IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV-2014-404-000445
[2015] NZHC 2227

BETWEEN	WATER GUARD NZ LIMITED Plaintiff
AND	MIDGEN ENTERPRISES LIMITED First Defendant
	DAVID JAMES MIDGEN Second Defendant

CIV-2012-404-000915

BETWEEN	WATER GUARD NZ LIMITED Plaintiff
AND	CYNORTIC WATER SYSTEMS LIMITED First Defendant
	MARK JAMES SULLIVAN and SUSAN MARY SULLIVAN Second Defendants
	CYNORTIC LIMITED Third Defendant
	REINER GEORGE BRAGULLA Fourth Defendant
	CYNORTIC INTERNATIONAL LIMITED Fifth Defendant

Hearing:	6 - 20 and 22 July 2015
Counsel:	M Fisher and L Hui for Plaintiff D Grove for First Defendant in 445 proceeding A D Marsh for First and Second Defendants in 915 proceeding No appearance for Third - Fifth Defendants
Judgment:	15 September 2015

JUDGMENT OF ASHER J

This judgment was delivered by me on Tuesday, 15 September 2015 at 4.30 pm pursuant to r 11.5 of the High Court Rules.

Registrar/Deputy Registrar

Table of Contents

Introduction [1]
Background [6]
Procedural matters [17]
THE MIDGEN PROCEEDING (CIV-2014-404-445) [20]
The misrepresentation as to sales claim against the Midgen interests [21]
Factual background [23]
The contrasting positions [52]
The agreements [55]
The correspondence [59]
Due diligence [62]
Actions after sale [72]
Credibility [74]
The broad picture [80]
Conclusion on misrepresentation as to sales [83]
The misrepresentation as to sales claim against the Bragulla interests [86]
The claims relating to the defects [93]
The indemnity clause and implied terms [95]
The defective units [106]
The stainless steel chamber weld splits [112]
Failure of the ballast [119]
Overheating of the Platinum II units [130]
Defective glue [132]
Poor seals, leaking flexible hoses, filter heads and other miscellaneous complaints [136]
Breach of term [140]
Failure by Morgan Ltd to take proper steps when claims arose [145]
The implied term [147]
Failure to mitigate [153]
Assessment of ability to mitigate [162]
The misrepresentation as to defects claim against the Midgen interests [184]
The misrepresentation as to defects claim against the Bragulla interests [193]
Conclusion on the Midgen proceeding [204]
THE BRAGULLA/SULLIVAN PROCEEDING (CIV-2014-404-915) [207]
Background [210]
Mounting tensions [213]

The addendum to the BSA [221]
Breaches of the EDA [228]
Declarations under the EDA [236]
Injunctions sought [247]
The economic tort claims [250]
Inducing breach of contract [251]
Assessment of whether the tort has been proved [261]
Unlawful means conspiracy [273]
Fair Trading Act claims [279]
Conclusion on the Bragulla/Sullivan proceeding [281]
Result [287]

Introduction

[1] This judgment determines parts of a multi-faceted dispute concerning the manufacture and sale of Water Guard filtration units in New Zealand. The plaintiff, Water Guard NZ Limited (Morgan Ltd), a company controlled by Stewart Morgan, brings various claims in two separate proceedings which in the interests of expediency have been heard together.

[2] In the first proceeding, Morgan Ltd claims against Midgen Enterprises Limited (Midgen Ltd) and its principal, David Midgen (collectively, the Midgen interests). Morgan Ltd says the Midgen interests misrepresented Water Guard unit sale figures when Morgan Ltd bought the New Zealand distribution business from them in 2013. It further claims that the units supplied were not fit for purpose and not of merchantable quality.

[3] In the second proceeding, Morgan Ltd claims against five defendants not including the Midgen interests. The third defendant, Cynortic Limited (in liquidation), was the original manufacturer of the units. Its principal is the fourth defendant, George Bragulla. For the purposes of this judgment and to avoid confusion I will refer to Cynortic Limited as Bragulla Ltd, and to it with Mr Bragulla collectively as the Bragulla interests. Morgan Ltd says Mr Bragulla and Bragulla Ltd, like Midgen Ltd, misrepresented the sale figures during the sale of the distribution business, and the quality of the units.

[4] In addition, the second proceeding concerns the purchase by the first defendant, Cynortic Water Systems Limited, of part of the manufacturing business

from Bragulla Ltd. Mark and Susan Sullivan are the second named defendants and are the principals of the first defendant. I will refer to Cynortic Water Systems Limited as Sullivan Ltd, and to it with the Sullivans collectively as the Sullivan interests. Morgan Ltd says the Sullivan interests, in conjunction with the Bragulla interests, tortiously interfered with Morgan Ltd's rights under its contract with Midgen Ltd.

[5] The fifth named defendant is Cynortic International Limited, a company to whom Bragulla Ltd purported to sell part of the manufacturing business.

Background

[6] Water Guard units filter and treat water. Water is channelled through the units to get rid of particles, and is subjected to ultraviolet light to kill bacteria. The photograph below shows the design and appearance of one of the Water Guard units:

[7] The water comes in the pipe at the bottom right, goes through the plastic filters shown and then through a metal hose to the top steel cylinder which contains an element emitting ultra violet light, before emerging for use at the pipe at the top right. The electricity is supplied by a device known as the ballast, shown to the left

of the filters. All the Water Guard units, although they vary in the number of filters, the position of the ballast, and certain other features, have this general layout.

[8] Bragulla Ltd is the original manufacturer and supplier of the units. On 23 June 2010 Bragulla Ltd entered into an exclusive distribution agreement with Midgen Ltd (the EDA).[1] Pursuant to that agreement Midgen Ltd had the exclusive right to market, distribute and sell Water Guard units and related products in New Zealand and Pacific Island nations. The terms of the EDA will be considered in more detail later in this judgment.

[9] Between 2010 and 2013, Midgen Ltd distributed and sold Water Guard units in New Zealand that were manufactured and supplied by Bragulla Ltd. Nothing untoward occurred in this period in relation to the EDA, and there was by all accounts a well functioning commercial relationship between the parties.

[10] That state of affairs began to come to an end in September 2013, when both Mr Midgen and Mr Bragulla independently decided to sell their respective interests in the Water Guard business.

[11] Mr Midgen was the first to sell. In early September 2013, the principal of Morgan Ltd, Mr Morgan, became aware that the Midgen Ltd business was for sale. He met with Mr Midgen. On 16 September 2013 Mr Morgan and Mr Midgen signed an agreement for sale and purchase in which Midgen Ltd sold the distributorship business to Mr Morgan or his nominee for $440,000 (the Midgen–Morgan agreement, or MMA). There was a due diligence clause in the agreement.

[12] From early on in the negotiations Mr Morgan was assisted by his friend and business associate Wayne Cameron, who would ultimately work in the business. Mr Morgan and Mr Cameron met with Mr Midgen and Mr Bragulla, and checked various matters. It is common ground that Mr Bragulla consented to the sale to Morgan Ltd on 7 October 2013. On 9 October 2013 the due diligence clause was declared by Mr Morgan to be satisfied, and on 15 October the agreement was declared to be unconditional. A notice of assignment from Midgen Ltd to

[1] Midgen Ltd was then known as Water Guard NZ Ltd, the name currently in use by the plaintiff.

Mr Morgan or nominee was signed by Mr Midgen and Mr Morgan on 30 October 2013. The sale was settled on 1 November 2013.

[13] Ten days after Mr Midgen agreed to sell the distribution business, on 26 September 2013, Mr Bragulla entered an agreement for sale and purchase of the manufacturing business as vendor and with Mr and Mrs Sullivan or nominee as purchaser (the Bragulla–Sullivan agreement, or BSA). That agreement was subject to due diligence by the Sullivans to be completed by 12 November 2013. The due diligence was completed on 8 November and the agreement was declared unconditional that day.

[14] On 8 January 2014 Mr Bragulla sent to Mr and Mrs Sullivan a proposed draft addendum to the agreement which would leave Bragulla Ltd as owner of parts of the manufacturing business. Meanwhile, on 30 January 2014, Mr Bragulla entered into an agreement which on its face appeared to sell what was left of the business to a company called Cynortic International Limited.

[15] On 17 February 2014 the Sullivans signed the addendum with one change from the document forwarded by Mr Bragulla. The BSA as modified by the addendum was settled on 24 February 2014.

[16] The present dispute arose out of these two agreements. From November 2013 onwards the relationship between Mr Morgan and the Midgen, Bragulla and Sullivan interests deteriorated, and this led to the issue of multiple proceedings.

Procedural matters

[17] Morgan Ltd's claims have been contested and defended from the outset. The claims against the Sullivan interests have been contested throughout. The position is different with Bragulla Ltd and Cynortic International Ltd. They were initially represented, but Cynortic International Ltd did not defend the case at the hearing before me and nor has the liquidator of Bragulla Ltd. Mr Bragulla has made no appearance as a party or witness. His whereabouts are not known by the other parties, and I am informed that he is overseas. He is not a New Zealand national.

Given Mr Bragulla's absence, Morgan Ltd's case against the Bragulla interests proceeds by way of formal proof.

[18] Although there is factual overlap between the claims against the Midgen, Bragulla and Sullivan interests, each claim is separate and distinct. The parties accordingly agreed that the two proceedings should not be amalgamated but should be heard together consecutively, so as to save costs. The evidence called throughout the hearing in relation to each proceeding is admissible in the other.

[19] I will deal first with the claims against the Midgen interests arising out of the sale by Midgen Ltd to Morgan Ltd under the MMA. This involves considering related claims against the Bragulla interests, to the extent there is overlap with the Midgen claims. I will then consider the unrelated contractual and tortious claims against the Sullivan and Bragulla interests that relate to the BSA.

THE MIDGEN PROCEEDING (CIV-2014-404-000445)

[20] Morgan Ltd claims that Mr Midgen and Midgen Ltd made false representations that induced it to enter the MMA. It further claims that the units supplied by Midgen Ltd were defective and not fit for purpose.

The misrepresentation as to sales claims against the Midgen interests

[21] Mr Morgan claims Mr Midgen misrepresented to him that Midgen Ltd had achieved sales of 600 Water Guard units in the 12 months prior to the agreement to purchase the distribution business. He says Mr Midgen explained that Midgen Ltd had sold 161 units for cash, which in addition to the 439 sales recorded in the accounts brought total sales up to around 600 units per annum. It is claimed that this was a misrepresentation as only 439 units were in fact sold.

[22] Mr Midgen and Midgen Ltd reject Mr Morgan's claims and deny any represention that there were any cash sales not shown in the books. The main issue, therefore, is whether Mr Midgen made this representation as claimed.

Factual background

[23] There are two key documents relevant to this claim. The first is the agreement for sale and purchase between Midgen Ltd and Mr Morgan or nominee dated 16 September 2013 (the MMA). It contained no express warranty as to the number of sales that had been achieved. In the box on the first page of the agreement it was stated that the turnover warranty was $576,127 excluding GST for the period of 1 April 2012 to 31 March 2013. It is accepted by Mr Fisher for Morgan Ltd that this represents the sale of approximately 439 units and was accurate.

[24] The second document is the EDA between Bragulla and Midgen, which said that the distributor should maintain a "minimum annual sales quota of 600 units pa".

[25] In 2013 Mr Midgen engaged Peter Nola as broker for the sale of the distribution business. It was through Mr Nola that Mr Morgan first heard of the opportunity to purchase the business. Mr Nola issued a brochure written by a colleague referring to various aspects of the business, but it did not set out the actual number of units sold. There were, however, profit table comparisons set out for 2011 to 2013 which showed, consistent with the turnover figures shown in the MMA, of sales of $576,127 and a working owner's cash surplus of $196,836.

[26] There was an initial meeting with the agents, Mr Morgan and Mr Midgen, at Mr Midgen's home in August 2013. The meeting went well and on about 7 September the parties signed a conditional agreement subject to due diligence. Mr Morgan then got Mr Cameron involved in reviewing information provided at the meeting, preparing a due diligence checklist, and conducting due diligence using software he developed called "ExitWhen".

[27] On 9 September 2013, after telephoning Mr Midgen, Mr Morgan sent him an email asking various questions. Mr Midgen sent the email back answering the questions. Mr Morgan's seventh question referred to para (h) of the EDA:

> Item h) says that to maintain your exclusive distributorship status you need to sell 600 units PA. You mentioned you have operated the business for 3 years and that there are 4500 units in New Zealand. So it would appear that there was 3000 units in the market prior to you commencing? And further that you have not maintained the minimum number of required sales to meet

> the manufacturers minimum sales level. Please advise therefore what has been the consequences of this?

[28] Mr Midgen's answer was:

> We are now up to 600 PA and George is very happy with what we have done and are doing on his part.

[29] This further question was asked by Mr Morgan:

> The Cancellation of Agreement option a) states that the Manufacturer has the option to buy back the Distributors business after 2 years of operation if the annual sales volume is not 600 units. Please advise if the Manufacturer as chosen to ignore this clause?

[30] Mr Midgen answered as follows:

> Cynortic [Bragulla Ltd] ignored this due to the economic climate and the continued growth we have achieved over this time.

[31] On Wednesday, 11 September 2013 Mr Morgan and Mr Cameron went to Mr Nola's offices where they met with Mr Midgen. There were some amendments made to the agreement. Mr Morgan claims that at this meeting Mr Midgen said that on the sales numbers he had been achieving, which included "cash sales", Mr Morgan would have no difficulty in purchasing "all the units" by 28 January 2015. He was referring here to a clause in the MMA which required Morgan Ltd to purchase all stock held by Mr Midgen by 28 January 2015. Mr Midgen denies referring to any cash sales at this meeting.

[32] On 12 September 2013 Mr Morgan and Mr Cameron travelled to Tauranga to meet Mr Bragulla at his factory. In the course of that meeting Mr Morgan states that he asked Mr Bragulla how many units Mr Midgen had sold over the past year in New Zealand. Mr Bragulla said that Mr Midgen had sold "about 750".

[33] Following this visit to Tauranga, Mr Morgan had a further discussion with Mr Midgen. Mr Morgan pointed out that Mr Bragulla had said that he was selling around 750 units per year and asked him to be more specific. He deposed that Mr Midgen said that his books would show 440 per year, but that in fact he was doing over 600 per year and that the difference was cash sales. Mr Morgan says that

Mr Midgen told him that he had purchased a $120,000 Ferarri motor vehicle from the previous year's cash sales. Mr Morgan says he asked Mr Midgen what he did with all the cash and Mr Midgen said he had a safe that was stuffed full. Mr Cameron was not at this discussion, but Mr Morgan says he reported it to him. Mr Midgen absolutely denies making those statements. The odd customer would pay in cash, but such sales were recorded in the MYOB accounts.

[34] The MMA was finally executed by all parties in final form on 16 September 2013.

[35] On 18 September 2013, Mr Cameron and Mr Morgan met Mr Midgen at his home. Mr Cameron uploaded MYOB information stored on the Midgens' computer to his Dropbox account. During the visit Mr Midgen showed Mr Cameron the Ferarri motor vehicle. In the course of this meeting Mr Morgan told Mr Midgen that he wished to negotiate changes to the EDA with Mr Bragulla.

[36] On 21 September 2013 Mr Morgan went with Mr Midgen to a trade show in Napier. He claims that he asked Mr Midgen how he transacted the cash sales. He says that Mr Midgen responded that he often took a trailer to Tauranga to purchase units from Mr Bragulla discounted for cash, and then sold the units to people who wanted to pay cash and who did not require invoices.

[37] In the meantime Mr Cameron had prepared a due diligence document that included a business situation report and a document listing due diligence concerns. The document showed the sales recorded in the MYOB accounts and the turnover shown in the agreement for sale and purchase. There was no mention of cash sales. His investigations were made available to Mr Morgan.

[38] On 9 October 2013, Mr Morgan's solicitors confirmed that the due diligence condition was satisfied. The letter sought confirmation that:

> Your client's annual sales and order volume exceeded 599 machines in the first 2 years of the Agreement or evidence that Cynortic [Bragulla Ltd] has waived its right to appoint a second distributor for New Zealand in accordance with sub-clause (a) of the "Duration, Termination and Cancellation Agreement" section of the Distribution Agreement.

Mr Midgen responded direct by email on that day stating:

> Water Guard NZ order exceeded that of 599 units in the first 2 years.

[39] On 10 October 2013 Mr Bragulla sent an email to Mr Morgan. After talking about price and the minimum order of 600 units he stated:

> With Dave in NZ selling about 700 machines a year now and me selling about 400 machines a year to Australia, we can achieve this excellent pricing …

[40] On 15 October 2013, Mr Morgan's lawyers wrote to Mr Midgen's lawyers, confirming that all the purchaser's conditions had been satisfied and the agreement was unconditional.

[41] In the meantime Mr Morgan had been discussing with Mr Bragulla changes that he proposed to the EDA. By 10 October 2013 they were in a state of disagreement about proposed changes. It was not until 17 October 2013, when Mr Morgan met with Mr Midgen at his home to discuss matters relating to the operation of the business, that Mr Morgan discovered the manufacturing business had been sold to the Sullivans. At that stage Mrs Sullivan came around and was introduced.

[42] Mr Morgan was troubled by the Sullivans' purchase. However, despite his reservations on 27 October 2013 in an email sent to Mrs Sullivan he consented to the sale and confirmed he understood she would be the new manufacturer of Water Guard units. It soon became clear that Mr Morgan was left with some feelings of dissatisfaction, and that he had reservations about Mr Bragulla.

[43] On 30 October 2013 a formal deed of assignment was signed between Midgen Ltd and Morgan Ltd, and the MMA settled on 1 November 2013. At that point Morgan Ltd took over Midgen Ltd's rights as distributor under the EDA. On 7 December 2013 Mr Morgan sent an email where he asked Mr Midgen for evidence that the EDA has been transferred. He also requested Mr Midgen help him obtain an injunction preventing Mr Bragulla from selling the manufacturing business to the Sullivans.

[44] Lawyers became involved as between the Sullivans, Mr Bragulla and Mr Morgan. On 30 December 2013 Mr Morgan emailed Mr Bragulla and Mrs Sullivan advising that he was preparing a case for costs, damages, and ongoing warranty claims, against Bragulla Ltd for breaches of the EDA. He invited Mr Bragulla to consider buying back the Water Guard name, brand and EDA "on terms and conditions set exclusively by me".

[45] On 5 January 2014 Mr Morgan visited the Midgens at home and handed a letter to Mr Midgen, who was mowing the lawn. In the letter he said that he was very unhappy with the purchase. Amongst other things he said this:

> George [Bragulla] gave us annual system sales figures of 750 units for the previous financial year. I questioned this with you because your books showed you had never exceeded sales of 400 units per annum, you advised that the balance was down to cash sales. On this cash sale point I questioned you several times, your final answer was that discounted unit cash sales were a minimum of $5000 per month. This has been shown to be incorrect, with only one cash sale in 2 months. As my budgeting for the business purchase was based on the inclusion of these sales the fact they are not there is of concern.

[46] Mr Morgan also asked for recompense for the reduced value of the business. On 22 January 2014 Mr Morgan and the Midgens met at the Midgens' home. Mr Morgan deposed that he challenged Mr Midgen about his earlier statements about cash sales, and the statement that he had purchased his Ferarri from cash earned from those sales. He said that Mrs Midgen appeared to be agitated by this and said that the Ferarri was purchased by her from the sale of her Vodafone shares. He said that Mr Midgen hung his head down and said nothing, being clearly uncomfortable. Mr Morgan said that Mr Midgen did not answer his questions about whether he had told him about the Ferarri being purchased from cash sales. He took their silence as indicating that they were not going to buy the business back and were not sympathetic to his predicament.

[47] There were some further discussions between Mrs Midgen and Mr Morgan. On 6 February 2014 the Midgens sent a response to Mr Morgan's 5 January 2014 letter. The allegation concerning the representation as to cash sales was denied, as were other claims relating to the quality of the units.

[48] The Midgens organised another meeting with Mr Morgan at their home on 11 February 2014. In the end Mr Morgan chose not to attend, but Mr Cameron went. The meeting was mainly about the warranty claims. However, at the end of this meeting Mr Cameron on instructions from Mr Morgan handed them a letter headed "basis for a statement of claim" which alleged Mr Midgen had made representations about cash sales, purchasing the Ferarri with cash sales, and saying "you can count on $5,000 pm".

[49] Throughout this period there was also a dispute over stock. In November 2013 Midgen Ltd had possession of a large number of Water Guard units that were with a company called Now Couriers Ltd, which acted on Mr Midgen's direction. In November Now Couriers advised that they did not want to continue holding stock, and suggested that the service be provided by another related business, Online Secure Distribution facility. The stock was duly transferred to that facility. The stock fell effectively under Mr Morgan's control at that point.

[50] Mr Midgen wrote to Mr Morgan on 14 February 2014 expressing his concern that Mr Morgan had effectively taken control of the stock, and asking for its transfer back. By a reply on the same day Mr Morgan stated that Mr Midgen should involve his solicitor and that he did not agree to Mr Midgen moving the stock. Mr Midgen was not given permission to enter the property where the stock was held.

[51] Midgen Ltd then applied for a mandatory interim injunction requiring Mr Morgan and Morgan Ltd to return all the stock taken from Now Couriers. After a defended hearing a mandatory interim injunction was granted by Fogarty J on 9 April 2014 requiring Mr Morgan and Morgan Ltd to allow Midgen Ltd to remove the stock, and ordering costs in favour of Midgen Ltd against Mr Morgan and Morgan Ltd.[2]

The contrasting positions

[52] Between Mr Morgan and Mr Midgen there was in their evidence a major difference as to what was said about past sales that cannot be explained by mistake

---

2 *Midgen Enterprises Ltd v Morgan* [2014] NZHC 704.

or faulty recollection. Mr Morgan was adamant that he was told on a number of occasions by Mr Midgen about past cash sales which pushed the previous year's sales up to 600. Mr Midgen was equally adamant that Midgen Ltd never transacted unrecorded cash sales, and that he never said anything to Mr Morgan about unrecorded cash sales. The sales discussed were of 439 units only. Given the discrepancy, this is a credibility issue.

[53] Mr Fisher for Mr Morgan and Mr Grove for Mr and Mrs Midgen each supported their case by reference to various circumstances and documents. Mr Fisher pointed to the amount paid by Mr Morgan for the goodwill of $275,000, which he argued only could be justified if the net profit had included the cash sales. He submitted that the annual quota of 600 units under the EDA meant it was likely the parties discussed sale volumes as Mr Morgan would have wished to make sure that quota could be fulfilled. He relied on the references to 600 units in the email exchanges. He referred to the uncontradicted evidence of the representations by Mr Bragulla that there were 700 or more sales. He argued that this was corroborative of the Midgen misrepresentation.

[54] Mr Grove for Mr and Mrs Midgen submitted that given that the Midgens clearly had never transacted any undeclared cash sales meant that any representation to that effect was most unlikely. He relied on references to the actual true turnover in all the formal documents between the parties. He submitted that the email references to the 600 sales in fact proved that there was no misrepresentation as they were part of queries about the consequences if the 600 sales quota was not achieved. He argued that the MYOB accounts which were examined by Mr Morgan and his agents, and the turnover in the agreement, were consistent with 439 sales only. He relied on parts of Mr Cameron's evidence about what he heard, and the fact that in all of Mr Cameron's detailed due diligence considerations, which were in writing and prepared in discussion with Mr Morgan, there were references only to the 439 sales, and no references to additional cash sales.

The agreements

[55] The words of the MMA support Mr Midgen's version of events in that they only refer to revenue from 439 sales of $576,127. The clause requiring Morgan Ltd to purchase all stock held by Midgen Ltd by 25 January 2015 is inconclusive. That is because although on existing sales Mr Midgen was not selling sufficient stock to warrant orders to the level required by the agreement, two major new customers and increased sales were anticipated.

[56] The EDA is poorly drafted and not easy to follow on the term referring to 600 units. Clause (h) on page 3 of the EDA requires the distributor to maintain:

> …a minimum annual sales quota of 600 units p.a. to maintain his exclusive distributorship rights. All orders have to be placed on a 6–monthly forward basis of min. 320 units with 50% deposit payable on date of order.

The last sentence indicates that the clause is concerned with orders from Midgen Ltd to Bragulla Ltd, and not sales by Midgen Ltd to the public.

[57] This must be read with a later reference at cl (a) on page 4 of the EDA to the manufacturer's right to appoint a second distributor if after the end of two years of operation, "…distributor's annual sales and order volume is less than 600 machines." Mr Grove argued that these two clauses required 600 orders from the manufacturer each year, but not 600 sales to customers. Mr Midgen stated that he thought the requirement was for orders and not sales.

[58] It is not necessary to determine this interpretation issue which is raised to support the credibility of the parties. It is possible both parties are telling the truth. On one hand, I accept that Mr Midgen may have thought that the obligation in the EDA related to orders and not sales. However, equally I accept that it would have been important for Mr Morgan that he could realise 600 sales per annum so that he could sell the units that he was bound to order per annum from the manufacturer.

The correspondence

[59] In the email exchange on 9 September 2013,[3] the reference by Mr Midgen is to "600 PA." He was responding to Mr Morgan's question about the need "to sell" 600 units per annum, and that he had "not maintained the minimum number of required sales to meet the manufacturer's minimum sales level." Mr Morgan's question appeared to acknowledge that Mr Midgen was not achieving 600 sales per annum, and Mr Midgen's answer that he was achieving 600 per annum could be seen as a reference to orders rather than sales. In fact Midgen Ltd was achieving approximately 600 orders per annum. This was Mr Midgen's explanation of what he referred to in the exchange, and it is consistent with the context. So on balance I consider that a contextual reading of this exchange tends to support Mr Midgen's account of events.

[60] In the 9 October 2013 email exchange Mr Morgan referred to Midgen Ltd's annual sales and order volume which "exceeded 599 machines in the first 2 years of the Agreement…"[4] This was a reference back to cl (a) on page 4 of the EDA concerning the right to appoint a second distributor if after the end of two years the distributor's annual sales and order volume was less than 600 machines. It is not clear whether the reference is to 599 sales over one year, or the two year period. Mr Midgen's answer was that the "[Midgen Ltd] order exceeded that of 599 units in the first 2 years". This is also ambiguous, although a natural reading tends toward orders of 599 for the combined two years. It does not prove a misrepresentation, and is consistent with Mr Midgen's version of events.

[61] In summary, in relation to the written evidence of exchanges prior to the agreement becoming unconditional, I do not regard them as in themselves determinative of whether there was a representation, and one on which Mr Morgan relied. The language used is loose and ambiguous, and in terms of what the parties understood possibly conducive of misunderstanding. However, while the exchanges are not entirely consistent or inconsistent with the evidence of either protagonist, in my view they tend to support Mr Midgen's account rather than Mr Morgan's.

---

3 The relevant exchange is set out at [27]–[30] above.

4 Set out at [38] above.

Due diligence

[62] The due diligence was carried out primarily by Mr Cameron, working for Mr Morgan. The due diligence process is of importance in assessing whether there was a representation as to cash sales, as a key purpose of due diligence was, as Mr Morgan and Mr Cameron accepted, to check the accuracy of Midgen Ltd's accounts.

[63] The MYOB accounts were examined by Mr Cameron. Those accounts were consistent with 439 sales. Mr Cameron's due diligence checklist works off these accounts and the earnings and cash flow shown. There is no reference in his checklist to cash sales.

[64] His business situation report referred to sales in the "last year" as including "530 units plus spares", explained by Mr Cameron as sales of 430 units plus 100 anticipated for the big new customer. His calculation works off the warranted future maintainable earnings figure of $127,247, and applies an EBIT multiplier of 3.5 to get a sale price roughly equivalent to the amount paid. In his key numbers he lists 439 sales.

[65] These two documents support entirely Mr Midgen's account of what he said about the sales, and provide no support for Mr Morgan's claim that he was told of further cash sales, bringing the total to 600. It is most surprising, if there had been a reference to significant cash sales, that this is not referred to in these due diligence documents as they go to the heart of what due diligence is about. The only possible explanation consistent with the evidence of Mr Morgan, is that Mr Cameron chose deliberately to make no reference to cash sales because he disapproved of them or was fearful of the consequences of mentioning them. I will consider this when I assess overall credibility.

[66] Mr Cameron also prepared a list of due diligence concerns. It referred to Mr Midgen having sold 1106 units which was roughly consistent with the sales shown in the accounts, and not consistent with any cash sales. He referred to Mr Midgen buying 600 units per annum "for the first time". This is consistent with Mr Midgen's evidence of ordering 600 units. He also stated "Dave [Mr Midgen] is

struggling to achieve 500. NOT SO ACCORDING TO TAURANGA." On the second page he referred again to the "Manufacturer" saying there were more than 700 sales and he asked "But where are the sales recorded?".

[67] In his evidence he explained that these statements were a reference to Mr Bragulla's assertion that Mr Midgen was selling greater quantities than the books disclosed. This due diligence list then is consistent with Mr Bragulla representing there were more sales, and thus it supports Mr Morgan's case against him.

[68] However, the list runs quite contrary to Morgan Ltd's claims against the Midgen interests. Mr Cameron did not list any Midgen cash sales representation in his due diligence concerns document, but he did list the Bragulla representation of more than 700 sales as if it ran contrary to what Mr Midgen was saying. There would have been no reason for Mr Cameron to question the discrepancy if he was thought the difference was made up by cash sales, as he claims Mr Morgan told him.

[69] I did not find Mr Cameron's explanations under cross examination as to why he did not show such sales in his notes and figures to be satisfactory. If he knew there were cash sales, his calculations based on the declared turnover were a waste of time. He might just as well have not bothered, if he knew the figures were a gross underestimate. Yet he worked off the MYOB figures throughout. It is surprising that he referred to the Bragulla representation but not any alleged Midgen representation on the same topic, which would have been more important as it came from the vendor. If he was fearful of mentioning cash sales it would be expected that he would not mention Mr Bragulla's representation. But he set that out in writing. It is all consistent with Mr Midgen accurately representing 439 sales only.

[70] Mr Cameron may have been confused by Mr Morgan's statements to him about the Bragulla representations, and muddled these with the alleged Midgen representations. Whatever the explanation, I reject his evidence that he was told by Mr Morgan of Mr Midgen representing cash sales. I also do not accept his evidence that Mr Midgen told him on 1 November 2013 that one of the things that Mr Midgen would miss was the cash sales.

[71] Mr Cameron still works for Mr Morgan and at times in his evidence seemed to be an advocate for his complaints. He has adopted Mr Morgan's attitude towards the Midgens and the Sullivans, that Mr Morgan was sold a pup.

Actions after sale

[72] Mr Grove placed weight on the fact that when Mr Morgan first raised the issue of a misrepresentation as to sales, it was a different misrepresentation to that now pleaded and alleged. Mr Morgan's first misrepresentation claim, in his letter of 5 January, did not say Mr Midgen said that there were annual sales of 600 units. He instead referred to Mr Bragulla's statement about sales of 750 units and Mr Midgen asserting discounted unit cash sales of a minimum of $5,000 per month. He stated that his budgeting for the purchase of the business had been based on the inclusion of these sales. Mr Morgan repeated the cash sales of $5,000 per month allegation in the draft statement of claim that was handed up at the end of the meeting of 11 February 2014.

[73] Mr Morgan's first misrepresentation claims are inconsistent with Mr Cameron's due diligence calculations of purchases, and inconsistent with Mr Morgan's pleaded misrepresentation by Mr Midgen of cash sales of 161 units per annum. Cash sales of $60,000 a year (at $5,000 a month) indicate sales of less than 161 a year, given that the profit margin exceeded $500 a unit. Therefore, the earliest claims by Mr Morgan are to an extent inconsistent with the position he now takes.

Credibility

[74] Both Mr Morgan and Mr Midgen gave evidence. Mr Morgan harbours obvious anger and resentment towards the defendants. He developed a hostile mode of communicating with Mr Bragulla from November 2013, with the Sullivans from December 2013, and with the Midgens from January 2014. In contrast I found Mr Midgen to be a temperate witness who sought to avoid confrontation and find solutions (although in relation to my later consideration of the alleged defects I find he was at fault).

[75] I look at the respective personalities of Mr Morgan and Mr Midgen. Mr Morgan is possessed of strong grievances that in my view developed into an unwarranted dimension of confrontation and exaggeration. He was often bitter and sarcastic in his statements. He showed great and disproportionate resentment. Mr Midgen on the other hand struck me as a person who avoids confrontation and is careful and considered in his actions, and moderate in his responses. He seemed to me to be by nature cautious and law abiding, a person who would not wish to carry out large scale tax fraud, let alone make up a story that he had participated in such activity. He does not appear to be a risk taker. It would run quite contrary to Mr Midgen's character as I perceive it, for him to lie about a significant cash sales business.

[76] As I have indicated, in my assessment the correspondence before the agreement became unconditional does not support Mr Morgan's version of events, and Mr Morgan's first misrepresentation claims against Mr Midgen were different to the one he now alleges, which does not support Mr Morgan's credibility.

[77] Importantly, none of the written material (of which there is a considerable amount) supports Mr Morgan's allegations. This could be understandable, if the representation was of cash sales because emails and the agreement for sale and purchase might fall into the hands of the Inland Revenue. But it is harder to understand why the private due diligence calculation Mr Cameron prepared for Mr Morgan does not show the alleged cash sales. They would have been critical to the future profit calculations, and it was a private document. It does refer to Mr Bragulla's statement as to cash sales, but not to any by Mr Midgen. Mr Cameron's calculations are made throughout on the actual MYOB figures given by Mr Midgen.

[78] There is one important further aspect of Mr Cameron's evidence that runs contrary to Mr Morgan's claim of a false sales representation. It was clear from Mr Cameron's evidence that he was concerned about the volume of sales and the likely return to Mr Morgan. He was at the meeting of 11 September 2013 and Mr Morgan's evidence was that Mr Midgen referred to cash sales at that meeting. Importantly, Mr Cameron recalled no such reference. He claimed that he was

focusing on other matters. In my view, he would have been most interested in any representation as to cash sales by Mr Midgen. It went to the heart of his due diligence exercise. He would have remembered such a misrepresentation if it was made. The fact that he could not recall it is inconsistent with Mr Morgan's case.

[79] Mr Fisher invited me to draw an inference against the Midgen interests, because the agent involved in the sale who was present for some meetings (Mr Nola) was not called by them. I draw no such inference. There is nothing to indicate that the agent would have any reason to recall details of any discussions about turnover. It was open to Morgan Ltd to obtain a brief from Mr Nola or subpoena him. It did not do so.

The broad picture

[80] I turn to the broad dynamics of the purchase. The goodwill shown on the agreement was $275,000. Mr Lucas, an experienced accountant, was called by Mr Morgan. He gave evidence, which I accept, that on the figures shown in the accounts there was a net surplus shown after shareholders' salaries of somewhere between $100,000 and $110,000 for the previous year. He thought that the right multiplier was about two, which meant that Mr Morgan had paid too much for the business. This would tend to support Mr Morgan's claim that he was prepared to pay the asking price because of the cash sales.

[81] However, Mr Cameron in his due diligence calculations has worked off the declared turnover, and used a multiplier of 3.5 rather than 2 in his calculations. Such a multiplier does lead, on Mr Cameron's calculations, to a price similar to that paid by Mr Morgan on the declared figures shown in the accounts.

[82] There is an explanation for this. I am satisfied that Mr Morgan was anticipating a lot of extra sales from two new big customers, that if realised would give him the turnover of about 600 sales a year. In Mr Cameron's business situation report there are references to building the business and sales to "Newco". Increased sales are projected. Mr Midgen gave evidence of an arrangement with a company he called DVS, where he was expecting sales of 150 to 200, although this was not yet confirmed. He told Mr Morgan about this. He took Mr Morgan to attend a training

day with DVS, and was confident that if DVS was diligently pursued, it would place significant orders. There was also another major customer that was a prospect. These prospects may well have led them to apply the higher multiplier, and to be optimistic. Mr Morgan on his own evidence accepted that he was aware of the prospects, but when he started to find defects in the units, deposed that he focused on getting the units right rather than pursuing the new sales prospects with the big potential customers. In Mr Midgen's view, he wasted a very likely prospect of increased sales for no good reason.

Conclusion on misrepresentation as to sales

[83] It is my conclusion that Mr Midgen did not misrepresent the sales of units. He did not untruthfully refer to cash sales. I found him to be a believable witness. In contrast Mr Morgan did not present as a balanced or accurate witness. The proven facts on overview do not support what he says, and his demeanour and reactions in the witness box left me doubting his evidence. I also reject Mr Cameron's evidence on the topic of statements by Mr Midgen about cash sales. I do not believe it.

[84] Aspects of Mr Midgen's evidence that Mr Fisher criticised do not show Mr Midgen to be untruthful. His muted reaction when confronted with Mr Morgan's allegations at the 11 February 2014 meeting is understandable, as I accept that he was dumbfounded and distressed at Mr Morgan's extreme accusations. His willingness to ask a high price for the goodwill must be seen in the context of his increasing sales, and the excellent new customer prospects. It is true that Mr Bragulla was telling Mr Morgan about cash sales by Mr Midgen, but I accept Mr Midgen's evidence that he told Mr Morgan that Mr Bragulla was wrong, and he should work off the MYOB accounts. In fact, the sales that Mr Morgan achieved in the months that followed his purchase were consistent with those accounts.

[85] The claim based on misrepresentation of the number of units sold fails.

The misrepresentation as to sales claim against the Bragulla interests

[86] Morgan Ltd also claims that Mr Bragulla represented that Midgen Ltd had sold 700 units in the preceding 12 month period. Although this claim is brought in

the second proceeding, it is convenient to consider it now in the context of the claim against Mr Midgen and Midgen Ltd for misrepresentation. As noted above, Mr Bragulla and Bragulla Ltd have not defended the proceedings or appeared, so this claim proceeds by way of formal proof.

[87] There is no doubt that Mr Bragulla did make the representation of sales of 700 units. He said that in his email of 10 October 2013 where he referred to "Dave in NZ selling about 700 machines a year now…". The representation is referred to by Mr Cameron in his due diligence concerns document. Bragulla Ltd and Mr Bragulla have not presented any evidence to refute the representation. I find it formally proven.

[88] The claim is brought under two heads. The first claim is under s 9 of the Fair Trading Act 1986. Given my conclusion above I am satisfied that Mr Bragulla in trade engaged in misleading or deceptive conduct, contrary to s 9 of that Act, by saying that Mr Midgen had achieved 700 sales. Liability is strict; there need be no intention to deceive.[5]

[89] However, liability does not follow. It is clear from his due diligence concerns document that Mr Cameron was querying the representation. He stated "Dave has bought more than 700 units pa according to the Manufacturer! But where are sales recorded?" I accept Mr Midgen's evidence that he told Mr Morgan on a number of occasions when the Bragulla statement was raised, that there were no cash sales and the sales were accurately recorded in the MYOB accounts. While Mr Morgan may have been intrigued by Mr Bragulla's statements, he was told they were not true, and his advisor Mr Cameron did not rely on them when he went through due diligence. Nor in my view did Mr Morgan.

[90] Thus the remarks of Mr Bragulla did not influence Mr Morgan in his decision to purchase the business from Midgen Ltd. It is clear that Morgan Ltd has suffered

---

5 *Goldsbro v Walker* [1993] 1 NZLR 394 (CA) at 406 per Hardie Boys J; see also Stephen Todd and John Burrows "Deliberate Falsehoods" in Stephen Todd (ed), *The Law of Torts in New Zealand* (6th ed, Brookers Ltd, Wellington, 2013) 781 at 807.

no loss or damage "by" Mr Bragulla's conduct, as is required for compensation under s 43.[6] Accordingly I refuse to make an order under that section.

[91] The second claim is brought under the common law tort of deceit. It is also a requirement that the claimant must have in fact acted in reliance on the misrepresentation.[7] For this reason the deceit claim must fail. In these circumstances I do not consider it necessary to determine whether the statement was in fact deceitful.

[92] It is necessary to record, however, that Mr Bragulla appears to me to have been at times unusually opinioniated and misguided. I deal with Mr Bragulla's headstrong behaviour later in this judgment. It is relevant here because it helps explain why Mr Bragulla may have thought that Mr Midgen was selling more units than he was. Mr Midgen as a conservative businessman was ordering a lot more units than he needed immediately. He ended up with over a year's worth of supply. Mr Bragulla may well have (wrongly) thought to himself that Midgen Ltd must be achieving more sales than in fact it was.

The claims relating to the defects

[93] Morgan Ltd claims that there were defects in the Water Guard units sold by Midgen Ltd before it purchased the business, for which Midgen Ltd is liable under an indemnity clause in the MMA. It further claims that defective Water Guard units were supplied to it after the settlement of the MMA in breach of an implied term that the units would be fit for purpose or of merchantable quality. Finally it is claimed that Midgen Ltd and Mr Midgen made various representations about the quality of the units.

[94] This part of the claim took many days of evidence, and involved extensive submissions. Rather than try to summarise all that evidence and submissions at the outset, I propose to focus on the particular defects alleged, the pleaded allegations,

---

6 *Red Eagle Corporation Ltd v Ellis* [2010] NZSC 20, [2010] 2 NZLR 492 at [29]–[30].

7 *Amaltal Corporation Ltd v Maruha Corporation* [2007] 1 NZLR 608, (2006) 3 NZCCLR 1 (CA) at [46].

and the defences raised. Related claims have been brought against the Bragulla interests, which will be considered later.

The indemnity clause and implied terms

[95] Morgan Ltd claims Midgen Ltd is liable for defects in products distributed by it before settlement of the MMA. Clause 22 states:

> The Purchaser assumes no liability for any products manufactured and distributed by the Vendor and the Vendor shall promptly indemnify the Purchaser against claims brought against the Purchaser in respect of any products manufactured and/or supplied by the Vendor prior to the date of settlement.

[96] The wording is clear. The indemnity applies to all units that had already been distributed to customers by Midgen Ltd prior to settlement of the sale to Morgan Ltd. Midgen Ltd must indemnify Morgan Ltd against all claims. Although the clause does not refer to defects, the indemnity must be read as applying to only reasonable defect claims. There was no obligation to indemnify for a meritless claim. Mr Fisher did not suggest otherwise.

[97] The next pleaded contractual claim relates to goods that were supplied by Midgen Ltd to Morgan Ltd both as part of the settlement of the MMA and after settlement by direct supply by Midgen Ltd on request from Morgan Ltd. It is pleaded that this was pursuant to an agreement for the sale of goods, and that the terms implied by the Sale of Goods Act 1908 apply. The implied terms of fitness for purpose and merchantable quality are set out in s 16.

[98] The condition that an item is reasonably fit for purpose will arise when the sale is in the course of the seller's business, the buyer makes known his or her particular purpose, and the buyer relies on the seller's skill or judgment. However, that condition will not arise when the sale is of a specified article under its trade name.

[99] By contrast, a condition that an item is of merchantable quality will arise when the item is bought by description, the seller deals in items of that description,

and the buyer has not examined the items in a manner which ought to have revealed the defect complained about.

[100] Mr Grove does not contest that both terms can be implied in the MMA, but submits they were not breached.

[101] As to what constitutes "reasonably fit", Hardie Boys J in *Finch Motors Ltd v Quin (No 2)* said:[8]

> The Act does not impose on a seller the liability of a guarantor that the goods are absolutely fit for their purpose. The test is one of reasonableness … liability for latent defects rests on the seller.

What is reasonable must depend on the circumstances, with particular regard to the purpose communicated to the seller and the qualities necessary for the item to be fit for that purpose, as well as any consequence of use.[9]

[102] In the context of the bulk sale of units to a distributor pursuant to an agreement to sell a business, the test should be whether the units supplied are commercially saleable and will be fit under their contractual description for the likely end customers of the purchaser/distributor. This is because the vendor knows that the purchaser buys to then on-sell to those customers.

[103] In contrast to fitness for purpose, whether an item is of merchantable quality does not depend on the particular purpose for which the item is bought. It is a qualitative assessment of the item having regard to all the purposes for which an item with that description would normally be used.[10] It is sometimes expressed in terms of saleability, acceptability, and usability. As noted in *Cehave NV v Bremer Handelsgesellschaft mbH*:[11]

> It is a composite quality comprising elements of description, purpose, condition and price. The relative significance of each of these elements will

---

8 *Finch Motors Ltd v Quin (No 2)* [1980] 2 NZLR 519 (HC) at 523.

9 *Sayers v Jenkins Labels Ltd* HC Hamilton CP78/97, 1 September 1988 at 17.

10 *Ashington Piggeries Ltd v Hill (Christopher) Ltd* [1972] AC 441 (HL) at 504 per Lord Diplock; *Jewson Ltd v Boyhan* [2004] 1 CLC 87 (CA).

11 *Cehave NV v Bremer Handelsgesellschaft mbH* [1976] QB 44 (CA) at 80; as adopted in the context of s 7 of the Consumer Guarantees Act 1993 in *Contact Energy Ltd v Jones* [2009] 2 NZLR 830, (2009) 9 NZBLC 102,634 (HC) at [95].

> vary from case to case according to the nature of the goods in question and the characteristics of the market which exists for them. This may explain why the formulations of the test of merchantable quality vary so much from case to case.

[104] Damages are sought for $38,927 being the cost incurred in meeting the claim of customers under cl 22, $56,800 being the cost of making the units fit for purpose and of merchantable quality, and $240,358 being the assessed value of future costs.

[105] There are also claims of misrepresentations by Mr Midgen and Bragulla Ltd about the quality of the units. However at this juncture I will first consider whether any of these defects exist as a matter of fact. I will then consider whether any of the units were in breach of the indemnity clause in the MMA (for those supplied before settlement) or in breach of the implied terms as to quality and fitness (for those supplied after settlement).

The defective units

[106] It is necessary by way of background to set out the particular unit models, as they had different features and different alleged problems. The models and some of their characteristics were summarised in a chart supplied by the plaintiff. It sets out the models and certain features of the models:[12]

Unit	Time period	Ballast (w)	Lamp (w)	Chamber (mm)	Glue joins	Filters	Flexible hose / MacUnion
Gold 0	2008/2010	75	95	65 x 830	3	3	Flexible hose
Gold I	2010/2012	75	95	65 x 830	3	3	Flexible hose
Platinum I	2010-2012	160	130	65 x 830	3	3	Flexible hose
Septreat	2011-current	75	95	65 x 830	3	1	Flexible hose
Silver II	2012-2014	40	40	65 x 830	3	2	Flexible hose
Gold II	2012-2013	95*	95*	108 x 910	3	3	Flexible hose
Platinum II	2012-2013	2x 95*	2x 95*	108 x 910	3	3	Flexible hose

[12] I have deleted a column "sold by".

Silver III	2014-current	40	40	89 x 910	5	2	MacUnion
Gold III	2014-current	95	75	89 x 910	5	3	MacUnion
* This lamp was tested by the plaintiff and found to have an actual output of 88–93 watts							

[107] Mr Morgan and Mr Cameron in their evidence said that Morgan Ltd began to receive legitimate customer complaints about defects from the time it settled the purchase and thereafter. For example, in early December there was a fire in a unit on Waiheke and in the end Mr Morgan thought the fire was caused by a defective unit. Mr Bragulla thought his position was wrong, that the real cause was inadequate maintenance, and that Mr Morgan was acting unreasonably. Mr Morgan and Mr Bragulla became increasingly belligerent and abusive in their discussions about the defective units, with neither making any effort to observe ordinary civility.

[108] Mr Morgan says that the Midgen and Bragulla defendants were unhelpful when told of the problems, and did not give meaningful assistance. According to Mr Midgen's evidence, in December and January Morgan Ltd began to order parts for Water Guard units directly from China and not through Bragulla Ltd. It was only until the meeting on 11 February 2014, and after a discussion that lasted three and a half hours, that the Midgens set out a proposal for the replacement of faulty parts or any faulty units and for a further meeting involving Mr Bragulla and Mr Sullivan.

[109] In the present claim, in essence Morgan Ltd asserts that as it investigated it came to appreciate that there were certain fundamental defects in the design of the units that would lead to problems unless they were fixed. They say they have had to fix and replace parts on many units. Also, to prevent claims, from about April 2014 they have dismantled, altered, and re-assembled units prior to delivery.

[110] The allegations of defects were not fixed through the trial, but in the end as best I could ascertain, the following defects were alleged:

(a) The stainless steel chambers in the Gold II and Platinum II units are prone to split where the end plates have been welded on to the chamber.

(b) The ballast in the Gold II and Platinum II units is susceptible to water damage and not powerful enough to supply the wattage required.

(c) The lamps in the Platinum II units overheat leading to leakage.

(d) Some of the units were manufactured with defective glue resulting in leaking heads, hoses and joins.

(e) Some of the units suffer from poor seals, leaking flexible hoses, and other miscellaneous complaints.

[111] I consider the alleged defects.

The stainless steel chamber weld splits

[112] It can be seen from the photograph at [6] above that at the top of the Gold II and Platinum II units there is a large stainless steel cylinder. Mr Cameron gave evidence that he had recorded 41 instances of the failure of these chambers. His reports were made in a systematic way when the defects were complained about and rectified, and show that the chambers split where the end plates on the cylinder had been welded on to the chamber. There was some documentation adduced in support of each claim. Mr Cameron was not challenged on this evidence. I accept his evidence about these 41 instances of failure.

[113] Morgan Ltd called an expert from the stainless steel industry, a Mr Appleton, who gave evidence that his company repaired about 50 of the units by re-welding them. He identified two faults. First, he deposed that the end plates were of the same diameter as the cylinder making it difficult to achieve a sufficiently strong weld to withstand the water pressure from within the cylinder. Second, he stated that the welds had been weakened by them being sanded down.

[114] Although Mr Appleton was not truly an independent witness, as he had done work for Morgan Ltd, I found his evidence to be credible and convincing. Mr Midgen himself acknowledged that he had encountered the weld issue while he was involved in the business, in the email he sent to Mr Sullivan on 12 February 2014. He noted that he had three such issues prior to the sale.

[115] Midgen Ltd called its own witnesses in relation to defects. An expert, Mr Hogg, had not been given any failed chambers to inspect, but he observed that he did inspect a chamber of the "old thinner type" at Mr Midgen's house which had no leaks and which in his opinion was adequate for its purpose. He suggested that a failure of the chambers could be a consequence of unduly high water pressure which could be a fault of the installer rather than the manufacturer of the units. I did not find this evidence to be of great assistance as not all of the large chambers fail, and Mr Hogg may have inspected one of those functional chambers.

[116] Chambers of course had been used for the units for the previous three years. However, in 2012 the chamber sizes were increased for the Gold II and Platinum II units from 65 x 830 mm to 108 x 910 mm. These units were supplied through 2012 and 2013. In my view the quantity of evidence of defects for units of this size proven in the evidence for Morgan Ltd, together with the evidence of Mr Appleton, which I accept, show the larger chambers were often defective when used in the Gold II and Platinum II units. The larger chambers required additional strengthening, and this was not appreciated by the manufacturer. The joints did not necessarily fail immediately, but those of insufficient strength would do so over an unacceptably short time.

[117] On the evidence before me, it is not the case that all Gold II and Platinum II units will fail. However, in relation to those that have failed, and undoubtedly in relation to a percentage of those that are still unsold in the market, the Gold II and Platinum II units are not fit for purpose and not of merchantable quality in that they may well develop failures in the chambers which will lead to leaking and the ultimate failure of the unit. I consider the defect to be sufficiently prevalent for it to be reasonable for all Gold II and Platinum II units to have the welds on all units strengthened in the manner presently conducted by Morgan Ltd.

[118] I do not consider that there were any problems in relation to fitness for purpose or merchantable quality in relation to the smaller chambers that had a 65 x 830 mm size.

Failure of the ballast

[119] The ballast receives the mains electricity and then distributes it to the lamp. It was the case for Morgan Ltd that the ballast in the Gold II and Platinum II units failed for two reasons. First, it was alleged that it was not powerful enough for the wattage demand installed on the Gold II and Platinum II units; and second, given its position in the unit, it was susceptible to moisture damage as a result of either environmental moisture or water entering the units.

[120] Morgan Ltd called two experts that supported these contentions. The first was Mr K Hudson who considered that the ballast was underrated to supply a 95 watt load to the UV light tubes. The second was Mr W Chan who observed a ballast failing as a result of water leaking onto it.

[121] Mr Hudson's evidence was based on the premise that 95 watt lamps were used in the units. This was also Mr Cameron's initial assumption in his evidence. However, having heard various experts I am of the view that the actual wattage was lower than this, and generally did not exceed 90 watts. Mr Cameron revised his assumption in evidence to 88–93 watts, and in cross-examination said that he had the lamps tested and that they showed 88–93 watts. These tests were not made available.

[122] Accordingly I do not consider Morgan Ltd has made out a sufficient case to prove that the ballast was underpowered for the actual wattage used by the lamp. I record that I did not find any of the evidence of Mr Hudson particularly convincing, and note that he had not himself verified the actual loads that were imposed on the ballast. Mr Hudson seemed to me to be something of an advocate for Mr Morgan's cause.

[123] I also do not accept the contention that the units were so susceptible to water damage to be unfit for purpose or not of merchantable quality. Mr Cameron gave

evidence about ballasts suffering from water damage. A practice was developed by him and Mr Morgan whereby as part of the repair and upgrading of the units held by Morgan Ltd, the ballast was placed in a separate watertight unit inside the larger unit cover. Mr Cameron's background has been in accounting and I do not regard him as an expert in either the plumbing or electrical technical areas that relate to the unit. Although I accept his evidence on the repairs he carried out, I did not find all his explanations of why there were problems convincing, and he seemed to me to be adopting something of a counsel of perfection on the lack of extra cover for the ballasts.

[124] In addition I found Mr Chan's expert evidence of no assistance in any respect. He had observed the functioning of some units and certain leaks, but had not in my view made any satisfactory effort to discern the cause of the leaks or failures. For instance he observed the effect of water on an electronic ballast, and put forward the obvious proposition that once water had leaked onto a ballast it would fail. This was of no assistance in relation to the issues in this case. In this respect I refer to the evidence of the expert called by Midgen Ltd, Mr Adaway. He is a consulting electrical engineer and I accept his evidence that the electrical equipment was adequate in quality and design for the requirements that could be expected would be placed on it.

[125] I do not accept the basic premise of Morgan Ltd that the ballast had to be enclosed in a watertight compartment. The ballast was in a compartment that was screwed to the wall to which the unit was attached, and which was designed to protect the unit from the weather. There was no satisfactory evidence put to me indicating that the unit cover that was provided leaked. While the ballast is labeled "for indoor use only" an at least partially indoor environment was created by the use of the screwed on cover, and I am not satisfied that ballasts will normally fail if properly installed in such enclosed outdoor units. The ballast itself is a standard item, and there is nothing to suggest that there is any inherent defect in it. I am not satisfied that the unit became defective because of the place and method by which the ballast was put in the unit.

[126] Obviously if there was leaking from the unit itself inside the cover, and that water either sprayed or dripped onto the ballast, that could cause problems with the ballast. That is a different issue. However, in terms of moisture ingress from outside, whether by way of water coming in directly or by moisture vapour, the plaintiff has not proved its case on the ballast.

[127] The 24 ballast issues raised by customers and plumbers in the period April to October 2013, which Morgan Ltd claims can be made out from the daybook, are in my view exaggerated. Many claims of failures of the ballast can be attributed to leaks that have been caused by plumber or owner error in installation or maintenance. If such installation or maintenance errors lead to leaks and water getting in the ballasts, of course there will be problems, but this does not make the units unfit or not of merchantable quality.

[128] It is important in this regard to record that I consider that Mr Morgan and Mr Cameron became overly critical of the functioning of the systems. They have sought in their repair programmes to make them as perfect as possible, and that may be an understandable position for them to take. However, Midgen Ltd cannot be blamed if the very high standards that Morgan Ltd is now imposing on the units they supply were not previously adopted.

[129] It is often the case that mechanical equipment that is of merchantable quality and fit for purpose can nevertheless be improved. Indeed, that has been a constant cycle of improvement since the industrial revolution. Motor vehicles are now far more reliable than they were 50 years ago. That does not mean that the motor vehicles provided 50 years ago were not fit for purpose and of merchantable quality. Providing they functioned adequately according to the standards of the day, there was no breach of the implied terms of the Sales of Goods Act. In my view the ballasts, used in the way they were in the units, functioned in a satisfactory way.

Overheating of the Platinum II units

[130] In most units only one lamp is used, but in Platinum II units there are two lamps. Morgan Ltd claimed that the two lamps caused the water in the chamber to

heat up to a high temperature, resulting in heat damage to nearby components and leaking.

[131] There was a lot of evidence about the temperatures that would arise. There was some limited evidence of fire, and there is the fact that Mr Bragulla appeared to recognise a problem and these units are no longer manufactured. In the end having regard to this evidence I am satisfied that there was an overheating problem in the Platinum II units with two lamps that was caused by having two lamps in the stainless steel chamber rather than one. This was a defect in the design of the units which made them unfit for purpose and not of merchantable quality.

Defective glue

[132] Morgan Ltd adduced a considerable quantity of evidence about leaking heads, hoses and joints. Mr Midgen in his evidence rejected the suggestion that any of the glue joints leaked. However, he acknowledged a problem with the white glue, which appears to have caused leaks in the joints after a period of time. Morgan Ltd has re-manufactured the units replacing the seals, including those with the white glue.

[133] I consider the joints featuring the white glue were defective. There is an email from Mr Bragulla to an Australian customer of 25 February 2014 in which he acknowledged a manufacturing fault relating to a "bad batch of glue". This is clearly the white glue, which he contrasts with the black rubber-type glue which he says is an excellent sealant. He noted that most of the leaky units were in New Zealand. This letter gives credence to Mr Cameron's anecdotal evidence about the number of leaks found in relation to joints sealed with the white glue.

[134] However, I am not satisfied that any units other than those which used the white glue had leaking problems. I am not satisfied that the joints with black glue gave rise to serious problems, and consider that Mr Cameron was overreacting in his evidence on this point. Assessing the evidence as best I can I find that there was a white glue issue, but this applied only to a limited number of units. I find below that otherwise the seals were fit for purpose.

[135] As to the number of the units, I accept the evidence and submission for Morgan Ltd that there were 600 units affected by the white glue in the Gold III, Silver II and Silver III categories. On a rough reckoning 45 per cent of those units were so affected to be defective. However, my findings on the numbers of units affected by the failure of the white glue and the percentage of affected units are not final as there is still to be a damages hearing.

Poor seals, leaking flexible hoses, filter heads and other miscellaneous complaints

[136] There was no convincing evidence of any general problems with the seals. I accept Midgen Ltd's position that many reported problems involved installation and maintenance errors. There was no scientific analysis of the seals. Mr Morgan and Mr Cameron have overreacted in replacing them other than when white glue was used.

[137] Morgan Ltd provided some evidence of problems with the flexible hoses. However, I do not consider it has been shown that there was any inherent weakness or design defect. In particular I do not consider that they were either too thin or prone to pinhole leaking as alleged. There was simply no convincing expert evidence that supported this proposition. Any failures in the flexible hoses could be explained by problems with the water pressure, or installation and maintenance errors. The plaintiff's evidence was insufficient on this point.

[138] For the same reason I reject the suggestion that the filter heads were defective and not fit for purpose. There is no evidence indicating that the filter heads were unsatisfactory, and none of the experts gave evidence of examining such an allegedly defective filter head.

[139] There were other miscellaneous complaints about the units referred to in the evidence, but none of these were sufficient to prove the units were defective.

Breach of terms

[140] In summary, I find the following three defects exist:

(a) In the Gold II and Platinum II units with the large 108 x 910 mm stainless steel chambers, the end plates welded onto the chamber are of insufficient size and strength leading to a significant proportion of those chambers to split.

(b) The Platinum II units are liable to overheat.

(c) The Gold III, Silver II and Silver III units that were manufactured with white glue are liable to leak.

[141] Each of the three defects, if it was present, made the unit involved unsaleable. Any one of these defects would lead to a failure of the part that would lead to leaking. Leaking was not acceptable for the reasons I have outlined. I find they were not fit for purpose under s 16(a) because:

(a) The purpose (water filtering) was made known.

(b) Morgan Ltd relied on Midgen Ltd's skill and judgment as seller and distributor of the units for the past three years.

(c) The goods were of a description which it was Midgen Ltd's business to supply.[13]

(d) As I have set out, the units with defects were not reasonably fit for water filtering. If any part of the unit breaks down causing leaks this is a serious matter. A leaking unit becomes unuseable. Units likely to leak in this way can be regarded as unsaleable to the public by a reasonable distributor, and were therefore not fit for that purpose.

Given this finding it is not necessary to determine liability under s 16(b).[14]

[142] Midgen Ltd is liable under the indemnity clause for reasonable claims relating to these defects in the Gold II, Silver II and Platinum II units supplied by it

---

[13] Mr Grove accepted that the fitness for purpose and merchantable quality terms were implied.

[14] I did not receive any submissions on whether the sales to Water Guard were sales by description.

before settlement of the MMA on 1 November 2013. It is further liable under the Sale of Goods Act for damages relating to those units supplied to Morgan Ltd pursuant to or after the MMA in breach of the implied term. It is also liable under that Act in respect to the more recent Silver III and Gold III units, which were all purchased after settlement.

[143] It was accepted by the parties that should I find only some of the defects proven, then there would have to be a further damages hearing, as the damages calculations have been prepared on the basis that all the defects were proven. I cannot therefore make any award of present or future damages under this head, and I do not address any quantum issues. Damages will be considered at a later hearing if the parties cannot agree.

[144] I do record, however, my view that the repair costs actually incurred by Morgan Ltd for work on the three defects were likely to be reasonable. Morgan Ltd appears to have run an economical and careful repair operation, and the actual expenses incurred were not challenged. However, I am not able to determine on the evidence before me whether the re-manufacturing as conducted was the appropriate remedial measure, given that the re-manufacturing was for a more extensive set of defects. Also I cannot determine the issue of the future costs of repairing the defects given that the calculations were based on all the defects being established. I set out my view below on whether Morgan Ltd took proper steps to mitigate losses, which bears on the defendants' liability for damages.

Failure by Morgan Ltd to take proper steps when claims arose

[145] Mr Grove for Midgen Ltd submits that liability does not follow from any defects because Morgan Ltd did not take proper steps when the claims arose. Midgen Ltd was always prepared, he submitted, to rectify any valid warranty claims at no cost to Morgan Ltd. However Mr Morgan made no such warranty claims to Midgen Ltd in this manner. In doing so it did not follow a fair procedure and did not mitigate Morgan Ltd's loss.

[146] Two legal categories for this argument were advanced. First, that there was an implied term of the MMA that the defendants would be allowed to provide the

replacement parts to rectify any defects. Second, that Morgan Ltd would not have suffered its loss had it taken reasonable steps to mitigate the loss.

The implied term

[147] There was no method prescribed in the MMA for the making of claims for defects. There was no obligation placed on Morgan Ltd to take any particular steps when a claim was received, or to give Midgen Ltd or Bragulla Ltd the chance to replace the defective part of the unit. The contract was silent on how cl 22 would operate.

[148] Mr Grove submitted that lacuna was filled in by an implied term that the plaintiff would refer to defects to Midgen Ltd, who would be allowed to provide replacement parts and rectify any defects at no cost to the plaintiff.

[149] The Court of Appeal in *Hickman v Turn and Wave Ltd* considered when a term may be implied into a contract.[15] The Court set out the well known *BP Refinery* formulation:[16]

> In [their Lordships'] view, for a term to be implied, the following conditions (which may overlap) must be satisfied: (1) it must be reasonable and equitable; (2) it must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it; (3) it must be so obvious that it goes without saying; (4) it must be capable of clear expression; (5) it must not contradict any express term of the contract.

[150] The Court also considered the Privy Council's discussion in *Attorney-General of Belize v Belize Telecom Ltd*.[17] The Court concluded:

> [248] We agree that the approach adopted in the *BP Refinery* case should not necessarily be regarded as a cumulative list of elements all of which must be satisfied before a term may be implied. However, each element is a useful indicator relevant to the ultimate question of what a reasonable person would have understood the contract to mean. This is to be construed objectively by a notional reasonable person with knowledge of the relevant background.

---

15 *Hickman v Turn and Wave Ltd* [2011] NZCA 100, [2011] 3 NZLR 318 at [241]–[249].

16 *BP Refinery (Westernport) Pty Ltd v President, Councillors and Ratepayers of the Shire of Hastings* (1977) 16 ALR 363 (PC) at 376.

17 *Attorney-General of Belize v Belize Telecom Ltd* [2009] UKPC 10, [2009] 1 WLR 1988.

[151] Having regard to those variable tests I do not consider the term contended by the defendants arises as a matter of construction or necessary implication in the MMA. There are two key background facts that must be recognised. First, as I detail later in this judgment, Morgan Ltd would reasonably want serious defects to be fixed immediately in order to avoid greater claims and to maintain its goodwill. The need for quick turnaround to avoid claims means it would not be reasonable or necessary for business efficacy to expect Morgan Ltd to refer those defects in all circumstances to Midgen Ltd. Second, although Morgan Ltd had purchased the units from Midgen Ltd, it knew the units were acquired from the manufacturer, Bragulla Ltd. In the ordinary course of business one would expect defects in the manufacture of the units to be referred to the manufacturer, not the middle man.

[152] It is my conclusion that it does not go without saying that the contract came with a requirement that all manufacturing defects be at first instance referred to the supplier. It may have been fairer or more convenient from Midgen Ltd's perspective for it to deal with defects, but that is not what the contract says, and that without more is insufficient to read in such an implied term. As a matter of practice, Morgan Ltd required a more urgent response.

Failure to mitigate

[153] I now turn to the second argument. Mr Grove submits that since Midgen Ltd had been ready willing and able to examine defective units and rectify any valid claim at no cost, Morgan Ltd did not need to do the repairs. It would have been reasonable for Morgan Ltd to refer repairs to Midgen Ltd, and it was inappropriate for it to take repairs into its own hands. There has been therefore a failure to mitigate its loss.

[154] This argument has been brought both in relation to the defective units supplied by Midgen Ltd before settlement, and those supplied after settlement. Although damages for the former arise pursuant to the indemnity clause in the contract, and the latter pursuant to the Sale of Goods Act, in analysing this issue I consider there is no difference in approach. While the indemnity clause is drafted in unqualified terms it is clear as a matter of interpretation or construction that the

indemnity covers only loss that directly and naturally results from reasonably made claims. This means that liability accrues on the same footing under the indemnity as it does under s 54(2) of the Sale of Goods Act. In particular, loss that would not have occurred had Morgan Ltd taken reasonable steps in mitigation would not directly and naturally result, and therefore would not be recoverable as loss.

[155] The issue for all units therefore is whether Morgan Ltd's decision not to refer repairs to Midgen Ltd and do the repairs itself was a reasonable decision given its duty to mitigate its loss.

[156] Mr Grove in support of his submission relied on dicta in *J & B Caldwell Ltd v Logan House Retirement Home Ltd*[18] and *T & P Developments Ltd v Yu.*[19] In *J & B Caldwell Ltd*, Fisher J noted in relation to the duty to take reasonable steps to mitigate loss in the context of breach of contract, that a plaintiff must adopt a course in remedying its own loss which "will cause the least loss to the liable defendant".[20] Fisher J quoted Viscount Haldane LC in *British Resting House Electric and Manufacturing Co Ltd v Underground Electric Railways Co of London Ltd* where he stated that the plaintiff's actions in remedying a breach of contract must be those "which a reasonable and prudent person might in the ordinary conduct of business properly have taken".[21]

[157] In *T & P Developments Ltd*, Glazebrook J stated in the context of the rectification of defects:

> [119] Obviously it is the plaintiff that contracted with the defendants and thus the defendants would have been entitled to require to remedy the defects, whether or not the subcontractors agreed to do so. However, in this case, the plaintiff has been prevented from being able to exercise its rights against its sub-contractor. It cannot be expected to meet the cost of third parties doing work which it was entitled to have done by sub-contractors without any additional cost.

---

18 *J & B Caldwell Ltd v Logan House Retirement Home Ltd* [1999] 2 NZLR 99 (HC) at 105.
19 *T & P Developments Ltd v Yu* HC Auckland, CP18-SD99, 11 April 2001.
20 At 105.
21 *British Resting House Electric and Manufacturing Co Ltd v Underground Electric Railways Co of London Ltd* [1912] AC 673 (HL) at 690.

[158] Glazebrook J noted the decision of *Pearce & High Ltd v Baxter & Baxter*[22] where an implied contractual right to the return of the property for the purpose of remedying the goods was recognised. Evans LJ stated:[23]

> The cost of employing a third party is likely to be higher than the cost to the contractor of doing the work himself would have been. So the right to return in order to repair the defect is valuable to him. The question arises whether, if he is denied that right, the employer is entitled to employ another party and to recover the full cost of doing so as damages for the contractor's original breach.
>
> In my judgement, the contractor is not liable for the full cost of repairs in those circumstances. The employer cannot recover more than the amount which it would have cost the contractor himself to remedy the defects.

[159] I recognise and apply these principles. If a party that has received defective goods chooses a process of remedy that is appreciably more expensive than a reasonable alternative readily available and offered by the defendant, the party has failed to mitigate its loss. In the end any final decision will turn on a detailed analysis of the facts, and an assessment of whether a plaintiff has unreasonably turned its back on an alternative solution that is significantly cheaper or more practical for the defendant.

[160] In response Mr Fisher pointed to various factors that undoubtedly distinguished the cases cited on their facts from the present. He emphasised that a number of the cases involved express contractual rights that were enjoyed by a defendant to effect repairs, and that they were therefore distinguishable. Mr Fisher also relied on the judgment of Chambers J in *Gunton v Aviation Classics Ltd*[24] where the head note summarises the Judge's analysis and states:

> Where there is a breach of warranty it was open to the purchaser to repair goods to comply with the warranty unless it was unreasonable to do so at the time.

[161] Mr Fisher argued that in the absence of any contractual restraint under the MMA, Morgan Ltd acted reasonably in remedying customer problems immediately and then subsequently making a claim against Midgen Ltd under the indemnity.

---

22 *Pearce & High Ltd v Baxter & Baxter* [1999] BLR 101 (CA).
23 At 104.
24 *Gunton v Aviation Classics Ltd* [2004] 3 NZLR 836 (HC).

Mr Fisher pointed out that the costs incurred by Morgan Ltd in remedying the defects were reasonable, and so were its disbursements.

Assessment of ability to mitigate

[162] What is required is an assessment of the issues facing Morgan Ltd. The nature of the faults is that they were serious and required urgent remedial action. Customers were generally dependent on the working of the unit for water supply. The reaction of any reasonable distributor when it received notice of defects would be to go to the site to carry out urgent repairs. The water was normally needed for the customer on an hour by hour, day by day basis, and there was the possibility of a dangerous electrical malfunction and fire due to leakage of water onto electrical equipment.

[163] I accept that Morgan Ltd would reasonably wish to act quickly to effect urgent repairs. If it went out to a site where a defect was reported, and found a chamber leaking, it would want to repair or replace the chamber with all possible speed, to restore water and avoid further damage.

[164] As it happened on 14 November 2013 Mr Morgan wrote to Mrs Sullivan about a number of concerns. These included reported faults in the units. Ultimately he was directed by Mrs Sullivan to deal with Mr Bragulla in relation to complaints. He requested some parts from Mr Bragulla. On 19 November 2013 he received a response from Mr Bragulla advising him that all inquiries and orders would have to go through Mr Midgen. Mr Bragulla noted that he was not Mr Morgan's supplier and had no contract with him. Mr Morgan contacted Mr Midgen and said that he was seriously concerned at Mr Bragulla's stance. Mr Midgen stated that he would find a way through the problem. There was some discussion between them about different parties manufacturing the units. He made no proposal to urgently fix malfunctioning units.

[165] On 4 December 2013 Mr Midgen sent an email to Mr Bragulla seeking a solution to the problems that were starting to be experienced with the commercial Platinum II units. Mr Bragulla initially advised that he would swap the commercial units. The next day he withdrew that offer. At about this time there was then a fire

in a Gold III unit at a bakery premises on Waiheke. Although there was detailed evidence about the fire and what happened, I do not propose traversing it all. I am not by any means satisfied that there was an actual defect in the Waiheke unit, but there is no doubt that for some reason, probably a leak from an external source such as water pouring on the unit from broken spouting, that there was a fire.

[166] However, that incident contributed to the deterioration in the relationship between the parties, which impacted on the ability of Morgan Ltd to seek repair from the supplying and manufacturing interests. I have no doubt that Mr Bragulla and Mr Sullivan were prepared to replace the Waiheke unit, but the parties did not successfully communicate when Mr Bragulla and Mr Sullivan visited Morgan Ltd's premises. In my view both parties behaved oddly. Mr Cameron, not Mr Morgan, came out and met Mr Bragulla and Mr Sullivan. Mr Sullivan did not introduce himself and was described as a fire inspector, an unfriendly way of initiating contact with the sole New Zealand distributor. Mr Morgan then refused to come out and meet Mr Sullivan and Mr Bragulla, a divisive action given they controlled his sole source of Water Guard units.

[167] The consequence of the general stand-off that developed through November and December was that there were no warranty parts supplied to Mr Morgan within a quick timeframe, and no system set up by Midgen Ltd for the quick processing of defect claims.

[168] On 30 December 2013 Mr Morgan sent an email to Mr Bragulla and Mrs Sullivan outlining complaints including by implication the defects. He received no response. On 5 January 2014 he delivered the draft letter to Mr Midgen at his home when Mr Midgen was mowing the lawn, and in that letter amongst other things he raised a number of workmanship issues. Mr Midgen did not in any formal way respond to that letter.

[169] Mr Morgan attempted to get various shut-off valves and spare chambers from Mr Bragulla in January, but Mr Bragulla was not helpful. Mr Morgan then sourced some parts elsewhere.

[170] Through February 2014 Mr Morgan became more committed in his view that there were serious design faults. In March 2014 Mr Cameron visited a number of plumbers around the North Island, which led him to the belief that there was widespread dissatisfaction with the product. In April 2014 Mr Cameron recommended to Mr Morgan that in order to fix defects he dismantle, change and re-assemble all units prior to delivery.

[171] Morgan Ltd commenced that process of re-manufacturing. The main work done was re-gluing joins using hemp, fitting ballasts inside a plastic box designed to keep moisture out, altering the lamps in the chambers, pressure testing each unit and if there was a leak in the filter head, disassembling the unit and replacing the filter head.

[172] The shadow that hangs over the assessment of the reasonableness of the parties' respective positions was the unpleasant personal relationship that very quickly developed between Mr Morgan and Mr Bragulla after settlement of the MMA. They were very much at arms' length by mid-November. Both were at fault, Mr Morgan more so. Mr Morgan became unduly angry and sanctimonious about problems when they arose. But Mr Bragulla was casual and often rude in his responses. There were problems emerging that he did not adequately acknowledge. However, despite approaches, Mr Morgan would not confer or discuss, and was insulting in his words and actions. The Midgens and the Sullivans were rather caught in the middle between the stand-off between Mr Morgan and Mr Bragulla. The Sullivans I think found the issue too hard to deal with, and they were not to settle the business until March 2014. Given that they did not own the business until then, in the meantime they left it to Mr Bragulla.

[173] Mr Midgen, as I have already observed, is a man who adopts a reasonable stance in business. He avoids confrontation. He endeavoured to improve relations between Mr Bragulla and Mr Morgan. He was unsuccessful, and from early January his own relationship with Mr Morgan deteriorated. I see this deterioration at a personal level being the fault of Mr Morgan rather than Mr Midgen. Mr Morgan was confrontational and unpleasant. His action in giving Mr Midgen a letter of demand while he was mowing the lawn was the beginning of a discernible rift. This

unfortunately contributed to Mr Midgen putting his head in the sand rather than concern himself with remedying the defects.

[174] At no stage did Mr Midgen come up with any practical plan for dealing with defects when they arose. There were occasions when he asked for the parts to be submitted and for warranty claims to be made in a formal way, but this was not a fair response from Mr Midgen. Morgan Ltd was dealing with urgent claims, and it had to be able to respond quickly. I accept the evidence of Mr Cameron that on one occasion when a part needed to be replaced, it took Bragulla three weeks to provide the replacement part.

[175] An example of the impasse as to warranty claims that had been breached can be seen in an exchange between Mrs Sullivan and Mr Morgan from 20 January 2014. Mr Morgan advised her of five instances where the new Gold system chambers burst. He asked for six chambers. Mrs Sullivan responded the next day asking him to fill out a claim form and details about any unit and offering to send it back to him. Mr Morgan responded on the same day that there was no level of trust and he felt uncomfortable about giving details of the sale. He was in essence stating he would not fill out any claim form, and requiring them to provide the replacements at his say-so, failing which he said he would buy them from elsewhere.

[176] Mr Morgan's position was unreasonable as it could not be expected that he could get a replacement from the manufacturer without providing details and satisfying it that there was a true defect. However, his response must be seen in the context of it being clear by now that there was a problem with the chambers, and the unwillingness of Mr Bragulla to concede this. Although this exchange did not involve Mr Midgen in a direct way it shows the nature of the impasse that had arisen, and Mr Midgen's transfer of the problem to Mr Bragulla.

[177] It is clear from the exchanges of emails through January and February 2014 that Mr Midgen was, at least on occasions, endeavouring to hand over the warranty claims that Mr Morgan was making against his company to Mr Bragulla. This further incensed Mr Morgan. Although Mr Morgan may be criticised for the abusive tone of his emails, he was correct when he insisted that ultimately the contractual

responsibility for the defects rested with Midgen Ltd and not with Bragulla Ltd. Mr Midgen's contractual responsibility to Mr Morgan was not being adequately recognised by Mr Midgen and he was wrong to hand over matters to Mr Bragulla.

[178] Even at the meeting that took place on 11 February 2014, attended by the Midgens and by Mr Cameron (Mr Morgan would not go), the position taken by the Midgens was that they wanted the allegedly faulty parts so that they could be forwarded to Bragulla Ltd. If there were faulty replacement parts they would be replaced. Mr Midgen did not accept any direct responsibility on the part of Midgen Ltd to itself urgently fix the defects.

[179] Given all these factors, I do not think that Morgan Ltd's abandonment of any effort to get the Bragulla, Midgen or Sullivan interests to help him in a direct way with defect claims was when viewed objectively unreasonable. Such a procedure would be slow, and the outcome, on past performance of Mr Midgen, Mr Bragulla and Mrs Sullivan, uncertain. In my view Mr Morgan had little choice but to try and maintain Morgan Ltd's goodwill by effecting immediate repairs without going through any formal warranty procedure. His anger and hostility and refusal to discuss were factors in hindering the creation of a process to deal with the complaints, but it was up to Midgen Ltd to propose a reasonable alternative remedial response that would ensure quick repair. It did not come up with such a response, and Mr Midgen's default position was for Mr Bragulla to deal with warranty issues.

[180] I also consider that in the circumstances Morgan Ltd's re-manufacturing efforts were likely to be reasonable. The costs involved were modest and have not been challenged. Mr Morgan had to do something. He could not continue to sell and supply defective units.

[181] Mr Morgan was, in part, affecting some repairs that were not legitimate defect claims, including replacing filter heads and flexible hoses, and many flue joins and lamps. I am not satisfied that quarts, sleeves, valves and fittings had to be replaced. But the other repairs as they relate to proven defects were necessary. Morgan Ltd's alternative option – to try and lodge claims against the Midgen, Bragulla, or Sullivan interests, and wait for repairs – was not in all the circumstances

a viable commercial option. Such a claim might be rejected (as early claims were indeed rejected by Mr Bragulla), and the processing of such claims could take a long time. Any delay could result in serious damage to the reputation of the product. In hindsight, Mr Midgen should have put to one side his difficulties in dealing with Mr Morgan, and if he wanted to affect repairs and supply parts, come up with a proposal to do so immediately when claims were received. But he did not do so.

[182] I record also Mr Grove's suggestion, in cross-examination, that Mr Morgan set out from the time of or shortly after the purchase of the distribution business, to set up his own manufacturing operation. I consider that Mr Morgan did have ambitions to manufacture himself, and this could be seen as consistent with the aggressive and hostile attitude he took quickly after settlement. However Mr Morgan has not made up allegations of defects as part of a Machiavellian plan, as there were indeed three significant defects. Mr Cameron and Mr Morgan's concerns which led ultimately to them re-manufacturing the units at least in this respect were sincere. But I do think that he has overreacted to defect problems and that is why many of his defect claims have not succeeded.

[183] In conclusion on this defence, I do not accept Mr Grove's arguments that there was a breach of the duty to mitigate loss. In my view Morgan Ltd has a good claim for the particular defects that I have identified, and the remedial measures taken in respect of those defects. If all parties had acted reasonably, the manufacturer (Bragulla Ltd), supported by Midgen Ltd would have entered into an agreement with Morgan Ltd to replace and where necessary repair defective parts, and they would have come up with their own re-manufacturing plan. Instead, when the parties fell out, Mr Bragulla took a skeptical stance and Mr Morgan became angry and suspicious. Mr Midgen tried to get the parties to talk, but did not take responsibility. Given that the defects were the vendor's (Midgen Ltd) and the manufacturers' (Bragulla Ltd and Sullivan Ltd) responsibility, and those parties did not come up with commercially satisfactory remedial options, Midgen Ltd cannot now resist damages on the basis that Mr Morgan should have given them more remedial opportunities.

The misrepresentation as to defects claim against the Midgen interests

[184] As a separate cause of action Morgan Ltd claims Midgen Ltd and Mr Midgen made misrepresentations about an absence of problems in the units. I set out the representations as pleaded:

> 6.6 all claims from customers relating to defective units were of a minor nature, the first defendant had discharged its legal and contractual obligations to customers in relation to claims for defective units and the first defendant had incurred costs of around $1,200 per annum in meeting such obligations:
>
> (a) the representations were express and implied;
>
> (i) the written representation was contained in an email exchange between Stewart Morgan and the second defendant dated 25 September 2013;
>
> (ii) the implied representations were implied from the context of the email exchange dated 25 September 2013;
>
> 6.7 the first and second defendants had no knowledge of any systematic defects or faults in the water filtration units;
>
> 6.8 the distribution network of plumbers had not raised any issues about the adequacy of support provided by the first defendant to deal with product defects or faults;
>
> 6.9 there was no basis to believe that claims by customers for defective units would increase or be materially different from the nature and extent and the historical defects represented by the first and second defendants;

[185] It is alleged that these were misrepresentations because:

> 9.3 a substantial number of water filtration units sold by the first defendant were not fit for the purpose or of merchantable quality and suffered from latent design or manufacturing defects;
>
> 9.4 a number of plumbers to whom the first defendant supplied water filtration units had expressed to the second defendant their dissatisfaction with the quality or fitness for purpose of the water filtration units and with the first defendant's handling of defects reported by customers of the first defendant.

[186] Mr Midgen admits that he said to Mr Morgan that all claims from customers relating to defective units were of a minor nature and that Midgen Ltd had incurred costs of approximately $1,200 per annum in meeting such obligations. He says this was true. The costs were recorded in the MYOB accounts. He denies making any

statements about systemic faults or defects, and says he did not know of any. He says that he made no representation about plumbers not raising issues, but that in any event no plumbers had raised issues about the adequacy of support. He denies the fitness for purpose and merchantable quality allegations.

[187] In support of the claims the day book which records daily entries including at least some of the defect claims was produced. Ms Kim Marshall, Mrs Midgen's sister, who worked for Morgan Ltd for some months after purchase and had previously been employed by Midgen Ltd to run the office, gave evidence that there were very few warranty claims against Midgen Ltd.

[188] I accept Mr Midgen's evidence that the statements he made about the number and quantum of claims were accurate. The day book and the accounts are consistent with what he said. There was no evidence called by Mr Morgan of complaints at any higher level than represented, save for some ambiguous later letters after complaints had become more frequent. I also accept his evidence that the distribution network of plumbers had not raised any issues about the adequacy of support in relation to product issues. I am sure Mr Midgen would have raised frequent complaints with the manufacturer, Mr Bragulla, if they had been occurring. They would have been the ultimate responsibility of Bragulla Ltd. The correspondence prior to settlement showed no such complaints. Although there had been some problems they were of the sort that could be expected with such units. I found Mr Midgen to be a truthful witness. There was no basis to believe that the level of claims for defects would increase or be materially different from the position as it had been.

[189] There were references by Mr Midgen to the sale of three leaking chambers. However, I think that the increasing number of complaints after settlement had by February changed Mr Midgen's view on the fitness of the units. Back in September/October 2013 he had genuinely thought there were no significant inherent defect issues. The failures were starting to become more frequent at about the time of settlement on 1 November 2013, and the number of failures continued to increase incrementally after that date so that by February 2014 Mr Midgen was recognising a problem with them.

[190] I have no doubt that Mr Morgan, who is extremely sensitive to failures, was more vigilant in noting them and more proactive in endeavouring to prevent them occurring than Mr Midgen. However, I also have no doubt that at settlement Mr Midgen thought that although there would be occasional problems as there is with any mechanical product, there were no systemic defects likely to give rise to significantly increased claims in the future.

[191] For this reason this finding is not inconsistent with my finding that the units with the larger chambers were defective. These units had only been supplied since 2012, and so had not been in the marketplace for long at the time of sale. Mr Midgen did record some reported failures, and the representations that he made to Mr Morgan were not inconsistent with those reported failures.

[192] The misrepresentation claims against Midgen Ltd and Mr Midgen relating to defects therefore fail.

The misrepresentation as to defects claim against the Bragulla interests

[193] In addition Morgan Ltd claims that Bragulla Ltd and Mr Bragulla made representations about the quality of the units which were false. Although this claim is brought in the second proceeding, it is convenient to deal with it here.

[194] The representation is described in the following way in the fourth amended statement of claim:

> …
>
> (b) in September 2013, Bragulla demonstrated to Stewart Morgan and Wayne Cameron at the premises of Cynortic the assembly method for the water filtration units and the testing method employed to ensure the units were fit for the purposes;
>
> (c) Bragulla made statements during the demonstration to the effect that the water filtration units were of a high quality, were very well designed and were subject to a robust testing regime before leaving the premises of Cynortic Ltd:
>
> (d) further, and alternatively, in the above circumstances:

(i) Bragulla had a duty to speak out and disclose that a number of the water filtration units were not fit for the purpose or had certain design or manufacturing defects;

(ii) Bragulla's failure to speak out constituted a representation that the water filtration units manufactured by Cynortic Ltd were fit for the purpose and did not suffer from any design or manufacturing defects.

[195] It was also Mr Morgan's evidence that Mr Bragulla made statements at the meeting of 12 September 2013 in Tauranga that the units were of high quality, were well designed and subject to a robust testing regime. Mr Bragulla did not appear and gave no evidence at the hearing and Mr Morgan's evidence was not challenged. They are the sort of remarks that Mr Bragulla was, in my view, likely to have made.

[196] Indeed, it is my assessment having read the extensive correspondence and reviewed all the facts that Mr Bragulla is likely to have sincerely believed that the units were of good quality. As I have stated, I have accepted Mr Midgen's evidence that as at September 2013 there had not been many complaints about defects, and the units had been selling well for three years and were distributed throughout New Zealand.

[197] In this regard I refer to Mr Bragulla's email of 18 November 2013 to Mrs Sullivan, which I consider to be genuine and truthful. He observed in relation to Mr Morgan's complaints about the seals that there had never been issues about the seals for the last four years and that he considered Mr Morgan's complaints "rather strange".

[198] There were, however, as I have found, three defects in the design and manufacture of the units, being the welds to the large water chambers, the use of two elements in the Platinum II units, and the use of the defective white glue in some units. While they were not appreciated to be significant defects by Mr Bragulla prior to settlement of the MMA, these were in fact serious defects and meant that in those particular respects particular units were not fit for purpose. Those units could not be fairly described as being of high quality. There was, to this extent, a misleading statement made by Mr Bragulla, and what used to be called an innocent

misrepresentation. I record that I do not consider that Mr Cameron's evidence established any misrepresentation on this issue made to him by Mr Bragulla.

[199] I therefore find that there was a misrepresentation by Mr Bragulla to Morgan Ltd to this extent, although it was not deceitful. I record also that the mental element for deceit is making a false representation knowing it to be untrue or having no belief in its truth or being reckless to the truth, but I do not consider that Bragulla was reckless to the truth.

[200] Since the misrepresentation was not made in the context of a contract between the Bragulla Ltd and Morgan Ltd, and in the absence of any deceit, the claim can only succeed under the Fair Trading Act.

[201] I record that I would not have upheld the other types of claims for misrepresentation against Mr Bragulla. The evidence adduced of misrepresentation is a short sentence by Mr Morgan about what Mr Bragulla said. There is not enough to infer that by his "silence" on the topic of defects, there was any misrepresentation.

[202] I find that while the deceit claim has failed, Morgan Ltd has made out a case of misleading conduct under the Fair Trading Act in respect of those units affected by those three defects. Any award for damages is likely to be the same as the assessment of damages that will be made in relation to the cl 22 breach of warranty claim and the fitness for purpose and merchantable quality causes of action, made out against Midgen Ltd. Damages cannot be awarded at this point and will have to await the second hearing.

[203] It can be observed that Midgen Ltd may have a claim for indemnity or contribution from Bragulla Ltd, but there has been no such claim made in this proceeding.

Conclusion on the Midgen proceeding

[204] The claims against the Midgen interests (Mr Midgen and Midgen Enterprises Ltd) for misleading statements about cash sales and turnover, and misleading

statements in relation to defects, fail. There were no misrepresentations by Mr Midgen.

[205] The claims based on an implied term of fitness for purpose in respect of defects in the units against the Midgen interests succeed in relation to splits in the stainless steel chambers in the Gold II and Platinum II units, overheating in the Platinum II units and defective white glue in the Gold III, Silver II and Silver III units, and the defence for failure to mitigate loss fails. The claim in respect of other defects fail.

[206] I direct that there is to be a damages hearing to assess the loss suffered by the plaintiff in respect of the three defects.

THE BRAGULLA/SULLIVAN PROCEEDING (CIV-2014-404-000915)

[207] In the second proceeding Morgan Ltd makes claims against the Bragulla and Sullivan interests. Some of these claims have already been considered. The claim that Mr Bragulla misrepresented Midgen Ltd's sale figures is dismissed. However, the claim that Mr Bragulla misrepresented the quality of the units under the Fair Trading Act is upheld.

[208] The remaining claims primarily concern the partial sale of the manufacturing business between Bragulla Ltd as vendor and Sullivan Ltd as purchaser (the BSA). The statement of claim is not easy to follow, but broadly put, Morgan Ltd claims the Bragulla and Sullivan interests have acted in a manner inconsistent with Morgan Ltd's rights under the EDA.

[209] Morgan Ltd seeks four different lots of relief. After a long initial narrative it seeks an injunction against Bragulla Ltd restraining it from appointing or assigning under the EDA, declarations about its rights under the EDA, including a declaration that Sullivan Ltd has no interests under the EDA, and an inquiry into damages against Bragulla Ltd. The second pleaded claim is against Bragulla Ltd and Mr Bragulla for misrepresentations, and has already been considered.[25] The third

[25] See [86]–[92] and [193]–[203].

claim is that Mr Bragulla, Sullivan Ltd, and/or the Sullivans induced Bragulla Ltd to breach the EDA. It is also claimed all the defendants conspired to cause harm to Morgan Ltd by unlawful means, by entering into the BSA. An injunction is sought against Bragulla Ltd, the Sullivans and Mr Bragulla restraining them from distributing or selling directly or indirectly or appointing any other person to do so. Declarations and an inquiry as to damages are sought. The final claim is against all parties under the Fair Trading Act. Damages are sought only against Bragulla Ltd and Mr Bragulla. Injunctions are sought against all parties.

Background

[210] Some of the background has already been considered at [13]–[16] above. In broad terms, the BSA was signed on 26 September 2013, declared unconditional on 8 November 2013, and settled on 24 February 2014. However, an important intervening event occurred in January 2014, which proved the catalyst for this proceeding and the basis of the economic tort claims.

[211] In January the Sullivans and Mr Bragulla agreed to amend the sale of the manufacturing business so that Bragulla Ltd would remain as owner of parts of the business (as it happened, Mr Bragulla purported to assign that remnant to the fifth named defendant, Cynortic International Ltd, in late January). As I will outline, the idea was Mr Bragulla would remain the contact point with Mr Morgan and the intermediary between him and the Sullivans. It arose in the context of mounting difficulties between the Sullivans and Mr Morgan. It led to a variation of the BSA, referred to as the addendum. The addendum in its final form was signed on 17 February 2014.

[212] The addendum is critical, as the conduct in settling the BSA "as varied by the addendum dated 17 February 2014" is what is relied on to support the inducement and conspiracy claims. Before discussing this addendum further it is necessary to outline some of the background, as it is important context that helps explain the Sullivans' position and why the parties felt the need to enter the addendum at all.

Mounting tensions

[213] I have already detailed some of the hostility that overshadowed the dealings between Mr Morgan and the Midgen, Sullivan and Bragulla interests.

[214] As I have said, hostilities developed between Mr Morgan and Mr Bragulla after Mr Morgan took over as distributor on 1 November 2013. Mr Morgan was displeased to find that the manufacturer, Bragulla Ltd, had agreed to sell the business to Sullivan Ltd, although after a period he formally accepted that transfer. On 10 October 2013 Mr Bragulla proposed to Mr Morgan a new formal distribution agreement to replace the EDA involving some proposed changes including the introduction of a termination clause for breach on 48 hours. Mr Morgan was suspicious and concerned about these proposed changes and would not agree to them.

[215] Also in November Mr Morgan faced the defect claims that began to arise. As I have detailed Mr Morgan was dissatisfied and angry with how the Sullivans and then Mr Bragulla responded. In the weeks that followed settlement of the MMA he formed the view that he had been sold a pup and that the units were defective. He began to make claims.

[216] Mrs Sullivan in her email correspondence on 14 November initially responded to Mr Morgan's concerns in careful and courteous manner. Mr Morgan in contrast replied in an extremely belligerent and disparaging manner. Mrs Sullivan's polite proposal that they have a meeting was not taken up by Mr Morgan. The flavour of Mr Morgan's responses is captured by this comment by him:

> The manufacturer is not responsible for marketing in New Zealand, so please respect the agreement and stay out of the business I have purchased. Anybody contacting the manufacturer … should be referred to the manufacturer. And to be honest i[t] concerns me that a person with your background would need this clarified!

[217] Another example of Mr Morgan's rudeness is his email to Mrs Sullivan when she sent him Mr Bragulla's response about the Waiheke incident:

> You call that a response! Don't you think you need to adopt a professional attitude and address the issues?

> I think the time has come to start paying the legal team some money.

By 18 November Mrs Sullivan understandably was finding Mr Morgan impossible to deal with.

[218] The cross-examination showed that the Sullivans were taken aback by Mr Morgan's anger and contempt. Although Mrs Sullivan had an MBA and considerable business experience, Mr Sullivan was a Vicar and they were both new to the water filtration industry. Mr Morgan's belligerence and intractability was outside their experience. His inability to deal with issues in a constructive business-like way was baffling and a source of great concern. I accept the evidence of the Sullivans that they had made every effort to form a good business relationship with Mr Morgan, but found it impossible because of his actions, and the way in which he treated them. He continued to be aggressive and non-responsive to their actions. This is why they backed off involvement in the defect claims while Bragulla Ltd still owned the business. Overall I consider they did make initial genuine efforts to get Mr Morgan to meet with them and to establish a good working relationship, but Mr Morgan refused to co-operate.

[219] I have no doubt that it was in this context that Mr Bragulla, sensing that the Sullivans were not well equipped to deal with Mr Morgan's belligerence, took it on himself to deal with Mr Morgan. Mr Bragulla sent a number of emails to the Sullivans through November and December which were hostile to Mr Morgan and which can be seen as aimed at limiting Mr Morgan's ability to disrupt the New Zealand operation. Mr Bragulla on occasions misconstrued his legal obligations to Mr Morgan, and as I have observed, he adopted a rude and belligerent attitude. It is symptomatic of how the relationship between Mr Morgan and Mr Bragulla was heading, that Mr Bragulla observed:

> I think that this poor man does not need a plumber but rather a mental health professional.

[220] Mr Bragulla's attitude was unfortunate, albeit unsurprising given Mr Morgan's highly provocative language and behavior. For the Sullivans' part, I interpret their actions in sending email responses which appeared to go along with Mr Bragulla's proposals in dealing with Mr Morgan, as not showing any intention to

hurt Mr Morgan or defeat his rights, but rather to try and find a way forward in the face of the anger and belligerence on the part of both sides.

The addendum to the BSA

[221] While I do not propose going through the correspondence between Mr Morgan, Mr Bragulla and the Sullivans item by item, there were certain key communications. Mr Bragulla sent an email to the Sullivans on 7 December 2013 stating that he wanted the Sullivans to have a clean start. He mentioned setting up a company Cynortic International Ltd. Mrs Sullivan responded that she was unsure of the legal issues. Mr Bragulla starting liaising with his solicitors to find a way of changing the contractual arrangements. The Sullivans took no active steps.

[222] On 8 January 2014 Mr Bragulla sent the Sullivans a proposed draft addendum to the BSA. Mr Bragulla in his email to Mrs Sullivan said of the addendum "it will keep Morgan off your back". The effect of the proposed addendum was to exclude the EDA from the assets and intangibles being sold under the BSA. As noted above, the EDA had been assigned to Mr Morgan, as well as the East African operation, such as it was. Clause 2.2 of the addendum provided:

> The purchaser, Cynortic International Ltd, undertakes and agrees to supply [Bragulla] Ltd with Water Guard Systems and spare parts, as required, so that Cynortic can fulfil its obligations under the EDAs. The purchaser will not sell into those markets any Water Guard Systems that are stocked and sold by the above distributors covered under the EDAs while the relevant EDA remains on foot.

[223] The reference to "Cynortic International Ltd" appears to have been an error, as the purchaser was Sullivan Ltd, and Cynortic International Ltd was not a supplier, and not yet a transferee.

[224] I have detailed above Mr Morgan's refusal to engage on issues that were arising in a co-operative way, and his belligerent and implacable manner. In such a context I have no doubt the proposal whereby Mr Bragulla would deal with Mr Morgan rather than the Sullivans proved irresistible to them. It is no surprise they went along with it. They did not see it as changing their role as the

manufacturer and supplier to the New Zealand market, or Mr Morgan's role as distributor.

[225] On 30 January 2014 Mr Bragulla and Mrs Renate Hoffman entered into an agreement (which lacked any legal sense) whereby Mr Bragulla sold the assets of the "seller" (which was Mr Bragulla but on the wording of the agreement included "Cynortic International Ltd") to her for $90,000. The assets sold included the name of Cynortic International Ltd and all contracts made by Mr Bragulla. The EDA was specifically transferred and was assigned to Ms Hoffmann by cl B.1. I find that the Sullivans had no role in or contribution to this arrangement, which was a misguided scheme invented solely by Mr Bragulla.

[226] The Sullivans continued through January and February to send courteous emails to Mr Morgan. They did not accept that the products were defective, but proposed further discussions to find a way forward. On 3 February the Sullivans asked for a meeting and Mr Morgan, as was his pattern, brushed off these suggestions, and made threatening statements.

[227] The addendum in final form was signed by the Sullivans on 17 February 2014, still a week before settlement of the agreement on 24 February 2014. The agreement was in the same form as that originally sent by Mr Bragulla, but the last sentence of cl 2.2 whereby the purchaser stated it would not sell into markets any Water Guard units that were stocked and sold by the distributors covered by the EDA was deleted.

Breaches of the EDA

[228] The first part of the current statement of claim contains a number of allegations. It pleads express and implied representations by Bragulla Ltd and Mr Bragulla, which have been dealt with earlier in this judgment. It pleads the entry into the BSA and various events that followed. It pleads in a paragraph that is admitted by the Sullivans:

> 12 CWS Ltd and the Sullivans have since:

> 12.1 asserted that the plaintiff is not a valid assignee of the rights, title or interests of the distributor under the EDA;
>
> 12.2 marketed Water Guard filtration systems and parts or UV water filtration systems and parts associated with the brand name Water Guard for sale to persons in New Zealand and Australia;
>
> 12.3 distributed or sold Water Guard filtration systems and parts or UV water filtration systems and parts associated with the brand name Water Guard to persons in New Zealand and Australia;
>
> 12.4 declared their intention to appoint other persons to market or sell or distribute Water Guard filtration systems and associated products in New Zealand, the Pacific Islands and Australia. …

[229] The Sullivans while admitting the paragraph assert that these actions have not been undertaken or carried out since April 2014 and plead also that the Sullivans have agreed to account to the plaintiff for any loss of profits as a result of any sales undertaken by them in New Zealand. They deny that they purported to cancel the EDA.

[230] The breaches alleged against the Sullivans relate to events in March–April 2014. My view is that after settlement the Sullivans despaired of a working relationship with Mr Morgan, and thought they would try some sales themselves, to keep things going. On 6 March 2014 Mr Sullivan sent an email to Mr Morgan stating that their purchase did not include any of the distribution contracts which were retained by the previous owner, and that they intended to make their "own distribution arrangements". It was noted that the Water Guard trade mark was registered to Sullivan Ltd and as they had not given permission to Morgan Ltd, Mr Morgan should refrain from its use. On 14 March 2014 Mr Sullivan sent another email to Mr Morgan stating:

> I confirm that you do not have any contract with Cynortic Water Systems Ltd. As such we do not recognise your authority to either service, sell or maintain our systems.
>
> I request that you remove any information from your website that suggests any relationship with us and the range of Water Guard products.
>
> Please note that maintenance, alteration removal or replacement of any part of our units by anyone other than our appointed, trained and qualified agents, voids warranty conditions.

[231] These emails were undoubtedly contrary to the terms of the EDA, in that they sought to limit Morgan Ltd's right to use the Water Guard name and exclusively distribute the products in New Zealand. Under cross-examination Mr Sullivan referred to these emails as a "mistake". I will return to this.

[232] Through March and April 2014 there was another act contrary to the terms of the EDA in that Sullivan Ltd directly sold some refurbished stock (which the Sullivans believed they were entitled to do under the agreement to sell).[26] There were also some direct sales of new stock into the rural market. The numbers were limited. It appears there were about three actual sales. The total profit made was $702. These actions in selling the stock were contrary to the provisions of the EDA, and the Sullivans accept that they must account to Mr Morgan for any profits.

[233] While the Sullivans breached the EDA that must be seen in the context of Mr Morgan's hostility and their belief that Mr Morgan planned to set up his own business manufacturing Water Guard units. Further, the Sullivans had reason to believe that Mr Morgan had acted in breach of the EDA in sourcing parts from overseas vendors. Two customers had contacted the Sullivans advising that Mr Morgan had supplied parts that were not sourced under the EDA.

[234] As it happened Mr Morgan protested about the March emails and briefed his solicitors. He proceeded to threaten to obtain an injunction, and then issued proceedings. It would seem that in late April or early May the Sullivans appreciated that they had been acting contrary to the provisions of the EDA by directly selling units. Ultimately by consent, orders were made requiring the Sullivans not to enter into any other distributor agreements in New Zealand and refer all inquiries to Morgan Ltd.[27] In addition there were orders that the Sullivans were not to distribute or sell directly or indirectly Water Guard units.

[235] Later in the year, in a letter of 10 December 2014, Sullivan Ltd sent a letter through its solicitors purporting to terminate the EDA. Mr Morgan then successfully

---

[26] Although they were challenged on this, I accept the evidence of Mr Sullivan that they genuinely thought that they had the right to sell refurbished stock, after Mr Morgan had rejected their proposals to replace defective stock.

[27] *Water Guard NZ Ltd v Cynortic Water Systems Ltd* HC Auckland CIV-2014-404-915, 12 May 2014.

filed and obtained an injunction after a defended hearing to stop action on the purported cancellation on terms that Mr Morgan continued to source product from Sullivan Ltd.[28]

Declarations under the EDA

[236] Morgan Ltd in this first head of claim also seeks declarations defining its rights under the EDA. It seeks declarations from the Court that:

(a) Morgan Ltd is the distributor of Water Guard units under the EDA.

(b) Bragulla Ltd remains liable to Morgan Ltd as manufacturer under the EDA.

(c) Sullivan Ltd does not enjoy any legal or beneficial interest in the rights, title or interests of the manufacturer under the EDA.

[237] The first two declarations are unopposed by any party. They do no more than reflect the terms of the EDA. It is not suggested now by any party that the EDA has been cancelled or is not in effect. Sullivan Ltd consents to (a) and (b). The Bragulla interests have not appeared to oppose (a) or (b). These declarations are granted accordingly. I am not, however, willing to grant the declaration sought at (c).

[238] A declaration is a formal statement by a Court pronouncing upon the existence or non-existence of a legal state of affairs.[29] The proposition that a Court can make a declaration only if there are rights or duties presently owed between the relevant parties was rejected in *Peters v Davison*.[30] While in New Zealand declaratory relief can be granted under the Declaratory Judgments Act 1908, and as a remedy for judicial review, the Court has a stand-alone jurisdiction to grant declarations. The power to grant a declaration in these circumstances is not covered in a specific way in the High Court Rules. It can be seen as part of the Court's

---

28 *Water Guard NZ Ltd v Cynortic Water Systems Ltd* [2014] NZHC 3389.

29 Lord Woolf and Jeremy Woolf *Zamir and Woolf: The Declaratory Judgment* (4th ed, Sweet & Maxwell, London, 2011) at [1–02].

30 *Peters v Davison* [1999] 2 NZLR 164 (CA) at 187.

inherent jurisdiction. The broad nature of the remedy was discussed by Hammond J in *Kung v Country Section NZ Indian Association Inc*:[31]

> This kind of approach is very like the approach of a Court to equitable remedies, the broad question being whether justice requires a declaration. A wide range of factors will then be relevant: whether a plaintiff has a sufficient interest in the proceedings; whether an issue is now moot; and the practical utility of issuing a declaration. And I can see no reason why the so-called traditional equitable defences, or at least the ideas which underlie them, are not also apposite to declarations. To take a simple example, if a plaintiff's conduct has been itself questionable, why should (say) the clean hands doctrine not also apply to declaratory relief?

[239] The remedy is discretionary.[32] There are a number of reasons why I decline to exercise the jurisdiction here.

[240] First, while Sullivan Ltd has no direct interest under the EDA as a party or assignee, I do not consider it can be said that Sullivan Ltd is devoid of any interest under the EDA. Under cl 24 of the BSA all the intellectual property owned by Bragulla Ltd passed to Sullivan Ltd. While the manufacturer under the EDA remained Bragulla Ltd, the intellectual property and manufacturing rights had been sold to Sullivan Ltd. Sullivan Ltd has an interest in the software of the manufacturer, and it has the sole right to manufacture the units in New Zealand. Under cl 2.2 of the addendum the Sullivans have an obligation to supply to Bragulla so that it can meet its obligations under the EDA. The EDA is indeed the central feature of the addendum. More generally the EDA features heavily in the BSA, as the manufacturer's right under the EDA is the main consideration for the large price the Sullivan interests paid pursuant to the agreement.

[241] Sullivan Ltd therefore has an interest and rights in the EDA as the New Zealand manufacturer. If Mr Bragulla was not supplying Morgan Ltd under the EDA, Sullivan Ltd would have rights against Bragulla Ltd to require it to perform its obligations under cl 2.4.2 of the addendum to supply Morgan Ltd in terms of the EDA. In a sense, in the unusual structure Mr Bragulla created, Sullivan Ltd had at

---

31 *Kung v Country Section NZ Indian Association Inc* [1996] 1 NZLR 663 (HC) at 665–666. This statement was made in the context of an application under the Declaratory Judgments Act 1908, but applies to declarations generally.

32 *Guarantee Trust Co of New York v Hannay & Co* [1915] 2 KB 536 (CA) at 572; Woolf and Woolf, above n 29, at [4–01].

least a contractual interest, and perhaps also a fiduciary interest in Bragulla Ltd's performance of the EDA.

[242] Second, there is some relevant history to the declaration sought. Originally, in the first amended statement of claim, dated 11 July 2014, Morgan Ltd sought a declaration that Sullivan Ltd was the assignee of Bragulla Ltd under the EDA (the opposite of its present position). In the second amended statement of claim, dated 12 December 2014, Morgan Ltd pleaded Sullivan Ltd was either the assignee of the manufacturer under the EDA or had an equitable or beneficial interest in the rights, title and interests of the manufacturer (again, the opposite of its present position). Then in the third and fourth amended statement of claim, Morgan Ltd reversed its position. It now submits that the addendum means Sullivan Ltd was not assigned rights under the EDA, and accordingly Sullivan Ltd does not enjoy any legal or beneficial interest in it.

[243] It is clear that this change of position has occurred for tactical reasons. Mr Morgan wants to try and negotiate some arrangement with the liquidator of Bragulla Ltd whereby he takes over the manufacturing, thereby cutting out the Sullivans from the manufacturing process.

[244] It seems to me likely that if Mr Morgan did indeed negotiate such an arrangement with the liquidator of Bragulla Ltd, it could involve him breaching the EDA (although the liquidator may consent to that), and it would also involve him defeating Sullivan Ltd's rights under the BSA. As Mr Fisher put it for Mr Morgan, the Sullivans would have no return for its purchase of the manufacturing business save for its rights against Mr Bragulla (whereabouts unknown) and Bragulla Ltd (in liquidation). Bragulla Ltd's liquidation was the unilateral act of Mr Bragulla, and was no fault of the Sullivans. I do not think a Court declaration should issue to assist Mr Morgan on such a course. It is inappropriate to use the Court's powers to grant tactical declarations for business purposes such as the one sought here.

[245] Third, Morgan Ltd is in my view plainly in breach of the EDA at present. It has placed no meaningful orders for parts or units. Having heard Mr Morgan give evidence, I am satisfied that he does not intend to place any orders. There is no

evidence indicating that he complied with the direction given in the December 2014 injunction that he should buy all parts from Sullivan Ltd. And as noted above, I accept the submission of Mr Marsh that Mr Morgan and Morgan Ltd intend to negotiate with Bragulla Ltd's liquidator in a manner that will defeat the rights of Sullivan Ltd under the BSA. Morgan Ltd's interest in the EDA is undoubted, and is not now challenged by the Sullivan interests. Morgan Ltd seeks the declaration not to establish its interests, but to limit arguments that the Sullivan interests might have against the liquidator of Bragulla Ltd, should Morgan Ltd persuade the liquidator to transfer the manufacturing rights to Morgan Ltd. The ability of the liquidator to do that is not before me and has not been argued, and the declarations sought may have a collateral and unintended function.

[246] All three of these factors point against the grant of declaration (c), and I decline to do so.

Injunctions sought

[247] Further to the declarations, Morgan Ltd seeks an injunction restraining Bragulla Ltd from:

> (a) appointing or purporting to appoint any other person to market or sell or distribute Water Guard filtration systems and associated products or UV water filtration systems or parts associated with the brand name Water Guard to any person in New Zealand or the Pacific Islands or Australia;
>
> (b) assigning or purporting to assign to any other party, the rights, title or interests of the manufacturer under the EDA;
>
> unless authorised expressly by the EDA to engage in such conduct in terms of the EDA, but subject always to the plaintiff being given the option to purchase the rights, title and interests of the manufacturer under the EDA and/or the first option to be the distributor of Water Guard products for part or all of Australia;

[248] Bragulla Ltd has taken no steps to oppose the injunction. Such an order would do no more than exactly reflect the terms of the EDA, and there is no suggestion the EDA has been cancelled or is not in effect. Further, the Sullivan interests, although not the proper contradictor, do not oppose the order or provide

reasons why it should not be granted. Therefore this injunction as sought at pp 6–7 of the fourth amended statement of claim can be granted.

[249] Injunctions are also sought against other defendants later in the statement of claim. It would restrain distributing or selling Water Guard products in New Zealand, Australia, or the Pacific, and marketing Water Guard products for sale in those jurisdictions. These injunctions and other remedies are sought consequent upon findings of liability in tort, and will now be considered.

The economic tort claims

[250] Morgan Ltd claims that Mr Bragulla, Sullivan Ltd, and/or the Sullivans induced Bragulla Ltd to breach the EDA by entering into the BSA. In the alternative it claims they conspired together to injure Morgan Ltd by unlawful means.

Inducing breach of contract

[251] The tort of inducing breach of contract has a long and chequered history. As Hazel Carty describes in her illuminating book on the topic,[33] the tort became shrouded in uncertainty and complexity soon after the House of Lord's seminal decision in *Lumley v Gye*,[34] and it was not until its relatively recent overhaul by the House of Lords in *OBG v Allan* that it has regained coherence.[35] In New Zealand the tort was most recently considered by the Court of Appeal in *Diver v Loktronic Industries Ltd.*[36] The Court referred to the analysis of the tort in *OBG*, and the earlier Court of Appeal decision *Jiao v Barge*,[37] which had embraced the much maligned and now outmoded 'unified theory' of the economic torts. It noted some difference between the *OBG* and *Jiao* formulations, but as nothing turned on the difference it was content to proceed using the *OBG* test that had been adopted by the parties without further discussion of the issue.[38]

---

33 See the discussion in Hazel Carty, *An Analysis of the Economic Torts* (2nd ed, Oxford University Press, 2010) at 30–35.
34 *Lumley v Gye* (1853) 118 ER 749 (QB).
35 *OBG Ltd v Allan* [2007] UKHL 21, [2008] 1 AC 1.
36 *Diver v Loktronic Industries Ltd* [2012] NZCA 131, [2012] 2 NZLR 388.
37 *Jiao v Barge* CA236/05, 19 July 2006.
38 *Diver v Loktronic Industries Ltd*, above n 36, at [31].

[252] The *OBG* formulation has been employed on a number of occasions in the High Court.[39] I consider it the appropriate basis on which to determine liability in this case. The elements of the tort, post-*OBG*, are identified in *The Law of Torts in New Zealand* as follows:[40]

> (1) There must be a legally enforceable contract in existence.
>
> (2) The defendant must have engaged in conduct which in fact induced a breach of the contract.
>
> (3) The defendant must have known that his or her conduct would induce the breach.
>
> (4) The defendant's conduct inducing the breach must have caused loss or damage to the plaintiff.
>
> (5) The defence of justification may arise.

[253] Although it is useful to partition the tort into elements, the essence of the tort was captured by Jenkins LJ in *DC Thomson v Deakin*:[41]

> Direct persuasion, procurement or inducement applied by the third party to the contract breaker, with knowledge of the contract and intention of bringing about its breach …

[254] I examine the issue from the point of view of the Sullivan interests entering the addendum and their position on settlement, which is the focus of the pleading.

[255] Morgan Ltd claims the Sullivan and Bragulla interests each independently breached the EDA on numerous occasions in the November 2013 – May 2014 period. It claims in the inducement to breach contract cause of action, that Bragulla Ltd breached the EDA by:

> (a) transferring its intellectual property to Sullivan Ltd, thereby failing to maintain title to its intellectual property as required by the EDA;

---

39 *Wholesale Distributors Ltd v Songle Supermarket Ltd* [2014] NZHC 2548 at [38] per Moore J; *Cookright Filtering Services Ltd v Wallis* [2013] NZHC 2535 at [21] per Gendall J; *Onyx Bar & Café (Cambridge) Ltd v Jans* [2012] NZHC 948 at [41] per Associate Judge Faire; *ABC Developmental Learning Centres (NZ) Ltd v Artemis Early Learning Ltd* HC Christchurch CIV-2010-409-1198, 25 June 2010 at [44] per French J; *SGS New Zealand Ltd v Nortel (1998) Ltd* HC Whangarei CIV-2006-488-284, 20 December 2007 at [122] per Winkelmann J.

40 Cynthia Hawes "Interference with Business Relations" in Todd, above n 5, 667 at 676.

41 *DC Thomson & Co Ltd v Deakin* [1952] Ch 646 (CA) at 694.

(b) failing to offer Morgan Ltd the option to purchase the manufacturing business or the option to be the distributor of Water Guard products for part or all of Australia, in breach of the EDA;

(c) failing to carry on business as the manufacturer of Water Guard products and otherwise refusing to perform its obligations under the EDA, including its obligation to Morgan Ltd to:

(i) supply parts and spares;

(ii) provide assistance and help; and

(iii) cooperate in all aspects of Morgan Ltd's business; and

(d) purportedly assigning to Cynortic International Ltd the rights, title and interests of the manufacturer under the EDA without giving Morgan Ltd an option to purchase and/or an option to be the Australian distributor.

[256] I accept that in transferring the intellectual property to Sullivan Ltd, Bragulla Ltd failed to maintain title to its intellectual property as required by cl B on page 2 of the EDA. I also accept that in selling the intellectual property, and all the business save for the New Zealand and East African operations, Bragulla Ltd breached its obligation to give Morgan Ltd as assignee the first option to purchase the business. The consent Mr Morgan had given to the transfer of the EDA was for a sale of all the manufacturer's rights to Sullivan Ltd. This did not happen, and the consent cannot be construed as extending to the final BSA as varied by the addendum.

[257] The issue is whether the Sullivans intentionally induced Bragulla Ltd to breach. In order to answer that question it is necessary to consider the nature and extent of the Sullivans' knowledge.[42] As the Court of Appeal held in *Diver*:[43]

> Liability for inducing breach of contract requires the defendant to "actually realise" he or she is inducing a breach of contract. It is not sufficient to

[42] Hawes, above n 40, at 681; citing *OBG Ltd v Allan*, above n 35, at [192] per Lord Nicholls.
[43] *Diver v Loktronic Industries Ltd*, above n 36, at [33].

> know that an act is being procured which, at law or as a matter of construction of the contract, is a breach. Nor is it sufficient that the defendant ought reasonably to have realised that a breach of contract would result.

[258] The Court quoted from the speeches of Lord Hoffmann, Lord Nicholls and Arden LJ in assessing what knowledge is sufficient in relation to the third element. The Court proceeded to analyse a number of New Zealand cases, but its focus was on the issue of wilful or Nelsonian blindness, which is not in issue here.

[259] Of relevance is Lord Hoffman's statement in *OBG* that it is necessary in considering knowledge to distinguish between ends, means and consequences:[44]

> If someone knowingly causes a breach of contract, it does not normally matter that it is the means by which he intends to achieve some further end or even that he would rather have been able to achieve that end without causing a breach. Mr Gye would very likely have preferred to be able to obtain Miss Wagner's services without her having to break her contract. But that did not matter. Again, people seldom knowingly cause loss by unlawful means out of simple disinterested malice. It is usually to achieve the further end of securing an economic advantage to themselves. As I said earlier, the Dunlop employees who took off the tyres in *GWK Ltd v Dunlop Rubber Co Ltd* 42 TLR 376 intended to advance the interests of the Dunlop company.
>
> On the other hand, if the breach of contract is neither an end in itself nor a means to an end, but merely a foreseeable consequence, then in my opinion it cannot for this purpose be said to have been intended. That, I think, is what judges and writers mean when they say that the claimant must have been "targeted" or "aimed at". …

[260] Mr Fisher for Morgan Ltd submitted that the Sullivans knew about the EDA and its terms and by entering into the addendum they intended Bragulla Ltd to breach the EDA for their own ends. He pointed to the evidence concerning the parties' intention at the time the addendum was entered into which suggests, in his submission, that the Sullivans intended to cause a breach of the EDA.

Assessment of whether the tort has been proved

[261] It is true that a legal analysis of the position of the Sullivans would have revealed that by entering the addendum and bifurcating elements of the business the Sullivans were breaching the EDA. It is also true that they knew of the EDA and had read it. However the impression I had when I heard their evidence was that

---

44 *OBG Ltd v Allan*, above n 35, at [42]–[43].

neither of them had read it closely. I entirely believe their evidence that neither of them thought that in signing the addendum they were so altering the assignment as to create a breach of the EDA.

[262] The clearest demonstration of this is the addendum itself. I agree with Mr Marsh's submission the terms of the addendum clearly show that it was intended by the parties that Bragulla Ltd would continue to meet its obligations to Morgan Ltd under the terms of the EDA. It was a specific requirement under the terms of that addendum that Bragulla Ltd would retain its rights "and obligations" under the EDA and that parts would be supplied so that the Bragulla Ltd "can fulfil its obligations under the EDA". Thus, on its plain words the addendum contemplates the EDA remaining in place and enforceable as between the Bragulla Ltd and Morgan Ltd.

[263] I accept Mr Sullivan's evidence that when part of cl 2.3 of the addendum was removed, the intention was not to defeat Mr Morgan's exclusive distributorship arrangement. Rather Mr Sullivan believed that under cl J on p 3 of the agreement, the manufacturer could sell units if the distributor did not want to purchase them from Bragulla Ltd. Mr Sullivan stated that Mr Morgan had made it quite clear he did not wish to purchase any, or take any refurbished machines from Bragulla Ltd, and Mr Sullivan thought that this meant that refurbished machines could be sold by Sullivan Ltd without breaching the agreement.

[264] I consider that he sincerely held the view that by deleting the last part of cl 2.3, he was keeping open the rights under the clause rather than defeating the rights of Morgan Ltd, despite the fact that it is far from clear that his interpretation of the clause was correct.

[265] The Sullivans in my view are persons who by instinct wish to observe the law and their obligations. They entered into the addendum not to spite Morgan Ltd or defeat its interests. They envisaged, rather, that its rights as distributor under the EDA would be unaffected. They intended to create a buffer between them and Mr Morgan so that they did not have to deal with him. That was the Sullivans' end goal. With their focus squarely trained on going forward with practical solutions to

the deadlock as suggested by Mr Bragulla, it is no surprise they overlooked the legal consequences of those solutions.

[266] This analysis is supported by the wider context. As I have noted elsewhere, the early correspondence showed that they tried very hard to form a working relationship with Mr Morgan. Throughout December and onwards as the relationship deteriorated with Mr Morgan they did no more than respond (without committal) to Mr Bragulla's suggestions. In late January and February the Sullivans tried to meet with Mr Morgan to try find a way forward. This does not show any desire at the time to induce a breach of the EDA. Quite the contrary.

[267] After the agreement was settled the Sullivans did act in a way that could be interpreted as showing an intention to defeat Mr Morgan's interests. In March they sent the letters seeking to prevent Morgan Ltd from trading, and told Mr Morgan to stop using the name Water Guard and to stop distributing Water Guard units. They had no right to do this. But the situation had stalemated by then. Mr Sullivan was acting in a desperate and naïve way to try and unlock an impasse. He backed down from this position when Mr Morgan protested, and when he received legal advice. I accept his claim that the sending of the letters in March was a reactive mistake.

[268] I accept that apart from these aberrations, including their misguided effort to terminate the EDA in December 2014, born of frustration at Mr Morgan's hostility and refusal to deal with him or to place orders for any units or parts, they were prepared to honour Morgan Ltd's position as exclusive distributor in New Zealand. Indeed, the December notice of termination was sent on the basis that they were bound by the EDA. It was not proceeded with. As Mr Sullivan pointed out, it was in the end entirely in their interests to see Mr Morgan succeed. If this happened they would sell more units and more parts.

[269] Similarly I do not regard the few sales that they effected after March 2014 as indicating that they had an intention to sell in breach of the EDA at the time they settled the agreement. The later letter that they sent to Cynortic International Ltd seeking permission to distribute product in the New Zealand market I see also as a

reactive and frustrated response to the complete lack of orders for even parts by Mr Morgan.

[270] I also record that I am satisfied that the Sullivans did not participate in the transfer to Cynortic International Ltd, and that this was a half-baked scheme concocted entirely by Mr Bragulla.

[271] In the end from Mr Morgan's perspective nothing changed practically as a consequence of the addendum. He remained the exclusive distributor in New Zealand with an exclusive right to source all Water Guard systems and parts. In fact he chose not to order parts under the EDA and to access parts elsewhere. The Sullivans' later actions after the agreement was settled as their relationship with Mr Morgan deteriorated were reactive and not indicative of any earlier plan to defeat Mr Morgan's interests.

[272] Therefore the tort was not committed by the Sullivan interests. They had some knowledge of the EDA, but no intention to breach it.

Unlawful means conspiracy

[273] It was stated by the Court of Appeal in *Wagner v Gill* that the following elements need to be satisfied for this tort to arise:[45]

(a) the existence of a combination;

(b) unlawful action (unlawful means);

(c) intention to injure the claimant; and

(d) actual damage to the claimant.

[274] Mr Fisher submits there was a conspiracy between any two of the defendants to injure Morgan Ltd by amongst other things unlawfully inducing Bragulla Ltd to sell its intellectual property rights to Sullivan Ltd. The combination is said to have

[45] *Wagner v Gill* [2014] NZCA 336, [2015] 3 NZLR 157 at [50].

targeted Morgan Ltd, with the intention of depriving Morgan Ltd of its rights as exclusive distributor under the EDA.

[275] For the reasons I have already set out, I do not consider that the Sullivans intended to injure Morgan Ltd when it settled the BSA as varied by the addendum. Indeed, my analysis of the correspondence shows that there was very little conferral between the Sullivans and Mr Bragulla. Mr Bragulla was a law unto himself and did what he wanted, save for their agreement that through the addendum they would leave Mr Bragulla in place as a buffer between them and Mr Morgan. I do not consider that the Sullivans conspired to do anything with Mr Bragulla. Certainly I do not consider that they sought with him to injure Mr Morgan.

[276] I note in particular the Court of Appeal in *Wagner v Gill* stated:[46]

> On balance, our preference would be to retain the requirement that the conduct must be directed at the claimant. …

[277] I accept Mr Sullivan's evidence that (save for occasions of temporary reactive behaviour) his general wish was to see Mr Morgan succeed and for him to sell a lot of units. That sentiment is consistent with the bulk of the Sullivan's behavior and with their best interests as manufacturer of Water Guard products. I have no doubt that if Mr Morgan had communicated with the Sullivans, and purchased parts from them and proceeded to purchase units when his supply ran out, that the Sullivans would have happily continued to deal with him. Having heard Mr Morgan give evidence and considered Mr Marsh's submission, I accept that Mr Morgan has not for some time had any intention of ordering units under the EDA, and I consider that he has been importing parts from China and other places in breach of the EDA. It has been his agenda to not deal with the Sullivans that has been the root cause of the problems between them. Their wish at the relevant time was for him to start ordering from them. There was no conspiracy to harm Mr Morgan.

[278] I received no submissions on the issue of whether Mr Bragulla could be liable for conspiracy, or indeed inducement to breach contract, with Bragulla Ltd alone. Whether such liability might arise may not be a straightforward question, but in any

---

[46] At [106] (footnote omitted).

event may be moot. Since this is an interim judgment, and in case Morgan Ltd might wish to pursue it, I expressly do not determine that issue, and reserve it for further argument if required.

Fair Trading Act claims

[279] It is also pleaded that the defendants have each breached the Fair Trading Act by misleading Morgan Ltd into declaring the MMA unconditional. In the end there is no relief sought against the Sullivans and Sullivan Ltd under this head.

[280] For reasons I have already given, I would have granted no relief. I have already dealt with the claims against the Bragulla Ltd and Mr Bragulla. I reject the claims save in respect of the three specified defects.

Conclusion on the Bragulla/Sullivan proceeding

[281] Sullivan Ltd (Cynortic Water Systems Ltd) and the Sullivans have admitted that they should account to the plaintiff for the loss of any profits as a result of any sales undertaken by them in New Zealand. The sum in question is very small, as there were only a few sales over a short period. Sullivan Ltd consents to an account of profits for sales by it and has nominated a sum it will pay. Any remaining issues as to quantum in that regard can be dealt with at the damages hearing.

[282] However, save for this admission, no claim has been made out against Sullivan Ltd or the Sullivans. I refuse to grant a declaration that the first defendant (Sullivan Ltd) has no interest in the EDA. The claims for inducement to breach contract, conspiracy and the Fair Trading Act claims against Sullivan Ltd and Mr and Mrs Sullivan fail. In so far as there may be tortious claims that relate to an inducement to breach contract or conspiracy between Mr Bragulla and Bragulla Ltd, leave is reserved for an application to have a further hearing on that topic if necessary.

[283] While Mr Bragulla is not liable for the misrepresentations as to sales, he is nevertheless liable under the Fair Trading Act in respect to his misrepresentations of quality (in that there were the three defects).

[284] Bragulla Ltd (Cynortic Ltd) is also liable for the same misrepresentations. In addition, as one of the parties to the EDA Bragulla Ltd is liable to Morgan Ltd for breaches of that contract. As I have outlined, the EDA was breached in that there was ultimately a sale to Sullivan Ltd on terms not agreed to by Mr Morgan and in breach of the obligation not to sell the manufacturing business, and there was also a transfer of some of the intellectual property to Sullivan Ltd. However, it is far from clear to me that any loss has been suffered as a consequence, but since an inquiry as to damages has been sought and I have not had full submissions on the issue, I adjourn the question of any loss arising for a further hearing, if necessary.

[285] I do not consider the claims brought against Cynortic International Ltd under the Fair Trading Act and in tort have merit. Cynortic International Ltd did not exist when Mr Bragulla made the misrepresentations of quality, and there was no evidence given at the hearing that Cynortic International Ltd had conspired to injure Morgan Ltd by unlawful means. However, as I set out in the next paragraph I do declare that Bragulla Ltd, not Cynortic International Ltd, remains liable to Morgan Ltd as manufacturer under the EDA. There is no evidence of any act or novation discharging Bragulla Ltd's contractual liability.

[286] I make the following orders and declarations:

(a) An injunction restraining the third defendant, Bragulla Ltd from:

(i) appointing or purporting to appoint any other person to market or sell or distribute Water Guard filtration systems and associated products or UV water filtration systems or parts associated with the brand name Water Guard to any person in New Zealand or the Pacific Islands or Australia;

(ii) assigning or purporting to assign to any other party, the rights, title or interests of the manufacturer under the EDA;

unless authorised expressly by the EDA to engage in such conduct in terms of the EDA, but subject always to the plaintiff being given the

option to purchase the rights, title and interests of the manufacturer under the EDA and/or the first option to be the distributor of Water Guard products for part or all of Australia.

(b) A declaration that the plaintiff is the distributor under the EDA.

(c) A declaration that the third defendant, Bragulla Ltd, remains liable to the plaintiff as manufacturer under the EDA.

Result

[287] Liability is established as set out in [204]–[206] and [281]–[286] above.

[288] There is to be an inquiry into damages in respect of the claims where liability is established.

[289] Costs are reserved.

[290] I direct a telephone conference after 14 days to discuss:

(a) A timetable for submissions on costs.

(b) A timetable for a damages hearing.

[291] If a party so requests, that may be a face to face conference.

……..

Asher J

Solicitors/Counsel:
M Fisher, Auckland.
D Grove, Auckland.
Saunders Robinson Brown, Christchurch.