New Zealand Employment Relations Authority Decisions

Smith v Gray (Auckland) [2018] NZERA 21; [2018] NZERA Auckland 21 (19 January 2018)

Last Updated: 2 February 2018

IN THE EMPLOYMENT RELATIONS AUTHORITY AUCKLAND

[2018] NZERA Auckland 21
3014515

BETWEEN ALLAN SMITH Applicant

AND ALISTER GRAY AND KAREN WATSON First Respondents

AND AFTER HOURS AUTOMOTIVE LIMITED Second Respondents

3021451

BETWEEN ALISTER GRAY AND KAREN WATSON First Respondents

AFTER HOURS AUTOMOTIVE LIMITED Second Respondents

AND ALLAN SMITH Member of Authority: Jenni-Maree Trotman

Representatives: Warwick Reid, Advocate for the Applicant Mark Beech & Emma Miles , Counsel for the Respondents

Investigation Meeting: 29 November 2017 and 18 December 2017 at Tauranga

Submissions received: 18 December 2017 from Applicant

18 December 2017 from Respondent

Determination: 19 January 2018

DETERMINATION OF THE EMPLOYMENT RELATIONS AUTHORITY

A. Mr Smith was employed by After Hours Automotive Limited.

B. After Hours Automotive Limited is ordered to pay to Mr Smith the sum of $19,146.90 gross within 14 days for wage arrears.

C. Mr Smith must pay $5,000 by way of penalty for breach of the duty of good faith. 75% of that amount ($3,750) is to be paid to After Hours Automotive Limited. The remaining 25% ($1,250) is to be paid to the Employment Relations Authority. The Employment Relations Authority will then pay this sum into a Crown Bank Account.

D. Payment of the penalty must be paid within 28 days of the date of this determination.

Employment Relationship Problem

[1] Mr Smith was the owner/operator of an auto repair workshop trading as Katikati A1 Quick Lube and Smithy's Workshop.

In or about February 2016 Mr Smith orally agreed to sell this business to the first and/or second respondents. Settlement took place on 1 April 2016.

[2] Mr Smith claims that, subsequent to the parties reaching agreement on the sale and purchase of the business, the parties agreed that he would be employed by the first and/or second respondents. In accordance with that agreement he claims he was employed from 4 April 2016 to 21 December 2016. During this period he claims he did not receive payment of any wages and claims wage arrears.

[3] At material times Mr Gray and Ms Watson were the directors of After Hours Automotive Limited. The respondents claim it was After Hours Automotive that agreed to purchase Mr Smith's business. The respondents collectively deny they employed Mr Smith. Whilst agreeing Mr Smith carried out some work for After Hours Automotive, they claim this was not undertaken as an employee. They claim the work Mr Smith undertook was either undertaken as part of the terms of sale of the business, as a volunteer, or as an independent contractor.

[4] The respondents have filed a counterclaim. If Mr Smith is found to be an employee, they claim he has breached his duties of good faith and/or duty of fidelity and/or fiduciary obligations. They claim penalties. Mr Smith denies this claim.

[5] As permitted by s 174E of the Employment Relations Act 2000 (the Act), this determination has not recorded all the evidence and submissions received from Mr

Smith and the respondents but has stated findings of fact and law, expressed conclusions on issues necessary to dispose of the matter, and specified orders made as a result.

Issues

[6] The issues to be determined are:

a) Was there an employment relationship between Mr Smith and the respondent/s?

b) If Mr Smith was an employee then:

i. Who was Mr Smith's Employer?

ii. What wages, if any, are owed to Mr Smith?

iii. Did Mr Smith breach his duty of good faith, duty of fidelity and/or fiduciary obligations?

iv. If so, are the respondents entitled to damages?

c) Should either party contribute to the costs of representation of the other party?

Issue 1: Was there an employment relationship?

[7] The first issue I need to determine is whether or not Mr Smith was employed by the respondents. To do so I must first decide whether or not Mr Smith falls within the definition of employee under s 6(1) of the Act. If he was not an employee the Authority has no jurisdiction to determine his claim.

[8] The respondents submit Mr Smith was not an employee. They say this is because Mr Smith either undertook the work as part of the terms of sale of the business, as a volunteer or he was an independent contractor.

Did Mr Smith undertake work as part of the terms of sale of the business?

[9] The terms of sale of Smithy's Workshop were not recorded in writing and are largely in dispute. Whilst the parties agree that it was a term of the sale of the business that Mr Smith would remain "in the business" it is uncertain whether this

was as a volunteer, a contractor or as an employee. I therefore turn to look at these alternative arguments.

Was Mr Smith a "volunteer"?

[10] Section 6(1) (c) exempts a volunteer from being an employee. It defines that exemption as being applicable to someone who does not expect to be rewarded for work to be performed as a volunteer; and receives no reward for work performed as a volunteer.

Did Mr Smith perform work?

[11] The evidence which I heard and viewed clearly establishes that Mr Smith performed work for the first and/or second respondents.

[12] Mr Smith undertook Warrant of Fitness (WOF) inspections. The WOF records show Mr Smith was the person who primarily undertook WOF inspections for the business from late April 2016 until December 2016. During this period Mr Smith undertook 514 warrants on his own and 17 with Mr Gray. Mr Hope, a friend and witness for the respondents, said he viewed Mr Smith undertaking WOF inspections throughout the day. This is consistent with the WOF records which record the date and the time when WOF inspections were undertaken.

[13] Mr Smith performed vehicle services, mechanical repairs, and fitted tyres for the business. Mr Smith is a diesel mechanic with over 50 years experience. He said that when he was not undertaking WOF inspections he was asked by the respondents to perform vehicle services, undertake mechanical repairs, change/fit tyres and attend to other work on behalf of the respondents. This included answering the phones, providing quotations and assisting walk in customers.

[14] Mr Smith's evidence was supported by over 40 job sheets, and the workshop diary entries, provided to me by the respondents. These show Mr Smith undertook services and mechanical repairs for the respondents from April to December 2016. In addition, Mr Gray said that whilst he tried to undertake the vehicle services himself, often a WOF inspection would lead to further work being required which Mr Smith would undertake. He said Mr Smith would also perform mechanical work for "walk in" customers.

[15] Mr McClusky, another friend and witness for the respondents, said he was aware Mr Smith was undertaking repairs and mechanical work in addition to WOF inspections. He said he knew this from speaking to Mr Gray who would complain to him that he had asked Mr Smith to do certain work but he had not done it. He also said Mr Gray told him what the job entailed. Mr Hope also said he saw Mr Smith helping Mr Gray out with jobs such as servicing and changing brake pads.

Did Mr Smith expect to be remunerated for the work he performed?

[16] Mr Smith said he expected to be remunerated for the work that he undertook. Whilst this is disputed by the respondents, it is Mr Smith's expectation and not the respondents that is the focus of the s 6 definition.1

[17] Mr Smith's expectation of being remunerated for the work he undertook for the respondents is credible in the circumstances.

a) There is no plausible reason why Mr Smith would work for the business for no remuneration.

b) The terms of sale of the business did not include a requirement for him to perform work for the business.

c) The purchase price for the business did not include a payment for goodwill nor for Mr Smith's services.

d) Mr Smith was not in a financial position to work without remuneration. I do not accept Ms Watson's evidence that Mr Smith undertook the work to "give him something to do".

e) Mr Smith's evidence was that he made multiple demands for payment of wages. Mr Gray acknowledges these discussions but says they related to demands for payment of the purchase price of the business. He said these demands were met by way of regular weekly amounts of $500.00 which were applied towards the purchase price of the business.

f) In September 2017 the weekly payments of $500.00 stopped. It was about this time that Mr Smith spoke with Mr Gray again about his wages. He

said he had become so desperate for money that he had taken $290 from

1 *The Salad Bowl Limited v Amberleigh Howe-Thornley* [2013] NZEmpC 152; [2013] ERNZ 326 at [36].

petty cash and placed an IOU in the till. Mr Gray recalled this conversation. He said Mr Smith told him he needed money to survive. He said he asked him what he wanted and Mr Smith said $300.00 a week. Mr Smith denies asking for $300.00 a week. Mr Gray then organised for

$300.00 week to be paid to Mr Smith.

Did Mr Smith receive a reward for the work he performed?

[18] Mr Smith was paid $300.00 a week from 29 September 2016 until 15

December 2016. I am satisfied these payments were a "reward" for the work Mr Smith performed. In reaching this finding I have taken into account Ms Watson's evidence that the purchase price for the business had been repaid by the time these payments commenced. In addition, After Hours Automotive's records show the payments were coded as contractor payments. The respondents were not able to provide me with any explanation as to what this payment was for other than as reward for work undertaken.

[19] In these circumstances I conclude that Mr Smith was not a volunteer.

Was Mr Smith an employee?

[20] As was said by the then Chief Judge Colgen in *Salad Bowl Limited v Amberleigh Howe-Thornley*, simply because one is not a "volunteer", does not make one an "employee". If someone claiming to be an employee does not meet the test under s 6(1) (a) of the Employment Relations Act, then he or she cannot have that

status.2

[21] In deciding whether Mr Smith was employed by the respondents, the Authority must determine the real nature of the relationship between the parties. This assessment includes considering all relevant matters, including any matters that indicate the intention of the persons. The Authority is not to treat as a determining matter any statement by the parties describing the nature of their relationship.

[22] The Supreme Court in *Bryson v Three Foot Six Limited (No. 2)* addressed

what "all relevant matters" in s 6(3) (a) of the Act means.[3] It said:

2 Ibid At [38].

3 [2005] NZSC 34; [2005] ERNZ 372.

"'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 require the Court or 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 ... "

Common Intention?

[23] There was no written employment agreement. However, this is not decisive in determining the parties' intentions.4 In the case of oral contracts, intention has to be derived from the parties' statements at the time and the commercial environment in which the contract was made and, if that is not sufficiently clear, from their subsequent conduct and dealings5.

[24] The respondents submit there was no intention to enter into an employment relationship. They submit Mr Smith remaining with the business was simply him performing an obligation agreed by the parties in the sale and purchase agreement. Namely, holding the WOF licence to enable the operation of the business. Mr Gray explained that the respondents did not have a Warrant of Fitness Licence for the premises. Until this was obtained they needed to rely on Mr Smith's licence. Without this the business could not perform WOF inspections.

[25] I do not accept the work Mr Smith performed was pursuant to an obligation he owed under the sale and purchase agreement. Whilst the parties agreed that Mr Smith would remain in the business to enable it to utilise his WOF licence they did not agree, as part of the terms of the sale and purchase agreement, that he was to perform any work. Mr Smith and Mr Gray were clear during questioning that the use by the business of Mr Smith's license did not require him to perform the WOF inspections or to be present when the WOF inspections were undertaken.

[26] Mr Smith says it was the parties' intention that he would be an employee. He says the initial agreement was that he would stay working in the business, on a part-

time basis, to carry out WOF inspections. However, when the respondents were

4 *D'Arcy-Smith v Natural Habitats Ltd* [2015] NZEmpC 123.

5 *Page v Waipu Citizens and Services Club Inc,* unreported, AEC 1/98.

unable to secure the services of Mr Smith's son-in-law, Mr Lewsley, to carry out mechanical work it was agreed Mr Smith would be required to work on a full-time basis.

[27] Mr Gray says there was no agreement at the outset of the parties' relationship that Mr Smith was to be an employee. However, this evidence conflicts with a statement Mr Gray made to the Police on 21 December 2016. The Police record of the conversation with Mr Gray, which was created on 24 December 2016, records *"after the sale of the workshop, SMITH was kept on as a part-time worker, and paid weekly".* Mr Gray disputes he told the Officer this but confirmed he has not sought to correct the police records.

[28] I am satisfied in these circumstances that, at the outset of the parties' working relationship, the parties' common intention was that Mr Smith was to be an employee.

[29] Intention is only one of the relevant matters for consideration. Section 6(3) requires the Authority to consider all relevant matters including intention but does not elevate intention over those other matters, which include the control test, the economic reality test, and so forth. I therefore move to address those tests.

Control Test

[30] The control test looks at the degree of control or supervision exercised by the employer over the alleged employee's daily work. The test asks whether the alleged employer had the right to control the person alleged to be an employee.

[31] Assessing matters under this head, I find:

a) The respondents provided Mr Smith with the work he undertook. They required him to perform certain duties as directed on a day to day basis. The work required to be undertaken each day was listed by Mr Gray on a whiteboard.

b) Mr Smith was expected, inter alia, to undertake WOF inspections, vehicle services, tend to walk-in customers and undertake additional work required by a customer following a WOF inspection.

c) Mr Smith was required to undertake these duties at particular times and on particular days. In Ms Watson's words *"he* [Mr Smith] *had no say over*

the timing of work unless he booked the work in. It was basically me". This meant that Mr Smith had no control over the hours or days that he worked.

d) Mr Smith notified Mr Gray and/or Ms Watson when he was taking leave.

In the later part of the parties' relationship Mr Gray said he kept a record

of these absences.

e) All tools and equipment required for the performance of Mr Smith's work was provided by the respondents. These tools and equipment had been sold by Mr Smith as part of the terms of sale of his business.

f) Mr Smith stored personal items at the workshop and did cook some meals using the respondents' facilities. However, this was impliedly agreed by the respondents in that they raised no objection to this at material times.

g) Mr Smith undertook some repairs to his personal vehicles but this was done outside of working hours. The respondents were aware he was doing this and raised no objection at material times.

[32] The foregoing factors indicate a relationship of employment.

Integration Test

[33] This test considers whether the work performed by Mr Smith was an integral part of the business and whether he had effectively become "part and parcel" of the organisation.

[34] I find that the work Mr Smith did was an integral part of the business. In reaching this finding I have been influenced by the following facts:

a) Ms Watson explained that the respondents' core business in Katikati was WOF inspections, although it also serviced vehicles and changed brake pads and tyres. She said that Mr Smith's role was to primarily carry out the WOF inspections.

b) Mr Smith did not have a licence to undertake WOF inspections prior to the sale of the business. This was obtained in April 2016 after the respondents were unable to secure the assistance of Mr Smith's previous employees.

c) The WOF records show Mr Smith was the person who primarily undertook WOF inspections from May 2016 until December 2016. During this period Mr Smith undertook 514 warrants on his own and 17 with Mr Gray. Mr Gray undertook 117 warrants on his own and 17 with Mr Smith.

d) The work Mr Smith did was legitimate work which benefitted the respondents' business. The respondents received payment for all mechanical work undertaken by Mr Smith as well as for the WOFs which Mr Smith undertook. Ms Watson said After Hours Automotive charged out Mr Smith's time in 15 minute increments. His rate was assessed based on a charge out rate of $75.00 per hour plus GST. Where he performed a vehicle service the cost charged by the respondents to the customer was between $150 and $350.

[35] I conclude Mr Smith was integrated substantially into the business favouring a finding of an employment relationship.

Fundamental Test/Economic Realty Test

[36] This test requires consideration as to whether Mr Smith was effectively working in business on his own account. In *Downey v New Zealand Greyhound* Racing Association Inc, the Employment Court indicated that the fundamental test requires an examination of whether and how the applicant structures his or her alleged self-employed business. *6* The Court noted aspects such as the methods of payment, taxation and the description of the applicant's business inserted in the GST invoices as indicative of the applicant operating in business on his own account.

[37] Assessing matters under the fundamental test, I find:

a) Mr Smith did not issue invoices to the respondents.

b) Mr Smith remained GST registered during the period 1 April to 21

December 2017. However, I am satisfied that this was not because he was working on his own account.

i. Ms Nikora, Mr Smith's partner and the "book keeper" of his business,

explained that Mr Smith was required to remain GST registered

6 (2006) 3 NZELR 501.

because he had payments coming into his account relating to transactions prior to the sale of his business. GST needed to be accounted for on these transactions. It also needed to be accounted for in relation to payments made by Mr Smith for debts owing prior to the sale of his business. Mr Smith also accounted to IRD for the GST component of the payments made to him by the respondents for the purchase of his business.

ii. Mr Smith made purchases through his business account during the period 1 April to 21 December 2017 and set off these expenses against the GST he had to pay to IRD. However, these purchases were for private expenses and for expenses incurred on behalf of the respondents' business. They do not appear to be for any business he was personally operating.

iii. Whilst GST was claimed by Mr Smith for these expenses I am satisfied this was due to a misunderstanding of GST requirements. Ms Nikora explained that she had *"no idea about what to do and not to do with GST"*. She explained that for GST purposes she simply added up the debits in the business bank account. For income she simply recorded the total credits made into the business bank account during the relevant period. She said she paid no attention to what the credits and debits were for. This meant, for example, the GST returns included as income monies paid by Ms Nikora to the business account to assist Mr Smith with payment of bills. She also included numerous expenses to offset income. These expenses do not appear to be expenses associated with Mr Smith running his own business. This is a matter which Mr Smith will need to address with IRD.

c) On balance, there is no evidence that Mr Smith was undertaking work otherwise than for the respondents. The only income recorded on Mr Smith's personal tax return for the year ended 31 March 2017 is his superannuation. Whilst the respondents pointed to evidence that Mr Smith's son-in-law, Mr Lewsley, was undertaking a business, they had no evidence that Mr Smith was involved in this business. Mr Lewsley denied this was the case. Mr Gray confirmed that he just assumed Mr Smith was

working with Mr Lewsley because he saw Mr Smith's vehicle at Mr Lewsley's home. However, Mr Smith's daughter and grandchildren also resided at this property which gives little weight to Mr Gray's suspicions.

[38] For completeness I acknowledge there was evidence that Mr Smith undertook WOF inspections on his vehicle, and other family vehicles, during working hours. However, Ms Watson said Mr Smith was required to pay for these WOF and After Hours Automotive noted these charges in its records at the time the WOF inspections were undertaken.

[39] The foregoing factors indicate a relationship of employment.

Industry Practice

[40] The respondents submit that Mr Smith's working status should be classified as one of an independent contractor/licensee. This, they submit, is to maintain consistency with industry practice regarding classification of other licensees.

[41] In support of this submission the respondents refer to the Privy Council's decision in *Cheng v Royal Hong Kong Golf Club*7. In that case the Privy Council held that a caddy was not an employee of a golf club, but rather was a licensee of the club who entered into individual contracts with golfers each time he agreed to caddy for them.

[42] The respondents also refer to the Authority's decision in *Down v Web Genius Central NZ Ltd.8* In *Down* the worker was engaged by the company under a "License Agreement to Provide Services as a Licensed Local Web Marketing Adviser". The Authority held that the worker was a licensee and not an employee.

[43] I do not consider that either of these cases are relevant to the present circumstances. Mr Smith held the WOF licence for the building. The work he performed for the business was independent of this licence.

Finding on Issue 1

[44] Standing back and looking at the matter overall I conclude, on the balance of probabilities, that Mr Smith was an employee.

7 [1997] UKPC 40; [1998] ICR 131 (PC).

8 [2017] NZERA Wellington 69 at [23].

Issue 2: Who was the Applicant's employer?

[45] Mr Smith says that he was employed by Mr Gray and Ms Watson. They deny this. They submit that if the Authority finds Mr Smith was an employee then he was employed by After Hours Automotive.

[46] Mr Smith has the onus of establishing on the balance of probabilities who his employer was.

[47] The Employment Court judgment in *Mehta v Elliott (Labour Inspector*)9 provides guidance for the Authority in investigating the identity of the employer:

The question of who was the employer must be determined as at the outset of the employment. If that changed during the course of the employment, there must be evidence of mutual agreement to that change. Because Messrs Sheikh and Mehta give different accounts of who they believed employed Mr Sheikh, it is necessary to apply an objective observation of the employment relationship at its outset with knowledge of all relevant communications between the parties. Put another way, who would an independent but knowledgeable observer have said was Mr Sheikh's employer when he commenced employment?

[48] I find that an independent but knowledgeable observer would have said Mr Smith was employed by After Hours Automotive at the time he commenced employment. In reaching this finding, I have considered the following factors relevant:

a) The parties had a trading relationship at the time Mr Smith commenced employment.

b) Mr Smith said that trading relationship was with Mr Gray and Ms Watson trading as Morton's Garage. The respondents say that the relationship was with After Hours Automotive trading as Morton's Garage.

c) Neither party provided me with any invoices or statements which showed After Hours Automotive's name at the time Mr Smith commenced employment. However, it was Ms Watson's evidence that she provided Mr Smith with monthly statements which clearly set out After Hours Automotive's name. She produced an example of this statement. Whilst this was dated July 2016 she said it was in the same format as those issued earlier.

d) Mr Smith denied seeing any statements or otherwise identifying After Hours

Automotive. He said he never saw the July 2016 statement and at material

9 [2003] NZEmpC 110; [2003] 1 ERNZ 451

times did not know After Hours Automotive existed. The first time he heard the name was when the first deposit came into his account on the 28th of July

2016. In support of his denial he refers to a letter he wrote to the New Zealand Transport Agency on 7 April 2016. This correspondence stated that he had sold his business to Mr Gray who had named it Mortons Garage Katikati.

e) Weighing the evidence of the parties I am satisfied on balance that Mr Smith was aware that he was contracting with After Hours Automotive at material times. His letter of 7 April 2016 was written on the same day as he signed a Westpac Merchant Credit Card Facility Agreement. This agreement identified the new owner of the business as "After Hours Automotive Services Limited trading as Mortons Garage Katikati". In addition, his letter of 7 April 2016 referred to the application form which had been sent by Mortons Garage to the New Zealand Transport Agency. This application was issued to Mr Gray as the director of After Hours Automotive Services Limited trading as Mortons Garage Katikati.

Issue 3: Are Wages owed to the Applicant?

[49] Where there has been default in payment to an employee of any wages or other money payable under an employment agreement, those monies may be recovered by the employee.10

[50] Mr Smith's Statement of Problem seeks recovery of wage arrears calculated at a rate of $25.00 per hour. However, during

the investigation meeting this sum was changed to $21.00 per hour. This was consistent with Mr Smith's evidence during questioning although it differed from his written statement where he said the parties agreed he would be paid $21.00-$22.00 per hour. The respondents initially disputed any discussion over payment of wages. However, during questioning Mr Gray said the parties agreed in September 2016 that a sum of $300.00 per week would be paid to Mr Smith.

[51] In the absence of any clear agreement on what Mr Smith was to paid, I

conclude that it is appropriate to calculate compensation for wage arrears at the applicable rate under the Minimum Wage Act 1983. This was pleaded by Mr Smith

10 Section 131 Employment Relations Act 2000

in his Statement of Problem in the alternative. The applicable rate at material times was $15.25 per hour.

[52] Next, it is necessary to determine the length of time Mr Smith worked. Mr Smith said he worked 40 hours per week from 4 April 2016 to 21 December 2016. The respondents dispute this.

[53] Having carefully considered the evidence produced to me I accept Mr Smith was employed from 4 April 2016 to 21 December 2016. In addition, in the absence of wage and time records, I accept as proven that Mr Smith worked 40 hours per week. This is consistent with the WOF records which show he was undertaking warrants throughout the day during this period. It is also reasonably consistent with the workshop diary entries and job sheets I viewed which show him undertaking other types of work during this period.

[54] From 4 April 2016 to 21 December 2016 there were 37.29 weeks. Multiplied by 40 hours per week comes to a total number of hours of 1491.6. Multiplied by the hourly rate of $15.25 I reach a figure of $22,746.90. From this sum I deduct the sum of $3,600 for monies received by Mr Smith.

[55] After Hours Automotive is ordered to pay to Mr Smith the sum of $19,146.90 within 14 days of the date of this determination.

Issue 4: Counterclaim

[56] The respondents claim that Mr Smith has breached his duties of good faith, fidelity and breached his fiduciary duties.

Breach of good faith?

[57] Section 4 of the Act requires parties to an employment relationship to deal with each other in good faith. Specifically that requires the parties to be active and constructive in maintaining a productive employment relationship by being responsive and communicative.

[58] The respondents' statement of problem pleads that Mr Smith breached his statutory obligations of good faith by unlawfully uplifting equipment from After Hours Automotive's business. They say that Mr Smith's breaches lead to After Hours

Automotive suffering loss in that it was unable to operate its business as normal and lost its customer base. Mr Smith denies this.

[59] Having heard from the witnesses I am satisfied that Mr Smith breached s 4 of the Act.

[60] By December 2016 the relationship between the parties was seriously strained. Mr Smith said he was unhappy that he was not getting paid and the respondents' were not paying his creditors as agreed. Adding to his distress was the respondents' decision to employ another mechanic which he understood would take over his work. He said he went to his doctor because of the stress that the situation was causing him and was told that he had to do something about it. He said that as far as he was concerned "*the deal we had made had come to an end, and I needed to call time on the arrangements before this went any further*".

[61] Mr Smith put a plan into place to exit the relationship. He spoke with the landlord to inform the landlord he was leaving. He sought advice from the police about removing equipment from the respondents' business. He spoke to Mr Lewsley to see if he would assist with the movement of his items from the respondents' premises. Although Mr Smith denies this, I find it is likely that he also spoke to Mr Lewsley about going into business together. This is enforced by Mr Lewsley's evidence that they had "floated" the idea of having a business together where Mr Smith did the WOF inspections and he did the mechanical work.

[62] The law is clear that an employee is not prohibited from preparing for participation in his own business following the cessation of current employment. However, the employee must do so in a manner which does not undermine the employment relationship.11

[63] In the present case I consider Mr Smith's action went further than simply preparing for a competitive business. He planned to take, and did take, equipment which belonged to the respondents. This equipment assisted him in establishing a post-employment business. Whilst the extent of the equipment taken is in dispute, what is clear is that the equipment that was taken by Mr Smith belonged to the respondents. Each of the items Mr Smith said he took were included in the chattels

list he supplied to the respondents for the purposes of the sale of the business. As Mr

11 Caffe Coffee (NZ) Ltd v Sune Farrimond [2016] NZEmpC 65 at [36].

Smith did not have security over these chattels, he had no legal right to remove them regardless of whether or not the respondents had paid for these items.

[64] I am satisfied that Mr Smith failed to comply with his obligations of good faith. The taking of the chattels was done whilst Mr Smith was still an employee and undermined the employment relationship. This breach was serious and sustained. Mr Smith has refused to return the items. I am satisfied that a penalty should be imposed.

Breach of duty of fidelity?

[65] The respondents allege Mr Smith breached his duty of fidelity by unlawfully uplifting equipment from After Hours Automotive's business. As the factual circumstances relied upon to support this claim are the same as that relied upon to support the respondents' claim for breach of good faith, I do not intend to consider this matter separately or to impose a separate penalty.

[66] The second aspect of the respondents' claim is that Mr Smith diverted After Hours Automotive's potential customers to Mr Lewsley's garage. Having heard from the witnesses I do not accept there is sufficient evidence to establish Mr Smith diverted business. There was competing evidence as to whether or not Mr Lewsley was operating a business at material times or not. Even if he was, I am not satisfied that there is evidence that establishes, on a balance of probabilities, that Mr Smith was diverting After Hours Automotive's customers to this business or indeed to any business he intended to form in the future.

Breach of fiduciary duty?

[67] The respondents' statement of problem pleads that Mr Smith owed a fiduciary duty to After Hours Automotive to act bona fide in the interest of the business. Secondly, not to place himself in a position of actual or potential conflict between the interests of the business and his personal interests. They allege Mr Smith breached this duty. They rely on the same factual circumstances as those relied upon to support the claim for breach of the duty of good faith (uplifting equipment) and the breach of the duty of fidelity (diverting customers).

[68] The term "fiduciary" in the context of an employment relationship was considered by the Privy Council in *Arklow Investments Ltd v Maclean12.* In that case the Court adopted the following definition:13

A fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances, which give rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary. This core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal. ...

[69] Whether a relationship is fiduciary turns on where an employee ranks in the hierarchy of the business.14 An employee who is a director or shareholder, or holds another senior and responsible position, may well be under a duty of fidelity. However, an employee who does not hold such a position will normally not be a fiduciary and may rather be under a duty of fidelity.15

[70] In the present case, Mr Smith was neither a director nor a shareholder of the second respondent. He did not hold a senior role within the business. His employment as a mechanic did not elevate his obligations of fidelity, trust and confidence to those of a fiduciary as alleged by the respondents. Accordingly, I find there has been no breach.

Quantum of Penalty

[71] Having decided that a penalty is appropriate, I must now determine the quantum. This is to be determined using the four step approach outlined by the Employment Court in *Jeanie May Borsboom (Labour Inspector) v Preet Pvt Limited and Warrington Discount Tobacco Limited* [2016] NZEmpC 143.

Step 1

[72] Step one is to identify the number of breaches and the maximum penalty applicable. In this case there has only been one breach. This means Mr Smith is liable

to a maximum penalty of $10,000.

12 [2000] 2 NZLR 1 (PC)

13 Ibid at [10].

14 Transnet NZ Ltd v Dulhunty Power (NZ) Ltd [2007] NZHC 519; [2007] ERNZ 379 at [33].

15 *Korbond Industries Ltd v Jenkins* [1991] NZEmpC 88; [1992] 1 ERNZ 1141: *Long Beach Holdings Ltd v Chia & La*

Planche (HC Christchurch, 25 November 1998) William Young J

Step 2

[73] Step 2 involves the consideration of the severity of the breach. This requires a consideration of the nature and extent of the breach, whether the breach was intentional, the nature of any loss suffered and whether there have been any previous breaches.

[74] I have already stated that I consider the breach was deliberate. The Respondents claim that the breach resulted in them having to close their business. They say this resulted in them suffering significant loss which they have particularised. This was in the form of the monies they had paid Mr Smith for the business plus the expenses they incurred to close the business and relocate the remaining equipment.

[75] The second part of step 2 is to consider any mitigating circumstances, whether compensation has been paid and/or some steps taken to mitigate the effect of the breach, and the personal circumstances of Mr Smith. In this case I consider there are mitigating circumstances which must be taken into account. These include the respondents' failure to pay Mr Smith his wages for a lengthy period of time. This resulted in Mr Smith having to source alternative work and resulted in him suffering significant stress and anxiety. Mr Smith has not sought compensation for this.

[76] I assess the degree of severity at 50%, a potential penalty of $5,000.

Step 3

[77] Step 3 is an assessment of Mr Smith's ability to pay. I have no evidence either

way of Mr Smith's ability to pay. This step is therefore neutral in my calculations.

Step 4

[78] Step 4 is to apply the proportionality principle. This is consideration of whether the potential penalty I have arrived at is proportionate to the breach and any harm occasioned by it. At this stage I must assess if the amount I have reached is just in all of the circumstances. Looking at recent Authority and Court imposed penalties for breach of good faith I conclude an appropriate penalty is $5,000.00.

Conclusion on Quantum

[79] Adopting the approach applied by Judge Inglis in *Lumsden v Skycity Management Limited16* I consider it appropriate that part of the penalty be paid to After Hours Automotive, as employer, as it has suffered the impact of the breach and has been obliged to take steps to enforce its rights. I apply the same ratio of payment as Judge Inglis to reflect this.

[80] Mr Smith is ordered to pay $5,000 by way of penalty for breach of the duty of good faith. I direct that 75% of that amount ($3,750) is to be paid to the second respondent. The remaining 25% ($1,250) is to be paid to the Employment Relations Authority. The Employment Relations Authority will then pay this sum into a Crown Bank Account.

[81] Payment of the penalty is to be paid within 14 days of the date of this determination.

Costs

[82] The parties are encouraged to resolve costs by agreement. If that is not possible, then Mr Smith has 14 working days to file a costs memorandum. The respondents have a further 14 working days to file their costs memorandum. Mr Smith then has three working days to file and serve a reply. This timetable will be strictly enforced.

Jenni-Maree Trotman

Member of the Employment Relations Authority

16 [2017] NZEmpC 30.