The employment status of a company director in Rainford v Dorset Aquatics Ltd

By Daniel Brown
3PB Barristers

Rainford v Dorset Aquatics Limited (EA-2020-000123-BA)

[ ] paragraph number of the Employment Appeal Tribunal's ('EAT') judgment
Parties referred to as they were in the Employment Tribunal ('ET')

Introduction

1. In this case the EAT considered the employment status of a statutory director and 40% shareholder of a limited company. The only other (60%) shareholder was the Claimant's brother.

2. There was no dispute that the Claimant carried out work and received (latterly) £1,500 a month from the Respondent [8]. The Claimant received this monthly payment regardless of the hours he worked. This Claimant's brother received the same monthly payments. The monthly payments were subject to PAYE and national insurance contributions but this was purely for tax reasons, on the advice of company accountants [8].

3. The Claimant and his brother also jointly agreed the amount to be paid to themselves by way of dividend (each brother received an amount proportionate to his shareholding) [8].

4. The Claimant had no written contract of employment, service agreement or other written terms. Moreover, there was no evidence before the ET of any relevant oral agreement [4].

ET's judgment

5. The ET found that the Claimant was not an employee nor a worker of the company. In addition, the ET concluded that the Claimant was not in business on his own account. In other words, the Claimant did not fall into any of the categories referred to in s.230(3) Employment Rights Act 1996 ('ERA 1996').

6. The ET also found that the Claimant had a right of substitution and was therefore not required to perform work personally. While there was no evidence that the Claimant had ever made use of a substitute, the ET's conclusion was based on the evidence of the Claimant's brother, that he would not have had a problem with the Claimant using a substitute.

Grounds of appeal

7. The first ground of appeal contended that because the company was not the Claimant's client or customer, as a matter of law, the Claimant must be a worker or employee.

8. The second ground of appeal suggested that the ET erred in law by implying a right of substitution into the agreement between the parties.

9. The third ground of appeal asserted that the ET had treated the Claimant's status as a company director or shareholder as mutually exclusive with employee or worker status.

10. There was a fourth ground of appeal related to the adequacy of the reasons given for the ET's conclusion as to when any worker relationship would have ended; ultimately the EAT accepted that the ET had given adequate reasons for its conclusion on this issue [30]. As this ground of appeal does not concern the law on employment status, it is not considered further below.

EAT's judgment

11. The EAT started by noting that this was a case in which there were no express contractual terms such that, if any employment or worker contract existed, it was necessarily one implied from the conduct of the parties and any other relevant circumstances [14]. The decision about whether such a contract should be implied is one of fact for the ET [14]. Accordingly, the EAT may generally only interfere if the decision is perverse or if the ET took into account irrelevant factors/excluded relevant considerations.

12. The EAT held that in cases of this kind, where the employment status of a company director is in issue, the directly relevant case law is *Clark v Clark Construction Initiatives Ltd* [2008] ICR 635 (EAT, Elias J), *Secretary of State v Neufeld* [2009] EWCA Civ 280 and *Dugdale v DDE Law Ltd* (unreported, EAT, HHJ Richardson) [15].

13. Helpfully, the EAT summarised the principles derived from *Clark* and *Neufeld* in the following terms [16]:

    (1) There is no reason in principle why someone who is a shareholder and director of a company cannot also be an employee, even if the person has total control over the company;

    (2) Whether the shareholder/director is an employee is a question of fact for the tribunal;

    (3) In cases where matters have been dealt with informally it may be a difficult question as to whether the correct inference is that the shareholder/director was truly an employee;

    (4) In considering the issue it will be necessary in particular to consider how the parties have conducted themselves, what they have actually done and how they have been paid;

    (5) Where the conduct of the parties is inconsistent with the existence of a contract of employment or is in some areas not governed by such a contract, that will be an important factor pointing away from a finding that the shareholder/director is an employee;

    (6) It follows that the lack of any written employment contract or other record thereof, is likely to be an important consideration;

    (7) The fact that the shareholder/director has control of the company or that his personal investment in it will stand to prosper with the company will be "part of the backdrop" but will not *ordinarily* be relevant to the issue and can and should therefore be ignored (see: **Neufeld** para [86]).

14. The EAT also held that the payment of a "salary" with payslips and PAYE/national insurance deductions may be of little significance in a case where it is organised entirely by a company accountant for tax reasons without any particular awareness on the part of the putative employee and only covers a small part of the payment made to a shareholder/director [17(4)].

15. More generally, the EAT affirmed that, in accordance with the Supreme Court's judgment in *Uber v Aslam* [2021] UKSC 5, the primary underlying question in cases concerning employment status is one of statutory rather than contractual interpretation; the relevant statutory purpose of the ERA 1996 is the protection of workers who are vulnerable because they are in a relationship of subordination and dependence; a "touchstone" of such subordination and dependence is the degree of control exercised by the putative employer over the individual concerned [17(1)].

16. The EAT also reiterated that, as established in *Carmichael v National Power Plc* [1999] ICR 1226 (HL) and *Autoclenz v Belcher* [2011] UKSC 41, it is open to the ET to take the parties' subjective views about their obligations into account in ascertaining the terms of any agreement and a genuine right of substitution is inconsistent with an obligation to perform work personally, even if it is not used [17(2)-(3)].

17. **Applying the above principles to the grounds of appeal, the EAT held as follows.**

18. Ground 1: the fact that the Claimant carried out work for the company and received money from the company does not mean that one of the three categories of contract specified in s.230(3) ERA 1996 must exist; it is possible for working shareholders/directors to organise their relationship through the company's corporate structures without individual contracts of employment [20]. This possibility must be present in the case of a very small company owned and run by two brothers [20].

19. The statement made by Lady Hale at paragraph 31 of the judgment in *Clyde & Co v Bates van Winkelhof* [2014] UKSC 32, concerning the distinction made in employment law between employees, workers and those who work on their own account for clients and customers, was not intended to mean that every individual who does work for another and receives money must come within one of those three categories [21].

20. For the reasons above, Ground 1 was dismissed.

21. The EAT held that Ground 2 was misconceived as there was no contractual agreement into which any right of substitution could be implied [22]. However, in any event, it had been open to the ET to take into account the evidence of the Claimant's brother to the effect that he would have had no problem with the Claimant using a substitute [23].

22. The EAT accepted that it would have been an error of law for the ET to have regarded the Claimant's status as a shareholder/director as exclusive of employment or worker status but it did not accept that the ET had approached matters in that way [25]. The Claimant's status as a shareholder/director and his family relationship with the only other shareholder/director were not completely irrelevant in the exercise of deciding the Claimant's employment status; the ET was not bound to disregard these matters [25]. Given that the putative employer was a two-brother company in which the Claimant was one of the brothers, it was open to the ET to give the issue of the Claimant's integration into the business next to no weight [25]. Ground 3 was therefore also dismissed; the ET took into account relevant factors and the decision was not perverse [29].

Comment

Decisions on employment status are notoriously fact specific and this judgment does not change that. However, this case may be significant in relation to small companies where no terms of service are in place. It demonstrates that the mere fact that a director has done work for and received payment from a company will not always be sufficient to establish a worker or employment relationship; it may not be necessary to imply such a relationship if the evidence suggests that the parties intended to operate purely through corporate structures. Even where a director receives regular monthly payments subject to deductions in respect of PAYE and national insurance, this may not carry much weight if the arrangement was in place purely for tax reasons.

This document is not intended to constitute and should not be used as a substitute for legal advice on any specific matter. No liability for the accuracy of the content of this document, or the consequences of relying on it, is assumed by the author. If you seek further information, please contact the 3PB clerking team.

9 January 2022

Daniel Brown

Barrister
3PB

Telephone: 0330 332 2633
daniel.brown@3pb.co.uk

3pb.co.uk