

*Under the Employment Relations Act 2000*

**BEFORE THE EMPLOYMENT RELATIONS AUTHORITY  
AUCKLAND OFFICE**

**BETWEEN** Stacey Hogan (Applicant)  
**AND** Graham & Keys Limited (Respondent)  
**REPRESENTATIVES** Brett Vautier for Applicant  
Jerry Noble for Respondent  
**MEMBER OF AUTHORITY** Vicki Campbell  
**INVESTIGATION MEETING** 7 July 2006  
**SUBMISSIONS RECEIVED** 21 and 28 July 2006  
**DATE OF DETERMINATION** 21 September 2006

DETERMINATION OF THE AUTHORITY

**Employment relationship problem**

[1] Mr Stacey Hogan claims he was unjustifiably dismissed by his employer Graham & Keys Limited (“G & K”).

[2] Mr Hogan says he was employed by the company as an employee on 1 April 2004 when he also became a shareholder and director of the company. Mr Hogan says he was employed on the basis of a salary of \$8,518.00 payable monthly but that there was no written employment agreement.

[3] He says that on 20 December 2004 he was removed as a director of the company and required to hand over his keys and leave. He says this amounted to a dismissal and is unjustified. He seeks remedies including lost wages, compensation for hurt and humiliation and costs.

[4] In response G & K say Mr Hogan was not an employee, rather he was one of three director/shareholders who received monthly drawings to be reconciled at year end with profit earned from the clients of the company. Therefore the Authority has no jurisdiction.

[5] The issues for this determination:

- What was the real nature of the relationship between Mr Hogan and G & K?
- If he was an employee – was Mr Hogan unjustifiably dismissed?

### **The tests**

[6] The nature of employment relationships is governed by section 6 of the Employment Relations Act 2000. The issue for the Authority is whether the evidence establishes the existence of a contract of or for services, when it is viewed in its totality (see *Smith v Practical Plastics Ltd*, [1998] 1 ERNZ 323).

[7] The tests applicable to establishing the real nature of the relationship include consideration of :

- analysis of the terms and conditions which the parties have agreed to;
- the intention of the parties – although this is not decisive;
- analysis of the historical control, integration tests and the fundamental test (which examines whether a person is performing the services on their own account); and
- industry practice.

(*Curlew v Harvey Norman Stores (NZ) Pty Ltd* [2002] 1 ERNZ 114; and *Koia v Carlyon Holdings Ltd* [2001] 1 ERNZ 585; *Bryson v Three Foot Six* [2003] 1 ERNZ 581 (EC) and *Bryson v Three Foot Six*[2005] 3 NZLR 729 (SC).

### **Background**

[8] From 1990 to 2002 Mr Hogan operated his own business as a sole trader providing architectural design services to his clients. In 2002 he formalised his business structure and registered his company “The Design Office Limited” with the Companies office. Mr Hogan told me that during the time he operated as a sole trader and then as a limited liability company he generally employed from 2-4 employees. Mr Hogan had his own accountant during that period and he continued to use his own accountant during the period of his involvement with G & K.

[9] From 2001 the directors of G & K were Mr Brian Keys, and Mr Antonius Peters and his wife Mrs Catherine Peters. They were also shareholders of the company.

[10] It is common ground that in November 2003 Mr Hogan, Mr Keys and Mr Peters commenced negotiations regarding the possible merging of The Design Office Limited and G & K. Mr Keys had indicated his intention to retire from the company in November 2005 and therefore,

the directors were looking for an additional partner who could continue to work in the business with Mr Peters, following Mr Keys retirement.

[11] Mr Hogan discovered G & K was looking for another partner for the business when he visited Mrs Keys hardware company and she advised him of the opportunity. Mr Hogan then met with Mr Keys.

[12] In December 2003 valuations of both businesses were sought to assist in the finalisation of a share price to enable the merging of the companies to take place. Valuation documents had been completed and were received by March 2004. There were a number of outstanding matters relating to the valuation of Mr Hogan's business. Notwithstanding the outstanding issues, an agreed price of \$130,000 (\$65,000 for Mr Peters' shares and \$65,000 for Mr Key's shares) was struck in March.

[13] In August 2004 transfer forms were completed and lodged with the Companies office registering Mr Hogan both as a shareholder and as a director. The effective date is recorded as 1 April 2004.

[14] It was common ground that the formalisation the share price and the value of contribution of Mr Hogan's business were not completed until about August 2004. Mr Hogan paid Mr Peter's his \$65,000 in October 2004.

### **What was the real nature of the employment relationship?**

*Analysis of the terms and conditions which the parties have agreed to*

[15] There were no written agreements between the company or any of the three shareholders evidencing the nature of their relationship after 1 April 2005. This is in contrast to "employees" engaged by G & K who had written individual employment agreements.

[16] When entering into his arrangements with G & K it was agreed that Mr Hogan would pay a specified amount of cash in addition to the value of his business which was to merge with G & K's business. It was agreed that the cash value would be \$130,000. In return for entering into this arrangement it was agreed Mr Hogan would work within the business and receive a 1/3<sup>rd</sup> share of the profits.

[17] During the period of his involvement with G & K, Mr Hogan received a monthly payment of \$8,518,00. Mr Hogan told me he received that amount after tax. Mr Hogan told the Authority that the payment was his salary and that he was an employee. He relied on a document entitled "Resolution of Directors" dated 31 August 2004 to support his view that he was an employee. The resolution he relied on states:

The appointment of all shareholders and Directors as employees of the company or contractors to it for the year ending 31 March 2005 is approved and confirmed.

[18] Other resolutions included in the 31 August 2004 document included a resolution to pay shareholders and directors remuneration (defined in the resolutions as including directors fees, salaries, wages, bonuses, commissions and management fees) which was not to be less than the net profit of the company. The resolutions stipulated that in addition, all drawings taken during the year ended 31 March 2005 were to be counted as part payment of the remuneration.

[19] The resolutions are not determinative in this matter. The resolutions refer to shareholders and directors as being either employees or contractors and remuneration was defined widely to incorporate any form of income from the business.

[20] Both Mr Peters and Mr Keys told the Authority that it was agreed that the money paid to Mr Hogan on a monthly basis was not salary, it was drawings, and was not net but was a gross amount with Mr Hogan liable to make his own tax arrangements. Mr Peters told me Mr Hogan received monthly drawings at the same level as he did, as agreed, and that it was always made clear to Mr Hogan that the drawings were an early payment of projected profits. Mr Peters and Mr Keys were unequivocal in their evidence that the payment of income tax was Mr Hogan's responsibility, just as they were responsible for their own tax. I accept the evidence from Mr Peters as it accords with the documented evidence produced to the Authority through accounting records and correspondence from G & K's accountant to Mr Hogan regarding Mr Hogan's tax arrangements.

[21] The Annual Accounts for the year ended 31 March 2005, in particular the "Current Account" record, shows that drawings received by each director for the year, were deducted from, among other items, a "salary" figure listed in the accounts for each director. Both Mr Peters' and Mr Hogan's drawings were in excess of the stated salary and this is shown in the accounts as an asset (as the money is owing to the company as Mr Hogan and Peters had overdrawn their current account and could be required to pay the money back to the company).

[22] On or about 20 October 2004 the Accountant for G & K emailed Mr Hogan and advised him about provisional taxes due to be paid in November 2004. Provisional tax is usually payable where the income is not taxed at source. In his email Mr Tizard explained to Mr Hogan that he will need to speak with his accountant about what he should be paying by way of provisional tax. No issue was taken by Mr Hogan regarding this advice.

[23] I am satisfied that Mr Hogan was at all times aware that he was not in receipt of “salary” payments. Copies of statements from the IRD show that Mr Hogan was required to pay provisional tax during his time with G & K. Mr Hogan told the Authority that he had his own accountant working for him during this time and that he relied on the accountant to provide the best tax advantage for him. This is a benefit not usually available to employees.

[24] In early December 2004, Mr Keys wrote to Mr Hogan expressing his disappointment that Mr Hogan had failed to pay to Mr Keys the agreed \$65,000 (he had paid Mr Peters his \$65,000 in October). In his letter Mr Keys outlines some proposals which may be available if Mr Hogan was unable to come up with the money to finalise the purchase of his share of the business. One of the proposals includes Mr Hogan being put on wages. In his letter Mr Keys points out that Mr Hogan had been paid drawings over the previous eight month period at the same rate as Mr Keys without completing the purchase of the shares.

[25] On receipt of Mr Keys letter, Mr Hogan sought legal advice. A letter was prepared by Mr Hogan’s lawyer and forwarded to Mr Keys on 10 December 2004. The letter refers to a meeting held on 6 December 2004 where Mr Hogan was advised by Mr Peters and Mr Keys that they no longer wished to have him involved in the business. There is no reference in the response letter to suggest Mr Hogan was anything more than a working director/shareholder and was in receipt of drawings as a 1/3<sup>rd</sup> partner of the firm. Neither does the response letter take issue with Mr Keys’ suggestion that the relationship between G & K be altered and for Mr Hogan to be put on “wages” instead of receiving monthly drawings.

[26] It seems that in December 2004 Mr Hogan did not consider himself to be an employee. If he had, I would have expected to see questions raised about Mr Keys belief that Mr Hogan was on anything other than “wages” and why Mr Keys believed that putting Mr Hogan on “wages” was an option.

*Intention of the parties*

[27] On 23 February a document setting out the basis of an agreement between Mr Keys, Mr Peters and Mr Hogan was drafted. This document indicates that in February 2004 the intention of the parties was that Mr Hogan would purchase 1/3<sup>rd</sup> of a share of G & K and likewise Mr Keys and Mr Peters would each purchase a 1/3<sup>rd</sup> share of The Design Office Limited. In practice that was to be achieved through The Design Office Limited becoming part and parcel of G & K. The value of goodwill and future work of The Design Office Limited was used as part payment of Mr Hogan's 1/3<sup>rd</sup> share in G & K with the balance being made up by equal cash payments to Mr Keys and Mr Peters.

[28] It was also agreed that Mr Hogan's contracting draftsman would join the merged firm, however, that did not eventuate.

[29] On 20 February 2004, Mr Keys wrote to Mr Hogan outlining an estimate of the potential income for the business for the following two years, 2005 and 2006, being \$1.75m. The primary purpose of the letter was for Mr Hogan to present to his bank. In a note attached to the letter Mr Keys states that the amount of \$1.75m would be physically difficult to achieve and a more likely figure would be \$1.2m. On the basis of the \$1.2m divided by the three shareholder/directors and multiplied by 55.8% (presumably accounting for overheads such as employee salaries etc) the expected income for each of the shareholder/directors would be \$223,200 each.

[30] It was a requirement of the merger that Mr Hogan achieve registration as an Architect. This was necessary so that Mr Hogan could sign off plans and reports. Under the rules of the New Zealand Institute of Architects only registered Architects are able to sign off such documents. It was also a requirement for the business insurance policies applicable at the time. The major reason behind Mr Hogan's merger with the business was to allow Mr Peters and Mr Hogan to take over the business in November 2005 when Mr Keys retired. By November 2005 Mr Hogan need to be in a position where he could meet the obligations of the business in relation to the rules of the New Zealand Institute of Architects and its insurance policies.

[31] I am satisfied that the intention of all three shareholder/directors was that they would work and share equally in the profits of the business.

*Control*

[32] When jobs came into the business they would be assigned to either Mr Peters, Mr Keys or Mr Hogan. The director was then responsible for the design work and for the management of the project through to completion. Mr Hogan told me in relation to his work, that until about June or July 2005 he was involved in one major project. He says he was doing this work on behalf of Mr Keys as it was Mr Keys' client. Mr Keys says that he provided work to Mr Hogan because the promised work from Mr Hogan's business never eventuated.

[33] Mr Hogan did confirm that when clients came directly to him they were clients that had been clients of his company, prior to the merger. Likewise the clients that went directly to the other partners were their clients, which they, also, had bought into the business. When Mr Hogan left the business he was advised that he was entitled to take his own clients and any equipment with him.

[34] Mr Hogan also told me that he was required to work set hours and that if he wished to start late or finish early he was required to ask permission. He gave one example where he says he was reprimanded for going home early. Mr Keys denies he reprimanded Mr Hogan – he says he may have asked where he was, but it would not have been done as a manager reprimanding an employee. Mr Keys says the directors all worked, and were expected to work, normal business hours.

[35] Mr Hogan told the Authority that Keys exerted control over his work and over the business operations as a whole. In support of that contention he described an incident where he had made a suggestion that the business purchase a new photocopier. Mr Hogan says Mr Keys made the decision that the business would not do so, even though Mr Peters agreed with Mr Hogan that they should. Mr Keys says that the suggestion came following a discussion by the three directors of a need to put a cash injection into the business. Mr Keys says it wasn't prudent to purchase a new photocopier when cash was needed for the business. Mr Peters didn't agree with Mr Hogan's version of events. He told the Authority that while he agreed the business needed a new photocopier, there were more pressing priorities and so he agreed with Mr Keys that it wasn't a good time to be purchasing a new photocopier.

[36] Contrary to Mr Hogan's view, Mr Peters told the Authority that as far as he was concerned the business wasn't run by one director. He said all three directors were involved in the decision making process and each had an equal say.

[37] Mr Hogan also gave evidence that he was told regularly that all his work had to be signed off by Mr Peters or Mr Keys. Mr Keys says he and Mr Peters did raise concerns with Mr Hogan about presenting plans and reports to clients before they had been signed off by either of them and that these concerns were raised at every directors meeting held with Mr Hogan. Mr Keys said, and I accept, that having a registered Architect sign off plans and reports was necessary to meet the rules of the New Zealand Institute of Architects. Mr Hogan was not a registered Architect and therefore could not sign off plans or reports.

[38] I accept that the requirement for Mr Peters or Mr Keys to sign off plans and reports due to their registered status, is quite different to a situation where Mr Hogan's work was being supervised by a more senior person in the firm and to whom he had a reporting relationship. Indeed the evidence shows that Mr Hogan, worked for a number of clients without any supervision. Also, as the director responsible for staffing matters, he worked through a disciplinary process which resulted in dismissal of an employee. The decision to dismiss was made by Mr Hogan as a director of the business.

[39] I find that the relationship between the three directors was at all times as equals in the business with equal rights to decision making which was generally done on the basis of a consensus by all three directors. I accept the submissions from Mr Noble that it would not be unusual for there to be implicit agreements as to the hours each director would work and the effort each would put in to the business.

[40] I am satisfied that Mr Hogan worked autonomously with the exception that he could not sign off of plans and reports. This arose not as a result of Mr Hogan being supervised by Mr Keys or Mr Peters, but as a direct result of his failure to become registered.

#### *Integration test*

[41] The question for the Authority is whether Mr Hogan was employed as part of the business and whether his work was an integral part of the business compared with contract for services where the work is not integrated but is only an accessory to it.

[42] I am satisfied that the evidence strongly points to Mr Hogan's work being an integral part of the business. However, that conclusion is not determinative, I would expect Mr Hogan's work for the business to be integral if he was a working director.

*Fundamental test*

[43] I have already traversed the evidence relating to the payment of tax on the drawings received by Mr Hogan. While tax status can be an indication of what a person intends his contractual relationship to be, in Mr Hogan's case the evidence as to his tax status is not conclusive.

[44] Up until 1 April 2004 there is no dispute that Mr Hogan was in business on his own account. He employed staff and contractors within his business and took the risk in doing so. I am satisfied that after 1 April 2004 Mr Hogan continued to be in a position where he could direct the fortunes of the business. He invested the goodwill of his own business together with \$130,000 of his own money into G & K. In return it was up to him (in concert with the other directors) to bring work into the firm. His drawings were reconciled against his share of the profits made by the company in the same way as the other directors. Mr Hogan accepted at the investigation meeting that if the business did not generate profits he would not get paid. It follows then, that if the business generated profits to the extent referred to by Mr Keys in his note of 20 February 2004, Mr Hogan stood to gain considerably over and above the drawings he had received.

[45] I conclude that Mr Hogan had a degree of responsibility in the investment and management of the business. I have also concluded that he had the opportunity of profiting from sound management in the performance of the business's day to day functions.

*Industry Practice*

[46] It is not uncommon for professional firms to be run by way of a partnership. Of course in this case the legal entity was a properly registered limited liability company. No evidence was given as to the industry practice in these circumstances.

**Determination**

[47] G & K was a registered limited liability company and not a partnership. I have been guided by *Godsalve v Allerby Real Estate Limited* (1998) NZELC 98, 482, where, in similar circumstances, Colgan J, (as he was then) found that while:

... the claim that shareholders and directors of companies are also in partnership rests uneasily with conventional and statutory notions of partnership arrangements it does not follow that their relationship must thereby have been of another sort.

[48] Following the courts reasoning in *Godsalve v Allerby Real Estate Limited* I prefer to find that the informal day to day operating relationships at G & K was in the nature of a partnership and not one of employment.

[49] In light of the facts, measured against the established principles, I find the real nature of the relationship was not a contract of service, Mr Hogan was not an employee of G & K. I am unable to be of any further assistance to him.

### **Costs**

[50] Costs are reserved. The parties are directed to attempt to resolve the question of costs between them. If they can not do do they are to file and serve submissions on the subject and the matter will be determined.

Vicki Campbell  
Member of Employment Relations Authority