IN THE EMPLOYMENT RELATIONS AUTHORITY
CHRISTCHURCH

[2018] NZERA Christchurch 35
3019811

BETWEEN	SAMANTHA WERNER Applicant
A N D	PC & KL BLACK LIMITED (deregistered) First Respondent
A N D	KAREN LYNDA BLACK Second Respondent
A N D	PAUL CRAIG BLACK Third Respondent

Member of Authority:	David Appleton
Representatives:	Anna Oberndorfer, Advocate for Applicant Richard Hearne, Counsel for Respondents
Investigation Meeting:	Determined on the papers
Submissions Received:	2 March 2018 from Applicant 14 March 2018 from the Respondents
Date of Determination:	20 March 2018

DETERMINATION OF THE
EMPLOYMENT RELATIONS AUTHORITY

A. The Authority does not have the jurisdiction to enforce the record of settlement against the second and third respondents personally.

B. The test for lifting the corporate veil has not been made out.

C. Costs are reserved.

Employment relationship problem

[1] Ms Werner seeks the leave of the Authority to join Karen and Paul Black to the proceedings in order to enforce the terms of a record of settlement against them.

Effectively, Ms Werner is asking the Authority to lift or pierce the corporate veil so that Mr and Mrs Black become personally liable for the obligations of the first respondent (the company) which has been removed from the Companies Register since the statement of problem was lodged.

[2] Mr and Mrs Black oppose the application on the basis that the legal test for lifting the corporate veil has not been satisfied.

The material facts

[3] Ms Werner was employed by the respondent company and resigned from her position on 25 September 2015. She raised a grievance on 27 December 2015 for constructive dismissal and, following unsuccessful negotiations between the parties, Ms Werner lodged a statement of problem with the Employment Relations Authority on 25 May 2017 citing claims against the company.

[4] On 15 June 2017 the parties were directed to attend mediation and they did so on 4 August 2017 when a record of settlement was entered into pursuant to s 149 of the Employment Relations Act 2000 ("the Act").

[5] According to the terms of that record of settlement, the company was to pay to Ms Werner within seven days of the date of the agreement, the sum of $6,500 in terms of the provisions of s 123(1)(c)(i) of the Act together with a further $3,500 plus GST upon production of an invoice towards Ms Werner's legal fees. The company also agreed to provide a positive reference in relation to Ms Werner.

[6] Ms Werner says that the positive reference was provided by the company but that the two payments have not been made. This is not denied by the respondents. The respondents say that this is because the company could not pay that amount, or any other amount.

[7] Mr and Mrs Black were the sole directors and shareholders of the company. Ms Oberndorfer asserts that the company had already dispensed with its assets before Mr and Mrs Black filed a statement in reply in June 2017, and attended mediation and entered into the record of settlement on 4 August 2017. The statement in reply lodged with the Authority in respect of the current proceedings states that the respondent company had ceased trading in March 2016. The company was removed from the Companies Register with effect from 15 December 2017.

[8] Ms Oberndorfer therefore submits that Mr and Mrs Black acted deliberately and knowingly when they caused the company to enter into the record of settlement which Ms Oberndorfer says was a "deception which can only be equated to an act of fraud". She submits that the directors knew that the company would not be able to meet the financial terms of the settlement as they had already disbursed the remaining funds to themselves prior to this date. Ms Oberndorfer states that the directors used the company as a "façade to pretend that their liability would be met".

Relevant legal principles

[9] It is not contested that the Authority has the power pursuant to s 221 of the Act to join parties to proceedings. Section 221 states:

> **221 Joinder, waiver, and extension of time**
> In order to enable the court or the Authority, as the case may be, to more effectually dispose of any matter before it according to the substantial merits and equities of the case, it may, at any stage of the proceedings, of its own motion or on the application of any of the parties, and upon such terms as it thinks fit, by order,—
> (a) direct parties to be joined or struck out; and
> (b) amend or waive any error or defect in the proceedings; and
> (c) subject to section 114(4), extend the time within which anything is to or may be done; and
> (d) generally give such directions as are necessary or expedient in the circumstances.

[10] It is arguable that the action sought by Ms Werner is not actually an act of joinder given that the first respondent no longer exists, so that there is no action to join the second and third respondents to. Rather, it may be seen as an action to enforce the record of settlement against the second and third respondents. Either way, the nub of the issue is whether the Authority has the jurisdiction to order the second and third respondents to comply with the terms of a record of settlement which they were not parties to.

[11] Section 137 of the Act gives the Authority power to order compliance against any person who has not complied with, inter alia, any terms of settlement or decision that s 151 provides may be enforced by a compliance order. Section 151 applies to any agreed terms of settlement that are enforceable by the parties under s 149(3) and so includes the record of the settlement between Ms Werner and the company.

[12] The Authority may make a compliance order against persons that have been joined in proceedings and who are in a position to compel a party against who or which orders have previously been made to meet its legal obligations.[1]

[13] However, of course, this does not assist Ms Werner as there was no relevant legal entity which Mr and Mrs Black can be ordered to make comply with the terms of the record of settlement. The company no longer exists, having been removed from the Companies Register. I refer to s 15 of the Companies Act 1993 which states that the company is a legal entity in its own right separate from its shareholders and continues in existence until it is removed from the New Zealand Register.

[14] Rather, Ms Werner seeks to pierce or lift the corporate veil of the company. This concept was ventilated by His Honour Judge Perkins in the Employment Court judgment of *Katherine Bennett and Others v Sean Michaels and Others*[2]. Judge Perkins examined the authorities in some detail and it is instructive to replicate the following passages from Judge Perkins' judgment. Citations have been omitted, as have some of the extensive quotations.

> [19] The principles applying to situations where the corporate veil will be pierced or lifted are now well established. As stated in Butterworths New Zealand Law Dictionary, 'corporate veil' is a "description of the principle of limited liability of individual members of a company, who are treated as legal entities separate from the company and are not liable for the company's debts". Black's Law Dictionary describes piercing of the corporate veil as "The judicial act of imposing personal liability on otherwise immune corporate officers, directors or shareholders for the corporation's wrongful acts …
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> [21] *Prest v Petrodel Resources Ltd* is the leading United Kingdom case on the subject and has been influential in New Zealand. There are also New Zealand authorities which pre-date this judgment. In *Prest* at first instance, the High Court in this matrimonial property case relied on the following principles, (as summarised at the Supreme Court):
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> > (a) Ownership and control were not in themselves sufficient to pierce the corporate veil. (b) Even where there was no unconnected third party interest the veil could not be pierced only because it is necessary in the interests of justice. (c) The veil can only be pierced if

[1] *Northern Clerical IUOW v Lawrence Publishing Co of NZ Limited* [1990] 1 NZILR 717 at 722, confirmed by *Health & Body Clinic Limited & Others v Anita Zhao* [2011] NZEmpC 51.
[2] [2016] NZEmpC 137 at [19] et seq.

> there is impropriety. (d) The impropriety must be linked to the use of the company structure to avoid or conceal liability. (e) In order to pierce the veil, both control by the wrongdoer and impropriety must be demonstrated. (f) A company may be a façade even though originally incorporated without deceptive intent.

[22] The first instance decision was reversed at the Court of Appeal, but that decision was itself overturned by the Supreme Court. While not directly addressing the list of principles expressed by the High Court Judge (Moylan J) at first instance, the Supreme Court elucidated their meaning and application.

[23] Lord Sumption in the Supreme Court stated that the veil could only be pierced when there was an existing legal obligation which was deliberately evaded by the establishment and use of a company. The veil could be pierced only for the purpose of depriving the company or its controller of the advantage they would otherwise obtain from the company's separate legal personality. He said [omitted]

[24] These statements establish that the company has to have been set up with the *intention* of evading the legal responsibility of the person, if the courts are to pierce the corporate veil to expose that person to personal liability. This will happen rarely.

[26] Lord Neuberger, who surveyed other jurisdictions, concluded that it would not be right for courts to "step in and undo transactions, save where there is a well-established and principled ground for doing so." He accepted that "fraud unravels everything".

[27] *Prest* makes clear that control is not a factor to be considered. LJ Rimer stated that, "… it makes no difference to the fact of a company's separate entity that a single individual controls all its shares. That is, and always has been, a commonplace circumstance".

[28] It is clear from those statements that where a finding is not made that the company was created to evade a legal or fiduciary obligation, the veil cannot be lifted.

[31] *Square 1 Service Group Ltd v Butler* is the main Employment Court case referred to in later Authority determinations and judgments on the subject. In that case the issue was whether the company was created as a sham in order to disadvantage the particular litigant; and the Court found that that purpose was not a prerequisite. It was enough that a sham had been created for any reason. However, the influence of the equity and good conscience jurisdiction of the Employment Court was noted:

> I acknowledge the generally cautious approach taken by Courts in interfering with the long established law of corporate separateness confirmed as long and as authoritatively ago by the Privy Council in *Salomon v Salomon* & *Co Ltd* [1897] AC 22; [1895-9] All ER Rep 33. The cautious approach of Courts even now is illustrated by judgments such as that of the Court of Appeal in *Re Securitibank Ltd (No* 2) [1978] 2 NZLR 136, at pp 158 and 159 per Richmond P.
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> In this Court and in the Employment Tribunal such cautions must be considered in light of the statutory requirement to act in equity and good conscience and given the special nature of employment relationships, especially between individual persons and corporations. This is illustrated by decisions such as *NZ Seamens IUOW* v *Gearbulk Shipping (NZ) Ltd* [1990] 1 NZILR 688, 698.

[32] In *Gearbulk*, while the Labour Court found that it did not need to look behind the corporate veil (to find out whether the actions of the parent company could be fixed on its subsidiary NZ company), it nevertheless acknowledged in obiter its equitable jurisdiction to do so:

> If there be any doubt, we consider that the wide jurisdiction enjoyed by this Court under s.279(4) of the Labour Relations Act 1987 enables us to conduct our consideration of the case by recourse to equitable principles. The drawing aside or piercing of a corporate veil is an equitable doctrine in the Courts of ordinary jurisdiction.

[33] In *Musa*, the Employment Court referred, again in obiter, to the discretion to lift the corporate veil, saying:

> The discretion to lift the corporate veil is one to be exercised rarely and sparingly although that has been done by the Employment Court and its predecessors in a few cases. In those rare cases where the veil has been lifted it has been done so in relation to companies and where there has been a finding of a deliberate sham or arrangement which is a mere façade designed to conceal the true facts. The DHB is not a company and it is not appropriate for the application of the discretion.

[34] *Empress Abalone Ltd v Langdon* is one of the very few employment cases where the corporate veil has been lifted. In that case it was necessary to do so because one of the defendants had had a prior employment relationship on his own account with the plaintiff, and the issue involved the use of confidential information received from his previous employer, to the advantage of his own company. These reasons for lifting the corporate veil would not meet the criteria laid down in *Prest*; and it could be argued that applying the doctrine was not necessary in that case given the personal confidentiality obligations of the previous employee.

> [35] While there is discussion in the authorities about the circumstances in which the corporate veil can be lifted, and cautions commonly given about whether it is open to the Court to lift the veil in most circumstances, the authorities are united in accepting that the one established ground for lifting the corporate veil is in the event of a sham or deliberate fraud.

[15] Judge Perkins in *Bennett v Michaels* did lift the corporate veil to find that Mr Michaels should be personally liable but did so having found that "Mr Michaels deliberately created and used the corporate entities in order to hide behind them and divert any income received from the running of the businesses to himself personally while avoiding liability."

Discussion and disposition

[16] First, there is no allegation by Ms Werner that the company was created as a sham or as part of a deliberate fraud. Whilst Ms Oberndorfer submits that effectively a *fraud* occurred when Mr and Mrs Black caused the company to enter into a record of settlement, promising to make payments to Ms Werner which they knew it could not honour, I do not believe that that is a situation which falls within the principles explored at length and in depth by His Honour Judge Perkins in *Bennett v Michaels*.

[17] Ms Oberndorfer emphasises in her submissions the special nature of the employment relationship and the statutory nature of the mechanism designed to address the employment relationship problems. She submits that it is open to the Authority to lift the corporate veil under circumstances "where the conduct is a deliberate evasion of liability". She submits that it would be reasonable for the Authority to exercise its discretion to join Mr and Mrs Black in these particular circumstances in the interests of equity and justice.

[18] Ms Oberndorfer also draws my attention to s 157 of the Act which provides at s 157(2) that the Authority must, in carrying out its role, *inter alia*, aim to promote good faith behaviour.

[19] Ms Oberndorfer also refers to the purpose of s 149 records of settlement as a means of effectively resolving employment relationship problems at a reasonable cost level and that the applicant will be denied any recourse or justice should the directors not be joined. She also refers to public policy issues whereby the final and binding nature of entering a record of settlement pursuant to s 149 of the Act must be upheld or else that the Authority would effectively be condoning the "deceptive conduct of

the respondent directors" which would not comply with the principles of natural justice.

[20] The starting point must be that Mr and Mrs Black were not parties to the record of settlement. The record of settlement imposed no obligations upon the Blacks in their personal capacity, either directly or by requiring the company to procure that they did or refrained from doing anything (and, in any event, the doctrine of privity of contract provides that a person cannot be liable in respect of obligations imposed on that person by a contract made between others, so that they would not have been personally bound by such a promise).

[21] The cases cited by the Employment Court in *Bennett v Michaels* of the corporate veil being lifted are cases where a corporate limited liability structure had been used to attempt to evade the personal liability of individual shareholders. However, the Blacks never had any such liability towards Ms Werner. All liabilities owed to her were owed by the company, a separate legal entity, and no-one else. Prior to the record of settlement being entered into, Ms Werner was asserting that she had a personal grievance against the company. That claim was what the company was settling. Therefore, the Blacks were not sheltering behind a façade to escape a personal liability.

[22] Furthermore, the benefit in entering into the record of settlement was a benefit gained by the company, not by the Blacks, as the company thereby extinguished all its liabilities to Ms Werner, save those promised in the record of settlement itself.

[23] However, had the record of settlement not been entered into, and had proceedings continued in the Authority and Ms Werner won, it is highly likely that Ms Werner would still not have recovered anything from the company. The company had ceased trading in March 2016 and so, even if there had been misrepresentations made by the directors on behalf of the company it is likely that, ultimately, Ms Werner was not deprived of anything which she would otherwise have had, save perhaps, a declaration of unjustified dismissal. However, that would have been a pyrrhic victory, as she would not have been able to have recovered any remedies awarded or her costs, which would have been greater than $3,500 plus GST.

[24] It is for this reason that I also do not believe that Ms Werner can rely on an alleged fraud to "unravel everything". There is no definition of fraud in the Crimes

Act 1961, but it is generally viewed as comprising knowingly providing false or misleading information for unfair, unjustified or unlawful gain. The Blacks themselves did not make any obviously unlawful gain by causing the company to enter into the record of settlement, and the company did not either, given that it was in no position to pay any remedies that the Authority may have entered into.

[25] In addition, even if Mr and Mrs Black did cause the company to enter into a settlement agreement knowing that the company could not honour the promises made in that record of settlement, any such misrepresentation would have been made by them as agents of the company and, as such, they cannot be personally liable in my view.

[26] Furthermore, it is my view that, if Parliament had intended the Authority to have the power to enforce a record of settlement against directors and shareholders of a company in circumstances similar to those currently before the Authority, it would have expressly legislated for such a possibility. I refer to s 142Y of the Act which enables an employee to recover from a person who is not the employee's employer any wages or other money payable to the employee if, *inter alia*, the default is due to a breach of employment standards. It would have been relatively simple for Parliament to have made "a person involved in the breach" (as defined in the Act), liable to pay to an innocent party sums owed by that party's employer by way of a binding record of settlement. It has chosen not to do so.

[27] Ms Oberndorfer also makes reference to s 136 of the Companies Act which states:

> **136 Duty in Relation to Obligations:**
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> A director of a company must not agree to the company incurring an obligation unless the director believes at that time on reasonable grounds that the company will be able to perform the obligation when it is required to do so.

[28] However, I agree with Mr Hearn when he asserts that that duty is owed to the company, not to creditors, by virtue of s 169(3) of the Companies Act.

[29] I also note s 97 of the Companies Act which states that, except where the constitution of a company provides that the liability of the shareholders of the company is unlimited, a shareholder is not liable for an obligation of the company by reason only of being a shareholder.

[30] In conclusion, the company was liable to Ms Werner, and not the Blacks personally. That is the very nature of limited liability companies. Ms Werner's loss is actually attributable to the company becoming insolvent. She is therefore in the same position as any other creditor would be. The legal test for lifting the corporate veil has not been made out. If the Authority were to do so it would be impermissibly obliging the second and third respondents to incur a liability they never legally had. That would not be in keeping with the equitable and good conscience jurisdiction of the Authority, which must apply equally between the parties.

Determination

[31] Whilst I have a great deal of sympathy for Ms Werner's position, I am unable to find that the case is made out to lift the corporate veil and to order Mr and Mrs Black to pay to Ms Werner the sums due to her under the record of settlement.

Costs

[32] I reserve costs. I urge the parties to seek to agree how costs are to be dealt with between them but if they are unable to reach agreement within fourteen days from the date of this determination the respondent may serve and lodge a memorandum setting out what contributions to its costs it seeks and the basis for that. Ms Werner will then have a further fourteen days within which to serve and lodge a written response.

David Appleton
Member of the Employment Relations Authority