The Personal Scope of the Employment Relationship

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1. Introduction

The personal scope of the employment relationship is crucial in English law and today is it a more live question than ever before. There are three distinct statuses:

- Employee
- Worker; and
- Self-employed.

The first two are defined by statute. S.230(1) ERA 1996 explains that an 'employee' is:

> An individual who has entered into or works under (or where the employment has ceased, worked under) a contract of employment.

'Contract of employment' is defined by s.230(2) ERA as 'a contract of service or apprenticeship, whether express or implied, and, (if it is express) whether oral or in writing. In s.230(3) workers are defined. The term includes employees (ie those working under a contract of employment) but also applies to 'an individual who has entered into or works under (or where the employment has ceased, worked under)

> (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 who 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.

While employees are defined by reference to the fact that they are employed under a contract *of* service, the self-employed have a contract *for* services.

For the purposes of employment protection, employees enjoy the greatest level of protection, self-employed the least; while, for the purposes of tax law, the opposite is the case – the self-employed enjoy the most favourable tax regimes, employees the least. However, this representation is over-simplistic and has changed in recent years. In particular, new tax rules have made it more difficult to enjoy self-employed tax status, while workers have enjoyed an increasing number of rights. This is partly to do with a policy choice by the Labour government and partly as a result of EC law. The key issue, then, is how to distinguish between these different statuses. This is not an easy task, as Mummery LJ noted in *Franks* v. *Reuters*:[1]

> Drawing a line between those who are employees (and so have statutory employment rights) and those who are not entitled to statutory employment protection has become more, rather than less difficult as work relations in and away from the workplace have become more complex and diverse.

2. Employees

2.1. Defining Employees

In *Express and Echo*[2] the Court of Appeal (Peter Gibson LJ) said that it was necessary to ask four questions to determine whether an individual was an employee:

1. Is there a contract?[3]
2. What are its terms?

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[1] [2003] IRLR 423, para. 18.

[2] [1999] IRLR 367.

[3] Here the standard requirements apply: there must be an intention to be legally bound, an agreement reached by the process of offer and acceptance, and some form of value ('consideration'), given by the employer to the worker in return for a service. On the importance of this, see *Hewlett Packard* v. *O'Murphy* [2002] IRLR 4.

3. Are there any terms inconsistent with it being a contract of employment?
4. Is it a contract of services or for services?

Questions three and four are the most pertinent to our enquiry. Question three raises the issue of delegation. If, as on the facts of *Express and Echo*, an individual can delegate to a third party the performance of the services then the contract will not be a contract of employment.[4]

Question four goes to the heart of the enquiry as to whether the contract is one of employment. Over the years, a number of tests have been developed by the courts to determine the answer to this question, tests which had already 'collapsed into a maze of casuistry' by 1951.[5] One test concerns control – that the servant agrees that in the performance of that service he will be subject to the other's control in a sufficient degree to make that other master.[6] While this formulation sounds rather anachronistic and so has been subject to certain modifications (reflecting the changing nature of control from 'how to' to 'what to'[7]) the use of the control test has by no means died out. As recently as 1995 the Court of Appeal suggested in *Lane* v. *Shire Roofing*[8] that the test to determine whether an individual was an employee was 'who lays down what is to be done, the way in which it is to be done, the means by which it is to be done and the time when it is done?.'

In other cases the courts have looked at the level of integration of the individual into the employer's business. For example, in *Stevenson, Jordan & Harrison Ltd* v. *Macdonald & Evans*[9] Denning LJ said that under a contract of service 'a man is employed as part of the business and his work is done as an integral part of the business; whereas under a contract for services his work, although done for the business, is not integrated into it, but is only an accessory to it.' The integration test places less emphasis on the personal 'subordination' of the employee and more upon the way in which the work is organised. However, the test may be of less use in situations where the boundaries of the organisation are diffuse or unclear, as in the case of sub-contract or agency labour.[10]

The courts have also examined the economic reality of the situation,[11] looking to see whether the provisions are consistent with it being a contract of service (eg does the employer have the power to select and dismiss, is the worker paid a wage or a lump sum, does s/he have to render exclusive service, or to work on the employer's premises; does the employer own the tools and the materials; does the employer bear the primary chance of profit or risk of loss; is the work an integral part of the business).[12] This approach shows the extent to which the courts will not just look at one single factor but instead take a multiple or 'pragmatic' approach, weighing up all the factors for and against a contract of employment and determining on which side the scales will settle.[13] This prompted some to suggest that the 'elephant test' applied to determining the question whether the contract was one of employment[14] – that judges knew a

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[4] Although cf *MacFarlane* v. *Glasgow City Council* [2001] IRLR 7 where more limited powers of delegation did not prevent the contract from being one of employment.

[5] O.Kahn-Freund, ''Servants and Independent Contractors' (1951) 14 MLR 504 considered in B.Hepple, 'Restructuring Employment Rights' (1986) 15 ILJ 69 who noted the artificiality of the control test once the managerial and technical functions are split.

[6] *Ready Mixed Concrete (South East) Ltd* v. *Minister of Pensions and naitonal Insurance* [1968] 2 QB 497, MacKenna J at p.515; *Nethermere (St.Neots) Ltd* v. *Gardiner* [1984] ICR 612, Stephenson LJ, p.623.

[7] See Viscount Simmonds in *Mersey Docks & Harbour Board* v. *Coggins & Griffiths Ltd* [1947] AC 1, 12.

[8] [1995] IRLR 493, 495 (Henry LJ).

[9] [1952] 1 TLR 101, 111.

[10] B.Burchell, S.Deakin, S.Honey, 'The Employment Status of Individuals in Non-Standard Employment', DTI, Employment Relations Research Series No.6, 1999, 5.

[11] This includes looking 'beyond and beneath' the documents to what the parties said and did, both at the time when they were engaged and subsequently, including evidence as to how the relationship had been understood by them: *Raymond Franks* v. *Reuters Limited* [2003] IRLR 423, para. 12 (Per Mummery LJ).

[12] *Ready Mixed Concrete (South East) Ltd* v. *Minister of Pensions and National Insurance* [1968] 2 QB 497; *Market Investigations* v. *Minister of Social Security* [1969] 2 QB 173; *Lee* v. *Cheung and Shun Shing Construction & Engineering* [1990] IRLR 236.

[13] I.Smith, *Industrial Law*, (London, Butterworths, 2003).

[14] B.Wedderburn, *The Worker and the Law* (3rd ed, Harmondsworth, Penguin,1986), 116.

contract of employment if they saw it.[15]

However, despite the evolution of a number of tests to be used to determine the existence of a contract of employment, in modern law one test seems to have taken precedence over all others, particularly in the context of atypical workers such as homeworkers,[16] agency workers,[17] zero-hours contract workers[18] and casual workers. This is the test of mutuality of obligation – only if such mutuality exists will the individual be an employee. The importance of this test was emphasised by the House of Lords in *Carmichael*.[19] Carmichael was employed as a tour guide at a power station, working on a 'casual as required basis.' She sought a written statement of the terms of her contract under s. ERA 1996. The employers resisted the complaint on the grounds that she was not an employee. The House of Lords had to consider whether she had a global contract spanning both the time she worked and the periods when she did not. The ET found that there was no global contract – that she was employed on a series of successive ad hoc contracts of service or for services and that when she was not working as a guide the employers were under no contractual obligation to the power station. The House of Lords agreed. Lord Irvine of Lairg (then Lord Chancellor) said that there was no obligation on the power station to provide casual work nor on Carmichael to undertake it. For this reason, there would be an absence of 'that irreducible minimum of mutual obligation necessary to create a contract of service.'

For a similar reason, in the earlier case of *O'Kelly*[20] the Employment Tribunal found that a 'regular casual' waiter at a hotel was not an employee and so could not claim protection from dismissal on the grounds of trade union membership. The tribunal listed nine factors which were consistent with the regular casuals being employed under a contract of employment (eg they provided their services in return for remuneration for work actually performed, they did not invest their own capital or stand to gain or lose from the commercial success of the business, they worked under the employer's discretion and control, wearing clothing provided by the employers, tax and national insurance payments were deducted at source). It then listed four factors which were not inconsistent with a contract of employment (eg they were not provided with a written statement of terms, there were o regular hours) and then five factors which were inconsistent with the relationship being that of an employer/employee (eg the engagement was terminable without notice on either side, the individuals were not obliged to accept work and the employers were not obliged to provide work and it was the practice of the industry that casual workers were engaged under a contract for services). Despite the fact that numerically the factors favouring a finding of a contract of employment outweighed those against, and despite the fact that if O'Kelly had turned down work without good reason he would have lost his status as a regular casual, the tribunal gave overriding weight to the absence of mutuality of obligation and so found that he was not an employee.

Decisions such as *Carmichael* and *O'Kelly* place casual workers in an invidious position. It cannot really be said that they are in business on their own account since they lack the relevant assets and so cannot enjoy the tax advantages connected with being self-employed. On the other hand, they are not employees who benefit from employment protection and social security benefits. They might be considered workers (see below) and so enjoy a certain number of benefits but they may not even satisfy that test.

Whichever test or combination of tests is used, tribunals are obliged to examine a number of factors to determine whether an individual is an employee. However, since determining whether an individual has a contract of service is said to be a question of mixed law and fact[21] this means

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[15] See, e.g. *Cassidy* v. *Ministry of Health* [1951] 2 KB 343, Somervell LJ.
[16] *Nethermere (St.Neots) Ltd* v. *Taverna and Gardiner* [1984] IRLR 240.
[17] *Wickens* v. *Champion Employment Agency* [1984] ICR 365.
[18] *Clark* v. *Oxforshire Heatlh Authority* [1998] IRLR 125.
[19] *Carmichael* v. *National Power* [2000] IRLR 43.
[20] *O'Kelly* v. *Trust House Forte Plc* [1983] IRLR 369. See also *Clark* v. *Oxfordshire Health Authority* [1998] IRLR 125; *Stevedoring & Haulage Services Ltd* v. *Fuller* [2001] IRLR 627 where, by contract, the employer stipulated that the worker was not entitled to regular employment.
[21] *Express and Echo*, above n.2, para. 23.

that an appeal to the EAT is possible only where the employment tribunal is wrong about the law (ie applied the wrong legal test) or reached a perverse decision on the facts (ie one which no reasonable tribunal could have arrived at).[22]

2.2. What rights do employees enjoy?

As indicated above, employees enjoy the greatest protection. In particular, they are protected against unfair dismissal, and they enjoy rights to maternity and family friendly policies (such as the right to request flexible working). A full list is attached as an appendix.

3. Workers

3.1. Defining Workers

Although workers are increasingly enjoying individual rights (see below), the definition of worker was originally of most interest in the context of defining the collective right to strike (ie the immunity of strike organisers in tort). Thus, s.296 TULR(C)A 1992 defines 'worker' in much the same way as s.230(3) ERA and an equivalent definition is found in the context of the Working Time Regulations 1998 and the National Minimum Wage Act 1998.[23]

As we have seen, the concept of worker includes employees but it also includes certain independent contractors who contract personally to supply their work to the employer.[24] Such individuals therefore have a relationship of dependence with the employer but without meeting the requirements of employee status. They have been referred to as the 'dependent self-employed,' a category which includes freelance workers, sole traders, home workers and casual workers.[25]

The definition of 'worker' was recently considered in *Byrne* v. *Baird*[26] which raised the question whether the subcontractor in the building industry was a worker for the purpose of claiming holiday pay under the Working Time Regulations. Mr Recorder Underhill QC recognised that the intention behind the regulation giving rights to workers was to create 'an intermediate class of protected worker, who is on the one hand not an employee but on the other hand cannot in some narrower sense be regarded as carrying on a business.'[27] He recognised that workers enjoy protection because of their subordinate and dependent position vis-à-vis their employers and for this reason the test for workers shared much in common with the test for employee, including control and mutuality of obligation but with a lower 'pass-mark' so that cases which failed to reach the mark necessary to qualify for protection as employees might nevertheless do so as workers.[28]

The position of those working for agencies is particularly uncertain. Given the lack of mutuality of obligation, it may be that they are not considered employees of the agency[29] but

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[22] *Edwards* v. *Bairstow* [1956] AC 14.

[23] In the guidance on the Working Time Regulations, a worker is described as someone who has a contract of employment or 'someone who is paid a regular salary or wage and works for an organisation, business or individual. Their employer normally provides the worker with work, controls when and how the work is done, supplies them with tools and other equipment, and pays tax and National Insurance contributions'. This is distinct from someone who runs his or her own business, is free to work for a number of different clients and customers and can profit from the sound management of his or her own business.

[24] Although cf The Transfer of Undertakings (Protection of Employment) Regulations 1981 provides that "employee" is "any individual who works for another person whether under a contract for service or apprenticeship or otherwise" but goes on to specifically provide that it does not include a person who "provides services under a contract for services". This unique coverage goes beyond the 1996 Act definition of 'employee', but not as far as the 'worker' definition in that Act.

[25] B.Burchell, S.Deakin, S.Honey, 'The Employment Status of Individuals in Non-Standard Employment', DTI, Employment relations Research Series No.6, 1999, 12.

[26] [2002] IRLR 96.

[27] Para. 17.

[28] Ibid.

[29] Although they might eventually become employees of the user undertaking if a contract of service between the individual and user could be implied: *Franks* v. *Reuters* [2003] IRLR 423, para. 33. Cf *Montgomery* v. *Johnson Underwood* [2001] IRLR 269 considered below.

legislation regards them as employees for the purposes of tax and national insurance law. The law has also expressly extended protection to agency workers in certain fields, such as the minimum wage, discrimination law, health and safety and working time.[30] In recognition of the need to protect such vulnerable workers, s.23 of the Employment Relations Act 1999 gave the government the power to extend the protection of employment rights to these individuals by secondary legislation,[31] a power that Buckley J urged the DTI to use in one such agency worker case, *Montgomery* v. *Johnson Underwood*[32] where the Court of Appeal found there to be insufficient control of the worker by the agency[33] (the alleged employer) for the agency worker to be employed by the agency (but insufficient mutuality of obligation to find that the user undertaking was the employer or that any contract existed between the worker and the user). The government has not yet used this power but has put the matter out for consultation.[34]

3.2. What rights do workers enjoy?

The principal rights enjoyed by workers are those under the National Minimum Wage legislation, the Working Time Regulations, the Public Interest Disclosure Act and the Part-time Work Regulation (see Annex 1).

4. The Self-Employed

Some legislation extends to the self-employed or independent contractor, as long as s/he is contracted personally to execute the work in question. For example, s.82 Sex Discrimination Act 1975[35] defines 'employment' as

> Employment under a contract of service or of apprenticeship or a contract personally to execute any work or labour…

The discrimination legislation also gives certain rights to applicants for employment as well as to 'contract workers.'

The health and safety legislation (s.53(1) HASAWA 1974) is principally concerned with the protection of 'employees' (a term interpreted by the Court of Appeal in *Lane* v. *Shire Roofing*[36] sufficiently broadly to include workers) but also imposes certain obligations on employers to the self-employed, defined more broadly than the SDA as an 'individual who works for gain or reward otherwise than under a contract of employment, whether or not he himself employs others.'

5. Tax and Social Security

In tax and social security law, the concept of employee determines (in part) which workers are liable to pay Class 1 national insurance contributions (SSCA, s.2) and Schedule E income tax. This raises the question whether the same tests should apply to the definition of employees

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[30] Most of these rights are enforced against the person who pays the individual.

[31] Section 23(4) states that an order under the section may:
a. provide that individuals are to be treated as parties to workers' contracts or contracts of employment;
b. make provision as to who are to be regarded as the employers of individuals;
c. make provision which has the effect of modifying the operation of any right as conferred on individuals by the order;
d. include such consequential, incidental or supplementary provisions as the Secretary of State thinks fit.
The power in Section 23 applies to any right conferred on an individual under the following legislation:
- The Trade Union and Labour Relations (Consolidation) Act 1992;
- The Employment Rights Act 1996;
- The Employment Relations Act 1999;
- Any instrument made under section 2(2) of the European Communities Act 1972;
- The Employment Act 2002.

[32] [2001] IRLR 269, para. 43.

[33] Although there might be sufficient control by the user undertaking: *Motorola Ltd* v. *Davidson*

[34] DTI, *Discussion Document on Employment Status in relation to Statutory Employment Rights*, URN 02/1058

[35] See also s.78(1) RRA 1976 and s.68(1) DDA 1995 and s.1(6)(a) EqPA 1970

[36] [1995] IRLR 493.

for worker protection and for taxation purposes. Some suggest that the answer is no because, for the purposes of taxation, it is in the public interest to define the term employee as broadly as possible whereas, in the case of employment protection since no third party is affected the courts should respect the parties definition of status. For this reason there have been statutory extensions of the definition of 'employee' to prevent evasion of social security and tax law[37] and generally the test for the existence of the contract of employment is more easily satisfied for tax and national insurance purposes. This may well have the effect of individuals finding themselves classified as employees for tax purposes and so getting none of the tax advantage but not employees for the purposes of employment legislation and so enjoy no employment protection.

6. Conclusions

As we have seen, today the determination of employment status principally regulates the extent to which an individual can enjoy employment protection, some social welfare benefits and which taxation regime applies to them. This also has consequences for employers. Once courts decide that an individual is an employee this means that employers are subject to certain legal liabilities. As Burchell et al point out, this is based on the view that the employer is better placed than the employee either to avoid the risk in question by taking steps to contain or neutralise it (the *least-cost avoider* rationale) or to spread the risk through insurance or pricing policies (the *best-insurer* rationale), possibly in conjunction with the state through the social insurance or taxation systems. In other words, when a tribunal decides on the employment status of a particular individual, it is in effect deciding where the burden of taking precautions against the risk of a certain type of loss should be allocated.[38]

[37] Eg agency workers: Social Security (Categorisation of Earners) Regs (SI 1978/1689; s.38 Finance (No.2) Act 1975. Labour-only subcontractors: ss.29-31 Finance Act 1971, ss.68-71 Finance (No.2) Act 1975; Finance Act 1980, sched 8

[38] B.Burchell, S.Deakin, S.Honey, 'The Employment Status of Individuals in Non-Standard Employment', DTI, Employment relations Research Series No.6, 1999, 6.