IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV 2008-404-005112

BETWEEN	SURE CARE SERVICES LIMITED First Plaintiff
AND	ROBERT THORNE LAWRENCE AND DEON JOHAN WESSELS Second Plaintiffs
AND	JOY CHIUNG-YI TSENG LAWRENCE AND JILL CHIUNG-HUI TSENG WESSELS Third Plaintiffs
AND	AT YOUR REQUEST FRANCHISE GROUP LIMITED First Defendant
AND	ADRIAN COURTNEY KENNY Second Defendant

Hearing: 20 January 2009

Counsel: A F Grant for plaintiffs
R M Dillon for defendants

Judgment: 31 July 2009 at 11:30am

JUDGMENT OF ASSOCIATE JUDGE ABBOTT

This judgment was delivered by me on 31 July 2009 at 11:30am, pursuant to Rule 11.5 of the High Court Rules.

Registrar/Deputy Registrar

Solicitors:
Stewart Germann Law Office, PO Box 1542, Auckland 1140 for plaintiffs
Gaze Burt, PO Box 91345, Auckland 1142 for defendants

[1] This proceeding concerns a dispute over franchise agreements for the conduct of home and commercial services businesses operating under the name "At Your Request". The first defendant (which I will refer to as AYRFG) as franchisor with the first plaintiff (Sure Care) as franchisee and the second plaintiffs (as guarantors) entered into several agreements for regional franchises for the Tauranga, Rotorua and Whakatane areas.

[2] The plaintiffs say that AYRFG has breached numerous terms of the agreements, and misrepresented many of the aspects of the business to them. They claim they have cancelled the agreements and sue for their loss of expected profits (alleged to be $4,290,000). As a second cause of action they say that both defendants (the second defendant is a director of AYRFG) have breached the Fair Trading Act 1986. The plaintiffs seek to recover sums paid under the agreements, compensation for expenses incurred and income or earning opportunities lost as a consequence of entering into the agreements.

[3] The defendants have protested the jurisdiction of the Court to hear the claim. They have applied to dismiss or stay the proceeding on the ground that each agreement contains an arbitration clause under which the parties have agreed to refer all disputes to arbitration.

[4] The plaintiffs oppose the application on a number of grounds. The principal grounds are that the arbitration clause does not require disputes to be referred to arbitration, that arbitration is inappropriate because the third plaintiffs are not parties to the agreement, and that it would be contrary to public policy to enforce the arbitration clause because of the deceitful conduct of the defendants.

Relevant background

[5] In August 2005 Mr Lawrence and Mr Wessels (the second plaintiffs) became interested in the At Your Request franchises run by AYRFG. In August and

September 2005 they had a number of meetings and discussions with Mr Kenny (the second defendant) as to the manner in which the franchises operated.

[6] On 12 September 2005 the second and third plaintiffs incorporated Sure Care for the purpose of purchasing regional franchises for three services (home care, lawn care and commercial care) in the Tauranga, Rotorua and Whakatane regions. The second and third plaintiffs are two husband and wife couples. They became (and remain) shareholders. The second plaintiffs became (and remain) directors.

[7] Sure Care entered into the franchise agreements on or about 13 September 2005. The second plaintiffs gave guarantees of Sure Care's obligations. Sure Care paid total franchise fees of $100,000 and a further $97,000 for equipment, materials and other costs of setting up the businesses. The agreements contained identical standard terms, including a disputes resolution clause (clause 24).

[8] Disputes arose between the parties. The plaintiffs contend that AYRFG breached several terms of the agreements and had misrepresented the franchise businesses to them. The parties attempted to resolve their differences. This included attending a mediation as required under the disputes resolution clause, but that was unsuccessful.

[9] After the mediation the plaintiffs stopped making royalty payments to AYRFG pursuant to the franchise agreements. Both parties gave notice of cancellation in late 2006.

[10] The plaintiffs issued this proceeding on 11 August 2008. On 1 September 2008 the defendants wrote to the plaintiffs (through respective solicitors) invoking an arbitration provision in the disputes resolution clause and referring all the disputes raised in their statement of claim to arbitration. They invited the plaintiffs to withdraw the proceeding and advised that they would apply to the Court to dismiss the proceeding if the plaintiffs did not do so. The plaintiffs did not withdraw the proceeding. The defendants then brought the application that is now before the Court.

The application, competing positions, and issues arising

[11] The defendants rely on clause 8(1) of the first schedule to the Arbitration Act 1996 under which it is mandatory for the Court to stay a proceeding in respect of a matter which the parties have agreed to refer to arbitration, unless certain factors exist:

> **Schedule 1, Chapter 2**
>
> **8 Arbitration agreement and substantive claim before court**
>
> (1) A court before which proceedings are brought in a matter which is the subject of an arbitration agreement shall, if a party so requests not later than when submitting that party's first statement on the substance of the dispute, stay those proceedings and refer the parties to arbitration unless it finds that the agreement is null and void, inoperative, or incapable of being performed, or that there is not in fact any dispute between the parties with regard to the matters agreed to be referred.

[12] The defendants say that they have referred to arbitration all the disputes set out in the statement of claim, pursuant to an agreement to arbitrate these disputes contained in clause 24(3) of the franchise agreements. They seek dismissal or stay under r 131 (now r 5.49) of the High Court Rules (on the grounds that clause 8(1) precludes the Court's jurisdiction) or under r 477 (now r 15.1) (on the grounds that it would be an abuse of process to continue with this proceeding in face of the reference to arbitration).

[13] The plaintiffs say that clause 8(1) does not apply because, on its true construction, clause 24(3) is not an agreement to arbitrate and because it cannot apply to the claim under the Fair Trading Act. Further they say that if clause 24(3) is an agreement to arbitrate it is inoperative as the plaintiffs elected litigation and the defendants accepted that election. Alternatively, they say that clause 24(3) is inoperative because the defendants have waived their right to arbitration or are estopped from enforcing it. They also say that it cannot apply in any event to the third plaintiffs or the second defendant (who are not parties to the franchise agreements). Finally, they say that clause 8(1) should not be applied because it would be contrary to public policy to enforce the agreement to arbitrate: s 10(1) Arbitration Act 1996.

[14] The issues that the Court must determine, therefore, are:

a) Whether, as a matter of construction, the plaintiffs are required to submit these disputes to arbitration.

b) Whether the arbitration clause applies to a claim for breach of the Fair Trading Act.

c) Whether the arbitration clause is inoperative because the parties have elected litigation.

d) Whether the defendants have waived their right to arbitration or are estopped from insisting upon it.

e) Whether the fact that the third plaintiffs and the second defendant are not parties to the agreement precludes arbitration.

f) Whether there are public policy considerations that preclude arbitration.

Conduct of hearing and further submissions

[15] Although this is the defendants' application, it was common ground that its success or otherwise would turn on whether the plaintiffs were able to establish any of their grounds for opposition. For that reason counsel for the plaintiffs, Mr Grant, presented his argument first (addressing the defendants' written argument at the conclusion of his submissions).

[16] After counsel for the defendants, Mr Dillon, had replied Mr Grant sought leave to present further written submissions in reply, contending that the defendants' arguments went beyond the defendants' written synopsis in a number of respects, which could not have been anticipated. I granted leave for the plaintiffs to file further written submissions but only in reply to new matters that had emerged in the oral argument. I also reserved leave for the defendants to seek an opportunity to

answer any matters on which they believed they were prejudiced by the further submissions.

[17] Mr Grant filed further submissions. Shortly afterwards counsel standing in for Mr Dillon (who had gone on leave) filed submissions in response without seeking leave or identifying any claim to prejudice. Mr Grant objected to these further submissions. He sought leave to reply to them if the Court accepted it was appropriate to read them.

[18] Neither counsel has conformed strictly to the terms for providing further submissions. Mr Grant addressed seventeen matters in his reply to Mr Dillon's oral argument. A number of the arguments had been raised in Mr Dillon's written submissions. Of the remainder, there were only two that I regard as potentially relevant to the issues before me. Both appear to me to relate to his argument on public policy. The first is whether clause 11.3 of the franchise agreements (an exclusion clause) should be given any weight. The second was the addition of the decision in *Wilkinson v Osborne* (1915) 21 CLR 89 to the case law he relied on in support of his public policy argument. I have taken both into consideration.

[19] Although counsel standing in for Mr Dillon did not comply with the terms for filing any further response, he may not have appreciated what the terms were. I note that he filed his submissions on the basis that the defendants, as applicants, should be entitled to the last reply. The reply does not go significantly beyond the original submissions on the issues that matter. For that reason I am not prepared to allow Mr Grant to make any further submissions.

Construction of the arbitration clause

[20] The arbitration clause is part of a wider disputes resolution clause. It is helpful to see it in context. The relevant parts are:

> **24 DISPUTE RESOLUTION**
>
> 24.1 **Notice:** Should any dispute arise between the parties touching any matter under this Agreement, then such dispute shall be defined by written notices by the party raising it to the other party and shall

> forthwith be discussed on a 'without prejudice' basis by the parties in an attempt to resolve their differences amicably and expeditiously.
>
> 24.2 **Mediation:** If the discussions in clause 24.1 fail to resolve the relevant dispute, then the parties agree that within fifteen Business Days of the date of the Notice of the dispute, the parties may refer the matter to a mutually agreed mediator…and must not litigate or refer to arbitration prior to mediating….
>
> 24.3 **Arbitration:** If the mediation procedure in clause 24.2 fails to resolve the relevant dispute, then the parties agree that either party may refer the issue to arbitration in accordance with the Arbitration Act 1996….
>
> 24.4 **No Delay:** It is agreed by both parties that any such arbitration is to be conducted and completed without delay and neither party will impede the arbitration in any way.
>
> 24.5 **Ruling Confidential:** It is agreed that parties, their advisors and consultants will hold the ruling of the Arbitrator confidential.

[21] Mr Grant's opening submission was that clause 24.3 did not require the plaintiffs to submit their disputes to arbitration. He based this submission on the phrase in clause 24(3) reading "either party may refer the issue to arbitration". He argued that the word *may* indicated that arbitration is not mandatory, and allowed the parties to chose litigation or arbitration. He contended that this interpretation was supported by the wording of clause 24.2 (the mediation clause) that the parties "must not litigate or refer to arbitration prior to mediating" and by the wording of clause 24.4 that if arbitration is chosen "any such arbitration is to be conducted and completed without delay". He said that clause 24.2 reserves the right for each party to litigate after an unsuccessful mediation, and the words *any such* in clause 24.4 indicate that arbitration is not compulsory. In the event of uncertainty, Mr Grant submitted that the *contra proferentem* rule of interpretation should apply against the defendants.

[22] Mr Dillon submitted in response that clause 24(3) was clear that once mediation has failed either party may refer the disputes to arbitration. He argued that once a party has done so, the Court must stay the proceeding if so requested (and the defendants have so requested by appearing under protest and bringing this application).

[23] I am unable to accept Mr Grant's submission. The use of the word "*may*" in clause 24(3) is permissive to the extent that the parties can elect whether to take their dispute to arbitration (as against bringing it to the court). However, it has to be read as part of the phrase "*the parties agree that either party may refer the issue to arbitration*". I consider this phrase means that once one party decides to refer a dispute to arbitration both are bound to that course. The phrase carries an implication of an agreed consequence. If the phrase was construed as Mr Grant suggested, it would be meaningless.

[24] I find that once a party takes the step of referring a dispute to arbitration, clause 24(3) requires that they follow that course. Clause 24 read as a whole, and the wording of clauses 24(2) and 24(4) referred to above, are entirely consistent with this construction.

Does clause 24 extend to disputes under the Fair Trading Act?

[25] Mr Grant submitted that, in any event, the arbitration clause does not apply to conduct that infringes the Fair Trading Act 1986. He argued that the statutory obligation to comply with the terms of that Act is not "a matter under this agreement" bringing such claims within the ambit of clause 24.

[26] I see no reason to exclude disputes under the Fair Trading Act from the ambit of clause 24(3). There is no suggestion that the defendants are not required to comply with the Fair Trading Act. The complaint is that the defendants' conduct caused the plaintiffs to enter into the franchise agreements. The plaintiffs seek civil redress (to which they are entitled under the Act) for the alleged breach. It is still, in effect, a matter "touching the agreement" in the same way that the alleged misrepresentations are.

Is the arbitration clause inoperative because the parties have elected litigation?

[27] Mr Grant next submitted that if clause 24(3) is mandatory it is inoperative (applying the language of clause 8 of Schedule 1 of the Arbitration Act 1996). He argued that if it allows the parties an election to arbitrate or litigate, the plaintiffs

have elected litigation and the defendants have accepted that election. He based this submission on an exchange of correspondence between solicitors after both parties had served notices of cancellation, and particularly a letter from the defendants' solicitors (dated 14 December 2006). This letter was in reply to a letter from the plaintiffs' solicitors (dated 1 December 2006) challenging the defendants' cancellation of the agreements. It concluded with the statement

> "We hope to be able to file proceedings against your client before the end of the year, but if having regard to our own commitments and the commitments of counsel, that is not possible, we will file them in the new year. Can you please let us know if you have instructions to accept service on behalf of your client."

[28] The defendants' solicitors stated in the opening paragraph to their letter of 14 December 2006

> "we…confirm that we are authorised to accept service on behalf of our client."

[29] I do not accept Mr Grant's submission for two reasons. First, the acceptance was not as unequivocal as he would have me find. The defendants' solicitors ended the same letter with the statement

> "…any claims that your client has with regard to the Franchise Agreements…need to be addressed through arbitration as provided for in clause 24 of the Franchise Agreements."

This position was repeated in a subsequent letter dated 9 February 2007.

[30] Secondly, although the letter of 1 December refers to filing of a proceeding (a term usually associated with a Court proceeding) there is no explicit reference to a Court proceeding as distinct from an arbitral proceeding, The defendants' solicitors clearly saw the latter as the appropriate approach – and pointed the plaintiffs' solicitors to that.

Is the clause inoperative through waiver or estoppel?

[31] In their grounds of opposition the plaintiffs contended that the defendants had waived their right to insist on arbitration or were estopped from insisting on that right. In his initial submissions Mr Grant submitted that the statement by the defendants' solicitors that they were authorised to accept service was an unequivocal indication that the defendants were not insisting on the right to refer the disputes to arbitration: *New Zealand Railways Corporation v Fletcher Development* (1990) 1 NZ Conv 190,464 at 190,467. In supplementary submissions Mr Grant re-phrased this submission and said that this was a further reason for clause 24(3) to be inoperative. He initially made the same point in respect of the ground of estoppel, but in oral argument did not pursue that ground.

[32] In reply Mr Dillon contended that the defendants have not waived their right to arbitration (which requires a clear and unambiguous action), and said that there is no basis for an estoppel. Both counsel referred to the correspondence I have set out above.

[33] I do not accept that the solicitors' statement was inconsistent with the defendants' insistence on arbitration, or that the plaintiffs can have understood that the defendants would not insist on the arbitration clause, for the reasons I have given on the last point. Further, there is no evidential basis on which to find that it was unconscionable for the defendants to revert to an insistence on arbitration (the basis for any estoppel: *National Westminster Finance NZ Ltd v National Bank of NZ Ltd* [1996] 1 NZLR 548,549) even if the letter of 14 December 2006 could be construed as an acceptance of court proceedings.

Is arbitration precluded by the claims of the third plaintiffs and the claims against the second defendant?

[34] Mr Grant submitted that the application should be denied because clause 24(3) does not apply to the claims by the third plaintiffs and those against the second defendant as they are not parties to the franchise agreements.

[35] Mr Dillon argued that it does not matter that the third plaintiffs and the second defendant are not parties to the arbitration agreement as no cause of action is

advanced by or against them, other than jointly with or against the parties to the arbitration agreement.

[36] Although I accept that the third plaintiffs have pleaded that they have suffered losses in their own right, their claims are dependent on the claims being advanced by the first and second plaintiffs. They have not pleaded any dealings between the defendants and them additional to the defendants' dealings with the other plaintiffs, nor of any deceptive or misleading conduct directed specifically towards them. For that reason their claims will not succeed if the other plaintiffs' claims do not.

[37] I accept that the plaintiffs all have claims against the second defendant (Mr Kenny) in person. Mr Kenny is director and majority shareholder of AYRFG. The plaintiffs have not pleaded any conduct by Mr Kenny which would not also give rise to liability on the part of AYRFG. I anticipate that Mr Kenny is willing to have the first and second plaintiffs' claims (if not all plaintiffs' claims) heard in an arbitration. If so, the same applies to the third plaintiffs' claims against him as their claims against AYRFG.

[38] The third plaintiffs cannot be compelled to partake in an arbitration, but I do not see that they need do so. If the alleged representations which are said to comprise the misleading conduct are established as between their husbands and the defendants, they can then pursue their independent claims if they wish. They will still have to show that they too were mislead and have suffered loss as a result, but that is the only discrete aspect of their claims. On the other hand, if the other plaintiffs cannot establish misleading and deceptive conduct, the third plaintiffs' claims will also fall away.

[39] Rule 1.2 of the High Court Rules (formerly r 4) requires the rules to be applied in a way that will best secure a just, speedy and inexpensive determination of a proceeding. In the circumstances I consider that if the other claims should otherwise have to be determined by arbitration, and Mr Kenny agrees to the claims against him being included in the arbitration, this is an appropriate case to stay the claims of the third plaintiffs to await the outcome of the arbitration.

Is arbitration precluded on public policy grounds?

[40] Finally, Mr Grant submitted that it would be contrary to public policy to enforce the arbitration clause. In support he referred me to a number of cases in which the courts have had to decide whether to uphold claims for confidentiality in face of a public interest in the subject of the confidence: *Initial Services Ltd v Putterill* [1968] 1 QB 396; *Fraser v Evans* [1969] 1 QB 349; *Hubbard v Vosper* [1972] 2 QB 84; *Church of Scientology v Kaufman* [1973] RPC 635; *Malone v Commissioner of Police of the Metropolis (No 2)* [1979] 2 All ER 620; *Attorney-General for the United Kingdom v Wellington Newspapers Ltd* [1988] 1 NZLR 129; and *B v Auckland District Law Society* (HC Auck M1539SD99, 6 July 2000, Paterson J).

[41] This submission arises out of AYRFG's marketing of the franchise business as one based on honesty, integrity and fairness. The plaintiffs say that they were induced to enter into the agreements by this (and other representations) but that the way in which the business has operated is to the contrary. Mr Grant said that the substantial number of misrepresentations pleaded illustrate business practices designed to conceal from prospective purchasers the way in which the franchise operates in fact. He argued that evidence adduced from three former franchisees as to their experiences (much of which has not been answered by the defendants) showed that the plaintiffs' case was not an isolated one and that the practices were systemic. He submitted that requiring the disputes to be determined by arbitration would allow these practices to continue to the detriment of the public, and specifically prospective purchasers of franchises. He invited me to accept a similar public interest defence to the present application so as to bring the practices out from behind the closed doors of arbitration.

[42] In response Mr Dillon submitted that any public policy factor favours arbitration where disputes are capable of private settlement. He said that the defendants disputed the claims and would answer them all substantially at the appropriate time (they have not filed a defence as to do so would be a step in the proceeding which could preclude arbitration). He submitted that provisions for confidentiality and arbitration are standard features of commercial agreements and

that reasonable protection for prospective purchasers was built into the franchise agreements in the form of requirements to obtain legal and financial advice and to identify any representations which have induced them to enter into the agreements, and a 21 day "cooling-off period" after signature (only 7 days is allowed in the standard agreement promulgated by the Franchise Association of New Zealand). He submitted that the interests of the 214 existing franchisees in protecting the AYR brand also had to be taken into account. He noted that, although the plaintiffs' submission of dishonest practices suggested fraud, the plaintiffs have not pleaded fraud and submitted that it could not be sustained on the evidence in the present case.

[43] The cases relied upon by Mr Grant establish that:

(a) Public interest can be a defence to a claim for breach of confidence, but there needs to be just cause and excuse for breaking the confidence: *Fraser v Evans* at 361;

(b) Although it is not limited to this, the defence can be raised where there is misconduct of such a nature that it ought in the public interest to be disclosed to others: *Initial Services Ltd v Putterill* at 405;

(c) The disclosure must be to one who has a proper interest to receive the information (for example, disclosure of a crime to the police); however, there could be cases where broader disclosure (such as to the press) will be justified: *Initial Services Ltd v Putterill* at 406, *Malone v Commissioner of Police* at 635;

(d) The court considering the defence must balance the public interest in upholding confidentiality with the countervailing public interest in disclosure: *B v Auckland District Law Society* at [40].

[44] Although the Court has an overriding entitlement not to enforce an arbitration agreement for public policy reasons in an appropriate case (this is recognised in s10(1) of the Arbitration Act 1996), counsel did not refer me to any case where the courts have declined to enforce an arbitration agreement merely on the grounds of

public interest in the subject matter. Mr Dillon referred to *CBI NZ Ltd v Badger Chiyoda* [1989] 2 NZLR 669 where the Court of Appeal decided that it was not contrary to the public interest to give effect to a clause in an arbitration agreement ousting the jurisdiction of the court to review an award for error of law on the face of the award. However, that case does not help in the present application, save in that it is an illustration that public policy considerations can be relevant.

[45] I am not persuaded that the cases cited by Mr Grant are directly on point. In this case the claim is not for breach of confidence *per se* but rather to enforce an agreement to resolve the disputes by arbitration rather than litigation. Nevertheless, they provide a useful basis for analysis.

[46] The cases indicate that there needs to be a balancing of interests. In that respect the starting point in my view is the public interest in upholding agreements. I accept that confidentiality and arbitration clauses are regularly used in commercial agreements. There is a proper commercial rationale for them. Considerable weight needs to be put on the parties' agreement to resolve their disputes in a particular way. I note that the plaintiffs initially accepted the disputes resolution clause (by going to mediation).

[47] I accept, on the other hand, that the plaintiffs have advanced matters which, if proven, could amount to conduct which should be disclosed. However, the matters are not proven at this time. Mr Grant invited me to treat the plaintiffs' claims as well-founded. He criticised the defendants' failure to reply to each allegation made against them. I am not persuaded that it would have made any difference for the defendants to have done so. I am in no doubt that the defendants dispute the substance of the plaintiffs' case. Mr Kenny has provided affidavits from which I am satisfied that there are two sides to the dispute. I am not in a position to resolve disputes as to fact on this application (which in effect is what Mr Grant would have me do). For that reason I do not consider it helpful to traverse the various allegations and responses.

[48] It is also relevant to look at the public interest that the plaintiffs are advancing. They say that they have a concern about prospective purchasers. I

accept the submission of Mr Dillon that the agreements provide several safeguards for them. Notwithstanding the sceptical view of the plaintiffs, I suspect it is also open to any purchasers to make inquiries of existing franchisees. In addition, there are currently 214 existing franchisees whose businesses may be adversely affected if allegations are made public and are subsequently shown to have no merit or to apply only to the plaintiffs. The second plaintiffs appear to recognise this possibility - at an early stage of the dispute (in a complaint letter dated 21 June 2006) they referred to their concern about "brand devaluation" as a consequence of the matters they were raising.

[49] Perhaps most tellingly, however, the cases relied upon by Mr Grant suggest that disclosure is not unlimited – it must be to a person with a proper interest in the information. I consider that, at least at this stage (when allegations are unproven), there is no good reason to disclose more generally than to the arbitrator as the person whom the parties agreed would resolve their disputes. I see no reason for these unproven allegations to be disclosed to the public at large.

Decision

[50] I am satisfied that clause 24(3) of the franchise agreements requires these disputes to be determined by arbitration if one party so elects. The defendants have so elected. I consider that the plaintiffs claims for breach of the Fair Trading Act are claims touching matters under the franchise agreement and therefore within the ambit of clause 24(3). I am not persuaded that clause 24(3) is inoperative for any of the reasons advanced by the plaintiffs, or that the claims by the third plaintiffs preclude the other claims being determined by arbitration. I do not accept that the defendants should be denied the right to have the disputes determined by arbitration on public policy grounds.

[51] The second defendant is to file and serve a memorandum confirming that he agrees to the disputes against him being determined by arbitration under clause 24(3) at the same time as the claims against the first defendant. He is to do so by 7 August 2009.

[52] The claims by the first and second plaintiffs are to be dismissed, and the claims by the third defendants stayed pending determination of the first and second defendants' claims by arbitration, upon the filing of the memorandum referred to in the last paragraph. The Registrar is to allocate a case management conference for the proceeding if the memorandum is not filed as directed (or within any extension of time that the court may grant).

[53] I am unaware of any reason for costs not to follow the event on a standard scale basis. However, as counsel did not address me on this I will not make an order at this point. If counsel are unable to agree, memoranda are to be filed within 14 days.

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Associate Judge Abbott