

**IN THE EMPLOYMENT RELATIONS AUTHORITY
AUCKLAND**

[2016] NZERA Auckland 28
5552850

BETWEEN CATHERINE STORMONT
 Applicant

A N D PEDDLE THORP AITKEN
 LIMITED
 Respondent

Member of Authority: Eleanor Robinson

Representatives: Catherine Stewart, Counsel for the Applicant
 Ashley Sharp, Counsel for the Respondent

Investigation Meeting: 24-26 November 2015 at Auckland

Submissions Received: 7 December 2015 from the Applicant
 8 December 2015 from the Respondent

Date of Determination: 22 January 2016

DETERMINATION OF THE AUTHORITY

Employment relationship problem

[1] The Applicant, Ms Catherine Stormont, claims that she was unjustifiably dismissed by reason of redundancy by the Respondent, Peddle Thorp Aitken Limited (Peddle Thorp), on 19 December 2014.

[2] Ms Stormont also claims that Peddle Thorp (i) failed to correctly pay her bonus entitlement, thereby breaching the express terms of her individual employment agreement (the Employment Agreement) and (ii) breached the statutory duty of good faith by failing to be responsive and communicative in dealing with this matter.

[3] Peddle Thorp denies that it unjustifiably dismissed Ms Stormont and claims that she was justifiably dismissed by reason of redundancy.

[4] Peddle Thorp also claims that on a proper construction of the Employment Agreement considered in the light of business common sense, Ms Stormont was correctly paid her bonus entitlement.

Issues

[5] The issues for determination are:

- (a) How is the bonus due to Ms Stormont to be calculated
- (b) Was Ms Stormont unjustifiably dismissed;
- (c) Was there a breach of the duty of good faith by Peddle Thorp not being responsive and communicative in response to Ms Stormont's queries relating to the calculation of bonus;
- (d) Was there a breach of the Employment Agreement in regards to the calculation of bonus

Background facts

[6] Peddle Thorp is an architectural practice with approximately 50 employees. In early 2010, Peddle Thorp saw an opportunity to build the Interiors part of the practice by bringing in new clients. Accordingly it engaged a recruitment agency and Ms Stormont was put forward as a suitable candidate for the position of Associate – Interior Design.

[7] In that position, Ms Stormont would be responsible for building and operating the Interiors Division of Peddle Thorp, initially in a sole position, and she would also have responsibility for interior design work referred by Architects in the practice.

Terms of Employment

[8] Mr Terrence Barnes and Mr Richard Goldie, Directors, interviewed Ms Stormont and offered her the position of Associate – Interior Design. The terms of the offered position were confirmed in a letter dated 26 November 2009 which stated:

You will join the practice as an Associate – Interior Design at a salary of \$120,000 pa and this will be reviewed at the discretion of the Directors. The commencement date would be 1 March 2010 or sooner by mutual agreement. The overall remuneration package includes:

- 1. The above salary.*
- 2. An annual Southern Cross medical insurance allowance of \$2,000.*

3. *A mobile phone.*
4. *The cost of memberships to relevant professional organisations at the discretion of the Director in charge of Interiors.*

Attached are the specific conditions of the contract offer. Please note that the offer is staged into three annual stages each with their respective performance assessment criteria. You will be reporting to Richard Goldie.

[9] Enclosed with the letter was a copy of Peddle Thorp's General Conditions of Employment which set out the general contractual terms and referred to the Specific Conditions of Employment Contract (collectively the Employment Agreement) which set out the specific conditions pertaining to the position.

Specific Conditions of Employment Contract

[10] The specific conditions of employment stated:

*Special conditions of Employment Contract:
Stage 1*

- *Dates: 1 March 2010 to 31 March 2011*
- *Your title will be 'Associate'*
- *You will report to Richard Goldie*

Your performance will be assessed on your ability to:

1. *Run all aspects of your project(s) independently in accordance with Peddle Thorp Architects standards.*
2. *Take on the overall operation of the Interiors at Peddle Thorp Architects.*
3. *Establish new Clients to the company.*
4. *Communicate effectively with Clients and staff.*
5. *Your performance assessment will include your ability in the context of the items above to regard, enhance and protect the ongoing interests of the company.*
6. *Achieve at least a breakeven position for the Interiors at Peddle Thorp Architects. Should you achieve a profit for the Interiors you will receive a gross bonus equivalent to 20% of the gross profit.*

[11] The bonus was only applicable to Stage 1, i.e. the first year of employment. Specific Conditions of Employment at stages 2 and 3 included the possibility of Ms Stormont obtaining shareholding rights, dependent upon (i) the achievement of: "*at least 20% profit ...*" and (ii) the Directors sole discretion upon achievement of "*the projected 20% profit target ...*".

[12] Under a clarification statement, the Specific Conditions of Employment Contract stated:

Clarifications:

1. *Income and costs for the Interiors:*
 - (a) *Time spent by Interiors and other staff on Interiors projects will be recorded for the purpose of understanding Interiors' costs (for comparison against income) in the Peddle Thorp time-cost system.*
 - (b) *Time spent by Interiors supporting architectural projects will be charged against these projects at pre-agreed sums.*
 - (c) *The cost for the Interiors will include staff salaries including your own, plus the share of direct and office overheads. In general a breakeven position is at around 2.2 x staff salaries.*

[13] Ms Stormont said that she interpreted from clause 1(c) that her performance in the first year of employment was assessed on her ability to achieve at least a breakeven position for the Interiors Division, and provided she achieved the breakeven position, she would be entitled to a gross bonus equivalent to 20% of the gross profit.

Management Meetings

[14] Peddle Thorp held bi-monthly meetings which were attended by the Associates and Directors. One of the bi-monthly meetings was financial and performance summaries including those of the Interiors Division were provided at these meetings. The financial matters to be discussed and on which information was provided were those affecting the practice and the work on hand. There were also associated management meetings for issues such as resourcing.

Bonus Issues 2010

[15] Ms Stormont, who commenced employment with Peddle Thorp on 1 May 2010 said that in June 2010, some two months later, she requested Peddle Thorp to provide her with a report tracking the performance of the Interiors Division. In response, she received a two page memorandum from Mr Forrest dated 2 June 2010 together with the year to date income statement to 31 May 2010.

[16] In the memorandum, Mr Forrest set out how the monthly reporting was going to be set out for the Interiors division. He explained that the method of cost accounting and management reporting systems and the method of apportioning costs set out in the

memorandum was a method which had been applied consistently at Peddle Thorp and made it clear that the administration costs were going to be deducted, as were actual salaries of staff, and taxation was also a factor in this calculation..

[17] The memorandum stated:

... Coalface salaries: when all timesheets are in Helen will run a standard report to tell us the sum of timecosts for the period.

Admin: while for the purposes of this discussion I have set admin allocations at 80% of coalface salaries that figure will be reviewed and adjusted if necessary. I expect it to finally fall somewhere in the 80% ballpark. You will also note that the actual admin allocation is the same as the budget. The rationale for that treatment is that the budget number becomes a fixed commitment to the company. It says that INTERIORS will pick up its admin allocation budget unaltered by fluctuations in coalface salaries.

Tax: we use a slightly higher rate than the basic company rate to cover non-deductible costs.

Multiplier: 2.1 is the minimum number if we are to proceed with confidence. ...

[18] Ms Stormont did not raise the matter of Interiors Division performance relating to her bonus entitlement until 18 May 2011.

Bonus Issues 2011

[19] On or about the end of the financial year, 31 March 2011, Ms Stormont received a “summary of Interiors for the period of 1 April to 31 March 2011” which she claimed caused her considerable concern as the Interiors Division performance was measured as unprofitable and showing at a loss.

[20] She believed that the process used to allocate administration expenses was an inaccurate measurement of the profitability of a business unit as it appeared to have been done on a pro rata basis company-wide.

[21] As a result of her concern, she sought independent advice from a financial adviser who measured the profitability of the Interiors Division and calculated the bonus entitlement owing to her to be in the sum of \$61,400.00.

[22] After receiving this information, Ms Stormont presented these calculations to Mr Goldie by way of an email dated 18 May 2011. Together with the email, Ms Stormont included a letter addressed to Peddle Thorp with the amended bonus calculation. In the letter dated 18 May 2011, Ms Stormont had written:

In the deliberations over the Shareholders Agreement aspects of my Employment contract became unclear and despite inquiry have not been resolved. There are other circumstances in my employment which remain unaddressed or unsatisfactorily concluded.

This letter lists these with a view to advancing agreement immediately.

1. *The employment contract states an entitlement for the year ended 31 Mar 2011 to a gross bonus equivalent to 20% of the gross profit (of Interiors). The suggested formula at 2 June 2010 (as updated 31 Jan 2011) is not defined in terms of gross bonus or gross profit.*
2. *The formula workings have not been addressed with me particularly the need to exclude inherited or loss leading projects, the construct of allocated actual administration costs (as distinct from the rule of thumb multiple of coalface salaries) and the relevance of including tax in the format.*
3. *I received on Tuesday a summary of Interiors which had not been discussed with me before tabling at the Finance Meeting on Friday. I realise it is a management accounting production and my amendments to a bonus calculation formula is included for discussion. Could you please have at hand an interest write-back calculation and the methodology for calculation of overheads for that discussion.*
...
7. *My reservations on balance to the agreement would have been satisfied by the incorporation of 100% distribution of profits (after directors' allowance for bad debts), a requirement for shareholder pro rata loan levy (based on directors' forecast cash requirements) and for A shareholders to be restricted to market base salary remuneration.*

[23] Mr Goldie responded to Ms Stormont by email dated 18 May 2011. In the email, he stated:

... There are a number of misunderstandings in your calculations, for example what "Gross profits" is, which you have determined is simply income minus labour. This would be the case if one was a contractor. What Gross profit means is profit before tax i.e. income – (labour plus overheads). ...

I will discuss this with Lex. In the meantime we shall talk.

[24] On 1 July 2011, Ms Stormont said Mr Goldie presented her with a document entitled "*Interiors Division financial performance for the year 31 March 2011*". This document calculated that the gross bonus due to her was \$1,800.00. Ms Stormont said she still considered the calculations were incorrect for the following reasons:

- (a) The calculations for her bonus were based on net profit rather than gross profit as set out in the Employment Agreement; and

- (b) The financial report model allocated expenses on a company-wide pro-rata basis rather than attempting to identify what would be the real Interiors Division expenses.

[25] Ms Stormont said she had always considered her bonus entitlement for the first year of 20% of the gross profits to be a fair calculation as she considered there were no additional costs or overheads to setting up the Interiors Division apart from her salary. Ms Stormont also stated: *“I considered that other formulas are more complicated and the gross profit method would be the easiest way to assess my bonus entitlements and was well suited to my first year employment.”*, and that: *“Any profit over and above my salary would be a bonus in itself to Peddle Thorp”*.

[26] On 25 October 2011, Ms Stormont received another document entitled *“Interiors Division financial performance for the year 31 March 2011”* which detailed on the first page: *“Determination of the pro rata share of company overheads is to be borne by Interiors division for the year to 31 March 2011.”*

[27] The second page set out the calculation of the bonus due to Ms Stormont in the sum of \$1,526.80 owing to her, this was the last calculation she received from Peddle Thorp. At the bottom of the document it stated *“agreed gross taxable bonus at 20%”*.

[28] Accompanying the calculations from Mr Forrest had been an email from Mr Goldie stating that he was attaching the summary and ending with: *“happy to talk!”* Ms Stormont said that she had never agreed to the calculation or the stated sum being the bonus owing to her.

[29] Ms Stormont said that she had not discussed the matter further with Mr Goldie, and the bonus issue had not been resolved by the end of 2011.

Bonus issues 2012

[30] Ms Stormont stated that during 2012 she was immersed in personal matters, and there were no discussions regarding the bonus issue.

Bonus issues 2013

[31] Ms Stormont said that during the 2013 performance review she raised the issue that her first year bonus was still unresolved and owing.

[32] At her own cost, she engaged the services of an independent accountant Mr Rowan Wilde, as she believed this would have credibility and be a proactive step in resolving the

issue. Based on the information she had available at that time, Mr Wilde prepared a calculation of her bonus entitlements which he calculated in the gross sum of \$48,600.00.

[33] Mr Goldie received an email from Mr Wilde on 2 September 201 which stated:

...

We also attach a definition of gross profit: the difference between revenue and the cost of providing the service before deducting overhead. We believe wages should be deducted to give a true contribution. ...

We believe the bonus calculations provided to us incorrectly use tax paid profit and give a significantly lower figure.

[34] Mr Wilde said that his view of the clause in the Employment Agreement relating to bonus was very clear and provided a straightforward method for Ms Stormont's bonus calculations.

[35] He had confirmed to Ms Stormont that in his opinion, she was correct to interpret "gross profit" as set out in the Employment Agreement, as revenue less direct labour and materials or disbursements, if any. He said this was the standard and accepted accounting definition of gross profit.

[36] When he subsequently contacted Mr Goldie by telephone, it appeared to him that Mr Goldie was confused as to the definition of gross profit. It was following this telephone conversation that he sent an email to Mr Goldie on 26 September 2013 in which he confirmed his calculations of the bonus and included a printout from Wikipedia indicating that gross profit was the difference between revenue and the cost of making a product or providing a service, but before deducting overheads, payroll, tax and interest payments.

[37] Mr Barnes said that staff reviews were not conducted in 2012 and 2013 due to a redundancy situation affecting mainly architecture staff, but said that Ms Stormont had raised with him the bonus issue in 2013 shortly before a Peddle Thorp 'retreat' at which the Associates would be present.

[38] Ms Stormont said that by December 2013 there had been no resolution on the bonus issue, and she had met with Mr Barnes and another Director, Mr Brad Luke, who informed her that a mistake had been made in the Employment Agreement wording which should have stated 'net profit' and not 'gross profit'.

Bonus Issue 2014

[39] Ms Stormont received an email from Mr Goldie on 15 January 2014, stating:

... Not being an accountant I made an honest mistake in assuming "gross profit" meant the income left after overheads are deducted. What I now understand is known as 'gross profit' I thought was nett profit (i.e. profit after overheads, tax etc).

I'm sure you agree that it makes little sense to reward a person in an Associates position on the basis of overall fees achieved, with no regard to the quality of the commissions, or efficiency performing them. Further, the effect of deducting 20% of the gross profit for your bonus would be to achieve a loss for the Interiors of around \$40,000. Clearly this is nonsensical. ...

I hope there is a sensible way we can resolve this. Let's talk.

[40] Ms Stormont replied on 16 January 2014 stating that before she and Mr Goldie met, she required a: "*line by line breakdown of the expenses details for the end of that FY*".

[41] As she wanted to explore the calculations of net profit, she had asked Mr Wilde in early 2014 to prepare another calculation, providing him with further details. Mr Wilde's calculation of the net profit bonus based on the more detailed information Ms Stormont provided was \$35,557.00, and he also provided a more accurate calculation of the gross profit bonus in the sum of \$61,400.00.

[42] Ms Stormont said her performance review was due in October 2014 and as she expected that the bonus issue would be on the agenda for discussion, she decided to wait until then to submit Mr Wilde's latest calculations.

Letters dated 6 October 2014

[43] In 2014, Peddle Thorp again held staff performance reviews. Mr Barnes said that whilst Peddle Thorp decided to meet with Ms Stormont in 2014, the meeting was not to be a performance review and it was delayed due to Ms Stormont being away on overseas travel until her return in October 2014.

[44] Ms Stormont said she returned from overseas travel expecting that her performance review would take place, and in line with that expectation she was advised that there would be a meeting to be held on 6 October 2014.

[45] However she was shocked to receive a formal letter on 6 October 2014 advising her that Peddle Thorp was proposing a restructure and that, should the proposal be implemented, her role as Associate for the Interiors Division would be disestablished. The letter, which was signed by Mr Barnes, stated:

Dear Catherine,

The Directors have been considering the work undertaken by Interiors and the nature of work generated in this area.

When we established the Head of Interiors at the Associate level, the direction of this area principally involved the generation of Interiors' business that was additional to the established architectural business.

In reviewing the work we have undertaken in Interiors, it is apparent that much of recent Interiors work is serving our architectural projects rather than independently generated work.

The capability to secure and deliver independent interiors work requires a structure that includes senior and middle level resource, and this has been our reasoning for the current structure. However we now consider that our estimation of the market for discrete interiors work, has been overly optimistic.

We are now considering reducing the scope of the Interiors Division to focus purely on the interiors work that forms part of our architectural projects. This thinking has resulted in us questioning whether we need a senior position in the Interiors area.

We are considering establishing a structure which would see an Interiors Assistant working closely with our Architects to provide the Interiors work required by our clients.

If we decided to proceed with this change your position of Head of Interiors at the Associate level would be disestablished.

The changes outlined are only at the proposal stage. We want to discuss the proposed changes with you, consider your feedback and any alternatives or options that you believe would be viable. ...

[46] The letter concluded with the advice that a meeting had been scheduled for Monday, 13 October 2014 to which Ms Stormont was invited to bring a support person or representative.

[47] Ms Stormont was also provided with a letter regarding the bonus issue dated that same day, 6 October 2014 which was signed by Mr Barnes. It stated:

Further to our discussions relating to the calculation of the profit bonus we wish to have a further discussion with you to see if we can achieve resolution in this matter.

If there is any information you wish to provide us ahead of that discussion please do so. I note we have the information provided by Nigel Wilde of Hayes Knight City Limited.

We have scheduled a meeting for Thursday 9th October. Brad and I will be present and you are of course welcome to bring a representative or support person to this meeting.

Bonus issue

[48] Ms Stormont engaged a barrister Ms Jane Latimer, to act on her behalf. Ms Latimer wrote to Peddle Thorp on 17 October 2014 with respect to both the issues raised in the letters dated 6 October 2014.

[49] In the letter Ms Latimer requested: “*Any information, written or otherwise relating to the disputed 2011 bonus. This includes any notes, emails, texts or information in the minds of the directors.*”

[50] Ms Wood replied to Ms Latimer’s letter dated 17 October 2014 on 6 November 2011 stating that the bonus issue was: “*completely independent of the proposal to restructure*”

[51] In a letter to the Directors of Peddle Thorp which was sent attached to an email from Ms Latimer dated 16 December 2014, Ms Stormont wrote under a sub heading ‘*My Observations of late:*

We have an outstanding bonus issue going back to April 2011. Unable to resolve this with RG, I raised it in my performance review in 2013 with Terry in order to get accurate information. I engaged a professional accountant to work out the bonus using normal accounting processes. This is in excess of your calculations. I believe this has been a real annoyance during my employment and knowing it would be addressed in the performance review of 6 October 2014 you decided that you would get rid of me. I am a nuisance because of that. It is too coincidental that I receive a formal letter on the bonus then immediately after in the same meeting I receive a formal letter relating to you considering making me redundant.

[52] The Directors of Peddle Thorp, namely Mr Barnes, Mr Luke and Mr Goldie replied to Ms Stormont’s letter on 19 December 2014. In regard to the bonus they observed that the matter of the bonus was not related to the restructuring proposal and stated:

It is acknowledged that you raised issues in 2011 in relation to the bonus calculation: more particularly these matters that you raised related to the expense allocation (in other words, what expenses were deducted in arriving at the bonus calculation). The expense allocations were set out in correspondence at the commencement of your employment and the Company Accountant discussed these cost allocations with you when you raised the aforementioned issues. ... we have at all times been consistent in what was indicated to you in the

written communications detailing these deductions and in the subsequent discussions with the Company Accountant within the first three months of your employment with us.

[53] Following the termination of her employment with Peddle Thorp on 24 March 2015 Mr Brett Francis, General Manager, wrote to Ms Stormont confirming that Peddle Thorp had twice attempted to pay her the bonus payment of \$1,526.80 gross, which she had refused.

Restructuring issue

[54] Ms Stormont said she had been unable to make sense of the rationale behind the redundancy proposal as it appeared to be lacking substantive commercial reasons. She considered she had been managing an efficient and profitable Interiors Division and at no stage during her employment had she been made aware that the Interiors Division was not efficient or that the Directors had any concerns about it.

[55] Ms Wood said that she had been surprised that Ms Stormont could not make sense of the rationale behind the redundancy, explaining that the question of the restructuring had nothing to do with the question of any financial profitability or otherwise of the Interiors Division, but it was rather a simple situation as explained in the letter dated 6 October 2014, that is that despite the clearly articulated purpose of bringing Ms Stormont into the firm to run and grow the Interiors Division, some five years later, 76% of the Interiors work was originating with the Architects in the practice rather than from Ms Stormont herself.

[56] Although Mr Barnes had signed the letters dated 6 October 2014, the letter in relation to the restructuring proposal had been drafted by Ms Sylvia Wood, Director of Know How, a Human Resources consulting service, who had been engaged by Peddle Thorp. Ms Stormont engaged a barrister Ms Jane Latimer, to whom Ms Wood wrote on 6 November 2014, addressing both issues.

(i) Information request 17 October 2014

[57] The meeting scheduled for 13 October 2014 was rescheduled at Ms Stormont's request and took place on 17 October 2014.

[58] Ms Wood said that at that meeting, Ms Latimer presented a letter claiming that Peddle Thorp had acted prematurely and had not provided the relevant information that would enable Ms Stormont to consult. Ms Wood said the letter contained a broad, wide-ranging information request which went far outside any information relating to the proposal which could impact on Ms Stormont's continued employment.

[59] In the letter dated that day Ms Latimer made a request for information relevant to the restructuring proposal and information: *“that may assist the employee to understand the background and rationale for the proposal”*.

[60] In response Ms Wood suggested in an email dated 21 October 2014 that Ms Stormont work with Mr Goldie to determine which invoices were: *“pure interiors and those that have been generated from architectural projects”*.

[61] Ms Stormont said she had been shocked by the request because she would have expected Peddle Thorp to have conducted thorough research and analysis before presenting her with a proposal to disestablish her role.

[62] Ms Wood said the intention behind the invitation to Ms Stormont to meet and agree on the invoices was offered as a means of eliminating further disagreement and ambiguity about whether or not a particular client was an independent design client, sourced and brought into the business by Ms Stormont, or whether it was a referral from an architect within the practice.

[63] The invitation was however withdrawn when Ms Latimer pointed out that she believed it to be highly inappropriate.

(ii) *Letter dated 6 November 2014 and response*

[64] Peddle Thorp provided numerous documents in relation to the requested information on 6 November 2014. In a letter dated that same day Ms Wood stated:

... The restructure as proposed by the directors is to manage the Interiors Division more efficiently to rely on the Interiors work generated by the Architects to the practice and to utilise a middle level position as the dedicated interiors resource. ...

The proposal is not driven by the financial aspects of the Interiors Division and the suggestion that they have somehow failed in their obligation by not producing a business case is rejected. Rather the initial aim to establish an independent business has not progressed as the Directors had first envisaged and therefore they are considering reducing its scope to be a function that supports the Firm’s architectural projects.

[65] Ms Wood explained that included in the information provided to Ms Stormont had been a table which set out that only 24% of the work managed by the Interiors Division

originated from the Interiors Division's independent clients, and that 76% was work that originated with the Architects.

[66] On 11 November 2014 Ms Latimer responded and asked:

What does your client mean by its proposal to "manage" the interiors Division more efficiently?

*... Under "point 1 and 2" of your letter you, having stated earlier in your letter that the proposal was not driven by the financial aspects, confuse Catherine and me by explaining that the review of the work undertaken by Interiors related to "the financial information regarding the work generated by Interiors vs the work generated by the Architectural arm of the practice ... This is very confusing. Clearly you are saying that the review and the rationale for the proposal **does** relate to the financial information. Accordingly, please disclose the financial information you are relying on.*

[67] Ms Wood explained that she did not agree that efficiency had to be measured by the financial state of a business; rather the question was whether, given that 76% of the Interior Division's work was generated by the Architects, Peddle Thorp required a dedicated senior person to run it, or could it be managed more efficiently by having a less senior person under the supervision of the Architect referring the work.

[68] Ms Wood replied to Ms Latimer on 25 November 2014 setting out Peddle Thorp's view of the matter and addressing the matter of Ms Stormont's performance, stating:

.... In response to your questions as to performance and relationships it must be placed on record that in my client's view neither aspect has any relevance to the proposal to restructure. My clients have advised that they do not recall any confidential discussions regarding Ms Stormont's performance or any informal information relating to relationships Ms Stormont had with clients, directors or colleagues. What they have said is that they have a very high regard for Ms Stormont's interiors work and consider her to be highly skilled. ...

[69] Ms Wood concluded the letter by confirming that Peddle Thorp wished to consult with Ms Stormont on the proposal and receive her feedback on the proposal, requesting a meeting to be confirmed on 27 or 28 November or 1 December 2014 when this process could take place. However if Ms Stormont was not well enough to do so, or preferred to provide her feedback and/or alternatives and options in writing, this would be acceptable.

[70] Ms Wood said there was no response to her letter of 25 November 2014 and accordingly on 3 December 2014, she sent a further letter to Ms Latimer indicating that if she had no further advice from Ms Latimer or Ms Stormont by 5pm on Monday, 8 December 2014, Peddle Thorp would have to conclude that Ms Stormont did not wish to agree to mediation which she had offered.

(iii) *Ms Stormont's Response to the restructuring proposal*

[71] Ms Stormont said she had been working from home because she had been suffering from stress-related symptoms following receipt of the letter of 6 October 2014. On 16 December 2014, she responded to the proposed disestablishment of her role. In the letter she outlined a number of concerns regarding the rationale and genuineness of the proposal as well as outlining key areas of concern about the process that Peddle Thorp was following. In the letter, she had stated:

My engagement at Peddle Thorp was on the basis that Peddle Thorp said they needed someone to head an interiors division as they were losing interior work attached to their architectural projects by not having a committed Interiors group.

Serving architectural projects was always part of my role so I am not sure why this is an issue now unless it is not profitable. But you have not raised this with me. ...

This rationale of where the work comes from has no relevance to my proposal redundancy unless we were without work. ...

[72] Ms Stormont reiterated her view that she could not understand how greater efficiencies could be achieved by managing the Interiors Division via a senior Architect.

[73] Ms Stormont also reiterated her view that the restructuring issue had been promoted by the bonus issue and the 'nuisance' to Peddle Thorp that issue had become, and concluded that: "*I do not believe there is a sound commercial reason to make my role redundant. I also believe that the alleged commercial reason is a sham to hide the real reason*"

[74] Ms Stormont offered to meet with the Directors of Peddle Thorp and work on a process to ensure that the work of the interiors Division was properly accounted for and measured.

(iv) *Peddle Thorp's Response*

[75] The Directors, being Mr Barnes, Mr Goldie and Mr Luke, responded to Ms Stormont in a lengthy letter dated 19 December 2014 in which she was advised that her employment would terminate by reason of redundancy and that Peddle Thorp would consult with her as to whether any other positions were available for her. In the letter the Directors advised:

.... Our view is that after considering the nature of projects (and their scope) that have been undertaken leads us to conclude that the volume of the Interiors work in our practice can successfully be undertaken by our architects and by our design assistant. ...

You are correct in saying that we have not raised with you the issue of profitability of Interiors work. The restructure does not rest upon and has never been represented as being dependent on financial performance. As a practice we must provide interior services. In considering the restructure we propose that this could be properly and adequately resourced by our architects and our design assistant. In short, and we accept you disagree with this view, our proposal provides a more efficient manner of going about the relevant matter.

...

You refer to the matter of the bonus and state that this is the basis behind the redundancy. This is simply not the case. ...

[76] The letter concluded with the statement that the employment conditions in the Employment Agreement provided for further consultation regarding the period of notice in the event of redundancy. The letter proposed that the three months' notice applied and that Ms Stormont's final day of work would be 20 March 2015.

[77] Mr Barnes said Ms Stormont did not engage in any consultation with Peddle Thorp about the proposal of the three months' severance.

[78] Ms Stormont said that Peddle Thorp, despite the advice that it would do so, did not attempt to explore redeployment options with her.

[79] Mr Barnes said that although Peddle Thorp had looked at alternative and redeployment options, there were no other interior design posts other than her own role which was being disestablished and that of the Interiors Division Assistant. In addition, given that Ms Stormont did not hold any architectural qualifications, a position created by one of the Architects leaving Peddle Thorp could not be filled by her. Nor were there any administrative roles which were suitable for her.

[80] During the three month notice period Mr Barnes said that Ms Stormont's attendance at work had been erratic and sporadic, and she did not engage in any consultation process.

[81] Ms Stormont's last day of employment at Peddle Thorp was 12 March 2015, although she was paid until 20 March 2015.

[82] On 8 May 2015, a personal grievance was raised on behalf of Ms Stormont and mediation was requested. The parties did subsequently attend mediation, however, this was

not successful in resolving the issue and on 21 April 2015 a statement of problem was filed with the Authority.

Determination

How is the bonus due to Ms Stormont to be correctly calculated?

[83] There has been much discussion in this case upon the interpretation of the words ‘gross’ profit as set out in point 6 of Stage 1 in the Specific Conditions of Employment. In accordance with the Employment Agreement which incorporated the letter dated 26 November 2009, and the General and Specific Conditions of Employment, Ms Stormont was entitled to a bonus to be calculated in accordance with point 6 of Stage 1 in the Specific Conditions of Employment which stated subject to the Clarifications conditions:

Achieve at least a breakeven position for the Interiors at Peddle Thorp Architects. Should you achieve a profit for the Interiors you will receive a gross bonus equivalent to 20% of the gross profit.

[84] Mr Wilde interpreted this calculation based upon a Wikipedia definition of ‘gross profit’ as being: “*the difference between revenue and the cost of providing the service before deducting overhead*”

[85] Mr Goldie and Peddle Thorp subsequently accepted that a mistake had been made in the wording (drafting) of point 6 of Stage 1 in the Specific Conditions of Employment, an explanation which was not accepted by Ms Stormont who claimed that ‘gross’ should not have read ‘net’. I also note that the Stage 2 and Stage 3 elements of the Specific Conditions of Employment refer only to “*profit*” and “*profit target*” which does not support Ms Stormont’s contention that the word ‘gross’ was intended. There is a further typing error in the words ‘*the profit 20% profit target*’ which supports the poor drafting contention.

[86] In *NZ Meat Workers & Related Trades Union Incorporated v Silver Fern Farms Ltd (formerly PPCS Ltd)*¹ (“*Silver Fern Farms*”) Judge Shaw referred to the principles of contractual construction in interpreting collective agreements as having been summarised by the Employment Court in *New Zealand Tramways and Public Transport Union Inc v Transportation Auckland Corporation Ltd*². The Employment Court in that case had observed that:³

The starting point is to examine the words used to see whether they are clear and unambiguous and to construe them according to their ordinary meaning. Consideration must be given to the whole of the

¹ [2009] ERNZ 149

² [2006] ERNZ 1005

³ *Ibid* at para [16]

contract. The circumstances of entering into the transaction may be taken into account, not to contradict or vary the written agreement, but to understand the setting in which it was made and to construe it against that factual background having regard also to the genesis and, objectively, the aim of the transaction ...

[87] Whilst there is not a dispute over a collective agreement at issue in this case, I observe that the Court in that case referred to consideration being given to the whole of the contract.

[88] In *New Zealand Professional Firefighters Union & Ors v The New Zealand Fire Service Commission*⁴ Judge Ford referred to the importance of a contextual cross-check :

.the Court should not readily accept any suggestion that there is, nevertheless, an error in that interpretation but it is still necessary to carry out the contextual cross-check Justice Tipping referred to in Vector in order to affirm that the plain and unambiguous meaning has not been altered by context.

[89] In looking at the circumstances of how the parties entered into the Employment Agreement and their intentions relating to remuneration, there is no evidence of any discussions or negotiations that took place prior to the Employment Agreement being formalised. Mr Goldie of Peddle Thorp drafted the terms of the Employment Agreement which Ms Stormont accepted without query.

[90] Peddle Thorp made an offer of remuneration which included a basic salary plus a three year incentive scheme; in year 1 (2010) the incentive was to be in the form of a cash bonus, and in years 2 (2011) and 3 (2012) the incentive was to be via a share purchase arrangement. The incentive scheme was subject to a condition precedent that the Interiors Division achieved breakeven.

[91] I find that the incentive scheme was an integrated 3 year package subject to the Clarifications section of the Specific Conditions of the Employment Contract.

[92] It was not until the end of the financial year March 2011 that Ms Stormont contended that the wording of point 6 of Stage 1 was unclear in relation to the meaning of the phrase 'gross profit', despite the fact that she received bi-monthly summaries of the Interiors Division financial performance which were in a format which mirrored the requirements of the Clarifications section of the Specific Conditions of the Employment Contract, and did not mention the phrase 'gross profit'.

⁴ [2011] NZEmpC 149 at para [29]

[93] Examining the Employment Agreement as a whole, and particularly the Specific Conditions I find that the three stages of the incentive scheme including point 6 of Stage 1 are subject to the Clarifications conditions which state:

- a. Costs would be recorded for analysis;
- b. Time spent by the Interiors Division in supporting the Architectural projects would be charged against those projects; and
- c. Costs for the Interiors Division included staff salaries (including Ms Stormont's) and plus a share of direct and office overheads.

[94] Further in *ASTE v Chief Executive of Bay of Plenty Polytechnic*⁵ Judge Colgan, as he then was, observed that the interpretation of a collective agreement should not be narrowly literal but should accord with business common sense, stating at para [23] that:

The interpretation, rather than being based simply on dictionary meanings and grammar, should fulfil the purpose of the contract. Even if the drafting is inept, the Court should be able to give effect to the underlying intent. Moreover, if a literal interpretation gives rise to nonsense in practice, the Court should endeavour to find a more liberal interpretation which satisfies business common sense and fulfils the parties' purpose.

[95] Point 6 of stage 1 sets a condition precedent: “*achieve at least a break even position for interiors*”. And: “*should you achieve a profit ...*” going on to state: “*gross bonus*” and: “*equivalent to 20% of the gross profit.*” The use of the term ‘*gross bonus*’ I find refers to taxable income considerations and is not relevant to the calculation itself.

[96] The requirements to ‘*break even*’ and ‘*should you achieve a profit*’ clearly refer to the performance achievement after all costs (described fully in the Clarification conditions) have been met. In the presence of these requirements I find it is common business sense to consider that the 20% bonus is to be calculated using the profit obtained in fulfilling the condition precedent. If the intention was to pay a bonus based on the gross profit interpretation only, there would be no reason to have stated the condition precedent.

[97] I also find stages 2 and 3 of the incentive scheme to be part of the whole agreement, and the condition precedent here is to achieve ‘*the 20% profit target*’ to allow the share option arrangements to be available. The ‘*20% profit target*’ is consistent with what is intended in stage 1. In addition I find that because the share option possibility replaces the cash bonus in

⁵ [2002] 1 ERNZ 491 at 500

year 1, it is reasonable and follows logic that the share option would be at least equal in value to the value of the stage 1 incentive. For this not to be so would mean that on Ms Stormont's interpretation of the bonus calculation her remuneration for stage 2 and 3 in total terms would be significantly less than that for stage 1. However on Peddle Thorp's interpretation of the bonus calculation it follows that the incentives achieve a financial outcome in the same financial terms - namely 20% of the net profit achieved in Interiors.

[98] I find that in accordance with the Clarifications conditions, the profitability position for Interiors was to be calculated utilising the revenue achieved (billings) less (i) the direct costs of the Interiors Division (which include all relevant staff salaries, including that of Ms Stormont, and a credit for the time spent by the Interiors Division on Architectural projects that had been charged to those projects), and less (ii) the share of direct and office overheads.

[99] On 2 June 2010, one month after Ms Stormont commenced employment with Peddle Thorp, Mr Forest, in a memorandum addressed to Ms Stormont, sets out clearly the format to be used in financial reporting, which mirrors the intentions of point 6 of Stage 1 and the Clarifications conditions. Ms Stormont did not query any aspect of the memo which clearly refers to allocated administration costs.

[100] Accordingly the subsequent bonus payment to Ms Stormont would be a 20% gross payment of the resulting profit once breakeven had been achieved, which was indicated to be generally at approximately 2.2 x staff salaries.

[101] Whilst Ms Stormont disputes Peddle Thorp's interpretation of the basis of the bonus calculation, I note that in both her Statement of Problem and Brief of Evidence she refers only to the wording of point 6 of Stage 1, and ignores the section headed Clarifications.

[102] I find Ms Stormont's understanding to be at variance with the clear wording in the Clarifications conditions in the Employment Agreement. Also, I accept that throughout 2010-2011 Peddle Thorp produced and made available to Ms Stormont on a bi-monthly basis a summary of the financial information for the Interiors Division and that Ms Stormont attended the relevant meetings at which these matters were discussed. Therefore I find Ms Stormont's claim that she was unaware of the profitability of the division until after 31 March 2011 to be lacking in credibility.

[103] Further in *ASTE v Chief Executive of Bay of Plenty Polytechnic*⁶ Judge Colgan, stating at para [23] that:

⁶ [2002] 1 ERNZ 491 at 500

The interpretation, rather than being based simply on dictionary meanings and grammar, should fulfil the purpose of the contract. Even if the drafting is inept, the Court should be able to give effect to the underlying intent.

[104] In this case I accept, as indeed Peddle Thorp appear to do, that their drafting was inept. I observe that in Peddle Thorp the Interiors Division did not exist in a vacuum, it was part of an organic whole which worked alongside and as part of the Architectural Division. It had office space and facilities provided, it was serviced by the office administration, and operated as part of the whole. In such a scenario I find that business common sense dictates that a breakeven position and profitability of the Interiors Division would operate on accountancy principles applicable to a service practice such as Peddle Thorp.

[105] I determine that the bonus due to Ms Stormont in respect of the year ended 31 March 2011 is to be calculated in accordance with the Clarifications Conditions in the Specific Conditions of Employment, utilising the formula:

Client Revenue (i):	XXXXXX
Less: Staff salaries including Ms Stormont (ii)	(XXXXXX)
Share of direct and office overheads (iii)	(XXXXXX)
Profit for 20% bonus calculation (vi)	<u>XXXXXX</u>

Notes

- (i) Client revenue figure to be agreed between the parties.
- (ii) To include any adjustment pursuant to clause 1 (b) of Clarifications.
- (iii) The total overhead costs of \$2,350,000.00 to be distributed on a share basis. The share of overheads to be calculated using the ratio Total Revenue/ Interiors Revenue.
- (iv) The Clarifications Conditions do not include for any deduction for Corporation Tax, which is not classified as an overhead cost.

Was Ms Stormont unjustifiably dismissed?

- (i) *Did Peddle Thorp have genuine reasons for the restructuring exercise?*

[106] The Court of Appeal statement of the law regarding the genuineness of a redundancy in *GN Hale & Son Ltd v Wellington Caretakers IUOW*⁷(*Hale*) was that:

⁷ [1991] 1 NZLR 151

An employer is entitled to make his business more efficient, as for example by automation, abandonment of unprofitable activities, re-organisation or other cost-saving steps, no matter whether or not the business would otherwise go to the wall. A worker does not have a right to continued employment if the business can be run more efficiently without him.

[107] However since *Hale* was decided, justification for dismissal is now as stated in the Employment Relations Act 2000 (the Act), which at s 103A sets out the Test of Justification as being:

S103A Test of Justification

- i. For the purposes of section 103(1) (a) and (b), the question of whether a dismissal or an action was justifiable must be determined, on an objective basis, by applying the test in subsection (2).*
- ii. The test is whether the employer's actions, and how the employer acted, were what a fair and reasonable employer could have done in all the circumstances at the time the dismissal or action occurred.*

[108] The Test of Justification requires that the employer acted in a manner that was substantively and procedurally fair. An employer must establish that the dismissal was a decision that a fair and reasonable employer could have made in all the circumstances at the relevant time.

[109] In a more recent case than *Hale*, *Michael Rittson-Thomas T/A Totara Hills Farm v Hamish Davidson*⁸ (*Rittson*), the Employment Court referred to *Hale* and its previous comments about *Hale* in *Simpsons Farms Limited v Aberhart*⁹. His Honour Chief Judge Colgan considered that the Court cannot impose or substitute its business judgment for that of the employer taken at the time, however:

[54] ... the Court (or the Authority) must determine whether what was done and how it was done, were what a fair and reasonable employer would (now could) have done in all the circumstances at the time. So the standard is not the Court's (or the Authority's) own assessment but rather, its assessment of what a fair and reasonable employer

⁸ Unrep [2013] NZEmpC 39 20 March 2013

⁹ [2006] ERNZ 825,842

would/could have done and how. Those are separate and distinct standards.

[110] In this current case, although there is evidence that there would be a financial benefit by making Ms Stormont's position as Head of the Interiors Division redundant, Peddle Thorp has not relied upon that financial rationale as being the primary reason for the restructuring, rather the decision to restructure was based upon the rational that as three quarters of the Interiors Division's work was referred by the Architects, there was no requirement for an Associate – Interiors Design position. Rather the Interiors Division could be managed effectively through the referring Architect and an Interiors Assistant.

[111] I have considered whether there were other considerations motivating the redundancy proposal, in particular the unresolved bonus issue and the difficulties in the relationship between Mr Goldie and Ms Stormont.

[112] The bonus issue was not resolved at the time the restructuring proposal was made, although I observe that at that stage, Mr Goldie had confirmed on 15 January 2014 that he had made a mistake regarding the drafting of the wording relating to 'gross' and 'net profit', and offered to meet Ms Stormont to discuss it. There is no evidence that Ms Stormont accepted the offer to meet and talk.

[113] Peddle Thorp did not evade the bonus issue during October 2014. In the letter dated 6 October 2014, Ms Wood, on behalf of Peddle Thorp invited Ms Stormont to have a further discussion with a view to resolving the issue. This offer was reiterated in a letter from Ms Wood dated 6 November 2014.

[114] Whilst I accept that Ms Stormont concluded that the two issues were connected, I do not find that the bonus issue motivated the restructuring proposal.

[115] Ms Stormont had difficulties relating to her relationship with Mr Goldie during her employment. On one occasion he made an offensive remark about which she complained, and she also considered that he was undermining her position by conferring directly with her Assistant on Interiors Division's assigned work.

[116] Whilst I accept that these are issues about which Ms Stormont felt justifiably upset, I do not find that they motivated the restructuring proposal.

[117] I find that there were genuine business reasons for Peddle Thorp to disestablish the position of Associate –Interior Design, and consequently make Ms Stormont redundant.

(ii) *Did Peddle Thorp follow a fair process?*

[118] An employer who is proposing to restructure its business must not only have genuine reasons for undertaking the restructuring, but must follow a fair procedure in respect of affected employees.

[119] Provisions of the Act govern questions of justification for dismissal and, in particular, by reason of redundancy. Section 4 of the Act addresses the requirement for parties to the employment relationship to deal with each other in good faith. Section 4(1A)(c) in particular is relevant to a redundancy situation and requires an employer who is proposing to make a decision that will, or is likely to, have an adverse effect on the continuation of employment of an employee to provide to the employee affected:

(i) access to information, relevant to the continuation of the employees' employment, about the decision; and

(ii) an opportunity to comment on the information to their employer before a decision is made." s4 (1A)(i) and (ii).

(a) *Access to information*

[120] Whilst it was Peddle Thorp's position that the restructuring was not based upon financial considerations, it nonetheless provided the information requested by Ms Latimer on behalf of Ms Stormont in detail. I also observe that during the course of her employment, Ms Stormont was provided on a regular basis, that is bi-monthly, with financial information relating to the work of the Interiors Division and its origination.

[121] Included in the information provided was a table setting out the amount of the Interiors Division work generated by the Interiors Division and the Architects in the percentages of 24% to 76%.

(b) *Opportunity to comment*

[122] The initial letter dated 6 October 2014 stated that the restructuring proposal was just a proposal at that stage, and Ms Stormont was provided with an opportunity to consult and provide feedback at a meeting scheduled to take place on 13 October 2014.

[123] That meeting actually took place on 17 October 2014 and was not a consultation but a request for information. What subsequently ensued was a protracted written series of communications, and a repeated request from Ms Wood on behalf of Peddle Thorp on 25

November 2014 for Ms Stormont to provide feedback, either in person at a meeting on one of three suggested dates, or in written form.

[124] Ms Stormont responded to the restructuring proposal in a detailed letter dated 16 December 2014 to which the Directors provided a detailed response on 19 December 2014 confirming the restructuring decision, but inviting further consultation during the three month notice period.

[125] I find that Ms Stormont had an opportunity to comment on the restructuring proposal before a final decision was made.

[126] I find that Peddle Thorp carried out a fair process.

[127] I determine that Ms Stormont was not unjustifiably dismissed by Peddle Thorp.

Was there a breach of good faith?

[128] Ms Stormont claims that Peddle Thorp breached the duty of good faith it owed her by not engaging with her fully in the bonus calculation issue.

[129] There was clearly a divergence of views as to how the bonus should be calculated by the two parties which was not resolved at the time Ms Stormont's employment came to an end. However I find that Peddle Thorp was open to discussing the matter with Ms Stormont as outlined in the preceding paragraphs, and was being communicative towards her.

[130] I find no breach of good faith in the manner in which Peddle thorp approached the bonus issue.

Was there a breach of the Employment Agreement?

[131] I have not found that the Peddle Thorp failed to pay the bonus in accordance with clause 6 of the Employment Agreement and find on that basis no breach of the Employment Agreement.

Costs

[132] Costs are reserved. The parties are encouraged to agree costs between themselves. If they are not able to do so, the Respondent may lodge and serve a memorandum as to costs within 28 days of the date of this determination. The Applicant will have 14 days from the date of service to lodge a reply memorandum. No application for costs will be considered outside this time frame without prior leave.

Eleanor Robinson
Member of the Employment Relations Authority