

Appeal No. UKEAT/0644/06/MAA
UKEAT/0367/06/MAA

EMPLOYMENT APPEAL TRIBUNAL
58 VICTORIA EMBANKMENT, LONDON EC4Y 0DS

At the Tribunal
On 19 June 2007
Judgment handed down 25 July 2007

Before

THE HONOURABLE MR JUSTICE ELIAS (PRESIDENT)

MRS J M MATTHIAS

MR D NORMAN

ENFIELD TECHNICAL SERVICES LTD

APPELLANT

MR R PAYNE

RESPONDENT

MR IAN GRACE

APPELLANT

BF COMPONENTS LTD

RESPONDENT

Transcript of Proceedings

JUDGMENT

APPEARANCES

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SUMMARY

Unfair dismissal – Exclusions including worker/jurisdiction

These two appeals consider the circumstances in which contracts will be considered illegal so as to preclude an employee from taking claims for unfair dismissal. In **Payne** the Employment Tribunal found that there was no illegal contract; in **Grace** that there was. The EAT upheld the **Payne** decision and overturned the **Grace** decision.

In **Grace** the issue also arose as to whether the Tribunal was entitled to conclude that the circumstances were too speculative for it to make any assessment whether dismissal would have occurred in any event. The EAT held that in the light of recent cases such as **Scope v Thornett** [2007] IRLR 155 and **Software 2000 Limited v Andrews & Ors** 2 UKEAT/0533/06, it was not.

THE HONOURABLE MR JUSTICE ELIAS (PRESIDENT)

1. We have heard two appeals together because each raises the question of how the doctrine of illegality falls to be applied in two separate unfair dismissal cases. We first set out the facts of the two cases, together with the material conclusions of the Tribunal. We then consider the law. Finally we apply the law to the circumstances of the case.

PAYNE v ENFIELD TECHNICAL SERVICES

2. In the second case, Mr Payne alleged that he had been unfairly dismissed by his employers, Enfield Technical Services Ltd, on 13 March 2006. The employers contended that he was not an employee. Alternatively, they submitted that if he was an employee then he was working under an illegal contract because both parties were representing to the tax authorities that he was self-employed.

3. The background facts on which the employers relied are these. Mr Payne was offered employment for a probationary period as a catering equipment engineer. He had expressed an interest in working as a subcontractor. The employers said that they would consider this but would require an undertaking from him that he would work exclusively for them. Subsequently the parties agreed what was termed a sub-contractors contract which contained that undertaking. The Inland Revenue were making enquiries as to Mr Payne's status for tax purposes. It was beneficial to Mr Payne to be treated as someone employed under a contract for services rather than being an employee. In September 2004 the Revenue expressed the view that whilst the matter was not clear cut, they were prepared to accept Mr Payne's status as one of self employment i.e employment under a contract for services.

4. The Tribunal concluded that Mr Payne was an employee, and that finding is not challenged. They then considered and decisively rejected the illegality argument in the following

uncompromising terms (paras 13-16):

“...It is clear that it was not an illegal contract, nor tainted with illegality. The fact is that the Claimant at the onset of the engagement made a choice that he would prefer to be treated as self employed. Arguments could be raised in support of self employment status or employment status and generally the matter is never cut and dried but must depend upon various characteristics and background details. Indeed the Inland Revenue said that it was a finely balanced matter (D28). In the Tribunal’s view, just because a document had been prepared by the Respondent (D23-24) and signed by the Claimant purporting to support the case for self employment, does not render the contract illegal.

The dividing line between self employment and employment status can often be blurred and in the Tribunal’s experience it is a regular occurrence that the Inland Revenue will scrutinise arrangements of purported self employment status to see whether it falls on that line or on the line of employment status. In the event, facts generated by the Respondent and signed by the Claimant were put before the Revenue arguing that the reality was self-employment.

The Tribunal finds that there is nothing inherently illegal regarding the contract. The parties were arguing that the factual situation should be interpreted as one of self-employment as opposed to employment status. Furthermore, the parties were complying with Inland revenue guidelines at the time that if somebody is self-employed, tax would be deducted at source at 18% and there was a CIS certificate in place.

In the Tribunal’s view the Respondent in pursuing this rather vestigial argument of illegality were motivated by the unfairness, as they see it, of the Claimant having his cake and eating it, by urging upon the Respondents at the inception of his arrangement a self employed position and then when the engagement ceased and it suited him, to change his stance to maintaining he was an employee. The situation in the Tribunal’s view comes nowhere near the circumstances where the contract could be determined to be illegal.”

GRACE v BF COMPONENTS LTD

5. In the **Grace v BF Components** case, this is the second time there has been an appeal to this court. The background briefly is this.

6. Mr Grace took proceedings for unfair dismissal against his employers. He had been working for them from June 2002 until January 2004 when his contract was terminated. There were a number of issues which the Employment Tribunal had to determine.

7. There was an issue as to whether he had been employed by the same employer throughout and

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had the requisite period of continuous employment. The principal argument about continuity was the submission that he was self employed until September 2003 and could not count that first period to establish the necessary twelve months' continuous employment.

8. There was the dispute as to why he had been dismissed, and whether it was for redundancy or for some different reason. There were issues as to whether the procedures had been properly complied with and, if not, whether he would have been dismissed in any event. (The relevance of this last point, referred to below as the **Polkey** point, was solely to the issue of any compensation that might be payable. Section 98A(2) of the **Employment Rights Act** 1996 which renders certain dismissals fair where procedural defects have made no difference to the outcome was not in force at the material time.)

9. The Tribunal concluded that Mr Grace had been employed by the same organisation throughout and that he had the requisite continuity of employment. They held that he was dismissed by reason of redundancy, but that there had been a failure to comply with appropriate procedures, in particular a complete lack of consultation. Had there been such consultation, the Tribunal estimated that Mr Grace would only have been retained in employment for a further four weeks before being dismissed. Compensation would have had to be assessed accordingly.

10. On appeal to the Employment Appeal Tribunal, Mr Grace contended that the Tribunal had failed adequately to analyse the issue of whether his dismissal was by reason of redundancy or not, and that they had reached an unsustainable conclusion with respect to the decision that dismissal would have occurred in three weeks in any event.

11. The employers cross appealed and contended that the claim ought to have failed on the ground that the Tribunal did not address an issue that was orally argued before them, namely the question of illegality. That point arose in this way. The dismissal was in January 2004 and it was therefore

necessary for the employee to establish continuity back to January 2003. However, Mr Grace had ostensibly been employed on a self-employed basis until September 2003. After that date it was common ground that both parties had represented that he had been engaged under a contract of employment. The Tribunal found that in the period before September, although the parties represented his position to the Revenue as being that of a self-employed person, in fact he was at all times an employee working under a contract of employment.

12. The employers do not challenge that finding. However, they submit that it necessarily follows that since he had knowledge of the arrangement and was actively participating in it, the Tribunal ought to have concluded that in the period leading up to September 2003, he was engaged in an illegal contract. Since it was an illegal contract, it could not be relied upon for the purpose of establishing continuity of employment. Therefore, since continuity only ran from September 2003 there was no jurisdiction for the Tribunal to hear the unfair dismissal claim.

13. The Employment Appeal Tribunal (HHJ Ansell presiding) upheld the appeal with respect to the issues of redundancy and **Polkey**. They also upheld the cross appeal, concluding that the issue of illegality had been raised and had not been determined when it ought to have been. The Employment Appeal Tribunal were urged by Mr Pilgerstorfer, Counsel for the employers, to determine the illegality point themselves on the basis that there was sufficient material to do that. However, the EAT decided that in the circumstances the appropriate step was to remit each of these issues to a fresh tribunal. Of course, the illegality issue was crucial because, if correct, it rendered the other issues irrelevant.

The Tribunal's finding on illegality

14. The Tribunal on the second occasion had to make the determination of whether there was an illegal contract on the basis of the evidence before the first Tribunal. The first Tribunal had found

that from the beginning of the relationship in June 2002 Mr Grace had submitted his invoices for gross pay and had paid his own tax and national insurance. The company suggested that he should invoice them in that way. He did not receive sickness or holiday pay but he attended the office regularly and devoted himself wholly to the work of the employers.

15. Some ten weeks after commencing employment the company asked him to go onto a salaried basis but he rejected that because he did not think he could earn enough to live on. Then in August 2003 the employers told him that he would be regarded as an employee by the Revenue and that they were going to put him “on the books”.

16. He sent an email reply in which he complained that the pay was too little to support him and his family; and that whilst he wanted to remain in employment he would prefer to remain self employed. However, the company insisted on his accepting a contract of employment, saying that this is how he would be regarded by the Revenue and they were therefore responsible for his tax and national insurance. They threatened to dismiss him unless he accepted the new contract and he reluctantly did so with effect from the 15 September 2003.

17. On the basis of these facts the first Tribunal found that he was an employee throughout his period of employment. The question, however, which they did not address and which the second tribunal had to consider was whether the contract was illegal until put on a proper footing.

18. Mr Pilgerstorfer submitted that there was plainly knowledge and participation in an arrangement that meant that payment of tax was delayed. The parties had represented that Mr Grace was employed when in fact he was not. He cited numerous authorities, some of which we consider later in this judgment, in support of the proposition that it was an illegal contract.

19. The Employment Tribunal agreed. They found that there was not sufficient participation in the

arrangements in the first ten weeks before he had been offered a contract of employment because the arrangement was at the behest of the employer. However, there was thereafter. He had opted to retain his self-employed status when given the option to enter into a contract of employment. He plainly had knowledge of the relevant facts.

20. They went on to hold that even if they were wrong about that, he became fully aware by August 2003 that the employers were liable to deduct tax and national insurance. Notwithstanding that, he still insisted on being treated as self employed for a further three weeks until reluctantly accepting employment status. That period of illegal performance would of itself break the continuity and defeat his claim for unfair dismissal.

21. Accordingly, in this case it is the employee challenging the finding that there was an illegal contract; in **Payne** it is the employer appealing the finding that there was not.

The remaining matters.

22. The Tribunal went on to make further findings in the event that their conclusion on illegality was wrong. They concluded that the dismissal was indeed genuinely due to redundancy as the first Tribunal had found. They were not given the authority to re-open the question of whether or not there had been a failure to comply with procedures.

23. They considered what would have happened, had proper procedures been followed. They concluded that there had been a failure to warn or consult, and that the procedural defect was “so fundamental that it makes it impossible to say that the failure made no difference or that we can sensibly reconstruct the world as it might have been”. Accordingly they made no reduction under the **Polkey** principle.

The issues on appeal.

24. The Tribunal's decision has been appealed by both parties. Mr Grace has appealed the finding of illegality, and he appeared in person before us. He submits that the Tribunal wrongly applied the tests of knowledge and participation.

25. The employers were given leave after a preliminary hearing to seek leave to argue in their cross appeal that the Tribunal's conclusion with respect to the **Polkey** aspect of the decision were wrong in law. They contend that the Tribunal misdirected itself in concluding that it could not speculate as to what might have happened had consultation occurred. We granted leave for the point to be pursued. We will leave that issue until the end of this judgment because it is a separate 'stand alone' question.

The Law

26. The basic propositions of law are not in dispute.

(1) There is a common law doctrine of illegality which can defeat claims in contract or tort. The underlying principle was identified by Lord Mansfield in **Holman v. Johnson** (1775)1Cowp.341:

“The objection, that a contract is immoral or illegal as between plaintiff and defendant, sounds at all times very ill in the mouth of the defendant. It is not for his sake, however, that the objection is ever allowed; but it is founded in general principles of policy, which the defendant has the advantage of, contrary to the real justice, as between him and the plaintiff, by accident, if I may so say. The principle of public policy is this; *ex dolo malo non oritur actio*. No court will lend its aid to a man who founds his cause of action upon an immoral or an illegal act. If, from the plaintiff's own stating or otherwise, the cause of action appears to arise *ex turpi causa*, or the transgression of a positive law of this country, there the court says he has no right to be assisted. It is upon that ground the court goes; not for the sake of the defendant, but because they will not lend their aid to such a plaintiff. So if the plaintiff and defendant were to change sides, and the defendant was to bring his action against the plaintiff, the latter would then have the advantage of it; for where both are equally in fault, *potior est conditio defendentis*.

The question therefore is, whether, in this case, the plaintiff's demand is

founded upon the ground of any immoral act or contract, or upon the ground of his being guilty of any thing which is prohibited by a positive law of this country.”

(2) As Lord Mansfield made clear, the doctrine is rooted in public policy. As such it can work harshly on the parties in particular cases, as Lord Goff noted in Tinsley v Milligan [1994]1A.C.340,

“the principle is not a principle of justice; it is a principle of policy whose application is indiscriminate and so can lead to unfair consequences as between the parties to litigation. Moreover, the principle allows no room for the exercise of any discretion by the court in favour of one party or the other.”

- 3) There are three categories of case where a contract may be tainted with illegality. These were identified by Lord Justice Peter Gibson in his seminal judgment in Hall v Woolston Leisure Services Ltd [2000] IRLR 578 (paras 30-31). The first is where the contract is entered into with the intention of committing an illegal act. The second is where the contract is expressly or impliedly prohibited by statute. The third- and the category relevant to these two appeals- is where the contract was lawful when made but has been illegally performed, and the party seeking the assistance of the court knowingly participated in the illegal performance.
- 4) In order to fall within this third category, it is traditionally said that there are two requirements. There must be knowledge of the illegal performance and participation: see the observations of Gibson LJ in the Hall case, para 31, referring to passages from the judgments of Lord Denning MR and Scarman LJ, as he then was, in Ashmore Benson Ltd v Dawson Ltd. [1973] 1 WLR 828.
- 5) Implicit in the analysis of Gibson LJ is of course a third requirement, namely that the performance must be illegal. It must be a form of illegality which properly attracts the

operation of the doctrine.

- 6) The concept of knowledge requires that the employee must have knowledge of the facts which renders the performance illegal: Gibson LJ in Hall para 38. However, it is irrelevant whether the party appreciates that what he is doing is illegal. Ignorance of the law is no excuse. This has been reiterated on many occasions: see e.g. **Miller v Karlinski** (1945) 62 TLR 85(CA); **Salvesen v Simons** [1994] IRLR 52.
- 7) The concept of participation on requires some active participation. There are cases in which the courts have held that mere knowledge of the illegality coupled with a failure to do anything about it can constitute participation: see e.g. **Newland v Willer (Hairdressers) Ltd.** [1981] IRLR 359 where an employee who became aware that her employers were deceiving the Revenue was held to be a participant in the scheme and therefore unable to claim unfair dismissal. However, in the **Hall** case the facts were similar. Mrs Hall asked to receive her pay gross but it came to her attention that her employers were deceiving the Revenue and not paying the appropriate tax. The Court of Appeal held that the Employment Tribunal was wrong to find that this was sufficient to render the contract an illegal one. There was no illegality by Mrs Hall. Peter Gibson LJ said this (para 47):

“Her acquiescence in the employer’s conduct, which is the highest her involvement in the illegality can be put, no doubt reflects the reality that she could not compel her employer to change its conduct.”

Lord Justice Mance, as he was, similarly held that there was no participation arising from the fact that she had turned a blind eye to the fraud on the Revenue, from which she did not benefit. He referred expressly to the **Newland** decision and said that he had doubts “about both the reasoning and the outcome of it”. (para 80).

- 8) In the context of unfair dismissal claims, it is now settled law that if the underlying contract of employment is illegal then it is against public policy to allow the claim to

be pursued: **Tomlinson v Dick Evans U Drive Ltd.** [1978] IRLR 77 (EAT) applied in **Davidson v Pillay** [1979] IRLR 275, both of which were cited with approval by Gibson LJ in the **Hall** case. Moreover, the employee cannot count any period during which he was employed under an illegal contract as part of his period of continuous employment for the purpose of obtaining the requisite continuity to pursue a claim: see **Hyland v J. H.Barker (North West) Ltd.**[1985] ICR 861 where continuity was broken by a four week period during which the employee received a tax free benefit which both parties knew to be illegal.

- 9) Whether there is knowledge or participation is a matter of fact for the Tribunal. Absent a misdirection or perverse decision, the Employment Appeal Tribunal cannot interfere.

Authorities on illegality.

27. We were referred to an extensive number of authorities in an impressive and very detailed skeleton argument provided by Mr Pilgerstorfer. We here focus on the circumstances in which the conduct has been found to be illegal. Most of the cases involve some form of fraud on the Revenue. No doubt this is both because it is the most likely form of illegality which will occur in practice in the employment context, and because the wrongdoing is continuous. (The occasional act of immoral or illegal behaviour during the performance of the contract may not be sufficient to render the whole contract illegal: see e.g. **Coral Leisure Group Ltd v Barnett** [1981] IRLR 204 (EAT).)

27.In the **Hall** case the employee was promoted to head chef and asked that her salary be increased to £250.00 per week net of deductions. She was paid that but her pay slips accompanying her pay showed that deductions had been made. She queried this with her

employers and was told “it’s the way we do business”. The Tribunal found that the contract was tainted with illegality but the Employment Appeal Tribunal disagreed. As we have indicated, they considered that her acquiescence did not amount to participation. She had done nothing unlawful herself and received no benefit from the employers’ failure to deduct tax. The court recognised that the position might be otherwise if she had failed to declare her tax but even then Lord Justice Mance expressed the view (para 80) and indicated he would need some persuading that her non-compliance with the duty to pay tax could render the contract of employment itself illegal.

28. In **Hall** the court referred without disapproval to another case on which Mr Pilgerstorfer strongly relies, **Salveson v Simons**. Mr Simons was employed as an estate manager. He was paid an annual salary and he asked that it be paid in two parts, £10,000.00 paid monthly to him and £2,200.00 payable to a partnership which he operated with his wife. The advantage of the arrangement was that payment of tax due on that proportion of the remuneration that was paid to the partnership could be deferred and there were certain legitimate business expenses which could be offset against that money.

29. The Tribunal accepted that none of the parties knew or believed or even suspected that what they were doing was wrong. In these circumstances they held that it was not an illegal contract but the Employment Appeal Tribunal (Lord Coulsfield presiding) allowed the appeal. Lord Coulsfield noted that there were three cases which involved a fraud on the Revenue on what he termed “a direct and immediate sense” (para 13). These were **Miller v Karlinski**, to which we have made reference, **Napier v National Business Agency Ltd** [1951] 2 All ER 264, and **Corby v Morrison t/a The Card Shop** [1980] IRLR 218

30. In **Miller** the plaintiff received his remuneration partly by way of salary and partly on what was termed ‘travelling expenses’. This misrepresented to the Revenue the true nature of the payments and resulted in a shortfall in the tax properly payable.

31. In **Napier** the contract provided for a salary of £13.00 per week with £6.00 for expenses. The judge found that this was a ruse and that the figure of £6.00 was a sham which bore no relation to the expenses actually incurred. Accordingly, it was an illegal contract and could not be sued upon.

32. **Corby** was a case in which the employee received a basic wage fixed by a Wages Council Order and a sum of £5.00 paid gross. That was not declared on the wage packet as both parties knew, and this was held to be an illegal contract by the Employment Appeal Tribunal, May J presiding.

33. May J also decided **Newland v Willer (Hairdressers)** to which we have already made reference, in which the employee received no benefit from the arrangement but was held to be a party to an illegal contract because of knowledge and acquiescence. As we have noted, there is considerable doubt as to whether the Employment Appeal Tribunal in that case was correct in finding that there was the requisite participation. That case too, however, involved the employers in misrepresenting the remuneration they were in fact paying Mrs Newland.

34. Finally, the judge referred also to **Hewcastle Catering Ltd v Ahmed & Anor** [1991] IRLR 473. In that case the employers devised a scheme whereby they would evade VAT on services provided to customers who paid their bills by cash. Waiters were instructed to inform the manager if the customer wished to pay in that way and the manager would arrange for the issue of a different type of bill. This was an attempt to circumvent the payment of VAT. Customs & Excise officers investigated the matter and two of the managers were charged with criminal offences.

35. Four of the waiters appeared to give evidence at the committal proceedings and they were

dismissed. They sued for unfair dismissal and were successful. The employers appealed on the basis that the Tribunal ought to have found that it was an illegal contract, but the Employment Appeal Tribunal dismissed the appeal and the Court of Appeal dismissed a further appeal from the decision of the Employment Appeal Tribunal.

36. Beldam LJ, with whose judgment Balcombe and Neill LJ agreed, pointed out that the obligation to make the VAT returns was imposed on the employer; that there was no benefit to the employees from the arrangement; that they were not employed specifically to participate in a fraud on the Customs & Excise Commissioners; and that it might discourage disclosure of wrongdoing if employees were to be found to be party to an illegal contract in circumstances such as this. In addition, their role in the operation of the scheme was very limited.

37. The most recent decision is that of Underhill J in **Ms L Damond v The Enterprise South Devon** UKEAT/005/07. That case was in many ways similar to the **Salvesen** case. Ms Damond was employed initially for one day a week as a “director in charge” of a company. It became clear, however, that she would be required full time and she began to work five days a week. Initially, she was given the option of being paid either as an employee through the payroll or through one of her companies and she chose the latter option. That arrangement continued from mid-January to mid-April 2005.

38. She was dismissed in January 2006 and commenced proceedings for unfair dismissal and damages for wrongful dismissal. The employers took the point that the arrangement up until 2005 was illegal being a fraud on the Revenue. Accordingly, it could not be taken into account for the purposes of assessing qualified service. On that basis she did not have sufficient continuity of employment.

39. The Employment Tribunal found that the contract was illegal during the period when the

remuneration was paid to the company and upheld the employers' contention. An appeal to the Employment Appeal Tribunal failed. Mr Justice Underhill described the effect of the Salvesen case as follows (para 12):

“What therefore *Salvesen* decides is that where an employee has made a positive choice to operate arrangements which have the effect of depriving the Revenue of payment to which it is entitled, contracts giving effect to those arrangements will be unenforceable notwithstanding that the employee may genuinely have believed them to be lawful. The position might be different where the initiative came from the employer; but those are not the facts in that case.”

40. In this case Underhill J concluded that even though the possibility of providing services under the illegal arrangement had come from the employer, the employee was an experienced business woman who had exercised the choice to take advantage of that method of payment. He considered that Salvesen was really determinative of the case and that there was nothing in any of the subsequent cases to which he was referred, including the Hall case, which cast doubt on the correctness of that decision.

41. Applying the knowledge, plus participation test, as established by the authorities, he held that Ms Damond had knowledge of the arrangement and was actively participating in it. Accordingly, she was barred from pursuing her claim for unfair dismissal. (She could pursue the notice pay claim because that was dependent upon the status of her contract when it terminated, and by then the arrangement had been made lawful).

Discussion.

42. In our judgment the essential feature of all the cases where there has been found to be illegality is that the parties have knowingly entered into arrangements which have to their knowledge represented the facts of the employment relationship to be other than that they really were.

43. In **Salvesen** and **Daymond**, the parties were representing that services had been provided by a partnership or company when in fact that was false. In **Miller** and **Napier** they were representing that certain payments were for expenses when that was patently not the case; in **Corby** the employee was involved in the more traditional deception of receiving a sum under the counter.

44. The cases of **Tomlinson v Dick Evans “U” Drive** and **Davidson v Pillay** were of a similar kind. They were representing that the remuneration received was less than it really was. All these cases can properly be described as a fraud on the Revenue, even although in some cases the parties themselves did not appreciate that what they were doing was illegal. The parties were concealing either the true nature of the relationship or the payments being made pursuant to it.

45. In none of these cases has the contract been held to be illegal merely as a consequence of the fact that the parties in good faith and without misrepresentation wrongly characterised their relationship with the result that the wrong tax regime was adopted. That is a relatively common occurrence. Tribunals frequently have to determine whether someone ostensibly employed under a contract for services has in fact been subject to a contract of service. Such cases typically involve the employee resiling from the arrangement he originally made.

46. However, that is not of itself contrary to public policy, as the Court of Appeal confirmed in the case of **Young and Woods v West** [1980] IRLR 201. Ackner LJ summarised the reason as follows (para 32):

“It is suggested, again by Mr Clifford, that it would be contrary to public policy to allow him to resile from his agreement. That, of course, was the basis of the dissenting judgment of Lord Justice Lawton in the Ferguson [1976] IRLR 346 case and, as it was the dissenting judgment, I need not, respectfully, refer to it again, save only to say this. Public policy is a dangerous argument to mount in this type of case where it just happens that the merits are on the side of the appellant. As the majority judgment of the Employment Appeal Tribunal pointed out:

‘... individual labelling of the relationship would strike at the root of the protection afforded to an employed person by the Employment Protection legislation.’

It would not only strike at that protection, but also at the protection afforded by other acts such as the Factory Acts and other analogous legislation.”

48. Moreover, it is noteworthy that in that case a distinguished Court of Appeal (Lord Denning MR, Ackner and Cairns LJJ) did not address the issue of illegality at all. It is true that it was not apparently raised before them, but one might have expected the Court to take the point of its own motion if the illegality was plain from the arrangements before them.

49. Mr Pilgerstorfer in this case has laid emphasis on the observations of Underhill J in para.12 of the **Damond** case (reproduced above at para. 40). We respectfully agree with the decision in that case, and the observations should be read in the context of the particular facts. However, read on their own, we respectfully disagree with the width of those remarks. We do not consider that the authorities, or **Salvesen**, support the proposition that if the arrangements *have the effect* of depriving the Revenue of tax to which they were in law entitled then this renders the contract unlawful. For reasons we have given, in our judgment there must be some form of misrepresentation, some attempt to conceal the true facts of the relationship, before the contract is rendered illegal for the purposes of a doctrine rooted in public policy.

Applying the law to each of these cases.

Payne v Enfield

47. Mr Pilgerstorfer submitted that there was no doubt whatsoever that the employee was participating with knowledge in the illegal contract. Mr Roberts, counsel for Mr Payne, did not seek to deny that there was knowledge and participation. His submission that the Tribunal was entitled to find that the contract was not illegal.

48. We agree. In this case there was no misrepresentation of any kind. The Revenue were told

about the nature of the relationship. The characterisation of that relationship was wrong, as the Tribunal subsequently found. However, it would be absurd if a contract were held to be illegal because the parties in good faith thought that it could legitimately be considered to fall into one legal category whereas in fact it fell into another. There is no reason why public policy should penalise an employer or employee for getting the law wrong; indeed, there is every reason why it should not do so.

49.As the Tribunal here noted, there is often a fine dividing line between those properly described as employees and those who are self employed. In many cases lawyers may reach different conclusions on the same facts. It would be extraordinary if adopting the wrong characterisation – wrong in the sense that it was not the view of the court subsequently charged with determining the matter- could place the parties outside the law’s protection. It would be even more offensive in circumstances, as here, where the Revenue is informed of the nature of the relationship and accepts the legal characterisation adopted by the parties.

50.In our judgment the Tribunal was plainly right and acted with robust good sense in saying that there was nothing illegal in this relationship at all. The employee would not, it is true, have paid the tax which he should have done as a matter of law, but that does not mean that the contract was immoral or illegal. Moreover, as the judgment of Ackner LJ (as he then was) in the Court of Appeal in, para 34 demonstrates, once the employee’s true status is determined, he can be required by the Revenue to repay such tax as has been wrongfully withheld.

51.Mr Pilgerstorfer made the observation that it was unattractive for a party to the contract to seek to resile from the status which he has voluntarily undertaken. As we have indicated, that is not, however, itself contrary to public policy. Moreover, it is important to appreciate where the logic of Mr Pilgerstorfer’s argument goes. If the contract is illegal because of the wrong characterisation, it would not merely be denying the employee the right to seek compensation for unfair dismissal, which does involve him resiling from his earlier position. It would also mean

that he could not sue for unpaid wages, a claim which does not involve him acting inconsistently at all. Quite what public policy could justify that conclusion is difficult to fathom.

Grace v BF Components

52. This case is not as clear as the **Payne** case. This is because there was active consideration of Mr Grace's status and at least by August 2003 the employers had made it plain that it was their strongly held view that he should be treated as an employed person. He knew that was they were unwilling to continue to treat him as self employed. Nevertheless, he did not at any stage seek to misrepresent the facts of the relationship to the Revenue. When first employed he understood that the relationship could be characterised as one of self employment. It is not suggested that he knew that this was a wrong characterisation, and indeed there were some features more consistent with a contract of employment rather than a contract for services. For example, he did not receive holiday or sick pay which is often a badge of self employment. He was wrong about his status and from August 2003 the employers made it clear that they were not prepared to continue to treat him as a self employed person. He was reluctant to accept that decision and only did so when he was effectively told that he would be dismissed otherwise.

53. We accept that on occasions where the parties have sought to claim self employed status knowing that this was not sustainable then it might be legitimate to infer that they are seeking to misrepresent the true nature of their relationship. It is not, however, the mischaracterisation of the legal status which is the relevant misrepresentation; it is the implicit representation about the underlying facts of the relationship. The only evidence of that here is the finding that he continued to want to be treated as self employed even after the company had told him that in their opinion he plainly was not. He was unwilling to accept their analysis, albeit only for a short period while he considered the employer's offer. The Tribunal say that he thereafter knew that the status had been wrongly described. More accurately it seems to us that he knew that this is what

his employers were representing. We do not think that his further exploration of the new position adopted by the company can be said to constitute a misrepresentation of the facts of the relationship such as to render the contract illegal.

Grace: the cross appeal.

54. We turn to the cross appeal. The position is that the appellants were given the right to renew their application and to cross-appeal at the substantive hearing. We considered the matter and thought it appropriate that they should have permission to pursue the point.

55. The basis of it is as follows. In the original Tribunal decision the Tribunal found that Mr Grace had been dismissed by reason of redundancy. The Tribunal found that there was no warning or consultation at all about the dismissal. Apparently, the company had assumed that Mr Grace did not have sufficient continuity of employment to raise an unfair dismissal claim and that he was therefore not entitled to any consultation.

56. It hardly puts the company in a good light that it would only consult where legally obliged to do so. Be that as it may, the employee was terminated without notice and was given four weeks' pay in lieu of notice. In view of this it is hardly surprising that the Tribunal found that the dismissal was procedurally unfair.

57. The Tribunal concluded nonetheless that if there had been proper consultation the dismissal would have occurred albeit four weeks later, and then limited compensation accordingly.

58. The Employment Appeal Tribunal on appeal noted that the issue had arisen late in the proceedings and they were plainly concerned that Mr Grace may not have had a proper opportunity to make submissions on the **Polkey** point. The Employment Appeal Tribunal also observed that whilst consultation may have made no difference to any possibility of continuing employment with the employer, the position was not so clear with respect to other associated

companies in the group.

59. On remission the second and different Tribunal did not hear any more evidence. They did hear submissions. Mr Pilgerstorfer submitted that there was nothing that could have been said by Mr Grace which could have saved his job. This was a finding which the earlier Tribunal had made and was binding on them. Mr Grace submitted that the failure to consult went to the heart of the issue and that in such circumstances **Polkey** was inapplicable.

60. The Tribunal agreed with Mr Grace. They held that it was conceivable that Mr Grace might have said something which could have caused the employers to change their minds, including accepting a change in terms and conditions of employment. Finally they said this:

“...the failure to warn and consult was so fundamental that it makes it impossible to say that the failure made no difference or that we can sensibly reconstruct the world as it might have been.”

61. The reference to “reconstructing the world as it might have been” was a reference to the decision of the Inner House of the Court of Session (delivered by Lord Prosser) in **King v Eaton Ltd No 2** [1998] IRLR 686 at para 19. Mr Pilgerstorfer has submitted that the Tribunal was in error in a number of ways.

62. First, they were not entitled to question the finding of fact by the earlier Tribunal, namely that dismissal would have occurred in any event. The purpose of the remission was to allow submissions to be made by Mr Grace, but not for the fundamental findings to be re-opened.

63. Second, he observes that the Court of Appeal in the case of **Lamb v 186K Ltd** [2005] ICR 307 expressed the view that it was unproductive to draw a distinction between substantive as opposed to procedural infringements. However, the Court did agree that the appropriate question

to ask was the one identified by Lord Prosser at para 19 in the **King** case:

“...The matter will be one of impression and judgment so that a tribunal will have to decide whether the unfair departure from what should have happened was a kind which makes it possible to say, with more or less confidence, that the failure made no difference, or whether the failure was such that one cannot sensibly reconstruct the world as it might have been.”

64. Further, Mr Pilgerstorfer referred to the subsequent decision of the Court of Appeal in **Scope v Thornett** [2007] IRLR 155 in which the Court held that a tribunal should not readily avoid determining what might have occurred in the context of assessing compensation on the ground that the exercise is too speculative. The Employment Tribunal’s task will almost inevitably involve uncertainties and the tribunal should not opt out of that duty because their duty is a difficult one and may involve speculation: see the observations, in particular, of Pill LJ at paras 33-37.

Discussion.

65. We had some sympathy for the Tribunal hearing this matter on the second occasion. They were in some difficulty given the lack of any additional evidence. However, the submission of Mr Pilgerstorfer that the facts could not be revisited at all would mean that the whole exercise second time round would have been a complete waste of time. We do not think that the Employment Appeal Tribunal can have intended that that should have been the effect of the remission.

66. Equally, however, we think that the Tribunal did err in concluding that because the failure to consult was such a fundamental defect, it necessarily precluded any assessment of the outcome of those consultations. That is inconsistent with the approach in the **Scope** case. Furthermore, the Employment Appeal Tribunal (Elias P) summarised the effect of these decisions in **Software 2000 Limited v Andrews & Ors** [2007] IRLR 568, para 54. The EAT pointed out that when assessing compensation a tribunal can only properly act on the assumption that employment

would have continued indefinitely where “the evidence that it might have been terminated earlier is so scant that it can effectively be ignored.”

67. We agree with Mr Pilgerstorfer that it is simply not possible to say that the evidence in this case was so scant, and the task so speculative, that no assessment of future loss could be made. That was something the Tribunal had to do. However, neither can we accept, as we have indicated, that the Tribunal was compelled to accept the finding of the first Tribunal that employment would have been terminated after four weeks.

68. With great reluctance we have come to the conclusion that this matter will have to be remitted to a tribunal for a third time, solely in order to assess the **Polkey** question. However, we do not see how it can properly do that without hearing further evidence on this issue. It is desirable, if possible, that it should go back to the same Tribunal who carried out the second hearing rather than involve a third tribunal. We take this step with an extremely heavy heart because the dismissal in this case was in January 2004 and the cost of these proceedings must already be out of all proportion to the likely sums at stake. We very much hope that even at this stage the parties can agree a sum of compensation and bring this particular rollercoaster litigation to an end once and for all.

Disposal

69. We uphold the appeal, and find that Mr Grace was therefore entitled to compensation for unfair dismissal. We also uphold the cross-appeal and conclude that the second Tribunal was in error in concluding that they could not properly determine what might have happened had effective consultation taken place. We remit the matter to that Tribunal to determine the **Polkey** question in the light of the guidance issued in **Software 2000**. The Tribunal should both hear evidence on that matter as well as submissions.

