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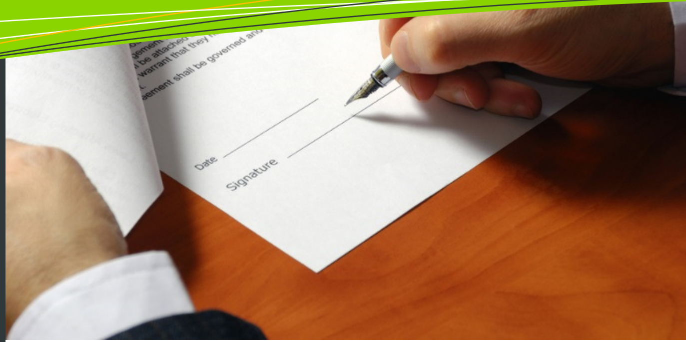

a regular newsletter for clients of mcphail gibson & zwart

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Failure of a Forfeiture Clause

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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- Training
- Monthly newsletter

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A recent Employment Court challenge from the Employment Relations Authority considered the effect of forfeiture clauses in circumstances where full notice was not provided.

The employee, Ms Livingston, was employed at the Redwood Hotel from July 2011.

Her employment agreement provided for the provision of six weeks' notice under the following *terms:*

"12.1 Employment may be terminated be either employer or employee upon six weeks notice of termination being given in writing. The employer may elect to pay six weeks wages in lieu of notice and in the event that the employee fails to give the required notice then equivalent wages shall be forfeited and deducted from any final pay including holiday pay.

6.4 Should the employee be indebted to the employer for wages forfeited due to lack of notice (clause 12.1) or for any other reason (including negligent transaction processing under clause 6.3) or the failure to return property belonging to the employer, the employee agrees that the appropriate sum may be deducted from the employee's wages and/or holiday pay or final pay."

She was offered and accepted alternative employment to start on 1 August 2012 and resigned on 19 July 2012 providing two weeks' notice. She was aware at this stage that this was a breach of her employment agreement.

On 6 August 2012 her employer wrote advising that she had forfeited four weeks' pay. The sum of $1,943.00 being the total of her final pay and holiday pay was withheld. This was the sum of all wages owing to her at the time.

The Court considered whether or not the forfeiture provision was enforceable, with the employee arguing that clause 12.1 should not be upheld and should be properly seen as a penalty.

The Court referred back to a 1914 House of Lords decision; ***Dunlop Pneumatic Tyre Company Ltd v. New Garage and Motor Company Ltd*** *UKHL 1 [1915] AC 79. That decision distinguished between liquidated damages and penalties in the following ways:*

i. *"The essential nature of liquidated damages is a genuine pre-estimate of damages likely to be suffered as a result of the breach of contract concerned."*

ii. *"Any sum payable will be a penalty if it is extravagant or unconscionable in relation to any possible amount of damages that could have been within the contemplation of the parties at the time the contract was made."*

The Employment Court considered the case under its equity and good conscience jurisdiction:

"Courts of equity and Courts of conscience have always turned their backs on any agreement that imposes a penalty or a forfeiture. It is one thing for the parties to agree, as part of a settlement, that damages are payable in the event of a particular breach. If the amount agreed on is a genuine estimate of the loss that the parties expect will be caused if there is a breach of the contract, then that estimate is called liquidated damages and is recoverable. However, if the amount concerned is not a genuine pre-estimate, but is an attempt to compel performance by holding it as a threat over the head of one of the parties, it becomes a penalty and will not be recoverable. This is because equity takes the view that it is unconscionable in a case of breach of contract to recover a sum which is out of proportion to the loss which actually occurs."

Ozturk v. Gultekin [2014] 1 ERNZ 572

Such cases will reply on the facts of each situation. The employer in this case acknowledged that they suffered no financial loss as the result of the short notice claiming instead that the pay was withheld '*to compensate the company for the stress and hassle*'. It was acknowledged that the cost of recruiting and training a new receptionist was the same regardless of the period of notice given.

The Court found that the only consequence of the short notice was that another part-time receptionist was called upon to work extra hours. There was no additional cost.

In addition the Court considered the employer's above response regarding the fact that the forfeiture was to compensate for stress and hassle. The employer was a limited liability company, and a *"company cannot suffer personal stress and there was no evidence that any stress which might have been experienced by Mr Freeman or other staff resulted in any loss to the plaintiff. More to the point, there was no evidence that, when the employment agreement with Ms Livingston was made, it was contemplated that any loss to the plaintiff might result from stress to staff if she gave less than six weeks' notice."*

Ultimately the Court found *"that the purpose of the forfeiture clause was to compel Ms Livingston to give six weeks' notice by holding over her the threat of losing wages if she did not comply. As such, it was a penalty provision which, in equity and good conscience, the Court ought not to allow the plaintiff to enforce. The challenge on this issue is dismissed."*

Having decided that the forfeiture clause was unenforceable the Court then went on to consider the effect of Ms Livingston's breach of contract. It was accepted that in giving only two weeks' notice she was aware that she was breaching the agreement. The Court went on to consider the principles to be applied in deciding whether or not to apply a penalty for breach and the quantum of the same:

"A penalty is imposed for the purpose of punishment of a wrongdoing which will consist of breaching the Act or another Act or an employment agreement. Not all such breaches will be equally reprehensible. The first question ought to be, how much harm has the breach occasioned? How important is it to bring home to the party in default that such behaviour is unacceptable or to deter others from it?

The next question focuses on the perpetrator's culpability. Was the breach technical and inadvertent or was it flagrant and deliberate? In deciding whether any part of the penalty should be paid to the victim of the breach, regard must be had to the degree of harm that the victim suffered as a result of the breach."

Xu v. McIntosh [2004] 2 ERNZ 448 (EmpC)

The Court considered a number of issues relevant to the imposition of a penalty in this case:

- No harm was suffered by the employer.
- The breach was deliberate and done in full knowledge of the clause.
- It is unlikely that the breach would be repeated.
- General deterrence; *'agreements are made to be kept'*. Breaches that are purely for the benefit of one party ought to be denounced and deterred.
- Penalties are infrequently awarded against employees.

The Court awarded a penalty against the employee of $500 for breach.

The end result of the case was therefore the employer had to reimburse wages of $1,943.00 and the employee was required to pay a penalty of $500.00

This is a significant case for employers. It is clear that the Court will look beyond the wording of the contractual provisions in cases of forfeiture for failure to provide due notice. In the absence of real and calculable harm it seems that these provisions will be challengeable on a case by case basis.

Employment Relations Practice Course

Our next Employment Relations Practice Course has been set down for **Wednesday 4 and Thursday 5 November 2015.**

Places on this course are already filling up fast.

Further information in regard to the course content and registration details can be found on our website – www.mgz.co.nz/training

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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