Determination Number: AA 164/06
File Number: AEA 1166/05

Under the Employment Relations Act 2000

BEFORE THE EMPLOYMENT RELATIONS AUTHORITY
AUCKLAND OFFICE

BETWEEN	Karen Hormann (Applicant)
AND	Virtual Warehouse Limited (Respondent)
REPRESENTATIVES	Lewis Turner, Counsel for Applicant Peter Davey, Counsel for Respondent
MEMBER OF AUTHORITY	Robin Arthur
INVESTIGATION MEETING	9 March 2006
SUBMISSIONS	16 March 2006 (Applicant); 4 April 2006 (Respondent); 21 April 2006 (Applicant in reply); and 1 May 2006 (Respondent in reply)
DATE OF DETERMINATION	10 May 2006

DETERMINATION OF THE AUTHORITY

[1] This matter concerns employment relationship aspects of what is also a commercial dispute between the applicant – the respondent's minority shareholder – and the respondent's chief executive, Joanne Holley – its majority shareholder and sole director.

[2] The applicant is employed as the respondent's financial controller. She seeks declarations as to whether she is owed certain sums for wages and holiday pay said by the respondent to have been foregone as part of an agreement to purchase shares, whether she is entitled to other accumulated holiday leave said by the respondent to be in excess of her entitlement, and whether she was treated fairly on her return to work following maternity leave. She seeks orders for the unpaid salary claimed and compensation for hurt and humiliation.

[3] She remains employed by the respondent, for whom she has worked since 1999, but has not attended work since 25 August 2005, taking what she has described as stress leave. A doctor's note dated 1 December 2005 says the applicant is "generally in good health" and there are no concerns about her working provided her issues with the respondent and Ms Holley were resolved.

[4] The parties attended mediation twice before the investigation meeting. At the close of the investigation meeting, I encouraged the parties to continue to endeavour to resolve the issues between them rather than wait for the Authority to issue a determination. Subsequently, at the request of the respondent, I issued a direction to mediation. The minute containing the direction repeated a concern I had expressed to the parties at the investigation meeting. Any determination of this Authority can only deal with some of the issues for the business in which the applicant and Ms Holley are both senior employees and business partners. There is a real risk that a protracted

dispute could cripple the business in which they both have considerable investments of time and money. Further expensive litigation may follow. The livelihoods of the two other staff employed by the respondent are also at stake.

[5] The parties have since attended further mediation without resolving the issues between them. Having now received final submissions from their representatives, this determination may be issued.

The investigation

[6] Witness statements were provided by the applicant; Ms Holley; the respondent's finance associate, Heather Hopkins; its customer care manager, Ruth Horsfall; and its accountant Paul McCormick, a partner of the chartered accountancy firm Grant Thornton. The witnesses answered questions put by the Authority and the parties' respective counsel. Closing submissions were provided in writing.

The issues

[7] The issues for resolution in this determination include:

(i) whether the applicant is owed the sum of $118,038 for salary and holiday pay accrued to 30 June 2003; and

(ii) whether the applicant is owed for holiday entitlements accrued after 1 July 2003; and

(iii) whether, if salary and holiday pay are owed, any interest should be awarded on those amounts; and

(iv) whether the respondent breached its duties as the employer of the applicant on her return to work from maternity leave in April 2005 (part time) and in August 2005 (full time), and if so, whether any orders and other remedies ought to be made.

The share agreement

[8] In order to determine whether the applicant is owed salary and holiday pay accrued to 30 June 2003, I must make some findings on the nature and terms of arrangements made during 2003 for the the applicant to buy shares in the respondent.

[9] The applicant accepts that she removed accrued salary owed to her from the company's books shortly after arrangements were made for her to take up a 25 per cent shareholding. However she says there was no agreement or understanding that this amount was "lost to us forever". Rather she says she expected this "debt" would be made good in due course if the business recovered sufficiently to do so. She says she would not have paid that amount for the shares as they had no value at the time.

[10] The respondent says that there was an agreement made orally on or around 20 June 2003 to rescue the business. It had demands from creditors and some of its existing shareholders were themselves in financial difficulty, with one in liquidation. Ms Holley and Ms Hormann, assisted by Mr McCormack, agreed on a number of arrangements which would result in Ms Holley owning 60 per cent of the shares and Ms Hormann owning 25 per cent of the shares. The other 15 per cent of shares would continue to be held by an existing shareholder but Ms Holley would have an option to buy those shares for a nominal amount so she would effectively control 75 per cent of the shares.

[11] This agreement included both Ms Holley and Ms Hormann forgoing accrued unpaid salary and holiday pay entitlements. From December 2001 the company had not been able to pay their wages due to cash flow problems. In June 2003 the proportion of salary owed was used to determine the proportion of shareholder advances which would be reassigned from existing

shareholders to the two women.

[12] The applicant submits that the respondent's version of events is utterly at odds with the reliable evidence and that it was "*inherently unlikely*" that she would have agreed to give up the accrued salary and holiday pay for "*worthless shares and without a shred of documentation*".

[13] Having heard from the witnesses and carefully reviewed the documents provided, I disagree. For the following reasons, I find on the balance of probabilities that the applicant did make the agreement as described by the respondent.

[14] The strongest factor is the applicant's subsequent conduct. In July 2003 while finalising the company's financial statements for the year ended 31 March 2003, the applicant personally made journal entries in the accounting system reversing out wages accrued for her and Ms Holley as at 31 March 2003. She then made further journal entries reversing out accrued wages for the two women for the months of April, May and June 2003.

[15] I accept as reliable the evidence of Ms Hopkins that Ms Hormann told her at the time that this was part of an arrangement to purchase shares in the company whereby Ms Hormann would have a 25 per cent stake and Ms Holley would eventually have 75 per cent.

[16] I do not accept Ms Hormann's evidence that the accrued wages and holiday entitlements were removed only because they "*represented a significant liability on the books*" or made an "*unattractive picture*" in the financial statements. She is a qualified accountant. I do not accept that if it were intended that these amounts would continue to be a liability of the company that she would not have properly accounted for this in the company's books.

[17] Further evidence relating to Ms Hormann's subsequent conduct are documents she produced on 31 October 2004 and on 1 August 2005 where she refers to "forgone" wages. Neither document suggests an ongoing liability of the company for those amounts.

[18] As late as 7 August 2005, when Ms Hormann had expressed dissatisfaction with the future of the company and was asked by Ms Holley to say what she wanted, Ms Hormann's suggestions on her entitlements did not include payment of the wages foregone in June 2003. That claim did not emerge until a letter written on 25 August 2005.

[19] I also do not accept her argument that the shares were worthless at the time of the June 2003 agreement. That argument is made to impugn the notion that she would have agreed to forgo the amount of money that she did for the shares. It is not the Authority's role to judge the quality of the bargain made but the facts show it was sufficiently beneficial such that it was more likely to have been made, rather than as unlikely as the applicant suggests.

[20] Ms Hormann had been interested in investing in the company for some time. In December 2001 she provided the company with an unsecured loan of $50,000 and discussed a shareholding. In January 2002 she signed a heads of agreement which included her agreement to purchase 17.5 per cent of the shares for $60,960, capitalising the $50,000 loan and pay the balance by the middle of that year. She would also have an option to purchase further shares at a set price and become a director. That agreement was not fully implemented as the company continued to have financial difficulties. By April 2003 Ms Hormann had advanced another $30,000 in unsecured funds to the company. She had a real interest in rebuilding its financial viability.

[21] There were two aspects of value from the shares that Ms Hormann agreed to purchase in June 2003 (and which were formally transferred to her on 17 December 2003). Firstly, a portion of the

advances owed to other shareholders were assigned to her ($12,511). Secondly, there was significant value in the accrued tax losses of the company to 31 March 2003.

[22] Mr McCormick's evidence was that these losses could provide a tax benefit of more than $370,000. Provided the company continued to trade, this amount could be offset against future income. Ms Holley and Ms Hormann took care in their arrangement on share purchases not to breach the 50 per cent shareholder continuity requirement in order to retain the tax loss benefit – and that was the reason for an existing shareholder continuing with a 15 per cent holding (subject to an option for purchase by Ms Holley).

[23] Ms Hormann was aware of this potential value. She prepared the accounts recording the value of the tax losses and showing an asset to that value as a future tax benefit. Mr McCormack estimated the tax benefit to Ms Hormann – based on her proportion of shares – to be more than $90,000. In that light the amount of salary and holiday pay forgone for the share purchase in certainly not disproportionate to the benefit or prospective benefit of the investment.

[24] It is also not disproportionate to an offer Ms Hormann made in June 2004 to buy from Ms Holley an additional 25 per cent shareholding for the price of $100,000. Ms Holley did not accept the offer but it demonstrates that only 12 months after the 2003 agreement, and prior to her present dispute, Ms Hormann did accept the shares had considerable value.

[25] I emphasise too that Ms Hormann participated in the 20 June 2003 meeting with Ms Holley and Mr McCormick as an investor and potential shareholder. She was also an employee at the time, but there is no suggestion that she was overborne in any way to forego the salary and holiday pay used to pay for her shareholding. In one way her decision was no different than if had been paid the money as an employee one day and decide to invest it in the company the next. However in one important respect it was different. By forgoing the salary and holiday pay, Ms Hormann and Ms Holley were able to 'invest' the gross amount in the business. If they had arranged for the respondent to pay them that amount and then invested it back, they would first have had to deduct the necessary PAYE. The method they chose avoided that and increased the value of their investment.

[26] For these reasons I am satisfied that there was an agreement with the applicant on the terms alleged by the respondent. It follows that the respondent does not owe the applicant for salary and holiday pay entitlements accrued by her to 30 June 2003. I decline to make the declaration sought by the applicant in respect of those amounts.

[27] However I do not consider that the evidence supports any contention that any further salary or holiday pay amounts were intended to be 'forgone' in return for the share purchase. This turns to the issue of the accumulation of holiday leave in the period from June 2003.

Holiday pay after 1 July 2003

[28] Until October 2004 the respondent's finances were not sufficiently robust for the salaries of Ms Holley and Ms Hormann to be paid in full. The company acknowledges, as I understand it, that there are outstanding salary payments still due from the period between 1 July 2003 and October 2004.

[29] However an issue has arisen regarding holiday pay entitlements.

[30] Ms Hormann took maternity leave in mid-February 2005 and her baby was born later that month. In late April she returned to work two days a week. She brought her baby with her. Ms

Holley observed that Ms Hormann was finding the return to work difficult. Over a three hour lunch on 20 May 2005, Ms Holley talked with Ms Hormann about taking a further period of leave. I accept Ms Hormann's evidence that during conversation with Ms Holley that day, Ms Holley said that Ms Hormann had plenty of leave and should take it.

[31] Ms Hopkins gave Ms Hormann a leave form confirming that she would have 50.5 days of accrued annual leave entitlements by 31 August 2005. Ms Hormann completed the form applying for 51.5 days of annual holidays and annual holidays in advance for the period from 14 May to 12 August 2005. Apart from three days in July, covering a leave break for Ms Hopkins, Ms Hormann did not return to work until 15 August.

[32] The respondent initially alleged that Ms Hormann was entitled to only 30 days, not 50.5 days, of paid annual leave by 31 August 2005. It relied for this proposition on a supposed term of Ms Hormann's employment agreement prohibiting accumulation of annual leave above 30 days. It does not now rely on that but submits that Ms Hormann's holiday entitlement from 1 July 2003 to March 2006 was 41.25 days and that she had taken 27 days of leave earlier in that period (and before starting her extended parental leave). However that earlier leave was not properly deducted from her entitlement during that period.

[33] Ms Hormann accepts that during this period the company's records were not adjusted for leave taken by her and Ms Holley. This was partly because, until October 2004, she and Ms Holley remained on part salary only. The other reason was that she and Ms Holley had decided to let their holiday pay accumulate as a form of income protection if the company went into liquidation. During the investigation meeting she acknowledged that she "*was aware the leave entitlement was inflated because of that*". However her argument – in short – is that Ms Holley was also aware of this at the time that she encouraged the applicant to take additional paid leave in May 2005. Ms Hormann says that Ms Holley told her she had plenty of leave owing and she should take it.

[34] I accept Ms Hormann's evidence on this point. Ms Holley did not seek to dispute it. I find that Ms Holley offered and Ms Hormann accepted additional paid leave. At that time Ms Holley was aware that Ms Hormann's recorded entitlement may be inflated but intended her to use that recorded entitlement in the form of further paid leave. On that basis I find that the proper starting point for the calculation of any leave entitlements should be on the basis that Ms Hormann was entitled to 50.5 days as at 31 August 2005.

Other deductions

[35] The respondent also claims it is entitled to deduct $2765 from any salary or holiday pay owed to the applicant. This amount is said to relate to reimbursement of cash payments by the applicant to a painter and for a phone system. The evidence from both parties was insufficient, I consider, to make any finding on this point and I decline to do so. There were also some other amounts at issue but the respondent's closing submissions abandoned its claims on those amounts.

Treatment on return to work

[36] Ms Hormann returned to work on 15 August 2005. She alleges that, both during her absence on parental leave and during August, she was unfairly treated and ostracised.

[37] This determination will not review all the detailed evidence on interactions during this period – some as trivial as whether the reason Ms Hormann would not attend one business meeting with Ms Holley was because she had a prior hairdressing appointment. However having considered the oral and written evidence of the witnesses, and carefully reviewed the background documents and

the parties' written submissions, I am satisfied that Ms Hormann was not unfairly treated and ostracised as an employee during this period.

[38] During her absence on parental leave, Ms Hormann met with Ms Holley and other staff many times. Ms Holley counts "*nearly 30 occasions including company lunches to celebrate her baby's arrival and Karen's birthday and a company dinner to celebrate a successful end of year*". Ms Hormann in evidence could agree that there was contact on at least 22 occasions over that period.

[39] When she returned to work, her baby accompanied her. A corner of the office was rearranged to provide a sleeping and changing area. New shades for the windows were installed. This was a workplace of four women. Two other women had older children and – as emerged in the evidence – had them at work at various times. The only real difficulty was that Ms Hormann herself felt uncomfortable and sensitive to times when her baby might be unsettled and disturb her colleagues or interrupt their work. Rather than make other childcare arrangements, she had opted to bring her baby to work and there is no evidence that any of her colleagues discouraged her from doing so.

[40] I do not accept that any ill ease she felt at returning to work was the responsibility of the respondent. Ms Hormann was herself responsible for causing tension with her collegues. For example, she brusquely demanded Ms Horsfall surrender her carpark. It was closer to the office than Ms Hormann's, and more suitable for carrying in the baby and associated paraphernalia. Ms Holley did not make an issue of Ms Hormann's rude treatment of a junior staff member but instead offered her own carpark to Ms Hormann.

[41] I accept that Ms Holley made repeated efforts to ease Ms Hormann's return to work – some of which have already been mentioned. She also had several informal meetings with Ms Hormann in cafes and restaurants to try and talk through issues.

[42] An important shareholder issue had arisen in July – a new investor wanted to join the company and buy shares. The value of the shares and contributions of the existing shareholders – both to them and a potential investor – appears to be at the centre of the underlying issues in the applicant's dispute with Ms Holley.

[43] At a company meeting with Ms Holley and Mr McCormick on 1 August (and prior to her return to work), Ms Hormann had presented her analysis of the company's value and issues to be considered. Importantly Ms Holley considered that assessment understated her contribution. The two women discussed the figures the next day and Ms Holley asked Ms Hormann what she wanted. Ms Hormann responded on 8 August with a proposal to convert some leave taken into an additional salary payment, an additional after-tax lump sum, interest on cash advances to the business backdated to 2001, and a shareholder agreement. Despite some email correspondence, these issues were unresolved by the time Ms Hormann returned to work on 15 August.

[44] Ms Hopkins knew, at least in part, about the issues between the shareholders because Ms Holley had asked her to check some figures. Ms Hormann complains that on 16 August Ms Hopkins accused her of trying to collapse the company, a comment Ms Hopkins denies. She admits asking Ms Hormann what she hoped to achieve and saying that what she did affected her too.

[45] On 22 August Ms Holley called a staff meeting with Ms Hormann, Ms Hopkins and Ms Horsfall. The meeting was said to be an attempt to "clear the air". Ms Holley says she knew that Ms Hopkins and Ms Horsfall felt insecure about the future of their jobs and unhappy about the atmosphere in the office.

[46] Ms Hopkins says that this meeting, on couches in the lounge area of the company's offices

took place "over several pots of coffee", was "long, thought provoking and at times robust" but ended amicably. Ms Hormann complains that "shareholder issues" were discussed with the other employees but I prefer Ms Holley's evidence that it was, in fact, Ms Hormann who raised those issues. I find nothing inappropriate in the occurrence of the meeting or the opportunity for Ms Hopkins and Ms Horsfall to discuss issues affecting the future of their jobs with their two senior colleagues who are the shareholders and business partners. Ms Hormann may have interests as an employee but she also had some obligations as a part owner in the respondent to be sensitive to the concerns of the other employees about their own futures.

[47] Having attended work on six days from 15 August, Ms Hormann has now not attended work since 25 August. On that day she advised the respondent that she was taking "stress leave". She provided a medical certificate from her GP stating that she was "*unfit for duty from 25 August 2005*" and would be reviewed on 8 September. A further certificate dated 8 September stated that she remained unfit for work "*as a result of work related stress*" and would be reassessed in one month.

[48] A further certificate dated 25 November stated she was unfit for duty from 8 October. That certificate was accompanied by a note stating her doctor's opinion that "*it would be detrimental to her health if she were to return to work unless the issues she has with Ms Jo Holley and her employer, Virtual Warehouse, are resolved*".

[49] On 5 December 2005 Ms Hormann provided a letter from her doctor stating that she was "*generally in good health*" and could return to work. The doctor expresses the opinion however "*that it would be detrimental to her health if she were to return to work unless the issues she has with Ms Jo Holley and her employer are resolved. From what she has told me the treatment she received from Ms Jolley (sic) on her return to work was quite unacceptable and very stressful.*"

[50] I note that the doctor carefully describes her opinion as being based on "*what she has told me*". I am not satisfied that Ms Hormann has established that the cause of her absence was "work related stress" related to any breach of duty owed to her as an employee by the respondent. Rather the evidence supports the view that she is involved in a dispute with her fellow shareholder which she found distressing and resolved to stay away from work until it was resolved.

[51] She was paid her full salary for the period from 25 August to 25 September but has received no further payments from the company since then. There was an unnecesssarily fractious contest between the parties' counsel over the provision of medical certificates and whether the applicant should subject herself to assessment by another doctor. It was not, in the circumstances, unreasonable for the respondent to seek relevant medical information.

[52] In filing her statement of problem Ms Hormann originally sought as an order requiring the respondent to agree "*a protocol governing the Applicant's immediate return to work*". The respondent agreed to attend further mediation on this issue and requested a draft "protocol" from the applicant.

[53] The applicant, by letter of counsel of 21 December 2005, took the view that any protocol should be worked out following determination of her entire claim. However she was willing to return to work prior to the Authority investigation meeting provided that Ms Holley "*acknowledge[d] the truth*" of her claim and apologised to her in writing. At the investigation Ms Hormann accepted this was an unhelpful precondition and withdrew it. In closing submissions she has abandoned the request for an order for a protocol stating instead that her intention is to return to work when the Authority issues its determination. She requests leave to apply for such an order should that prove necessary after her return to work. She submits, correctly, that both parties will

have obligations to address "*the relationship issues*" in good faith and suggests that the assistance of a mediator or a workplace psychologist may be effective.

Determination

[54] For the reasons given above, this employment relationship problem is resolved by the following findings:

(i) The applicant is not entitled to payment of $118,038.41 for unpaid salary and holiday pay accrued to 30 June 2003; and

(ii) Any calculation of residual salary and holiday pay entitlements should be based on her holiday pay entitlement as stated on her leave form in May 2005; and

(iii) The respondent did not breach its duties to the applicant as an employee during her parental leave or on her return to work in August 2005.

[55] While issues between Ms Hormann and Ms Holley as shareholders are not within the jurisdiction of this forum, the parties have an ongoing employment relationship. They will now need to work through a number of aspects, including the applicant's stated intention to return to her duties. The findings in this determination should be sufficient for the parties to calculate any entitlements still owed to the applicant. If they are not, or the parties have real difficulty doing so, I reserve leave for either party to apply for further direction. In closing submissions the respondent proposed paying outstanding salary by instalments. Leave is reserved to either party to apply for further determination or directions in relation to salary and holiday payments.

Further mediation

[56] Both parties have indicated there may be a need for further mediation of issues between them. The Mediation Service has already corresponded with the parties about its willingness to assist further if requested. The parties are free to approach and make arrangements with the Mediation Service however leave is reserved to apply to the Authority for a direction if that is necessary or would assist.

Costs

[57] The parties are encouraged to attempt to resolve any matters of costs between them. If they are not able to do so, either party may apply to the Authority for a determination of costs. To assist the parties' discussions I note some relevant factors as being the respondent's unsuccessful applications in both the Authority and the Employment Court for removal of this matter to the Court, the ongoing employment relationship, the success of the respondent on a large part of this matter and the success of the applicant on a smaller part. The parties need to also be mindful of the modest level of costs generally awarded in the Authority as explained by the Employment Court in *PBO Ltd v Da Cruz* (unreported, EC Auckland, AC2A/05, 9 December 2005, Colgan CJ, Travis and Shaw JJ).

Robin Arthur
Member of Employment Relations Authority