IN THE EMPLOYMENT RELATIONS AUTHORITY
CHRISTCHURCH

[2013] NZERA Christchurch 90
5399425

	BETWEEN	DIANE LIVINGSTON Applicant
	A N D	G L FREEMAN HOLDINGS LIMITED Respondent

Member of Authority:	Helen Doyle
Representatives:	Carren McDonald, Advocate for Applicant Tim McGinn, Counsel for Respondent
Investigation meeting:	9 May 2013 at Christchurch
Submissions Received:	On the day
Date of Determination:	16 May 2013

DETERMINATION OF THE AUTHORITY

A **I have found that the forfeiture provision in clause 12.1 of the individual employment agreement is not enforceable because it is a penalty provision.**

B **I have ordered G L Freeman Holdings Limited to pay to Diane Livingston the sum of $1,943.50 being forfeited accrued annual leave and payments for alternative days.**

C **I have not awarded interest on that amount in the circumstances.**

D **I have not found any evidence of actual damage and have therefore made no award of damages.**

E I have ordered that there be a penalty payable by Diane Livingston in the sum of $500 for breach of clause 12.1. $250 is to be paid into the Authority to then be paid into the Crown Bank Account and $250 is to be paid to G L Freeman Holdings Limited.

F I have reserved the issue of costs and failing agreement have set a timetable.

Employment relationship problem

[1] Diane Livingston says that the forfeiture by G L Freeman Holdings Limited of accrued annual leave and payment for alternative days in lieu of working on a public holiday was the imposition of a penalty for not giving six weeks notice under clause 12.1 of her individual employment agreement (the employment agreement) rather than a genuine pre-estimation of the damage that would be caused in the event of a breach of the notice requirements.

[2] It was clarified at the Authority investigation meeting the amount of pay withheld from Ms Livingston in her final pay and how it was made up. The combined amount forfeited for accrued annual leave and payments for alternative days was $1,943.50 gross. Ms Livingston seeks to recover the sum of $1,943.50 gross together with interest and costs.

[3] Clause 12.1 provides:

> *Employment may be terminated by either employer or employee upon six weeks notice of termination being given in writing. The employer may elect to pay six weeks wages in lieu of notice and in the event that the employee fails to give the required notice then equivalent wages shall be forfeited and deducted from any final pay including holiday pay.*

[4] Clause 6.4 that provides:

> *Should the employee be indebted to the employer for wages forfeited due to lack of notice (clause 12.1) or for any other reason (including negligent transaction processing under clause 6.3) or the failure to return property belonging to the employer, the employee agrees that the appropriate sum may be deducted from the employee's wages and/or holiday pay or final pay*

[5] G L Freeman Holdings Limited owns and operates the Redwood Hotel in Christchurch. I shall refer to the company as G L Freeman in this determination. The Authority heard evidence from Gordon Freeman who is the sole director and shareholder of G L Freeman.

[6] G L Freeman does not accept that Ms Livingston is entitled to be reimbursed for holiday pay and alternative days. It says that clause 12.1 in the agreement does not impose a penalty but is a genuine estimate of the loss that would be caused by failure to give the requisite notice.

[7] G L Freeman also seeks a penalty against Ms Livingston for breaching her employment agreement because she gave two weeks notice of termination instead of the six weeks required in her employment agreement. It seeks a penalty against Ms Livingston in the sum of $5,000 and requests that half of that sum be payable to it in recognition of the cost and inconvenience suffered above that addressed by forfeiture of her accrued annual leave and payment in lieu of working statutory days.

The issues

[8] The issues before the Authority to be determined are as follows:

(a) Is the provision in clause 12.1 for the forfeiture of holiday pay or wages enforceable?

(b) If the provision in clause 12.1 is not enforceable then did G L Freeman suffer damage for which an award should be made?

(c) Should there be a penalty awarded to the respondent for the breach of clause 12.1 of the employment agreement?

Is the provision in clause 12.1 for the forfeiture of holiday pay or wages enforceable?

[9] Ms Livingston commenced her employment with the Redwood Hotel on 27 July 2011. Her position as described in her employment agreement was front desk reception. The duties she was responsible for whilst rostered included cash handling, banking, completing the daily audit, accommodation and restaurant bookings and training new staff.

[10] Mr Freeman described the Redwood Hotel in his statement of evidence as a large establishment with a licensed restaurant and bistro, *Sequoia 88*, which provides lunch and dinner. There are 27 accommodation units, conference facilities, a wholesale liquor bottle store, five bars, gaming and a large gym. Mr Freeman described Ms Livingston's role as a key role and Ms Livingston agreed under questioning that her role was an important one.

[11] Ms Livingston said that she became unhappy in her role and started to look for other positions. She was unable, because of her financial situation, to leave her employment without securing another role first. Ms Livingston was able to secure another position and entered into a written employment agreement with her new employer on 17 July 2012.

[12] Ms Livingston then resigned from her employment on or about 19 July 2012 and gave two weeks notice, with her final working day at the Redwood Hotel being 1 August 2012. As required by her employment agreement she delivered her written notice in person to Mr Freeman. Mr Freeman's evidence about what was said when Ms Livingston gave him notice of her resignation in writing was different to Ms Livingston's. Mr Freeman said that he advised Ms Livingston that if she did not give the required notice he would look to enforce clause 12.1 as she would be leaving him in the *lurch* by leaving so quickly. Ms Livingston, he said, responded that she was *sorry* and that she *realised this short notice will cause a lot of problems but I need to take this new job as the hours and the job suit me better.* Mr Freeman said that he did not respond or engage with Ms Livingston further on this as he did not have a witness in case issues arose, as is his normal policy.

[13] In her written notice of resignation, Ms Livingston said that she had found another role and that she would seek legal advice about her holiday pay. She said that in respect of the legal advice Mr Freeman said words to the effect *good luck with that* and *it sounds expensive* and Mr Freeman thought he may well have used the words about the expense of such action. Ms Livingston did not accept that Mr Freeman told her when she gave notice that her holiday pay would be forfeited. She did not accept that she had been apologetic because she had not given the full amount of notice. Ms Livingston said that she did not want to lose her holiday pay but believed that continuing to work would have been difficult and that under the circumstances, two weeks was the *top end of my limits*. Ms Livingston said that she had had some issues

with Mr Freeman and was expecting some difficulty during her notice period but accepted that nothing of concern arose during the notice period. Ms Livingston said that she had been aware, because it was well known within the hotel, that Mr Freeman had deducted or withheld other employee's holiday pay and wages.

[14] The key point of difference in the evidence is whether Ms Livingston apologised for failing to give the correct notice and whether Mr Freeman advised holiday pay would be forfeited. I accept as submitted by Mr McGinn that an apology from an employee not giving the required notice would normally seem more likely than not. In this case though, having heard Ms Livingston's evidence, I am not satisfied that she apologised. Ms Livingston had, before handing Mr Freeman the written resignation, formed a view there was a real risk her holiday pay would be forfeited and she intended to obtain some advice about that. I find it likely in those circumstances that she approached the matter more defensively than apologetically. I could not safely conclude that Mr Freeman advised that holiday pay would be forfeited. This is because I find there was a real likelihood from his brief discussion with Ms Livingston that he concluded she already knew that was likely. In any event not a lot turns on what was said at the time notice was given at least with respect to this first issue.

[15] It became clear to Ms Livingston from 6 August 2012 on receipt of her final pay that holiday pay had not been paid. On 22 August 2012 Ms McDonald wrote initially to Mr Freeman and then on 10 September 2012 to Mr McGinn seeking reimbursement of the money owed. In the letter dated 10 September 2012 Ms McDonald asked for evidence of any losses and any steps to mitigate those losses. There was no response to that letter.

[16] Ms Livingston accepted that she signed her employment agreement containing the notice period and although she considered six weeks excessive notice did not raise any issues with Mr Freeman about it. Ms Livingston had an opportunity to obtain advice about her agreement but said she did not do so.

[17] Mr Freeman in his evidence explained why the period of six weeks notice was required. He said the role of receptionist at the Redwood Hotel was very involved and six weeks gave someone the time to be able to train in the position so the company was not compromised if the receptionist left early. Mr Freeman regarded Ms Livingston's role as a key role. He explained the training regime for a new

receptionist in some detail. It involved a new employee spending a period of time supervised before moving to being unsupervised on the afternoon/evening shift and then moving to the morning shift which was more complicated because it involved auditing the takings for the bars, accommodation, gaming funds, balancing the floats and undertaking the banking. Mr Freeman explained that it was not easy to find the right person for the role as it required familiarity with hotel accommodation as well as reception and also the ability to handle cash and complete the daily audit and that it took three to four months to be proficient in the role.

[18] Mr Freeman said that there are usually four receptionists at the Redwood Hotel although one is part-time. The receptionists cover the fourteen rostered shifts per week over the seven day period. The morning shift is 7am to 3pm and the afternoon/evening is 3pm to 11 pm. Mr Freeman said in evidence that the receptionists are all paid a similar hourly rate. Ms Livingston commenced her employment on $14.50 per hour although that had increased to $15.50 at the time of her resignation.

[19] Mr Freeman in his oral evidence agreed that he wanted to make sure that employees give six weeks notice in the circumstances. In answer to a question from Ms McDonald he said that all 80 employees at the Redwood Hotel have six week notice and forfeiture clauses in the event of failure to give notice.

[20] Mr McGinn correctly submits the question of whether a sum stipulated is a penalty or a genuine attempt to estimate damages is to be decided with regard to the particular employment agreement and, at the time the agreement was entered into and not at the time of the breach - *Dunlop Pneumatic Tyre Co Ltd v. New Garage & Motor Co Ltd* [1915] AC 79 (HL).

[21] One of the principles from *Dunlop* is that it is no obstacle to a conclusion that there was a genuine pre-estimate of damage because the consequences of breach are such so as to make precise pre-estimation impossible. It was stated in *Dunlop* that is just the situation where pre-estimated damage was the true bargain between the parties. In *Dunlop* tyres were supplied to the defendants under an agreement in which they agreed not to sell or offer in breach of the agreement tyres, tubes or covers. If this occurred then £5 by way of liquidated damages was to be paid for every tyre, tube or cover sold or offered in breach of the agreement. It was held in that case that whilst the fine may seem disproportionate to the harm caused, news of the

undercutting would spread and the resultant damage to Dunlop would be impossible to estimate. It was held it was therefore reasonable to quantify the damage at a fixed but not extravagant figure.

[22] Other cases in this area emphasise that undue focus should not be on the language used in deciding whether the sum stipulated is a penalty or genuine pre-estimate but on the substance of the provision. If the intention of the parties as ascertained from the employment agreement as a whole is to assess the damages for a breach of the notice provision then the forfeiture provision in clause 12.1 is a genuine pre-estimate of damage and the clause should be upheld. If though the intention of the parties as ascertained from the employment agreement is to secure performance of the notice provision by the imposition of a fine or penalty then the forfeiture provision is in the nature of a penalty and is unenforceable - *Ozturk v Gultekin, (T/A Halikarnas Restaurant)* [2004] 1 ERNZ 572.

[23] The effect of concluding that a penalty clause is unenforceable is ameliorated by the fact that the damage actually suffered can still be established in the ordinary way. In *Ozturk* Chief Judge Goddard found that a provision in a settlement agreement signed by a mediator providing for an additional payment of $2,500 in the event of a default in paying a set amount by monthly instalments was a penalty provision and was unenforceable. Chief Judge Goddard said in [7] that the *Court has the jurisdiction to relieve against penalties and forfeitures, but anyone who seeks equity must be prepared to do equity. The most likely outcome of this case, if it resumes, is that Mr Gultekin will receive relief against the penalty to which he agreed on condition that he pays compensation to the plaintiff, Mr Ozturk, in a sum broadly equivalent to the interest that Mr Ozturk may be considered to have lost as a result of the defendants default.* It was stated in that case that amount of interest could not possibly have exceeded $250 for the period.

Conclusion about clause 12.1

[24] Clause 12.1 provides for forfeiture of wages for the period the required notice of six weeks is not provided. The total possible amount which could be forfeited in the event six weeks notice was not given is an amount equivalent to six weeks wages. At Ms Livingston's hourly rate at the time the employment agreement was entered into of $14.40 that is, based on a 40 hour week, the sum of $3,480.

[25] Mr Freeman explained how he had arrived at that notice period of six weeks. He took into account the period of time to advertise, hire and train a replacement receptionist. Although he thought that would take three months he was mindful of the downside of such lengthy notice periods where the relationship may have soured or where he had initiated the termination and concluded six week was a fair compromise in the circumstances for a key role. Ms Livingston agreed to six weeks notice in the event of termination.

[26] The issue is not that the requirement for six weeks notice is unreasonable but whether the forfeiture provision if such notice is not given is a genuine assessment of liquidated damages or in the nature of a penalty. The obligation for six weeks notice in the employment agreement is a mutual obligation. Mr McGinn compared a scenario where G L Freeman paid Ms Livingston six weeks in lieu of notice and she obtained employment within that period thereby making a windfall. I accept that could occur although clause 12.1 does provide the employer with discretion whether to pay notice in lieu or require it to be worked out.

[27] Parties to an employment agreement are allowed to make an assessment of potential loss at the time they enter into an agreement and it can sensibly avoid the difficulty later of proving loss. It must though be a genuine forecast of the probable loss. It cannot be a provision used to force an employee to perform the agreement by holding a threat over his or her head. In *Dunlop* it was held that a sum is a penalty if it is extravagant and unconscionable in amount in comparison with the greatest loss that could possibly follow from the breach.

[28] Mr McGinn seeks to distinguish the language in clause 12.1 of the employment agreement from other decided cases in the Authority about notice periods and forfeiture where there was reference in the clause itself to a penalty. Care needs to be taken not to put undue emphasis on the language used. Forfeiture is defined as, and is the language of, penalty but that is not in my view the determining factor. There is also Mr Freeman's evidence that he wanted to make sure employees give him six weeks notice. Before the Authority can conclude that both these matters support that the true intended character of clause 12.1 was a penalty to ensure performance it is necessary to determine if there is evidence that supports the clause is a genuine estimate of liquidated damages.

[29] Mr McGinn submits that the consequences of the breach of notice could not be known at the time of entering the employment agreement and that the sum of six weeks loss of wages on a sliding scale down to reflect the number of weeks notice provided was a genuine forecast of the loss that could flow from the breach. Mr McGinn submits that clause 12.1 does not impose a fine but rather requires the employee party to pay/forfeit an equivalent amount to the notice not worked. Mr McGinn submits that because payment of wages is weekly then it is unlikely that more than one week's wages would be forfeited and that there may not also be sufficient accrued annual leave to be forfeited for the entire period.

[30] I accept that there will be situations where the consequences of breach are not known and could be significant such as in *Dunlop* but I am not satisfied that could be said in this case about the failure to give notice.

[31] The evidence from Mr Freeman was that he had not made any financial projections with respect to the forfeiture provision in the employment agreement. Mr Freeman said that finding a person with the requisite skills for the receptionist position was difficult and I have no reasons not to accept that but the cost of hiring and training a new person are costs incurred in any event when an employee resigns. Ms Livingston was not the only receptionist and that would have been known at the time the employment agreement was entered into. Mr McGinn submits that the resources of another staff member would have to be diverted in the event an employee resigned without giving the required notice to train a new staff member. Any genuine pre-estimation of loss would have to account for the fact that Ms Livingston would not also be in receipt of wages whilst such diversion of another staff member took place. The likely loss arising from the breach is really very limited.

[32] I am not satisfied that the greatest loss which could possibly follow from the breach is equivalent to one week's wages or holiday pay for each week notice is short. The forfeiture provision I find is out of proportion and extravagant when compared to any likely loss arising from the breach.

[33] I find in conclusion that the forfeiture provision in clause 12.1 of the employment agreement is not enforceable because it is in the nature of a penalty to compel performance rather than a genuine assessment of liquidated damages.

[34] Ms Livingston is entitled to recover the money that was withheld from her final pay.

[35] I order G L Freeman Holdings Limited to pay to Diane Livingston the sum of $1,943.50 being accrued annual leave and payment for alternative days.

[36] I am not minded in circumstances where there was a genuine dispute about the enforceability of the provision and the contractual notice period was not given to award interest on the sum of $1,943.50.

If the provision in clause 12.1 is not enforceable then did G L Freeman suffer damage for which an award should be made?

[37] Mr Freeman gave evidence that it took about five weeks from the date of notice of resignation to employ a new receptionist and in the interim three weeks Ms Livingston's shifts were covered by the other receptionists undertaking additional shifts. Mr Freeman said that they were paid at the same rate as Ms Livingston.

[38] I find in conclusion that there is no evidence of any actual damages as a result of the failure to give six weeks notice.

Should there be a penalty awarded to the respondent for the breach of clause 12.1 of the employment agreement?

[39] Ms McDonald submits that as Mr Freeman did not respond and engage with Ms Livingston about the two week notice period he should be taken to have agreed to the shorter notice period. She was critical of the absence of any discussion about deduction from her final pay until a written notice received with her final pay after employment was terminated.

[40] There should have been earlier advice given to Ms Livingston about what deductions were made from her final pay. It was not until the investigation meeting that she understood what amounts had been withheld and that is quite unsatisfactory. I do not however accept that Mr Freeman agreed to the shorter notice period. Ms Livingston in my view would know that would be very unlikely.

[41] I find that there was a breach by Ms Livingston of the requirement in clause 12.1 of her employment agreement to give six weeks notice. Ms Livingston was well aware of that obligation but entered into an employment agreement with a new

employer with a commencement date of two weeks before giving written notice. Ms Livingston was unhappy in her role and had initially lodged a personal grievance although that was withdrawn and I cannot place reliance on that.

[42] There was I find a degree of deliberateness where there was knowledge of the requirement to give six weeks and a start date with her new employer had been agreed in two weeks time before the giving of written notice.

[43] Clause 134 of the Employment Relations Act 2000 provides for liability for a penalty in the event of a breach of an employment agreement. The action for the recovery of a penalty was commenced within 12 months from the date the breach became known to G L Freeman.

[44] I find that there should be a penalty for failing to adhere to the notice requirements but that it should be a moderate penalty. G L Freeman has had the benefit of Ms Livingston's money withheld from her final pay for some months and there was an attempt at an early stage by Ms Livingston's advisors to ascertain actual damage caused by Ms Livingston's failure to give notice to which there was no response. As it transpired although there was inconvenience because of the failure to give notice there was no actual proven damage.

[45] I find in conclusion that there should be a penalty awarded in the sum of $500.

[46] I order Diane Livingston to pay half of the penalty in the sum of $250 into the Authority and then into the Crown Bank Account. The remaining sum of $250 is to be paid to G L Freeman Holdings Limited as I accept there was inconvenience.

Costs

[47] I reserve the issue of costs. I would encourage the parties to see if agreement could be reached based on the usual daily tariff of $3,500 with an adjustment for a shorter investigation day and because both parties have had a measure of success. In that regard I record the issue of the enforceability of clause 12.1 occupied more time in evidence and submission than the penalty.

[48] If agreement cannot be reached about costs then Ms McDonald has until 29 May 2013 to lodge and serve submissions as to costs and Mr McGinn has until 12 June to lodge and serve submissions in reply.

Helen Doyle
Member of the Employment Relations Authority