IN THE EMPLOYMENT RELATIONS AUTHORITY
AUCKLAND

AA 224/09
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	BETWEEN	MICHAEL BRYAN KELLY First Applicant
		KATHRYN RAE McGILL Second Applicant
	AND	LODGE AT 199 LIMITED Respondent

Member of Authority:	Alastair Dumbleton
Representatives:	First Applicant in person, and as representative for Second Applicant Rose Alchin, counsel for Respondent
Investigation Meeting:	20 April 2009
Submissions Received	8, 13 and 18 May 2009
Determination:	8 July 2009

DETERMINATION OF THE AUTHORITY

Employment relationship problem

[1] The question to be answered by the Authority in this determination is whether an employment relationship existed at material times between Mr Michael Kelly and Ms Rae McGill, and the company registered as Lodge At 199 Limited. The issue is whether each applicant was an employee within the meaning of the Employment Relations Act 2000.

[2] Section 6 of the Act requires the Authority in deciding that issue to determine the real nature of the relationship between the parties concerned. In doing so, under s 6(3), the Authority:

> *(a)* *must consider all relevant matters, including any matters that indicate the intention* [of the parties]*; and*
>
> *(b)* *Is not to treat as a determining matter any statement* [by the parties] *that describes the nature of their relationship.*

[3] Ms McGill did not attend the investigation meeting and could not be examined on her claim. No direct evidence has therefore been taken from her to support her application, although Mr Kelly contends that she was employed under the same arrangements applying to him and of which he gave evidence.

[4] Mr Kelly and Ms McGill claim that Lodge At 199 Ltd failed to pay salary, holiday pay and allowances, due to them from their employment by the company as employees between 1 April and 20 October 2007. They each claim $14,000 as unpaid salary.

[5] After the claims were commenced the parties undertook mediation but they were unable to resolve the problems between them.

[6] There is no dispute that Mr Kelly and Ms McGill gave a great deal of time to providing their personal work for the luxury accommodation business of Lodge At 199 Ltd. They carried out a range of functions big and small in managing and running the company's two boutique lodge properties.

[7] There is nothing intrinsically about the particular work Mr Kelly and Ms McGill did that determines or indicates the nature of the relationship under which it was performed. That kind of work is not the exclusive domain of employees under an employment relationship but was work which could equally be performed by a person under a different relationship, such as a contractor under a contract for services, or an owner/partner, or a party engaged in a joint venture.

[8] There is no dispute between the parties in this case about the nature of the relationship between them prior to April 2007, the date from which Mr Kelly and Ms McGill claim they became employees and entitled to wages or salary. Before then they were not employees of Lodge At 199 Ltd. At the beginning the relationship was essentially the one described by Mr Kelly in his letter of 12 January 2005 to Mr Stuart Walker and Mrs Susan Walker, the financiers of the lodge business. Mr Kelly proposed a *"Joint venture,"* which he said was to be:

> *… set up whereby the business is a JV and profits are shared.*

> …
>
> *How this would work will depend on what each party brings. Obviously we offer sweat equity in setting up the business and operating it and all the contacts, expertise and reputation that goes with that.*

[9] Mr Kelly provided a budget to the Walkers to demonstrate the viability of the business, which at that time had only one lodge.

[10] In his letter he said that under the joint venture a lease on the Lake Tarawera lodge property would return the Walkers about $70,000 a year and that he and Ms McGill expected *"at least $100k salary from such a venture as this."* He said this was because *"we are after all doing 100 hour weeks Monday-Sunday without a break as well as building a business and goodwill."*

[11] Further Mr Kelly in his letter proposed:

> *… a 60/40 split in profits to $150k and 50/50 thereafter. In the second and third years this will really prove to be rewarding. At such time as you wish to sell, the goodwill associated with the business would be split 50/50. Capital gains are your gain from your investment and I cannot see any equity in sharing such gain. Should the property be sold without the business (ie as a private home) the business could be valued at 50% value paid to us from the proceeds of the sale.*

[12] Mr Kelly concluded his January 2005 letter by pointing out that its contents were for discussion and the detail would need to be worked through once the basic structure had been agreed upon.

[13] The joint venture nature of the relationship with the Walkers at the beginning was also confirmed by Mr Kelly in a letter written by him on 5 April 2005 to a solicitor, Mr Brian Adams. Mr Kelly advised that he and Ms McGill were setting up a new luxury lodge in Rotorua and that the property itself belonged to the Walkers. He said that the lodge business would be *"a Joint Venture between us"* and said he considered the arrangements could be best formalised by forming a New Zealand shelf company to be 50% owned by each party. He proposed that the company would operate the business of the lodge, and collect and pay GST. In his letter Mr Kelly said that he and Ms McGill wanted exclusive use until the agreement was dissolved by mutual agreement. He noted that there was no lease payment to be made at all to the

Walkers for the property, and that *"we do not draw a wage."* Mr Kelly also said in his letter:

> *The agreement is based on the fact that the Walkers provide a Lodge with all amenities and chattels to the business. We bring the expertise to start, operate and build the business. The "lease" value is put at $70k per annum while our expertise and time is put at $100k plus. So we have agreed that the first $150k in profits will be split 60/40 in our favour and at 50/50 thereafter.*

[14] And he continued:

> *When the agreement to "lease" the property is determined the value of the business is to be split 50/50 ie the Walkers take the house back as a private residence, they pay us in cash 50% of the current value of the business.*
>
> *In thinking this through Rae and I do not want to be tied to the place for ever so from our point of view we would not want to be tied down for more than 2-3 years. So I suppose we should have the right to sell our 50% to anyone of whom the Walkers approve … .*

[15] The arrangement entered into at the beginning of the relationship between Mr Kelly, Ms McGill and the Walkers is succinctly described in the written statement of 3 May 2008 provided to the Authority by Mrs Susan Walker:

> *Our agreement was that we would contribute the money free of interest and Michael and his partner Rae McGill would put in the labour free of charge.*

[16] Consistently with the evidence given by Mr Kelly, she went on to say:

> *From recollection we were to claim $70,000 New Zealand rent and after that we were to split the profits 50/50. Michael produced budget forecasts that profits would be made, and we were clearly in business to earn those profits.*

[17] The Walkers claim that in about 2006 the arrangements were changed to the extent that Mr Kelly, at his request, took monthly drawings on account of the expected profit that the business had been budgeted (by Mr Kelly) to make, and it was agreed that he could draw funds against a loan account he had with Lodge At 199 Ltd. Mrs Walker said of this in her statement:

> *… $4,000 NZ per month from the Lodge account … was effectively money direct from us as we were supporting the conversions and cash losses at the time.*

[18] In March 2007 when the Walkers visited New Zealand and met Mr Kelly and the company accountant Mr Keith Robertson, they became concerned about poor profitability and cash flow in the business. Mr Kelly was asked not to take any further drawings from the company and to give all records to Mr Robertson, who the Walkers had asked to take over the financial side of the business.

[19] Although the business was assessed as having made a loss the Walkers decided to continue supporting it, with Mr Walker agreeing to bear 90% of the considerable losses.

[20] The Walkers deny that Mr Kelly was ever paid wages and say that the $4,000 per month he received was drawings as an advance on future profits in what was a profit sharing arrangement.

[21] The Walkers deny that there was any change at any time to the nature of their relationship from one of being joint venturers, to one of being employer and employees. With reference to her husband's gesture of goodwill, Mrs Walker said that he had:

> … *agreed to fund 90% of the losses* [estimated to have been about $1M] *and therefore he cannot now ask Michael to pay his 50% share of this. It is a pity that Michael now seems to have forgotten this commitment and contribution to our partnership, or the fact that he was to contribute labour free of charge.*

[22] And as Mrs Walker put it:

> *Michael was allowed to take $4,000 NZ drawings for a limited period of time from the company in lieu of the profits that we had expected to be forthcoming. These profits did not materialise, however, again as a gesture of goodwill my husband agreed that he would waive the reimbursement of those drawings which had been taken.*

[23] Among the documents produced by Mr Robertson on behalf of Lodge At 199 Ltd was a budget for April 2007 showing $4,000 as projected *"Drawings"* for *"Mike & Rae."* By contrast another amount is shown as *"wages"* for Kath, a person employed in the business.

[24] A budget prepared for 2007/2008 also contains the same information and the same amount of $4,000 for each month in respect of *"Rae and M."*

[25] An income statement for the year ended 31 March 2007 for Lodge At 199 Ltd shows Managers *"reimbursement"* at a certain sum.

[26] Mr Robertson when he took over the financial affairs of the company, in an email dated 18 October 2006 expressed his surprise to Mr Kelly that he was taking drawings of $48,000 pa and charging GST on them as well as a *"Manager's salary,"* while drawing $4,000 per month plus GST. Mr Robertson pointed out that GST was not able to be charged on drawings. He also pointed that it was not prudent for a company to pay a salary to an owner exceeding the profit of the company.

[27] Also in relation to the $4,000 received by Mr Kelly from the company each month, this was paid against an invoice for $4,000 and $500 GST rendered by *Par-Excellence*, Mr Kelly's trading trust.

[28] Mr Kelly's evidence is that there was a change made by the Walkers to his and Ms McGill's remuneration in early 2007. He says that Mr Robertson made a demand on him for $200,000 being his purported share of losses to March 2006, and it appears his response to that was to point to:

> *The verbal agreement with Walker is that Kelly would operate the Company but Walker would fund it.*

[29] Mr Kelly referred to the invoicing of $4,000 plus GST per month for his management services from February 2006 until March 2007. He says that he and Ms McGill were being put under pressure to reduce their shareholding from 50% to 10% and although this was done and he ceased being a director of Lodge At 199 Ltd, no payment was made in return. He says:

> *At the same time Kelly and McGill were told that they were not to invoice the Company for remuneration but would now be paid individually with PAYE being paid. Kelly and McGill provided personal bank account details and personal IRD numbers to Robertson.*
>
> *From April 2007 no further invoices were raised. From this time Kelly and McGill were very clearly under the impression that they were employees and would be paid wages.*
>
> *At this time approximately all were told Kelly and McGill were not to be paid anything.*

[30] Mr Kelly refers to the existence of:

> *… a clear expectation of remuneration from April 1 2007 until October 20 2007 when he* [Mr Kelly] *and Ms McGill stopped working for the business.*

[31] The case for the applicants is that they were promised by Mr Robertson on behalf of Lodge At 199 Ltd remuneration during that period of nearly seven months, and that they had always been under the impression they were employees during that time.

[32] I find that the impression the applicants had, or their expectation of being remunerated as employees during the period of claim, was not based on the existence of any employment relationship that had been formed.

[33] Merely changing the basis on which remuneration was paid does not, by itself, change the nature of a relationship to that of employer/employee if it had been a different one, such as a partnership or a joint venture, from the beginning.

[34] Wages are paid and PAYE deducted because a person is an employee, not the other way round.

[35] The circumstances outlined above as I find them to be strongly indicate that employment was not the real nature of the relationship between the parties. I find that throughout their relationship with Lodge At 199 Ltd, Mr Kelly and Ms McGill speculated upon their equity in the business growing from the sweat they put into it to yield them a return from profits made and goodwill built up.

[36] In *Bryson v Three Foot Six Ltd (no 2)* [2005] ERNZ 372 the Supreme Court considered a number of principles to be relevant in deciding cases such as this. Relevant matters under s 6(3) of the Act, were regarded by the Court as including features of control and integration and also whether a contracted person was working on his or her own account.

[37] The evidence shows that Mr Kelly retained and used a very high degree of control in the way he and Ms McGill performed their work. His strong resentment of Mr Robertson being given control over the financial affairs of the business is some demonstration of this. The integration test when applied shows that Mr Kelly and Ms McGill must be viewed as having been closely integrated into the business, but together, as a unit, rather than as individuals individually providing their service.

[38] Mr Kelly was obviously disappointed with the performance of the business, as his returns from it were affected by the lack of profitability. But he had speculated on the clear and considerable stake he had in generating profitable returns from the

business. The absence of profits did not allow him to change to a different relationship attracting wages to make up for his losses. I find that Mr Kelly and Ms McGill were, as a unit, in business on their own account and took the risk that they would not be remunerated to the level they had hoped for.

[39] The Court in *Bryson* also held common intention to be a relevant factor under s 6 of the Act. In this regard in this case the most that can be said is that Mr Robertson did try to ascertain the intention of the parties towards entry into an employment relationship but that nothing was finally agreed to.

[40] The Authority has no doubt that Mr Kelly and Ms McGill put a considerable amount of time and effort into building up the Lodge business over several years. For some of that time they received no regular remuneration. I am satisfied, however, that no legal entitlement to wages or salary as employees arises in this case. Mr Kelly and Ms McGill were, I find, in business on their own account with the opportunity of improving their financial position and stake in the business through their work and by use of their skills and acumen. Whether that improvement ultimately occurred was the risk that they undertook as joint participants in a business venture.

Determination

[41] For the above reasons, the Authority determines that Mr Kelly and Ms McGill were not employees within the meaning of the Employment Relations Act 2000. Employment was not at any time the real nature of their relationship with Lodge At 199 Ltd. Mr Kelly and Ms McGill are not therefore able to have determined a claim that they were underpaid remuneration for their work.

Costs

[42] Costs are reserved.

[43] As the respondent wishes to seek an award, Ms Alchin may file within 21 days a memorandum detailing the actual costs incurred. A copy of this will be served on Mr Kelly and Ms McGill who shall have a further 21 days in which to file a reply in writing.

A Dumbleton
Member of the Employment Relations Authority