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Chameleons at Large: Entrepreneurs, Employees and Firms – the Changing Context of Employment Relationships

Abstract:

Current labour markets are witnessing a proliferation of hybrid or quasi-employment status whereby company directors and limited liability partners are gaining access to employment rights. At the same time, legislation is creating new forms of employee shareholder status, where employees trade employment rights for shares in the company. New corporate structures are being developed to promote one man companies, SMEs and hybrid company/partnerships.

This paper examines some of these developments in the light of the theory of the firm and the jurisprudence of company and employment law and considers the implications for workers, employers and the self-employed.

Keywords:

Employee, Entrepreneur, Firm, Employment Status

Introduction

The context of the paper is a set of recent developments in both the organisation of the firm and employment status. The paper traces some of these developments by
identifying new forms of quasi-employment status or hybrids, which reflect some features of employment and some features of self-employment.

The paper addresses the theme of professional self-employment by examining ways in which some traditionally self-employed individuals are acquiring employment status. This may involve a reversal of roles in that some employees have become more entrepreneurial and at the same time some entrepreneurs have become more like employees. This osmosis of some of the central actors in the firm has important implications for the labour market. The changing status of both employee and entrepreneur requires a re-examination of the core constructs of both employment and company law.

The paper will focus on the inter-relationships between employees and entrepreneurs at the commercial periphery of the employment spectrum. What is the purpose and effect of new forms of quasi-employee status? Are these hybrid relationships a symptom or effect of changes in patterns of employment? The paper will also address changes in corporate structure which accommodate these relationships.

The paper is structured in four main sections. The first part examines the essential characteristics of entrepreneurs and employees. The second examines the notion of the so-called ‘entreployee’ and provides a structure for the analysis of new hybrid types of employee. The third section looks at the notion of employee-owners and employee shareholders. The final section examines judicial approaches to the corporation and traces recent developments regarding the employment status of company directors and quasi-equity partners.
Part One: Entrepreneurs and Employees

The central submission of this paper is that the employee relationship is changing into a more entrepreneurial type of relationship (Collins, 2001; Lazear, 2005). This section will therefore attempt to identify these two distinct types and then examine the new forms of hybridity relating to employees and entrepreneurs that have emerged in modern labour markets.

Definitions of Employee and Entrepreneur

A central problem that must be addressed at the outset is the issue of definition. First, there are no satisfactory definitions of either the term ‘employee’ or ‘entrepreneur’. The term ‘employee’ is a legal term of art, which is central to the scope of employment law, as many employment rights are dependent on inclusion in the category of employee. However, there is no substantive definition of the term in statute in many common law systems, including the UK and Australia and the judiciary have been unable to provide a complete definition in one hundred and fifty years of case law. All we have at present is a loose factual matrix currently embodied in the so-called multi-factor methodology of Ready Mix Concrete v Minister of National Pensions and National Insurance [1968] 2 QB 497. The effect of this is not only that no clear boundary line exists between employment and self-employment, but also that the definitional lack of clarity provides fertile ground for the gradual osmosis of new forms of ‘employment’ status which may result in real hybridisation of disparate and functionally different types of status.

By contrast, the term ‘entrepreneur’ is not a legal term of art. Rather it is a description of particular forms of behaviour in the market. There is again no agreed definition of the concept. In particular, although innovation is an important aspect of
entrepreneurship, it is unclear whether innovation is a necessary element or whether self-employment or ownership of a firm are equally entrepreneurial (Licht, 2006).

It is suggested that entrepreneurship has two main features: first, the creation of new economic opportunities, second, the introduction of an idea into the market in the face of uncertainty (Hamren, 2014). The following definition is provided by Henrekson (2007):

*A person can be said to engage in entrepreneurial venture if she either (1) perceives and creates new economic opportunities… new products, new production methods and new product market combinations and (2) introduces her or his idea in the market in the face of uncertainty by making decisions on location, form and the use of resources and institutions.*

The Basis of Employment Status

The basic distinction between ‘dependent’ and ‘independent’ or ‘autonomous’ labour is central to all systems of labour law (Hepple, 1986; Burchell et al., 1999; Freedland and Kountouris, 2008).

Employment law poses a distinction between the employee who has a contract of service and the independent contractor who has a contract for services. This simple binary distinction poses self-employment as the default position, as all relationships that do not satisfy features of employment are automatically classified as ones of self-employment (Leighton and Wynn, 2011). Such a classification fails to recognise many types of person e.g. many freelancers and contractors who may be dependent on a single employer as employees and also falsely characterises many relationships exhibiting high degrees of risk and independence as employees (Leighton and Wynn, 2011; Freedland, 2003).
The aim of this paper is to focus on the entrepreneurial end of the spectrum of employment relationships (Wynn and Leighton, 2011). The entrepreneur is traditionally placed before the SME but after the dependent employee (see figure 1).

**Self - Employment and Entrepreneurship**

Self-employment is a widely used measure of entrepreneurship, particularly in the economic literature (Parker, 2006). Some of the research on entrepreneurship suggests that some self-employed individuals are not pure entrepreneurs because they are not innovators or arbitrageurs (Parker, 2006; Schumpeter, 1934). ‘Dependent self-employed workers’ or those who depend on a single employer for work may also be excluded.

If self-employment is not a necessary or sufficient condition of being an entrepreneur, then the possibility arises that some entrepreneurs (and even those who own their businesses) may claim to be employees in order to gain the benefits of employee status. Before considering the practical implications of this phenomenon, let us first examine some basic differences between the two categories of individuals.

**Distinctions between Employees and Entrepreneurs**

In functional terms, employees may be distinguished from entrepreneurs on a number of essential dimensions. Here, I shall map out three areas of divergence, that of subordination/control, dependence/independence and risk. These dimensions have been chosen as illustrating those essential factors which a court may take into account in deciding whether an individual is an employee or not.

The basis of employee status has been identified as the idea of ‘subordination to the capitalist enterprise’ (Hepple, 1986). Subordination or control is an inherent aspect of
the employment relation which arises from the need of the employer to direct labour. The master-servant model from which the contract of employment developed, was based on the employer's powers of direction and discipline (Deakin and Morris, 2012, Fox, 1974). This legal basis of the employment contract is also recognised in the economic theory emanating from Coase's (1937) influential theory of the firm. The structural features of the employment contract were a necessary element of the governance structure of the firm. By contrast to the employee, the entrepreneur is often characterised as an individual who assumes control of resources including labour in order to maximise profit:

_The contract is one where the factor, for a certain remuneration ...agrees to obey the directions of an entrepreneur within certain limits….if one contract is made for a longer period, instead of several shorter ones, then certain costs of making each contract will be avoided._

Coase’s definition of an entrepreneur as the individual who founds a firm by directing labour, is a narrow definition. Not all entrepreneurs found firms or use labour in order to make profit. However, it is submitted that Coase’s distinction between directing and directed labour is important in economic and legal terms.

The second aspect of the employee relationship crucial to employee status is the notion of dependence. An employee is dependent on an employer for the provision of work, whereas an entrepreneur is characterised by his or her ability to independently coordinate resources. The classic distinction is that between an employee who submits his labour to the enterprise in consideration of a wage, and the independent entrepreneur who chooses self-employment in order to sell his services to the market (Demsetz, 2011). The freelancer or contractor creates a
market for services or goods in order to make profits, whereas the employee relies on an employer to create a market for his labour (Aghion and Holden, 2011; Casson, 2003). The result of this is that the employee becomes dependent on the employer for work, whereas the contractor finds a market himself.

This distinction is further amplified by the phenomenon of firm start-up. An individual who decides to start up a firm in order to coordinate certain resources is exercising the entrepreneurial functions of direction and risk-taking. Management and risk-bearing are considered classic functions of the entrepreneur (Licht, 2007; Fama, 1980). The decision to found a firm by opting to become self-employed involves an individual in a number of coordinating initiatives, each of which carries certain risks. The business man needs to set a price to the customer for services, advertise the product, advertise vacancies, fix wages and screen applicants (Casson, 2003). He must also build a reputation for quality. By contrast, the employee, after finding a job, relies on the employer to deal with products, customers and other factors of production (Casson, 2003).

The third aspect is risk. The entrepreneur as the protagonist of economic activity calculates risk for profit (Licht, 2007; Hamren, 2014). The economic role of the entrepreneur involves bearing the risk of buying at certain prices and selling at uncertain prices (Stevenson and Jarillo, 1990).

Risk-taking has been assumed in the legal literature as a function which often distinguishes employment from self-employment. The economic test for employment status (Market Investigations Ltd v Minister of Social Security [1969] 2 QB 173) asks whether the worker is in business on his or her own account, as an entrepreneur, or works for another who takes the ultimate risk of loss or chance of profit (Deakin and
Morris, 2012, 162). Risk-taking can involve any or all of the normal factors of production, for example, ownership of tools, equipment and plant, arrangements made for tax, national insurance, VAT, statutory sick pay, degree of financial risk and responsibility for investment and management, number of assignments and risk of running bad debts and opportunity to work for other employers (O’Kelly v Trusthouse Forte [1984] QB 90). Entrepreneurial activity, then is perhaps the clearest indicator, in legal terms, of self-employment and distinguishes economic risk-takers from employees who enter contracts of employment as an insurance against economic shock.

Of course, employees as wage earners, cannot entirely insulate themselves against economic risk, as they risk dismissal for economic or other reasons. (Howe and Trebilcock (1993) Employees also make entrepreneurial decisions to leave firms and found their own businesses. The transition from employee to entrepreneur, however, indicates motivational factors based on risk-taking and profit-seeking which re-emphasise the employee/entrepreneur distinction (Blanchflower and Oswald, 1998; Hvide, 2009).

The distinguishing features of employees and entrepreneurs are summarised in figure 2.

An objection to the model outlined so far is raised in the work of Schumpeter (1934) which makes a division between ownership and control of the firm. The entrepreneur is simply involved in “the carrying out of new combinations which we call “enterprise”. This narrow definition allows Schumpeter to include in the category of entrepreneur
not only ‘independent’ businessmen but also ‘dependent’ employees of a company such as managers or members of boards of directors. In addition, Schumpeter makes a distinction between ‘entrepreneurs’ and ‘capitalists’, allowing him to distinguish shareholders from entrepreneurs and to dispose of the conception of entrepreneurs as risk-bearers:

*Shareholders per se, however, are never entrepreneurs but mere capitalists, who in consideration of their submitting to certain risks participate in profits.*  (Schumpeter, 1934)

This analysis of the entrepreneur has been highly influential in the development of corporate governance, allowing for the separation of the individual entrepreneur from the shareholding base in large corporations (Davies and Worthington, 2012). Small companies with controlling director shareholders are however in a different category.

**Part Two: The Merging of Employee and Entrepreneur Categories- A Modern Development?**

Let us now turn to the employee/entrepreneur dimension of the employment spectrum. I would like to illustrate this by reference to the emerging phenomenon of the so-called ‘entreployee’, a concept initially outlined by German sociologists G Voss and H. G Pongratz (Voss and Pongratz, 1998; Pongratz and Voss, 2003). The authors theorise an ‘emerging self-entrepreneurial type of labour power’ as a response to demands for increased organisational flexibility. As Tayloristic methods of labour control inhibit workers’ motivation and innovation, organisations reduce direct control and encourage employees’ self-organisation. Labour power becomes commercialised as work capacity is intensified by the self-control of the employee.
This results in a new type: ‘The formerly passive employee is becoming, in the strict economic sense, the entrepreneur of his or her own potential, in the individual market economy’. (Pongratz and Voss, 2003)

The word ‘entreployee’ combines the two terms, ‘entrepreneur’ and ‘employee’ (Hoge, 2011). It should be distinguished from ‘intrapreneurship’ which derives from the entrepreneurship literature (Antoncic and Hisrich, 2003). The focus of intrapreneurship is on how to increase organisational effectiveness and innovation, rather than focusing on historical changes in labour process (Hoge, 2011). There is however some convergence in the two concepts as intrapreneurship is one organisational strategy which encourages the development of new types of employees. To emphasise this coalescence, the term ‘entreployee’ is now commonly used in the business world to refer to strategies to develop internal talent by promoting the entrepreneurial skills of a particular workforce.

I draw primarily on Pongratz and Voss’s sociological analysis in this paper, while recognising the relevance of the ‘intrapraneurship’ literature to the transformations in workplace participation.

Phases of Labour Power

Pongratz and Voss (2003) develop a schematic of historical types of labour power as an analytical tool to explain distinct phases in the development of industrial society (Braverman, 1974). The first phase – the so-called proletarian worker resulted from the transition from feudal conditions to factory labour. The second phase or vocational employee stage (from Ger. Beruf) corresponds to the Fordist production environment. The standard or ‘typical’ employee is to some extent a product of the modern welfare state, with complex social security and training systems (see Deakin...
and Wilkinson, 2005). The typical employment contract represents a trade-off between provision of labour and protection from economic risk e.g. unemployment. The third phase sees the rise of entrepreneurial labour, involving commercialisation of labour capacity (the so-called ‘entreployee’).

I would seek to develop this schematic of historical types of labour power by adding a fourth phase which I would define as the ‘colonisation’ of employee status by the entrepreneur. This phase is theorised as being empirically distinguishable from phase three in that here, the true entrepreneur, ‘colonises’ aspects of employee status in order to protect against economic risk. This phase is particularly prevalent in times of high financial instability (Armingeon and Baccaro, 2012), where the entrepreneur seeks to protect against economic shock by claiming the rights of employee status at the same time as benefiting from the privileges of incorporation. New forms of quasi-employment relationships are created to accommodate these changes. Some of these forms exhibit more aspects of the entrepreneur than that of the employee (see Figure 3: Historic Phases of Labour Power- the Emergence of the ‘Entreployee’).

It is submitted that the fourth phase is a natural development of the move towards entrepreneurialism in modern competitive labour markets (Collins, 2001; Carree and Thurik, 2003). In phase three, the enterprise modifies the employee type to further utilise the labour of the standard employee. In phase four, the enterprise itself changes shape and at the same time, transforms the legal nature of employee status in order to maintain competitiveness.
It is this last phase which is the subject of this paper, which seeks to identify the judicial re-moulding of employee status to accord with the creation of new forms of corporate organisation.

**Entrepreneurship in Institutional Context**

The preceding section has provided a historical context for exploration of entrepreneurs as employees. This section will build on this by examining the institutional context in which entrepreneurship operates.

The main proponent of the role of institutions for entrepreneurial behaviour is Baumol (1990). His analysis suggests that individual entrepreneurial effort may be used to circumvent institutions where it is beneficial to do so, with the result that predatory activities prevail over socially productive entrepreneurship (Henrekson, 2008). Given that the activities of entrepreneurs can be productive, unproductive or even destructive, we can analyse changes in the legal and institutional background to assess the total consequences of entrepreneurial behaviour.

This paper builds on Henrekson’s model by examining the statutory and judicial context in which normative changes are taking place in the employee/entrepreneur framework.

**Part Three: Facilitating Entrepreneurial Employees - Employee Owners and Employee Shareholder Status**

One method of altering the traditional hierarchical basis of the employee relationship is to shift economic risk away from the employer and transfer it to the employee. The principle that the employer should assume responsibility for social and economic
risks arising from the employment relationship by means of social insurance (Deakin and Wilkinson, 2005) has begun to decline with the development of new entrepreneurial forms of employee status (Prassl, 2013).

Employee ownership as a mechanism of control has become common since the early 1970s, particularly in the United States (Lawrence French, 1987). The distribution of ownership rights across the workforce allegedly reduces alienation, stimulating productivity and legitimising managerial control (Garson, 1977). Employee share ownership has a potential for re-aligning interests between companies and employees by emphasising common interests and shared stakes (Pendleton, 2010). There is a considerable literature on the effects of employee ownership on employee attitudes and behaviour, most studies finding higher organisational commitment (Poole and Jenkins, 2013; Pendleton et al, 1998; Logue and Yates, 2001; Kruse, 2002). The employee ownership model tends to support the thesis of the entreployee as a category of employee involving commercialisation of the employment relationship in that the emphasis moves to economic objectives of firm and employee by promoting firm performance, improving workplace cooperation, information sharing and thus reducing labour management conflict (Kruse, 2002).

As has been argued earlier in the paper, however, the divergence between the interests of employees and entrepreneurs may result in a conflict of interests. Shareholders and employees have different objective functions: shareholders are focused on equity value, whereas employees seek to maximise their own social interests including compensation, job security, private benefits and leisure (Kose et al, 2015). Strong labour rights may increase the bargaining power of employees and heighten employee-shareholder conflicts of interest (Kose et al, 2015).
In this context, it is of interest that the recent model of employee shareholder status introduced in the UK appears to be designed to weaken labour protection rather than promote the employee engagement as a stakeholder in the firm.

The new s.205A of the Employment Rights Act 1996 provides:

An employee shareholder agrees to have different employment rights to employees and receives fully paid up shares of a minimum value of £2,000 in the employing company.

In return for this small parcel of shares, the employee shareholder forfeits major employment rights including general unfair dismissal rights, statutory redundancy payments and the right to flexible working. Such a trade-off may not be particularly attractive to standard employees despite the considerable tax incentives, however, the attractions to senior and managerial staff, where a stake in the company is deemed more beneficial than employment security are not inconsiderable.

The UK scheme is based on the reduction of employee security in return for property rights, a much more controversial concept than that of the ESOP, the employee stock ownership plan, as developed in the US. The UK scheme has been characterised as potentially dismantling the contract of employment (Prassl, 2013). From the employee perspective, the renunciation of employment rights for a handful of shares is hardly a fair swap. Employees are being encouraged to share in the financial risk of the firm and become employee owners, but in order to do so, they sacrifice their traditional security rights as employees. A £2,000 stake in the firm as an offer to become ‘entrepreneurial’ seems small recompense for abandoning traditional employee status.
The UK model of employee shareholder is a reminder that employee ownership is a contingent concept. While there are benefits to employee shareholding, these benefits may not be realisable in financial or governance terms for employees. Typical shareholdings may not be large and are freely alienable. Many employee share plans in large, listed companies do not provide effective control rights and employee shares of total equity are usually relatively small (Pendleton, 2010). The concept of employees as stakeholders in the firm may hold out more promise than real benefits for employees.

**Part Four: Judicial Approaches to Entrepreneurs**

The paper has thus far discussed some of the difficulties of defining professional self-employment at the business, entrepreneurship end of the self-employment spectrum. We have traced a movement towards more entrepreneurial forms of employment and outlined so-called hybrid types in the form of the ‘entreployee’ concept. This final section examines judicial approaches to these new phenomena, by examining first, the relationship between the entrepreneur and the firm and secondly, new developments in the employment status of company directors and equity partners. The aim here is to illustrate, in legal terms, the possible development of a new phase of industrial labour types, the ‘colonisation’ of employee status by company directors.

**The Entrepreneur and the Firm: Saloman v Saloman**

The classic exemplar of the self-employed entrepreneur and his or her relationship to the firm is the UK House of Lords case of *Saloman v Saloman* [1897] A.C. 22. This case is chosen as it forms the basis of company law in common law jurisdictions and thus illustrates the method by which the jurisprudence of company
law structures capitalist relations. The case is also important as an example of the phenomenon of the so-called ‘one-man company’, a legal form which lends itself to the furthering of economic activity by solo entrepreneurs.

Saloman was a trader who sold a solvent business to a limited company with a nominal capital of 40,000 shares of one pound each, the company consisting only of the vendor and six family nominees. The House of Lords held that Saloman was not personally liable to the creditors when the company was wound up as the company was a separate legal entity and the business belonged to the company, not to Saloman as its agent.

The rule established in Saloman has enormous implications for the entrepreneur who wishes to found a firm to pursue a business venture, as incorporation enables the personification of the business so the entrepreneur’s liability for debts can be separated even though the entrepreneur retains control and reaps the profits. It has never been questioned whether the extension of legal privileges to small traders and investors is good legal or economic policy despite the warning given by Kahn Freund in 1944:

> However, owing to the ease with which companies can be formed in this country…ever since the calamitous decision in Saloman v Saloman, a single trader or a group of traders are almost tempted by the law to conduct their business in the form of a limited company, even where no particular business risk is involved, and where no outside capital is required.

The potential for abuse is greater with small trading firms as incorporation can conceal the realities of trading relationships, allowing entrepreneurs to create shams and simulacrum by assigning assets to companies and still acting as individuals
rather than as directors and shareholders (Kahn Freund, 1944; Wardman, 2012; Davies and Worthington, 2012). The legal fiction of separate personality can encourage the entrepreneur to set up a company with limited capital and defraud creditors (Davies and Worthington, 2012). Problems of delinquent entrepreneurs are increased in the case of private limited companies where there is limited publicity of financial status and no minimum capital requirements.

**Entrepreneurial Employees: Employment Status of Company Directors**

An important consequence of the doctrine of separate corporate personality is that it is jurisprudentially possible for a sole director of a one man company to be employed by the company and thus acquire employment status. Here the jurisprudence of company law is at odds with basic concepts of employment law, for as we have noted earlier, the basis of employment status is subordination. How can a company director both control the activities of a company and also be subject to the control of the company? In order to solve this legal conundrum, company law has resorted to the fiction of dual capacity as is seen in *Lee v Lees Air Farming* [1961] A.C. 12, which perhaps solves problems at the level of company law but does nothing to solve the acute problems left to employment law.

Lee had formed a company in which he beneficially owned all the shares and appointed himself as sole governing director. He was chief pilot for the company and was killed in a flying accident. The company had insured against liability to pay compensation under the NZ Workmen’s Compensation Act. In order for his widow to claim that compensation, she had to prove that her deceased husband had been an employee of the company.
The Privy Council held that his position as sole governing director did not make it impossible for him to be a servant of the company in the capacity of chief pilot, for he and the company were distinct legal entities which could enter a valid contractual relationship. In effect, Lee, as governing director and agent for the company, could make a contract with himself in another capacity and give himself orders as servant of the company. As Davies and Worthington (2012) comment, ‘In effect the magic of corporate personality enabled him to be master and servant at the same time and to get all the advantages of both (and of limited liability)’.

It should be noted here that the Court did not in this instance deem it necessary to inquire as whether the individual satisfied the normal tests which distinguish an employee (contract of service) from a self-employed person (contract for services) as Lee only needed ‘worker’ status for the purposes of statutory compensation. However, this decision sets the basis for 100 per cent employee shareholders to enter valid contracts of employment.

At a policy level there are clearly issues as to whether the purposes of employment law are properly served in holding that majority shareholders should acquire access to employment rights. At a legal level, the concept of control has clearly been bypassed by concepts of separate legal personality and dual capacity. The legal and policy issues will now be explored in more detail.

**Policy and the Purposes of Employment Law**

In the *Lee* case, there was a certain policy logic in allowing the claim as it was a claim for industrial compensation under a statutory insurance scheme covering benefits for dependants of employees of the company he had set up. Lee had paid
into this fund. It is a different matter where a shareholder director claims employment protection from national insurance funds when a business fails.

Employment protection legislation is traditionally designed to provide severance compensation which provides a form of insurance against risks of unemployment as workers may not personally be able to afford to insure against such risks. Firms are better able to insure against fluctuations in income than workers are (Pissarides, 2010). Termination of the relationship is a different matter for directors of companies, who are in a position to negotiate generous severance payments or ‘golden handshakes’ and can often negotiate their own terms of leaving (Cheffins, 1997).

The problem of abuse of employment protection legislation by shareholder directors was recognised by Mummery LJ in the UK case of Buchan v Secretary of State for Employment [1997] B.C.C. 145. Here a majority shareholder was held by the Employment Appeal Tribunal not to be an employee of the company for the purposes of claiming on state insurance funds on the insolvency of the company. The reason was that as a majority director and controlling shareholder he was able to block any decision by the board as to his own dismissal. The purposes of employment law would be undermined if such entrepreneurs running a business through the medium of a limited company were able to insulate against business risk:

*The context in which the issue of employee or non-employee arises under the Act is protection of employment. The purpose of the Act is to provide for state-funded compensation to be available for employees employed by those whose businesses have failed financially. It is not the purpose of those provisions to provide*
compensation to an individual businessman or entrepreneur whose own
incorporated business ventures have been unsuccessful. (Mummery J)

It is worth noting here that the legal position in private companies is that a director in
a private firm may be able to defeat an attempt to remove him (under s.168
Companies Act 2006) by inserting in the articles of association, a term to the effect
that increases the votes to his shares on a resolution to remove him (Bushell v Faith

Company Law and the Regulation of Small Companies

The key question for this paper is to where the appropriate dividing line should be
between the entrepreneur who incorporates a firm and controls that business and
the manager who is still subject to the control of the firm. How far is it desirable to
allow directors of companies to acquire employment status when they are able to
exercise control over their own employment relationships? Should additional
employment rights be accorded to directors who have the privilege of trading with
limited liability or should those rights be qualified by requiring a degree of ‘outside’
control over the relationship (Wardman, 2003).

Let us restate the issue in a different way. The structuring of the firm to enable the
pursuit of risky capital ventures by separating ‘ownership’ of the company (the
shareholding) from control of the firm by delegating management to a board of
directors is a common feature of large firms. However, in small companies where
owners and managers are often the same person, the corporate governance
machinery which separates these roles may obstruct effective management (Davies
and Worthington, 2012).
In UK law, the composition, structure and functions of the board of directors are left to a large degree to be decided by the company itself through its articles of association. In the case of a private company, one single director is sufficient (S. 154 Companies Act, 2006) and many of the regulatory controls are relaxed, for example, no obligation to hold an AGM and shareholder decisions can be taken by a meeting of the members rather by written resolution.

The import of this for small companies is that entrepreneurs may be able to operate largely informally and dispense with many of the safeguards against improper practice. The recent development of Limited Liability Partnerships increases the internal flexibility of governance. The spread of the ‘one-man’ company exacerbates these problems as ownership and control are then synonymous. The Company Law Review reported that 65 per cent of active companies have turnover of less than £250,000 and 70 per cent have only two shareholders and 90 percent fewer than 5 shareholders. (Davies and Worthington, 2012) The Review decided that such 'micro' companies were best left without further regulation.

The policy issue then is how far current ‘light touch’ regulation of the SME and the ‘one-man company’ encourages forms of entrepreneurism which are not socially or economically beneficial.

Company law has developed techniques to deny separate legal personality through the concept of ‘piercing the corporate veil’ and the doctrine of ‘sham’ or ‘simulacrum’. By lifting the corporate veil, the court is able to look behind the veil of incorporation to gain information about the nature, intention or motivation behind a particular act of the company (Wardman, 2003). Where the corporate structure is a mere façade concealing the true facts (Re Bugle Press [1961] Ch. 270), the court may ‘pierce the
veil of incorporation’ and treat the company as the alter ego of the controlling shareholder, that is treat them as one. However, in practice, the courts rarely lift the corporate veil (Deakin and Morris, 2012).

**Employment Status of Company Directors: Encouraging the Entrepreneur/Employee?**

In what ways does corporate governance enmesh with concepts of employment status? Is the truly independent entrepreneur a category that is treated differently for purposes of employment status?

Against the background of *Saloman* and *Lees*, Morrison J stated in *Secretary of State for Trade and Industry v Bottrill*, [1997] IRLR 682 as follows: ‘There is nothing in the statute which says that ‘one-man companies’ fall into some kind of special category.’

The willingness of the English judiciary to maintain flexibility in the application of the factual criteria for employment status has resulted in a mass of contradictory case law in the area of director shareholders.

One area where the courts might inquire more closely into a claim that a controlling shareholder is also an employee of the company is in the area of insolvency or corporate restructuring (Deakin and Morris, 2012). However, even in this area, the last two decades have witnessed a gradual loosening of traditional criteria for employment status, particularly in the area of control. It is submitted that this distortion has resulted in increasing acceptance of the entrepreneur as employee.

Let us illustrate this proposition by a re-examination of the key employment tests of ‘control’ and ‘entrepreneurial’ tests in the context of company directors.
Control

The current modern UK decision on the employment status of majority share-holders is the Court of Appeal decision in Secretary of State for Business Enterprise and Regulatory Reform v Neufeld [2010] EWCA Civ. 280, where the Court re-asserted the primacy of company law orthodoxy as stated in Saloman and Lees. Neufeld was a 90 per cent shareholder and managing director of a small firm. He was a working director, was on the pay roll and paid tax and National Insurance. He had no written contract. He also gave personal guarantees and made a personal loan of £20,000 to the company. In view of the fact that he had risked his own capital, it was argued that he was running his own business as a manager. The Court of Appeal, however, held that he was an employee and allowed his claim against the National Insurance Fund on the insolvency of the company.

Neufeld establishes that a majority shareholding in a company, even if it gives that person total control of the company, will not deny employee status to the individual entrepreneur. Thus a person with an economic interest in a company so that they own the company can still be an employee. What this means for control is spelt out by Rimer LJ in terms of ‘formal’ control and practical control. At the formal level, the control condition of an employment contract is dispensed with for majority shareholders. They cannot satisfy such a condition as the company and the putative employee are one and the same person. Practical control is also non-existent, as the individual has control over his own destiny, including the fact that he cannot be dismissed without his own consent (Neufeld, para 80).

The result of this logic is that a court is bound to ignore the realities of control in the case of majority shareholders. Thus in the earlier case of Fleming v Secretary of
State for Trade and Industry [1997] IRLR 682, control was relegated to only ‘one of a number of relevant factors’ rather than being a ‘rule of law’. This down-grading was continued in Bottrill, where control became an ‘important’ rather than a ‘decisive’ factor, as in Buchan. Bottrill however, re-introduced a reality dimension to control. Bottrill had set up a business with two employees and one other director. He held the one share of the company which was issued i.e. a 100 per cent holding, but this was a temporary measure as it was intended that an American company, which supplied the products would become the majority shareholder in the future. Bottrill’s company became insolvent before the US Company made its investment, and Bottrill, who had a genuine signed contract of employment, was dismissed by the receiver and claimed redundancy. The Court of Appeal supported Bottrill’s claim.

The new dimension of control introduced in Bottrill referred to the degree of control exercised by the company over the majority shareholder by other directors or shareholders. This is in effect control ‘in reverse’ – it is control by the company over the individual rather than control by the individual over the company (Howell, 2008). This different test is in one sense, useful, as it allows the court to determine with more exactitude, whether the majority shareholder is subject to control of other directors. However, it also brings further practical difficulties. For example, there are different categories of directors, including non-executive directors. Secondly, shareholding does not necessarily correlate with numbers of votes. Weighted voting rights may be allowed in private companies attaching increased votes to a directors shares on a resolution to defeat him so that he can defeat such a resolution (Bushell v Faith [1970] AC 1099). Thirdly, in large companies with a diverse shareholding, effective control can be exercised with a decreasing proportion of votes, so that in
reality, where there is a diverse shareholding, a director may have more power than a director with a 50 per cent shareholding (Howell, 2000).

A further modification of the principle of control is made in the later decision of Neufeld. Here the relevance of control is linked to the contract of the shareholder director. This reasoning transfers the focus of attention away from the power of the shareholder over the company’s decision making and towards the individual’s contractual relationship with the company. Rimer LJ states that director control over the company should not be a relevant factor where there is a genuine contract in writing. Instead, it is only relevant where there was no contract in writing so that it is necessary to ascertain the contents of the contract by examining conduct of the parties (Neufeld, Para 61). This approach distances the inquiry as to the nature of power in the company.

The result of this is that the concept of sham, traditionally used to control corporate abuses is used in Neufeld to scrutinise the contract, not to control abuse of the company form. The entire inquiry can then examine contractual behaviour (or lack of it) rather than the wider picture of company structures. The scope of inquiry is diminished to examining the conditions for formation and variation of contract and how the parties have conducted themselves under the contract (Neufeld, paras 83-84). This approach may be valuable in determining whether a particular director has acted as an entrepreneur or as an employee. For example, in the case of small companies, where matters are handled informally, the court will examine acts in the capacity as a director and distinguish those from acts in the capacity of employee such as whether an entrepreneur has been paid a salary (pointing towards employment) or by way of director’s fees (pointing to self- employment) (Neufeld, para 85). However, those entrepreneurial factors of control related to ownership of
capital are firmly removed from view. Thus, the amount of share capital invested, personal guarantee of company obligations, possibility of gaining on investment are stated to be irrelevant to employee status, as they only indicate an ‘owner acting as owner, which is inevitable in such a company’ (Rimer LJ, Neufeld, at para 86).

The significance of the contractual approach developed in Neufeld is seen in a stark form in the recent case of Robert Stack v Ajar [2015] EWCA Civ 46. The Court in Neufeld had shewn awareness of the problem of the rogue entrepreneur in recognising that control, ownership and investment should still form ‘part of the backdrop of the inquiry’ (Neufeld, para 86) into employment status in cases of small companies and that a line needed to be drawn somewhere between the entrepreneur and the employee. However, contract was perhaps not the safest way to solve the problem.

In Stack, an experienced entrepreneur was invited to invest in a newly formed company and became a director with two others, all owning equal shares. Only one director had a service contract and was paid a normal salary. Stack and the other director only received dividends. Stack never sought payment but his director’s loan account showed personal benefits of over £150,000. Stack never signed a contract of employment and indeed ran a number of his own businesses from premises he rented to the company. In these circumstances, it seems remarkable that when his appointment was terminated, he should claim unfair dismissal as an employee and unpaid wages. He was clearly a businessman, not an employee and had no contract to prove otherwise. Despite the fact that his was a purely commercial relationship, the Court of Appeal allowed his claim as an employee and managed to fashion a contract from pre-incorporation discussions between the three promoters of the company. Neufeld was not mentioned anywhere in the judgment. However, the
purely contractual analysis allowed a fictitious agreement to be constructed on the basis of unproven express terms and an implied term to pay wages on the basis of what reasonable businessmen would expect.

The case of *Stack* is clearly wrongly decided. But more than this, the decision to allow this entrepreneur to claim employment rights indicates that the hybrid entrepreneur/employee category is very much alive and that the adventurer can turn into an employee when it suits the purpose of settling an argument with other co-adventurers. The unscrupulous entrepreneur is encouraged in this process by a set of principles of company and employment law designed to facilitate business. All of Stack’s actions were more consistent with entrepreneurial activity than the acts of an employee. The small business environment encouraged by UK company law designed to promote enterprise and the modifications to the ‘control’ and ‘entrepreneur’ tests in employment law enabled a businessmen to assign assets to a company to avoid personal liabilities, but then pursue employment claims when arguments arose.

**The Entrepreneur Test**

*Stack* indicates that in the context of company ‘start-up’ and ‘micro-business’, the fact that a businessman is acting in the capacity of an entrepreneur in building a business, is not inconsistent with employee status. In a non-business context, risk-taking is seen as the key pointer against employee status – the entrepreneurial test or ‘economic’ reality test established in *Market Investigations Ltd v Minister of Social Security* [1969] 1 All ER 241 has in fact denied employee status to many individuals who take financial risk but do not have an identifiable business of their own.
However, key entrepreneurial skills operating through the organisation of a company are promoted as is confirmed in *Connolly v Sellars Arenascene Ltd* [2001] ICR 760. Here an accomplished entrepreneur operated a number of businesses, some on a franchise basis and some as joint ventures under the umbrella of a company operating three divisions and a subsidiary. He was sole director and controlling shareholder and entered a contract of service with his companies. The tribunal found his service agreement was not a sham designed to put him in a favourable position in the event of insolvency and his claim for unfair dismissal was upheld. The Court of Appeal supported his claim on the policy basis of business promotion:

*If a person with the skills and success attributed by the tribunal to the respondent were qualities which prevented a person in his position from enjoying the status of employee, it would be a severe and unwarranted deterrent to business enterprise.* (Pill LJ, para 17)

This ruling shows that employee status can be remoulded to suit business need and that employment law may be reconfigured to support failed businesses at key stages of the economic cycle.

**Evaluation and Conclusion**

This paper has identified a dichotomy in the traditional categorisation of employee status whereby elements of practice normally indicative of self-employment such as risk taking and an absence of control have been reversed in the context of the small business enterprise. An expanding category of ‘entreployee’ that emerges chameleon-like and changes colour in broad daylight has been charted both historically and by means of an examination of recent case law in a UK context. The cases presented are not an isolated instance, but indicative of a general trend
towards further commercialisation of the employment relationship (Wynn and
are one reaction to competitive pressures in product and labour markets. The
findings in this paper, however, indicate an opposing trend whereby individuals,
traditionally regarded as independent and entrepreneurial, are actively pursuing the
benefits of employee status, while at the same time acting as employers and
business operators.

It is argued that such trends may have adverse consequences in social and
economic terms in that the State may become insurer in terms of insolvency
payments for individuals who have already limited their liabilities for loss and have
not contributed to social security systems through national insurance payments.

A number of legal techniques can be employed to regulate more closely this
category of entrepreneur/employee. Mummery LJ’s attempt in Buchan to block
attempts by shareholder directors to gain employment rights might with hindsight
appear to have been too crude in policy terms.

A blanket exclusion of controlling shareholders from employment rights might deny
some individuals who have insured by paying tax and national insurance by
legitimately signing contracts of service with the company. Other cases have put
forward controls on abusive entrepreneurial behaviour. In Clark v Clark Construction
Initiatives Ltd [2008] IRLR 364, Elias P. suggested three instances where a court
should not allow directors to gain employment status: first, where the company is
itself a sham; second, where a contract is entered into for some ulterior purpose, for
example in order to secure insolvency payments or to circumvent the rules on priority
of creditors and third, where the parties’ conduct is not in accordance with the
contract (Clark, para 94). The current case law as exemplified by Neufeld and Stack has emphasised ground three and tended to ignore grounds one and two, with the result that more basic questions as to the legitimacy of a particular corporate form or opportunistic entrepreneurial behaviour have not always been fully explored.

In particular, more attention might be focused on the company law doctrines of lifting the veil of incorporation. To return to Kahn Freund (1944):

Is it tolerable that businessmen should be able to rid themselves of their liabilities, just because when assigning assets belonging to a company which is a “sham, simulacrum and a cloak” they fail to act as shareholders or directors rather than as individuals?

By taking a contractual approach in recent director cases, the courts appear to have identified the issue incorrectly. The issue is not really the nature of the contractual relationship between the company and the individual but rather whether the company and the individual should be treated as two separate persons with capacity to enter a contract with each other (Tolmie, 1997). There is ample scope for taking up Kahn Freund’s admonition and inquiring more carefully as to how and when the courts should pierce the corporate veil, especially in the case of ‘one-man companies’ and ‘micro’ companies, where power lies in the hands of one or two directors (see the concept of ‘single economic unit’ in Adams v Cape Industries Plc [1990] Ch. 433). This would enable a more thorough scrutiny of the structural conditions whereby some types of entrepreneurs can osmose so easily into false types of employment status. In this way the chameleons would be returned to their original hues and not strut about so readily in the future.
References:


Tables and Diagrams:

**Figure 1: The Spectrum of Employment Relationships (adapted from Leighton and Wynn, 2011)**

<table>
<thead>
<tr>
<th>Standard Employee</th>
<th>Dependent worker</th>
<th>Independent professional/Entrepreneur</th>
<th>SME</th>
</tr>
</thead>
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←----------------------------------------------------------------------------------------------------------------------------------→

‘Non-standard employee’ eg part-time, casual

Employed  <<<<<<<<<<<<<<<<<<<<<<<<<<<<<<<<<<<<<<<<<<<<<<<<<<<<<<<< Self-Employed
Figure 2: Functions of Employees and Entrepreneurs

Contrasting Entrepreneurs and Employees

Entrepreneur
- Independent
- Self-employed
- May start a business
- Middleman - Creates a market for services
- Risk-taker
- Assumes control
- Uses capital

Employee
- Dependent
- Employed
- Employed by firm
- Relies on employer to create a market
- Insures (protected) against risk
- Subject to control
- Part of structure of capital

Figure 3: Historic types of labour power in capitalism and the Emergence of the ‘Entreployee’ (adapted from Pongratz and Voss, 2003)

Phase 1: Proletarian worker (early industrialisation)

Raw working capacity

Severe exploitation, no social protection
Phase 2: Vocational employee (Fordism)

Structural technical and organisational control

Developed Social security systems

Phase 3: Entreployee (Post Fordism)

Systematic self-control of work

Self-exploitation, precarious social security

Phase 4: Colonisation Phase

Hybridisation of employee status

Colonisation of social security aspects of employee status