

**IN THE EMPLOYMENT RELATIONS AUTHORITY
CHRISTCHURCH**

CA 166/08
5118960

BETWEEN H P HANNA & CO LIMITED
Applicant

AND PETER O'BOYLE
Respondent

Member of Authority: Helen Doyle

Representatives: Linda Penno, Counsel for Applicant
Peter O'Boyle in person

Investigation Meeting: 14 August 2008

Submissions received: 27 August 2008 from Applicant
16 September 2008 from Respondent

Determination: 3 November 2008

DETERMINATION OF THE AUTHORITY

Employment relationship problem

[1] HP Hanna & Co Limited (Hanna & Co) is a limited liability company that carries on business as chartered accountants. Peter O'Boyle is a chartered accountant who was employed as an associate by Hanna & Co from 11 December 2000 until the end of August 2005.

[2] Hanna & Co says that Mr O'Boyle breached clause 9(ii) of his employment agreement because he did not pay goodwill for clients he took over following his resignation.

[3] Hanna & Co seeks payment of goodwill in the sum of \$10,356.71 together with interest and costs. A penalty was also sought but I am not satisfied that the action for the penalty was commenced within the time limits in s.135(5) of the

Employment Relations Act 2000 and the penalty claimed in those circumstances cannot be considered.

[4] Mr O'Boyle does not accept that he has any obligation to pay goodwill to Hanna & Co as he did not approach any of the Hanna & Co clients but rather they approached him. Mr O'Boyle said that he put his interpretation of clause 9(ii) to the directors of Hanna & Co at the time that he gave three months' notice of his resignation and they did not disagree with his interpretation at that time or make any other comment whatsoever. Mr O'Boyle counterclaims and says Hanna & Co owe him a part year reimbursement of his Institute of Chartered Accountants of New Zealand (ICANZ) fees in the sum of \$109.97 together with money for underpaid and unpaid bonuses for the financial years ending 31 March 2005 and 31 March 2006.

[5] Hanna & Co accepts that under the employment agreement there is an amount owing to Mr O'Boyle in the sum of \$109.97 for ICANZ fees but does not agree that there is any money or entitlement due to Mr O'Boyle in terms of the 2005 or 2006 financial year profit share bonus.

Issues

[6] The issues for the Authority are:

- What is the meaning of clause 9(ii) of the employment agreement;
- Is the covenant in clause 9(ii) a reasonable one;
- What bearing does the conversation Mr O'Boyle had with the directors of Hanna & Co, Michael and Piers Hanna, on 9 June 2005 about his understanding of clause 9(ii) have;
- If the point is reached where quantum for goodwill is required to be considered, then what is due and owing by Mr O'Boyle;
- Is Mr O'Boyle entitled to payments for bonuses?

What is the meaning of clause 9(ii) of the employment agreement?

[7] Mr O'Boyle says that no goodwill under clause 9(ii) is payable for clients of Hanna & Co who approached him and chose to come to his new accountancy practice.

He says that the clause only applies to situations where he approaches clients and encourages them to come to his new accountancy practice.

[8] Clause 9(ii) provides:

In the event of termination of this contract and the employee takes over any company client, then the employee covenants to pay goodwill to the company at the current rate applying in the region for the purchase of fees except for clients introduced to the company by the associate.

[9] The dispute is about the meaning of the words *takes over* in relation to any client of Hanna & Co. The relevant meaning of the words *take over* as defined in the New Zealand Oxford Dictionary is:

- (i) *Succeed to the management or ownership of.*
- (ii) *Take control.*

[10] This can be contrasted with the meaning of the word *take* on its own. The relevant meaning of the word *take* in the New Zealand Oxford Dictionary is:

- (i) *Lay hold of; get into one's hands.*
- (ii) *Acquire, get possession of, capture, earn or win.*

[11] Because clause 9(ii) uses the words *takes over* with respect to any company clients, then it is the take over of the control of the clients from Hanna & Co which triggers the application of the clause and not how that control is obtained. For that reason, I do not agree with Mr O'Boyle's interpretation of clause 9(ii) that it applies only to situations where Mr O'Boyle encouraged clients to come to his accountancy practice.

Is the covenant in clause 9(ii) a reasonable one?

[12] Mr O'Boyle says that the covenant is not a reasonable one. He says that there was no consideration for it, there is no time limit for it and there was no interest for Hanna & Co to protect.

[13] Whether or not a particular covenant is reasonable requires regard to be had to the history of the employment, the nature of the protection it affords to the employer and the impact on the employer of an employee taking over clients on resignation and the effect on Mr O'Boyle of a covenant being enforced. Consideration also has to be given to any relevant issue of public interest although Mr O'Boyle is not restricted in taking over company clients but there is a cost if he does.

[14] The appropriate time to assess reasonableness of the covenant is at the time the employment agreement was entered into. Mr O'Boyle was an associate at that time and Hanna & Co wanted to preserve its client base from the influence that an associate would have over clients. That is a valid factor which would support reasonableness of such a covenant because as an associate I accept Mr O'Boyle would have reasonably significant influence over clients.

[15] I do not consider that an inquiry into the adequacy of consideration is necessary in this case where the covenant was not by way of variation to an existing employment agreement. I note that Mr O'Boyle, whilst having an issue about bonus payments, does acknowledge in his submission that the share of profit in the employment agreement for associates was expected to be more than the level of bonuses provided to staff who were not associates.

[16] There is no time limit in clause 9(ii). Mr Hanna agreed that there had to be a reasonable period of time within which goodwill would be payable in terms of company clients. The last date for any goodwill claimed by Hanna & Co was 12 April 2006 with most of the amount claimed for goodwill arising from clients taken over in early November 2005.

[17] The covenant, to be reasonable, cannot be unlimited as to time. There is in the employment agreement a requirement that Mr O'Boyle give 13 weeks' notice in the event of termination if he is intending to practice on his own account or in association, directorship or partnership with another accountancy practice. Michael Hanna gave evidence that some clients require work to be performed on an annual basis rather than more regularly so, that may impact on whether or not there is an earlier take over of a client. In my view, however, the reasonableness of the protection is to cover for the first few months of departure when clients are more likely to change because of a relationship built up with the associate.

[18] Taking into account the notice period required of 13 weeks, I find a reasonable protection for Hanna & Co from the point of termination of employment would be three months. I have reached that conclusion as to reasonableness because the period of three months coupled with the notice period would give sufficient time in my view for steps to be taken by Hanna & Co to minimise client loss.

[19] I reach the conclusion that the covenant is unreasonable because it is without any limit as to time. I am of the view, however, that I should exercise my discretion under clause 8 of the Illegal Contracts Act 1970 and modify the provision by limiting the time for the covenant in clause 9(ii) to a period of three months after the termination of the contract. With that modification, the provision would have been reasonable at the time the employment agreement was entered into. Clause 9(ii) is modified accordingly.

What bearing does the conversation Mr O'Boyle had with the directors of Hanna & Co, Michael and Piers Hanna, on 9 June 2005 about his understanding of clause 9(ii) have?

[20] On 9 June 2005, Mr O'Boyle had a discussion with Piers and Michael Hanna. Mr O'Boyle advised them of the fact that he was resigning and that he may be going into practice on his own account. Mr O'Boyle talked about his interpretation of clause 9(ii) and that goodwill would only apply in the event that he approached clients and not if clients approached him.

[21] There was no response at that time to his view of the clause and Mr O'Boyle is particularly aggrieved by that. Michael Hanna said in his evidence that he did not consider Mr O'Boyle's work intentions definite and in those circumstances he chose not to enter into a debate about clause 9(ii) and sour the employment relationship unnecessarily.

[22] Mr O'Boyle said in his evidence at the Authority investigation meeting that if there had been disagreement expressed at the time with his view of clause 9(ii) then he may not have taken over one or two of the clients, but would still have taken the balance who approached him. Mr O'Boyle said that he would have approached clients himself. In his final submission, Mr O'Boyle said he would also have claimed holiday pay on bonuses for previous years and raised the issues at the time that he now does in terms of underpaid bonuses and payment for an additional 2006 bonus.

[23] On 19 October 2005, Mr O'Boyle wrote two letters to the directors of Hanna & Co. One letter set out clients who came into the firm through Mr O'Boyle and he requested records for those clients and the other letter set out clients who had asked Mr O'Boyle to look after their accounting work and Mr O'Boyle also sought their records.

[24] On 4 November 2005, Mr Hanna wrote to Mr O'Boyle and advised in terms of the second letter that goodwill was payable in respect of the clients who had asked Mr O'Boyle to look after their work. Mr Hanna explained in his letter that he had contacted Bizstat and had been advised the current goodwill percentage payable was 63% as a percentage of fees. Mr Hanna included the phone number of Bizstat in his letter. Mr Hanna explained in his letter that the percentage is normally calculated by multiplying the previous year's annual fees to derive goodwill. Mr Hanna set out the fees charged to the client and the percentage of the fees and invoiced Mr O'Boyle for \$7,150 (inclusive of GST).

[25] On 21 November 2005, Mr O'Boyle responded to the letter and advised that, amongst other matters, he could see no obligation to pay goodwill to Hanna & Co and he referred to the fact that there was no disagreement with his interpretation of clause 9(ii) at or following the discussion in June 2005.

[26] With the benefit of hindsight, it would obviously have been preferable had there been a response about clause 9 (ii) in June 2005 from Hanna & Co's perspective. An employer has good faith obligations to be communicative and responsive and whilst it may have caused some short term difficulty in relations, it could have avoided difficulties long term.

[27] Having heard from Mr O'Boyle, I am not satisfied that he can have been said to have acted to his detriment in reliance on the silence. Mr O'Boyle accepted that he would still have taken over most of the clients who approached him and it did seem that there was a strong likelihood that Mr O'Boyle would not have been persuaded that his interpretation of clause 9(ii) was incorrect.

[28] Rightly or wrongly a decision was made not to enter into a discussion with Mr O'Boyle at that point about the clause. I accept Michael Hanna's evidence that he did not believe it was inevitable that Mr O'Boyle would go into private practice and did not wish to sour the relationship. I do not find that silence can be taken in the circumstances as amounting to an unequivocal agreement to Mr O'Boyle's interpretation or as a misrepresentation so as to change or vary the express provision in the employment agreement.

What is the goodwill payable?

[29] I accept Ms Penno's submission that Mr O'Boyle has never taken an issue with the quantum of the claim, even when asked during the telephone conference with the Authority whether there was an issue. There was no reference to quantum in Mr O'Boyle's statement of evidence. Mr O'Boyle was of the view that there was no obligation for him to pay anything at all.

[30] At the Authority investigation meeting, Mr O'Boyle raised for the first time a dispute about the formula used to calculate goodwill by Hanna & Co. There needs to be some finality to this matter for both of the parties because it has been without resolution for a considerable period of time.

[31] I find that the goodwill percentage payable of 63% was the current rate that applied in the region as at November 2005. Mr O'Boyle was given an opportunity to contact Bizstat himself and provide a different figure at the time. I do not find that any issue can be had with the goodwill percentage payable.

[32] Mr O'Boyle wants to be provided with the basis on which the goodwill was assessed which is the fee invoiced for the previous year's annual fees. I think that is reasonable. Mr O'Boyle also wanted an explanation for significant fee variations from previous years because he says that it is not reasonable to assess goodwill on the basis of a one-off larger fee. I have considered that matter. Although there may be some larger one off fees over the course of any client/accountant relationship it is swings and roundabouts. Provided that there is a consistent approach for assessing goodwill as there is here on the basis of the previous years annual fees then I find that that is a reasonable approach. There will be some change to the goodwill amount because of the modified time period, but I do not consider that will be significant.

[33] I believe it is important that client identity and fees remain confidential and I will not set those out in my determination. Within 10 days of the date of this determination, Ms Penno is to send an amended invoice to Mr O'Boyle for the amount of goodwill payable for clients that Mr O'Boyle took over in the three month period following termination. Ms Penno should attach to the invoice support documents for the previous year's annual fees on which goodwill was assessed. The formula for assessing goodwill on the previous year's annual fees is reasonable and does not change.

[34] Leave is reserved in the circumstances for Ms Penno to return to the Authority if an order as to the amount of goodwill is required and the Authority will make a final determination on the amount of goodwill to be paid by Mr O'Boyle to Hanna & Co.

Interest on amount owing

[35] Mr O'Boyle has had the benefit of taking over clients from Hanna & Co and performing work on their behalf since late 2005. I am not minded however to make an award that interest should be payable from that early time as there were some delays in progressing the matter on the part of Hanna & Co and the clause has required some modification.

[36] I make an order that there should be an award of interest from the date Ms Penno provides an amended invoice for goodwill until the date of payment under clause 11 of the Second Schedule to the Employment Relations Act 2000. The rate of interest, which at the date of making this determination does not exceed the 90 day bill rate plus 2% is 8%.

The bonus claim

[37] Mr O'Boyle has two claims against Hanna & Co. The first is that the company failed to comply with its obligations under clause 6 of his employment agreement in terms of the share he was paid with respect to profit for the year ending 31 March 2005. Mr O'Boyle said that one of the directors constructively reduced the profit by purchase of a company vehicle and subsequent payment of fringe benefit tax. Mr O'Boyle says that as a result of this, his share of the profit bonus was reduced by \$2,000.

[38] Clauses 5 and 6 of the employment agreement are relevant. For the year ending 31 March 2005, Mr O'Boyle received a payment of \$9,000 as his share of the profit by way of bonus. Clause 5 provides that a reduction of profitability would reduce the level of bonus and that the bonus each year cannot be guaranteed.

[39] Clause 6 provides the criteria, but the minimum share of fees is accepted to be not less than \$5,000 and that the share of profits allocated to each associate shall be paid within 63 days of the end of the year which is 31 March.

[40] Mr O'Boyle's claim is concerned with the way that profit was calculated. I do not find that Mr O'Boyle's claim is made out for a further payment of \$2,000 for the year ending 31 March 2005 because of any constructive reduction in profits. The way the profit was calculated is not a matter for Mr O'Boyle under the employment agreement but rather how that profit was allocated to him as an associate.

[41] The second claim is for a pro rata bonus payment for the months Mr O'Boyle worked in 2005 from April to the end of August. Mr O'Boyle says that he is entitled to a bonus to be calculated on the profit as at 31 March 2006 and on the basis of an expected minimum payment of \$5,000 as set out in clause 6.

[42] Clause 6 of the employment agreement provides for the share of profit allocated to each associate to be paid within 63 days of the end of the financial year. Clause 5 provides that the share of the company profit is paid to the employee usually within two months of balance date.

[43] As at the date that the payment would be made, Mr O'Boyle was not an employee. I have considered carefully the provisions in clauses 5 and 6 as to whether it is either expressly or impliedly provided that a pro rata payment of the profit share should be made in the event that the employment relationship is terminated before payment date. I do not find that any such obligation can be expressly or impliedly taken from the provisions referred to above. I do note that one of the matters to be taken into account in terms of a share of profit is whether the fees basis has been eroded by the loss of clients. In that regard, of course, Mr O'Boyle had taken over the work of some of Hanna & Co's clients which no doubt impacted on profitability.

[44] In conclusion I do not find that Mr O'Boyle's counterclaim has been made out.

Holiday pay on bonuses

[45] Although not part of Mr O'Boyle's claim, there was reference to holiday pay on bonus payments made over the period of his employment. I did not hear from Hanna & Co with respect to this matter. At this stage, and simply for completeness, I draw Mr O'Boyle's attention to s.14 of the Holidays Act 2003 which section defines the meaning of gross earnings for the purpose of assessing holiday pay. Any such claim in that regard would have to be assessed in terms of that section and the main issue to be considered by Mr O'Boyle is whether the bonus payments were payments that Hanna & Co was required to pay him under his employment agreement or

whether they were payments that Hanna & Co was not bound to pay Mr O'Boyle but were discretionary payments.

Costs

[46] I reserve the issue of costs. Ms Penno has until 5 December 2008 to lodge and serve submissions with respect to costs. Mr O'Boyle has until 19 December 2008 to lodge and serve a response to the applicant's submissions as to costs.

Helen Doyle
Member of the Employment Relations Authority