

October 2007 – that is New Zealand Guardian Trust Company Limited (Guardian).

[3] Guardian took over the business as a mortgagee in possession when Pacificare did not keep up with payments on loans used to buy the business.

[4] Pacificare's business was the operation of a hospital and rest home in Mangere. It does not own the land or premises.

[5] The business was purchased with term loans totalling around \$1 million. In May 2007 Pacificare executed a General Security Agreement (GSA) securing those loans with its assets. Guardian was the other party to the GSA, acting as the trustee of another entity, Primero Trust.

[6] By October 2007 Pacificare has fallen behind on its loan repayments. Guardian decided to exercise its powers under the GSA to become a mortgagee in possession of the business and assets of Pacificare.

[7] Guardian appointed an accountant, Ian Knobloch, as its agent to enter, hold and operate the business and those assets.

[8] On 31 October 2007 Mr Knobloch went to the hospital and rest home and took possession of the business.

[9] At the time of the Authority's investigation meeting Guardian continued to operate the facility as a mortgagee in possession.

[10] As part of his arrangements for entering into possession Mr Knobloch engaged Mangere Community Hub (MCH), another registered charitable trust, to provide services needed to continue operation of the hospital and rest home while Guardian had possession of the business.

[11] MCH subsequently employed some of the existing Pacificare employees to continue working at the facility – including Ms Kapi and Ms Nanai.

[12] Some other Pacificare staff were not employed by MCH, including finance

manager Anura Jayasekara and book keeper Geetha Jayasekara. Applications to the Authority by Mr and Mrs Jayasekara were investigated at the same time as the claims of Ms Kapi and Ms Nanai. A separate determination on the Jayasekaras' claims is also issued today (AA 319/09).

The investigation

[13] For the purposes of its investigation the Authority received written and oral evidence under oath or affirmation from Ms Kapi, Ms Nanai, Mr Jayasekara, Mrs Jayasekara, former Pacificare chief executive Afa'ese Manoa, former Pacificare chairperson and board member Taufao Lurch, Pacificare chairperson Fialauia Toailoa-Amituanai and Guardian's agent, Mr Knobloch.

[14] On its own motion the Authority joined MCH as a respondent and notices were served at its registered address. No statement in reply was received from MCH and no representative attended the investigation meeting.

[15] During the investigation meeting the parties' representatives were provided with the opportunity to ask additional questions and provide oral closing submissions.

Issues

[16] Resolution of the claim by Ms Kapi and Ms Nanai requires determination of the following issues:

- (i) Is it Pacificare or Guardian that is obliged to pay their annual leave entitlements; and
- (ii) Even if the obligation lies with Pacificare, is Guardian nevertheless required to pay for those entitlements from funds in a Pacificare bank account that Guardian took control of as mortgagee in possession?

Who is obliged to pay for accrued annual leave?

[17] On the day Mr Knobloch took possession of the business for Guardian Ms Kapi and Ms Nanai were told to keep working as usual. Although it was a little over two weeks before written formalities about employment were finalised, those

instructions came (directly or indirectly) from two men who attended the premises that day with Mr Knobloch. Ms Nanai and Ms Kapi later found out those two men were Gary Davis and James Papali'i who, respectively, acted as general manager and mental health services manager of the operation for MCH.

[18] Between 31 October and signing a written employment agreement with MCH on 19 November 2007 both women did their usual work and received their usual pay.

[19] However neither has been paid for holiday leave showing on their Pacificare wage records – 20 days for Ms Nanai and 5.37 days for Ms Kapi.

[20] Pacificare does not dispute the leave payments are owed but says funds to pay annual leave were in an ASB bank account of which Guardian has taken possession. It submits Guardian should be ordered to make payments from the funds it took from that account and used to pay other amounts owed by the business.

[21] Guardian submits the liability remains with Pacificare and that Guardian was legitimately entitled to use funds in that bank account for purposes such as paying rent to the landlord and loan instalments or interest due to Guardian.

[22] I find that the liability for the holiday pay entitlement of Ms Kapi and Ms Nanai remains with Pacificare.

[23] Their employment relationship with Pacificare ended on 31 October 2007 when Guardian became mortgagee in possession of the business and took steps to continue operation of the business through a service contract with MCH.

[24] I rely on the principle stated by the English Court of Appeal in *Reid v The Explosives Company Limited* (1887) 19 QBD 264, 267 for this finding. The case is referred to in a useful law journal article about mortgagees in possession provided by Mr Tiumalu-Faleseuga with his oral closing submissions for Mr and Mrs Jayasekara.¹

[25] While *Reid* was specifically about the effect on employment of a receivership

¹ Daniel Armstrong, "The Mortgagee Remedies of Entry into Possession and Receivership: Ancient Equity meets Modern Statute", [2000] VUWLR 35.

in a limited liability company, Lord Esher, *obiter*, described the effect on employees of a mortgagee taking possession in this way:

If there were one mortgagee of a business he might, on the failure of the mortgagor to comply with the terms of the mortgage agreement, take possession of the business. What would be the effect of that on the servants of the mortgagor who had contracts entitling them to notice of dismissal? Would the fact of the mortgagee taking possession be equivalent to dismissal by the mortgagor? We have tried to test that by the case of an employer who has servants in the same position and who shuts up his business. That would amount to a wrongful dismissal, and would give the servants a right of action. So the fact of a mortgagee taking possession of the business of the mortgagor would be equivalent to a dismissal of the servants, and as this would occur by the default of the mortgagor, it would be a wrongful dismissal and would give a right of action. (emphasis added)

[26] Lord Justice Fry in the same case stated he was “*not prepared to lay down that every entry by a mortgagee is a dismissal of the servants of the mortgagor from his employment*” but “*to see whether that has happened we should look to the facts in each case*”.

[27] Adapting the language and analysis of the judges in that Victorian-era case to the present day, I find Guardian’s entry into possession of the Pacificare business had the effect of terminating the employment agreements of Ms Kapi and Ms Nanai with Pacificare. That effect occurred because of failures by Pacificare, not Guardian.

[28] However Ms Kapi and Ms Nanai continued to work in the business at the express instructions of MCH’s managers. There was no employment relationship created with Guardian. Neither did the obligation for any residual holiday pay entitlement transfer from Pacificare to Guardian or MCH.

[29] Although not the subject of submissions by any party I have considered whether the particular circumstances may be within the scope of Part 6A of the Employment Relations Act 2000 (the Act). That Part provides protections for specified categories of employees – including workers in hospitals and aged care residential homes – in certain “*restructuring*” situations.

[30] However I consider the definition of “*restructuring*” at 69B of the Act does

not apply to the circumstances in the present matter. The act of a mortgagee going into possession under the terms of a GSA where the mortgagee continues to operate the business does not amount to contracting, selling or transferring of the business as defined in s69B(a). Neither is that agreement a “*contract*” or “*arrangement*” of the type referred to at s69B(b). It was not one made “*after*” the employer has been adjudged bankrupt or gone into receivership or liquidation – circumstances which do not apply and could not apply because:

- a. The GSA was made before Pacificare got into financial difficulties meeting its loan commitments; and
- b. Pacificare is not an individual who could be adjudged bankrupt and is not a registered company that could go into receivership or liquidation.

Must Guardian pay Ms Kapi and Ms Nanai from funds in a Pacificare bank account of which it took possession?

[31] Pacificare’s financial performance statement at the end of August 2007 showed net assets of \$1,990,892 against which – among other items – a current liability of \$211,346 was identified as “*payroll accruals*”.

[32] Mr Jayasekara, as its former finance manager, gave evidence that Pacificare had sufficient funds to meet those payroll liabilities – both for wages and paid annual leave. He said money for this purpose was kept in its 02 ASB bank account (the 02 account).

[33] A statement for the 02 account shows a balance of \$49,294.52 on 9 November with \$16,123.58 being withdrawn on 13 November for “*PT wages*” for the week ending 11 November 2007. A statement dated 23 November shows the balance of \$32,302.93 being transferred to the “*Agent in Possession*”.

[34] Pacificare submit that Guardian should be ordered to pay the holiday pay of Ms Kapi and Ms Nanai because Guardian’s agent Mr Knobloch took those Pacificare funds set aside for that very purpose.

[35] Ms Kapi and Ms Nanai submit such orders could be made on the basis that:

- a. either, the money in the 02 account was held in trust for workers such

as them;

- b. or, payments from those funds would be a remedy in restitution as Guardian had been “unjustly enriched” by taking possession of and using the funds in the 02 account .

[36] I do not accept those submissions from Pacificare and Ms Kapi and Ms Nanai for the following reasons.

Money not held on trust

[37] Firstly, the evidence does not support any conclusion that the funds in the 02 account were being held on trust or any other exclusive basis to pay annual leave entitlements.

[38] Mr Jayasekara’s evidence was while this account was used to hold money intended for pay related purposes, particularly annual leave, it was also used for other payments such as some made to IRD.

[39] While Pacificare’s financial performance statement identified the level of accrued payroll obligations, nothing identifies the 02 account as holding funds for that purpose on a trust basis for its employees. Mr Knobloch also gave evidence that, having checked with the ASB, there was nothing to indicate the 02 account or money in it were held on a trust basis.

Use of 02 account funds not ‘unjust enrichment’

[40] Secondly, the evidence does not support a conclusion that Guardian has been unjustly enriched by use of the funds in the 02 account or other Pacificare funds of which it took possession. Consequently it cannot be required to disgorge those funds as a remedy in restitution.

[41] The proposal for a remedy on such a basis was not raised until the oral closing submissions from the representatives of Ms Kapi and Ms Nanai. I accept Guardian’s counsel was not in a position to review the authorities and fully argue the point but I doubt Mr Rowe’s impromptu submission that the Authority simply has no jurisdiction

to consider such a remedy. Section 162 of the Act allows the Authority to make any order that the High Court may make under any rule of law relating to contracts. *A-G v Blake*² suggests restitution-based orders for disgorgement may be available in respect of a breach of an employment contract, and this might arguably be within the scope of rules of law referred to in s162.

[42] However, even if such a remedy were available, the grounds for awarding it have not been made out on the facts in the present case. There was no unjust enrichment of Guardian when it took the funds in the 02 account. It was merely exercising rights under the GSA.

[43] Mr Knobloch confirmed in his evidence that he was responsible for the transfer of funds from the 02 account. That money had been applied to other obligations of operating Pacificare's business, including payments of overdue rent to the landlord and overdue loan instalments to Guardian.

[44] I accept that the GSA gave Guardian a security interest over the money in Pacificare's accounts (clause 4(c)(i)(B)). Guardian was entitled under the GSA to take and use that money in operating the business of which it took possession, including making payments to itself for loan costs (clause 24 and 30(f)(ii)). It was not required to give priority to holiday pay owed to Ms Kapi and Ms Nanai.

[45] Pacificare remains entitled to whatever surplus may yet be accounted to it by Guardian from the operation, and any possible sale, of the hospital and rest home business. Mr Knobloch described that prospect as an equitable interest in the residue after paying what was owed under the GSA. Ms Kapi and Ms Nanai have a call on any such funds along with any other creditors of Pacificare.

[46] Ms Kapi and Ms Nanai remain entitled to payment of that holiday pay by Pacificare as soon as possible. However I make no compliance order for its payment under s137 of the Act. There was no evidence Pacificare had other funds not possessed by Guardian and consequently I could not sensibly specify a timeframe for payment as required for such an order.³

² [2001] AC 268 (HL); [1998] 1 All ER 833 (CA) at 845 per Lord Woolf MR.

³ s137(3) of the Act.

Summary of determination

[47] I have made the following findings:

- a. Pacificare's employment of Ms Kapi and Ms Nanai ended with the entry of Guardian as mortgagee in possession of the business of Pacificare on 31 October 2007; and
- b. Ms Kapi and Ms Nanai were not employed by Guardian;
- c. Any outstanding entitlement to holiday pay is owed by Pacificare, not Guardian; and
- d. Guardian is not obliged to meet those entitlements from funds it took for purposes permitted under the GSA; and
- e. Ms Kapi and Ms Nanai are entitled to seek payment, along with other creditors, by Pacificare from any funds accounted to it by Guardian that are surplus to the requirements of the GSA.

[48] No specific orders are made at this point.

Costs

[49] Costs are reserved. The parties are encouraged to resolve any issue of costs between themselves. In the event they are not able to do so, any application for costs should be lodged and served by no later than 28 days from the date of this determination. Other parties will then have 14 days from the date of that application being lodged to lodge and serve any reply they wish to make before the Authority determines costs. No application will be considered outside this timeframe without prior leave.

Robin Arthur
Member of the Employment Relations Authority