

*Under the Employment Relations Act 2000*

**BEFORE THE EMPLOYMENT RELATIONS AUTHORITY  
AUCKLAND OFFICE**

**BETWEEN** Kendrick Family Trust (Applicant)  
**AND** Nicholas Howard Barnes (Respondent)  
**REPRESENTATIVES** Michael Smyth, for applicant  
Brent MacDonald for respondent  
**MEMBER OF AUTHORITY** Janet Scott  
**INVESTIGATION MEETING** 5 July 2005  
**DATE OF DETERMINATION** 22 August 2005

**DETERMINATION OF THE AUTHORITY**

**Employment Relationship Problem**

The applicant seeks to recover the sum of \$11,454.54 from the respondent in overpayment of monies paid to him. The respondent initially sought to recover the sum sought through the Disputes Tribunal which has declined jurisdiction, having taken the view the respondent was in an employment relationship with the applicant.

The sum sought by the applicant is the PAYE determined by IRD<sup>1</sup> to be payable by the applicant in respect to the respondent's earnings as Executive Chef and Operations Manager in the restaurant business known as Metropole.

It should be noted that the applicant has always and continues to submit that the respondent was an independent contractor. The applicant brings the claim to the Authority for a determination of the respondent's status and to recover the monies in question, if the Authority determines the respondent is in fact an employee.

The respondent submits he was at all times an employee. He denies he is liable to reimburse the applicant for PAYE not deducted from his salary and paid to IRD.

**Background**

The background to this application is hotly disputed between the parties. It would be fair to say that in respect to the issues critical to determining Mr Barnes' status they agree on nothing. Their different positions are summarised.

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<sup>1</sup> For its purposes IRD has determined that Mr Barnes was an employee of the business. That status is currently under appeal with IRD.

## **The applicant**

The only witness for the applicant was Simon Kendrick.

Mr Kendrick met Mr Barnes at the Horse and Trap (a pub in Mt Eden). Mr Barnes who is an Irish national worked as a barman at the Horse and Trap. The two men struck up an acquaintanceship. To cut a long story short, Mr Kendrick and Mr Barnes discussed going into the restaurant business together with Mr Kendrick providing the finance and back room management expertise and Mr Barnes managing the front of house i.e. the operation of the restaurant.

A suitable business was identified by the two men and they consulted on the changes that would be made to make it more profitable. A business plan for the purchase and operation of the business was discussed and drafted for submission to the bank. Mr Barnes was described in that document as a principal of the business along with Mr and Mrs Kendrick. Mr Barnes agrees he had discussions with Mr Kendrick in respect of the Business Model and Marketing Plan section of the proposal put to the bank.

It was Mr Kendrick's evidence that it was agreed the Trust would buy and own the business as Mr Barnes had no capital to invest. Mr Barnes would however run the restaurant i.e. his contribution to proposed partnership would be his experience and expertise. The business was valued at \$300,000 and it was proposed and agreed that Mr Barnes would receive remuneration in the sum of \$70,000 gross per annum which would be paid on a weekly basis. In addition he would (presuming that profits allowed it) receive profit share in the sum of \$30,000 per annum. It was proposed this profit share would be taken as equity in the business so that over a period of five years Mr Barnes would build up a half share in the business. At some point in the future it was anticipated that a company would be formed and shares allocated in accordance with the agreed plan. It was, however, left open that Mr Barnes could – if he preferred at the time any profit share was realised - take the profit share in cash.

The business opened under the new ownership early in December 2002. Mr Kendrick gave evidence that in the interim period until the relationship between the Kendricks and Mr Barnes and was formalised by way of a partnership or company structure the parties needed some other arrangement to govern their relationship. From Mr Kendrick's perspective he needed to be in a position to remove Mr Barnes and to protect his investment should the business fail. According to Mr Kendrick, he and Mr Barnes discussed the issue and agreed that an independent consulting arrangement would be the best vehicle to formalise their arrangement. Mr Kendrick submitted that it was discussed that Mr Barnes would be engaged as an independent contractor and that Mr Barnes would be responsible for declaring and paying his own tax. Mr Kendrick's evidence was that Mr Barnes expressed particular approval of this arrangement because his remuneration would be paid without deductions for PAYE.

Mr Kendrick prepared the independent contractor agreement. In doing so he simply adapted a contract he had worked under when previously engaged on a consultancy contract. Mr Kendrick's evidence was that just prior to Christmas 2002 he gave the completed contract (which he had signed) to Mr Barnes for his consideration to discuss and/or sign and return. The contract was never signed and returned by Mr Barnes.

The unsigned contract described Mr Barnes being a contractor employed by the Kendrick Family Trust in the capacity of Executive Chef and Operations Manager. He was to be remunerated at \$1,346.15 per week on production of an invoice presented at the end of each week.

In terms of the operation of the business it was Mr Kendrick's evidence that Mr Barnes made all executive decisions relating to the running of the restaurant including

- Hiring and firing staff
- Setting staff wages
- Staff rosters
- Planning and changing menu and wine lists
- Deciding on and implementing marketing initiatives
- Arranging for business cards
- Selecting suppliers
- Changes to décor (minor)

In the day to day management of the business Mr Barnes described himself as the owner of the business and became known to the clientele as the owner. He arranged for business cards to be printed and his business card described him as Director.

Unfortunately, the business did not thrive and in May 2003 Mr Kendrick and Mr Barnes discussed the situation. As a result Mr Barnes drawings/salary was reduced by agreement to \$50,000 per annum.

Mr Barnes was a signatory in respect of the Metropole cheque account. The evidence shows that up until mid July 2003 Mr Barnes' remuneration was paid by cheque. On 16 occasions the cheques were written out and signed by Mr Kendrick and recorded as having been made out to NH Consultancy.<sup>2</sup> On 15 occasions Mr Barnes wrote out his own cheque, signed it and recorded it on the butt as payment to NH Consultancy. From 24 July Mr Barnes remuneration was taken in cash. There is no dispute that no PAYE was deducted from the sums paid.

The arrangements between the parties were complicated by the fact that in June 2003 Mr Barnes needed to renew his work permit. As part of this process his "employer" was required to satisfy Immigration Service that no New Zealander was available to fill the position held by Mr Barnes. The Service sought other information and assurances from Mr Barnes and his "employer." It is not in dispute between the parties that Mr Kendrick and Mr Barnes each worked to gather and supply the information required by Immigration.

For his part Mr Kendrick wrote to Immigration on 11 June 2003. In response to a question which called for evidence of attempts to recruit New Zealand citizens to fill the role Mr Kendrick wrote *"...My wife and myself (the two Trustees in the Kendrick Family Trust) were looking for a business, and as accountants and business people believed that we had the necessary skills to handle back of house aspects of a business. We discussed several business options with Nick, and recognising his abilities decided that with his specific industry experience and expertise we had a full complement of skills to take on a competitive market place. Accordingly, the role was not advertised because the role was envisaged to be that of a business partner rather than that of an employer/employee relationship.* (Emphasis mine).

And in answer to a request for information on the length of the contract Mr Kendrick wrote. *"Nick Barnes is currently on a consultancy contract, as that seemed to be the most appropriate at the commencement of the business. It should be noted, however, that the intention has been that should Metropole achieve financial performance targets, Nick would receive a part of his remuneration as an equity interest in Metropole. I am happy to offer Nick an employment contract*

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<sup>2</sup> Mr Barnes had no legal entity in the nature of a consulting company.

*should this be beneficial to his application; and can enclose the standard Metropole contract for your review*". (Emphasis mine).

As I understand the evidence a signed employment agreement between Metropole and Nick Barnes as Head Chef/General Manager was submitted with Mr Kendrick's advice to Immigration. However, as I understand Mr Kendrick's evidence Mr Barnes continued to be engaged under the unsigned 'consultancy agreement' that had governed the relationship between the parties since December 2002.

Mr Barnes engagement terminated at the end of August when it became apparent the business was not successful. Mr Kendrick ran the business alone until March 2004 when it was sold.

### **The Respondent**

Mr Barnes submits he was a barman at the Horse and Trap earning \$12 per hour when he became involved with Mr Kendrick. He accepts he assisted in the identification of a suitable business for Mr Kendrick to buy. He did this on the promise of a management position in the new business.

It is Mr Barnes' position that he was always engaged as an employee of Metropole and that it was Mr Kendrick's responsibility to deduct PAYE from the remuneration received by him and to forward it to IRD. Pursuant to this it is Mr Barnes' position that he was actually engaged on remuneration in excess of \$100,000 and the \$1,346.15 sum paid to him weekly (later reduced to \$1000 p.w.) was the net sum (net of PAYE) payable to him under his agreement with Mr Kendrick.

It was Mr Barnes' position that he had never discussed with Mr Kendrick a proposition that he would be an independent contractor responsible for payment of his own tax. He said that during his employment he had never sighted the 'consultancy agreement' submitted by the applicant in evidence. The first time he had seen it was when it was submitted to the Authority in the process of the investigation. The only agreement he had knowledge of was the signed employment agreement submitted in evidence.

Mr Barnes did not take issue with the applicant's evidence that he ran the restaurant on a day to day basis except that it was his position that Mr Kendrick took all executive management decisions and that some of his suggestions were turned down by Mr Kendrick for financial reasons.

Mr Barnes accepted that he had business cards prepared that described him as "Director".

### **Issues to be Decided**

Prior to determining whether the applicant can recover the sum sought it is necessary to determine the employment status of Mr Barnes. I am aware of the fact that IRD have deemed him to be an employee. As I understand it IRD considers similar tests to those that I am required to consider. However, as guardians of the tax base they bring their own perspective to the task. I note, too, the applicant is currently appealing the IRD ruling in this matter.

### **Legal tests**

With the passage of the Employment Relations Act 2000 the tests for determining what constitutes a contract of service changed (s.6 refers). Judge Shaw considered the recent case law<sup>3</sup> and stated

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<sup>3</sup> *Koia v Carlyon Holdings Ltd* [2001] ERNZ 585 and *Curlew v Harvey Norman Stores (NZ) Pty Ltd* [2002] 1 ERNZ 114.

*“The principles established by these cases may be summarised as follows:*

- *The Court must determine the real nature of the relationship.*
- *The intention of the parties is still relevant but no longer decisive.*
- *Statements by the parties, including contractual statements, are not decisive of the nature of the relationship.*
- *The real nature of the relationship can be ascertained by analysing the tests that have been historically applied such as control, integration, and the “fundamental” test.*
- *The fundamental test examines whether a person performing the services is doing so on their own account.*
- *Another matter which may assist in the determination of the issue is industry practice although this is far from determinative of the primary question.”*

More recently the Supreme Court considered the same case and stated at paragraphs 31 & 32.

*“The real question, it seems to us, is whether the Judge correctly directed herself in accordance with s 6.”*

*And:*

*“We are unable to find in her judgment anything concerning s 6 which does not appear faithfully to reflect the words of the section. That section defines an employee as a person of any age employed by an employer to do any work for hire or reward under a contract of service - a definition which reflects the common law. Particular relationships with which this case is not concerned are expressly included and excluded. The section then requires the Court or the Authority, in deciding whether a person is employed under a contract of service, to determine “the real nature of the relationship between them”. In doing so the Court or Authority is directed that it must consider “all relevant matters”, including any matters that indicate the intention of the persons. But it is not to treat as a determining matter any statement by the persons that describes the nature of their relationship.*

*“All relevant matters” certainly include the written and oral terms of the contract between the parties, which will usually contain indications of their common intention concerning the status of their relationship. They will also include any divergences from or supplementation of those terms and conditions which are apparent in the way in which the relationship has operated in practice. It is important that the Court or the Authority should consider the way in which the parties have actually behaved in implementing their contract. How their relationship operates in practice is crucial to a determination of its real nature. “All relevant matters” equally clearly requires the Court or the Authority to have regard to features of control and integration and to whether the contracted person has been effectively working on his or her own account (the fundamental test), which were important determinants of the relationship at common law. It is not until the Court or Authority has examined the terms and conditions of the contract and the way in which it actually operated in*

*practice, that it will usually be possible to examine the relationship in light of the control, integration and fundamental tests. Hence the importance, stressed in TNT, of analysing the contractual rights and obligations. In the passage of her reasons .....Judge Shaw accurately states what the Court must do and lists the matters which are relevant. She completes her list with reference to industry practice, making the unexceptionable general comment that it is “far from determinative of the primary question”.*

## **Discussion and Findings**

Note: In determining this matter I am not concerned with the wisdom of the arrangements between these parties. Nor am I primarily concerned with the fairness of those arrangements albeit fairness was a factor which drove the changes to s.6 of the Act. However, the facts of this case are a far cry from the mischief the amendments sought to rectify in relation to dependant contractors.

### **Credibility**

Mr Barnes was an extremely poor witness. He repeatedly told me he was just a barman earning \$12 per hour when he became involved with Mr Kendrick – the implication being that it was fanciful to assert they had gone into business together. He was adamant he was always an employee of Metropole but he was extremely uncomfortable in explaining the fact he had assisted Mr Kendrick to identify a suitable business to purchase; that he had identified improvements in the business and that he had ordered and used business cards that described him as a Director of the business.

Because the central plank of his argument is that he was an employee it was necessary to explain the fact that he wrote cheques paying himself \$1,346.15 per week (which equated to 70,000 per annum). He sought to persuade me that his before tax remuneration was in excess of \$100,000 per annum. This submission lacked credibility and was destroyed by his own evidence that he accepted the \$25.00 per hour recorded in the employment contract (equivalent to the remuneration \$50.000 pa he agreed with Mr Kendrick in April/ May) was a gross figure from which PAYE should have been deducted. There were 11 occasions when Mr Barnes wrote a cheque to pay himself \$1,000. He made no deduction for PAYE.

Mr Kendrick presented as the more credible witness of the two. Quite apart from my assessment of the credibility of the witnesses as they appeared before me, Mr Kendrick’s evidence is supported by the bank proposal which describes Mr Barnes as a ‘principal’ of the business and the contemporaneous explanation of the relationship that he gave to the Immigration Service in June 2004. Importantly, I note that this letter explains the existence of a signed employment agreement between the parties which contradicts a written agreement (admittedly not signed by Mr Barnes) which describes the relationship as a contract for services.

Where there are conflicts in the evidence given by these parties it is the applicant’s evidence that I accept as providing the more reliable account of the real nature of the relationship.

### **Was Mr Barnes an employee or an independent contractor?**

In deciding if Mr Barnes was an employee engaged under a contract of service it is necessary to determine the real nature of the relationship. In doing that I am required to consider all relevant matters including:

- The written and oral terms of the contract between the parties which will not be determinative of the matter but will provide an indication of the common intention of the parties.
- Any divergence from or supplementation of those terms and conditions which is apparent from the way the relationship worked in practice.
- How the relationship operated in practice.

Then it is necessary to apply the tests of control, integration and to ask if Mr Barnes was effectively working on his own account. Lastly I will touch on industry practice.

### What was the Intention of the Parties?

The parties disagree on the label they put on their relationship and there are two written documents which the parties variously rely on as evidencing their common intention.

Mr Kendrick relies on his oral evidence that he discussed the matter with Mr Barnes and prepared a contract for services which he signed and gave to Mr Barnes to discuss and/or sign and return. Mr Barnes did not sign that document and says he never even saw it during his employment. Mr Kendrick relies on the written employment contract as evidencing the intention of the parties.

The written employment agreement is quite clear on its face and if I were to rely on that then undoubtedly I would find the common intention of the parties was that Mr Barnes was to be an employee engaged on a contract of services.

The situation regarding the other document is less clear on its face. This is because it has not been signed by Mr Barnes. I note, too, that to the extent to which it was cobbled together from a contracting document that Mr Kendrick once worked under it does not describe the reality of the relationship between these parties as I have assessed the evidence. It purports to exercise a high level of control over the contractor which was not a feature of the relationship between Mr Kendrick and Mr Barnes. However, it does give some guidance to the common intention of the parties in that it is the only written evidence of the intention that Mr Barnes was to be remunerated at the rate equivalent to \$70,000 per annum which is what happened in practice. Otherwise the only relevant aspect of the document is that it describes the relationship as one of a contract for services.

I have found that Mr Kendrick's evidence was more credible as to the common intention of the parties - that evidence being supported by the description of Mr Barnes a principal in the bank proposal, the contemporaneous letter to Immigration describing the relationship in terms consistent with a contract for service and the fact that Mr Barnes planned and ordered cards which described him as a director of the business. The fact that the cheques for Mr Barnes' remuneration were recorded as payments to 'NH Consultancy' is also a relevant matter to be considered in the total mix. The common intention of the parties was I find -

- That Mr Kendrick and Mr Barnes would go into business together.
- That the business would be financed and owned by the Kendrick Family Trust with Mr Barnes providing the expertise and over time having the opportunity (through profit share over and above his basic remuneration) to build a 50% equity shareholding in the business.
- That contractual relationship between the parties in the initial stages was one between the Kendrick Family Trust and Mr Barnes as contractor on a contract for services and that Mr

Barnes would be paid basic remuneration of \$70,000 gross per annum and that he would be responsible for declaring and paying his own tax.

I also find that during the life of the relationship there was, in practice, no divergence from or supplementation of the contractual terms described above other than the fact that the parties later agreed that Mr Barnes basic remuneration would be reduced to \$50,000 per annum.<sup>4</sup>

#### How did the relationship work in practice?

I find that in practice the relationship worked in a manner that was consistent with the common intention of the parties. Mr Kendrick looked after the back room admin and regulatory aspects of running a restaurant and Mr Barnes had full control over the front of house that is the day to day operation of the restaurant including hiring and firing staff, setting pay rates, planning/changing the menus and wine list, acting as maitre d' and planning and implementing all marketing initiatives e.g. advertising, jazz promotions etc. I find Mr Barnes had a free hand in this and that Mr Kendrick bowed to his advice albeit that it was Mr Kendrick who supplied the operating capital.

Mr Barnes argued that some of his proposals were turned down by Mr Kendrick. He argued this showed where the real control lay.

I have considered this point because at the end of the day it was Mr Kendrick who held the purse strings. However, I find on the evidence that in terms of the day to day running of the restaurant it was Mr Barnes who was in control and Mr Kendrick relied on and allowed Mr Barnes complete freedom to run the restaurant operation as he saw fit. Some suggestions made by Mr Barnes could not be implemented for financial reasons. In particular there were only minor modifications to the décor of the restaurant. This was not, I find, evidence of control (in the sense of the common law control test) being exercised by Mr Kendrick over Mr Barnes. It was a reflection of the reality faced by most small, new businesses that operating capital is a scarce resource and as a result expenditure is closely watched and controlled.

In saying that the relationship between the parties worked in a manner that was consistent with their common intention and contractual relationship I accept, however, that had Mr Barnes been engaged as a employee in the role of Executive Chef and Operations Manager the relationship would, in practice, have looked much the same and Mr Barnes would have been expected to have a high degree of autonomy in running the restaurant. It is most unlikely, however, that had Mr Barnes been an employee that both Mr Kendrick and Mr Barnes would have been putting his remuneration down to NH Consultancy and failing to deduct and account for PAYE. There was absolutely no suggestion here of an arrangement between these parties that they would join forces to diddle IRD. I note, too, Mr Kendrick's evidence (which I accept) that IRD took no issue with the way the Trust accounted for PAYE in respect of employees of the business.

#### The Tests: Control, Integration and the Fundamental Test.

Control: Mr Barnes had full autonomy in running the day to day operations of the restaurant. Mr Kendrick deferred to his expertise in this. Mr Barnes had signing authority on the restaurant's cheque account and was permitted to write cheques for his own remuneration – which I would suggest is an uncommon feature of an employment relationship. Mr Barnes was only constrained in running the restaurant by the operational capital available to the business.

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<sup>4</sup> In saying this I find the employment agreement was produced for the particular purpose of supporting Mr Barnes application for an extension of his work permit. There was no subterfuge in this regard because when the agreement was submitted to Immigration Mr Kendrick openly explained the real nature of his relationship with Mr Barnes.

The evidence relevant to this test falls on the side of confirming this was a relationship in the nature of a partnership with Mr Barnes having the autonomy to run the restaurant as he saw fit. As noted the degree of autonomy could be consistent with that expected in the case of a senior employee but given the freedom allowed to Mr Barnes to draw down his own remuneration the situation overall is more indicative of partnership in association with a contract for services than is of an contract of service.

Integration: Mr Barnes was fully integrated into the restaurant business. In normal circumstances this would be indicative of a relationship in the nature of a contract of service. However, it is equally consistent was a relationship in the nature of a partnership which the evidence suggests was primary purpose of the relationship between these parties.

The Fundamental Test: Did Mr Barnes engage himself to perform the services with Metropole as a person in his own account?

Mr Barnes would say not. However, I find that what Mr Barnes now says and what his stated intention and his conduct was at the time he joined forces with Mr Kendrick (and throughout the life of their relationship) are two very different things.

It is true Mr Barnes put no capital at risk<sup>5</sup>. He did not provide his own tools – the premises, plant and equipment all being financed by the Kendrick family trust through the purchase of the restaurant. It is probable that the reality of the situation for Mr Barnes was that he viewed his relationship with Mr Kendrick from an immediate and bottom line position i.e. he would enjoy an improvement in his status and financial position (including the opportunity to receive his remuneration without deduction of PAYE) without financial risk. That is, it may have been a matter of all care and no responsibility on Mr Barnes' part knowing he could get another job if the restaurant was not successful. However, I find that he did enter into an arrangement with Mr Kendrick that would see him profiting from his own input into the restaurant. The intention of the parties was that if the business was successful that Mr Barnes could build up 50% shareholding equity in the business over 5 years. I do accept that it was open to Mr Barnes to later decide he would take his profit share as cash and that this can be a feature of an employment relationship. However, I find the predominant intention at the time the parties entered into relationship was that ultimately they would become 50:50 partners in a successful business.

Lastly, I find that industry practice is of no assistance in arriving at a determination of this matter. I find, those taking on the responsibility to run a restaurant business do so under a variety of arrangements – as owner operators, employees and as independent contractors and franchisees.

## **Determination**

Taking the evidence overall and considering it against the tests described in s.6 and relevant case law I find that Mr Barnes and Mr Kendrick were in a relationship in the nature of a partnership albeit their partnership arrangements had not been finalised. In the interim Mr Barnes entered into a contract for services with the Kendrick Family Trust. The absence of control and the opportunity for Mr Barnes to profit from the sound management of the restaurant business are features of the arrangement and conduct of the relationship which confirms its true nature as being a contract for services.

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<sup>5</sup> He provided the necessary expertise in running a restaurant.

That being the case the Authority has no jurisdiction to consider the question as to whether or not Mr Barnes should be directed to reimburse the Kendrick Family Trust for the PAYE not deducted from his remuneration. Had he been an employee there would have been a strong argument for (at the very least) holding him liable for the PAYE not deducted by him when he paid himself.<sup>6</sup>

## **Costs**

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

Janet Scott  
Member of Employment Relations Authority

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<sup>6</sup> Given that the person who pays wages is required under tax legislation to make the PAYE deduction in accordance with tax rules.