Neutral Citation: [2013] IEHC 331

THE HIGH COURT

Record No.: 2013/1796P

Between:

KM FRANCHISING LIMITED

PLAINTIFF

AND

TEDCO LIMITED, NOEL CANDON AND DECLAN HALTON

DEFENDANTS

JUDGMENT of Mr. Justice Birmingham delivered the 12th day of July, 2013

1. Before the court are three motions, one, an application brought by the plaintiff for an interlocutory injunction, in broad terms to restrain breach of a franchise agreement, and two applications for security for costs, one brought by the first and second named defendants and one brought by the third named defendant.

2. The background to these motions is that the plaintiff is the holder of the master franchise for Snap Printing in Ireland. The first named defendant, Tedco Limited, has operated a Snap Printing franchise at Clonshaugh Industrial Estate in North Dublin, the plaintiff and the first named defendant having entered into a franchise agreement in 2004. The second named defendant, Noel Candon, is a director of the first named defendant and is a signatory to and also a guarantor of the franchise agreement of the 1st March, 2004. The third named defendant, Declan Halton, is a former director of the first named defendant, having resigned from that position by letter dated the 5th January, 2013.

3. Snap Printing opened its first centre in Perth, Western Australia in 1903. The business expanded across Australia and in 1979 began operating on a franchise model. The first Snap Printing outlet in Ireland opened in 1984 in Dublin. Expansion in Ireland followed and by 2008 there were 24 centres in Ireland. At present there are 21 operating centres. The business model operated is that franchisees are independent self employed operators. The master franchise holder charges 8% of the unit's gross sales as a royalty fee. Of this 8%, 1% is remitted to the worldwide master franchise holder in Australia.

4. In 2004, the first named defendant and its directors, the second and third named defendants, took over an existing Snap centre at North Strand Road, Fairview in Dublin. Their management of the Fairview centre was very successful and they turned around a business that had been struggling and developed it further from there. It is of some significance to note that the defendants have made the point that the nature of the business has evolved considerably over the years. In the early years the business was essentially a retail one, with customers dropping in and placing orders for wedding invitations, flyers and the like. However, the widespread availability of computers and home printers has seen a decline in demand for traditional services. The defendants would say that Snap Printing has been slow to adapt and that they themselves have survived only by developing their own business model based on providing a comprehensive service to a small number of large commercial clients. The extent to which the first named defendant has diverged or had to diverge from the traditional business model is a factor in the current dispute.

5. In 2009, the first named defendant's franchise business moved from Fairview to Clonshaugh and since then has carried on business from a unit at Grattan Business Park in Clonshaugh. The first named defendant rents this premises from the second and third named defendants. The move was a successful one and as of April 2012, the Clonshaugh Snap Centre was the top performing centre in Ireland.

6. As noted, a franchise agreement between the plaintiff and the first named defendant was entered into on the 1st March, 2004. It is detailed one running to some 88 pages. The second named defendant is listed as a guarantor. It is to be noted that the document is not signed anywhere by the third named defendant but he is referred to in the body of the document as a director and shareholder of the first named defendant.

7. The plaintiff has drawn attention to a number of provisions in the franchise agreement which it says are particularly in issue. These are:-

> Clause 5.12(1)(a). The first named defendant agrees to develop, fit out and redecorate the premises so that it complies with the Snap Image.
>
> Clause 5.15(1)(e). The first named defendant agrees to use the premises for the proper conduct of the franchised business and for no other purpose.
>
> Clause 5.16. The plaintiff and persons authorised by it may enter the premises to inspect the state of repair and condition of the premises and to ensure compliance with the franchisee's obligations under the agreement.
>
> Clause 7.1. The first named defendant acknowledges and agrees that all intellectual property [as defined in Clause 1.1(34)] belongs absolutely to the plaintiff.
>
> Clause 7.4(1). The first named defendant must use the centre name [as defined in Clause 1.1(7)/Schedule 1, Item 16 as "Snap Printing"#E9] (E9 is the Snap reference for Clonshaugh) and the trade marks [as defined in Clause
>
> 1.1(68)] as the only marketing identification of the franchised business.
>
> Clause 7(6). The first named defendant agrees that all the goodwill and other rights and interests arising from the first named defendant's use of the centre name, the trade mark, the domain names, the website, the Snap image and the Snap system belongs to the plaintiff.

Clause 8.1. The first named defendant acknowledges and agrees that the confidential information [as defined in Clause 1.1(12)] is provided or has been obtained under an obligation of strict confidence to the plaintiff and comprises trade secrets of the plaintiff and is the plaintiffs property even if part of it has been developed by the first named defendant.

Clause 8(2). The first named defendant agrees that it must not, inter alia, before or after the end of the franchise disclose any confidential information to any person other than to employees of the first named defendant to the extent necessary for the conduct of the franchised business; after the end of the franchise or after an assignment of the franchise by the first named defendant use any part of the confidential information; without the written consent of the plaintiff in any way copy or reproduce the confidential information in any manner whatever.

Clause 8(3). The first named defendant agrees that it must ensure that its employees maintain confidentiality.

Clause 13(1). The first named defendant agrees, *inter alia*, to conduct the franchised business in accordance with good business practice and with reasonable care and skill.

Clause 19(1). The first and second named defendants acknowledge and agree that the plaintiff has considerable and recognised good will in the conduct of its franchised business; that the plaintiff should be entitled to protect that good will for its own benefit and the benefit of all network franchisees by restricting the first named defendant's ability to damage that goodwill by competing with the plaintiff or any network franchisee, and; that each of the restrictions imposed upon the first named defendant under this clause is fair and reasonable.

Clause 19(2). The first and second named defendants jointly and severally agree with the plaintiff that neither the first named defendant nor any guarantor will, during the restraint period [defined in Clause 1.1(56) as the period from the beginning to the end of the franchise and one year after the end/assignment of the franchise] and within the restraint area [defined in Clause 1.1(55) as the territory within Ireland where the franchised business is located, a radius of 3km from the centre point of the premises and a radius of 2km from the centre point of any Snap Printing Centre] directly or indirectly do any of the following things:

(1) Engage or be concerned or interested in any business or person that

(a) Supplies products or services the same as or similar to those at any time supplied in the franchised business or

(b) Could be reasonably be regarded as market competitor of the Snap Network or any Snap Printing Centre; or

(2) Canvas or solicit with a view to supplying any product or service the same as or similar to those at any time supplied in the conduct of the franchised business, to any person who is or has been in the twelve months before the end of the franchise, a customer of the franchised business or of any other Snap Printing Centre;

(3) Employ or engage any person who is or has been in the twelve months before the end of the franchise employed by the plaintiff, the first named defendant or any other network franchisee without first obtaining the plaintiffs written consent;

(4) Purchase any goods or services then supplied through any Snap Printing Centre from any approved supplier, without first obtaining the plaintiffs written consent.

Clause 19.3. Provides that 19.2 applies to the first and second defendants acting alone or in partnership or association with another person, as principal, agent, representative, director, officer or employee, as member, shareholder, debencher holder, note holder, or holder of any other security as trustee of or as a consultant or advisor to any person or in any other capacity.

Clause 21.2. Provides that the first named defendant must not assign, sell or otherwise dispose of its interest in the franchise or the franchised business without first offering to sell same to the plaintiff and obtaining the plaintiffs consent.

Clause 23.7(2). The first named defendant acknowledges and agrees that at the end of the franchise all of the good will, even if all or part of it has been developed by the first named defendant remains or reverts to Snap.

8. In general terms, despite some degree of friction on occasions, the franchise agreement operated without controversy until recent months. One aspect of the relationship acquires significance in the context of the current difficulties. In 2009 a number of franchisees and individuals, including the second named defendant, established a company known as Mediaware Digital Limited, primarily to service the requirements of Microsoft in Ireland. The relevance of this is that the defendants, who deny the allegations of wrongdoing laid against them, contend that recent developments merely represent a continuation of what was happening with Mediaware. In this respect, it may be noted that Mediaware was the cause of the friction with a dispute as to whether its activities came within the ambit of the franchised agreement.

9. A number of events occurred in the early weeks of 2013 which caused the plaintiff major concern, including the cancellation in February of a direct debit for royalty payments. It is however necessary to go back somewhat in time. On the 24th February, 2010 a company known as Esmark Finch Limited was incorporated with a registered office at 8 Gratton Business Park, Clonshaugh. The Directors included the third named defendant and Rolando Cedeno, an accountant who works as financial controller of Snap, Clonshaugh. The plaintiff says that in January 2013 it became aware that Esmark Finch was operating a graphic design and print business from a unit adjoining the unit from which the Snap business was carried out. The plaintiff complains that Esmark Finch:-

(1) Is operating with the same equipment as the franchised business.

(2) Is operating with the same staff as the franchised business.

(3) Is operating with some of the same directors and persons connected to directors as the franchised business.

(4) Is operating in part from the same business premises.

(5) Is targeting the customers and contracts of the franchised business.

(6) Has been involved in removing a number of Snap signs from the exterior of the Clonshaugh premises.

(7) Is accessing and making use of confidential information.

The defendants, as I have indicated, for their part deny allegations of wrong doing. Notice of termination of the franchise agreement as of March 2014 has been given. It is also contended on behalf of the defendants and more particularly the first and the second named defendants that there has been a major overpayment of franchise fees, a suggestion which is utterly rejected by the plaintiff. Indeed the plaintiff says that far from there having been an overpayment, an inspection it carried out on foot of a court order showed that revenue had been underreported and miscalculated, so that additional sums are due to it.

10. In the course of a number of very detailed affidavits, claims and counterclaims have been advanced. In essence the defendants, again more particularly the first and second named defendants, dispute that the franchise agreement of March 2004 reflects the reality of the relationship between the plaintiff and the first named defendant as it is now. They contend that the agreement related to a retail, over the counter business in North Strand and cannot be revived after many years. According to the defendants, whatever complaints the plaintiff may have by reference to the 2004 document cannot provide a basis for interlocutory relief, as the defendants' current operation is ongoing for many years, and it is said that the first named defendant has not operated the traditional franchise model since the move to Clonshaugh in 2003. The defendants are also very critical of aspects of the service they have received from Snap. In particular it is said that the IT system has proved completely inadequate to meet the needs of large clients with complex requirements.

11. The first and second named defendants are parties to the March 2004 agreement. If the matters averred to by Mr. David Moffat and Mr. John Edgar are established at trial, the plaintiff will have established that the agreement has been breached. The first and second named defendants have accepted that they operate a Snap franchise but say that the relationship is no longer governed by the 2004 agreement. While it is possible that that argument may ultimately succeed, at this stage, where the plaintiff is able to point to a formal written agreement which has not been adhered to, that in my view is more than sufficient to establish a fair issue to be tried.

12. It seems to me that, certainly so far as the first and second defendants are concerned, there can be no doubt but that the plaintiff has established the existence of a fair *bona fide* question to be tried. The fair *bone fide* issue to be tried is whether Esmark Finch is setting out to take business from the plaintiff and is thereby damaging its goodwill. In that context the fact that the second named defendant is alleged to have said that Esmark Finch could take business from the first named defendant is significant. Indeed, as I understand, the second named defendant accepts that he made that statement, but puts a different gloss or interpretation on it, saying that it was designed to point out the competitive advantages that companies that do not have to pay royalties enjoy.

13. The position in relation to the third named defendant is less straightforward. He was not a party to the franchise agreement of the 1st March, 2004 and to that extent his position is to be distinguished from that of his fellow director, the second named defendant. However, I have concluded that the plaintiff has established a fair *bona fide* issue to be tried as to whether the first and second defendants are acting in breach of confidence. It seems to me that there is fair issue to be tried as to the extent of the obligation of confidence owed by the third named defendant as the former managing director of the first named defendant. There is, in my view, a question to be tried as to whether the third named defendant is operating a business so as to achieve a commercial advantage from information that he has gained from the Snap group in setting up a rival business.

14. Having concluded that the plaintiff has established the existence of a fair issue to be tried as against all defendants, it is necessary to consider whether damages would be an adequate remedy and where the balance of convenience lies.

15. So far as the adequacy of damages is concerned, the point is made by the plaintiff that given the nature of a franchise relationship, damages are inherently inadequate. In this regard, the plaintiff refers to the decision of Laffey J. in *Irish School of Yoga Limited v. Murphy* [2012] IEHC 218 (Unreported, High Court, 28th May, 2012).

16. It seems to me that the fact that the franchise agreement comes to an end in March next year is a highly relevant consideration. The major element of any damages claimed, the loss of royalty payments, can readily be calculated (evidence was given that royalty payments average €8,000 per month). Also of significance is that an earlier dispute relating to the operation of Mediaware, that foreshadowed the current dispute, was settled on the basis of an agreement to pay compensation. It seems to me that that was, at least to an extent, a recognition of the fact that disputes of this nature are inherently capable of being addressed by the calculation and payment of compensation. However, it may be added that the defendants' position is not strengthened by the fact that the agreed compensation was not in fact paid.

17. In so far as the question of the balance of convenience is concerned, again it seems to me that the starting point for consideration of this issue has to be that the franchise agreement is now in its closing months and it is clear that it is not an agreement that will be renewed. I do accept of course, that while the franchise agreement comes to an end in March 2014, one must not lose sight of the fact that, by virtue of Clause 19.2 of the agreement, the restraint on competitive activity continues for a further 12 months after the end of the agreement. However, even bearing that fully in mind, the plaintiff's capacity to control the conduct of the defendants is time limited and the period for doing so is coming to a close. Also, without seeking to resolve disputed issues of fact, it does seem to me that much of what the defendants and Esmark Finch are about at this stage represents a follow on from what was happening with Mediaware.

18. If the plaintiff was to obtain all the orders that it seeks, this would in practice bring the business of Esmark Finch to a halt. If that happened, then the first named defendant, in turn, would be unable to meet the needs of its clients. It has neither the personnel nor the plant and machinery to be in position to do so. Granting the injunction sought would therefore bring the first named defendants' operation to a halt.

19. While ceasing the activity complained of would obviously have some advantages for the plaintiff, it would not be without downsides as it would halt the flow of royalty. It seems to me that the *status quo* or something close to the *status quo* is maintained by permitting the first named defendant and Esmark Finch to co operate and work together, in a way similar to what the first named defendant and Mediaware did in the past.

20. In concluding that the balance of convenience does not favour granting the injunctions sought, as I have done, I have had regard to the fact that if Esmark Finch is forced to shut down there will be very serious implications for the third named defendant. He will not be paid his salary and he has entered into guarantees in relation to the company's liability which would likely be called upon. If the

plaintiff's case ultimately failed, it would be very difficult, if not impossible to restore to the third named defendant what he had lost.

21. Accordingly, so far as the application for an injunction is concerned, I have concluded that while a fair issue to be tried has been made out, I do not believe that it has been established that damages would be an inadequate remedy, nor that the balance of convenience favours the granting of the injunctions sought. I have been influenced by the fact that I do not believe that 2013 has seen a truly major departure on what has been the previous practice. The one area where there certainly has been a departure from the *status quo*, is the decision of the first named defendant to halt the payment of the royalty fee. In the course of argument, I raised this issue with counsel for the first and second named defendants and I understood him to indicate that his clients would be prepared to continue to make the payments, calculated as heretofore, but would wish that the payments be paid into court. This is suggestion to which I have had regard in deciding where the balance of convenience lay. It will therefore be a term of the order refusing the injunction sought that the first and second named defendant must make a monthly payment calculated as heretofore into court until the franchise agreement comes to natural end.

22. I turn now to the question of the applications for security for costs. It is necessary to consider in the first instance whether the defendants have made out a *prima facie* defence to the plaintiff's claim. As Cooke J. pointed out in *Goode Concrete v. CRH Plc Roadstone Wood Limited and Others* [2012] IEHC 116 (Unreported, High Court, 21st March, 2012) the task that the court engages in is a limited one. At para. 41 he observed

> "The defendants must point to evidence which, if adduced and accepted, would deprive the plaintiff of its entitlement to the relief sought because the matter is considered at an interlocutory stage, the court makes no decision as to whether such a defence will succeed, nor is it engaged in any comparison between the relevant strength of the cases advanced by the plaintiff and the defendant. The court is concerned only to verify that the defendants genuinely intend to defend the action and that they have a stateable basis for doing so."

23. So far as the third named defendant is concerned the position is particularly clear cut. His case is very straight forward. He says that he was not a party to the agreement of the 15th March, 2004. In addition he says that he has not made use of the plaintiff's confidential information and has no intention of doing so. In these circumstances, I am in no doubt that the third named defendant has made out a *prima facie* defence.

24. The position as regards the first and second named defendant is not quite as clear cut. In a sense this is the obverse of the fact that the plaintiff was in a position to make out a very straightforward and clear cut case against them in the context of the injunction application. However, it seems to me that the affidavits sworn by the second named defendant set out in very considerable detail why it is contended that the relationship between the plaintiff and the first named defendant is not governed by the March 2004 document. These defendants have engaged in a serious manner with the plaintiff on every allegation of fact raised. It must be emphasised that this is not a question of making mere bald assertions. Each allegation has been addressed in great detail and the defendants' position on each topic is set out with great particularity. It seems to me that the threshold has been crossed by the first and second named defendants.

25. It is necessary now to consider whether the defendants have established that the plaintiff will not be in a position to pay the costs of the successful defendants, if the plaintiff's claim fails. The defendants have contended that the plaintiff's financial position is a precarious one. It is said that this precarious position is relevant not only to the security for costs motions. The defendants also contend that the undertaking as to damages that was offered by the plaintiff was not an effective one. I have already indicated that I am not acceding to the application for an injunction, but I should make it clear that in so deciding I was not influenced by the suggestion that the undertaking as to damages was not effective.

26. However, it is necessary to consider the defendants' arguments in detail in the context of the applications for security for costs. The defendants have analysed the accounts of the plaintiff and of the plaintiff's parent company. It is said that the parent is insolvent on a balance sheet basis and that accordingly, a debt owed by the parent company, KMCM Franchising Limited, would not be readily repayable. The defendants contend that this undermines the ability of the plaintiff to pay costs, which would be very substantial if the plaintiff is unsuccessful. I should make clear that I accept that this litigation will be lengthy and complex and by definition expensive. I have been offered estimates in the context of the two motions which are not in agreement but having dealt with the interlocutory applications and witnessed the extent of the disagreement reflected in the affidavits, I am convinced that the litigation will be lengthy and that accordingly it is right to approach this case on the basis that if the plaintiff is unsuccessful the costs that would be awarded against it would be very substantial indeed.

27. The plaintiff has argued that it could, if necessary, discharge costs from the combination of cash reserves and its monthly royalty incomes. If funds in excess of cash in hand were required, the plaintiff says it could access funds in three different ways. First, with the agreement of its bankers, Danske Bank, the plaintiff claims that it could adjust the rate at which it is repaying its loans in order to retain a greater quantity of royalty income for the purpose of meeting such costs. Secondly, it is said that a funds injection from shareholders would be an option. The third potential course of action put forward by the plaintiff is to access funds through the master franchiser in Australia. It might be argued that there is a certain vagueness in these suggestions. There is no confirmation that the bank would agree to what is suggested. The letter of comfort from Australia concludes with the following paragraph:

> "KM Franchising should take whatever legal actions are needed to bring an end to this breach situation. While we mutually understand that the responsibility for legal action rests with KM and that KM has the financial resources available to mount this challenge. Snap Franchising Limited in Australia is also ready to contribute where necessary."

It might be seen as somewhat vague that there is no indication of the level of support that Snap Australia would be willing to provide or indeed be in a position to provide.

28. In other circumstances this lack of specifics would cause major difficulty for the plaintiff. However, it seems to me that there is a wider picture which cannot be ignored. The Snap Printing Network is embedded in Ireland since 1984. Apart from the Snap Centres operated by franchisees across the country, it also has a substantial production facility in Baldonnell. While certainly not immune from the effects of the recession, the company continues to trade successfully and has a high level of cash receipts on an annual basis. According to a letter from the plaintiff's solicitors of the 4th March, 2013, the plaintiff has enjoyed double digit percentage EBITDA profitability for each of the last 20 years, up to and including this year. I note that the plaintiff generated an operating profit of almost €320,000 in 2011 and that according to Mr. Moffit's affidavit the 2012 figures which are currently being audited will show a 65% increase on the 2011 figure.

29. The reality is that failing to meet an order for costs would in all likelihood bring the plaintiffs operation to a close. I cannot see that being allowed happen. Of course an order for costs against it would be unwelcome for the plaintiff, but I feel strongly that if it

happened, the plaintiff would meet its obligations even if that would be achieved only with difficulty. Accordingly the defendants have failed to convince me that there is reason to believe that the plaintiff would be unable to pay the costs of the defendants if they are unsuccessful. This is not a case where the defendants require protection from litigation by a corporate body which is not a mark for the costs of such litigation.

30. There is a further consideration. The jurisdiction to order security for costs is discretionary. In *Hidden Ireland, Heritage Holdings Limited v. Indigo Services Limited* [2005] 2 I.R. 115, Fennelly J. made clear that the special circumstances which would see an order for security for costs refused is not confined to cases where the impecuniosity was caused by the defendants but rather that the court may have regard to any relevant circumstances which, as a matter of justice, would cause it to conclude that the order should not be made.

31. In my view, the nature of the allegations made against the defendants, relating to the deliberate breach of a franchise agreement, militates against the making of the order. This is also a factor in my decision. Accordingly, for the reasons stated I will refuse the orders sought for security for costs.