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THE ADVOCATE

a regular newsletter for clients of mcphail gibson & zwart

ISSUE 227

February 2014

When family and business collide

Client Services:

- General advice in relation to all employee-related issues
- Resolving Personal Grievances and Workplace Disputes
- Employment Agreements - drafting and negotiation
- Employment Relations Authority/Employment Court and Mediation Representation
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A recent Authority decision considered the consequences for family businesses and companies when things go wrong. The case was ***Kennington v. Canterbury Sailplanes Ltd (CSL)***. The small family owned company was operated and managed by its single employee, Mr Kennington (Mr K). Shares in the company were held by three individuals, Mr K (34%), his wife (Mrs K) (34%) and Mr M (32%). Mr M was the father of Mrs K and father-in-law of Mr K. It was accepted that he held the shares on behalf of a family trust. The marriage of Mr and Mrs K ended in 2011. Mr M had historically prepared the accounts for the company. Mr K, Mrs K and Mr M were all Directors of the company. Following the breakdown of the marriage there were a number of issues between the parties with respect to access to children, matrimonial property and the ownership of the company itself. The Authority described those issues as being '*acrimonious disagreements*'. Presumably the issues were of a kind that are common in such circumstances.

CSL was described as being in a difficult trading position and in 2012 the Directors were trying to determine the future for the company. This was made more complicated by the fact that Mr K, who referred to himself as Manager, refused to attend meetings with the other Directors or to provide financial information to them. Mr K wished to buy the company from the other shareholders and in order to do so had provided information to enable a valuation of the company. He refused however to provide trading information to Mr M.

In the absence of a shareholders agreement the procedures for the management of a company reverts automatically to the procedures of the Companies Act 1993. Section 128 of the Companies Act 1993 provides as follows:

"[128] Management of company

(1) The business and affairs of a company must be managed by, or under the direction or supervision of, the board of the company.

(2) The board of a company has all the powers necessary for managing, and for directing and supervising the management of, the business and affairs of the company.

(3) Subsections (1) and (2) are subject to any modifications, exceptions, or limitations contained in this Act or in the company's constitution."

Schedule 3 of the Companies Act deals with the proceedings of the Board of the company and sets out that a quorum for a meeting of the Board is a majority of the directors. A resolution of the Board is passed if it is agreed to by all directors present without dissent or if a majority of the votes cast on it are in favour.

A Directors meeting was called by Mr M and Mrs K for 13 April 2012, agenda items included, appointment of an accountant and auditor, management responsibilities and the future of the company. Mr K asked to defer the meeting *"until issues relating to relationship property are resolved."* The other Directors refused this and advised him that Mr K was to provide necessary trading information to the company and that a failure to do so could 'become an employment issue'.

The Board met on 13 April 2012 without Mr K. The attending Directors; Mr M and Mrs K, determined that Mr M would (as he had in previous years) prepare the annual accounts and required Mr K as manager to regularly report on sales, cash position, future projections and to prepare a budget. They also reviewed the future of the company recording that *"sensible and logical options include total sale to single existing shareholder, third party sale, or closure and/or liquidation."*

In the following weeks Mr K twice wrote to the Board asking that an independent accountant be appointed. Mr M responded refusing this but proposing by way of compromise that Mr K could appoint and pay for an auditor.

Disclaimer:

This newsletter is not intended as legal advice but is intended to alert you to current issues of interest. If you require further information or advice regarding matters covered or any other employment law matters, please contact **Neil McPhail**, **Raewyn Gibson**, or **Peter Zwart**.

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On 16 May Mr M and Mrs K wrote again to Mr K requiring "*the financial information to complete annual accounts and subsequently make decisions on the future of the company*". They advised that the accounts needed to be with the IRD by 7 June. They further expressed the view that the lack of information and communication were "*issues (which) strike to the heart of the employment relationship, which we now believe has reached an irretrievable point of irreconcilable differences.*"

"If you do not provide the requested financial information within 48 hours, and subsequently communicate and comply with the fair and legitimate instructions of the Directors, we see no alternative but to terminate your employment with the Company."

A further Directors meeting was called for 18 May 2012. Mr K again failed to attend. Mr M and Mrs K attended. The minutes record that because Mr K had failed to provide the required financial data, there needed to be a further meeting to require an explanation from him. He was called (as Manager) to a meeting with the Board on 25 May 2012 to discuss his continued refusal to provide information. He was urged to attend and advised that a failure to provide an explanation "*could put his employment in jeopardy*". He was advised of his right to be represented. He did not attend.

On 28 May 2012 Mr M wrote again advising that *"In the absence of an explanation and on the basis of your continued refusal the Board, by simple majority, has determined to provide you with one last opportunity to provide this information. If you do not provide the information required by noon 29 May, (your) employment will be terminated forthwith.*"

Mr K's representative wrote to the Board stating that he had provided the information to an accountant and that the books of accounts would be provided within 14 days. This letter also stated that Mr K had not attended meetings of Canterbury Sailplanes as it was inappropriate for him to attend such meetings "*bearing in mind the property relationship situation*".

On 29 May 2012, Mr M and Mrs K wrote to Mr K stating that, further to their letter of 28 May, as he did not provide the information by noon on 29 May, his employment was terminated forthwith.

The Authority determined, given s.128 of the Companies Act 1993 (above) that the dismissal of its sole employee was within the scope of the Directors' authority and powers. The Authority further determined that the dismissal was substantively justified:

"It is an implied term of all employment contracts that an employee must comply with all lawful and reasonable instructions of the employer made in the context of the employment relationship: New Zealand Printing and Related Trades IUOW v Clark and Matheson Ltd [1984] ACJ 283. As long as the order or direction of the employer is not illegal, immoral or dangerous, the employee must obey any proper instruction (upon penalty of instant dismissal) as long as the requirement is within the scope of the contract. Obedience is a fundamental implied term in an employment contract."

The Authority determined that the reason that Mr K refused to supply the information was because he was in a bitter matrimonial dispute with Mrs K and Mr M was taking her side in that dispute. It determined that Mr M and Mrs K gave a lawful and reasonable instruction to Mr K to provide the information and that they had *"genuine reasons and a legal need to obtain the information; the information was within the knowledge of Mr (K), it was relatively easy for Mr (K) to supply the information and he was obliged, as the manager of the company, to provide the information upon request."*

The Authority determined that Mr K's evidence that he was the only person who ran the company and that he should have been allowed to do so without interference ignored the fact that Mr M and Mrs K *"were legitimate directors of the company and that they had a legal duty to ensure that the company was being managed properly. They also had a legal duty to protect the assets held by the company, especially in light of the matrimonial dispute."*

The Authority went on to determine that the dismissal was procedurally fair stating that in light of the fact that Mr K "*steadfastly refused to attend any meetings"* or "*to communicate directly*" the company could not have acted in any different way.

While the actual circumstances of this matter may be unusual, the circumstances surrounding the breakdown of the family relationships and the flow on consequences of that are not. A significant number of small trading companies operate under similar structures with directorships and shareholdings split between family members. This case is a timely reminder that even when one type of relationship collapses other contractual and statutory obligations may remain.

While Mr K may have been reluctant to share information with his ex-wife and father-in-law, he still had obligations that required him to do so, even in circumstances where he clearly believed that doing so may disadvantage him in his ongoing matrimonial dispute. The lesson that can be taken from the actions of his fellow Directors is that they were still required to act in a procedurally fair manner and that by acting formally and with patience, their conduct was found to be procedurally fair.