Appeal No. UKEAT/0293/13/DA

EMPLOYMENT APPEAL TRIBUNAL

FLEETBANK HOUSE, 2-6 SALISBURY SQUARE, LONDON EC4Y 8AE

At the Tribunal
On 16 December 2013 & 19 March 2014
Judgment handed down on 30 May 2014

Before

HIS HONOUR JUDGE BIRTLES

(SITTING ALONE)

AJAR-TEC LTD — APPELLANT

MR R STACK — RESPONDENT

Transcript of Proceedings

JUDGMENT

FULL HEARING

APPOINTMENT FOR DIRECTIONS

APPEARANCES

For the Appellant	MR DAVID READE (One of Her Majesty's Counsel) Instructed by: Brian Harris & Co Solicitors 1 Marylebone High Street London W1U 4LZ
For the Respondent	MR TIMOTHY PITT-PAYNE (One of Her Majesty's Counsel) Instructed by: Speechly Bircham LLP Solicitors 6 New Street Square London EC4A 3LX

SUMMARY

JURISDICTIONAL POINTS – Worker, employee or neither

The Employment Judge was in error in finding the Claimant was employed under an express contract of employment as there was no consideration. He also failed to apply **Tilson v Alstom Transport** [2011] IRLR 169. In the absence of either an express or implied contract of employment it was also an error of law to find an implied term as to remuneration.

HIS HONOUR JUDGE BIRTLES

Introduction

1. This is an appeal from the judgment and Reasons of Employment Judge Pettigrew, sitting at Watford in August and December 2012. The written judgment and Reasons were sent to the parties on 8 January 2013. The Employment Judge decided that (1) the Claimant was an employee within the meaning of section 230 of the **Employment Rights Act 1996** and (2) that he was a worker within the meaning of the same section and Article 2 of the **Working Time Regulations 1998**.

2. This case has a procedural history which it is not necessary for me to go into in deciding this appeal.

3. The Appellant was represented by Mr David Reade QC. The Respondent was represented by Mr Timothy Pitt-Payne QC. I am grateful to both leading counsel for their written and oral submissions.

4. I heard the appeal on 16 December 2013 and reserved judgment. In the course of writing my judgment certain issues which I had not raised with leading counsel at the original hearing required further written or oral submissions. The Tribunal reconvened on 19 March 2014.

The factual background

5. The Employment Judge heard a number of witnesses, listed in paragraph 4 of the Reasons. The main witnesses were (a) Mr Stack, (b) Mr Martin, who was a director of the Appellant company, and (c) Ms Claire Thompson, who was a corporate manager of the Appellant company from June 2006 until November 2008.

6. The Respondent company is a supplier of audio/visual equipment and was incorporated on 19 April 2005. There were three shareholders. Save that Mr Martin received one additional share, the shareholding was equally divided between Mr Martin, Mr Stack and Mr Keane. The principal motivator behind the founding of the company was Mr Martin. He was leaving a job in marketing in 2004 and he approached Mr Keane, a financial advisor, with a view to setting up a business. Mr Martin was looking for financial backing. Mr Keane introduced him to some investors including Mr Stack. Mr Stack was looking for a project to invest in, and this one was attractive because he had skills derived from running a business in the building and contracting industry. Principally his skills were in relation to project management, but he also understood audio/visual technology, having done many installations. He was also experienced in procurement. Mr Keane in turn possessed financial expertise.

7. There were pre-incorporation discussions. The discussions that took place were on the basis that all the directors would eventually share equally in what Mr Stack described as "remuneration". That agreement was ratified post incorporation. Mr Stack's evidence was that there was an agreement that he would be paid on the same basis in relation to salary from incorporation, but only once there were resources to make payment. He said it was always understood that he would be remunerated at the same rate as Mr Martin back to the start of the company: Reasons, paragraph 6.2. Mr Martin received a salary from the start. He did not have another source of income. He began to receive payments under PAYE from the date when he joined the company in June 2005. He later received a statement of particulars of employment which was effective from 1 May 2007. The salary was £60,000 per year subject to review, with eligibility to receive private healthcare. It gave other standard conditions found in a contract of employment: Reasons, paragraph 6.4.

8. The company's accounts for the tax year 2006-2007 show a salary for Mr Martin. They do not indicate specifically a liability to Mr Stack, where there is a figure for creditors. Until the end of 2005 the company operated from a room in a property belonging to Mr Stack in Ealing. After six months it moved to another property owned by Mr Stack in Acton. It remained there for six months before returning to the Ealing address in July 2006. Mr Stack did some work to convert a room there. In addition the company used a flat of Mr Stack's in Hanwell for storage and dispatch of products.

9. There were various documents showing Mr Stack's role within the company and giving him different titles, such as "operations director" and "operational director and chief firefighter, fighting fires and undertaking logistical management". Both of these titles are dated 2006. In 2006 the company needed more space, which Mr Stack located, and the company took a lease on premises in Ealing. Some modifications were necessary, and Mr Stack carried out the work using various staff members as well as external contractors.

10. Mr Stack and Mr Keane and some other investors invested various amounts of money in the business. There were various withdrawals by the directors. The details are set out in Reasons, paragraphs 6.15 and 6.17.

11. Mr Stack's evidence was that he was an integral part of the company from the beginning with a full-time commitment: Reasons, 6.21.1. There was conflicting evidence before the Employment Judge as to the extent of Mr Stack's participation: Reasons, paragraphs 6.21-6.28. On the whole the Employment Judge preferred the evidence of Mr Stack and Ms Thompson to that of Mr Martin.

12. All directors were members of the staff private healthcare scheme, had company credit cards, and they used employee expenses claim forms.

13. There were various discussions about employment contracts and rules and procedures at a meeting on 13 June 2005, but no detail was given to the Employment Judge. There was another meeting on 21 October 2005, which did not take the matter any further. Early in 2007 a human resources consultancy was engaged to organise staff contracts. A template was produced and circulated to all employees. Mr Stack received one, but this was never completed or taken any further as far as his own contract was concerned.

14. In 2007 the company's solicitor produced a draft contract entitled "Senior Executives' Employment Agreement". It was discussed. A copy of the draft was annotated by the solicitor. The draft was circulated but no action taken any further, and Mr Stack did not sign any agreement.

15. There was a further meeting on 7 April 2009 at the company's solicitors, where there was a further discussion about responsibilities of the directors. However, those discussions were never realised. Relations between the directors deteriorated amidst arguments about money. Eventually Mr Martin and Mr Keane took a decision to terminate Mr Stack's appointment as a director of the company: Reasons, paragraph 6.36.

The Employment Judge's conclusions

16. Having set out the relevant statutory provisions, the Employment Judge reached its conclusions at paragraphs 8.1-8.22 of the Reasons. The Employment Judge said this:

> **"8.1 The first question is whether there was an express agreement that the claimant would work for the respondent and further whether he would get paid for what he did. Possibly that**

might be a deferred remuneration and possibly the amount might be ascertained by reference to some other factor such as what was paid to somebody else.

8.2 I find that it is overwhelmingly likely that the parties agreed when they were promoting this company that the claimant would perform work for the company and that that agreement was subsequently endorsed by the directors of the respondent company when it was formed. Just as it was agreed that Mr Martin would perform the sales activity, it was agreed that Mr Stack would run the operational side and provide operational director services.

8.3 The situation in reality is that a company is founded and formed by its promoters. They decide who are to be the first directors, they effectively determine the allocation of the shares and that normally reflects the respective contributions made to the equity of the company. The reality here is that these three, Mr Keane, Mr Martin and Mr Stack, wanted to form a company. They were to contribute different things. Mr Stack and Mr Keane were to provide their skills and money. Mr Martin was to deliver his skills. There is little doubt that there was nothing much to do at the beginning. Obviously, a certain amount of work needed to be done to get the company up and running in an administration sense, but principally Mr Martin need to get on the road and drum up the business. As the business came in, hopefully, the work would have to be performed, the books kept, financial controls arranged, money managed and so on. In my finding Mr Stack was the person who was to go about and indeed did go about setting up the infrastructure, the bank accounts, the trading accounts, the insurances, and all the administrative necessities of life for a limited trading company.

8.4 The company had directors' loan accounts. They reflect the money that the directors advanced to the business. Each of the directors here had loan accounts. They also received dividends and to some extent those dividends to pay off their indebtedness to the company by way of debit balances on the loan accounts.

8.5 The reality was also this. Mr Keane and Mr Stack were not to be full time involved with the company, certainly not initially. They had their own businesses in addition to their involvement with Ajar-Tec. There was not a major amount of administration to be done initially, but I found that it was envisaged at the time that Mr Stack would be engaged, to use a neutral term, in the company's activities because he had the skills of project management, familiarity with audio/visual equipment, and expertise in procurement. The plan was that he would bring these to the company as much as Mr Martin would bring his skill in sales.

8.6 A shareholder does not of necessity have any involvement with the operations of a limited company. He pays for his shareholding or is given it and he can just sit back and wait for the money, hopefully, to roll in. Frequently, of course, and particularly in small companies, the shareholders are the people who actually do the work, but this does not prevent them from being employees/workers as well, subject to consideration of the standard tests. Thus I found that it was the intention of the parties and their express agreement that Mr Martin would work full time in the company and would be paid and that Mr Stack would also work for the company albeit that the hours fell to be agreed at a later stage, or would be determined as needed depending on the amount of work that Mr Martin was successful in securing.

8.7 Was it express or implied that Mr Stack would work and get paid? The respondents urge an argument that it is not appropriate to imply a contractual term of this nature unless it is necessary to do and anything that the claimant did can be explained by his being a shareholder or a director of the company, therefore there is no necessity to imply anything about payment. As I have already remarked, it would not be a requirement that a shareholder would necessarily be involved in carrying out the trading activities of the company that he hold his shares. A director may be an employee or a worker subject to the tests enunciated above. There are many examples where directors have been held to be employees.

8.8. I questioned whether it made any sort of commercial sense in the circumstances of the case and having regard to the beginnings of this enterprise, for the claimant to be required to be required to deploy his skills in the trading operations of the company without being paid when, for example, Mr Martin was deploying his sales skills, but was to be paid. To argue that the claimant's rewards were limited to those deriving from his dividends again makes no sense because Mr Martin was also to benefit in this way as well as being paid for what he did by way of work. Putting it another way, if the officious bystander had asked the question of Mr Stack, Mr Keane and Mr Martin, 'You're getting together to carry out the activities, you have agreed that Mr Martin is going to work full-time and will get a wage. In addition he will get dividends. Mr Stack is going to work in this business, at least part time. He is going to get dividends, is he also to get a wage for what he does?' In my assessment the answer from all three would have been very clearly, 'Yes, of course he will'. Therefore I found that there was

an express agreement that the claimant would do work for the company and it was an implied term that he would be paid for what he did.

8.10 The fact that there was no provision in the accounts, and that contract documents were not signed, does not, in my finding, affect that determination. The fact that there were several opportunities for a formal contract to be entered into is actually consistent with the notion that there was some implied or verbal agreement already, but the time had not yet arrived when Mr Stack should be given a contract of employment to determine the detailed terms, including the amount he would actually be paid. I note that the directors' remuneration was discussed from time to time and that there is reference to a need for an income stream to Mr and Mrs Stack."

17. The Employment Judge therefore found that there was an express agreement that Mr Slack would work for the company and that it was an implied term that he would be paid for that work.

18. Having decided that there was an express contract for Mr Stack to do work for the company and be paid for it, the Employment Judge then considered the tests adumbrated in **Ready Mixed Concrete (South East) Ltd v Ministry of Pensions and National Insurance** [1968] 2 QB 497. He did this at Reasons, paragraphs 8.11-8.18. He concluded that Mr Stack was an employee and that it was not necessary for him to decide separately whether he was also a worker. However, an analysis of the relevant factors led to the same conclusion: Reasons, paragraph 8.19.

19. As far as payment was concerned, the Employment Judge said this:

"8.20 As to the date during which he held the status and the quantum of his remuneration, I found that the agreement was that Mr Stack would work in the business and receive payment but I do not find it was ever agreed explicitly what he should be paid, rather that it was implied that he would be paid a reasonable amount at a reasonable starting date. That would depend on the amount of work coming through and the amount of work which fell for Mr Stack to do as operations director.

8.21. I found that his status as employee would be from the beginning of the business, rather like Mr Martin's, but that he would be entitled to be paid only from the point at which he started to do a substantial amount of work for the company. Having regard to the circumstances, the dealings of the parties and my findings about the amount of work that Mr Stack did and the sort of contracts that he worked on, I would date the point at which he began to do substantial amounts of work for the company as July 2006 which is consistent with Mr Thomson's evidence.

8.22 The amount which would be reasonable for him to be paid will be the same as that paid to Mr Martin but it would be pro rata to the amount of work hours that Mr Stack actually did in proportion to a full week."

The relevant legal provisions

20. I begin with the definition of "employee". Section 230 of the **Employment Rights Act 1996** says this:

> **"(1) In this Act 'employee' means an individual who has entered into or works under (or, where the employment has ceased, worked under) a contract of employment.**
>
> **(2) In this Act 'contract of employment' means a contract of service or apprenticeship, whether express or implied, and (if it is express) whether oral or in writing."**

21. The term "worker" is defined by section 230(3) of the 1996 Act, which says this:

> **"(3) In this Act 'worker' (except in the phrases 'shop worker' and 'betting worker' means an individual who has entered into or works under (or, where the employment has ceased, worked under) –**
>
> **(a) a contract of employment, or**
>
> **(b) any other contract, whether express or implied and (if it is express) whether oral or in writing, whereby the individual undertakes to do or perform personally any work or services for another party to the contract whose status is not by virtue of the contract that of a client or customer of any profession or business undertaking carried on by the individual;**
>
> **and any reference to a worker's contract shall be construed accordingly."**

22. The same definition appears in Regulation 2(1) of the **Working Time Regulations 1998**.

The Notice of Appeal

23. I accept Mr Pitt-Payne's submission that there are three issues not in dispute between the parties to this appeal. First, there is no suggestion that the Employment Judge mis-stated the law at paragraph 7.1-7.6 of his Reasons. Second, there is no reason why in principle a shareholder and director of a company cannot also be an employee of the company under a contract of employment: **The Secretary of State for Business and Regulatory Reform v Neufeld** [2009] IRLR 475 at paragraphs 80-81. That case was specifically drawn to the

attention of the Employment Judge in the Appellant's counsel's closing note, paragraph 11, appeal bundle pages 64-65. The point was accepted by the Employment Judge, as it had to be, at Reasons, paragraph 7.6. Third, the question of employment status is primarily one of fact for the Employment Tribunal to resolve: **Quashie v Stringfellow Restaurants Ltd** [2013] IRLR 99 at paragraph 9 per Elias LJ, **The Hospital Medical Group Ltd v Westwood** [2013] ICR 415 at paragraph 3 per Maurice Kay LJ. I do not understand Mr Reade QC to dissent from those three propositions.

24. Mr Reade submits that the first question for the Employment Judge was whether there was a contract at all between the parties (and only if there was such a contract would it be necessary to go on to consider whether this was a contract for services or a contract of employment). He submits that the Tribunal addressed this question as matter of express contract "(The first question is whether there was an express agreement"): Reasons, paragraph 8.1. The Employment Judge found:

(a) It was "overwhelmingly likely that the parties agreed when they were promoting this company that the Claimant would perform work for the company": Reasons, paragraph 8.2;

(b) There was "an express agreement that the Claimant would do work for the company... and it was an implied term that he would be paid for what he did.": Reasons, paragraph 8.8.

25. Mr Reade submits that an express agreement that Mr Stack would do work for the company does not amount to a binding express contract if there is no consideration for such a promise. Here the Employment Tribunal did not find that Ajar-Tec agreed to remunerate Mr Stack for this agreement and there was accordingly no agreed consideration. The

Employment Judge said in terms, "I do not find it was ever agreed explicitly what he should be paid": Reasons, paragraph 8.20.

26. In those circumstances, Mr Reade submits that there was no binding contract, and the Employment Judge ought to have considered whether there was an implied (or inferred) contract according to the principles set out in **Tilson v Alstom Transport** [2011] IRLR 169, whether it was "necessary" to infer a contract (with it being insufficient to infer a contract simply that the Claimant looked, acted as, and was treated as an employee), the burden being on the Claimant to establish this. Mr Reade submits that the Employment Judge did not address the question of whether there was implied or inferred contract at all or the necessity test in **Tilson**. The Employment Tribunal was in error because it went on to consider whether there was an implied term as to remuneration (which presumes the existence of a binding contract). This is wrong in law because the Employment Judge had not found that there was an express binding contract and he had not addressed the question of whether there was an implied or inferred contract.

27. In **Tilson,** at paragraphs 7-9, Elias J said this**:**

> **"7. The principles for determining when such implication can take place are now well established and they were not in dispute before us. First, the onus is on a claimant to establish that a contract should be implied: see the observations of Mance LJ, as he was, in *Modahl v British Athletic Federation* [2001] EWCA Civ 1447, [2002] 1 WLR 1192, para 102.**
>
> **8. Second, a contract can be implied only if it is necessary to do so. This is as true when considering whether or not to imply a contract between worker and end user in an agency context as it is in other areas of contract law. This principle was reiterated most recently in a judgment of the Court of Appeal in *James v Greenwich London Borough Council* [2008] ICR 545 which considered two earlier decisions on agency workers in this court, *Dacas v Brook Street Bureau (UK) Ltd* [2004] ICR 1437 and *Cable and Wireless plc v Muscat* [2006] ICR 975. It is sufficient to quote the following passage from the judgment of Mummery LJ, with whose judgment Thomas and Lloyd LJJ agreed: (paras 23-24). Mummery LJ stated that the EAT in that case had:**
>
> > **'… correctly pointed out, at para 35, that, in order to imply a contract to give business reality to what was happening, the question was whether it was *necessary* to imply a contract of service between the worker and the end-user, the test being that laid down by Bingham LJ in *The Aramis* [1989] 1 Lloyd's Rep 213, 224:**

> ***'necessary . . . in order to give business reality to a transaction and to create enforceable obligations between parties who are dealing with one another in circumstances in which one would expect that business reality and those enforceable obligations to exist.'***
>
> **As Bingham LJ went on to point out in the same case it was insufficient to imply a contract that the conduct of the parties was more consistent with an intention to contract than with an intention not to contract. It would be fatal to the implication of a contract that the parties would or might have acted exactly as they did in the absence of a contract.'**
>
> **9. If an employment tribunal has properly directed itself in accordance with these principles, then provided that there is a proper evidential foundation to justify its conclusion, neither the EAT nor this court can interfere with the tribunal's decision."**

28. I am mindful that this was an agency worker case and I am also mindful of the comment by Elias LJ at paragraph 23 in **Ajar-Tec Ltd v Stack** [2012] EWCA Civ 543 that

> **"..there may be an issue whether the necessity test applied in the *Greenwich* and *Tilson* cases is appropriate for determining whether a contract exists in a case of this kind..."**

29. However, in my judgment, it does, and there is nothing in the case-law to suggest otherwise. See in particular what Elias LJ himself said at the beginning of paragraph 8 of **Tilson**. Mr Pitt-Payne QC submits that the Employment Tribunal did not separate the two questions of whether there was a contract between Mr Stack and Ajar-Tec from the issue of whether Mr Stack would be remunerated.

30. Mr Pitt-Payne QC submits that the Employment Tribunal did not separate these questions but discussed the two issues in conjunction with one another: whether there was an agreement that Mr Stack would carry out work for the company, and if so, whether there was an agreement that he would be paid for what he did: Reasons, paragraphs 8.1-8.11. The Employment Judge considered those questions together and reached the conclusion that there was a contract for Mr Stack to do work for the company and be paid for it: Reasons, paragraph 8.11.

31. I agree with Mr Reade QC. In my judgment, there was an error of law in the Employment Judge failing to separate out the issues in the way that he should have done. The

first issue was whether there was an express contract. The second issue was, if not, then was there an implied or inferred contract? The third question was whether there was an express term as to remuneration. The fourth question was, if there was not, then was there an implied term as to remuneration? The third and fourth questions clearly require the existence of a binding contract. It is clear that there was an agreement between the parties before Ajar-Tec was formed that the Claimant would perform work for the company, and that agreement was subsequently endorsed by the directors of the company when it was formed: Reasons, paragraph 8.2. However, that begs the question of whether or not this was a contract for the employment of Mr Stack by the company and that he would be paid for it.

32. Mr Pitt-Payne QC submits that the approach taken by the Employment Tribunal at Reasons, paragraphs 8.7-8.8, is not materially different from the approach set out in **Tilson**. He argues that the test of necessity is a proxy for identifying what, viewed objectively, the relationship between the parties must reasonably be taken to be: **Attorney General v Belize and Others v Belize Telecom Ltd and Anr** [2009] 1 WLR 1988 at paragraphs 21-27 per Hoffmann LJ. However, that case concerned the implication of terms into a written instrument – in that case the articles of association of a company. In other words the articles of association were a contractual document which was already in existence. The question was whether it was necessary to imply a further term into the written contract about the circumstances in which the directors would vacate office. It is a different situation from the **Tilson** case, which concerns whether or not a contract should be implied at all. Mr Pitt-Payne QC also relies on **Currencies Direct Ltd v Ellis** [2002] EWCA Civ 779 at paragraphs 19-21 per Mummery LJ. As Elias LJ said in **Ajar-Tec Ltd v Stack** [2012] EWCA Civ 543 at paragraph 14:

> **"To the extent that these cases concluded that there was an implied contract to pay a quantum meruit, they are no longer good law: see the discussion by Etherton LJ in *Benedetti v Sawiris* [2010] EWCA Civ 1427 at paras 140-141. But they are consistent with the principle that there may in an appropriate case be an implied contractual term to pay a reasonable sum for work done."**

However, that only applies if there was either an express or implied contract.

33. Finally Mr Pitt-Payne QC submits that, if the Appellant is right, then there can never be an implied contract between a director/shareholder in a company that the director/shareholder would work for the company in return for remuneration.

34. The short answer to that point is that in this case the Employment Judge did not find an implied contract but an express one. There is no reason why, on other facts, such a contract cannot be implied if the **Tilson** test is the correct one.

35. In my judgment the Employment Judge was in error in finding that there was an express contract of employment in this case with an implied term that Mr Stack should be paid remuneration for that work. There was no consideration. In those circumstances, it is difficult to see how, on the facts of this case (as found by the Employment Judge) the existence of an implied contract can possibly be satisfied. Mr Stack was the major investor as well as one of the three shareholders and had other substantial business interests, unlike Mr Martin, who had no other interests and no money and, unsurprisingly, worked for the company full-time and under a written contract of employment. Accordingly to the evidence recorded by the Employment Judge, and his findings of fact, throughout the three years that the Employment Judge found Mr Stack to have worked the equivalent of 80% full-time for the company, he never specifically sought, and certainly never received, payment for that work; and despite having had on two occasions the opportunity to resolve the position of remuneration and status on a formal basis at the suggestion of, respectively, accountants and solicitors he took no steps to do so. It is, I think, not possible to conclude that, in the light of these matters, the relevant

factual background is only consistent with Mr Stack working part-time under an implied contract of employment: **Tilson**.

Conclusion

36. For these reasons I think the Employment Judge was in error. On the facts found by the Employment Judge, I am quite unable to say that it is possible for me to imply a contract or a contract of employment between the parties. In those circumstances, the matter will have to be remitted to be tried again by a fresh Employment Judge. It must also follow that Mr Stack was not a worker either.