

**IN THE EMPLOYMENT RELATIONS AUTHORITY
WELLINGTON**

WA 120/08
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BETWEEN MAREIKE HUGHES AND
ADRIAN LEE HUGHES
Applicants

AND UPPER HUTT
COSMOPOLITAN CLUB
INCORPORATED
Respondent

Member of Authority: G J Wood

Representatives: Mike Gould for the Applicants
Michael Quigg and Tim Sissons for the Respondent

Investigation Meeting: 10 and 11 June 2008 at Wellington

Submissions Received: Due by 12 September 2008

Determination: 17 September 2008

DETERMINATION OF THE AUTHORITY

Employment Relationship Problem

[1] The Employment Relations Act provides for continuity of employment to employees providing food catering services if they are affected by restructuring and their work becomes the responsibility of a new employer. Mrs Mareika Hughes and her husband Adrian owned and operated a company (Hughes Catering Limited) that had the catering contract at the Upper Hutt Cosmopolitan Club. When the Club terminated Hughes Catering Limited's contract Mr & Mrs Hughes believed that the Club was required to employ them directly, as they were both employees of Hughes Catering Limited and their catering jobs had been lost once the Club had contracted the work in. The Club refused to employ them.

It believed the employment agreements between Hughes Catering Limited and Mr & Mrs Hughes were not valid and in fact were a sham.

[2] The primary issues for determination are:

- Do the protections of Part 6A of the Employment Relations Act extend beyond *vulnerable employees* and to owner/operators like the Hughes?; and
- Was the real nature of the relationship between HCL & Mr & Mrs H that of employer and employee? The two major aspects to this issue are whether the employment agreements were a sham and (if not) whether the traditional tests indicate that Mr & Mrs H were not employees of HCL in law for the purposes of protection under Part 6A.

The Facts

[3] The Club was destroyed by fire in 2004. When it reopened in 2005 it had undertaken a search for, and secured the services of, a new caterer. That caterer was Hughes Catering Limited, a company which had been incorporated on 30 September 2004. Mr and Mrs Hughes were both 50 percent shareholders in the company, and its only directors. The Club had, however, no reason for knowing that Mr and Mrs Hughes had incorporated a company to undertake the catering at the time the contract was signed, because it was neither indicated in their proposal nor in the contract, which was signed by Mr and Mrs Hughes on behalf of *Hughes Catering*.

[4] The contract between the Club and (in effect) the company is a comprehensive one, which in essence allowed Hughes Catering to use the Club's facilities to produce meals for members and others. It also provided that Hughes Catering was responsible for the quality of meals and the operation of the catering function, including hiring all staff. Over 2,000 meals per week were served. Given the range of hours involved throughout the week, a large number of staff were employed by Hughes Catering Limited. The contract commenced on 26 February 2005.

[5] I accept that as the result of accounting advice Mr and Mrs Hughes, as directors of Hughes Catering Limited, employed themselves as employees of the company from the beginning of the contract. Mr and Mrs Hughes were initially paid by the company at the rate of \$30,000 each per year, because it had minimal cash flow early on. On 22 May 2005 this was increased to \$60,000 per year, except between the end of June 2006 and the beginning of

September 2006 when (once again for cash flow reasons) the company, through its directors, Mr and Mrs Hughes, reduced their salaries to \$30,000 per annum.

[6] Mr Hughes was in charge of the food side of the operation, while Mrs Hughes was in charge of front of house management, as well as the accounting and finance functions. When being paid \$60,000 each they were by far the highest paid employees of Hughes Catering Limited.

[7] The Hughes' salaries were properly accounted for within the company and with Inland Revenue. No proper holiday records were kept, however. Furthermore, it was not until 9 September 2006 that Mr and Mrs Hughes signed their (comprehensive) individual employment agreements, which contained not only a \$60,000 salary, but also redundancy compensation of one year's pay. The reason for redundancy compensation at this uncommonly high level has never been satisfactorily explained. The only explanation for the delay in time in executing the agreements was that Mrs Hughes, who had responsibility within the company for such matters, had not got around to it. There was no satisfactory explanation as to why the employment conditions were significantly different to all other employees of Hughes Catering Limited, particularly in relation to redundancy.

[8] There was no reason for anyone in the Club to believe the Hughes were anything more than owner/managers. In particular, no indication was given to anyone in the Club that they were employees of Hughes Catering Limited. They conducted themselves as owner/operators throughout, setting their own (variable) hours of work, taking holidays to suit and generally coming and going as they pleased.

[9] The issue of the identity of the caterer was resolved by the time the second contract was entered into in November 2006. The contract itself had been subject to negotiation since January. These negotiations were difficult because of performance concerns held by the Club, which it felt was the reason for reduced catering turnover.

[10] In fact the quality of food and service provided by Hughes Catering Limited has been and remains a key area of dispute between the Club and the company (and by extension Mr and Mrs Hughes). This led the Club, on 28 June 2007, to exercise its rights under the catering contract for summary termination of the agreement, because of an alleged failure to produce food of a reasonable standard. That issue is still in dispute in another forum.

[11] The Club subsequently contracted in the catering and took on all the employees of Hughes Catering, except Mr and Mrs Hughes. On inquiry the Club stated that they did not consider Mr and Mrs Hughes to be employees of Hughes Catering Limited.

[12] On 3 July Mr Gould wrote on behalf of Mr and Mrs Hughes notifying the Club that they elected to transfer their employment to the Club under s.69A of the Employment Relations Act. The Club responded through its lawyers that it did not recognise the purported employment of Mr and Mrs Hughes by Hughes Catering Limited. It considered their arrangement to be a sham.

[13] Mr and Mrs Hughes then reported for work the next day, albeit not at their usual work times. They were told that their employment was not accepted. They did not appear particularly surprised at this, which in itself is not surprising, considering they had already been informed that the Club did not accept that it had a responsibility to employ them.

[14] Mr and Mrs Hughes could not find work for a long period thereafter. They have been to mediation with the Club but have been unable to resolve matters. It therefore falls to the Authority to make a determination.

Do the protections of Part 6A extend beyond *vulnerable employees* and to owner/operators like the Hughes?

[15] The object of the new Subpart 6A, entitled *Continuity of Employment if Employee's Work Affected by Restructuring* is to provide protection to specified categories of employees if, as the result of a proposed restructuring, their work is to be performed by another person. To this end it gives employees a right to elect to transfer to that other person as employees on the same terms and conditions of employment.

[16] This situation applies to managers and owner/operators like Mr and Mrs Hughes (if found to be employees) provided three conditions are met:

- Schedule 1A applies to them;
- if as a result of a proposed restructuring they will no longer be required by his or her employer to perform the work performed by them (s.69F); and
- the work performed by them, or work that is substantially similar, is to be performed by or on behalf of another person (s.69F).

[17] The key issue here is whether Schedule 1A applies, as it is agreed that the last two conditions have been met. This schedule applies to employees who provide services in the specified sectors, facilities or places of work referred to in the schedule. Of relevance here is one part of subsection (f), namely *food catering services in relation to any other place of work (within the meaning of the Health and Safety in Employment Act 1992)*.

[18] The Club claims, on the basis of statements made during the Select Committee process, that in order to qualify under Schedule 1A, people like Mr and Mrs Hughes must be *vulnerable employees*. As Mr Quigg submitted, it was stated in the Select Committee report that the groups in the Schedule were considered to be at risk because of factors such as a lack of bargaining power, or being employed in sectors that frequently undergo restructuring. He also noted that the Schedule can only be amended by Order-in-Council on the basis of a recommendation of the Minister, who must be satisfied that one of the following criteria for change are met:

- the employees concerned are employed in a sector in which the restructuring of an employer's business occurs frequently, or
- restructuring of employers' businesses in the sector concerned has tended to undermine employees' terms and conditions of employment, or
- the employees concerned have little bargaining power.

That does not, however, change the fact that Parliament saw fit to include the Schedule as it currently is. There have been no changes made to it.

[19] I do not accept that there is any necessity for employees covered in the Schedule to be *vulnerable employees*. Parliament has chosen through a considered process to cover certain categories of work, not certain categories of employees. The fact that prospective amendments to the Schedule must take into account certain issues is relevant primarily to such amendments. Parliament could have chosen to restrict the categories in a way that directly targeted Mr Quigg's category of *vulnerable employees*, but it has clearly chosen not to do so and the Authority can not ignore this.

[20] The key remaining issue is whether managers like Mr & Mrs Hughes provide food catering services. Clearly, food catering services include all those services provided to the Club so that its catering needs were met. In effect Mr Hughes was the executive chef and

Mrs Hughes was the restaurant manager, as well as both being directors and owners of Hughes Catering Limited.

[21] While efforts in support of Hughes Catering Limited's own requirements (other than the provision of catering services), such as updating the company's accounts, should be considered, I accept that they would not have taken up a large proportion of Mr and Mrs Hughes' time. Somebody had to supervise staff and act as front of house as Mrs Hughes was. Somebody else had to purchase goods and be the executive chef, as Mr Hughes was. These parts of their jobs, which I accept took up the majority of their time, clearly constitute food catering services. Just because managers like Mr & Mrs Hughes may have other duties that are company related, rather than directly providing food services, it does not follow that they are excluded from coverage by the Schedule. Here the vast majority of Mr and Mrs Hughes' time was spent on providing food catering services. I therefore conclude that they provided food catering services and are covered by the Schedule if employees for those purposes.

Was the real nature of the relationship between Hughes Catering Limited and Mr & Mrs Hughes that of employer and employee?

[22] It is at the heart of the Club's case that Mr and Mrs Hughes were never employees to whom this schedule applies, principally because they were not employees of Hughes Catering Limited.

[23] Section 6 of the Act deals with the meaning of *employee*. It states that unless the context otherwise requires, employee means any person of any age employed by an employer to do any work for hire or reward under a contract of service. It also provides that in deciding whether a person is employed by another person under a contract of service, the Authority must determine the real nature of the relationship between them. In so doing, the Authority must consider all relevant matters, including any matters that indicate the intention of the persons. It is also not to treat as a determining matter any statement by the persons that describes the nature of their relationship.

[24] The highest level New Zealand case on whether directors and shareholders of a company can enter into employment agreements with that company is *Lee v. Lee's Air Farming Ltd* [1961] NZLR 325. The Privy Council determined that the wording under the Workers' Compensation Act 1922 could in essence be analysed on the basis of whether Mr Lee was a person who had entered into or worked under a contract of service with an

employer, a test not dissimilar to the test to be applied here, as submitted by Mr Gould. In that case the Privy Council held that a person who holds practically all the shares in the company and is also appointed governing director with full power of government and control of the company's affairs, may still, in his personal capacity, enter into a valid contract of service with the company and then become a worker in the employment of the company for the purposes of the Workers' Compensation Act. The capacity of the company to make such a contract could not be impugned because the governing director himself was the agent of the company in its negotiation. The company and such persons were separate legal entities and although the governing director exercised the right of control over himself as an employee of the company he did so as agent of the company.

[25] At p.333 Lord Morris of Borth-y-Gest held that in relation to Mr Lee's work doing topdressing (for which he was paid wages) that:

It cannot be suggested that when engaged in the activities above referred to the deceased was discharging his duties as governing director. Their Lordships find it impossible to resist the conclusion that the active aerial operations were performed because the deceased was in some contractual relationship with the company. That relationship came about because the deceased as one legal person was willing to work for and to make a contract with the company which was another legal entity. A contractual relationship could only exist on the basis that there was consensus between contracting parties. It was never suggested (nor in their Lordships' view could it reasonably have been suggested) that the company was a sham or a mere simulacrum. It is well established that the mere fact that someone is a director of a company is no impediment to his entering into a contract to serve the company. ...

In their Lordships' view it is a logical consequence of the decision in Salamon's case (supra) that one person may function in dual capacities. There is no reason therefore to deny the possibility of a contractual relationship being created as between the deceased and the company. If this stage is reached then their Lordships see no reason why the range of possible contractual relationships should not include a contract for services and if the deceased as agent for the company could negotiate a contract for services as between the company and himself there is no reason why a contract of service could not also be negotiated. It is said that therein lies the difficulty because it is said that the deceased could not both be under the duty of giving orders and also be under the duty of obeying them. But this approach does not give effect to the circumstance that it would be the company and not the deceased that would be giving the orders. Control would remain with the company whoever might be the agent of the company to exercise it. The fact that so long as the deceased continued to be governing director, with amplitude of powers, it would be for him to act as the agent of the company to give the orders does not alter the fact that the company and the deceased were two separate and distinct legal persons.

[26] The issue has been addressed more recently by the Employment Court in *Smith v. Practical Plastics Ltd* [1998] 1 ERNZ 323. At 340 it was held:

It is common ground that a company director is not, as such, an employee of the company, but is an office holder upon appointment. It is clear that a director may however enter into a service contract and thereby become an employee, and that the contract may be express or implied.

[27] It was also held at 341:

The result in any particular case will depend on its facts and there will always be points of agreement and disagreement between the various authorities. The issue is whether, viewed as a totality, the evidence establishes the existence of a contract of service, whether express or implied, notwithstanding that the contracting party is a director and/or shareholder of the company.

[28] In *Secretary of State for Trade & Industry v. Bottrill* EATRF 98/013203, the United Kingdom Court of Appeal held that *Lee* does not mean there will always be a contract of service in similar circumstances. Rather it all depends on the context. The context in that case involved whether legislation which provided that upon insolvency the State would pay employees certain sums such as statutory redundancy payments and unpaid wages etc, would apply to the controlling shareholder. Under the statutory definition, there was no special meaning attached to the term *employee* other than that there should be or have been a contract of employment, which is a normal incident of employment generally. The Court of Appeal held that:

... whether or not an employer/employee relationship exists can only be decided by having regard to all the relevant facts. If an individual has the controlling shareholding that is certainly a fact which is likely to be significant in all situations and in some cases it may prove to be decisive. However, it is only one of the factors which is relevant and certainly is not to be taken as determinative without considering all the relevant circumstances.

[29] By way of guidance, the Court of Appeal went on to hold:

The first question which the tribunal is likely to wish to consider is whether there is or has been a genuine contract between the company and the shareholder. In this context, how and for what reason the contract came into existence (for example, whether the contract was made at a time when insolvency loomed) and what each party actually did pursuant to the contract are likely to be relevant considerations.

*If the tribunal concludes that the contract is not a sham, it is likely to wish to consider next whether the contract, which may well have been labelled a contract of employment, actually gave rise to an employer/employee relationship. In this context, of the various factors usually regarded as relevant (see, for example, *Chitty on Contracts* 27th ed. (1994) para.37-008), the degree of control exercised by the company over the shareholder*

employee is always important. That is not the same question as that relating to whether there is a controlling shareholding. The tribunal may think it appropriate to consider whether there are directors other than or in addition to the shareholder employee and whether the constitution of the company gives that shareholder rights such that he is in reality answerable only to himself and incapable of being dismissed. If he is a director, it may be relevant to consider whether he is able under the Articles of Association to vote on matters in which he is personally interested, such as the termination of his contract of employment. Again, the actual conduct of the parties pursuant to the terms of the contract is likely to be relevant. It is for the tribunal as an industrial jury to take all relevant factors into account in reaching its conclusion, giving such weight to them as it considers appropriate.

[30] The case of English Employment Appeal Tribunal of *Hauxwell & Hauxwell v. Secretary of State for Trade & Industry* EAT/386/01, which applied *Bottrill*, was very similar to the present case. Mr and Mrs Hauxwell owned and ran a company with 12 or 13 staff they were responsible for. They were paid a fixed salary. Unlike Mr and Mrs Hughes their terms and conditions were the same as other staff. Any decision about how the company operated was a joint decision between the couple and they had complete control of the company. Each had different roles in the company but they were not able to dismiss each other. Decisions on finance etc were made jointly and they acted as joint guarantors of loans made to the company. They were found not to be employees.

[31] Section 6 provides that where the real nature of the relationship is the test for the purpose of determining whether someone is an employee, unless the context otherwise requires. The context here is to provide protection, by way of continued employment, to certain categories of employee. In this context the real nature of the relationship may therefore be slightly more restrictive (in terms of finding whether a person is an employee) than may be the case for other sorts of protections under the Act, such as the rights to a written employment agreement, protection from unfair bargaining and union membership etc. All of this is capable of being considered within the framework of *Smith v. Practical Plastics*, as updated to take into account the provisions of the Employment Relations Act 2000 (see for example *Bryson v. ThreeFootSix Ltd (No 2)* [2005] ERNZ 372 (SC)).

[32] There are many distinguishing features between *Smith*, where the Court held that Mr Smith was an employee, and Mr and Mrs Hughes' situation. In *Smith* the directors were at arm's length to Mr Smith. They also only had a business relationship and Mr Smith could not exercise any control over the company's operation. He had no control of the company, including in hiring, firing, investment or finance. Furthermore, he was, in all aspects of his work, under the direct supervision of others and exercised little, if any, control over other

staff. He played no part in significant aspects of the company's operations and had little involvement in its management. None of those circumstances apply here. Mr and Mrs Hughes are instead far more like the couple in *Hauxwell & Hauxwell*.

[33] In Mr and Mrs Hughes' favour are that they had written employment agreements, filed tax returns and did a significant number of duties, as described above, that constituted food catering services. I therefore do not consider that the arrangements entered into between Mr and Mrs Hughes and their company were a sham. There were good reasons for them to be paid as employees for the work that they did - in particular so that they would have some security of income. The fact that no one at the Club was or could have been aware of Mr and Mrs Hughes' status as employees is irrelevant. To use a colloquialism, it was none of their business, at least until the catering contract was terminated.

[34] The real issue left then is whether or not Mr and Mrs Hughes were employees for the purpose of Part 6A. Them having written employment agreements is not determinative of the matter (s.6(3)(b)). I therefore will assess the standard range of common law tests usually applied in these circumstances.

[35] I conclude that Mr and Mrs Hughes were comprehensively integrated into the business and in control of it. Fundamentally, Mr and Mrs Hughes were in business on their own account, through the vehicle of Hughes Catering Limited. Their income had been significantly decreased twice (albeit for limited periods) to preserve the viability of the business, not actions normally accepted by employees. They also personally guaranteed major trade contracts for the company and therefore any debts arising. Furthermore, they loaned money to the company, apparently without any documentation or security.

[36] Another key factor is control. The company effectively had no control over Mr and Mrs Hughes, a married couple each with 50% shareholding in the company. There were no other directors or shareholders acting in any independent way to control the behaviour of Mr and Mrs Hughes should that need ever arise. There was no negotiation of their employment agreements, which were prepared by Mrs Hughes, and they contained redundancy clauses that were very generous considering their length of service and by comparison to the company's other employees. Mr and Mrs Hughes were entitled to come and go as they saw fit, took leave and breaks, and consumed alcohol as it suited them. Neither was able to dismiss the other. These factors are all inconsistent with the normal strictures placed on employees. This is consistent again with them not being employees.

[37] On the other hand, it must be accepted that on the integration test, Mr and Mrs Hughes were fully integrated into the operation of Hughes Catering Limited. It is no doubt for reasons such as those here that a range of tests has been formulated over the years.

[38] The clear preponderance of evidence and analysis demonstrates that Mr and Mrs Hughes were in business on their own account and were not employees. It would therefore be wrong to categorise them as employees for the purposes of Subpart 6A. I dismiss Mr and Mrs Hughes' claims accordingly.

Costs

[39] Costs are reserved.

G J Wood
Member of the Employment Relations Authority