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COMMERCIAL LAW

ARTICLE: "Actual legal obligations" should be examined in sham contracts

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Introduction

Following on from our previous articles in this area http://www.davidsonlargelaw.com/downloads/jul09substitutionandsham.pdf and http://www.davidsonlargelaw.com/downloads/apr09employmentcontractsham.pdf, a new case has come before the Court of Appeal in relation to sham contracts. The Court – which had two of the same judges as the previous case of *Protectacoat v Szilagyi* – overturned the Employment Appeal Tribunal's judgment and held that the respondents in the appeal were employees, not self-employed contractors. The correct approach for a tribunal in such situations is to examine the actual legal obligations of the parties.

Facts

The respondents in the appeal were several individuals who worked as valets for Autoclenz. For the sake of simplicity, the Court examined evidence relating to one of the individuals only, Mr Huntingdon, as a representative of the whole. The valets had all signed the same document when starting work for Autoclenz in which they were described as self-employed sub-contractors. The Court examined the clauses of these contracts, which included an obligation on the individuals to perform the services within a reasonable time in a good and workmanlike manner. The valets had to provide their own cleaning materials, but could (and did) purchase them from Autoclenz at competitive rates.

In 2007, Autoclenz required the valets to sign new contracts which, Autoclenz stated, did not alter any terms or conditions but only clarified certain matters. There were two contractual documents – one with terms and conditions, and one which was to be signed by the valets to accept these terms. In this latter document was a new term which stated that the valets could send a substitute to do their work if the substitute complied with Autoclenz's requirements.

The decision of the employment tribunal (ET) and the EAT

The ET judge considered all documents, noting that there had been no negotiation in relation to these terms, they had simply been imposed by Autoclenz on the valets. During the hearing Mr Hassall, the manager of the Measham depot of Autoclenz, gave evidence. Several of his comments were relied upon by the ET judge in reaching his decision:

- Mr Hassall stated that any valet who had refused to sign the new contracts in 2007 would not have been offered further work.

- Mr Hassall explained that any valet who could not turn up for work was required to notify him in advance. A day's notice if Autoclenz was not busy, seven days if they were.

- Mr Hassell confirmed that Autoclenz could not do the work required for British Car

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Auctions (their only client) if there was not an understanding that the valets could be relied upon to turn up everyday and do the work put before them.

The ET judge concluded that valets were employees because:

- They could not be considered businessmen working on their own account
- They had no real control over their hours
- When at work, they were subject to the direction and control of Autoclenz's employees
- They had no real say in their terms
- They had no real economic interest in the undertaking
- They could not source materials for themselves
- Rates of pay were determined and could be altered unilaterally by Autoclenz, and deductions to pay were made by Autoclenz.

He added that, if he was wrong in such a decision, he would have no hesitation in concluding that the valets were workers rather than employees, which would still entitle them to holiday pay.

The ET judge was satisfied that the valets were required to provide personal service to Autoclenz and the substitution clause that was added in 2007 did not reflect what was agreed between the parties – namely that the valets would show up each day to work and Autoclenz would offer them work if it was available. A clause in the 2007 contracts stating that the valets "will not be obliged to provide your services on any particular occasion nor… does Autoclenz undertake any such obligation to engage your services on any particular occasion" was a sham.

Autoclenz then appealed, arguing that the ET judge's findings were inconsistent or perverse. However, the EAT took on only one point, namely that the ET judge had relied on guidance from a particular previous case which had subsequently been overruled. The EAT approached the question of whether the contract was a sham by looking at the intentions of the parties and whether such terms were intended to mislead someone.

On this basis, the EAT found that there was no intention by the parties to mislead any third party, and the valets were held not to be employees. Instead, the EAT found that the valets were workers. Both parties appealed – Autoclenz arguing that the valets were not workers and that the contracts reflected the true relationship, while the valets argued that they were employees.

The Court of Appeal decision

The Court first considered the issue of mutuality of obligation. It restated various findings, such as the need for valets to give notice if they could not attend work and the fact that Autoclenz would be unable to fill its contractual undertaking to its only client, BCA, if it could not rely on the valets to turn up everyday. The Court held that these facts pointed to the conclusion that the valets were under an obligation to turn up for work unless a prior agreement had been reached, and so mutuality existed.

The Court then progressed to the issue of how to decide whether a clause is a sham. Lady Justice Smith, who gave the leading judgment, summarised and clarified her previous judgment in *Szilagyi*. A Tribunal should consider whether the words of the contract reflect the true intentions or expectations of the parties, not only at the beginning of the contract but also as time passes. The Tribunal should also consider whether it is evident that the

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agreement has been expressly or impliedly varied.

LJ Smith held that the "actual legal obligations" of the parties should be ascertained by examining all the relevant evidence. Such evidence would include not only the written term itself, but also how the parties conducted themselves. However, she warned that "the mere fact that the parties conducted themselves in a particular way does not of itself mean that the conduct accurately reflects the legal rights and obligations". In essence – just because a right is not exercised, does not mean that it is a sham.

With this reasoning, the court held that valets were under a contractual obligation to turn up for work, despite a written clause stating that no such obligation existed. The Court had more difficulty with the substitution clause since the Employment Judge's reasoning here got confused. Given that Mr Huntingdon had stated that he was unaware of his right to send a substitute (since he had signed the contract without reading the documentation), the court looked to what happened in practice. Autoclenz's argument that the right had always existed and had merely been "clarified" when it was included in the new contracts in 2007 was rejected. The Court instead gave weight to the evidence that, despite having worked for Autoclenz for over 17 years, Mr Huntingdon said he was unaware of such a right as well as the fact that Mr Hassall could not provide a single example of when a substitution had occurred. The court held that the substitution clause was also a sham.

Conclusions
It is clear from this case that where a contract exists, it will be the first port of call for a Tribunal. However, the Tribunal will not take the express terms at face value, but will also consider all relevant evidence to ensure that the document reflects the "actual legal obligations" of the parties. The fact that a contractual right has not been exercised will not automatically render it a sham term, but it will depend on the circumstances. Employers who have or are considering entering into contracts with sub-contractors would be wise to consider the context of the relationship as well as the terms of the contract to ensure that the relationship does not run the risk of being classified as an employment relationship or a worker relationship.

If you would like further information on this case and its impact on your workplace, please contact David Hill at dhill@davidsonlarge.com or Lucy Bond at lbond@davidsonlarge.com.

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