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The Legal Impact on Employers where there is a *Sham* Element in Contracts with their Workers

Abstract

As a consequence of recent legal decisions particularly, those over the last three years an employer that introduces a clause into his contracts (or enters in contractual relations with his workers) needs to ensure that the clause or contract is genuine and operates in practice as it states that it intends to. Otherwise, as the title of this article suggests there might be serious legal implications for an employer.

The clause (usually a substitution clause) or the type of contract entered into must not simply be a device to circumvent the correct application of the law in other words perpetrate a sham.¹ The recent development of legal rules that can invalidate sham clauses or bogus contracts in employment have proven beneficial to workers. In particular those workers that want to be treated as employees. As will be seen when a court or tribunal has a reasonable suspicion that the clause (or the contract itself) is a sham that is designed, for example, to exclude employee status (to those persons working under a contract with an employer) they may decide to ignore it and treat the contract as a contract of service. The affected worker will then have entitlement to the full range of employment rights available to an employee.² This article will consider relevant legal decisions from all areas of employment law that have a bearing on this topic. They will be analysed fully for the first time.³

¹ <http://dictionary.reference.com> usefully defines a sham as: something that is not what it purports to be; a spurious imitation; fraud or hoax.

² Redrow Homes (Yorkshire) Ltd v Buckborough and anor (2008) UKEAT 0528_07_1010

³ Other commentators writing in this area have tended to restrict their coverage to a specific aspect. E.g. Brodie, D Sham contracts and contracting out Employment Law Bulletin (2009), 91 (Jun), 6-8

Introduction

As already intimated an employer will often enter into a contractual arrangement with a worker⁴ or introduce a clause (e.g. substitution clause) into his contract simply as a device for ensuring that the contract will be treated by an employment tribunal or a court as a contract for services. Thereby, avoiding the liability attached to the numerous employment rights under statute given to an employee, working under a contract of service. It has been a vexed issue for the judiciary to determine if a person doing a job of work for an employer is an employee (who is able to benefit from the statutory rights afforded to persons with that status by employment law), a worker (who has limited protection under statute law) or some other status for example an independent contractor (who has extremely limited protection).⁵ To assist them in differentiating between these three fundamental classifications of person undertaking work for a employer the courts in the United Kingdom have set down various tests.⁶ However, in the interests of brevity most of these tests will be excluded from consideration in this article and only the development of the test that relates to the requirement of personal service will be considered in detail.⁷ Analysis of this test and its impact on the determination of which kind of contract applies will be undertaken . Then consideration of how the recent cases involving sham clauses in contracts or

⁴ Ministry of Defence v Kettles APPEAL NO. UKEAT/0308/06/LA also reported at 2007 WL 631655

⁵ *Locatio conductio operarum* is a contract where one party agrees to supply the other with a certain quantum of labour (contract of service). *Locatio conductio operis* is a contract where one party agrees, in consideration of money payment, to supply the other not with labour but, with the result of labour (contract for services). Sohm, Institutes of Roman Law, 311 (1892)

⁶ H. Collins, 'Independent Contractors and the Challenge of Vertical Disintegration to Employment Protection Laws' (1990) 10 Oxford Journal of Legal Studies 353; S.Fredman, 'Labour Law in Flux:The Changing Composition of the Workforce' (1997) 26 Industrial Law Journal 337

⁷ Express and Echo Publications v Tanton (1999) IRLR 367

sham contracts have affected this and other areas of employment law will be carried out.⁸

Traditional Position Regarding Personal Service and Substitution Clauses

The case law in the past has emphasised amongst other things that for there to be a valid contract of service a person carrying out the work must be expected to carry out at least part or all of the work personally. This issue was first considered over forty years ago in a High Court decision in *Ready Mixed Concrete (South East) Ltd v Minister of Pensions and National Insurance*.⁹ Justice MacKenna in that case stated that there were three factors necessary to establish if a contract of service applied and the first of these was “that the employee agreed to provide his own labour and skill in the performance of a service for the employer. “ Accordingly the freedom in a contract for an employee to do a job other than by his own hands (e.g. to get another to do it) was inconsistent with a contract of service.¹⁰ Also in *Snook v London and West Riding Investments Ltd*¹¹ (heard in the same year as *Ready Mixed Concrete* case) the Court of Appeal held that for a sham contract or clause to be challenged by the courts it would be necessary to establish that both contracting parties had worked together to arrange things so that they would deceive a third party. This created problems for workers that wanted to challenge their contractual arrangements by claiming that a sham clause applied as in most cases they had no knowledge of the sham element in the contract and no vested interest in deceiving third parties such as

⁸ Freedland, M *The Personal Employment Contract* (2003) Oxford University Press, Brodie, D *Sham contracts and contracting out* *Employment Law Bulletin* (2009), 91 (Jun), 6-8

⁹ (1968) 2QB 497

¹⁰ Similarly in the Privy Council Appeal of *Australian Mutual Provident Society v Chaplin and Another* (1978) 18 *Australian Law Reports* 385 Lord Fraser stated that the: ... power of unlimited delegation is almost conclusive against the contract being a contract of service.”

¹¹ (1967) 2 QB 786, CA

the tax authorities. The other factor that means the Snook decision will always invalidate any possible claim is that the nature of an employment contract is that the contract and its terms and conditions are prepared and presented by an employer (usually the party in the stronger economic position) to a prospective employee for him only to accept or reject. He would not negotiate his terms with this employer so it would be highly unusual for both parties to be responsible for creating sham terms or a sham contract as required in *Snook*. “The employee is usually either ignorant of the deceit or a victim of it.”¹²

Fortunately for workers in this position now this decision has been overturned and consequently the right to challenge sham clauses in contracts has dramatically improved. Before, considering the recent cases that have extended protection to workers that have been the victims of sham clauses it is necessary to outline the impact of the legal requirement of personal service in a contract of employment. This is key to understanding the importance of the legal decisions.

Personal Service

The requirement that an employee must provide his service personally to his employer before a contract of service can apply was set out by the Court of Appeal in *Express and Echo Publications Ltd v Tanton*.¹³ **Start here** This case underlined the earlier conclusion¹⁴ that where a worker did not have to perform work personally and could hire a substitute to carry out his work this was one of the factors (albeit a significant one) that was inconsistent with a contract of employment and the worker would be treated by the courts as self-employed regardless of other factors such as the employer

¹² Davies A.C.L Sensible thinking about sham transactions (2009) *Industrial Law Journal* Vol. 38 (3) pp 318-329 at p 318

¹³ (1999) 1RLR 367, CA

¹⁴ *Supra* 7

exercising control over his actions at work etc.¹⁵ In the *Tanton* case it was held that a clause in a driver's contract that provided: “ in the event that the contractor is unable or unwilling to perform services personally, he shall arrange at his own expense entirely for another suitable person to perform the services” was incompatible with it having been a contract of employment.

Evidential Issues

It has become apparent that what is said (verbally or in writing) in a contract is sometimes misleading or wrong. Despite this the contract is deemed the primary source of the terms and conditions of employment irrespective of how unfair they might be. So in the general law of contract the behaviour of the parties that takes place before or after the contract is formed or during the lifetime of the contract has not been deemed relevant to the interpretation of the contract. However, through various legal decisions it has become apparent that the contract of employment should be treated as an exception to this rule.

¹⁶ For example such behaviour ¹⁷ can be taken into account when determining whether a contractual arrangement or provision is a sham. When the way the contract is performed bears no relation to the terms in the agreement it will be open to the court or tribunal to go beyond the written text when construing the terms of a contract. When as a result of a contractual provision the personal service of the worker is not needed in the transaction (and can be carried out by a substitute) the courts will look at the genuineness of the right to provide a replacement worker. Factors they will consider are: does the employer have an

¹⁵ *Cassidy v Ministry of Health* (1951) 2KB 598

¹⁶ *Carmichael v National Power* (2000) I.R.L.R. 43

¹⁷ That is behaviour of the parties subsequent and consequent to the contract being finalised or during the currency of the contract.

unreasonable right of veto over the choice of a substitute¹⁸ or does the worker have the authority to choose and pay for the substitute himself.¹⁹

However, when a worker has to undertake work personally this does not necessarily mean that he must be an employee. It is often the case that self-employed individuals who undertake to do work for an employer will agree to do the work himself. The absence of a right to provide a substitute may be a factor that suggests someone is working under a contract of employment but it is certainly not conclusive on its own.

In the past the fact that substitution (allowed under a contract) had not actually occurred during the subsistence of a contract was not necessarily deemed relevant by the courts.²⁰ This was because a worker with a right to substitution was entirely free to ignore it and carry out the work himself. However, the courts are now more likely to view critically an employer's claim that there is a right of substitution where the substitution of a worker does not occur over a long period of time. Disproving the genuineness of a claimed right of substitution can be difficult. Employment tribunals are more likely to doubt their validity when other terms in the contract are found to be false or misleading or a claimed right of substitution does not seem to make sense in relation to the contract. An example of the latter situation would be where someone is chosen because of his particular skills. For example a person who is a; clothes designer, IT expert or person that has a high public profile. When there is a limit under the contract on the ability of delegation to a substitute given to a worker then this could point to it being a contract of

¹⁸ In *Tanton* the worker had put forward a substitute who was *suitable* to his employer

¹⁹ *McFarlane v Glasgow City Council* (2001) IRLR 7

²⁰ *Supra* 5

service. This was the case in *MacFarlane v Glasgow City Council*²¹ where it was held by the EAT that a substitution clause limited in its application was not necessarily inconsistent with the person who had the ability to substitute working under a contract of employment. In the *McFarlane* case in the event he could not personally carry out his work as a gymnastic teacher he had to choose his substitute from a list of gymnastic instructors approved and provided by the Council. The council could veto the replacement chosen and choose the replacement themselves. It was held by the EAT that Mr McFarlane was an employee of the Council.

There are certain tax cases where similar issues have been addressed and what follows is an analysis of these cases.

Sham Contracts and the IR35 Legislation

IR35 is a term that is used to describe United Kingdom tax legislation which is designed to ensure that where there is arrangement in place that purportedly involves self employed persons working for an employer it is not in reality disguised employment of that person and he is an employee. This law is enforced by the Tax Commissioners employed by Her Majesty's Revenue and Customs (HMRC). However, the findings of HMRC Commissioners on the tax status of an individual will not necessarily be binding on an Employment Tribunal, and vice versa. Where it is found to be disguised employment the person is taxed at a similar rate to persons working under a contract of employment.²² Disguised employees are normally workers who receive payment from a client via an intermediary and whose

²¹ (2001) 1RLR 7

²² Busby, N IR35: resolution of a taxing problem? (2002) *Industrial Law Journal* Vol. 31(2) pp 172–82.

relationship with the client is such that had he been paid directly by him he would have been his employee. For example in *Synaptek Ltd v Young (Inspector of Taxes)*²³ Mr. Stuchbury had formed his own company, which later became Synaptek Ltd and provided computer software services. The company in 1999 entered into a contract with an agency to provide software engineering services to EDS, an American company whose customer was the Benefits Agency. The question was, under this arrangement was Mr Stuchbury a self employed businessman or was he a disguised employee of EDS for the purposes of IR35 tax. The Tax Commissioners decided the latter situation applied and the case went on appeal and the Commissioners' decision was upheld. There were characteristics reminiscent of a contract of service namely; under the terms of the contract, Mr. Stuchbury was allocated the work by EDS and he had to abide by all EDS instructions and had to work at least 37.5 hours per week. Other factors that were less clear were he: was not entitled to either sick pay or holiday pay and his weekly timesheets had to be authorised by EDS and were submitted by them to the agency. There was a termination notice period of four weeks on either side. Also either EDS or the agency could terminate the contract if the work done by Mr. Stuchbury was not to the satisfaction of EDS. Synaptek Ltd had to provide its own professional indemnity insurance. The contract was for a fixed period of 6 months rather than being related to the completion of a particular project. In practice, Mr. Stuchbury decided his own working hours and how the work was done although, he reported to a line manager who was an employee of EDS. Synaptek Ltd had concurrent contracts with other clients. However, there was a substitution clause in the contract which did not give Synaptek Ltd. any right to perform the service to EDS by anyone other than Mr Stutchbury. The effect of the contract was that, unless

²³ (2003) All ER (D) 429

and until agreed otherwise the services had to be performed personally by Mr Stutchbury. In addressing the question whether that provision pointed to the contract being a contract for services rather than a contract of service, the Commissioners were entitled to regard it as simply one fact amongst others and in assessing the weight to be given to it they should take into account the extent to which the provision was utilised in practice. The substitution clause in this case was: “in the interests of continuity the Company shall use its best endeavours to procure that the Services are provided by the Company Employee personally but may with the consent of the Client substitute alternative personnel subject to procuring that such alternative personnel are bound by the terms of this agreement.” The right to provide a substitute worker was never exercised.

On appeal to the High Court they found in favour of the Inland Revenue upholding the original ruling of the Tax Commissioners that IR35 did apply to the arrangements between Mr Stutchbury and his end client, EDS. “The relative weight to be given to the various factors ... was a matter for the Commissioners. It is not possible, in my judgement, to say that they were wrong in the conclusion at which they arrived.”²⁴

This was a complicated case because of all the different factors pointing to both kinds of employment relationship (contract for services or a contract of service) however, it does indicate a willingness on the part of the court to look beyond the contractual arrangements in weighing up the importance of the factors and not be unduly swayed by the contractual documents and make a decision based on the reality of the situation.

²⁴ The Honourable Mr Justice Hart

In the following case a similar issue arose where a contractor was suspected of being a disguised employee of an employer who allegedly was liable to pay tax for them under the IR35 legislation.²⁵ In *Dragonfly Consultancy Ltd v Revenue and Customs Commissioners*²⁶ the case involved a Limited Company Contractor, Mr. Bessell, who provided his services as an IT tester through Dragonfly Consultancy Limited. He was a director of Dragonfly Ltd and had a 50% shareholding in the company. Dragonfly was engaged by an agency, DPP, to provide services to their client the Automobile Association (AA) between April 2000 and February 2003 under a series of seven fixed term contracts. Dragonfly was served with a notice in 2004 requiring them to pay PAYE tax (under IR35) and NI²⁷ for Mr Bessell for the full period in the sum of £99,000. Dragonfly appealed to the Special Commissioner against this decision but this was rejected. Dragonfly then appealed to the High Court and this was dismissed. One of the primary reasons for the dismissal of the appeal was that the contract did not reflect the working practices, particularly around the right of substitution. One of the contracts had stated that Dragonfly could provide a substitute in place of Mr. Bessel with DPP's express written consent (a limited right of substitution). However, subsequent contracts allowed the right of substitution and did not refer to DPP's written consent being required (an unlimited right of substitution). Also doubt was cast on the legitimacy of the substitution clause when evidence was submitted by

²⁵ The legislative rules dealing with intermediaries was included in Schedule 12 of the Finance Act 2000. However, the legislation is now commonly referred to as 'IR35.

²⁶ (2008) S.T.C. (S.C.D.) 430

²⁷ S.12(c) of the Social Security Administration Act 1992 states that where a company fails to pay National Insurance Contributions (NIC) in respect of its employees and the failure is due to the fraud or neglect of a director or other officer the unpaid NIC may be recovered from that director.

representatives from the AA (the client in this case) that indicated that they would not have agreed to accept any substitute turning up in place of Mr. Bessell. These cases have highlighted the willingness of the courts to depart from the principle established in the *Tanton* case (regarding the right to substitution) when the circumstances merit it. The implications for contractors is still unclear because, the cases are decided on the facts in each case and do not necessarily create a precedent. Although the contractual relationship of the worker with the contractor can be complicated (involving substitution issues and different forms of contracts) the bottom line is, as illustrated by these cases, that when sham contractual terms are used by employers the courts will be will ignore them and treat these workers as employees for tax purposes.

Recent Decisions Dealing With Sham Substitution Clauses

There have been various cases over the last three or four years where the courts and tribunals have dealt with the situation where a substitution clause in a contract is a sham. In the first two of these where sham clauses were allegedly used the EAT and the Court of Appeal followed the precedent of the Court of Appeal in *Tanton* and found in favour of the employer. In *Premier Groundworks Ltd v Jozsa*²⁸ the EAT relied on *Tanton* in their decision to uphold a substitution clause which gave a worker a general right to substitute but, with the proviso that adequate notice was given and that the substitute was suitably qualified and experienced. The clause stated “ Mr Jozsa shall have the right to delegate performance of [ground works] services under this agreement to other persons whether or not his employees provided that Premier Groundworks Ltd. is notified in advance and provided that any such person is at least capable

²⁸ Appeal No. UKEAT/0494/08/DM

experienced and qualified as Mr Jozsa himself.” The EAT held that: “where as in this case a party has an unfettered right not to personally perform the contractual obligations under contract but can delegate them for any reason to someone else, he cannot be a “worker” as defined in the WTR even though the person actually performing the contractual obligations has to meet certain conditions. “ The EAT made the point that that if the clause had not been so general but only applied in limited circumstances e.g. when the worker was unwell ²⁹ then the EAT might have been less inclined to uphold it.

In *Consistent Group Ltd v Kalwak* ³⁰ a group of Polish workers had been taken on by an agency (Consistent) and contracted out to work for a food processing company. The written agreement signed by Consistent and each claimant stated that the claimant was not a Consistent employee. It further stated that there was no obligation on Consistent to provide work or any obligation on the worker to accept any particular work assignment. Where an assignment had been accepted, the claimant had to perform the services himself or, if he could not, he had to ensure that the services were performed by a suitable substitute. A dispute arose between Consistent and the claimants and the claimant commenced proceedings against Consistent alleging that he was his employee. The Court of Appeal held that the previous decisions had been wrongly made by the ET and EAT. The main criticism levelled by Rimer LJ was that the tribunal chairman had failed to provide any reasoning for why the ‘obligations’ term was a sham. With respect to the principles involved in the decision the tribunal chairman should have been guided by the authorities in particular *Snook v. London and West Riding Investment Limited* ³¹ in determining whether there was a ‘sham.’ This ‘required a finding that both parties intended to paint a false picture as to the true

²⁹ Supra 17

³⁰ (2009) EWCA Civ 98

³¹ Supra 9

nature of their respective obligations. With respect to the principles relevant to the ‘sham’ question, The EAT ³² had reasoned as follows: ‘if the reality of the situation is that no-one seriously expects that a worker will seek to provide a substitute, or refuse the work offered, the fact that the contract expressly provides for these unrealistic possibilities will not alter the true nature of the relationship. It was argued by them ³³that some kind of ‘reality’ test was required to determine the issue. The EAT also believed the sham doctrine did not require an intention on both sides to present a false impression to others. However, Rimer LJ in the Court of Appeal disagreed with this analysis. He was not convinced by the argument that the substitution clause was a sham. He also believed (contrary to the EAT finding) that proof of a sham ‘requires a finding that, at the time of the contract, both parties intended it to misrepresent their true contractual relationship.’ Accordingly, the court did not uphold their finding that the claimant was an employee of Consistent.³⁴ Although these are recent cases that very firmly uphold the status quo as regards the courts’ approach to sham clauses there are other recent cases that will now be considered in which the judiciary have departed from this approach.

The New Approach

The tide began to turn in the case of Redrow Homes (Yorkshire) Ltd v Buckborough and another, ³⁵ when the EAT held that a substitution clause will be deemed a ‘sham’ where it is established that neither party to the contract intended for the clause to apply in reality. In this case Buckborough was a bricklayer who had entered into a

³² Elias P

³³ Ibid

³⁴ The Court of Appeal in the later case of Protectacoat Firthglow Ltd v Szilagyi in 2009 (see below) criticised this decision.

³⁵ (2008) UKEAT 0528_07_1010

contract with Redrow. A term of the contract purported to allow Buckborough if he wanted, to find someone else to do the work. Buckborough subsequently made a claim for holiday pay under the Working Time Regulations. In order to establish his right to holiday pay under the Regulations he had to show that he was a worker under Reg. 2(1). A worker includes employees and anyone under an obligation to provide work or services personally to an employer (but not in the context of operating their own business e.g. supplier or customer). Buckborough asserted that his contract fell within the latter category and was a contract for personal service. He argued that the right of substitution was a sham as neither Redrow or himself intended that right to be exercised. The Employment Tribunal agreed that Buckborough was a worker, holding that the term of the contract that allowed the work to be carried out by anyone was a sham and Buckborough was expected to carry out the work personally. Redrow appealed to the EAT who concluded that the both the end-user and the contractor might agree to the inclusion of a contractual term that may be considered a sham not only where the parties intend to 'deceive a third party' i.e. HMRC or the court but, also where the parties simply did not intend for the term to apply. The EAT also held that an obligation to ensure work was carried out meant that the contract was one of personal service and the person working under it was a worker for the purposes of the Working Time Regulations 1998. In both these cases the judge was willing to look beyond the contractual terms and determine the reality of the situation by looking at the behaviour of the parties. The reality was the contractual term that allowed others to fulfill the task where the worker was unable to do so was a sham.

This and the other cases cited in this article show that the requirement of personal service remains a fundamental factor in a contract of service but, it is not a conclusive test in determining the status of a worker. Although personal service will clearly be

undermined as a suitable determinant of contractual status when sham clauses are introduced into contracts by employers to try and put the matter beyond doubt. The next case is a useful illustration of the often complex issues involved.

In the case of *Autoclenz Ltd v Belcher and Others*³⁶ Autoclenz was a company that cleaned cars ready for auction. Valeters, such as Mr Belcher, the lead claimant, were provided with all of the necessary cleaning equipment and were paid for piece work. They paid their own tax and National Insurance and had signed agreements stating that they were self-employed. The self employed status had been accepted as correct by the Inland Revenue earlier in 2004. However, Mr Belcher and others claimed they were workers and brought a claim for unpaid wages and holiday pay under the
and the Working Time Regulations 1998.³⁷ The

Employment Tribunal that originally heard the claim found that despite the apparent self-employed status of the 20 car valeters they were in fact employees of Autoclenz, and in any event were at the very least “workers” within the meaning of s 230 of the

. The Employment Appeal Tribunal (EAT) upheld this finding in part by agreeing with the tribunal that the valeters were workers, but overturned its finding that the valeters were employees. The Court of Appeal however, found that the valeters were employees. It also went on to say that the existence of a contractual provision allowing for the right of substitution, which is never exercised, does not automatically mean that the contractual term is not a genuine one. However, given that the valeters were expected to attend work unless they gave appropriate prior notice did indicate some degree of mutuality of obligation. As a result the right of substitution was not realistically expected to be exercised and

³⁶ (2009) All ER (D) 134

³⁷ SI 1998/1833

the valeters were employees of Autoclenz. It was recognised that an employment judge would normally take any written terms as accurately reflecting what the parties agreed particularly, where there was a signed document confirming acceptance of those terms. However, it is often the case that one party will dispute the accuracy of these terms because of their failure to reflect the true employment relationship. The agreement between Autoclenz and the claimants also contained a substitution clause, which was found not to be a genuine aspect of the agreement. The Court of Appeal in Autoclenz clarified that where there is a dispute as to the genuineness of a written term in a contract the focus of the enquiry must be to discover the actual legal obligations of the parties. To achieve this, the tribunal will have to examine all the relevant evidence. This naturally includes the written term itself, read in the context of the whole agreement, as well as evidence of how the parties conducted themselves in practice and their expectations of each other. The case has been appealed to the Supreme Court who will hear the case and give their ruling shortly.³⁸

If there exists a written term permitting substitution, but over the course of the contract a particular claimant had never sought to provide such a substitute, it does not of itself necessarily mean that the substitution clause is not genuine. Employment tribunals must be wary of misconstruing non-exercise of a right, e.g. to substitute, with the non-existence of that right.

Both the Redrow and Belcher cases dealt with, among other things, the right of substitution which was deemed to be of no effect when the clause implementing it was a sham. It is vital that at least one of the contracting parties usually the worker

³⁸ The appeal of the decision in Autoclenz Ltd v Belcher (2010) IRLR 70 is listed for hearing in the Supreme Court in May 2011

contending that the clause is a sham specifically raises this as an issue before an Employment Tribunal. If it fails to do so it is not open to the Employment Tribunal to raise the issue themselves. The Court of Appeal held that this was the case in *Launahurst Limited v Larner*.³⁹

Recent authorities have confirmed that where substitution clauses or bogus contracts are in use the courts should search for the true intention of the parties and not be bound by the strict wording of the contract if this does not reflect the reality of the situation.

Recent Decisions Dealing With Sham Contracts

In *Ministry of Defence Dental Service v Kettles*⁴⁰ a job advertisement proved instrumental in the decision of an Employment Appeal Tribunal that a female worker was working under a contract of service. What is significant is that this decision was made by the EAT despite the existence of a written contract (signed by her) which clearly stated she was working under a contract for services.⁴¹ The acts were a woman responded to a job advertisement for the post of specialist orthodontist consultant. In the advert it stated the job was salaried and involved part-time employment in a clinic. She was the successful candidate however, on starting the job she was sent a letter which contained documents, one of which was described as an “invitation to tender.” Despite her reservations about the appropriateness of the contract, which she raised with her supervisor, she signed and returned the invitation to tender and was later sent a contract for the

³⁹ APPEAL NO. UKEAT/0188/09/MAA

⁴⁰ APPEAL NO. UKEAT/0308/06/LA also reported at 2007 WL 631655

⁴¹ Middlemiss, S Discriminating Material? Legal Liability of Employers for Job Advertisements *International Journal of Discrimination and Law* (2007) Vol. 9 pp 95-111

provision of consultant orthodontic services. Under the contract there was a substitution clause allowing her to use sub-contractors and although she read the clause in the contract she was not in a position to take advantage of it and she made this clear to her supervisor. The EAT concluded that: “the nature of the job advertisement, which plainly envisaged employment to work personally, the express finding of the Tribunal Chairman that Dr Kettle told the MOD she would not be able to find replacements,⁴² and the express finding of the Tribunal Chairman that the MOD found and paid for replacements, are taken together a sufficient basis for the Tribunal Chairman's conclusion that she was contracted to work personally. He did not err in law in reaching this conclusion.

.. 43

The question arose whether the Employment Tribunal should have restricted its consideration to the contractual documentation in the case or whether it was entitled to take account of the job advertisement and the subsequent conduct of the parties. They stated their position as follows: “It is true that, throughout the documents, there is reference to “contractor” and, in some cases, “independent contractor”, but equally the advertisement, which first of all attracted her to this post, is couched completely in employment terms. It mentions salary, a well run clinic, attractive remuneration, job-share and an Equal Opportunities employer. It is difficult for the Respondent to suggest that this advertisement was in some way unofficial.”⁴⁴

The EAT concluded in the *Kettle* case that despite the content of the contractual documents, reference needed to be made to all the circumstances of the case before reaching a decision. “Once granted that the Tribunal Chairman was entitled to look

⁴² It was found at the tribunal stage that; she could never provide a substitute or a locum orthodontist; she never did in practice and would have been unable to do so.

⁴³ Appeal No. UKEAT/0308/06 Clause 62

⁴⁴ Ibid 2007 WL 631655, Paragraph 19

outside the four corners of the contract documentation, as I conclude that he was, his conclusion that Dr Kettle was an employee of the MOD is not in my judgment perverse. In what can only be described as unusual circumstances the MOD had advertised for an employee, interviewed Dr Kettle for the advertised post (clearly a contract of service) and told her that she was successful in obtaining that post. Before producing after she was employed contractual documents which were irreconcilable with the job which had been advertised and it was clearly intended she would do.”

The EAT were able to attach sufficient importance to the job advertisement and subsequent actings of the parties in this case to override the terms of the written contract and other documentation which was inconsistent with the reality of the contractual situation.

It is not unheard of that an employer on appointing someone to undertake a specific job will between the time of them being selected for the position and starting the job change their mind about what the job entails or what kind of contract applies. The following decision offers some hope of redress for people in this unfortunate position. In *Protectacoat Firthglow Ltd v Szilagyi*⁴⁵ the claimant Mr Szilagyi had executed two documents. One of them was a deed purporting to create a partnership agreement with his assistant, Glen Nesbit, giving the partnership business name as M & G Coatings which was subject to the Partnership Act 1890. The other was a service agreement with the company Protectacoat Firthglow Ltd whereby the partnership undertook to provide services to them.

A dispute followed between the claimant and the company about whether or not a particular job required scaffolding or could safely be done from ladders. The company tried to terminate the arrangement with the partnership and the claimant brought a

⁴⁵ (2009) WLR (D) 67

claim against the company for unfair dismissal. The company contended that the contract was with the firm and accordingly the tribunal had no jurisdiction to hear the claim. This argument was not accepted by the Employment Tribunal and at a later stage the Court of Appeal had to determine whether Mr Szilagyi who had carried out the work for the company was their employee within the meaning of section 230 of the Employment Rights Act 1996. The Court of Appeal held that if the document purporting to retain the services of a person did not represent the true relationship of the parties the employment tribunal were entitled to hold that the document had been designed to deceive others and a sham and to assume the jurisdiction to determine a claim for unfair dismissal. The Court of Appeal dismissed the appeal by the company and Lord Justice Smith said in this case that in determining the proper legal relationship between the parties where there was a contractual document in place that would ordinarily be where the answer would be found. However, if either party claimed that the document did not represent or describe the true relationship, the court or tribunal had to decide what that true relationship was. For this purpose any document which could be shown to be a sham designed to deceive others would be wholly disregarded by Employment Tribunals in reaching a decision as to what the relationship between the parties was. So in a case involving a written contract an employment tribunal would ordinarily regard the documents as the starting point and ask itself what legal rights and obligations the document created. It might then be reasonably asked whether the parties had ever realistically intended or envisaged that its terms particularly, the essential terms central to the nature of the relationship (e.g. dealing with mutuality of obligation and the obligation of personal performance of the work), should be carried out as provided in the written agreement. The following quote neatly summarises the outcome of the case: “the claimant was in reality an

employee even though he had signed agreements purporting to set up a partnership between him and an assistant which would deal as an independent contractor with the defendant firm. In doing so, Smith LJ, giving the leading judgment, departed from the *Snook* definition of a sham in the employment context ⁴⁶ and offered a significant reinterpretation of the relatively recent Court of Appeal decision in *Consistent Group v Kalwak*... ⁴⁷ The decision paves the way for a much more worker-protective approach to the determination of employee status and is thus to be welcomed.” ⁴⁸

Conclusion

In *Protectacoat v Szilagyi* ⁴⁹ the Court of Appeal found that where one party was relying on the term of a contract and the other was not there was no need to show a common intention to mislead. It is enough that the written term did not represent the parties’ intentions or expectations. In such a situation, a tribunal should seek to ascertain the actual legal obligations of the parties. In the *Kettles* case the content of a job advertisement and things said by the employer at an interview were more persuasive evidence of the type of contractual relationship that should apply than a written contract for services (containing a substitution clause) given to the claimant after starting her job. So, despite the successes for workers in various decisions highlighted in this article (E.g. *Dragonfly*, *Kettle*, *Szilagyi* and the *Autoclenz* cases) the fundamental test derived from the decision in *Ready Mixed Concrete* over forty years ago has not dramatically changed. However, what has changed is the freedom given to tribunals and courts to look beyond the contract itself and consider the conduct and intentions of the parties to determine what the reality of the situation is. This has meant that sham contracts can be challenged.

⁴⁶ *Supra* 9

⁴⁷ (2008) IRLR 505

⁴⁸ *Supra* 27

⁴⁹ (2009) EWCA Civ. 98

What can also be concluded is that written contracts are still of vital importance however, with the caveat that the contractual terms must reflect the reality of the working arrangements and not include sham clauses or a sham contract.

With respect to the approach the courts should take to this issue in future the following quote highlights that despite an important burden being removed in these cases important evidential issues remain for those wanting to be treated as employees. “They should not now be deflected from a finding that an individual is an employee or a worker by contractual devices such as substitution clauses ... However, they still face the challenging task of deciding what the ‘true relationship’ is. This will place a renewed emphasis on the traditional tests for employee status such as control or subordination and dependence or risk allocation. “⁵⁰

There is an increasing tendency for employers to try and avoid the various statutory duties associated with the status of an employee (by amongst other things utilising sham clauses or contracts) by affixing to them a status where these rights are unavailable. This was recognised in a consultation paper prepared the Law Societies covering both jurisdictions in the UK in response to the European Commission's Green Paper Modernising Labour Law to meet the challenges of the 21st century.

In commenting on the uncertainty in the labour market caused by the complex and uncertain issue of employment status it stated that: “In particular, it encourages those seeking to avoid employment, and tax, and health and safety obligations, to press those in less strong negotiating positions to move to less secure, ostensibly self-employed, status. This leaves these same individuals with the onus of subsequently

⁵⁰ Supra 10 p 328

proving employment protection before being able to claim attendant employment rights. We would suggest, therefore, that this is a key area for legal reform within the UK (the same basic rules applying both in Scotland and the rest of the UK). “⁵¹

The legal development of these cases invalidating sham contracts and the comprehensive analysis of them all for the first time might reasonably be identified as part of the reform process called for.

⁵¹ Clauses 10 -11 Memorandum by The Law Society of Scotland and The Law Society, Select Committee on European Union - Written Evidence, House of Lords, April 2007 www.parliament.uk