



## THE LAW COMMISSION

### ILLEGALITY AND EMPLOYMENT LA W

#### BACKGROUND

The Law Commission is undertaking a long-running project into reform of the illegality doctrine.<sup>1</sup> One major difficulty has been the interaction between the doctrine of illegality and employment law. The employment contract is not like other contracts, given its role as a gateway to a host of statutory employment rights. The current law is complex, particularly due to the fact that two distinct tests have been applied, in a manner which has led to sometimes arbitrary results.

#### THE CURRENT LAW

##### The two tests

1. Some statutory rights have been interpreted as requiring a *legally valid and enforceable* contract. The rights subject to this “contract test” will be denied to those employees whose employment contract has been rendered unenforceable by the illegality doctrine.
2. Other statutory employment rights have been interpreted as requiring only a contract as a *factual* pre-condition for their application. In this case, the mere fact the contract of employment is unenforceable will not preclude reliance on the statutory right. This will only be denied if the “tort test” is failed. The “tort test” is whether the illegality is *so inextricably bound up with the claim that to allow it would mean the court would be seen to condone the unlawful conduct*.
3. The two tests:

The contract test	The tort test
Actions on contract itself (e.g. for wages)	Discrimination
Unfair dismissal	
Redundancy	

?? National Minimum Wage ??

<sup>1</sup> See Consultation Paper 154, *Illegal Transactions: The Effect of Illegality on Contracts and Trusts*, (1999).

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4. The distinction drawn between discrimination and unfair dismissal is not immediately obvious. At base a claim for unfair dismissal is a claim for breach of a statutory duty placed on employers. It resembles, much like discrimination, a statutory tort.

### **National Minimum Wage: Which Test?**

There is no case-law on the question of how the right to NMW interacts with illegality affecting the contract of employment.

s 1(2) of the NMW Act lays down that in order to qualify for NMW a person must be a “worker”. This is in turn defined by s 54 which says a worker is *inter alia* a person who works “under a contract of employment”. The question is whether a court would interpret “contract” within s 54 as meaning a *legal and valid* contract (i.e. the contract test) or simply a factual precondition (in which case recovery would only be barred if the illegality was so bound up in the claim that to allow it would make the court seem to condone it – i.e. the tort test).

From a strict legal perspective, it is difficult to escape from the conclusion that the “contract test” will be applied. This is due to the manner in which the right to NMW is given to employees: i.e. by a term implied into the contract of employment. The consequence of this is that if the employee is held to have participated in the fraud (on which see below), then the employee would lose the right to NMW.

From a policy perspective, this is not an attractive conclusion. This is particularly so since presumably almost all employers who deliberately pay below NMW do not accurately declare this to the Revenue. By agreeing to be paid cash in hand, employees may indirectly waive their right to receive NMW (which they cannot do by agreement: see s 49 of the Act).

### **The contract test**

5. Certain employment rights have been held to require a valid and enforceable contract. This obviously applies to actions on the contract itself (e.g. for wages), but also to unfair dismissal, and to redundancy payments.
6. It is fairly clear that contract may be rendered unenforceable if it is illegal as formed – for example a contract to commit a crime. There is less clarity as regards illegality during performance.<sup>2</sup> The key question is: when is a contract

<sup>2</sup> As matter of general contract law, *St John Shipping v Joseph Rank Ltd* [1957] 1 QB 267 supports the view that mere illegality in performance will not render the contract illegal, while *Ashmore, Benson, Pease & Co v Dawson* [1973] 2 All ER 856 suggests that it may be sufficient. This disagreement is mirrored in the employment law field; *Coral Leisure Group v Barnett* [1981] IRLR 204 suggests mere illegality in performance of an otherwise legal contract of employment will not affect the enforcement of contractual and subsequent statutory rights, while *Tomlinson v Dick Evans U Drive Ltd* [1978] IRLR 77 and others (see n. 3 below) take the *Ashmore Benson* approach.

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rendered unenforceable by unlawful performance? The courts have not answered this question in a coherent and consistent manner, and different types of illegality seem to be treated differently. Complications are caused by the fact in most cases the fraud is perpetrated by the employer, not the employee (for example the employer fails to deduct PAYE). The question then becomes what degree of involvement by the employee will prevent him from enforcing his contract and subsequent employment rights.

7. Most cases suggest that participation is required<sup>3</sup>, though there are indications that mere knowledge may suffice.<sup>4</sup> In relation to PAYE fraud the courts have taken a particularly harsh view. They almost seem to impose a positive duty on employees to report their employers to the Revenue if they are concerned about the non-payment of PAYE. This seems at odds with the general recognition of the inequality of bargaining power inherent in employment protection legislation.

Cases:

E.g. In *Tomlinson v Dick Evans U Drive Ltd*<sup>5</sup> A claimed for unfair dismissal and a redundancy payment. During her employment, A had received a weekly cash payment of £15, on which no tax was paid. A understood that this was put through the books as an expense in order to defraud the Revenue. EAT held that her contract of employment had been vitiated by the illegality in which she had **participated**, so her claim failed. The EAT said that even where a junior employee “goes along” with the fraud in circumstances where the employer is primarily to blame, the employee’s contract is not enforceable.

E.g. In *Newland v Simons*<sup>6</sup>, A complained of unfair dismissal. A had always been paid cash in hand. The employer was not making deductions for NI and income tax. There was no evidence that A knew of the illegality. The ET held that she either knew or ought to have known of the fraud after receiving her P60. The EAT overturned this holding that **actual (subjective) knowledge was required**, and not merely constructive knowledge as suggested by the ET.

8. The case in the second example, *Newland v Simons*, which suggests that mere knowledge without participation is sufficient, has been subject to heavy criticism and its correctness has been doubted by members of the Court of Appeal.<sup>7</sup> The

<sup>3</sup> *Ashmore, Benson, Pease & Co v Dawson* [1973] 2 All ER 856 (in a non-employment law context); *Tomlinson v Dick Evans U Drive Ltd* [1978] IRLR 77; *Hall v Woolston Hall Lesiure* [2000] 4 All ER 787; *Wheeler v Qualitydeep* [2004] EWCA Civ 1085.

<sup>4</sup> *Newland v Simons* [1981] IRLR 359. The EAT did reject the ET’s suggestion that constructive knowledge would be sufficient.

<sup>5</sup> *Tomlinson v Dick Evans U Drive Ltd* [1978] IRLR 77.

<sup>6</sup> *Newland v Simons* [1981] IRLR 359.

<sup>7</sup> *Hall v Woolston Hall Lesiure* [2000] 4 All ER 787, per Mance LJ at [80].

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recent decision of the CA in *Wheeler v Qualitydeep*<sup>8</sup> seems to affirm the need for participation, though in that case it was not even clear that the employee possessed the relevant knowledge; she had a very limited knowledge of English or familiarity with the UK taxation.<sup>9</sup> Other decisions seem to indicate that the courts attitude to PAYE fraud is particularly harsh.<sup>10</sup> There is therefore considerable confusion on exactly what is required before the employee's contract is tainted.

### The tort test

9. In discrimination cases, the courts have applied a different test. The reason for this was explained by Mance LJ in *Hall v Woolston*. Although the relevant legislation requires an employment contract as a pre-requisite for its application, this is merely a *factual* restriction on its scope. There is no requirement that the underlying contract be enforceable. There were clear policy underpinnings for this approach. If the alternative view were adopted, then if an employee's contract had been tainted by illegality, he could be subject to the most blatant discrimination or even racial abuse and yet be denied any remedy.
10. Given that an enforceable contract of employment is not required to make out a good case, when will a discrimination claim be barred by the illegality doctrine? The test is whether the illegality is so bound up in the claim that to allow it would be for the court to condone the illegal activity.

#### Cases

E.g. In *Hall v Woolston*<sup>11</sup> A alleged she was unfairly dismissed due to sexual discrimination, on the basis that she was pregnant. Entirely unrelated to this, the employer had falsified her payslips so they showed a lower net payment than A actually received. A queried this but was told that "it's the way we do business". The CA held an enforceable contract was not a necessary precondition for a claim on the basis of discrimination, which was a statutory tort. A's acquiescence in her employer's failure to deduct PAYE had no bearing whatsoever on the discrimination claim. A's claim succeeded.

<sup>8</sup> [2004] EWCA Civ 1085.

<sup>9</sup> Hooper LJ was keen to emphasise that this was not a usual case:

"This is a very unusual case concerning as it does a foreign national working in this country in that language with limited knowledge of the English language and of the tax and national insurance provisions of this country. Had she not had that limited knowledge, she may well not have succeeded".

<sup>10</sup> For example in *Hewcastle Catering v Ahmed and Elkamah* [1991] IRLR 473, involving VAT fraud, unfair dismissal claim succeeded despite *active participation* in the fraud by the employee. One of the factors which seems to have persuaded the CA is that the employees did not benefit from the scheme at all.

<sup>11</sup> *Hall v Woolston Hall Lesiure* [2000] 4 All ER 787.

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E.g. In *Vakante v Addey and Stanhope School*<sup>12</sup> A was an asylum seeker who applied to work at the defendant school without a work permit, by falsely stating he had a right to work in the UK. A made 17 allegations of race discrimination against the school. The CA applied the tort test, and held that A's claim failed. His illegal conduct in entering into the employment contract in breach of the immigration legislation was so bound up in the claim that allowing the claim would appear to condone his illegal behaviour.

### Summary

11. The policies which the law is pursuing in this area have not been fully and consistently articulated in the case-law. The courts seem to draw unjustifiable distinctions between different types of illegality. In particular, the cases take differing views on the fundamental question of how the balance of power in the employment relationship should be viewed.
12. The Law Commission at present favours the general adoption of the "tort test", though this change is unlikely to occur via legislation. A move away from asking "is this *contract* illegal?" to "would allowing this particular claim amount to condoning the illegal conduct?" would be a positive one and would allow a more nuanced approach to the difficult policy issues which are raised.

### OUR QUESTIONS

- (1) How often does illegality arise as an issue in employment law? How much awareness is there of the issues raised here?
- (2) Do employers often raise illegality as a potential defence to employees claims? If so, in the context of which rights is this most common?
- (3) What sorts of illegality are raised? Is it generally PAYE fraud, breach of immigration requirements?
- (4) How do tribunals handle these questions?

<sup>12</sup> *Vakante v Addey and Stanhope School* [2004] EWCA (Civ) 1065.