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COMMERCIAL LAW

ARTICLE: Substitution clauses and sham contracts

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Introduction

Readers of our bulletin will recall our article on sham contracts and intentions to mislead third parties: (http://www.davidsonlargelaw.com/downloads/apr09employmentcontractsham.pdf)

A new case in the Employment Appeal Tribunal has considered the effect of substitution clauses on an individual's status as a worker, and whether such clauses could be shams designed to deprive employees of protection from dismissal.

The facts

Mr MacGettigan worked for Archer-Hoblin Contractors Limited from 15 October 2007 for five months as a steel fixer. The contract governing Mr MacGettigan's relationship with Archer-Hoblin stated that he was providing services to the company as a self-employed contractor who would not receive sick or holiday pay, and would not be subject to the grievance procedure.

In addition, there was a substitution clause which allowed him to: "send someone with similar experience and qualification in your place. You will be paid for the work they do and must then arrange to pay the substitute yourself. You must notify the Contractor of the substitute for security and Health and Safety purposes."

The decision of the tribunal and the EAT

The tribunal judge held that Mr MacGettigan was a worker within the definition of the Working Time Regulations 1998 and so could claim holiday pay. In reaching this conclusion, the tribunal judge took into account the fact that Mr MacGettigan had not delegated his work during the five months, as well as Mr MacGettigan's evidence that he felt that, if he had sent a substitute, he would have lost his job. Archer-Hoblin appealed, citing the example of another of their self-employed contractors who had exercised his right of substitution without suffering detriment.

The EAT held that the tribunal judge had erred in his findings. The EAT considered the factors to be taken into account when examining substitution clauses. They also restated the principle that the existence of a limited power of delegation is not necessarily inconsistent with the existence of a contract of employment.

The EAT drew helpful examples from previous case law to demonstrate the difference between an unqualified and a qualified right of delegation. An unqualified right to delegate might allow the contractor to choose whomever they like as a substitute, so long as they notify the company in advance and ensure that their substitute is at least as qualified as they are. In contrast, a qualified right might leave the contractor no choice in their substitute, possibly requiring them to choose a substitute from a pre-approved register. In addition, the substitute might be paid directly by the company rather than the contractor, and the company might even be able to organise a substitute without involving the contractor at all.

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The EAT held that there were two stages of analysis needed in a substitution clause case. Firstly, deciding whether the clause is of a limited or unlimited nature, which is a matter of construction. Secondly, whether the clause is a sham or genuinely reflects the intention of the parties, which requires examination of what occurred in practice. The EAT held that the tribunal judge had erred since, when considering the nature of the clause itself, he took into account both Mr MacGettigan's thoughts and whether the right had been exercised. These factors should have been considered only at the second stage of analysis, when deciding whether the clause was a sham – not at the first stage, when deciding whether the right was qualified or unqualified.

The EAT held that Mr MacGettigan had an unqualified right to substitution and so he could not be considered a "worker", unless the clause was shown to be a sham. The case was remitted to a different tribunal for consideration.

Conclusion
At a time when employers will be looking to reduce their workforce as a means of cutting costs, it is imperative that employees and workers (who have employment rights such as the right to holiday pay and, in the case of employees, protection from unfair dismissal) can be clearly distinguished from genuinely self-employed contractors (who do not have such protection).

Any substitution clauses should be considered carefully to decide whether they afford an unqualified or qualified right of substitution; if the latter, then it is possible the individual could be found to be worker. In either case, the clause will fail if it cannot be shown to reflect the intentions of the parties or the reality of the situation. In essence: did the parties ever intend that such a clause could be exercised, or was it merely included in the contract as a means of depriving the individual of employment protection?

This case comes hot on the heels of another case where the EAT considered the documentation between a hospital and a theatre porter before comparing it to the reality of the situation to decide whether the porter was an employee or self-employed. To read about this case, please see our article at:
http://www.davidsonlargelaw.com/downloads/jul09casualworkers.pdf

If you would like to discuss this case and how it might impact on your business, please contact David Hill at dhill@davidsonlarge.com or Lucy Bond at lbond@davidsonlarge.com.

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