimp v Kawakawa Engineering Ltd. (unreported, 29th November 1977, A.Nos. 105 and 107/75, Whangarei). Accordingly, while the existence or non existence of an agreement may be relevant, the cause of action exists on its own unsupported by the need for an agreement.

Thirdly, and probably second in order of importance, counsel for Mr. Smith relied on certain evidence in the affidavits suggestive of the fact that there is nothing particularly secret about the chemicals, that the substances used can be readily obtained on the market, that the plaintiff discovered this shortly after entering into the arrangement with the American owner because, when the compounds were analysed, it was discovered that it was not necessary to bring the material into New Zealand: it was already available here. Mr. Smith, in paragraph 4 of his affidavit filed yesterday, sets out the position with regard to chemical compounds. I do not propose to discuss that paragraph nor to discuss the conclusions reached by Mr. Smith

because it would be wrong for this type of information to be made public. In this particular branch of the law one has to divorce one's mind from the complexities of patents, designs, and trade marks. One is concerned with the way in which businessmen go about gathering together information, analyse it and then use it for their business pursuits. It is often a fact that after all the research is done the end result is something completely simple. Simplicity is not the issue. The issue is whether someone has spent time and effort in gaining the know-how. The affidavits of Mr. Smith indicate that a degree of time and effort was thus spent. The whole doctrine, if it may be called such, of "reverse engineering" is based on the principles to which I have referred. There are, in my judgment, pointers to existence of a triable issue on this issue of whether the information is such as to retain any element of confidentiality. I refer, in addition to the time and effort put in by Mr. Smith, to the covenants which employees and franchise holders were required, during the time that he was with the company, to sign. As I expressed to counsel for Mr. Smith at some stage of the argument, it is a little inconsistent for Mr. Smith now to say that the system is so simple as not to be a fit topic for protection by the law relating to confidence yet when he, as a member of the company was engaged in selling franchises and taking on employees (one must infer) was assiduous to protect the confidential information which he now says should not be protected.

The fourth submission of counsel for the defendant

was based on the old case of Herbert Morris Ltd. v Saxelby [1916] 1 A.C. 688. I do not really need to discuss that authority because it is concerned with restraint of trade in the employer/employee type of relationship. It is a case far removed from the equitable doctrine of confidence with which the essential part of this case is concerned.

As a fifth submission counsel for Mr. Smith contended that Mr. Smith would be quite unlikely to divulge the formula, or lack of it, to purchasers from him for the very good reason that, upon doing so, he would have nothing to sell. The short answer to that, in my judgment, is that the "springboard principle" applies to give the plaintiff, if it does own the system, the clear right, as against Mr. Smith, to use it. Counsel for the plaintiff did not place any reliance on the springboard principle preferring to have Mr. Smith restrained from making discovery to others. In that respect he submitted that unless restrained in some way the plaintiff has no control whatever over his conduct, and, if he did choose to divulge the information, the plaintiff could have no possible control over third parties. With respect, I find that submission hard to refute and I accept it.

Having dealt with what I believe to be all the submissions put to me by counsel for Mr. Smith on the first matter it is my judgment that the evidence, conflicting though it may be, establishes an arguable case fit for trial.

One then turns to balance of convenience issues. I was referred to some evidence about what the position is in Los Angeles with regard to this particular system. I was invited to take judicial notice of the purported fact that the population of Los Angeles is roughly the equivalent of New Zealand. Los Angeles supports 100 franchise holders or dealers. The plaintiff has succeeded in granting only 19 within New Zealand. Accordingly, I have been asked to draw the inference that the New Zealand market is a very long way away from saturation point. This serves, it was submitted, to distinguish this case from American Cyanamid Co. v Ethicon Ltd. [1975] 1 ALL E.R. 504. There the market was particularly limited. The parties were engaged in marketing a particular type of prescription drug. It was, of course, perfectly plain that entry of a competitor into such a restrictive market could have had devastating results. But it is contended that this is not the position here if the Court compares the Los Angeles experience with the present position in New Zealand. In any event I am asked to infer from the rest of the evidence that there is a substantial untapped market in New Zealand. It would be quite wrong for the Court to take judicial notice of comparative populations between Los Angeles and New Zealand or to draw any inferences about how people in a foreign country might behave by comparison with the average New Zealander. Even if it be a fact that there is a large untapped market in New Zealand the plaintiff is, as a matter of law, entitled to keep it all, that is if the plaintiff is entitled to the protection of the equitable doctrine of breach of confidence.

The personal circumstances of Mr. Smith have been put to me. He is 56 years of age, he has been a storekeeper at Waiheke Island for the last 12 months or so. He is selling that business. He is desirous of making a livelihood out of what he considers to be his idea which he pioneered and brought into New Zealand. He wishes not only to make that his livelihood but also, during the next few years of his working life left, to make security for his retirement. It is essential, it is contended, for him to get under way straight away because it takes time to build up this type of business. Counsel cited, as an example, delay in waiting for the next issue of yellow pages.

Counsel for the plaintiff, naturally, asked me to consider the position of that company compared with the disadvantage to Mr. Smith, if restrained, pending final determination of this action. Counsel contended that the contest is between potential destruction of the plaintiff's existing business against delay to Mr. Smith in commencing a business and one which, it appears at the moment, has involved him in no expenditure - at least there being no evidence of that aspect of the matter. I think perhaps that counsel puts it a little high when he uses the word "destruction" but nevertheless it would not be too high to use the word "inroads" in its place. Counsel for the plaintiff then referred to the potential loss in terms of turnover to the plaintiff against the delay factors which will affect Mr. Smith if restrained.

Finally, I was addressed by both counsel on the

question of delay. Counsel for the plaintiff relied on the fact that the injunction was granted on the 19th December 1983 and that, as far as he is concerned, no application was made to this Court by or on behalf of the defendant until 26th March 1984 which is but a few days ago. I have already referred to the apparent delay between the swearing of the affidavit by Mr. Smith and the filing of the motion. It may be that if counsel for Mr. Smith had been given further time yesterday he may have been able to get in affidavit form, the cause of that delay. I do not propose to hold the delay from 22nd February to the 26th March 1984 against Mr. Smith. However, the period between the time the Court office opened about 20th January 1984 and the 22nd February 1984 is a substantial period. One would have thought that the relatively simple affidavit and the motion to set aside could have been filed in the Court office before the end of January and this matter given a fixture by the middle of February. The point is that Mr. Smith has already, himself, suffered delay.

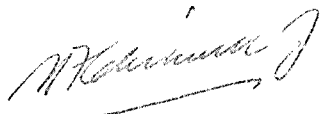
It is my judgment reviewing all the evidence and the matters to which my attention has been directed by both counsel that the balance of convenience favours the plaintiff and not the defendant. It is, therefore, a proper case for an injunction. In my view the original orders made by Sinclair J. were properly made. In my judgment there is no need to vary those orders in order to cover the proposed new name of Mr. Smith's proposed venture. I have recorded Mr. Beech's concession in this judgment. However, that may

not be a great advantage to Mr. Smith if he is unable, as he will be unable, to operate the system contrary to the terms of the orders made by Sinclair J. which I now confirm.

In the course of argument I was referred to paragraph 11 of Mr. Smith's affidavit of 2nd April 1984. That paragraph offends Rule 135 of the Code of Civil Procedure. It must accordingly be struck out and I so order.

Because there are certain matters which ought not at this stage to enter the public domain I further order that the affidavit as a whole be not available for search. It is to be placed in a sealed envelope. It is to be opened only on the authority of a Judge of the High Court or a Judge of the Court of Appeal and then subject to such terms and conditions as the Judge may impose.

So far as costs are concerned I do not think it proper at this stage to hear counsel. Costs should be reserved pending the final resolution of the action. The formal order of the Court is, therefore, that the defendant's motion to set aside interim injunction is dismissed.



Solicitors :

Plaintiff : Neumegeu & Co., Auckland.

Defendant : Morgan-Coakle, Ryan & Collis, Auckland